

DIRECT TESTIMONY  
OF  
OSCAR S. WOOTEN  
SOUTH CAROLINA ELECTRIC & GAS COMPANY

- 1 Q. PLEASE STATE YOUR NAME AND ADDRESS.
- 2 A. Oscar S. Wooten, 328 Main Street, Columbia, South Carolina.
- 3 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?
- 4 A. I am Executive Vice President-Finance, of South Carolina Elec-  
5 tric & Gas Company.
- 6 Q. MR. WOOTEN, PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND  
7 EXPERIENCE.
- 8 A. I am a graduate of the University of Richmond in Richmond, Virginia  
9 holding a degree in Accounting, and I am also a Certified Public  
10 Accountant. I have practiced public accounting and was employed  
11 by the Atomic Energy Commission at the Savannah River Plant as an  
12 audit supervisor for approximately four years. I have been employed  
13 by South Carolina Electric & Gas Company since 1954 and held various  
14 positions in the Company's Accounting Department before assuming my  
15 present position.
- 16 Q. PLEASE DESCRIBE YOUR DUTIES AS EXECUTIVE VICE PRESIDENT-FINANCE, OF  
17 SOUTH CAROLINA ELECTRIC & GAS COMPANY.
- 18 A. I am directly responsible for the Company's Secretarial, Treasury,  
19 Accounting and Data Processing Departments, including preparation  
20 of budgets and forecasts and all financial statements issued by the  
21 Company. I have the primary function of raising funds and advising  
22 the Company's management on its present financial position and prob-  
23 lems with respect to finance. In addition, I am responsible for  
24 developing and maintaining the Company's investor relations program

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1 with the financial community.

2 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

3 A. My testimony, as chief financial officer, will deal with our Company's  
4 urgent need for adequate rate relief. I consider the relief to be  
5 essential if South Carolina Electric & Gas Company is to continue to  
6 operate. It should be noted that the standard of living of our custo-  
7 mers, as well as other citizens of this state can only decline if our  
8 Company is no longer able to provide reliable utility service as a  
9 result of not being allowed to charge adequate prices for our services.  
10 In addition, I will illustrate by my testimony the Company's present  
11 financial condition and the resulting effect of this rate increase.  
12 Because of inflationary pressures on all costs of operations, our  
13 Company has been unable to earn the return previously allowed as  
14 reasonable by this Commission. The fact that an historical test  
15 period employing previously incurred costs is used in the ratemaking  
16 proceedings makes it virtually impossible in times of inflation  
17 for the Company to earn its allowed return. It is possible to adjust  
18 for the effects of inflation through the use of an attrition allowance,  
19 or by projecting income and expenses with a forward test year. How-  
20 ever, without the use of such adjustments it becomes even more impera-  
21 tive that a sufficient rate of return on equity be allowed. The  
22 following tabulation shows historical earnings of SCE&G from 1968 -  
23 1979.

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	<u>12 Months Ending</u>	<u>Earnings per Average Common Share</u>	<u>Period End Return on Equity</u>
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2			
3	March 31, 1979	\$2.00	10.70%
4	Dec. 31, 1978	\$2.26	12.02%
5	Dec. 31, 1977	\$2.22	12.12%
6	Dec. 31, 1976	\$1.97	11.36%
7	Dec. 31, 1975	\$2.09	11.86%
8	Dec. 31, 1974	\$1.47	7.57%
9	Dec. 31, 1973	\$1.75	9.89%
10	Dec. 31, 1972	\$1.98	10.46%
11	Dec. 31, 1971	\$1.72	10.29%
12	Dec. 31, 1970	\$2.00	12.85%
13	Dec. 31, 1969	\$1.91	13.65%
14	Dec. 31, 1968	\$1.78	14.38%

15 As a result of the effects of inflation on our Company, our earn-  
16 ings and our coverage ratios, which are the two main determinants of  
17 financial stability, have seriously deteriorated. For the twelve  
18 months ending June 30, earnings per average common share had declined  
19 to \$1.78; and period end return on equity had fallen to 9.30%. Without  
20 rate relief this downward trend will continue to the point that we will  
21 be unable to attract, on reasonable terms, the capital necessary to  
22 complete our present construction program, or to commence new ones.  
23 Also, maturing securities need to be redeemed at the lowest possible  
24 cost in order to allow the cost of service in the future to be as low  
25 as possible. Our customers will suffer if the continued economic  
26 development of our service area is jeopardized. If we receive the

