REBUTTAL TESTIMONY

OF

CARLETTE L. WALKER

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2002-000-E

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Carlette L. Walker. My business address is 1426 Main Street, Columbia, South Carolina.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS DOCKET?

A. Yes.

Q. PLEASE DESCRIBE THE SCOPE OF YOUR REBUTTAL TESTIMONY.

A. My testimony comments on and, where appropriate, rebuts the testimony of the witnesses indicated.

Q: PLEASE ADDRESS THE TESTIMONY OF THE DEPARTMENT OF THE NAVY'S WITNESS, MR. DONALD COATES, CONCERNING ALLOWANCE FOR CASH WORKING CAPITAL.

A. Mr. Coates makes the assertion that the Commission should exclude from cash working capital expenses related to items in Material and Supplies Accounts. Specifically, he asserts that the amounts related to Account 501 (which includes fossil fuel for steam plants), Account 509 (which includes SO2 emissions

allowances inventory), and Account 547 (which includes fuel oil), should be excluded from the cash working capital calculation. He asserts that including these amounts in the calculation results in "double counting" since the Company earns a return on these costs while they are included in Materials and Supplies Inventory. He further asserts that amounts related to Account 904 (which includes uncollectible accounts) should be excluded from the working capital calculation because these costs are not cash expenses.

Q: ARE THESE ASSERTIONS CORRECT?

A. No. Mr. Coates' analysis reflects a misunderstanding of the way that transactions involving Materials and Supplies Inventory Accounts are handled by the Company. Let me explain why, beginning with his assertions concerning items held in Material and Supplies Inventory Accounts.

When coal, emission allowances, or fuel oil are purchased, they are placed in Material and Supplies Inventory Accounts until they are used. During this time, the Company earns a return on its investment in these inventories. However, at the time these inventories are consumed in the operation of our plants, inventory is reduced, earnings cease, and fuel expenses are recorded. The Company then must wait until bills are generated and mailed to customers and customers pay them in order to receive the return of its cash investment in these fuels and other expenses. In short, there is no double counting. Earnings cease as soon as the materials are removed from inventory. And there is a significant lag between the date the materials are removed from inventory and the date

payment is received from customers. The allowance for cash working capital recognizes the capital employed by the Company between the time the expense related to these materials is recorded and the time the Company receives payment for the resulting electric service provided to customers using those materials.

In fact, for transactions involving the Materials and Supplies Inventory Accounts, there may well be the need for more cash working capital rather than less. When the Company buys and uses non-inventory items, there is typically some lead-time between receipt of the material and payment of the bill from the vendor. This lead-time acts as an offset to the lag between use of the material and the customers' payment for services rendered. By contrast, when inventories are removed from Materials and Supplies, the expense is recognized immediately. There is no offset against the lag in receiving revenue.

Q: HOW DOES THE COMPANY'S PROPOSED TREATMENT OF THE FUEL RELATED EXPENSES COMFORM WITH ESTABLISHED COMMISSION PRECEDENT?

A. The Commission has consistently applied the cash working capital formula the Company is proposing. In fact, the orders and directives on which current practice is based clearly envision all such expenses being a part of the cash working capital computation.

Q: PLEASE DISCUSS MR. DONALD COATES' ASSERTIONS CONCERNING THE ALLOWANCE FOR CASH WORKING CAPITAL ON UNCOLLECTIBLE ACCOUNTS.

A. Mr. Coates takes the position that uncollectible accounts should not be included in calculating the allowance for cash working capital because, he asserts, uncollectibles do not constitute cash expenses. This assertion is incorrect. Uncollectible accounts are indeed cash expenses. The amounts reflected in this account represent revenues that the Company has recognized when bills were issued but for which the related cash has not materialized. Accordingly, they represent cash that the Company will not receive to reimburse it for its cost of fuel and fixed costs associated with providing the electric services. The cash that the Company is not receiving to cover these expenses is cash that the Company must provide to support its operations out of cash working capital. Accordingly, the amounts reflected in the account are properly included in the cash working capital calculations.

I would note that the Commission has consistently included "non-cash" items in its cash working capital calculations since the adoption of the one-eighth formula in 1974. In addition, the Commission has specifically ruled that it is not appropriate to exclude "non-cash" items from cash working capital calculations. Order No. 89-588 (p.39).

Q: MRS. WALKER, DO YOU HAVE ANY OTHER COMMENTS ON TESTIMONY FILED RELATING TO THE COMPANY'S PRO FORMA ADJUSTMENT FOR WORKING CAPITAL?

A. Yes. Mr. Watkins has requested that the Commission direct SCE&G to perform a lead-lag study in its next rate case, and if SCE&G chooses not to do so, not to include any cash working capital in its rate base.

There is a long history supporting use of the one-eighth formula before the Commission. On November 13, 1974, the Commission issued a directive that requires the inclusion of working capital in rate base be based on the accepted formula of one-eighth of Operating and Maintenance Expense ("O&M ") less Purchased Power Expense.

