

NEW POWER eXECUTIVE Biweekly

Friday, Sept. 30, 2005 Vol. 9

\$2 Billion Funding For CA Energy Savings Program

A special to New Power Executive from the editors of the Foster Electric Report

The California Public Utilities Commission (CPUC) Will Spend more than \$2 billion over the next three years to fund energy efficiency programs at California's four major private utilities – Pacific Gas & Electric, Southern California Edison, San Diego Gas & Electric Co. and Southern California Gas.

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Public Officials, Power Companies Brace for Winter

A special to New Power Executive from the Editors of SNL Energy's Power Daily North America

With Winter Approaching, State Officials and Electric Companies are looking into ways to assist customers with potentially increased utility bills.

Connecticut Gov. Jodi Rell called for a summit Oct. 7 to determine the state's fuel assistance needs, accord-

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Internet Ad Spending Way Up

According to Internet Marketing Research Firm e-Marketer.com, US Internet advertising revenues for the first six months of 2005 reached a new high. The firm said that 2005 is on track to be the best year for Internet advertising in history. The Interactive Advertising Bureau and PricewaterhouseCoopers released Internet advertising revenue fig-

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Corp Officers Stay the Course

Earlier This Month Deloitte Research Issued a Report

entitled *Which Way to Value? The US Power and Utility Sector, 2005-2010*. In a nutshell, the report groups into three broad categories all sorts of contrasting views on what the next five years may hold: continuity, tough times and rising expectations. Oddly, most utility execs surveyed for the report claimed the continuity scenario was the clear strategy ahead. Apparently the "back to basics" mantra morphed into a "stick to the

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Retail Market Watch

NY Mandates Real-Time Pricing for Largest Customers

New York utilities have 60 days to draft plans for mandatory real-time pricing for their largest customers, as well as proposals for public outreach programs to attract those customers.

Until the New York Public Service Commission issued the order this week, participation in real-time pricing had been voluntary. Utilities have been preparing to implement the pricing scheme, but the PSC says "burdensome electricity price increases" mean a "more rapid pace is now needed."

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Emissions Desk

First Down at the Emissions Bowl

The folks behind the attempted state-level, end-run around the Bush administration on carbon emissions reductions, mostly Northeastern states, didn't have a good month. US District Court Judge Loretta Preska threw out a multistate lawsuit against the country's major electric generators (officially *State of Connecticut et al. v. AEP et al.*) saying it was none of her business.

The lawsuit is basically a cry for help, since calls for action have fallen on deaf ears in the legislative branch. But the judge's explanation lays out why we probably won't see a federal CO2 trading mandate during the remainder of the Bush administration, at least.

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EXECUTIVE FORUM

Commentaries from inside the market

Power Moves

Renewable Sheep

Original market commentary by Dr. Robert Michaels, professor of economics, CalState, Fullerton

Why exactly are so few of us in the smarter end of the energy community not railing against state-imposed renewable portfolio standards (RPS) for utilities?



Put aside the facts that the power generated by renewables is minimal and that for now they offer few interesting

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Terzic on Strategy

Broadband's Emerging Role

By Branko Terzic, Deloitte Services, LP

The new technology of broadband over power line communications (BPL) can be used for utility-related purposes and for diversification. That creates an opportunity for a fair competitive advantage, but poses a potential regulatory problem. Here's how.

The advantages of utilities adopting BPL technologies hold great appeal. Proponents cite the ability to take advantage of a number of operating and maintenance cost-reduction features. BPL could lower the cost of remote

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Market Intel Desk

The High-Stakes Nuclear Power Game

By Diane Borska, president, the Borska Group Inc.

Watching the big players position themselves on the chessboard of future nuclear power plant development has become a fascinating pastime. A world formerly of interest only to policy wonks, green activists and pencil-pocketed engineers has become a compelling example of high-stakes international business development. With a somewhat uncertain timeframe and yet with signifi-

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opportunities for trades or hedges. Someone has finally produced a document that exhaustively summarizes the case against renewable requirements, and when you put all of the reasoning together, it's a pretty strong one.

A few months ago W. David Montgomery of Charles River Associates presented *Renewable Portfolio Standards: A Solution in Search of a Problem* to the Harvard Electricity Policy Group. (I am unaware of his client.) It's a good and easy read, found at <http://www.ksg.harvard.edu/hepg/Papers/Montgomery%20Renewable%20Portfolio%20Standards.pdf>

Just when we thought that economic efficiency might be making some headway in pollution control, along comes RPS. Montgomery begins by showing that RPS violates almost every economic principle of sound environmental policy. It is about forcing the choice of certain technologies rather than following the efficient course of dealing directly with pollutants. Even if RPS reduces some pollutants, it is only about electricity and leaves untouched the many other industries where they might cut more cheaply. (Just as in generation dispatch, we want to equalize incremental costs of pollution removal from the various sources.) RPS is also based on the wrong geography – pollutants tend to either be concentrated in small locations or to cover the nation, rather than fitting inside any individual states.


