Investing In Our Energy Future

The Impact of the Economic Slowdown

Introduction
The current economic slowdown is exerting financial pressures on the energy industry. This is similar to what many other industries, businesses, and individuals are experiencing. As one of the nation's most capital intensive industries, the access to capital markets is critical in allowing energy companies to build the necessary infrastructure to meet growing demand. This paper is intended to provide insight into the impact of the current economic slowdown on the energy industry and recommend policy changes and actions to help manage through this crisis.

Discussion
Continuing investment in utility infrastructure is necessary to be able to continue to meet the energy demands of customers in a reliable, safe and secure manner. New investments in infrastructure on an annual basis are perhaps two to three times the value of the depreciating existing assets. This is primarily the result of depreciation of long lived assets, where the normal annual inflationary increases over many years results in marginal costs that far exceed average book costs.

In order to continue to invest in the system, appropriate regulatory support is needed to attract investment capital – both debt and equity. This is necessary to fund the necessary capital and the O&M costs of running the business. This is particularly critical at a time when investors are reviewing the risks and opportunities of potential investments in light of the current financial crisis.

Con Edison alone expects to spend nearly $8 billion to maintain and reinforce its energy delivery systems over the next several years. The magnitude of infrastructure improvements will require new funds from the debt and equity markets.

Current New York State policies have caused investors to view it as unsupportive. Recent changes in the capital markets have reduced the pool of capital available for new investments. Investment managers have as much as a third to a half fewer dollars to invest, and funds flows have been negative for most managers. As a consequence, investors have a choice about where they invest their incremental dollar. For investors seeking the safe haven of utility investment, they may seek to invest in utilities who serve customers in states where credit trends are stable or improving, and where owners believe that they are fairly compensated for their investment. New York must be one of those states.

To attract the capital necessary to implement the State Energy Plan, the Plan must contain policies that foster a favorable climate for investors Those policies include: appropriate recognition of the business risks of providing a revenue-capped essential and universal service, allowance of returns that reflect current and future costs of operating and maintaining delivery service at the safety and reliability standards established by the State, and use of incentives to owners when state policies have the effect of depriving the owners of business opportunities or otherwise increasing the risks of the business. Taken together, such changes can assure access to new capital.

Proposal

It is critical that any State Energy Plan allow utilities to continue to invest in order to provide the safe and reliable energy services its customers expect. In order to achieve its goals, the Plan would need to:

1. Recognize that both debt and equity investors have less new capital to invest and higher return expectations than they have in at least the past few years.
2. Recognize that the cash recovery provided by depreciation of facilities' installed decades ago cannot fund current maintenance levels of investment. As a result, new capital will be required each year for the foreseeable future to fund the capital needs of the system.
3. Encourage and even require regulators to consider new mechanisms to promote the flow of capital dollars to New York's utilities.
4. Support the credit quality of the State's utilities so that they can maintain the breadth of access to the debt markets they have today. Credit downgrades not only result in higher debt costs, but they also reduce the amount of funds a single investor (or investment fund) will invest in a company.
5. Recognize that owners cannot support a utility's investment plans when the raising of new capital penalizes existing owners. To avoid this, the State needs to allow utility company stocks to trade at appropriate levels above book value.
6. Reconsider policies that apply only penalties on utilities, and require regulators to also consider a balance of incentive and penalty mechanisms to achieve public policy objectives that will benefit customers in both the short and long run. Objectives suited to such mechanisms would include energy efficiency, renewable energy, or other goals that will provide long lasting benefits to customers and the public at large. Such policies would also improve the regulatory climate in the state, and serve to encourage necessary investment.