In Order No. 84-406-E/G, dated October 8, 1984, the Commission ordered the Company to compute its cash working capital using fully developed lead-lag studies. The reason for this departure from the 1974 directive was "to provide the Commission with the opportunity to review an alternative means of computing working capital." (Order No. 84-406 E/G at p. 2). The results of that experiment were reviewed in the Commission's 1987 rate order pertaining to SCE&G,

> The record of this proceeding indicates that the lead-lag study performed by SCE&G and submitted in response to the Commission Staff's Data Request approximates substantially the traditionally accepted formula approach in providing a reasonable measure of SCE&G's cash working capital requirements. We agree with SCE&G's witness Umbaugh that the expense and effort to prepare such a study does not justify its utilization for ratemaking purposes.

Order No. 89-588 (p.39).

In 1993, the Commission reaffirmed this conclusion:

> [T]he one eighth formula is a proper means to determine cash working capital. One reason is practicality. The lead-lag study is extremely complex and expensive. A utility company, like SCE&G, generates millions of bills for services each year and pays thousands of bills from suppliers. If the Commission were to order lead-lag studies, SCE&G's customers would ultimately pay the cost of them. Moreover, the outcome of the studies is very much dependent on the assumptions in labeling and tracking expenditures. . . .[U]tiltity companies are uniquely well suited for application of a standard formula for cash-working capital purposes.

Order 93-465 at p.36-37, June 7, 1993.

The Commission reaffirmed this conclusion in SCE&G's 1995 rate proceeding over objections of the Consumer Advocate that lead-lag studies should be required. Order 96-15, dated January 9, 1996 at p. 25-26.

The Consumer Advocate has produced no new evidence to challenge this well established rule that lead-lag studies are inconclusive, unnecessary and unjustifiably expensive. The justifications for not conducting such studies are equally applicable today as they were in these past cases. SCE&G's customers would ultimately pay the costs for studies that are of little or no practical use.

The Company supports the conclusion, stated in the testimony of the Commission Staff's witness, Mr. Ellison, that "[t]he formula approach provides a reasonable and unbiased estimate of the Company's cash working capital requirements." (Prefiled Testimony at p.22, lines 4-6). The Company

recommends that the Commission continue the utilization of the working capital formula as a means of measuring the cash working capital adjustment.

Q. MRS. WALKER, DO YOU AGREE THAT CASH WORKING CAPITAL SHOULD BE CALCULATED BY APPLYING THE ONE-EIGHTH WORKING CAPITAL FORMULA TO EXPENSES AFTER ACCOUNTING FOR O&M PRO FORMA ADJUSTMENTS?

A. Yes. The cash working capital calculation should be made using the best available information concerning the O&M expenses for which cash working capital will be required. As the Commission is aware, test year O&M expenses are only the starting point for determining the O&M expenses that should be recognized for rate-making purposes. Test year expenses only become an accurate reflection of O&M expenses for rate-making purposes after pro forma adjustments are made. The Commission makes such adjustments to remove non-allowable expenses and to remove or include expenses due to known and measurable changes that will occur at or before the time rates go into effect.

The allowance for cash working capital should reflect pro forma adjustments. Otherwise, the cash working capital allowance will not accurately reflect the true level of O&M expenses for which cash working capital is required.

Q. WHY HAS IT NOT BEEN THE PRACTICE IN THE PAST TO REFLECT PRO FORMA ADJUSTMENTS IN CASH WORKING CAPITAL?

A. There does not appear to be any principled reason in regulatory or rate-making policy to support not reflecting pro forma adjustments in the calculation of cash working capital allowances. In fact, Mr. Watkins adjust the cash working capital for the pro forma adjustments that affect O&M expenses. In addition, the record shows that the Commission has routinely made such adjustments in past proceedings. See Order 87-1381 dated December 30, 1987.

Q. MRS. WALKER, DO YOU HAVE ANY COMMENTS RELATING TO MR. WATKINS' ASSERTION THAT SCE&G IS SEEKING DOUBLE RECOVERY OF GRIDSOUTH COSTS?

A. Yes. Mr. Watkins makes the assertion that the Company is seeking double recovery of costs billed to GridSouth. In fact, none of the costs involved in the GridSouth project were included in test year retail electric expenses. In keeping with the FERC accounting order for GridSouth, the costs incurred by the Company relating to the formation of GridSouth were not recorded in the Company's O&M expenses. A specific balance sheet account was established on the books of the Company, and all direct costs associated with GridSouth were accumulated and charged to that account.

Q. THE CONSUMER ADVOCATE'S WITNESS MR. WATKINS HAS TESTIFIED CONCERNING THE COMPANY'S BUY/RESELL ADJUSTMENT. WHAT COMMENTS DO YOU HAVE ON THIS TESTIMONY?

A. Mr. Watkins asserts that the Company should place the risks and rewards for unregulated buy/resell transactions in its regulated accounts. He ignores the fact that the transactions in question are third party electric power trades that do not involve the use of SCE&G's generation assets in any way.

