THE ELECTRIC COOPERATIVES OF SOUTH CAROLINA
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The Honorable Thomas C. Alexander, Chairman
Joint Oversight Committee on the
S.C. Public Service Authority
P.O. Box 142
Columbia, SC 29202

Dear Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear on behalf of South Carolina's electric cooperatives. Each of you will be able to find hometown names among the list as they deliver electricity to every one of South Carolina's 46 counties and to more than 1.3 million people. It is impossible to find a community in South Carolina untouched by the work of over 2,500 cooperative employees and the leadership of over 200 democratically elected trustees. The 20 distribution cooperatives are independent companies, owned by their members—the consumers—who set their bylaws and elect their board members.

The 20 distribution cooperatives and Central comprise the membership of The Electric Cooperatives of South Carolina, Inc., an association that provides legal services, state and federal government relations, education and training, marketing and communications and publications services to each of the cooperatives. Since 2005, I have been privileged to serve as President and CEO of the state association. Central Electric Power Cooperative (Central) is a cooperative formed by—and owned by—the distribution cooperatives to aggregate, manage and transmit wholesale purchased power from Santee Cooper, Duke Energy Carolinas and the Southeastern Power Administration (SEPA). I appreciate your allowing John Tiencken, General Counsel of Central, to join me today. John brings a wealth of knowledge about the relationship between Santee Cooper and the cooperatives.

Within the testimony I will offer today, I hope to address the historical, functional and legal aspects of the relationship between South Carolina's cooperatives and Santee Cooper. I will also share some of the complexity and uncertainty affecting our utility industry and how those factors affect our current relationship and planning for the future. I also wish to relate some recent challenges faced by the cooperatives and Santee Cooper and a brief measure of my assessment of whether they were successfully and efficiently resolved. Finally, I would like to offer several recommendations for your committee as to how it may assess whether Santee Cooper is "meeting both the letter and intent of the law" and Santee Cooper's "short and long-term corporate health."

Historical Relationship

Santee Cooper's enabling act goes all the way back to April 7, 1934. It ushered in an era which brought about the construction of its lake, lock and hydroelectric system but which also brought about a period of evolution of its purpose to "benefit of all the people of South Carolina and for the improvement of their health, welfare and material prosperity." In February 1941 the National Defense Board declared Santee Cooper to be "necessary for national defense." At about the same time, Santee Cooper's Board of Directors entered into negotiations to purchase South Carolina Electric and Gas Company, only to be blocked by the South Carolina Supreme Court's ruling that the geographical limit on Santee Cooper's operation was below the confluence of the Broad and Saluda rivers. Instead, Santee Cooper worked with 14 of the state's 20 cooperatives, that joined together to form Central to build transmission lines to route Santee Cooper-generated electricity across a new transmission system which was generally independent of reliance upon investor-owned facilities. Central built the transmission system, leasing the system to Santee Cooper at an annual sum sufficient to repay the loans used to construct these new facilities. Upon repayment by the cooperatives in 1985 of those loans used to build the transmission system, Santee Cooper assumed ownership of the transmission system. At that point in time, Central served 35 of the state's 46 counties through 15 of the 20 cooperatives.

The five other electric cooperatives (Blue Ridge, Broad River, Laurens, Little River and York) served 11 Upstate counties from their inception (1939-1941). The "Upstate Five" initially purchased their wholesale power from investor-owned utilities. In the late 1970s, these five formed their own generation and transmission cooperative (Saluda River Electric Cooperative, Inc.) to serve as an aggregator and manager of purchased power but also as owner of 18 percent of one unit at the Catawba Nuclear Site in York County.

In 2008 the 20 electric cooperatives joined together as member-owners of Central, initially drawing upon Central's wholesale power contracts with Santee Cooper, South Carolina Electric and Gas Company (SCE&G), and SEPA. As of 2013, and pursuant to the December 2009 "Duke agreement," all 20 cooperatives' wholesale power needs are served by Santee Cooper, SEPA and Duke Energy Carolinas. By volume of electricity purchased in 2014, 93 percent of Central's power is purchased from Santee Cooper, 6 percent from Duke Energy Carolinas and 1 percent from SEPA. At its full phase-in on January, 2019, the Duke relationship is anticipated to meet approximately 20 percent of Central's needs with Santee Cooper providing 79 percent and SEPA 1 percent.