1 rates requested, our customers will benefit by continuing to have  
2 access to a reliable source of electricity and gas. In addition, the  
3 new jobs created through the expansion of existing industrial plants  
4 and the construction of new ones - a situation only possible when  
5 industry is confident that its source of electricity and gas is reli-  
6 able - will enhance the economic well-being of our customers and other  
7 citizens of this state. As a result of the financial condition to  
8 which the Company will return if the proposed rates are implemented,  
9 our customers will not only enjoy reliable service, but also the  
10 benefits of paying rates based on lower costs for capital than would  
11 have been charged if our financial condition were to continue to  
12 weaken.

13 Q. MR. WOOTEN, HOW CAN A COMPANY, BY SEEKING HIGHER RATES, BE ABLE  
14 TO PROVIDE BETTER SERVICE TO ITS CUSTOMERS AT A LOWER COST?

15 A. Better service means being able to provide reliable service. We  
16 must be able to build the plants necessary to satisfy the growing  
17 needs of our growing customer base. To be able to build the  
18 plants, we must be able to attract capital. To attract capital  
19 we must demonstrate a satisfactory degree of financial integrity.  
20 Better service means being able to provide electricity at the  
21 most reasonable cost to the consumer. To do so we must be able to  
22 obtain the raw materials necessary to provide electricity and gas at  
23 the most reasonable cost, and then to convert the raw materials into  
24 electricity and gas in an efficient manner. One of the basic raw  
25 materials is capital. Capital is the savings accumulated by inves-  
26 tors. To attract capital at a reasonable cost, thereby benefiting

1 our customers, we must demonstrate a satisfactory degree of finan-  
2 cial integrity.

3 Q. WHAT ARE THE CHARACTERISTICS OF A COMPANY POSSESSING A SATISFAC-  
4 TORY DEGREE OF FINANCIAL INTEGRITY?

5 A. The company should:

- 6 1) have a demonstrated ability to sell common stock at a  
7 price that will yield proceeds to the company at or  
8 above book value;
- 9 2) have a high bond rating (A or better); and
- 10 3) have the demonstrated ability to generate at least 50% of the  
11 cash requirements of its construction program internally.

12 Now I shall discuss each of these characteristics in detail. Selling  
13 common stock at a price above book value is important because to do  
14 otherwise reduces a portion of the existing shareholder's share of  
15 ownership. In addition, more shares must be sold to raise a given  
16 amount of equity capital than would have been necessary at a price  
17 equal to book value. As a result, the sale of common below book has a  
18 negative impact on the potential return to the investor, since the  
19 growth rate of the company's earnings and dividends are dampened.  
20 Earnings are important because dividends are paid out of earnings.  
21 Under stable interest rate and risk conditions, common share market  
22 price will generally track the rate of growth of dividends. For this  
23 reason, factors which negatively influence earnings and dividend  
24 growth, such as selling common below book, cause the common stock to  
25 become less attractive to the investor. When the stock becomes less  
26 attractive, the market price is depressed, increasing further the

1 cost of equity and debt financing to the company, resulting in higher  
2 costs to the consumer.

3 A high bond rating has become increasingly important to utilities.  
4 Considering the effect of bond ratings on the cost of debt, it is  
5 well known that the higher rated, or lower risk, debt issue can be  
6 sold at a lower cost to the company. The same holds true for pre-  
7 ferred stock and common equity. Concerning the effect bond ratings  
8 have on the availability of capital, the Employment Retirement  
9 Income Security Act of 1974 (ERISA) has caused investors to be-  
10 come more risk-averse, in that fiduciaries were made personally  
11 liable for any loss resulting from a breach of their fiduciary  
12 responsibilities. Consequently, investment managers have a per-  
13 sonal incentive to buy bonds and stocks of high quality. Further-  
14 more, in times of capital shortage, such as in 1974, and even in  
15 recent months, the terms of securities issued by companies with  
16 unsatisfactory financial integrity can only be marketed to the  
17 public with adverse sinking fund requirements, non-callable fea-  
18 tures, shorter than normal maturities, and similar constraints  
19 on the financial flexibility of the issuing utility.

