



## Basin Electric and the national recession

# An island in the storm

By Julie Slag

**F**inancial recessions have a way of grabbing people's attention, making them re-evaluate their priorities and future prospects. In the scramble for economic survival, you've got to know when to hold 'em and when to fold 'em. This fact also applies to corporations, small businesses and electric cooperatives.

During 2008-2010 when the United States experienced its worst recession since the Great Depression of the 1930s, Basin Electric grew its business by 6.2 percent. Basin Electric's membership also stayed in the economic game, mostly unscathed by recessionary impacts. Elsewhere in the nation, however, the recession forced many Americans to make difficult decisions about debt restructuring, financing, housing, employment, and family priorities as job opportunities and economic growth disappeared. Some corporations, banking institutions and iconic firms just folded and ceased doing business. The recessionary spiral was severe, and recovery is still elusive in some states. A recent report (see sidebar, page 10) claims the national recession, which began in December 2007, officially ended in June 2009.

### Riding out the storm

Buzz Hudgins, Basin Electric chief financial officer and senior vice president of Financial Services, says Basin Electric and many of its member systems fared better than others during the national crisis for several reasons. He believes energy development helped blunt the recession in the Upper Great Plains while supporting Basin Electric's growth.

"I think natural resource development activities in our area are one of the primary reasons we

have not felt the recession like the coasts have," Hudgins says. "We stayed fairly safe because our economy has traditionally marched to a

different drummer than the national economy. Also, agriculture is a major economic driver here, so we don't always move in sync with prevailing economic trends. Sometimes we're in a boom period while the rest of the country is in a recession or just the opposite. Despite this recession

and all the problems attached to it, coupled with the uncertain regulatory environment, I think we have safely navigated through it so far, in large part due to the flexibility of our construction and Basin Electric's financial strength."

### Despite major uncertainties, growth

Hudgins says the financial crisis and recession occurred during the middle of Basin Electric's construction program, which began in November 2003 and will end in June 2012 when Deer Creek Station is declared commercial. During

these nine years, Basin Electric will have spent about \$3.4 billion, more than doubled the Basin Electric balance sheet, and significantly grown and diversified its generation fleet.

“I am optimistic the United States is coming out of this recession, but I think it is going to take a fairly long period of time.”

*Buzz Hudgins, Basin Electric*

"Understand that Basin Electric's construction program was accomplished despite major uncertainties," Hudgins says. "We had to decide what to build in a changing regulatory environment. A planned coal-based unit fell by the wayside just as the economy and financial markets blew up. And, we

“One concern of mine is whether we are seeing a major paradigm shift in investment strategy by the public. Have we damaged our economy and beliefs to such an extent that what is going to emerge will be a far more cautionary investor, shunning historic risk taking?”

*Buzz Hudgins, Basin Electric*

accomplished this construction program with commodity prices fluctuating rather dramatically.”

This was a tough period for the cooperative, Hudgins says. “I didn’t know whether we could rely on our ability to raise capital. It turns out it was not the best market in which to raise debt, but we were successful in a very low interest rate environment. These were short-term impacts upon Basin Electric, and I think we safely navigated through them.”

## Slow speed ahead

Hudgins says the question facing management is whether Basin Electric will be encountering economic circumstances similar to the 1980s and 1990s when America came out of a recession rather quickly, and the cooperative finally experienced strong growth and demand for its power. He also says Basin Electric will have to decide about further diversification of its electric generation fleet and how to best achieve financial repair in preparation for the next major construction program down the road. “I do not think this recovery, whenever it occurs, is going to be like the 1980s and 1990s,” he says. “I think we are going to see very slow economic growth.”

Hudgins remembers it took Basin Electric quite a while to reduce its excess capacity in the ’80s and ’90s. “But the economy and demand for electricity continued to grow. Basin Electric was able to actually turn that liability into an asset.”

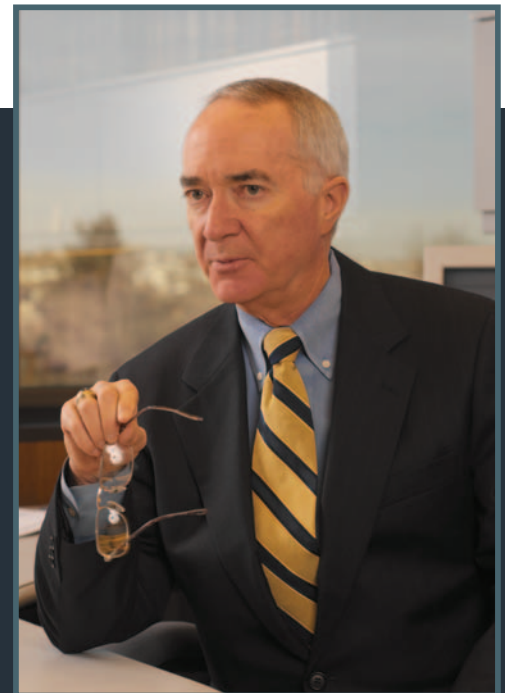
Now he says the cooperative will have some excess capacity for a time and also transmission constraints, an additional complication Basin Electric did not have in the ’80s and ’90s. Current excess capacity is significantly less than Basin Electric managed in prior years. “We were able to sell power as far east as Wisconsin and as far west as California,” Hudgins says. “Today, in our part of the country we are very much transmission constrained.”