Functional Relationship

South Carolina's cooperatives operate differently from most utilities which vertically integrate generation, transmission and distribution. Put simply, the model of most utilities is that all three functions are owned and operated by the same legal entity. For cooperatives in South Carolina, each of these functions is performed by a different legal entity. Wholesale power is purchased through their aggregation and transmission cooperative (Central), transmitted through high voltage lines to each of the 20 distribution cooperatives that, in turn, deliver electricity to their consumer-members through their distribution systems.

Within its wholesale power agreement (the Coordination Agreement) with Santee Cooper, Central does not pay a fixed rate per kilowatt-hour (kWh) of electricity purchased. Instead, it pays for a portion of Santee Cooper's costs for each of the factors listed below based upon Central's contribution to the total cost of each:

1) variable expenses (including fuel); and
2) fixed cost (including capital costs)

In addition, there is an administrative "adder." Based upon this arrangement, in 2014, the cooperatives purchased 57 percent of the electricity sold by Santee Cooper, yet paid approximately 60 percent of Santee Cooper's variable cost and 70 percent of its fixed costs. The higher percentage of capital cost paid reflects Central's cost-causation for generation capacity necessary to meet its proportionately higher contribution to Santee Cooper's peak capacity needs. In 2014, Central paid $1.125 billion of Santee Cooper's total electricity sales of $1.95 billion.

Central's relationship with Duke Energy Carolinas is similar in that the cooperatives are billed on their contribution to cost-causation for both variable and fixed cost.

Combined, Santee Cooper (168,000 meters) and the cooperatives (740,000 meters) serve over 1.7 million South Carolinians. Their combined transmission system is 5,101 miles of line. Santee Cooper's generation capacity (potential to generate electricity) is 5,322 megawatt (MW). As combined, their customer base, transmission system and generation capacity exceed any other utility's in South Carolina.

However, Santee Cooper and the cooperatives are not the same in any functional or legal sense of the word.

Legal Relationship

Santee Cooper was established as the Public Service Authority of South Carolina by the General Assembly in Section 58-31-10 et. seq. Its governance is reserved to a 12-member board appointed by the Governor, screened for qualification by the State Regulation of Public Utilities Review Committee (PURC) and confirmed upon the advice and consent of the Senate. Along with residency requirements (one per congressional district; one per the direct served counties of Berkeley, Georgetown and Horry, and two at large), two of the directors are required to have substantial electric cooperative experience yet cannot be actively serving as an employee or trustee of an electric cooperative.

Each of the 20 distribution cooperatives is a 501(c)(12) entity under the Internal Revenue Code. Each of these cooperatives is governed by a board of trustees ranging in size from eight to 12 members. The power and authority of electric cooperatives were generally established by the General Assembly in 1939. Often referred to as the Cooperative Enabling Act, Section 33-49-10 et. seq. requires each cooperative to conduct annual meetings of those consumer-members served. At each annual meeting, these consumer-members elect one-third of the cooperative's trustees.

Central Electric Power Cooperative, Inc., the 20 cooperatives' aggregator, manager and transmitter of wholesale electricity, is also organized as a 501(c)(12) cooperative. Its board of trustees is composed of two members of each of the 20 member-cooperatives. These 40 members are charged with the governance of Central. Since 1950, Central and Santee Cooper's relationship has been governed by the Coordination Agreement. (The Joint Oversight Committee staff has been supplied with a copy of this Agreement.) Contained within this Agreement are the concepts of Central paying a portion of Santee Cooper's variable and fixed costs and Central's ability to audit those costs.

Within its most recent amendment in 2013, the Coordination Agreement also established joint staff advisory committees to consider optimal fuel purchasing and financing options. While Central is granted opportunities to advise as to fuel and financing and, under certain conditions, to opt-out of Santee Cooper's decisions to build new generation, all corporate authority for Santee Cooper is reserved to its board.