SCE&G believes that it is sound regulatory policy to carefully segregate regulated and unregulated activities and to assure that only regulated actives are included in rates. Accordingly, SCE&G believes earnings or losses from non-regulated transactions are not properly included in regulatory accounts. I would point out that these transactions are very different from market sales of capacity or energy from our regulated plants. The sales in question here do not in any way involve generation assets that are part of our regulated rate base.

Q. MRS. WALKER, DO YOU RECOMMEND THAT THE COMMISSION ADJUST ACCUMULATED DEPRECIATION FOR PRO FORMA DEPRECIATION EXPENSE ADJUSTMENTS USING A ONE-HALF YEAR CONVENTION?

A. Yes. The annual depreciation expense for property, plant, and equipment is recognized evenly throughout the year. To the extent that property, plant, and equipment are being written off through depreciation and recovered in this monthly depreciation expense, I believe that it is unreasonable to assume that the return on these assets should be calculated based on the book value of the asset (original cost less recorded depreciation expenses) at the end of the period.

Q. MRS. WALKER, DO YOU AGREE WITH THE ADJUSTMENT PROPOSED BY MR. ELLISON TO REDUCE PROPERTY, PLANT, AND EQUIPMENT FOR THE INVESTMENT IN URQUHART RE-POWERING THAT IS CLASSIFIED IN STEAM PRODUCTION?

A. Yes. This reduction is appropriate, given that the entire Urquhart repowering project investment (including these steam production investments) was separately accounted for in the Company's Pro Forma Adjustment Number 17.

Q. MRS. WALKER, DO YOU AGREE WITH THE ADJUSTMENT RECOMMENDED IN MR. ELLISON'S TESTIMONY RELATING TO A STORM DAMAGE RESERVE TRUE-UP?

A. Yes. The storm damage reserve should be adjusted to reflect the actual amount of the reserve at the end of the test year ($76,000 increase in the reserve balance) and to correctly associate all storm damage reserve with retail operations ($264,000 increase in the reserve balance).

Q. MRS. WALKER, IS MR. WATKINS CORRECT IN HIS ASSERTION THAT THE COMPANY IS INSULATED FROM THE RISK OF EVEN MINOR STORM DAMAGE EXPENSES?

A. No. Mr. Watkins is apparently unaware that the Commission order approving the adoption of a storm damage reserve mandates that the first $2.5 million of storm damage O&M expenses incurred annually are not subject to storm damage reserve reimbursement.

Q. MRS. WALKER, SHOULD THE REDUCTION TO RATE BASE FOR STORM DAMAGE RESERVE FUNDS BE BASED ON GROSS FUNDS RECEIVED FROM CUSTOMERS OR THE AFTER-TAX AMOUNT OF FUNDS THE COMPANY ACTUALLY HAS ON HAND?

A. The reduction to rate base should be the after-tax amount of funds. Mr. Watkins has suggested that the reduction to rate base ignore the income tax expenses the Company has actually incurred in an effort to have the Company's stockholders share some of the risks of storm damages. As discussed in the answer to the previous question, The Company bears the risk of the first $2.5 million in storm related O&M expenses that are not subject to storm damage reserve reimbursement. Mr. Watkins does not dispute the fact that the Company has incurred tax expenses directly attributable to storm damage revenues, nor does he dispute that the net amount of ratepayer funds available to the Company is $16.8 million ($27.2 million of gross storm damage revenue less the $10.4 million of income tax expenses attributable to storm damage revenue). Just as with all other reductions to rate base, the storm damage reserve rate base reduction should represent the after-tax amount of ratepayer funds held by the Company. Mr. Watkins' proposal violates the fundamental principle that deductions from rate base to reflect customer-contributed capital should reflect the actual net amount of capital received by the Company from customers. Mr. Watkins is recommending that the income taxes associated with the storm

damage reserve be treated differently from all other taxes on customer-contributed capital.

Q. MRS. WALKER, DO YOU HAVE ANY OTHER COMMENTS RELATING TO ADJUSTMENTS PROPOSED IN TESTIMONY FILED BY OTHER INTERESTED PARTIES TO THE RATE PROCEEDING?

A. Yes. I do not disagree with the three adjustments proposed by Mr. Ellison, the PSC staff witness, relating to the use of a 12-month average materials and supplies inventory for rate base valuation (a rate base reduction of $11,043,000) and the exclusion from O&M of certain costs he considers to be non-allowable for rate-making purposes, including civil penalties charged to the Company in the amount of $101,000 (a total reduction in O&M expenses of $761,805), and property taxes (a reduction in O&M expenses of $1,477,000).

Q. MRS. WALKER, DO YOU AGREE WITH THE OPEB TRUE-UP PRESENTED IN MR. ELLISON'S TESTIMONY?

A. Yes. I agree with the recommendation to decrease rate base by $1,205,000 for OPEB true-ups.

Q. MRS. WALKER, DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.