20 A utility, in order to possess satisfactory financial integrity  
21 should be able to generate sufficient cash to supply 50% of its cash  
22 construction requirements. The utility business is capital intensive.  
23 That fact, coupled with its size, explains why the utility business  
24 accounted for one half of all common stock offerings during the past  
25 five years. The supply of new common shares issued by utilities is  
26 therefore large, but the industry is faced with a declining market

1 for those issues. Institutional investors have largely desert-  
2 ed the utility equity market, and the individual investor appears  
3 also becoming more selective with regard to risks and return. A  
4 diminished demand for utility common stock raises the question:  
5 "will there be sufficient capital made available to a utility in  
6 the future to satisfy the capital requirements of its construction  
7 program?" Due to this concern, prudence dictates that the manage-  
8 ment of a soundly run utility not rely on external sources for  
9 more than half of its construction requirements.

10 Q. WHAT WAS SCE&G'S FINANCIAL POSITION AT MARCH 31, 1979?

11 A. Considering the elements of financial integrity just discussed,  
12 our financial position is weakening.

13 First, concerning our ability to sell common stock at a price that  
14 will yield proceeds in excess of book value, the following chart  
15 demonstrates our experience since 1973.

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1 PUBLIC OFFERINGS OF COMMON STOCK SINCE 1973

2	Date of Public Offering	Number of Shares	Net Proceeds to Company per Share	Book Value per Share	Percentage Over or Under Book Value
4	12-12-74	2,360,000	\$ 9.405	\$17.405	-46.0%
5	7-10-75	1,500,000	\$14.955	\$16.281	- 8.1%
6	2-3-76	1,700,000	\$17.285	\$16.619	+ 4.0%
7	2-17-77	2,200,000	\$18.200	\$16.841	+ 8.1%
8	2-1-78	1,500,000	\$17.710	\$17.837	- .7%
9	4-18-79	1,000,000	\$16.355	\$18.499	-11.6%

10 As a result of our inability to consistently sell equity at a price  
 11 which yielded proceeds at or above book value, in order to obtain  
 12 the \$186 million in new equity raised since 1973, it has been nec-  
 13 essary to issue in excess of 1.3 million more shares than would  
 14 have been issued had we consistently sold common at a price which  
 15 would have produced net proceeds equal to book value.

16 PROCEEDS FROM THE SALE OF COMMON STOCK SINCE 1973

17	(A)	(B)	(C)	(B) ÷ (C) = (D)	(A)-(D)=(E)
18 Year	Number of Shares Issued	Net Proceeds to Company	Average Book Value	# of Shares that would have been Issued at Bk/Value	Additional Shares Issued
19 1974	2,489,422	\$23,869,108	\$17.382	1,373,208	1,116,214
20 1975	1,669,602	24,782,592	16.458	1,505,808	163,794
21 1976	1,928,831	33,281,418	16.862	1,973,753	(44,922)
22 1977	2,524,439	46,177,158	17.436	2,648,380	(123,941)
23 1978	2,081,259	36,913,379	18.188	2,029,546	51,713
24 1979*	<u>1,318,428</u>	<u>21,607,128</u>	18.313	<u>1,179,879</u>	<u>138,549</u>
25 Totals	<u>12,011,981</u>	<u>\$186,630,783</u>		<u>10,710,574</u>	<u>1,301,407</u>

26 \*through 6-30-79

1 At our current annual dividend rate of \$1.68 per share, the annual  
 2 dividend requirements for those 1,301,407 shares of stock which  
 3 were sold only because we were unable to sell at a price to yield  
 4 net proceeds at book value will total nearly \$2.2 million in 1979.  
 5 This, converted to charges to customers before taxes amounts to  
 6 between four and five million dollars annually.

