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New Deal for Roosevelt's TVA Seen as Hard Sell

By: Julie Johnsson and Mark Chediak – April 14, 2013

President Barack Obama's proposal to wean the Tennessee Valley Authority (3015A) from the U.S. government faces the same obstacles that have frustrated privatization advocates since President Dwight Eisenhower termed the state- controlled power company "creeping socialism" in the 1950s.

Selling the largest government-owned U.S. utility, created in 1933 by President Franklin Roosevelt to provide jobs and cheap power to the Depression-stricken Southeast, would potentially reduce the national debt by as much as $35 billion and allow TVA to spend more on pollution controls. Even so, privatization doesn't make political or financial sense, said Stephen Smith, a Knoxville-based TVA watchdog.

Investors may be put off by the TVA's $26 billion debt load, which may exceed the value of its aging coal and nuclear plants. The government would probably have to assume flood- control and other costs for the seventh-largest hydro-power river system from self-funded TVA. Republicans representing voters who benefit from the TVA's low rates are joining Democrats to oppose the move, splitting with traditional Republican support for privatization.

"The value to taxpayers just isn't there," said Smith, executive director of the Southern Alliance for Clean Energy, an environmental group that's criticized the TVA for coal-plant pollution and nuclear construction. "At the end of the day, you create a lot of controversy, problems, and I don't think you end up with a lot of revenues to the federal treasury."

Budget Proposal

Obama's TVA suggestion, included in his proposed budget as a deficit remedy, is focusing attention on the transformation under way in the U.S. power industry. Utilities may spend $1.5 trillion on infrastructure from 2010 through 2030 as generators shift from coal and nuclear power to cleaner natural gas and renewable energy, according to a 2011 report by the Edison Electric Institute, a trade group.

A sale might yield $30 billion to $35 billion in cash and reduced government debt obligations, said Travis Miller, a Chicago-based analyst for Morningstar Inc. (MORN)Though the TVA pays its own debt, the government still must record it as part of the national debt.
Selling the TVA would spare the government any liability for the $25 billion that may be needed over the next decade to clean up or replace its coal plants built a half-century ago,

Michael Granowski, principal with Bridge Strategy Group, a Chicago-based management consultant, said in a phone interview.

Rate Increase

Any structural changes to TVA, whose government mission is to keep customer rates low, would almost certainly raise power bills in its seven-state footprint. The authority's cheap rates, which are among the lowest third of utilities, are one reason TVA enjoys the "mother love" of a politically conservative region, said S. David Freeman, a former TVA chairman.

"The TVA Congressional delegation is like a lioness protecting her young 'uns," said Freeman, who was appointed by President Jimmy Carter to TVA's board in 1977, in a phone interview. "They will kill you if you mess with TVA."

Obama, a Democrat, is joining a cause long popular with fiscal conservatives from Senator Barry Goldwater to President Ronald Reagan to former U.S. House Speaker Newt Gingrich. Operating as a publicly traded company would give the utility more financial and operating flexibility to manage expensive equipment and plant upgrades required to meet new environmental rules, said Chris Edwards, an economist at the Cato Institute, a group in Washington that advocates for small government.

No Advantages

"They would be able to raise money from equity and not just debt," Edwards said in a phone interview. "What are the advantages of it being in the government? I don't see it."

A private power authority would be "more nimble than a state-owned enterprise," said Rick Geddes, a visiting scholar at the American Enterprise Institute in Washington, a group that favors market-based approaches to policy. "You will get sharp, business-focused incentives to innovate, raise revenue and minimize costs, subject to regulatory standards," said Geddes, also an associate professor at Cornell University.

Nonetheless, the idea of selling the TVA has few supporters in Congress, said Representative Steve Cohen, a Tennessee Democrat, in an interview.

"TVA as a going concern today is probably worth less than its debt and its rates have become increasingly less competitive, so if the goal is deficit reduction, I doubt this idea gains much traction," said Senator Bob Corker, a Tennessee Republican, said in a statement.

