

From conspicuous consumption to ubiquitous uncertainty

Scott G Schwieger, Senior Editor

With “global financial crisis” as part of the daily vernacular, the Federal Energy Regulatory Commission conducted a special workshop in Washington, in mid January, to explore the effects of tightening credit markets and capital-expenditure issues on the electric power industry. The development of energy infrastructure in the face of increasing volatility in financial markets and the coming wave federal public-policy changes were at the forefront of discussion.

Panelists included executive leadership from electric utilities and merchant generators with significant gas-turbine assets. They were on hand to help sort through the state of the industry and discuss the momentous challenges faced now and in the future. The excerpts below highlight the uncertain outlook for the industry to meet generation, distribution, and renewable needs and requirements. The entire transcript of the technical conference can be accessed at <http://www.ferc.gov/EventCalendar/Files/20090122072648-AD09-2-01-14-09.pdf>

Anthony Ianno: head of energy and retail global risk capital markets, Morgan Stanley.

The capital requirements in this industry over the next 50 years are tremendous. Estimates exceed \$1 trillion—on top of today’s rate base for US utilities, which is about \$750 billion. The new capital is needed to replace ageing infrastructure, improve the transmission grid, meet renewable portfolio standards, and conduct environmental upgrades.

Paul Bowers: CFO, The Southern Company.

As the industry enters a period of historic capital investment, it confronts two separate but interrelated challenges: First, the industry’s credit and financial strength is substantially lower than it was for a comparable period in the 1980s. Second,

capital markets are in turmoil, with unprecedented volatility, negatively impacting the availability and terms and cost of capital.

The current credit crisis facing the industry has come about for many reasons, including the following: the general state of the economy, contraction of lending by weakened financial firms, fewer financial firms to compete for the industry’s financing needs, and the increased risk caused by legislative and regulatory uncertainty.

Historically, utilities have had ready access to capital markets at reasonable rates; however, much has changed in recent years. As a whole, the average credit rating of the industry has dropped to triple-B at this point.

Bruce Levy: president, International Power America.

Prior to the recent change in economic outlook, most investors expected market prices to continue to rise, based on the well-known need for new generation capacity in both regulated and deregulated markets. This need suggested market prices would be driven to levels required to support new investment. However, the recession, with its corresponding drop in demand for energy and energy prices, has altered those forecasted increases and increased the uncertainty surrounding future capacity needs.

This uncertainty has been further impacted by reports from many power pools and ISOs (independent system operators) that capacity additions currently proposed are sufficient to meet the need for new capacity for five to 10 years. Equity financing for new investment is depends solely on market energy rates for revenue and margins, and that has become considerably more difficult and costly to finance.

Michael Polsky: president/CEO, Invenergy LLC.

The financial crisis has made it more difficult to build wind facilities. Capital has all but disappeared. A very strong power purchase agreement is critical to financing. It’s important to recognize that renewable technologies, in particular, are policy-driven; they are not free-market technologies.

Phil Leiber: CFO/treasurer, California Independent System Operator.

We’ve faced several credit challenges during 2008 and the Commission’s attention to credit matters at this time is appropriate. In December 2007, some defaults in the PJM/FTR markets spurred us to tighten in 2008 our credit policy for products that were established the year before.

While smaller companies defaulted in the PJM/FTR market, we were also affected by the problems of larger market participants, and we too had several near-misses in 2008. A Bear Stearns subsidiary was a participant in the California ISO, as well as a J P Morgan entity.

While there were no losses from their collapse, there were concerns.

The Lehman Brothers collapse in September also tested our concerns. Lehman Brothers had minimal obligations in the California market. We did require that they post some credits and no losses were incurred. However, losses were experienced at other RTOs.

We also asked whether we should reject letters of credit from some of the prominent banks. Some market participants were severely strained because of bankruptcies of their major customers. We faced other challenges in