7 Second, our present bond rating, single A, is third in line, behind  
 8 triple A and double A, for investors seeking quality. Our current  
 9 bond rating is the lowest rating for investment grade securities in  
 10 that many institutional investors and individual investors, either  
 11 because of legal limitations or as policy matters, will not pur-  
 12 chase a bond with a rating below single A.

13 Third, we have been unable to generate half our cash construction  
 14 requirements internally.

15 PERCENTAGE OF CONSTRUCTION EXPENDITURES GENERATED INTERNALLY

16 Year	(A) Construction Expenditures (000)	(B) Cash Flow (000)	(C) (B) ÷ (A)
17 1978	\$119,930	\$45,392	37.8%
18 1977	164,254	44,765	27.3%
1976	179,391	38,055	21.2%
19 1975	128,301	40,817	31.8%
1974	96,142	28,325	29.5%
20 1973	57,973	23,652	40.8%
1972	88,252	22,285	25.3%
21 1971	78,872	19,690	25.0%
1970	88,854	17,528	19.7%
22 1969	82,643	17,554	21.2%
23 1968	44,018	17,356	39.4%

24 Our cash flow has suffered from the inclusion of a non-cash credit  
 25 to earnings, allowance for funds used during construction (AFUDC),  
 26 in the return on common equity. In fact, the majority of our re-

1 reported earnings in recent years has been "non-cash." Since 1972, as  
 2 the following chart will demonstrate, the cash portion of our earnings  
 3 has not been sufficient to cover our dividends to our common shareholder.

4 PERCENTAGE OF DIVIDENDS COVERED BY CASH EARNINGS

5	(A)	(B)	(A)-(B)=(C)	(B)÷(A)=(D)	(E)	(C)÷(E)=(F)	
6	Year	AFUDC	Cash	% of EPS	Cash Div.	% Cash Div.	
	EPS	Portion	EPS	Non-Cash	Paid	Cov. by Cash EPS	
7	1979*	\$2.00	\$1.28	\$ .72	64%	\$1.62	44%
8	1978	\$2.26	\$1.32	\$ .94	58%	\$1.605	59%
9	1977	\$2.22	\$1.23	\$ .99	55%	\$1.55	64%
10	1976	\$1.97	\$1.04	\$ .93	53%	\$1.51	62%
11	1975	\$2.09	\$ .64	\$1.45	31%	\$1.48	98%
12	1974	\$1.47	\$ .35	\$1.12	24%	\$1.4675	76%
13	1973	\$1.75	\$ .54	\$1.21	31%	\$1.4175	85%
14	1972	\$1.98	\$ .58	\$1.40	29%	\$1.3675	102%
15	1971	\$1.72	\$ .57	\$1.15	33%	\$1.3125	88%
16	1970	\$2.00	\$ .67	\$1.33	34%	\$1.2425	107%
17	1969	\$1.91	\$ .39	\$1.52	20%	\$1.1725	130%
18	1968	\$1.78	\$ .13	\$1.65	7%	\$1.1025	150%

19 \*Twelve months ending 3-31-79

20 The return on equity we have been allowed to earn is calculated  
 21 after including the non-cash credit, AFUDC. As a result, our re-  
 22 ported earnings do not include sufficient cash earnings, and we  
 23 have had to resort to other sources for our cash dividend payments.  
 24 Those sources of cash have been depreciation and deferred taxes.  
 25 It may be necessary for any company, from time to time, to pay  
 26 cash dividends out of these sources. However, to do so on a

1 consistent basis, as we have been forced to do for seven of the  
 2 last eight years, is not indicative of a healthy financial situ-  
 3 ation. Depreciation exists to provide for the replacement of  
 4 obsolete equipment. Deferred taxes exist primarily because of  
 5 the federal government's desire to boost productivity by encour-  
 6 aging investment in new plant and equipment.

