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May 11, 2005

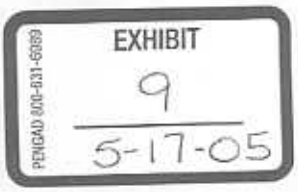
VIA EMAIL
James E. Brogdon, Jr.
Executive Vice President and Chief Legal Officer
Santee Cooper
P.O. Box 2946101
Moncks Corner, SC 29461-2901

Re: Credit Suisse First Boston Evaluation Report

Dear Judge Brogdon:

As you know, I take my responsibilities as a board member of Santee Cooper very seriously. Early on, John West sent me a copy of all the appellate legal opinions involving Santee Cooper from its inception in 1934. I have laboriously studied the Coordinating Agreement and the Amendments and related documents. I obtained one of the last copies of the History of Santee Cooper 1934-1984 and have reviewed it to have a fuller understanding of Santee Cooper – past, present and future.

What kept driving me to study these issues has been the Board's failure for the past 25 years to abide by the Enabling Act, and the General Assembly's tolerance of this failure. Specifically, I am referring to Section 58-31-110, SC Code, which requires that every 6 months the Board determine Santee Cooper's "net earnings" and pay over to the Treasurer whatever amount is not necessary to the prudent operations of the business or to meet bond obligations in order to defray the tax burden on the people of South Carolina. As the board member representing the 4th Congressional District (with the fewest percentage of people receiving benefits from Santee Cooper), I naturally was concerned about Upstate residents subsidizing the co-ops. I was told that since 1979, with the approval of certain members of the General Assembly, Santee Cooper had been allowed to pay just 1% of its revenue. I suggested that the payment formula be codified by the General Assembly so that the Board would not be put in the pickle of being charged by the Enabling Act to do one thing and encouraged by certain members of the General Assembly to do another thing (something that, if S-573 passes into law, will subject each board member to personal liability up to $50,000). Chairman T. Graham Edwards expressly told me on more than one occasion that inviting the General Assemble to clear this up could lead to unexpected consequences as the Legislature might feel compelled to tweak other aspects of Santee Cooper (tragicly, this premonition has proven to be the understatement of the year!).



Last summer, I was involved in a meeting to hear Credit Suisse First Boston make a pitch to do the evaluation of Santee Cooper. In November, CSFB sent a letter to Lonnie Carter confirming the engagement. There were some issues about making it clear that Santee Cooper was not directing the study. I was involved as liaison between Santee Cooper and CSFB to perfect the language of the letter, in my role as Chairman of the Legal Affairs Committee. This process created an informal connection between me and CSFB. Over the next few months, I occasionally coordinated the transfer of information between CSFB and Santee Cooper.

In reading the history of Santee Cooper 1934-1984, I noted that some of the information came from contemporaneous news accounts. In March, I started to put together a chronology of events on the creation of Santee Cooper, with the intention of going through newspaper archives to see what other stories were written about the creation of Santee Cooper. (For what it is worth, I have shared that chronology with Kyle Stock so he could review his own paper's archives). In early April, purely on my own initiative, I drafted an essay on the Brief History and Analysis of the S.C. Public Service Authority (Santee Cooper) and sent it to CSFB. My intention was to give them background information and to encourage them to capture some of it in their report to give it some historical context. In light of Senate Bill 573, I believed this historical context was important. CSFB suggested that they just include it as a foreword.

I agreed and did some style editing to make it read better as a foreword. I also made a couple of substantive additions. I specifically recall adding the comment that because of the New Deal money discrepancy between South Carolina and all the other states (which was actually pointed out by the News and Courier in 1933-34), a real argument could be made that the State in fact "paid" for Santee Cooper, since it forewent other money from the Federal Government in New Deal programs. I also added the figures and chart at the end that quantifies the value of the Central Contract at more than $8 billion over the next 18 years.

I emailed the text to CSFB on April 15, 2005 – a copy of my email and the text are attached. There may be a few word changes between this version and what was printed, but this was basically it. No other Board Member and no one in management was aware of, sanctioned or assisted in the foreword. I worked alone. Lonnie Carter and Guerry Green received copies of the report the night before it was released on May 5, 2004 and based on their comments to me, this was the first time they knew of it. I don't believe there is anything factually inaccurate in the foreword. However, I certainly understand that while I might see the glass half full, others might see the glass half empty – but the water level is still the same.

