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Fitch: Modest US Public Power Effects from Potential Rolling Blackouts

Fitch Ratings-New York/Austin-15 July 2022: Summer capacity constraints and rolling blackouts are not viewed as a near-term risk to US public power and electric cooperative credit quality, Fitch Ratings says. Fitch's rated portfolio of public power issuers typically own or contract for sufficient electric generation during the summer months to match or exceed their expected load demand, providing a financial hedge against market scarcity and volatile energy prices.

However, general economic inflationary pressures will necessitate rate increases in the sector, and customer tolerance for rate increases could be diminished by recurring rolling blackouts. To the extent utilities cannot pass through needed rate increases, utility financial profiles would likely weaken and could put pressure on credit quality over the longer term.

Supply shortages and the potential for rolling blackouts are likely to happen with more frequency across the US. The combined impact of heat conditions made worse by climate change, lower hydroelectric supplies resulting from drought, and the closure of carbon emitting coal-fired plants, have led to increased demand and reduced generation capacity in multiple parts of the country. Electricity market officials warned about capacity shortages this summer that could lead to temporary controlled outages, or rolling blackouts, including the Electric Reliability Council of Texas (ERCOT), the California Independent System Operator (CAISO), and the Midwest Independent System Operator (MISO) that manages an organized electric market covering 15 US states and one Canadian province.

Public power and cooperative utilities tend to own or contract for generation supplies conservatively so that they have more than sufficient reserves to meet potential increases in demand but there may be residual risk if temperatures cause demand to be substantially higher than anticipated. Costs of meeting demand in excess of power supply are typically modest in relation to utilities' overall budgets. Most utilities have a power cost adjustment feature in their rate structure that recovers power costs above budget or reduces rates to customers if power costs are below budget throughout the year. As a result of the conservative planning in the sector, public power utilities are often net sellers during scarcity events, protecting the financial profile of utilities during shortage or volatile pricing periods.

ERCOT, the organized electricity market operator across the majority of Texas, called for voluntary power conservation on Monday and Wednesday afternoons this week, given high temperatures across the state. The grid must remain balanced in real-time, with supplies exactly matching demand, a balance that can be challenging to maintain with large amounts of intermittent generation resources, given the natural fluctuation in solar and wind fuel types.

The call for voluntary conservation was successful, reducing peak demand to approximately 78.3GW on both days, and no rolling blackouts occurred. ERCOT noted the peak demand on the system on Monday and Wednesday was expected at 79.7GW and 78.5GW, respectively. Demand levels exceeded expected generation on these days given lower wind than typical for the time period, with less than 12% of available wind capacity on the grid for both days. ERCOT noted on Wednesday supplies were constrained by thermal plant outages and cloud cover in West Texas, which resulted in lower solar generation.

If rolling blackouts occur during a heat event in Texas this summer, they will likely last for a few hours, not days, as occurred in February 2021 during Winter Storm Uri, and would not impact long-term public power utility credit quality.

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