Backers of RPS seem to forget that reasonable programs are already in place to deal with most important pollutants. For SO_x and NO_x we can thank the economists for helping to bring about markets that have greatly improved the cost-effectiveness of control. RPS is either a substitute for less costly compliance measures or it leads to overcompliance that is not warranted by any balancing of benefits and costs. (I'm not as sure as Montgomery that today's power markets provide sufficient incentives for efficient diversification among fuels. I do not favor further regulation to force it either.)

NEW POWER EXECUTIVE

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But in today's world an RPS will bring with it only one source of diversity: windmills. Since wind resources are highly regionalized, a national RPS (narrowly avoided in the last energy bill) will in effect be a tax on non-breezy locales. Beyond that, RPS is unlikely to force the development of new technologies, because utilities will be able to pass on the costs of whatever they must do to satisfy it – and if 30 years of heavy funding have yet to produce usable solar power, don't count on RPS to do the job.

Greenhouse gas policy has yet to be set, but here too RPS would be peculiarly inefficient, for all of the same reasons that it is a poor tool for dealing with existing pollutants. Any worthwhile policy will have to be global, and far more stringent than Kyoto if it is to have any effect at all. But Sacramento is about to factor it into California utilities' resource decisions. And if we are really worried about global warming, RPS explicitly excludes the technologies that have the greatest potential to deal with it – nuclear, carbon sequestration and hydro.

So here's the question? Why do so many of us play the role of sheep in the renewable charade when we know a lot better? If we only say nice things about renewables because ignorant or venal people praise them, how should the trading community break the news about high bills and black-outs before we get blamed for them? The only sustainable energy for the foreseeable future is conventional energy, and we ought to tell the world about it.

Bob Michaels is professor of economics at California State University, Fullerton, and an independent consultant. The views expressed in this column are only coincidentally the professional opinions of the author, his affiliations or his clients. Contact Michaels at rmichaels@fullerton.edu.

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The commission cited the success of real-time pricing efforts by Central Hudson Gas & Electric and Niagara Mohawk Power as a sign that real-time pricing can benefit large commercial and industrial power customers.

The pricing plan allows large C&I customers to avoid high-cost peak usage by responding to real-time pricing signals. The accuracy of real-time price signals also makes demand-response programs more efficient, allowing more efficient generation supply investments, the PSC said.

But the practice must be more widespread in order to fully realize these benefits, the commission said. Even the two utilities it cited as success stories are required to do more under the new order. Niagara Mohawk must file a proposal to expand its real-time pricing program to "significantly sized customers," those a step below its largest customers. Central Hudson must create enhanced public education plans to augment participation in its real-time pricing program.

FirstEnergy Settlement Could Help Customer Choice

FirstEnergy is calling on the Public Utilities Commission of Ohio (PUCO) to approve a settlement between the power company, the Industrial Energy Users of Ohio, the Ohio Energy Group and two major municipalities in the state. The company wants to defer its plan to change rates at its Ohio units (Ohio Edison, Cleveland Electric and Toledo Edison) in order to cover increased fuel costs and distribution costs.

The increased rates were slated to begin in January, but in light of increased energy cost pressures on consumers, the company has proposed delaying any rate changes until 2009. The settlement agreement would require a rate certainty plan (RCP) that would lower FirstEnergy's regulatory transition charge by the amount the company raises rates to account for fuel costs, effectively stabilizing rates for its customers for the next three years. In 2009, the deferred increases will occur as customers of FirstEnergy's Ohio power companies see the regulated portion of their bills drop with the end of the transition cost recovery period, again easing the impact of the rate hike.

The settlement may help stimulate customer choice migration in the state. Some in the market claim the shopping credit is too small to actually enable customers to save money by switching to a competitive supplier. But the settlement will add base fuel costs and fuel deferrals to the shopping credit, which may make it more attractive to a greater number of electricity customers.

"I'm pleased that FirstEnergy listened to the concerns we and other cities raised about increasing electricity rates at this time," said Cleveland Major Jane Campbell, whose city was part of the settlement. "Putting off electricity price increases for the foreseeable future is essential to our efforts to provide basic services in the face of tight city budgets."

FirstEnergy says that if the RCP is approved, customers will "pay essentially the same price for electricity through 2008 that they paid in the 1990s."

Manufacturer Balks at Rates

Ormet Primary Aluminum, a major employer in southeastern Ohio, has asked state regulators to allow it to leave its electric cooperative and be considered part of AEP's service

territory. But the manufacturer has also filed a complaint against AEP subsidiary Ohio Power, claiming it provides inadequate service and has proposed rates that are discriminatory and unreasonable.

