Stable, mature industries—those that have a proven product, stable product demand, and low volatility related to their revenues and cash flow (the "defensive industries")—are attractive to investors as they offer more certainty and fewer business and financial risks. As a result, investors in these stable, defensive industries (such as utilities) will require a lower expected return compared to investors in less mature and more volatile industries. We describe this lower expected return requirement as a lower cost of capital. This lower cost of capital associated with defensive industries is manifested in lower borrowing costs and higher relative share values. In addition, in difficult financial market environments (such as we experienced in October 2008 through March 2009), these stable businesses typically experience less adverse stock price impact due to investors fleeing in order to reduce risk. Thus, in difficult markets, mature companies have demonstrated ongoing financial market access (investor demand) when those in other industries have not. This is the benefit (or the "insurance policy") of an investment-grade credit rating—lower capital costs and more stable access to capital despite market conditions.

The benefit to customers of cost-of-service rate-regulated utilities is that a lower cost of capital contributes to lower utility rates. Also of importance, but often taken for granted, is the comfort that comes with knowing that utilities will have capital access to support the reliability and growth needs of their service territories and, thus, will not adversely expose customer service needs, including customer growth plans.

Finance 201 - Financial Market Realities

With the exception of a very few periods over the past century, utilities have experienced unfettered access to relatively low-cost capital. Even during challenging financial market environments when many industries have been effectively frozen from capital access, utilities have been able to raise capital to support their business plans. The primary reason for the markets' willingness to provide capital to the utility sector is the confidence that investors place in the regulatory model, particularly the premise that utilities will be awarded the opportunity to earn a fair return on investor capital investment.

However, at times of regulatory model uncertainty, we have seen the financial markets punish utility securities. Examples of periods of investor uncertainty would include the timeframe post the 1973 oil embargo, which was prior to the enactment of fuel adjustment clauses for purchased power; the nuclear power plant abandonments and cost disallowances of the 1980s that led to multiple bankruptcies and financial distress for quite a few utilities; the PURPA cost fallout of the 1990s; and the post-Enron bankruptcy collapse of the merchant power sector in the early 2000s, which challenged merchant energy providers and heavily exposed utility counterparties. These events led to bankruptcies, longstanding financial distress for impacted utilities, and ongoing erosion in credit quality and investor confidence. These examples highlight that regulated businesses are vulnerable to risks related to business model changes, economic trends and regulatory policy changes. When investors focus on these issues as being material risks, the impact on investors and capital formation can be significant.