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BANKING CRISIS—
HOW MIGHT UTILITIES BE AFFECTED?

Over the past few weeks, business news headlines have been overwhelmed by echoes of the 2008 financial crisis as three U.S. regional banks failed, six others were put on review for credit downgrade, and a major European financial institution, Credit Suisse, had to be propped up by its central bank and then taken over by a rival, UBS Group.

Utilities are highly capital-intensive and rely on banks, particularly for short-term financing; should they be concerned about recent events? While the current situation does not (yet) seem to suggest that a "Lehman moment" is at hand, a look back at the sector's experience in prior financial crises and times of economic upheaval is instructive.

In 2008, financial markets seized up as several major financial institutions failed or had to be rescued. Liquidity dried up, and counterparty risk was of paramount concern. The market for commercial paper (CP), a key source of short-term financing for large corporations including utilities, shut down as major issuers such as Lehman Brothers and Bear Stearns faltered. By late 2008, the Federal Reserve took the unprecedented step of purchasing CP directly in an effort to resuscitate the market.

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While CP issuance is dominated by financial institutions, utilities are among the large corporations that issue it. During the 2008 financial crisis, most large utility companies retained access to the CP market, even as liquidity was greatly diminished. Longer-term financing also seized up, but the reopening of the corporate bond market was also led by successful offerings by some large investor-owned utility companies in 2009.

In 2020, the COVID-19 pandemic also brought considerable economic upheaval and financial market uncertainty, particularly in the energy sector, which was rocked when plummeting demand for transportation fuels collapsed prices and drove significant financial distress among energy producer and oilfield service companies. Utilities again faced challenging and illiquid market conditions, but they maintained access to short- and long-term capital even as other parts of the energy sector were experiencing record bankruptcies. Indeed, the current bank turmoil has again driven negative investor sentiment in upstream energy, while utility stock valuations have rallied.

The pandemic further highlighted the financial stability and resilience of the regulated utility business model. While capital markets were understandably concerned about lost sales volumes and rising customer bill delinquencies, neither issue proved to be particularly challenging. Increased residential sales volumes actually offset losses of lower-margin industrial sales as remote work took off. Investor-owned utilities worked with regulators to protect vulnerable customers while ensuring recoverability of bad debts—an effort that was further challenged by the tremendous spike in utility customer bills when the February 2021 winter storm stressed working capital for many southern and Midwestern utilities.

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Utilities, of course, are differentiated from "traditional" business sectors as regulated monopoly providers of products and services that are essential to a functioning economy and civil society. One utility CEO pointed out on his company's first quarter 2020 earnings conference call that "the whole economy is running on the internet, and the internet runs on electricity." While some banks may be too big to fail, utilities are too *important* to fail.

Throughout numerous periods of economic and financial upheaval, repeated demonstration of that simple fact has underwritten confidence in our sector and preserved access to capital. The spike in customer receivables from the 2021 winter storm provides a good example: a combination of long-term regulatory asset recovery and state-backed issuance of securitization debt provided a solution in a situation that could have precipitated a major crisis in other industries (e.g., airlines, banks). The ability of utilities, working with state regulators, to craft solutions to these types of financial challenges underpins the sector's ability to maintain access to capital when others can't.

In summary, while no two crises are alike (and hopefully the current situation won't come to resemble 2008 or 2020), utilities are once again likely to be very well positioned. This resilience, critical to the economy, should be highlighted to regulators, investors, and customers.

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