The company wants to leave South Central Power, part of the rural electric cooperative association, Buckeye Power. The move comes after Ormet's five-year, 20-megawatt transmission agreement with South Central Power expired last year. The transmission agreement proved problematic, because South Central couldn't supply more than 20 MW and Ormet found it too costly to purchase additional power on the wholesale market.

The aluminum producer was forced to curtail operations until an affordable supply of additional power could be found. South Central agreed to let Ormet shift its service territory under Ohio retail choice law, and the company sought a deal for 365 MW of supply from Ohio Power, the AEP subsidiary.

But Ohio Power required Ormet to pay market prices for electricity, prices that the company claims are much higher than the rates Ohio Power charges its other large industrial customers. What's more, Ormet says Ohio Power doesn't need to procure power from the market – it can easily provide for Ormet facilities' power needs using its own or AEP's generation capacity.

The company still wants to procure supply from Ohio Power so that it can resume full operation of its production facilities, so it has asked the PUCO to approve the service territory change to Ohio Power. But Ormet has also asked state regulators to require the power company to provide just and reasonable rates already afforded its equally large industrial customers.

RI Approves Rate Increase, Sort Of

The Rhode Island Public Utilities Commission approved the Narragansett Electric Company's rate increase this week, but the company didn't exactly get what it wanted. The commission rejected the company's recent attempt to double its proposed rate increase from 12.4 percent to 24 percent.

The company recently amended its rate proposal to ask for an additional 3 cents per kilowatt-hour. The extra charge, which would have raised the requested increase from 6.7 cents to 9.7 cents, was intended to compensate Narragansett for growing electricity expenses that the company calculates will cost it \$215 million by next September.

But regulators rejected an additional increase to the company's already controversial rate request, which has been opposed by Gov. Donald Carcieri and state lawmakers.

At a hearing last week, the governor said any increase in standard-offer service rates should be delayed until the full impact of hurricane damage to the nation's energy supply is known.

"I'm concerned that the proposed increase is being unduly affected by the uncertainty of the Gulf region," Carcieri told the commission. Stressing that some of the recent pressure on energy prices is a short-term phenomenon, the governor added: "I don't think it would be unreasonable to expect that at least a certain level of softening in fuel prices will occur subsequent to the storm season."

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meter reading, remote service connection and disconnection to rapidly respond to customer moves and provide for the instant ability to disconnect customers for nonpayment of bills. In service areas where retail access is in effect, BPL also allows automation of a customer's change in supplier. These benefits are all utility-related uses. They may or may not, on their own, economically justify BPL installation.

But there is more to the story.

The installation of a BPL network in an electric distribution system would also introduce another communications technology into the home and office. In some parts of the country, the extension of this new technology to homes and businesses new would bring competition to existing telephone- and cable television-owned fiber-optic or cable-based technologies. The electric utility-based BPL system could provide for media, voice-over Internet and Web services in competition with the other technologies. In other parts of the country, mainly rural and remote areas, BPL may be the only technology option.

Consideration of this competitive use for BPL depends on whether the utility's strategy includes "related diversification." If the answer is yes, should the method be acquisition, strategic partnership or "greenfield" investment? The reaction

of regulators plays a big role in planning such a diversification. One risk factor is the possibility of explicit or implicit adverse regulatory treatment of BPL investment or contracts. Regulators could impose excessively high charges for attachment of the BPL equipment to the existing facilities, unreasonable cost allocations under affiliate rules and other restrictions on management's ability to operate the BPL in a business-like and competitive manner. (Among various possible treatments, particularly offensive options include royalty payments for the use of the utility brand.) These are not far-fetched possibilities. I am reminded that Wisconsin regulators, while I was one of them, made the pole connection fees for an earlier joint-use technology (fiber optics embedded in a transmission line static wire) so onerous it ruined the economic attractiveness for the utilities.

The same could happen in the case of BPL technology. Management will need to elicit a clear policy statement or some other signal from the regulator as to how any utility-related BPL investment and expenses would be treated in future utility rate cases.

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At the hearing, state officials also argued that the new proposal was so substantially different than it should be considered a separate rate filing and face its own review process.

The PUC agreed, saying it would consider only Narragansett's original proposed increase to standard-offer service rates. On Thursday it approved the 12.4 percent increase, the largest rate hike in seven years for Narragansett customers.

Competition Has Brought Energy Savings for NY

"New York has established a firm foundation for competitive energy markets, and we will continue to work with the utilities and market participants to expand and improve opportunities for customers to take advantage of the choices now available to them," New York State Public Service Commission Chairman William Flynn said at a state energy forum last week.