In 2005, the General Assembly established a standard of care for Santee Cooper's directors (commonly referred to as the business judgement rule) in Section 58-31-55. In sum, the directors are required to exercise their duties in good faith, with ordinary prudence and in the best interest of Santee Cooper. Best interest is statutorily defined as a balancing of:

> "(a) preservation of the financial integrity of the Public Service Authority and its ongoing operation of generating, transmitting, and distributing electricity to wholesale and retail customers on a reliable, adequate, efficient, and safe basis, at just and reasonable rates, regardless of the class of customer;
>
> (b) economic development and job attraction and retention within the Public Service Authority's present service area or areas within the State authorized to be served by an electric cooperative or municipally owned electric utility that is a direct or indirect wholesale customer of the authority; and
>
> (c) subject to the limitations of Section 58-31-30(B) and item (3)(a) of this section, exercise of the powers of the authority set forth in Section 58-31-30 in accordance with good business practices and the requirements of applicable licenses, laws, and regulations."

In exercising this judgement, directors are called upon to consider pertinent information, opinions, reports or statements if prepared by Santee Cooper officers, legal counsel, public accountants and other experts. While not exclusive as to being resources for director information, Santee Cooper officers and staff are gatekeepers as to the board's agenda and furnished resources. Directors are generally immune from personal liability if they act in accordance with the best interest test and when they rely upon information provided by staff. However, the breadth and value of the information to be considered is only as wide and rich as staff allows.

Change and Uncertainty in the Utility Industry

The corporate and governance structures of both Santee Cooper and the electric cooperatives originate in an era when the chief challenge they faced was bringing electricity to the rural areas of South Carolina. These were areas where less than two percent of the population had access to what was to become a basic need - electricity. Most often, planning for future generation was based upon reliable and historical barometers of increased electricity use. Frequently cited was the near one-to-one correlation between growth in gross domestic product (GDP) and the use of electricity. Choice of generation-type was impacted by the cost of fuel (natural gas, nuclear or coal), the cost of construction of each generation type and environmental regulations affecting air and water quality. While major shifts in regulations were rare, the federal Fuel Use Act of 1978 caused a nationwide shift from natural gas-fired generation to either coal or nuclear. Otherwise, generation planning was incremental and fairly straightforward.

Within the last decade, three factors have brought substantial change and uncertainty into utility planning: 1) the opening, closing and reopening of the regulation of CO_2 emissions under the Clean Air Act, 2) the advent of distributed energy resources (DER) including rooftop solar and 3) an evolving utility business model driven by technological changes. In effect, it is an open and often debated question as to what services, and at what costs, tomorrow's energy utility will operate.

In passing Act 175 of 2004, the South Carolina General Assembly foresaw an era of technological change that required holistic, rather incremental, regulation. In revamping the Public Service Commission (PSC), establishing the Office of Regulatory Staff (ORS), and creating PURC, the General Assembly placed a premium on consensus-building, mediation and collaboration. During the legislation's consideration, this "time is of the essence" regulatory model was viewed as critical to the state's telecommunication industry. In an ironic twist, its chief value has proven to be within the electricity sector where strong leadership has resulted in nationally recognized regulation and legislation championed by environmental groups, consumers and utilities. Most recently Act 236 of 2014 established a framework and trajectory for distributed energy resources (DER) built upon thousands of hours of collaboration and solid, agreed-upon empirical data. In another example of success attributable to Act 175, when the EPA sought input from the states on the Clean Power Plan, South Carolina stakeholders, working under the leadership of ORS and DHEC's Division of Air Quality, brought about the reformation of the regulation that could result in billions of dollars of savings to South Carolina's ratepayers.