7 Q. WHAT WAS SCE&G'S CAPITAL STRUCTURE AT MARCH 31, 1979?

8 A.	Amount Per Books	Capitalization Ratios	Adjustments	Total As Adjusted	Capitalization Ratios
9 Long-Term Debt	\$651,625,605	51.60%	\$35,000,000 (3)	\$686,625,605	53.79%
10 Short-Term Debt	52,269,300	4.14	(37,516,000)(4)	14,753,300	1.15
11 Preferred Stock	153,951,000	12.19	-	153,951,000	12.06
12 Common Equity	<u>404,948,221 (1)</u>	<u>32.07</u>	<u>16,275,000 (5)</u>	<u>421,223,221</u>	<u>33.00</u>
13 Total	<u>\$1,262,794,126</u>	<u>100.00%</u>	<u>13,759,000</u>	<u>\$1,276,553,126</u>	<u>100.00%</u>

14 (1) Common Equity 418,027,578  
 15 Investment in Subsidiary 13,079,357 (2)  
 16 404,948,221

17 (2) Cost at March 31, 1979.

18 (3) \$35,000,000 bond issue at April 1, 1979.

19 (4) Reduction to bank notes and commercial paper through April, 1979.

20 (5) 1,000,000 shares common stock April 7, 1979.

21 Q. IS THIS A REASONABLE CAPITAL STRUCTURE?

22 A. Certainly not by current industry standards. Since 1974, the electric  
 23 utility industry has moved in the direction of a capital structure  
 24 which relies less on debt and more on equity. We have also moved in  
 25 this direction, but our capital structure still contains a smaller  
 26 proportionate cushion of equity for the senior security holder than does

1 that of the average utility.

2 CAPITALIZATION RATIOS

3 December 31, 1978

4		Weighted Industry*	
5		<u>Average</u>	<u>SCE&amp;G</u>
6	Debt**	51.5%	55.2%
7	Preferred Stock	12.2%	12.2%
8	Common Stock	36.3%	32.6%
9	Total	<u>100.0%</u>	<u>100.0%</u>

10 \* 75 major electric utilities

11 \*\* includes short-term debt and current portion of long-term debt,  
12 and nuclear fuel trusts

13 Many industry observers feel that 40% of an electric utility's capi-  
14 talization should be made up of common equity. I believe that, as  
15 the minimum, a 40% equity ratio should be the objective of any pru-  
16 dently managed electric utility that expects to be able to finance  
17 future construction on reasonable terms. It is certainly our  
18 objective, and it has been for a number of years. In light of the  
19 incident at Three Mile Island, a 40% equity ratio may soon be con-  
20 sidered to be insufficient.

21 Q. WHAT ARE THE COMPANY'S PROJECTED CAPITAL REQUIREMENTS?

22 A. As Mr. Summer testified, the Company's construction expenditures  
23 for the period 1979 through 1983 are expected to be approximately  
24 \$519 million, excluding nuclear fuel. Nuclear fuel expenditures  
25 are projected to be an additional \$95.1 million during this five  
26 year period. I will only review the first two years of the period

1 (1979-1980).

2 The Company's cash requirements for its construction program and  
3 for retiring maturing securities in 1979 are estimated to be \$196  
4 million, of which \$46 million will be provided by internally gen-  
5 erated funds made up of the portion of our earnings we will retain,  
6 and non-cash charges such as depreciation and deferred income taxes.  
7 The balance of the funds needed in 1979, some \$150 million, will be  
8 raised through short-term borrowings, the sale of bonds, preferred  
9 stock and common stock.

10 In 1980, the Company's total capital requirements are ex-  
11 pected to be approximately \$207 million, of which 72% will have to  
12 come from outside sources. During this period the Company will  
13 sell bonds, preferred stock, and common stock, and will rely on  
14 short-term borrowing. The exact timing and types of securities  
15 actually sold will be decided on the basis of the Company's  
16 ability to meet its coverage ratio requirements, and its ability  
17 to attain a reasonable capital structure. The nature of the  
18 capital markets in those years will also be a factor.

19 Q. CAN THE COMPANY RELATE A SOUND FINANCIAL CONDITION TO THE INVESTORS  
20 SO THAT IT WILL BE ABLE TO OBTAIN THIS ADDITIONAL CAPITAL UNDER  
21 CURRENT FINANCIAL CONDITIONS?

22 A. Our Company is in direct competition for investment funds with  
23 every other utility, and with every industrial, financial, and  
24 governmental organization. The only way we can sell our Company's  
25 securities is to make them sufficiently attractive. To make them  
26 attractive we must be able to earn and pay a competitive return.