The Independent Power Producers of New York noted at the meeting that the competitive power industry has invested billions to meet New York's energy demand, which has grown 18 percent over the last 10 years. The group said competitive suppliers have invested a combined total of \$6 billion in the state's energy infrastructure, while New York's energy users have saved more than \$7 billion since competition was introduced into the energy markets in 1996.

The IPP, which represents 100 New York energy companies, said energy suppliers and regulators are working to lower energy costs for customers. But there's more to be done. This week the energy group called on lawmakers to renew the expired Article X generation siting law so that more power plants can be built and competition can be stimulated in the energy business. The IPP decried the loss of a valued economic development tool in Article X, saying the result could

be that New York loses jobs to other states that have maintained power plant siting laws.

"We need to do something not only in our nation, but more importantly in New York State to diversify the portfolio of sources of energy that we can use, so we can become more dependent on sources here in the state instead of Canada or the Gulf Coast," Flynn said.

"It's all about choice. That's what we are trying to stress to people," Flynn said. "We are trying to get those companies into the area to compete against each other. Then people will have the choice, and hopefully it will be reflected in their bills."

MA Electric Looks at Supply Charge Increase

High wholesale electricity prices have prompted Massachusetts Electric Co. to ask state regulators for an increase in the supply portion of retail electric bills. The company asked the Massachusetts Department of Telecommunications & Energy to allow it to pass these higher prices on to its customers from Nov. 1 to April 30.

"Electricity rates and fossil fuel prices have been linked for several years and the prices on the world market have gone up," Mass Electric CEO Cheryl LaFleur said. "While we can't control what's happening in the world energy markets, we plan to do everything possible to make sure our customers are aware of what's coming and have all the information necessary to help them reduce their usage and manager their costs."

The state's largest utility selected the lowest price in a competitive bidding process to supply its basic service customers, but fuel costs for generators have pushed wholesale prices "significantly higher" in recent months, she noted.

Massachusetts Electric plans to launch a public education campaign to encourage its customers to reduce their

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The CPUC described the program Sept. 22 as the most ambitious energy efficiency and conservation campaign in the history of the utility industry in the US. The commissioners said the programs will cut energy costs for California's homes and businesses by more than \$5 billion, eliminate the need to build three large power plants over the next three years and reduce global warming pollution by an estimated 3.4 million tons of carbon dioxide by 2008 – the equivalent of taking about 650,000 cars off the road.

Commissioner Susan Kennedy, who chaired the energy efficiency proceedings, said the real value of the CPUC program is in the estimated 1,500 MW of electricity it will help save in avoided new generation that would have been needed during the next three years.

Among other things, the plan attempts to integrate energy efficiency into the resource acquisition plans of utilities. The CPUC pointed out that the state is also investing in the most aggressive renewable energy program in the US, as well as developing aggressive demand-response systems, such as dynamic pricing, that will give consumers the tools to help themselves and to take charge of their own energy future.

The CPUC said that these programs will replace 1,500 MW of energy usage over the next three years. The estimated gross saving to California's consumers over the life of the energy-saving measure that will be installed pursuant to the program is \$5.4 billion, double the costs expected of about \$2.7 billion.

The plan allows utilities to spend 2006 funding now to make sure that all energy efficiency programs that could possibly help customers through the coming Winter are fully funded and available, especially since high natural gas prices are predicted.

Observers say the state is facing natural gas retail price spikes exceeding 30 percent this Winter. The CPUC's action is intended to reinstitute the current state Energy Action Plan's so-called "loading order" that gives various energy-saving programs first priority in the state's planning process to meet future energy demand.

Commissioner Kennedy called the plan a "history-making effort" because it makes investment in energy effi-

ciency at least as profitable as building new generation. In other words, she said, before electric utilities in the state spend money to buy or build new generation, they must first invest in ways to help consumers use energy more efficiently.

Under the scheme, the state's four utilities divide \$1.97 billion over the next three years. Current funding for the utilities is about \$500 million for 2005, which goes up to \$580 million in 2006, \$645 million the following year and \$742 million in 2008.

The CPUC's decision orders each utility to take a more aggressive approach to energy saving programs and to assure the programs' cost-effectiveness from what the commission calls two points of view: (1) total resource cost, i.e., the value of the energy savings is greater than the total cost of installed measures and all program costs, and (2) program administration cost, i.e., the value of energy savings outweighs the cost of utility financial incentives to customer and all other program costs.

According to the CPUC, the increased funding is meant to enable both residential and business customers to take advantage of the diverse mix of energy efficiency and conservation programs that exist throughout California. Examples include rebates, which range from \$10 to \$600 for Energy Star appliances such as refrigerators, air conditioners, water heaters, and washers. Central to this approach, the CPUC said, is a single application for rebate opportunities, allowing customers to purchase and install appliances and then go online, for example, to receive an "e-rebate" or in many instances a "point-of-purchase" rebate at the store where the item was bought.

