MOODY'S
INVESTORS SERVICE

Announcement: Moody's Says Substantial Nuclear Plant Cost Overruns Increase TVA's Rate Pressure and Debt Ceiling Risks

Global Credit Research - 09 Apr 2012

New York, April 09, 2012 -- Moody's Investors Service said that the substantial cost overruns being incurred by the Tennessee Valley Authority (TVA) to complete a second unit at its Watts Bar Nuclear Plant will increase pressure on rates and potentially use up additional debt capacity under its federally mandated $30 billion debt cap, but will not immediately affect its Aaa senior unsecured rating or stable rating outlook. The extent to which TVA is able to raise rates or reduce costs to offset the impact of these added nuclear construction costs will be an important determinant as to how much flexibility the organization will be able to maintain under its debt ceiling. The ability and inclination of TVA's Board to raise rates to cover expenses is an important credit consideration and we would expect TVA to raise rates at some point during 2012 to address the additional cost pressures arising from Watts Bar 2.

RATINGS RATIONALE

On April 5, 2012, TVA announced a significantly higher cost estimate and delayed construction schedule for the completion of a second unit at its Watts Bar Nuclear Plant site. The new nuclear construction project was approved by the TVA Board in 2007 at an original estimated cost of $2.49 billion and a completion date in the fall of 2012. The revised cost estimate is a range of from $4.0 to $4.5 billion, 60% to 80% above the original estimate, with a new completion date of between September and December 2015, three years behind the original scheduled completion date.

The project has been plagued by mismanagement from the start, with TVA citing poor planning, cumbersome and overly complex work streams, and a lack of project controls and communications, among other reasons, for the delay. The construction project is also taking place adjacent to its operational and fully functioning Watts Bar Unit 1 nuclear reactor, adding an additional level of complexity. Because of these developments, TVA has replaced the management team at the project and has put in place more direct lines of reporting and accountability to TVA senior management. Although the TVA Board has been briefed on the new cost and schedule estimates, the latest update will be considered for approval at its April meeting.

The Watts Bar cost overruns will require between $1.5 billion and $2.0 billion of additional funding sources over the next three years, which will likely come from a combination of rate increases and additional financings. TVA also hopes to increase internal cash flow generation from a series of cost cutting measures taking place throughout the organization. In October 2011, TVA raised wholesale rates by approximately 2% after leaving wholesale rates unchanged in 2010. Although TVA's Board is required by law to set rates at levels sufficient to recover operating costs, service debt obligations, make payments in lieu of taxes to local municipalities, and make payments to the U.S. Treasury, the Board has shown a sensitivity to local economic conditions when considering and instituting rate increases.

Under the provisions of the TVA Act, TVA cannot have bonds or notes outstanding in excess of $30 billion at any time and as of December 31, 2011, it had $24.7 billion of bonds or notes outstanding that fell under this cap, up approximately $1 billion from fiscal year end 2010. After falling for several years, TVA's debt levels have again begun to increase as it finances part of its growing capital expenditure program with debt. TVA has begun to address the debt ceiling issue by considering alternative financing methods aside from its power bonds and discount notes, most recently by utilizing a $1 billion lease transaction to finance its nearly completed John Sevier combined cycle plant. Lease financing is not considered debt under TVA's statutory debt ceiling and permits TVA to finance ongoing capital expenditure requirements while maintaining financial flexibility under the ceiling. Before the Watts Bar 2 announcement, TVA's proposed FY 2012 financial plan anticipated that its statutory debt balance would fall from the current $24.7 billion to the $22 billion range given scheduled amortization and partly as a result of lease financings. TVA had been considering a possible lease transaction on its Watts Bar 2 plant, although recent developments will undoubtedly preclude this option over the near term.

We note that the incremental Watts Bar 2 construction expenditures will be incurred over a three year period, giving TVA some time to incorporate these additional costs into its rate structure and capital funding plan. Although substantial, the new cost estimate remains competitive on a per-megawatt basis with the new Vogtle and Summer nuclear plants being constructed by The Southern Company and SCANA, respectively. In addition, TVA has committed not to begin construction on its next new nuclear construction project at its Bellefonte site until nuclear fuel is loaded at Watts Bar 2, which is now not expected until late 2014 or early 2015. Accordingly, TVA recently reduced the number of contractors working on the Bellefonte nuclear project, which will also alleviate some capital expenditure requirements. We will continue to monitor the degree to which TVA incorporates the additional Watts Bar 2 construction costs into rates while simultaneously maintaining adequate flexibility under its statutory debt cap.

The methodologies used in this rating were Regulated Electric and Gas Utilities published in August 2009, and Government-Related Issuers: Methodology Update published in July 2010. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

The Global Scale Credit Ratings on this press release that are issued by one of Moody's affiliates outside the EU are endorsed by Moody's Investors Service Ltd., One Canada Square, Canary Wharf, London E 14 5FA, UK, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that has issued a particular Credit Rating is available on www.moodys.com.

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Moody's considers the quality of information available on the rated entity, obligation or credit satisfactory for the purposes of issuing a rating.

Moody's adopts all necessary measures so that the information it uses in assigning a rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see Moody's Rating Symbols and Definitions on the Rating Process page on www.moodys.com for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on www.moodys.com for the last rating action and the rating history. The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moodys.com for further information.

Michael G. Haggarty
Senior Vice President
Infrastructure Finance Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

William L. Hess

MD - Utilities
Infrastructure Finance Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653