

# Bond Case Briefs

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## What The Return Of Nuclear Power Plant Construction Means For Municipal Investors.

***The builder constructing the first new nuclear power plants in the U.S. in more than 40 years recently filed for bankruptcy protection. What does this mean for the project's completion, and, on a broader scale, the municipal market?***

The U.S. nuclear power industry is currently comprised of 99 nuclear reactors in 30 states, supplying approximately 20% of the country's electricity needs.<sup>1</sup> These facilities are held by both investor-owned utilities and municipal or public power utilities. The public power utility sector as a whole is viewed as a relatively safe and secure sector of the municipal market due to the stable demand for electricity and the ability of public power utilities to recover cost burdens through electricity rate increases to customers.

A combination of factors, including nuclear accidents at Three Mile Island in 1979 and Chernobyl in 1986, health and safety concerns and cost overruns due to regulatory issues and construction delays, led to a discontinuation in nuclear plant construction in the U.S. for decades. Now, rising fossil fuel prices and concerns regarding greenhouse gas emissions over the past several years have fueled what many believed to be a nuclear renaissance in the U.S. and other countries around the globe.

### **Westinghouse's role in nuclear renaissance**

Westinghouse Electric Company, a subsidiary of Japan's Toshiba Corporation and the largest builder of nuclear power plants in the world, is the lead construction contractor of the first nuclear plants to be built in the U.S. in nearly 40 years: Plant Vogtle in Georgia and Virgil C. Summer in South Carolina.

Substantial cost overruns and delays have led to massive financial losses for Westinghouse and the eventual Chapter 11 bankruptcy filing on March 29. The result is a heightened degree of uncertainty about the projects' future and an increase in the perceived riskiness for municipal bonds and the public power utilities involved with the projects.

### **Bond issuers exposed to Westinghouse**

Six municipal bond issuers have varying degrees of exposure to these nuclear projects.<sup>2</sup> Given their ownership interests in the facilities, the following four municipal bond issuers have already incurred substantial costs and issued debt to finance the construction.

- South Carolina Public Service Authority (Santee Cooper) is 45% owner of the Summer project.
- Oglethorpe Power is 30% owner of the Vogtle project.
- Municipal Electric Authority of Georgia (MEAG) is 22.7% owner of Vogtle.
- City of Dalton, GA is 1.6% owner of Vogtle.

Since the following two issuers have agreed to purchase power, they may experience financial

pressure as costs are passed along to all participants:

- Jacksonville Electric Authority (JEA) is a purchaser of Vogtle plant power under a 20-year contract that includes responsibility for construction cost overruns.
- PowerSouth is a purchaser of Vogtle plant power under a similar 20-year contract.

### **Who pays for cost overruns?**

Prior to the Westinghouse bankruptcy filing, the various project owners benefited from a fixed-price construction contract provided by Westinghouse, thereby shielding the municipal utilities from substantial cost overruns. Westinghouse, however, is likely to reject this contract in bankruptcy court and attempt to shift the burden of future cost overruns to the project owners, with likely negative impacts to the credit quality and ratings of the various owners. The project owners benefit from a limited guarantee provided by Toshiba, but Toshiba's tentative financial footing calls into question the potential benefit of the guarantee.

### **To continue the project or not to continue**

The public utility owners are now in the process of deciding whether or not to complete the project. The decision will impact the future cost burden, the need to raise additional debt and the magnitude of any future electricity rate increases to customers.

Municipal utilities benefit by having autonomous rate-setting ability, which means that the electricity rates the utilities charge to their residential, commercial and industrial customers are set by the utilities themselves and do not need approval from a regulatory body. Thus, plant construction cost overruns potentially can be recouped through higher electricity rates charged to customers.

This ability to raise rates fairly easily is one of the reasons public power is generally a high-quality, stable sector of the municipal market. Therefore, although the bond prices of the municipalities with exposure to these projects could further weaken, ultimate repayment is not likely to be an issue.

### **Bottom line**

We believe that some credit ratings fallout from the Westinghouse bankruptcy is likely. However, we remain confident that the public power utility sector as a whole is a relatively safe and secure sector of the municipal market because of the stable demand for electricity and the ability of public power utilities to recover cost burdens through electricity rate increases to customers.

1. Source: Nuclear Energy Institute, 2016; <https://www.nei.org/Knowledge-Center/Nuclear-Statistics/US-Nuclear-Power-Plants>
2. Source: Barclays Municipal Research, April 2017

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