New Deal

TVA has placed cheap power ahead of profits since it was created to bring electricity to poor Appalachian communities as part of Roosevelt's New Deal to lift the nation out of an economic depression.

The agency is self-regulated, meaning its presidentially- appointed board of directors sets rates to cover its costs of providing power to 9 million people in most of Tennessee and parts of six neighboring states, according to its website. TVA owns 29 hydro-power plants, 11 coal plants and three nuclear plants.

The company's financial management focuses on cash flow rather than profits, said John Thomas, executive vice-president and chief financial officer for Knoxville-based TVA, in a phone interview.

"We're trying to make sure we stay focused on fulfilling our mission, running our business effectively," he said.

Eisenhower Legacy

The power authority also has one of the heaviest debt burdens in the industry, a legacy of an Eisenhower-era rule that enabled TVA to tap debt, but not equity, markets for financing.

TVA's debt is equal to 57 percent of its assets, more than any utility except Houston-based Calpine Corp. (CPN)and Dallas-based Energy Future Holdings Corp (TXU)., which Moody's Investors Service says faces a "material restructuring" within 12 months. The TVA, which has $23 billion of bonds outstanding, risks exceeding its $30 billion debt cap to pay for infrastructure improvements needed to comply with environmental rules, according to Obama's April 10 budget proposal.
TVA's $1 billion of 3.5 percent bonds due December 2042 dropped to 98.3 cents on the dollar on April 12 after trading at 102.6 cents on April 9 following the budget announcement, according to Trace, the bond-price reporting system of the Financial Industry Regulatory Authority.

The worries about TVA's debt cap limit and future financial security are similar to those sounded by the Government Accountability Office in 1995, when Congressional Republicans were pushing the Clinton Administration to privatize it and four other power marketing associations.

Viability Threatened

TVA's $26 billion in debt gives it "little flexibility to meet competitive challenges," GAO, an independent agency that works for Congress, said at the time. "While no cash-flow crisis exists today, GAO believes that TVA's financial condition threatens its long-term viability and places the federal government at risk."

The debt cap, in place since 1979, applies only to bond financing and no other forms of debt, Thomas, TVA's CFO, said. The authority last year lease-financed a $1 billion natural gas plant and might pursue similar arrangements to avoid hitting its debt ceiling, he added.

Still, it's uncertain how TVA, which relies most heavily on coal for power generation, will grapple with updating its plants and complying with Environmental Protection Agency rules that are speeding a shift in the U.S. to cleaner-burning natural gas. Plant-owners are expected to retire 67 gigawatts of coal-fired power in the U.S. by the end of 2020, enough generation to light 53.6 million homes, according to Bloomberg New Energy Finance.

Financing Costs

"A lot of these structural changes are buffeting everyone," said Frank Graves, an economist with the Brattle Group, a Cambridge, Massachusetts-based consulting group. At the same time, Graves said, it's unclear whether being government- owned or private would make a big difference in how the TVA addressed its challenges.

Becoming private could raise the cost of financing for TVA, as equity investors will expect returns higher than the utility currently pays on bonds with an Aaa credit rating from Moody's bolstered by implicit government backing, Graves said in a phone interview. Cost savings might be found in making the operation more efficient although TVA "is not a place where people look around and think a lot of inefficiency needs to be mopped up," he said.

Another deterrent to a sale is the arcane structure that prohibits TVA from raising equity.

Nuclear Reactors

"It's going to be really hard to capitalize what is essentially a 100 percent debt-owned operation into a traditional investor-owned utility structure," Granowski, the power industry consultant, said in a phone interview.

Then there's the question of TVA's six nuclear reactors, its second-largest source of power, with construction under way to complete a partially-built seventh reactor about 50 miles (81 kilometers) northeast of Chattanooga, Tennessee. The government may attract better offers by waiting until TVA completes its $4 billion construction of Watts Bar unit 2, which is slated to come online in early 2015, about three years behind schedule, said Chris Gadmoski, nuclear analyst with Bloomberg New Energy Financial, in a phone interview.

"As an investor, I would feel better if that unit was operating to avoid any construction risk and licensing risk," Gadmoski said.