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Power Sector Faces Continued Financial Distress in 2021

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The last few months have seen the power sector plagued with enduring lower power prices, exacerbating the continued negative impact on power generation companies and electric utilities. There are a number of factors driving this, including the collapse in electricity demand resulting from the ongoing COVID-19 pandemic, systemic lower natural gas prices, and increased competition from renewables. Unless there is a significant step-up in electricity demand soon, the power generation sector will face continued financial distress, and an increase in bankruptcies and restructuring activity, in 2021.

A recent report from S&P Global Market Intelligence highlighted how the power generation sector has traditionally been the leader in gas demand growth, and in the immediate wake of the COVID-19 outbreak the share of natural gas in the sector reached a record high of just under 40%. However, that has been rapidly changing over the last few months, and the report underscores that, due to sluggish energy demand growth and the continued rise of renewables, the merchant power generation sector will continue to face distress.

Bills Are Stacking Up

The COVID-19 pandemic has certainly created challenges for independent power generation companies, but also many of their biggest customers, such as utilities. *TIME* magazine highlighted that many of the nation's largest utility companies are reporting thousands of their customers are 60 days or more behind on their bills and/or at risk of service termination. Some states, such as New York, have passed bans on shutoffs until early 2021. For power companies, this means many of their customers may struggle to pay or will be looking for a discount.

Many of the largest companies have begun to take action to address the problem. For example, Duke Energy, American Electric Power (AEP), FirstEnergy, and electric utility trade group Edison Electric Institute recently met with the Federal Energy Regulatory Commission to discuss the current state of the market. While larger players such as Duke and AEP didn't report any liquidity issues or substantive delays in their most capital-intensive projects, they were all clear that future uncertainty in the market remains one of the most significant threats to the sector, and will require ample and timely cost recovery.

While not new, another issue mentioned earlier that lingers over power generation companies is the continued growth of renewables, particularly solar and wind. More and more renewable energy resources continue to come online displacing traditional power generation sources, such as natural gas and coal. S&P Global noted that during the second quarter of 2020, solar project developers installed nearly three times as much solar capacity compared to the same period just a year ago. Similarly, the U.S. wind industry posted one of its strongest quarters ever, adding 2,369 MW of capacity. Fossil fuel generation in general continues to be distressed, and the environmental impact these sources (primarily coal) have is a rising concern among more and more organizations. As a result, investors and customers alike are generally averse to it.

Hydrogen Is a Wildcard

Among the wave of renewables is hydrogen, something that is still in its infancy but that could create a spur of investments and deals down the road. In fact, the American Council on Renewable Energy examined hydrogen's rise and found that a number of companies believe it could be a significant growth area because of its potential flexibility and ability to build upon existing infrastructure, allowing it to scale rapidly and create opportunities for a variety of industries. Some utilities, such as San Diego Gas & Electric, have already started announcing new hydrogen storage projects, which could start coming online by 2022. Others, such as Ohio's Long Ridge Energy Terminal, plan to convert an existing natural gas power plant to run entirely on green hydrogen gas, produced using zero-emission electricity. It is too early to tell whether hydrogen will live up to expectations, but the growing level of interest in it is notable, especially because of how inexpensive it can be to implement.

Additional impetus for the growth in renewable energy resources will come from President-elect Joe Biden's proposed "Clean Energy Revolution," a central pillar to his presidential campaign's plan to drive economic growth while addressing climate change. One of the key tenets of Biden's Clean Energy Revolution sets a target of a 100% clean energy economy that reaches net-zero emissions no later than 2050, an aggressive goal to say the least. The proposal is predicated on significant investment in clean energy, with a headline number of almost $2 trillion of federal investment over the next 10 years, with plans to leverage "private sector and state and local investments" to total "more than $5 trillion."

There's no way of knowing exactly what the future holds for the power sector, but the current market conditions, coupled with the decline in demand from the ongoing COVID-19 pandemic, have been a recipe for disaster for many power producers. Unless these economic conditions change, there will continue to be significant distress in the industry and more bankruptcies as we head into 2021. ■

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