1 We must also be able to convince the investing public that our  
2 financial condition is sound, and will continue to be so. The way to  
3 relate a sound financial condition today and tomorrow, is by demon-  
4 strating to the potential investor that we have a steady, predictable  
5 ability to earn him a fair and reasonable return on his investment in  
6 our Company. In these inflationary times, that is an impossible task  
7 if we must base our prices on out-of-date, historical costs. Since  
8 1970, our Company has been hard hit by inflation, and during this  
9 decade timely and adequate rate relief has been required. Until our  
10 nation comes to grips with inflation, that need will remain. This is  
11 true because our industry is especially susceptible to the ravages of  
12 inflation: first, our prices are based on historical costs; second,  
13 we must provide service in spite of the current cost of doing so; and  
14 third, we are in a capital intensive business. The impact of infla-  
15 tion on a utility's operating and capital costs render ineffective the  
16 utility's and its regulatory authorities' efforts to set revenue  
17 requirements that will produce a just and reasonable return on equity,  
18 so long as those revenue requirements are based on historical operating  
19 and capital costs.

20 Q. WHY IS RETURN ON EQUITY IMPORTANT?

21 A. New capital is attracted on the basis of the total return that  
22 can be earned on the investor's equity. By "total return" I  
23 mean that the investor is not only looking at the dividend yield  
24 currently available, but also at the growth in dividends he can

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1           expect. Such dividends should be paid out of earnings, leaving part of  
2           the earnings to be retained in the business. Historically, utilities  
3           have been able to increase earnings by the plowback factor, which is  
4           the increment to earnings from the amount of earnings retained by the  
5           business. If a company pays out 70% of its earnings, retains 30%, and  
6           earns a 13% return on equity, the plowback factor would be 3.9% (30% X  
7           13%). Earnings for the company would grow at the rate of 3.9% per  
8           year, so long as it retained 30% of its earnings and earned 13% on its  
9           equity.

10          Today, our Company's debt ratio is already above the industry average;  
11          consequently the use of more leverage as a means of increasing earnings  
12          must be ruled out. The sale of common equity above book value has not  
13          been possible in over a year. The plowback factor cannot be properly  
14          utilized so long as investors, by virtue of their present concern  
15          for getting their return "up front", in order to compensate for  
16          their lack of confidence in our Company's future earnings growth,  
17          insist on higher and higher current dividend yields.

18          In such an environment, an increase in the earned rate of return  
19          on equity is the only way a utility can show growth in earnings.  
20          The higher the return on equity the investor can reasonably expect  
21          to earn, the faster will be the growth in earnings, and consequently,  
22          dividends. By having reason to expect an improved growth in earnings,  
23          the investor will be satisfied with a lower current dividend  
24          yield, meaning a higher ratio of price to dividends, resulting in a  
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1 higher market price for stock.

2 The sale of common stock at a higher market price will favorably  
3 affect our Company's future, since the dilutive effects on earn-  
4 ings per share and return on equity of selling common below book  
5 value will have been minimized, if not eliminated entirely. A  
6 higher return on equity will therefore facilitate our sales of  
7 additional common equity, since new investors would not have cause  
8 for concern about the dilutive effect on earnings per share and  
9 return on equity of sales of new common below book value. To be  
10 able to sell senior securities, which provide the majority of the  
11 funds used in construction, we must be able to sell common stock.

12 Q. WHY IS THE COMPANY'S ABILITY TO SELL COMMON STOCK ESSENTIAL TO THE  
13 SALE OF OTHER SECURITIES?

14 A. Common stock is the foundation upon which all senior financing is  
15 built. The protection offered to the bondholder and the preferred  
16 stockholder by the common stockholder's investment is essential in  
17 their investment decision. To be able to market additional bonds  
18 and preferred stock, the Company must be able to market common  
19 stock, which is the cushion needed by the senior security holder.  
20 Not only is an improved return on equity essential to the Company's  
21 chances for being able to market additional common stock in the  
22 future without contributing to a situation which results in the  
23 confiscation of a portion of the existing stockholder's invest-  
24 ment, but an improved return on equity is necessary if we are to  
25 to be able to market new senior securities. To be able to sell  
26 new senior securities, certain fixed charge coverage ratios must be

1 met. The earnings on common equity, or the return on equity, pro-  
2 vides the support for meeting those minimum coverage ratios.