Credit given for such success should be widespread. All stakeholders came to the table, agreed to seek consensus, eschewed contempt for others' proposals prior to investigation and brought a mutual commitment to the long haul. Litigation was not bandied as a threat. I believe structural credit is due to several key factors found in Act 175:

1) six legislators and four public members (PURC) are uniquely responsible and accountable for the success of the PSC and ORS;

2) the Act and PURC encouraged and rewarded collaboration. In fact, it is an often noted "peculiarity" of South Carolina's regulatory environment; and

3) PURC "minded the store" on an annual basis through a stakeholder survey and agency hearing process that is the foundation of PURC's work and budget recommendations. All of this work by PURC is in addition to its screening of ORS Executive Director appointments and PSC candidates as to qualification. In my opinion, it represents the very best of legislative accountability and responsibility.

Act 175 of 2004 did not address Santee Cooper or its Board appointments. Santee Cooper reform legislation was enacted in 2005. Specific Santee Cooper oversight by PURC was limited to screening for the qualifications of gubernatorial appointments to Santee Cooper. There is no statutorily mandated annual survey and hearing process as there is with the ORS and PSC. This oversight committee's resolution to some of the difficulties encountered by Santee Cooper and the cooperatives over the past decade may lie in a similar annual survey and hearing process.

Opportunities to Learn and Improve

Over the last decade, Santee Cooper and the cooperatives have been challenged by a series of disagreements which ultimately were or could be resolved by an "let's agree on the numbers first" approach. These challenges were:

1) An industrial rebate offered by Santee Cooper in 2005;

2) The wisdom of shelving plans for the Pee Dee coal-fired power plant in favor of allowing the cooperatives to purchase existing generation output from Duke Energy Carolinas in 2010;

3) The opportunity to sell a portion of Santee Cooper's Jenkinsville Units Two and Three to either Duke Energy Carolinas or SCANA in 2010-2014; and

4) Santee Cooper's direct wholesale service of additional South Carolina electric cities in 2014-2016.

As a Santee Cooper wholesale customer that pays 70 percent of its fixed costs, Central directly and immediately feels the impact of Santee Cooper's choices. In paying based on its contribution to cost-causation and not a rate per kWh, Central is tied not only to the current ramifications of Santee Cooper's decisions but is also impacted by the long term nature of its relationship under the Coordination Agreement. In some of the above matters, a collaborative approach based on "agreeing on the numbers first" came only after significant pressure and passage of time. My review of Central and the state association boards' minutes (2005-2015) indicates a recurring cycle where only tremendous pressure is sufficient to move Santee Cooper decision-making away from initially held positions.

In some unfortunate cases, matters which should have been resolved through fair and mutual analysis of data became the subject of intense debate. Cooperative leadership frequently

viewed individual Santee Cooper Board members' involvement as indispensable to resolving disagreements. Both Santee Cooper and cooperatives deserve accountability and responsibility for creating and capitalizing on opportunities for consensus. PURC's annual oversight review of ORS and PSC offers real time enforcement of the value of collaboration. Unfortunately, a review of the last decade of Santee Cooper/cooperative challenges would only serve to prove the faultiness of memories on both sides and to increase, rather than reduce, the distraction of disagreement. Let us look ahead.

My Request of the Oversight Committee

There appear to be lessons to learn from PURC's success with ORS and PSC. Act 175 has created a culture that lends itself to innovation and collaboration. Statutory changes to PURC's authority over Santee Cooper may be necessary but should be carefully crafted so as to leave authority, responsibility and accountability with Santee Cooper's Board of Directors. In the near term, I would encourage PURC to work with you, your staff, ORS and other stakeholders to fashion an annual survey and review process of Santee Cooper. Under the law, a high premium is placed on Santee Cooper's board being the ultimate decision-maker as to the agency's "best interests." It is essential that information, well-sifted through a collaborative vetting process similar to that employed by ORS with various stakeholders, makes its way to the board.

Finally, disagreement and litigation can be expensive and result in lost opportunities. Could PURC, through an annual review, assess whether the Santee Cooper's culture has fully embraced the possibilities of consensus? I hope the oversight committee will stay the course in its ongoing inquiry and review until it has an opportunity to assess the value of any implemented changes.

Thank you for your efforts to protect this asset that is owned by the State of South Carolina, held in trust for those who have paid for it and dedicated to the benefit of our entire state.

Very truly yours,

Michael N. Couick
President and CEO