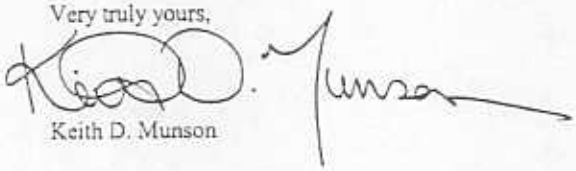
As for the question of who was the client – this was an issue when the engagement letter was signed by Lonnie Carter, CEO of Santee Cooper, in November 2004. My understanding is that CSFB believes that Santee Cooper was its client. I also believe that Santee Cooper may disagree with that conclusion. In CSFB's defense, although Santee Cooper was responsive in providing information, it was not responsive in providing guidance, such as when to release the report, in what format, etc. This is understandable based on Santee Cooper's position that it was

not Santee Cooper's study. As a matter of default, I ended up being the point of contact on these issues to keep the ball moving forward. Because CSFB believed that Santee Cooper was its client, I am sure they considered me (and justifiably so from their perspective) to be the client representative on these matters. CSFB made a clear demarcation between my foreword and their financial evaluation and I can vouch for the fact that, to my knowledge, no one else at Santee Cooper or on the Santee Cooper Board of Directors took any steps to influence what was contained in any section of the report, including the foreword.

I believe this answers Mr. Couick's questions. As we discussed, I do not believe that I can effectively intercede with CSFB with regard to obtaining this same information from CSFB. I would bring to your attention the fact that Santee Cooper entered into an indemnification agreement with CSFB and would likely be responsible for paying the expenses of CSFB in analyzing and/or responding to Mr. Couick's request. Ironically, this expense (which could be considerable at New York rates) would fall on the Santee Cooper ratepayers, just like allowing one ratepayer to sue all 11 Board Members -- for say, compromising the yearly disputes with Central over the cost of fuel adjustment -- could result in judgments equaling $550,000, which would be reimbursed to the directors by Santee Cooper and charged back against the ratepayers (except for maybe Central, who might argue this was an extraordinary expense outside its cost formula). Like I said, ironic. If anyone in the General Assembly does not understand this (and also intend it) then they need to slow down and give S-573 until January to ripen (or rot).

With warm regards,

Very truly yours,



Keith D. Munson

KDM/
Enclosure

cc: (via email)
Lonnie Carter, CEO
Guerry Green, Chairman

Munson, Keith

From: Munson, Keith
Sent: Friday, April 15, 2005 4:54 PM
To: Adam S. Davies (E-mail); Mary Beth Mandanas (E-mail)
Subject: Tweaked History/Forward re: Santee Cooper

Thanks. Have a nice weekend. KEITH

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Version Attached to KDM's 4/15/05 Email to CSFB

BRIEF HISTORY AND ANALYSIS OF THE S.C. PUBLIC SERVICE AUTHORITY (SANTEE COOPER)[1]

In 1926, the Columbia Railway & Navigation Company obtained a license from the Federal Power Commission to construct a hydroelectric project in the lower part of South Carolina. After the stock market crashed in 1929, South Carolina entered the Great Depression with the rest of the country and progress stalled on this private hydroelectric project. In 1932, Franklin D. Roosevelt was elected president, and he had been a supporter of public power as the Governor of New York. Representatives of South Carolina began lobbying FDR's supporters and administration concerning the possibility of the federal government participating in making the Santee River/Cooper River hydroelectric power project a public power project. FDR's administration was receptive to participating in the completion of the Santee River/Cooper River hydroelectric project.

To facilitate the federal government's involvement, legislation was introduced in the South Carolina General Assembly in 1933 to create the South Carolina Public Service Authority for the purpose of undertaking the Santee Cooper hydroelectric power generating project. However, the bill was defeated and the South Carolina General Assembly refused to create the South Carolina Public Service Authority ("Santee Cooper") (see generally, *History of Santee Cooper 1934-1984* by Walter B. Edgar) (hereinafter "*History of Santee Cooper*"). The reasons for opposing the creation of the South Carolina Public Service Authority included the belief by many members of the General Assembly that the production of power should be left solely to the private sector. However, after the 1933 defeat, the ardent supporters of the project set out on a state-wide education campaign to drum up public support for the Santee Cooper hydroelectric power project. As a result, in 1934, the General Assembly passed legislation creating the South Carolina Public Service Authority.