Also in the list are financing strategies; sustainable communities programs; integrated offerings to targeted markets, such as in agriculture and food processing, which incorporate best practices; a variety of energy efficiency measures; design assistance, equipment rebates; online energy audits for homes; and voluntary continued and new partnerships with local governments and universities and schools to help control energy costs for those groups.

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energy consumption this Winter. But the state's attorney general says more should be done. Attorney General Tom Reilly said power companies should be able to protect customers from short-term fuel price spikes. He said the DTE should put into place new methods for creating stable and reasonable electricity prices.

CT Manufacturers Choose Constellation NewEnergy

Connecticut's largest manufacturers association has chosen Constellation NewEnergy to meet its electricity supply needs. The 600-member Manufacturing Alliance of Connecticut (MAC) is partnering with NewEnergy to help the state's manufacturers stabilize their energy costs in a rising

market. So far, 44 members, collectively representing 33 megawatts of load, have decided to take part in the program.

Six years ago, MAC was the first group in the state to become a power aggregator in the competitive electricity marketplace, and it was the first aggregator to offer an electricity procurement program to its members. MAC President Frank Johnson says the market has now developed to the point that a beneficial aggregation project can be created.

"This will be the first significant electric pool created in Connecticut and we expect it will continue to grow as manufacturers work to avoid price volatility in the coming years. This program offers a desirable price, cost stability, reliability and flexibility – four necessary components in any successful aggregation project," Johnson says.

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ing to a statement Sept. 23. "Everyone ... will see a jump in fuel and heating oil prices and it will have a major impact on their finances this Winter," she said, noting Hurricane Rita and its effects on oil refineries. According to the statement, the National Energy Assistance Directors Association predicted the average heating costs this Winter, using current market prices, will be \$1,666 for homes using oil and \$1,568 for those using natural gas.

The Philadelphia Public Utility Commission met recently with its counterparts in other states to compare approaches for preparing customers for higher costs, the PUC said Sept. 27. The PUC will soon relaunch its "Prepare Now" campaign, which includes the PUC, utilities and consumer advocates. PUC Chairman Wendell Holland noted the importance of sharing information since "the fear is that [Hurricanes] Katrina and Rita are making a bad situation worse when it comes to higher Winter heating costs."

In Vermont, Gov. Jim Douglas announced Sept. 26 an \$8 million plan to prepare the state's Low Income Housing Energy Assistance Program (LIHEAP). He noted that there have been increases in fuel price and demand. In order to reach \$8 million, he proposed the state move \$1.7 million in unallocated general fund revenues and transfer \$3.5 million in surplus funds from the state's weatherization trust fund into LIHEAP.

Similarly, New Hampshire Gov. John Lynch asked the state's Congressional delegation on Sept. 27 to consider additional emergency funds for LIHEAP. His office of energy and planning estimates that, in order for household benefits to keep pace with costs and to address the number of low-income households needing aid, the state will need a minimum of \$33 million. On Sept. 23, Lynch directed state agencies to undertake a comprehensive assessment of the impact higher energy costs will have on the state budget. The estimates, which are to take into consideration such factors as costs for heating buildings, are due Sept. 30.

Consumer advocates like Pennsylvania's Sonny Popowsky said his office continues to educate consumers on natural gas price increases, which he called "catastrophic." He encourages people to take conservation measures like cleaning out furnace filters and telling those with low incomes about programs like LIHEAP. Similarly, Maryland Deputy People's Counsel Theresa Czarski said, "Our outreach really focuses on conservation," adding that turning down the heat in homes, among other measures, can help save money.

Companies like Orange and Rockland Utilities are also bracing for the Winter. "We expect the Winter heating bills for our gas customers to increase by 35 percent," said spokesman Mike Donovan. He said the company offers conservation tips, such as shutting off unused rooms in homes to ensure energy efficiency. "We also direct [gas and electric customers] to our retail access program, PowerSwitch," he said, noting that when customers sign up they are guaranteed a 7 percent discount on the commodity side of their bills for the first two months.

Likewise, Allegheny Energy Communication Manager Allen Staggers said, "Our only issue with our customers with rising energy costs is with our natural gas business, which we're

getting ready to sell." He said the company's electric customers rates in Maryland, Virginia and West Virginia will not change as there are rate caps in place.

Similarly, PPL Corp. spokesman George Lewis said the company's rates in Pennsylvania are capped and will remain so through the end of 2009. "We have been telling our [electric] customers that because of [the state's] rate cap structure, [they] have some certainty about what their electricity price is going to be. The rate cap gives them a shelter, really, from higher energy costs."