3 Q. WHAT DO YOU MEAN BY THE TERM "FIXED CHARGE COVERAGE"?

4 A. Fixed charge coverage is a number which defines the number of  
5 times earnings (after all operating and income deductions except  
6 income taxes and fixed charges) cover the fixed charges the Company  
7 must pay. "Fixed Charges," by definition in our borrowing con-  
8 tracts include (1) interest on all debt, (2) amortization of debt  
9 premium, discount and expense, and (3) allowance for rental pay-  
10 ments.

11 The fixed charge coverage ratio is important, not only because it  
12 determines whether the Company is legally able to issue new senior  
13 securities, but also because it is one of the primary indicators  
14 used by a potential investor to evaluate the quality of the secur-  
15 ities of a company and to measure the risk he is assuming. Senior  
16 security investors are interested in the yield on a security in  
17 relation to the risk that the interest or dividend will not be paid  
18 and, in the case of bonds and debentures, the risk that the prin-  
19 cipal will not be repaid when due. The adequacy of the Company's  
20 fixed charge coverage and the soundness of the Company's financial  
21 position provide a large measure of the assurance the investor is  
22 seeking.

23 Q. WHAT HAS HAPPENED RECENTLY WITH RESPECT TO SCE&G'S COST OF DEBT?

24 A. In recent years inflationary pressures have pushed up the inter-  
25 est rates we must offer on new issues of long-term debt. Since  
26 the rates paid on new issues are higher than those on the Com-

1 pany's outstanding issues, our embedded cost of long-term debt  
 2 has increased nine of the past ten years. As shown below, the  
 3 embedded cost of long-term debt has increased from 4.66% to 7.89%  
 4 since year-end 1968. As a result of this 69% increase in our  
 5 embedded cost of long-term borrowing, the Company is currently  
 6 paying \$21 million in additional annual interest charges on our  
 7 outstanding long-term debt solely because of a higher level of  
 8 embedded interest rates than in 1968.

9	Year	Embedded Cost of Debt	Fixed Charge Coverage Ratio (SEC)
10	1979 (as of 3-31-79*)	7.89%	2.41x
	1978	7.76%	2.67x
11	1977	7.62%	2.78x
	1976	7.70%	2.58x
12	1975	7.38%	2.79x
	1974	6.95%	2.22x
13	1973	6.60%	2.36x
	1972	6.47%	2.54x
14	1971	6.33%	2.39x
	1970	6.06%	2.63x
15	1969	5.51%	3.60x
	1968	4.66%	4.75x

16 \*Adjusted for April 1979 \$35,000,000 bond sale.

17 As a result of the higher fixed charges brought about by higher  
 18 interest rates, the Company's fixed charge coverage ratio has dropped  
 19 dramatically. In 1968, as the table above shows, our fixed charges  
 20 were covered 4.75 times. The ratio fell to a low of 2.22 times in  
 21 1974. As of June 30, our fixed charge coverage was only 2.28 times.  
 22 Our calendar year end coverage has not been this low since 1974. Not  
 23 only does a declining coverage ratio place our bond rating in jeopardy,  
 24 but it sets at risk our ability to issue new bonds. Under our bond  
 25 indenture, the issuance of additional bonds is conditional upon our  
 26 having achieved a level of earnings which will cover fixed charges a

1 minimum of two times. Reduced earnings affect our ability to sell  
2 additional bonds, new common stock, and new preferred stock, as well.

3 Q. WHAT ROLE DOES PREFERRED STOCK PLAY IN THE COMPANY'S FINANCIAL  
4 STRUCTURE?

5 A. Preferred stock provides protection for debt holders over and above  
6 that provided by common stock. Non-payment of preferred stock  
7 dividends will not put a company into bankruptcy. However, such  
8 an event would cause the company to forego payment of dividends to  
9 common stockholders, since preferred stockholders have, by defini-  
10 tion, a "preferred" status over common stockholders.