At the same time, in 1934, FDR's New Deal of public works projects was well underway and there was significant discussion among the states about getting their "fair share" of New Deal

[1] This history was provided by Keith Munson, Chairman of the Santee Cooper Legal Affairs Committee and attorney with Womble Carlyle Sandridge & Rice in Greenville, South Carolina.

money. South Carolina averaged only $41.61 per capita, whereas the rest of the states in the Union averaged $57 per capita. Supporters of the Santee Cooper project used this discrepancy to help win federal support for the project, which brought South Carolina's average above the national average. (*History of Santee Cooper*, p. 5). Of course, this took South Carolina out of the running for other New Deal money, and so in a very real sense, the state paid for the Santee Cooper project with its New Deal quota allotments (the federal government ultimately provided $21.7 million in grants and $26.5 in federal loans [$48.2 total] for the Santee Cooper project). (*Id.* at p. 7).

In July 1935, President Franklin D. Roosevelt approved the Santee Cooper project and wrote South Carolina's Senator James F. Burns to say that he was convinced that the project would significantly overcome the distress caused by unemployment in the area. Work camps were set up for some 6000 workers, who were drawn from the certified relief rolls of every county in South Carolina.

The driving force behind the Santee Cooper project was the generation of power "so that electricity could be provided for the rural areas of the state. In 1936, less than 2.5% of the farms in South Carolina had electricity." (*History of Santee Cooper*, p. 11). Overall, in 1934, only approximately 3% of South Carolina's rural residents had electricity. By 1944, more than 93% of South Carolina's rural residents had electrical power to light their homes.

Today, Santee Cooper's original predominant purpose to provide access to electricity for South Carolina residents has been universally achieved. In addition, most of the original secondary aspirations of Santee Cooper have also been achieved. These included: public works jobs during the Depression, eradication of malaria hazards, land reclamation, flood control in the low country and the provision of significant recreational facilities. In some respects, the Santee Cooper project is similar to another Franklin D. Roosevelt project – the National Foundation for Infantile Paralysis (i.e., the March of Dimes). In 1938, President Roosevelt began this grass-roots fundraising organization to defeat the then-raging epidemic of polio. By the 1960s, the polio vaccine and the efforts of the March of Dime had virtually eradicated polio in North America. This was a crossroads event for the March of Dimes and, instead of perpetuating its existence as a polio fighting organization, it redeployed its assets to address the significant problem of birth

defect and prenatal care. Today, most people are likely to associate the March of Dimes with preventing birth defects, rather than its original mission to battle polio.

Santee Cooper can be viewed as being at a similar crossroads. Its original predominant mission has been achieved. Consequently, its assets and equity have necessarily been redeployed. Over time, its mission has migrated from providing initial access to needed electricity to merely providing marginally cheaper electricity to residents along the coast, electricity wholesalers and existing industry.[2] Because this evolution in mission occurred gradually and seamlessly over time, the current mission may not have been the result of a deliberative public policy process.

When the General Assembly passed the enabling act to create the South Carolina Public Service Authority, it set up the State as the sole owner of Santee Cooper.[3] Today, with assets approaching $5 billion dollars, Santee Cooper is the largest single asset of the State of South Carolina. Consequently, a deliberative public policy discussion should occur on the appropriate utilization of the State's equity in Santee Cooper. In order to have a fully-informed public policy discussion, it is necessary to have an understanding of the value of the State's equity in Santee Cooper. Consequently, a significant purpose of this study is to value Santee Cooper under various alternatives and provide a mechanism for estimating the State's equity in Santee Cooper so that the appropriate public officials can have a policy discussion concerning the proper utilization of the State's limited resources.