Green Mountain Power, a purchase power distribution utility with some generation, has most of its supply prices fixed, said senior vice president Stephen Terry. He said the energy purchased from Vermont Yankee is fixed at 4 cents per kWh, and a contract with Hydro Quebec that will run from Nov. 1, 2005 through Nov. 1, 2006, will have the price fixed at 6.5 cents per kWh. He said the company also has a contract with Morgan Stanley, the terms of which are confidential, in which the company is protected against price spikes as long as the weather is not colder than usual. "As long as the weather is normal and we're in those plants that we buy from, we should be OK. But if something happens and we have to go to the open market, that's a very different situation."

National Grid USA companies Narragansett Electric and Massachusetts Electric have recently requested rate increases due to high electricity costs.

Not all are affected by potential price spikes, however. Entergy Nuclear Northeast Director of Communications Larry Gottlieb said, "The interesting thing is that nuclear power plants ... are unaffected by fossil-fuel price increases. It gives those power owners a nice advantage over facilities that use fossil fuels and really amplifies nuclear power being part of the energy portfolio." He noted that officials at one of Entergy's nuclear plants purchase fuel needed for the plant every two years.

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Foster Electric Report

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cant opportunities worldwide – China, the US, Canada, the UK, and even India, just to name a few – sophisticated multinational corporations are making strategic moves to ensure their place in this multibillion-dollar market.

The major players jockeying for position are Westinghouse, GE and Areva. The latter is a French power generation business conglomerate you may not have heard of, but which has in short order become a significant presence in the nuclear power industry worldwide. A look at what has been going on with each of these players reveals just how intriguing this world has become.

We'll start with Westinghouse, which has been much in the news since July when its current owner, BNFL, the British government's nuclear arm, announced it planned to divest itself of the operation. BNFL acquired Westinghouse in a proverbial fire sale from media giant CBS about six years ago, when the prospects for nuclear power were dim. But six years of escalating oil and natural gas prices, greenhouse gas concerns, and yes, even two enormous hurricanes, have put nuclear power very much front and center in the planning of many industrialized nations. The potential value of Westinghouse has increased rather dramatically into the multibillion-dollar range. Westinghouse has built close to half the reactors operating worldwide and has a next-generation design well advanced in the design certification licensing queue with the US Nuclear Regulatory Commission. Latest reports are that the leading bidders for Westinghouse include a joint offer by the private equity firm Cerberus Capital Management and GE, the Japanese industrial conglomerate Mitsubishi Heavy Industries, the Korean industrial conglomerate Doosan Heavy Industries and the leading US EPC firm Fluor Corp.

The outcome of this deal is highly uncertain, amid speculation that a GE acquisition has antitrust implications and that a foreign acquirer may face the same scrutiny the recently scuttled CNOOC–Unocal deal faced. Obviously, whoever ends up with the Westinghouse assets and operations becomes a major player. Oh, and just to make the stakes even higher, wire services are reporting today that BNFL plans to sell off its remaining business as well, a nuclear services group that maintains the UK's current nuclear fleet. As BNFL essentially disappears from the scene, the question arises: who will replace them?

GE, whose structure and ownership is of course rock solid, has its own interesting story. On Monday, the utility consortium NuStart announced it would develop a COL (construction and operating license) application for GE's advanced design, the ESBWR (aka the Economic Simplified Boiling Water Reactor). NuStart's planned application will be at a site adjacent to Entergy's Grand Gulf nuclear station. Separately, Entergy, apparently not so distracted by hurricane restoration that it can't participate in these matters, announced it would develop a COL application for an ESBWR project adjacent to its River Bend station.

All sounds good, right? But just days before, the NRC notified GE that its ESBWR design certification application was incomplete and not sufficient for the NRC staff to proceed with a detailed technical review and thus not acceptable for formal docketing.

Throwing GE a significant bone, the NRC said it would infit did see as sufficient. On the face of things, this appears to be somewhat of an embarrassment to GE because the NRC presented a laundry list of items where it requires additional information and analysis.

Whether this is a meaningful setback for the GE ESBWR, or some sort of a strategic move on GE's part, only time will tell. GE has clear ambitions outside of the US for its nuclear program and is an obvious contender for the Chinese market. Let us not forget yesterday's announcement by GE that it would acquire a 7 percent stake in a Chinese bank.

