SPECIAL REPORT

ENERGY

SANTEE COOPER VS. SCANA:

Which Ratepayers Will Pay More for V.C. Summer?

BY KATIE S. PLAYER, PHD

JUNE 2018

PALMETTO PROMISE INSTITUTE

Additional resources: palmettopromise.org
P.O. Box 12676 Columbia, SC 29211 | 803-708-0673

In the wake of the V.C. Summer debacle, a catastrophe shared by both SCANA (SCE&G) and Santee Cooper, most of the attention has been focused on SCANA ratepayers. This is curious, because it is the Santee Cooper ratepayer that is closer to the precipice.

EXECUTIVE SUMMARY

Santee Cooper customers are positioned to pay a much larger amount per customer for the failed V.C. Summer 2 & 3 project than SCANA (SCE&G) customers. This analysis estimates that Santee Cooper customers will pay a total of $50,294 per customer by the time the project debt is paid off in 2056; whereas SCANA customers will pay just under $15,000 over the next 50 years. These differences are almost entirely due to the differences in the number of customers each entity serves. Santee Cooper has roughly 180,000 retail customers whereas SCE&G has over 700,000. A customer-base of 700,000 means over 3x more customers to spread the cost of the failed project.

In this analysis, even if Santee Cooper's largest customer, Central Electric Power Cooperative, paid its share of rate increases, Santee Cooper customers would still be paying at least $20,835 each over the next 38 years. Both the timeline (38 vs. 50 years) and the amount ($20,835 vs. $15,000) imply Santee Cooper customers are in a more compromised position.

SCANA (SCE&G) is very clear in its Annual Report 2017 about how much it has already collected from rate increases to fund the failed projects and the risks it faces going forward. Santee Cooper financials are not nearly as clear and offer little in the way of guidance as to funding the failed project. When in doubt, instead of using simple percentage estimates from the income statement, this study has tracked the charges and expenses through the balance sheet, wherever necessary, to determine realistic calculations and estimates.

COMPARING SANTEE COOPER AND SCE&G

The chart below shows a direct comparison of Santee Cooper and SCE&G with respect to different expenses and the V.C. Summer 2 & 3 failed project. Santee Cooper had a 45% share in the failed project and SCE&G had a 55% share in the project. One of the most important differences the chart presents is the "Number of Residential Electric Customers." As seen below, SCE&G has four-times more (3.98x) residential electric customers for which it can divide up total costs related to the failed project. This difference in size of customer-base accounts for almost 100% of the difference in the estimated costs to be paid per customer for each of the entities ($50,294 for Santee Cooper, and $14,896 for SCE&G). If Central Cooperative customers are included in the per customer analysis, the total cost per residential bill drops to just under $21,000 over the life of the debt associated with the project, instead of $50,294 (Central accounts for nearly 60% of Santee Cooper electrical sales and revenues). Note: The estimate for Santee Cooper's cost per customer has decreased since our finding on 2016 financials were released (over $60,000 per customer) because Santee Cooper's customer-base has grown.

The next largest factor is the amount each of the entities has already collected for the project due to past rate increases. SCE&G has raised rates over 20% already to fund the project whereas Santee Cooper has raised rates a total of only 15.2%. SCE&G reports it has collected $1.9 billion for the project at 2017 year-end. Santee Cooper spokeswoman Mollie Gore reported that Santee Cooper had "collected about $540 million from customers (due to the 5 rate increases), with much of the money going towards the nuclear project."[1]

1 Source: Wilks, Avery G. "2 million in SC spared from rate hikes for bungled nuclear project", The State Newspaper. August 11, 2017. Online at: http://www.thestate.com/news/politics-government/article166673857.html

V.C. SUMMER IMPACT: SANTEE COOPER VS. SCANA (SCE&G)

	Santee Cooper	SCE&G
Amount rates have already increased (%)	15.2*	18-21.41[5]
Total amount customers have already paid towards project:	$540,000,000[1]	$1,900,000,000***
Amount paid per customer towards project as of 2017:	$1,196[2]	$2,643
Total Cost of Project	$4.56 billion*	$4.73 billion***
Total Cost of Project + Interest Costs	$9 billion*	$17.9 billion[5]
Outstanding Cost of Project at 2017 year-end	$4.56 billion*	$3.976 billion***
Outstanding Cost of Project + Associated Interest Costs	$8.87 billion	$10.71 billion[6]
Amount rates still need to increase to cover outstanding project costs and interest costs (%)	16*	NA
Total Expected Rate Increased needed to fund project since 2012 (%)	31.2*	NA
Total Cost of project to be paid per residential customer over the life of project related expenses and outstanding debt:[3]	$50,294	$14,896
Total Cost of project to be paid per residential customer over the life of project related expenses and outstanding debt if Central pays its 60% share of expenses:[3]	$20,835	-
Amount impaired for defunct project in 2017:	$4.11 billion**[4]	$1.118 Billion***[7]
Number of Residential Customers	180,658** (+ CENTRAL CO-OP)	719,000***

*Numbers and calculations are from the March 2018 report by Player & Maloney, “Santee Cooper’s Uncertain Future”.