Hudgins notes Basin Electric learned to manage its excess capacity in the late ’80s as well as low gas prices that plagued Dakota Gasification Company in the late ’90s. “I have confidence Basin Electric will manage through these issues again,” he says.

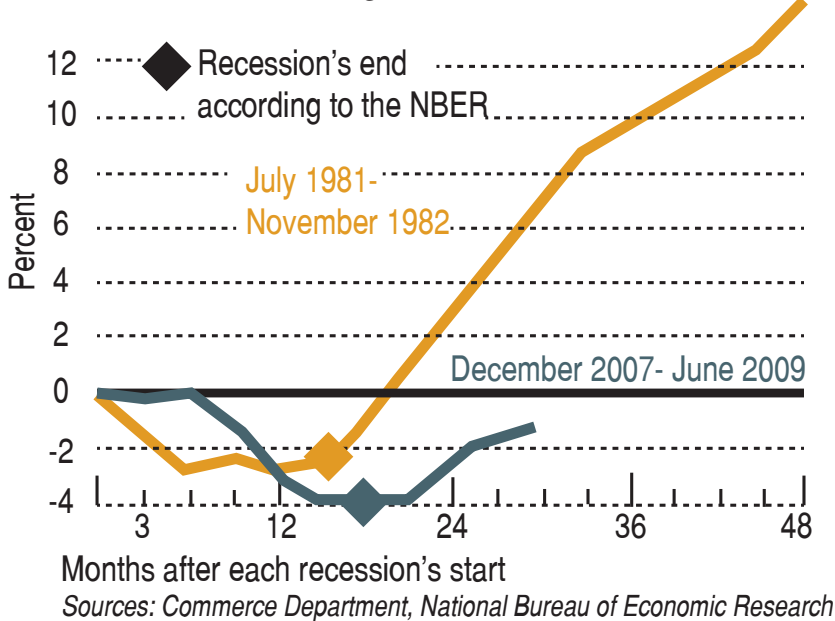
Some economists are predicting a double-dip recession because after the initial shock wave, the recession took a very deep dive. Federal stimulus money and the rebuilding of inventories helped America bounce out of the recession, but now GDP (gross domestic product) growth is slowing. Hudgins believes the third and fourth quarters of this year could turn negative and result in a W-shaped recovery, or the economy could continue low growth and make more of a U recovery, with a very long period of tepid growth. “I think it is going to be a ‘U.’ Whether it is a U or a W (a double dip), it is still a very bad economic situation.”

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He’s called “The Professor.” Basin Electric’s chief financial officer and senior vice president of Financial Services, Buzz Hudgins is known for his prefatory remarks about the U.S. economy at monthly board meetings. Hudgins reviews developments in the U.S. economy, Wall Street, banking, and lending institutions with directors and staff. Paul Sukut, Basin Electric deputy general manager, gave Hudgins the nickname years ago after watching him in front of the board. “Buzz has a wealth of knowledge and good instincts about finance and the economy,” Sukut says. “When he’s done talking, we’re all smarter than when we came in.”



## GDP cumulative change from start of the recession



## What Wall Street is saying about the recession

“It’s official: The 2007-2009 recession, which wiped out 7.3 million jobs, cut 4.1 percent from economic output and cost Americans 21 percent of their net worth, marked the longest slump since the Great Depression. The recession that started in December 2007 ended in June of last year, according to the National Bureau of Economic Research (NBER), but weaknesses still abound for the U.S. economy. The end of the recession occurred in June 2009, 18 months after the economy began sliding into a downturn in December 2007, said the NBER’s Business Cycle Dating Committee, a group of academic economists that determines the widely accepted benchmarks for U.S. recessions. ...

“The NBER acknowledged in its announcement that the end of the recession doesn’t signify a healthy economy, only that the period of declining economic activity, measured by indicators such as economic output and incomes, has come to an end.”

~ Wall Street Journal, Sept. 21, 2010

## No ordinary recession

Hudgins says it’s important to understand what causes a recession. “Historically, there have always been periods of expansion and contraction in any developed economy – it’s called a business cycle. Fluctuations within cycles were normally attributed to periods of either overproduction or under consumption. We did not have really a good mechanism to match production of goods and services with demand for goods and services,” he says. “Also, extraordinary events or shocks to an economy such as World War II or the 1973 oil embargo can bring on an expansion or recession.

“What is different from past recessions is this time people don’t remember what a recession is like; they don’t know how to react to it,” he says. “Financial recession is something new for many people because the advent of computer

technology has made the economy more flexible. We are now able to react quickly to match production to demand and produce a prolonged period of economic growth. Some economists were proclaiming the end of the business cycle as a result.”