And now Areva, which has its own next-generation design in line for licensing at the NRC, the EPR (European pressurized water reactor). The EPR is currently being built in Finland, another unit is planned for France and the design has also been proposed for China. Areva landed in the headlines earlier this month when it announced the formation of a joint venture company, UniStar Nuclear, with none other than Constellation Energy and global EPC firm Bechtel. The idea is to create a one-stop shop for utilities interested in new nuclear plants – a reactor and NSSS supplier (Areva), owner/operator (Constellation) and an engineer and builder (Bechtel). The concept will undoubtedly be emulated by others and these parties are uniquely suited to their roles. This venture creates the opportunity for smaller or non-consortium utilities to “acquire nuclear” in the form of either small equity stakes and/or long-term power purchase agreements. That's a model Constellation has already put in practice with its Nine Mile and Ginna assets and, of course, Constellation has the wherewithal to market whatever output is not fully contracted. We don't know whether the parties will export this model outside of the US, say to Canada, or even the UK or China. But it's something to consider.

So far all these players are holding their cards pretty close to the vest. It's a high stakes game with a growing pot.

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The NEW voice of the Coal Industry!

6 September 2005

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(EMISSIONS DESK from page 1)

Eight states, claiming they represent 77 million people and their natural resources and economics, want the five biggest power producers to cut carbon dioxide emissions that the plaintiffs claim total 650 million tons of CO₂ a year, or about 25 percent of the US electricity sector's total carbon emissions.

The judge essentially favored the defendants' argument, ruling that the question of whether 174 fossil fuel power plants contributed to global warming was not the business of the District Court for the Southern District of New York. It's a blatantly political question that needs to be decided by Congress or the White House, "branches that are accountable to the people, not to the judiciary."

Peska's 20-page ruling explains that the lawsuit asks for relief of a magnitude and scope that "reveals the transcendently legislative nature of this litigation." Yes, the suit asks the *court* to cap CO₂ emissions and mandate unspecified annual emissions reductions.

Detailing the snowball's chance this lawsuit has of moving ahead, she said that the states are asking the court to decide the appropriate level at which to cap the emissions of the power plants in question; decide the percentage of reductions that should be mandated; create a schedule for emissions reductions; assess the available alternative energy resources; and somehow balance not only the impact of such a plan on the US's power supply and its national security, but decide how that plan would affect US negotiations with other countries on climate change issues.

AEP and Cinergy attorneys argued that the AGs "put the cart before the horse," because no policy has come down from Congress or the President. That seemed to carry some weight with the judge. Harking back to a 1984 Supreme Court decision (*Chevron v. the Natural Resources Defense Council*), Peska noted that courts trying to resolve the typical air pollution case have to strike a balance between "strict schemes to reduce air pollution rapidly...and economic concern that strict schemes retard industrial development." Both have social costs, and balancing them is impossible without Congress and the President making an initial policy decision about the issue.

In other words, it ain't gonna happen.

(INTERNET AD SPENDING WAY UP from page 1)

ures for the second quarter and the first six months of 2005. For the quarter, online ad revenues totaled \$2.985 billion, a 26 percent increase over same period 2004. Revenues for the first half rose an identical 26 percent reaching \$5.8 billion.

"The consistent growth in overall revenues shows marketers may be shifting more of their total advertising budgets to online. This is a natural development, as research shows more consumers are spending a larger percentage of their media time online, while the flow of advertising dollars follows," said David Silverman of PricewaterhouseCoopers.

In both 2004 and 2005, search was the most popular ad format at 40 percent, followed by banners and classifieds.

The state attorneys general plan to appeal the ruling, and Vermont AG William Sorrell says he might get on board as well.

"This ruling, if it stands, threatens to undermine and erode our power as states to hold accountable out-of-state polluters who foul our air... These companies must be held accountable and forced to clean up," Connecticut Attorney General Richard Blumenthal said.

New York AG and gubernatorial hopeful Eliot Spitzer's office called the judge's decision "unduly narrow" and vowed to continue making noise about global warming until some kind of action is taken against "a real and inevitable environmental threat with grave human consequences."

The irony is that several of the companies named in the suit, such as AEP, Southern, Xcel and Cinergy, have been making headlines lately for their leadership in voluntary CO₂ emissions reductions.

As if that weren't enough, the states' other plan to sidestep the Bush administration's disinterest was dealt a blow by, of all people, the environmentalists. Nine Northeast states have been gung-ho about a program called RGGI, the regional greenhouse gas initiative. The plan is to set up a cap-and-trade program in New England that would reduce CO₂ emissions by 2020.

But now a gang of environmental groups claims in a new report that emissions offset credits are a loophole that "undermines the control of global warming pollution from power plants."

"The first phase of RGGI should not include offsets. Reductions should be achieved first and foremost from a mandatory cap on carbon dioxide emitted from fossil-fueled power plants in the Northeast," the report says. "Offsets should not be considered until the cap-and-trade program has matured and been proven effective."

Meanwhile a global climate specialist hit the real issue on the head during a speech at the University of Vermont. Someone is going to get rich finding competitive alternatives to fossil fuel, Pennsylvania State University Professor of Geosciences Richard Alley said. "Wouldn't it be useful if the United States were to have a piece of the action?"