**Source: Santee Cooper Annual Report 2017

***Source: SCANA Annual Report 2017

(1) Source: Wilks, Avery G., “Two million in SC spared from rate hikes for bungled nuclear project,” The State, August 11, 2017. Online at: http://www.thestate.com/news/politics-government/article166673857.html

(2) Total amount paid per customer is computed as follows: $540 million*40%/number of residential customers. Central accounts for 60% of sales, leaving 40% of collected revenues to be attributed to direct customers. This estimate is lower than the amount actually paid because the number of Santee Cooper direct customers has been increasing over the past several years.

(3) Cost of project per customer is computed using the total cost of the project ($8.87B and $10.71B for Santee Cooper and SCE&G, respectively) and total number of residential customers listed in each entity’s 2017 annual report. For SCE&G, this rough estimate of $14,896 per customer is roughly comparable to the company’s own estimates for the total cost of the project to be paid per customer of $14,700 (or $13,200 over 50 years plus $1,500 per customer that has already been collected as reported by SCANA). For Santee Cooper, the full costs are divided by “number of residential customers” both with and without Central Electric Power Cooperative paying its prorated share of the costs (roughly 60%).

(4) The associated V.C. Summer 2 & 3 assets for Santee Cooper were reclassed as Regulatory Assets on the balance sheet in 2017 (Santee Cooper Annual Report 2017).

(5) SCE&G rates are reported to have gone up a minimim of 18% and up to 21% dependinng on the source. (Sources: The State link at: http://www.thestate.com/opinion/opn-columns-blogs/cindi-ross-scoppe/article177780151.html, and regulatory allowed increases at: http://www.regulatorystaff.sc.gov/Documents/Electric%20and%20Gas/SCEG%20Electric%205-1-13.pdf).

(6) Total interest costs for SCE&G were estimated using bond issuances and an average cost of debt of 5.8%; these are estimates only and could differ from actual costs depending on SCE&G capital structure for the project (Source: SCANA Annual Report 2017, page 90). In June 2016, $425 million due in June 2046 was issued at 4.1%, another issuance of $75 million due in June 2064 at 4.5%. These issuance amounts totalling $500 million were subtracted from SCE&G’s outstanding cost of project of $4.73 billion leaving $4.23 billion to be estimated at an average cost of 5.8% for 30 years. Total interest due was computed for each respective debt-catorgory (by interest rate and maturity date) to find aggregate total interest for the project cost of $4.73 billion for a combined total interest cost of $6.733 billion.

(7) SCE&G, a subsidiary of SCANA, wrote-off $1.118 billion in regards to the failed project in 2017, the remaining $4.8 billion incurred from the project was reclassified as a regulatory asset and could be impaired further if SCE&G is not allowed to raise rates to recoup the costs (SCANA Annual Report 2017, Note 10).

OTHER FACTORS

Equity as a cushion

In corporate finance, debt-financing (or leverage) is considered a “fixed obligation” with payments that are structured and hold the legal obligation to be repaid. Equity is quite different. Equity payments are never “fixed” and never “obligated” and most equity will never be repaid. Instead of receiving fixed interest payments for use of their capital, equity investors make money when the company makes money (net income) because any money left after the debtholders have been paid, goes to the equity holders in the form of dividends, or stock price appreciation when the firm has good internal investment projects to undertake. Because equity investors are the last group of investors to be paid (all debt payments are senior to equity), it is the riskiest class of investments. The equity account on a company’s balance sheet balloons or swells in good years, and evaporates in rough years. For this reason, equity is said to be a “cushion,” it provides a way for the company to remain in business even if it goes through an unprofitable year…or three. Let’s look at a simple example:

THE ROLE OF EQUITY AS CUSHION

	Company 1 "Boom Year"	Company 1 "Bust Year"	Company 1 "Losses"
Net Operating Income	100	50	30
Debt Expenses	-40	-40	-40
Taxable Income	60	10	-10
Taxes	22.8	3.8	0
Net Income Available to Common Shareholders:	37.2	6.2	-10

In the above chart, we see the same company in three different years (or scenarios) and we see how each scenario impacts retained earnings (which is the equity account representing equity investors' residual claims to the business). When net income available to common shareholders (which is the increase, or decrease in retained earnings for the year) increases, stockholders have a large share of residual returns. When the company doesn't do as well (in the "Bust Year"), the stockholders are not compensated as much. And finally, if the company loses money (in "Losses"), the debtholders are all paid but retained earnings will be reduced by 10. If a company was entirely debt-financed (e.g. it had zero equity-holders) there is very little flexibility for changes, or shocks, to the company's income because all the company's stakeholders are bondholders with fixed entitlements to the company's resources.

SCE&G, through SCANA, has equity-holders. This group of investors will be the first to weather any of the shocks the company experiences and will "buffer" the structure of the company as a going-concern so long as all fixed-obligations are paid to debtholders.

Santee Cooper doesn't have equity investors, it doesn't have an "equity account" or this cushion that equity financing offers—all expenses, or losses, must be funded through rate increases.