Hudgins says today’s recession is also different because lending in the housing markets precipitated a financial crisis. “In today’s society the first thing you do is figure out who the culprit is before you figure out what the solution is. In this instance, everybody was to blame, including Congress, which pushed Fannie Mae and Freddie Mac into much looser lending standards on mortgages. The rating agencies were asleep at the switch, banks took advantage of an opportunity to make money, and lastly, the American consumer falsely believed home prices would always go up – all of them are equally to

blame for the housing crisis, which sparked the financial crisis, which brought on the current recession.”

Further, as a result of the recession, Hudgins says the federal government has expanded its role in the American economy. America is in the midst of trying to define what the role of government should be. “Is big government appropriate or not? The federal government has taken this crisis as an opportunity to significantly expand its role,” he says.

## Wave effect

Hudgins believes the current recession is the result of a “significant wave” that occurred in the United States when the federal government, state and local governments, corporations and individuals over-leveraged (increased their debt levels), a practice Hudgins says began in the 1960s. “Typically,

all of these entities were rewarded for over-leveraging,” he says. “The results of increasing debt levels over time can be characterized in several ways: you can say governments and individuals borrowed a lot of money and threw a huge party. Or, you can also say we have stolen prosperity from future years and brought it forward into current years.”

Hudgins says America is not unique in this regard; Europe has the same issues. But he does note the American consumer is severely impacting the recession by de-leveraging (saving money) at a current rate of 6 percent. “American consumers have finally ‘got it,’” he says. “For many years, we saw a negative savings rate, so this leveraging up of the American consumer was huge.”

During the 1980s, the American economy (and many other nations’ economies) grew at a steady rate, because the Baby Boomers were young and willing to buy TVs, durable goods, cars, and more, Hudgins says. “Demographically, the Baby Boomer generation has always had a big impact on the American economy and culture – and that is going to be a problem going forward. The American consumer is not who he used to be.”

Even in recessionary times, Basin Electric has been able to access capital. “From a credit perspective, or a Basin Electric bond rating, I think the strong credit foundations that support the Basin ratings are going to remain in place,” he says. “So, I do not expect to see any significant erosion in our bond ratings as opposed to corporate America, in general.”

Hudgins says the most important thing to remember about the recession is this fact: “Throughout it all, Basin Electric has stayed rock solid.”

## Recession from the power marketing perspective



**Dave Raatz**, Basin Electric’s manager of marketing and power supply planning, weighs in on how the recession has affected demand for electricity and impacted industries and loads in our membership service territory.

**State of the regional economy:** “I think the Upper Midwest hasn’t been impacted by the state of the economy as significantly as other parts of the United States. As it relates to Basin Electric, our electric load is significantly energy industry-type load, oil development, gas development, and coal mining, which have continued to be sustainable through this economy. As a result, we have not seen an overall reduction in households throughout our service area. We are still seeing farm consolidations, but a significant number of new families in the region are due to the energy-industry growth. The recession has definitely slowed expected non-energy industry growth in our area.”

**Coal bed methane:** “When we talked about building Dry Fork Station to serve expanding coal bed methane load and other load, we interviewed different companies. If you go back in the early 2000s, they were saying the cost of production of coal bed methane was \$3.00 to \$3.50 a dekatherm. At that time natural gas prices were significantly higher so it was a very economical to develop coal bed methane. Now we see significant shale gas reserves have been developed in the last year or two because of the high prices and the new drilling techniques. Gas is now \$4.50 a dekatherm. It’s just not economical for coal bed methane producers to continue development of new wells, which results in reduction of our coal bed methane loads.”

**Natural gas:** “We are seeing utilities aren’t using as much natural gas because there’s less electrical load due to reduced load levels, businesses have shut down, and manufacturers have reduced their operations due to reduction in consumption of commodities. Another significant shift in

perception is where this country is going to get its natural gas. Five or six years ago, we always thought the price of natural gas would be capped by the price to bring in LNG, liquefied natural gas. Now experts are saying the cap is going to be the cost to produce gas from shale. That’s truly a pretty big shift in what the experts are forecasting natural gas prices will be in this country.”

**Price of wind power:** “There are going to be major transmission issues if utilities are required to put in too much wind power. The real problem is this: you want to put wind generation where the wind blows the most, but that’s not where most of the electric load in the country is. So you’re either faced with building wind where it’s most economical and then investing in significant transmission, or you have to scatter the wind generation in less desirable areas, where the transmission is less costly. It’s important to note utilities aren’t the ones that ultimately pay the high cost of the wind, it’s the general public of the United States. Industry is going to have to pay for the high cost of renewable energy and associated transmission – that’s a fact of life.”

**Price of electricity:** “I think electrical energy is competitively priced for the average consumer in our area. Compared to other alternatives of producing electricity, the price today is pretty good. As an example, I was in Alaska last spring and talked to someone who was paying 500 mills for their electricity – all diesel-fired generation and the diesel had to be shipped in. I talked to the local mayor about a new power line that was under construction, and he was just thrilled with the new line because the town was going to be able to reduce its electric rates to about 250 mills. In comparison, our members’ distribution rates are around 80 to 100 mills.”

**Basin Electric’s wholesale rates:** “We’re very competitive as a wholesale power supplier. I remember in high school learning one of the things that made this country great was low-cost energy. I still believe this is very important to maintain our country’s economic stability.”