

RatingsDirect®

Public Service Authority of South Carolina; Retail Electric

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| <i>Unenhanced Rating</i> | A+(SPUR) / Negative | Outlook Revised |
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| <i>Short Term Rating</i> | A-1 | Affirmed |
| South Carolina Pub Svc Auth rev oblig | | |
| <i>Long Term Rating</i> | A+ / Negative | Outlook Revised |

Rationale

S&P Global Ratings has revised its outlook on the Public Service Authority of South Carolina (Santee Cooper) to negative from stable. At the same time, S&P Global Ratings affirmed its 'A+' long term and underlying ratings and 'A-1' commercial paper rating on the utility.

The outlook revision reflects litigation that puts at odds the interests of Santee Cooper and those of Central Electric Power Cooperative Inc., S.C., which procures power from Santee under a coordination agreement. In our opinion, the litigation could impair Santee Cooper's ability to recover costs associated with the cancelled Virgil Summer nuclear units 2 and 3, with \$4.5 billion spent on the project, no asset to show for it, and political pressures mounting. In our opinion, this heightens credit risk, and we believe that there exists a one-in-three chance that this lacking alignment of interests will lead to diminished credit quality within the next two years.

The most recent demonstration of the deteriorating climate is Central's filing of a cross-claim against Santee Cooper in an existing case (Cook v. Santee Cooper, et.al.) in which they are both defendants, brought by a ratepayer before the 14th Circuit Court of Common Pleas. The case, among other things, seeks to bar the utilities from charging ratepayers for the billions of dollars of costs incurred to date for the abandoned nuclear projects.

We understand Santee Cooper has already filed a motion to dismiss the existing case, asserting that it is statutorily and legally within its rights to recover costs associated with debt service on the units. Although it has yet to do so, we anticipate the authority will file a similar motion to dismiss the cross-claim.

Both Santee Cooper and Central have indicated that they do not believe the cross-claim threatens the validity of the coordination agreement, under which Central purchases energy for its 20 distribution cooperatives serving 700,000 end-use customers through 2058. Central's cross-claim alleges a breach of the agreement with Santee Cooper, which calls for an annual cost of service study to determine rates that Santee charges Central based on costs that are

"reasonably" recovered for "service" to be provided.

Regardless, we believe that should Santee Cooper be unable to recover its nuclear costs from Central, it would eviscerate a key underpinning of the coordination agreement, and a downgrade would likely follow.

Central (and its 700,000 end-use customers) accounts for about 70% of Santee Cooper's energy sales, and 60% of its revenue. Central has indicated that the nuclear project represents about 5% of the power costs associated with its billings to its members, while Santee Cooper has indicated that units represent 4.5% of power bills, or roughly \$5 per month for the typical customer. S&P Global Ratings estimates that the rate impact of a worst-case scenario -- one in which Santee Cooper's 177,000 customers were forced to pick up the entire cost of the nuclear units -- would result in at least a tripling of costs related to the project. In our opinion, this would represent a significant burden to ratepayers, and would likely affect our ratings on the utility.

Santee Cooper is also facing intense criticism from elected officials, some of whom have advocated the sale of the utility (which we have previously opined as very unlikely), while others have advocated restrictions on Santee Cooper's rate-setting autonomy. S&P Global Ratings believes that rate-setting autonomy is a key underpinning of credit quality for electric utilities in the public power sector, and should this diminish, we would likely lower the rating.

S&P Global Ratings previously lowered its rating on the authority Aug. 2, 2017. The downgrade reflected the decision to suspend the project, the significant amount of rate-supported debt with no productive asset to show for it, and Santee Cooper's exposure to legal and political fallout. In our opinion, we are now seeing the former.

Outlook

The negative outlook reflects the litigation, which could impair Santee Cooper's ability to recover costs associated with the cancelled nuclear units. In our opinion, we believe that there is a one-in-three chance that the litigation and lack of aligned interests between Santee Cooper and Central will lead to diminished credit quality within the next two years.

Upside scenario

We could revise the outlook to stable if the courts rule that the utilities are entitled to cost recovery on the abandoned investments, without Central pursuing efforts that in our view would eviscerate the coordination agreement.

Downside scenario

We could lower the ratings if the court rules against Santee Cooper in either the existing case or the cross-claim, calling into question the scope of cost recovery that the authority is entitled to under the agreement. We could also take a negative rating action if Santee Cooper's rate-setting autonomy diminishes.

The Central Cross Claim

Although Central has cited a number of bases for its cross-claims, its essence appears to rest on the contention that Santee Cooper, as co-owner of the nuclear project, does not have the right to recover costs for a project that is not "used" and "useful". Central's management has stated that the cross-claim is intended to preserve the utility's right to respond from a civil procedure standpoint in the event of that court does not approve the motion to dismiss the

existing case. Management has suggested it could take the courts several months to rule on the dismissal motions. Central has not said whether it would press these claims independent of the ruling.

Central's cross-claim also asks the court to direct Santee Cooper to place in a "constructive trust" 70% of an \$831.2 million payment Santee Cooper received from Toshiba Corp, the parent company of Westinghouse Electric, the nuclear units' bankrupt contractor. Santee Cooper received the money in December 2017, and under agreement reached with the state, is holding it in reserve until July 2018. The authority has indicated that it intends to use the Toshiba money to defray debt service costs, mitigating the project's rate impact, a benefit that would accrue to all customers of Santee -- including Central, its members, and their retail customers. An inability to use the money to pay down debt would further stress Santee Cooper's customer rates.

| Ratings Detail (As Of March 5, 2018) | | |
|--|-------------------|-----------------|
| South Carolina Pub Svc Auth retail elec (AGM) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (AGM) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (ASSURED GTY) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (BHAC) (SEC MKT) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (National) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (National) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth retail elec (National) | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth rev oblig (Taxable) ser 2016D due 12/01/2056 | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |
| South Carolina Pub Svc Auth rev oblig | | |
| <i>Unenhanced Rating</i> | A+(SPUR)/Negative | Outlook Revised |

Many issues are enhanced by bond insurance.

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