

(GUEST OPINION)

# Flaws in Carbon Principles

WE DON'T NEED FINANCIAL ENGINEERING //BY JASON MAKANSI

WE HAVE PLENTY OF GOOD REASONS TO blame Wall Street financial firms for the progressive deterioration of our economy. Here are some more.

Demand for electricity continues to climb. Supply keeps going down. In some areas, like Texas and the Northeast, the ratio between the two is getting critical. The industry is embracing renewable energy, smart meters, conservation and energy efficiency, but these techniques won't be nearly enough. The recession will probably dampen demand and new construction will be postponed, further aggravating the supply situation in the years ahead.

In reaction to global warming concerns and extraordinarily high costs for new capacity, generating companies have cancelled or postponed dozens of new coal plants. The industry is trying to permit a new fleet of nuclear plants, but the first ones won't be supplying electricity until 2017 at the very earliest. Wind energy facilities are getting built, but wind turbines run, at best, only at 35 percent capacity factor. Recent success stories for solar projects are high in public relations value but miniscule in terms of total production.

Several months ago, CitiGroup, JPMorgan Chase and Morgan Stanley unveiled their Carbon Principles. They will not finance new coal plants without carbon capture and sequestration, a solution experts concede will not be commercially ready until at least 2020 and will add 30 percent to 50 percent to capital and operating costs for coal plants. Financiers are also skittish about providing the debt financing for nuclear plants, which produce zero CO<sub>2</sub>.

But Wall Street has other green reasons not to finance two of our lowest-cost sources of baseload electricity. After the California energy crisis and the post-Enron meltdown in electricity, Wall Street firms bought gas-fired power plants around the country at bargain-basement prices. Today, they reportedly own about 5 percent of the total generating

capacity in the United States. They also acquired electricity and natural-gas trading operations from Houston-based energy firms.

Until they blew it with mortgage-backed securities and collateralized debt obligations, Wall Street firms salivated over the prospect of carbon trading, which is expected to be a \$1 trillion market by 2020 under proposed cap-and-trade schemes that are now likely to be ratified by Congress and the president.

Once they're back on their feet post-recession, financial firms could control virtually all the transactional value around power-generating assets – fuel



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trading of primarily natural gas, tax credits, electricity trading, carbon trading, and even SO<sub>2</sub> and NO<sub>x</sub> allowance trading.

The latest fleet of gas-fired combined-cycle plants has been averaging only around 50 percent capacity factor because of the high price of natural gas relative to other fuels. In past years, the capacity factors were even less. But in the future, they will have to run more if

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no new coal or nuclear plants are built, and limited contribution is available from renewable energy. This country has more natural gas-fired nameplate capacity sitting on the ground than coal. That's where much of the incremental megawatt-hours will be coming from in the years ahead.

When we need more electricity, the price of natural gas or carbon credits won't matter. Electricity is a necessity, not a luxury. Rates will skyrocket in competitive markets – most of the Northeast and Mid-Atlantic, Texas, Illinois, and California – because natural gas sets the market price.

Wall Street has a fiduciary duty to act in the best interests of shareholders. It has precipitated worldwide. But look into the future, past our current woes, and realize that it has been the fiduciary duty of these firms not to finance coal and nuclear plants. That makes their gas-fired assets and energy-trading operations that much more valuable going forward. Financing renewable energy, an activity enthusiastically



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embraced by financial firms in recent years, also enhances the future value of carbon trading.

Where was the outrage from the coal industry when those carbon principles were put forth? How did those Wall Street firms gain the complicity of leading coal-burning utilities? Several apparently signed on.

Wall Street specializes in financial engineering, not infrastructure engineering. Their shareholders may benefit in the short term, but ratepayers and the economy suffer in the long term. Sure, the electricity industry should be accountable for its contribution to global warming, but not as an emerging platform for the

kind of quarter-to-quarter financial engineering that's caused the mighty American economy to collapse. The value of electricity to our economy requires a long-term infrastructure-engineering approach, not financial engineering. ☒

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