This deliberative process should probably include discussion of several related matters. For example, although Santee Cooper receives no annual appropriations from the State, it does receive the benefit of tax exempt status which has been estimated to equate to approximately $50 million a year in lost tax revenue to the State of South Carolina. To make up for this, the General Assembly required Santee Cooper pay to the State, ". . . all net earnings thereof not necessary or desirable for the prudent conduct and operation of its business . . . to the State Treasurer for the general funds of the State and shall be used to reduce the tax burdens of the people of this State."

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[2] In fairness, it should be noted that Santee Cooper's rate is not always the cheapest alternative.

[3] "The South Carolina Public Service Authority is a corporation, completed, owned by and to be operated for the benefit of the people of this State." (§ 58-31-110, S.C. Code).

(§ 58-31-110, S.C. Code). According to the *History of Santee Cooper*, the amount distributed to the State was at one time calculated by "taking one half of the monies remaining in the Revenue Fund after all obligations have been met." (p. 19). For the past 15 years or so, the amount paid to the State has generally been limited to 1% of Santee Cooper's gross revenues. This is approximately $10 million, which is only about 1/5 of the property taxes avoided by Santee Cooper's tax exempt status. This $40 million difference is significant and was unanticipated at the time that Santee Cooper was created. Almost immediately after the South Carolina Public Service Authority was created, private power companies brought suit before the South Carolina Supreme Court to have the enabling Act declared unconstitutional. One of their complaints was that the tax exempt status of the South Carolina Public Service Authority would create a shift in tax liability to other citizens of South Carolina. The South Carolina Supreme Court disagreed, specifically noting that " . . . it appears from the record that the Authority will pay into the State Treasury a portion of its revenues which will reasonably be expected to be equivalent to taxes paid by a private corporation in like situation." (*Clark v. South Carolina Public Service Authority*, 177 S.C. 427, 181 S.E. 481, 486 (1934)).[4] Consequently, it appears that the current practice of Santee Cooper to pay an amount equivalent to only approximately 1/5 of the foregone property taxes is markedly lower than the expectation of the entities that created and validated the South Carolina Public Service Authority in the mid-1930s.

Another issue worthy of consideration in this deliberative process is the relationship among Santee Cooper, the electric cooperatives and ultimate users of Santee Cooper electricity in South Carolina. In 2004, Santee Cooper charged Central Electric Cooperative approximately 4.5¢ per

[4] Santee Cooper's payment of 1% of revenues to the state is well below the national median amount of 6.6% for large public power companies and 5.8% for all public power companies (American Public Power Association's 2005-06 Annual Directory & Statistical Report, p. 46). It is also well below the median amount of 5.1% paid by large investor-owned utilities. (APPA Statistical Report, p. 48). For 2003, Santee Cooper would have had to pay approximately $53 million to match similarly situated investor-owned utilities, approximately $60 million to match all public power companies, and approximately $68 million to match similarly sized public power companies. Even taking into account the additional $13 million dollar payment to the state in 2004, Santee Cooper still paid less than half of the median percentage of each of these comparable power company categories.

kilowatt hour (for electricity). Central then resold the electricity to the individual electric cooperative who resold the electricity to their residential and commercial customers. The mark-up by the time the electricity reached the residential customer was approximately 3.5¢ (to 8¢). For all of 2004, Central purchased 12,734,364,630 kilowatt hours of electricity from Santee Cooper, which were resold principally to residential customers of the individual co-ops. An average 3.5¢ per kilowatt mark up between Santee Cooper and the cooperative customer, would generate over $440 million in revenue (above the cost of electricity) for the cooperative system. The current contract between Central and Santee Cooper extends through the year 2023. Therefore, over the remaining life of the contract, the cooperative system can expect to generate more than $8 billion in revenue (in excess of its cost of electricity).[5] If efficiencies in the cooperative system could reduce the amount of revenue above the cost of electricity to $6 billion dollars, cooperative customers could save about 12.5% on their electricity bills for the next 18 years.[6]

KDM/cjm

[5] This is more than the value of all of Santee Cooper's assets and also exceeds the state's entire annual budget for fiscal year 2004.

[6] This would allow for an approximate 1¢ reduction in kilowatt hour cost, from approximately 8¢ to 7¢ (which is slightly more than the average rate paid by Santee Cooper's direct serve residential customers). This equates to a 12.5% savings: 7¢ / 8¢ = 12.5% savings.