11 Q. WHAT HAS HAPPENED TO THE EMBEDDED COST OF PREFERRED STOCK?

12 A. Due to the same influences that have affected the cost of our long-  
13 term debt, the embedded cost of preferred stock has increased over  
14 the years.

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	<u>Year</u>	<u>Embedded Cost of Preferred Stock</u>	<u>Preferred Coverage after Income Tax</u>
1			
2			
3	1979 (as of 3-31-79)	8.16%	1.55x
4	1978	8.04%	1.61x
5	1977	7.91%	1.58x
6	1976	7.89%	1.53x
7	1975	7.78%	1.57x
8	1974	7.18%	1.33x
9	1973	7.22%	1.57x
10	1972	7.22%	1.66x
11	1971	7.08%	1.66x
12	1970	6.56%	1.94x
13	1969	5.12%	2.05x
14	1968	5.12%	2.13x

15 For the period ending June 30, our preferred coverage after income  
16 tax had dropped to 1.44 times. The higher costs the Company must pay  
17 for its long-term debt and preferred stock, coupled with the extremely  
18 high interest rates we are currently paying for short-term borrowings,  
19 have been two of the primary reasons for our sharp decline in earnings.

20 Q. WHAT RETURN ON COMMON EQUITY ARE YOU ASKING FOR IN THIS PROCEED-  
21 ING?

22 A. We are seeking rates designed to cover all our costs, and we are  
23 attributing 13% annual cost to the use of our common shareholders'  
24 money.

25 Q. DO YOU CONSIDER THIS TO BE A FAIR AND REASONABLE RETURN?

26 A. As I have been organizationally given the responsibility of over-

1 seeing the obtaining of external capital by the Company for the past  
2 twelve years or more and have been in constant contact with the  
3 investing public and underwriters and independent advisors, I believe  
4 that the investors consider a return of 13% on equity to be inadequate.  
5 The reason the Company is requesting only a 13% return is that we are  
6 attempting to do what we can to operate on the barest essentials  
7 during this period of high rates of inflation. I would certainly consider  
8 that under today's conditions, a 14% return on equity is a minimum  
9 fair and reasonable return; however, we feel that our request is truly  
10 a "bare bones" request considering that it is the same granted by the  
11 Commission's Order in December 1977, and considering that new elements  
12 of risk have been assumed by the common stockholder since that date. I  
13 am referring to the risk borne by the shareholders of all utilities  
14 which employ, or soon will employ, nuclear energy as a fuel for the  
15 generation of electricity; as well as to the risk that high rates of  
16 inflation have become part of this country's way of life.

17 Q. PLEASE SUMMARIZE THE REASONS FOR YOUR REQUEST FOR INCREASED RATES.

18 A. The proposed increase is the bare minimum needed to restore our  
19 indicators of a sound financial condition, among them earnings  
20 and coverage ratios, to reasonable levels. The return on equity  
21 on which the increase is based is the same return the Commission  
22 found just and reasonable in its most recent order pertaining to the  
23 Company. Since that time, the perceived risk in owning the stock of a  
24 utility which derives, or will soon derive, a significant portion of  
25 its generation from nuclear energy has grown. This higher degree of risk  
26 is reflected in the reduced value placed on the ownership of such shares

1 by the investing public, as measured by the price paid for common  
2 stock. Since the risk borne by our shareholders is higher, a higher  
3 return should be granted to compensate them for the additional risk.  
4 As a bare minimum, the same return as previously found just and reason-  
5 able should be allowed.

6 If we are not allowed to increase our rates to reasonable levels,  
7 we will be subjecting our customers to the risk that our ability  
8 to provide adequate service will be diminished; the indicators of a  
9 sound financial condition will continue to show deterioration; and  
10 the coverage of our fixed charges will fall to a point that we will be  
11 unable to raise capital under reasonable terms. If we should become  
12 unable to raise capital, we could no longer be able to fulfill our  
13 responsibility to meet our service area's needs for electricity and  
14 gas. If that were to happen, South Carolina Electric & Gas Company  
15 would have become an impediment to the future economic development of  
16 our state and to the future economic well-being of its citizens.

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