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Fitch Ratings: PG&E Bankruptcy Not Likely to Affect US Public Finance Ratings

Fitch Ratings-New York-17 January 2019: PG&E Corporation's planned bankruptcy filing is not likely to adversely affect the credit quality of the state of California, its local governments or publicly owned utilities (POUs), according to Fitch Ratings.

PG&E Corporation announced on Monday that it intends to file a petition for Chapter 11 bankruptcy protection on or about Jan. 29. The utility provides power to about 16 million natural gas and electric customers over 70,000 square miles in northern and central California and is among the largest taxpayers in several cities and counties that Fitch rates. Following the announcement, Fitch downgraded PG&E's Long-Term Issuer Default Rating (IDR) to 'C' from 'BBB-'. In addition, the company failed to make a scheduled interest payment on senior notes on Tuesday.

The imminent bankruptcy filing reflects the impact of potential enormous wildfire-related liabilities related to the 2017 Tubbs and 2018 Camp Fires without a clear path to timely recovery of such costs under California law. California applies the doctrine of inverse condemnation to privately-owned utilities. Inverse condemnation typically holds governmental agencies responsible for compensating property owners for the damage to or taking of property by the government.

Purchased Power Agreements Affected
Fitch has downgraded to 'C' from 'BBB-' trust certificates issued by Genesis Solar LLC and Topaz Solar Farms, LLC's senior notes as a result of PG&E's erosion in credit quality and pending bankruptcy filing. In addition to its own generating fleet, PG&E serves its load by purchasing power from numerous independent power producers (IPP) under power purchase agreements (PPAs), including Genesis and Topaz. Many of these IPPs are renewable generators – wind and solar projects – which depend on revenue from PG&E.

Project ratings are typically constrained by the rating of the revenue counterparty under fixed-price PPAs. PG&E's bankruptcy would not necessarily trigger a downgrade of the rated project debt if the projects are deemed critical vendors and PG&E continues to honor its revenue contract commitments. However, any attempt by PG&E to reject PPA commitments would be considered significant credit deterioration as prevailing power prices, either merchant or newly contracted solar PPAs, are lower than the current legacy prices and would lead to deterioration of project's coverage metrics.

Long-Term Concerns for POUs
California's POUs are not expected to see material erosion in credit quality as a result of PG&E's ongoing financial and legal challenges. That said, issues driving PG&E's current challenges, the state's wildfire risks and California's inverse condemnation rules remain a long-term risk for the state's POUs. A potential PG&E bankruptcy should be manageable for POUs in the short to medium term due to the nature of the relationship between most POUs and PG&E, POUs' generally healthy liquidity levels, and the market and operational constructs within the state.

Fitch-rated POUs have many connections to PG&E ranging from physical interconnections between systems, joint projects, operational agreements, and others. However, POUs have few direct contracts with PG&E for power supply and generally are not reliant on PG&E-owned generation to meet their system loads. Potential slowdowns in PG&E projects, some of which are joint projects with POUs, could result in delays and additional costs. However, Fitch views them as unlikely to significantly impact POU credit ratings. Indirect effects from a potential PG&E bankruptcy include market volatility that could increase the cost of purchased power for some POUs and, longer term, potential changes in market tariffs or operational rules and financial requirements that could increase the cost of operations. At this point, Fitch does not expect potential rule changes to materially affect POU cost of operations.

Minimal Impact to State and Local Government Revenue and Operations
Fitch's analysis of the potential impact on the state and local governments indicate minimal threat to revenues and financial operations. If the utility were unable to emerge from a bankruptcy, the state would likely step in in some fashion to ensure service continues without interruption. Fitch expects that either rates (if PG&E emerges from bankruptcy) or taxes (if the state steps in and the utility assets become non-taxable, which Fitch understands would likely take several years) would have to increase to fund legal liabilities. In either scenario, the increased cost of running the utility would not be enough to affect either the state's ability to remain economically competitive or its credit quality. Fitch also does not foresee a meaningful impact on employment or earnings as the utility would continue to function in some form.

Fitch assumes that as a regulated utility, PG&E will continue to provide service and be required to pay property taxes throughout a Chapter 11 bankruptcy as it did during its 2001-2004 bankruptcy. According to the company website, PG&E paid $461 million in property taxes and another $137 million in franchise fees in the tax year ended June 30, 2018 to the 50 counties and 247 cities in which it owns and operates infrastructure throughout the state.

A handful of Fitch-rated local governments have PG&E as a major taxpayer. The largest are San Luis Obispo County (AAA IDR), in which PG&E is the largest taxpayer at about 5% of assessed value (AV) in fiscal 2018 and Fresno County (A+ IDR), in which PG&E (also the largest taxpayer) makes up about 3% of AV in fiscal 2017 (latest data available).

San Luis Obispo County reports it received about $10 million in property taxes from PG&E in fiscal 2018 (about 2% of governmental revenues). Even if PG&E failed to pay any property taxes going forward or the assets in the county eventually became non-taxable, Fitch does not believe such a loss would affect San Luis Obispo County's credit quality. The county retains solid expenditure flexibility and the highest gap-closing capacity with approximately $260 million in unrestricted fund balance (52.5% of spending) as of the end of fiscal 2018. PG&E AV in San Luis Obispo County is comprised mainly of the Diablo Canyon Nuclear Power Plant. PG&E plans to close the plant by 2025. In September 2018, the Governor of California signed legislation directing the PUC to fully fund a community mitigation settlement meant to soften the decrease in taxes.

If PG&E failed to pay property taxes to Fresno County or the assets became non-taxable, Fitch estimates the impact would be even smaller at about 0.5% of governmental revenues based on 3% of the $255 million (roughly 17% of governmental revenues) in property taxes the county received in fiscal 2017. The county retains solid expenditure flexibility and adequate gap-closing capacity to address a moderate revenue decline. The county had about $157 million in unrestricted fund balance at the end of fiscal 2017, equal to almost 12% of spending.

Total fiscal 2017 license, permit and franchise fee revenues from all payers in San Luis Obispo County were $11 million, or 2% of governmental revenues; franchise fee revenues were $17 million or 1% of governmental revenues in Fresno County.

Contact:

Amy Laskey
Managing Director
+1-212-908-0568
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Andrew Joynt
Director
+1-212-908-0594

Kathryn Masterson
Senior Director
+1-512-215-3730

Matthew Reilly
Director
+1-415-732-7572

Karen Ribble
Senior Director
+1-415-732-5611

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com