US Online Advertising Revenues, by Vehicle, First half 2004 & 2005 (in millions and as a % of total revenues)

	First half 2004	% of total revenues	First half 2005	% of total revenues
Search	\$1,817	40%	\$2,315	40%
Display ads	\$942	20%	\$1,157	20%
Classifieds	\$782	17%	\$1,041	18%
Rich media	\$368	8%	\$463	8%
Referrals/lead generation*	\$114	2%	\$347	6%
Sponsorship	\$414	9%	\$317	5%
E-Mail	\$70	2%	\$116	2%
Slotting fees	\$92	2%	\$58	1%

Note: first half 2005 total revenues=\$5.8 billion; *renamed category in 2005 specifically including lead generation activity, 2004 referred to simply as "referrals"

Source: Interactive Advertising Bureau (IAB)/PricewaterhouseCoopers (PwC), September 2005

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(CORP OFFICERS STAT THE COURSE from page 1)

basics” mindset when nobody was looking. This was a surprise to us; we thought the rising expectations/growth mode scenario would have captured the hearts and minds of utility chiefs by now. It’s certainly become the driving force for the rest of the energy sector, from E&Ps to LDCs to merchants.

We called Greg Aliff, Deloitte & Touche’s vice chairman and national managing partner, energy and resources, for some detail on this new report. While the conventional wisdom in the sector points to a continuity strategy, he says, it behooves utility execs to take a hard look at the other scenarios and, more importantly, to develop contingency plans in case the other two actually play out. Keep in mind that the survey of power and utility CEOs and CFOs was conducted pre-Rita and pre-Katrina.

One thing that struck us was the huge amount of actual commentary offered by survey participants. Definitely not the norm for energy industry reports. By the time the data is crunched for a report of this size, most individual messages are muted in the resulting broad generalizations these reports often present. Not here. *Which Way to Value* serves up individual quotes from execs and regulators alike, at times hammering popular notions about trends in the sector or offering pithy statements about how good it really is. These direct quotes certainly add depth to a survey that by and large reveals most utility execs aren’t that interested in a growth strategy right now, but might be five years from now.

The report itself dovetails with an earlier work performed by GF Energy in 2004. *Which Way to Value* drills a

bit deeper and projects out over a longer timeline, Aliff says. The study documents opinions that go against the industry’s prevailing assumptions on topics such as climate change, rate regulation, the “back to basics” strategy and natural gas. Taken together, it’s apparent the big concern on all of these topics comes down to the same basic principle: regulatory risk is giving everybody a whole lot of pause.

“I think that hits the nail on the head: Regulatory risk really is the big issue here. We had a sense of this going into the process, but we had no real idea how pervasive the feeling really was. Same goes with the ‘back to basics’ strategy. We were also a bit surprised to learn from these executives that the ‘back to basics’ strategy was going to stick for the next five years. Even among those whose views run counter to the prevailing ‘back to basics’ strategy or who have a different attitude about climate change or some of the other issues raised, regulatory risk seems to be the common thread ... Regulation was the change agent,” Aliff says.

For instance, a great number of execs said they were unwilling to commit to a certain climate change scheme or program, because they assume it will change dramatically at some point in the future. For one thing, they seemed concerned that by committing to one concept, like cap-and-trade markets, they may not get credit for it.

“My sense was that this was a pretty common sentiment. The utmost desire among all the participants was the desire for regulatory certainty,” Aliff says. “I think what they’re really saying is, ‘We can deal with the future effectively, and operate our companies reliably, and provide a good return for our shareholders if we know what regulation is going to hold for us.’”

Short of that, they may as well stick to the basics.

Executives also seemed fairly convinced that Wall Street and investors in general “will continue to be supportive of and happy with the steady rate of return and dividends that come with the more traditional, regulated type of operation. Along with this, they also seem to think that regulation’s going to be favorable. From a rates standpoint, they seem to feel they will get the rates necessary to facilitate the investments needed to meet the demand they see coming,” Aliff says.

On the subject of demand growth, all respondents seemed reasonably bullish on the economy.

Regarding LNG, the prevailing view was that this new gas source would not be the “silver bullet” answer for the country, despite expert analysis to the contrary. “These executives were not yet convinced that we’ll be able to site the new facilities necessary to make LNG that viable of a fuel alternative,” he says.

But on nukes and a greater dependence on coal, executives were bullish across the board. “When the question came to covering any future needs for baseload generation, the discussion centered on taking advantage of our great abundance of coal,” Aliff says. “Natural gas didn’t fare as well as it has in the past.”

Lots of good stuff in this one, we recommend it strongly. For a free download, go to www.deloitte.com and click on the Insights and Ideas tab, click research.



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