Corporate Income Taxes

SCE&G as a subsidiary of SCANA Corporation, is incorporated as a public company with thousands of equity shareholders. Because SCANA is classed as a U.S. corporation, it is subject to U.S. federal income taxes under corporate tax law. SCANA's total tax liability typically falls between 38-39% of net taxable income.

To understand how this impacts the bottom-line of the business, or potentially, the business as a "going-concern," let us examine two companies writing-off a defunct asset. For our purposes, let us assume the companies are completely identical except for how the two are structured: Company "Corporation" is classed as a C corporation under corporate tax law and has public shareholders, whereas company "State" is a state-run utility. Let's look at how the same loss effects each structure's bottom-line. SCE&G expensed part of the failed project in 2017 ($1.118 billion which had an after-tax effect of roughly $690 million and which has subsequently reduced "retained earnings available to common shareholders"). The corporation also warns that if it is not allowed to collect revenues to fund the defunct project it will need to expense another $3.976 billion due to the project. As of 2017, for Santee Cooper, the entire net cost of the project after salvage values, of $4.1 billion has been "impaired" as a regulatory asset. An asset can only be classed as a "regulatory asset" so long as the amount can be recovered via regulating bodies through future rate increases. Therefore, as of December 31, 2017 Santee Cooper expects to recover the entire cost of the project through future rate increases; whereas, SCE&G has already written off (or expensed) $1.118 billion as of December 31, 2017.

IMPACT OF INCOME TAXES ON AFTER-TAX NET INCOME

	Company "Corporation"	Company "State"
Balance Sheet Items:		
Asset 1	100	100
Asset Expense due to failed project:	-10	-10
Total Assets:	**90**	**100**
Income Statement Items		
Net Income before Taxes and Extraordinary Items	15	15
Extraordinary Expenses	-10	-10
Net Income before Taxes	5	5
Taxes	1.9	0
Net Income after Taxes	3.1	5
What After-tax Net income would have been without Extraordinary Expenses	9.3	15
Difference between After-tax net income with and without extraordinary expenses:	6.2	10

*With regulatory assets, this becomes a bit more complicated, because the impairment may not be "written off" but reclassed as a regulatory asset, which means electric rates must increase in future to pay it off.

Note: The important result here is difference between after-tax net income with and without the asset impairment. This difference is muffled by the corporate tax effect in the corporation, because the company's bottom-line is only effected by (1-tax rate), or 68% of the impaired asset. But for the "State" company, that doesn't pay taxes, its bottom-line is reduced by 100% of the asset impairment.

Use of Toshiba Note Funds

The use of the settlement funds from Toshiba is still uncertain for both Santee Cooper and SCE&G. Legislative action and pending lawsuits could impact the uses of the funds for both entities. The legislature, or courts, could decide that the entire amount of the funds go to retroactive rate reduction checks for customers across the board.

CONCLUSION

The three significant differences between the positions of SCE&G and Santee Cooper and each's respective customers are:

(1) The size of each entity's customer-base: a larger SCE&G customer-base means a lower total burden per customer for costs associated with V.C. Summer 2 & 3, whether Central Electric/cooperative ratepayers are included or not.

(2) The equity position of each entity: SCE&G has an equity account ($1.98 billion in retained earnings) which can absorb some of the costs if needed; whereas, Santee Cooper does not have any equity stakeholders. This means the entire burden of the failed project will be passed entirely on to customers, or, if possible, directly to bondholders in the case of restructuring.

(3) The tax consequences of each entity's structure: SCE&G pays corporate taxes which means the after-tax consequences to net income of an expense is equivalent to (1-tax rate) instead of 100%. In this case, around 68%, which means that for every $1 that is written off as an expense, it reduces after-tax income by $0.68. Santee Cooper faces virtually no tax consequences because it does not pay corporate taxes. Santee Cooper pays a nominal amount classed as "sums in lieu of taxes" based on operating revenues (roughly 1%).

Finally, SCE&G has already collected $1.9 billion to pay down the project which is divided up over 719,000 customers, whereas Santee Cooper has collected roughly $540 million across 180,000 customers and one "mega-customer," the Central Electric Power Cooperative (for its associated co-ops). The amount needed to pay off the project per residential customer will be almost 50% higher for Santee Cooper customers than SCE&G customers (if Central agrees to pay higher rates), or around 3x higher if Central is able to avoid rate increases. In the best-case scenario for Santee Cooper customers, their burden will be $6,000 more than that of SCE&G customers because there are simply fewer of them to shoulder the costs. However, if Central negotiates to keep its rates down, that would leave direct Santee Cooper customers to pay over $50,294 each over the life of the project (or $35,000 more than each SCE&G customer).

A consideration of the exposure presented by V.C. Summer of the two groups of ratepayers, SCANA and Santee Cooper, illustrates that it is the Santee Cooper ratepayer that faces a more uncertain and unsettling future.

Katie S. Player, PhD is Assistant Professor in the Department of Accounting & Finance of Wofford College in Spartanburg, South Carolina. Dr. Player received her PhD in economics from Clemson University in 2012 and was an Assistant Professor of Finance at Furman University 2012-15.