



The New Way to Attack the Carbon Problem: Rising Liability Issues

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It's kind of interesting that everyone is focused on cap and trade legislation and market design issues. There is another "dog in this fight." Carbon is rising as a liability issue. While I have argued that carbon risk management is a fiduciary responsibility for both energy and agricultural companies, I think what has been missed is that there are externalities to burning coal as well as other fossil fuels. Externalities equate to rising health care liabilities, sludge and mercury liabilities, and carbon dioxide liabilities. I fully expect to see a website shortly with some trial lawyer already poking around this fertile ground for a class action suit. It's not that farfetched as we saw a California trial lawyer have a very scary website on LNG safety and siting, and we have the historical precedent of tobacco case law.

The April 2nd Supreme Court decision that carbon dioxide is a pollutant is actually a seminal judicial ruling. It puts the carbon issue squarely on the balance sheet as a material issue. While I am not a lawyer, I have seen more financial pressure from shareholders on this issue of "climate change risk" this summer. We have also seen insurers and reinsurance companies drop coverage related to weather related risks. Well, human health issues can actually more materially impact the balance sheet of energy companies more than is often recognized (think of asbestos liabilities as an analogue here).

Does Carbon Risk Kill Coal?

This is not a rhetorical question. It seems obvious that carbon constraints change the economics of electricity generation options. The costs of gasification and carbon capture and sequestration are adding many hundreds of millions of costs to electric utilities. What utilities are really worried about is if they can recapture their financial investment risks through rate payers and that is why IGCC is moving slower than expected. It's one way forward as a clean coal solution but is becoming a more expensive and technologically risky solution.

Where Do Renewables Fit Into This Equation?

Renewables are not the panacea that many tout. The fact is that wind is intermittent and must be married to compressed air or other forms of battery storage. But the price of carbon emissions may make wind cheaper over the longer-term. Photovoltaics need scalable cost reductions to become economic without heavy subsidies. While costs have come down ten fold in the past 25 years, they need a further ten fold reduction to gain traction. The costs are still in the 20 to 40 cents/ kWh range. Concentrated solar power is the latest buzz word, but we need size and scale. Basically, we need breakthrough technologies for higher efficiency levels across the board for all renewables so that they are not dependent on subsidies. The large scale solar plants of today are highly inefficient and are dependent on the mandated RPSs to a great degree.

Will higher carbon prices make all renewables cheaper than new coal? It seems that IGCC and CCS are near geothermal costs as well as biomass IGCC. Concentrated solar and wind appear cheaper. We'll have to wait and see what happens on this one.

Energy Storage Becomes the Hidden Gem

All these new and existing energy technologies have additional costs for consumers. The fallacy that deregulation would bring cheaper prices never gained real traction among those in the know as who was going to pay for all this new investment in plant and equipment when you couldn't rate base the costs. Thus, storage is essential to make the breakthroughs for renewables. Batteries, fuel cells, flow cells, compressed air, pumped hydro and thermal storage are all too expensive for prime time. But that is going to change. The fact is that fossil fuel prices are going to rise to a new plateau post 2010 due to accelerating global demand and supply tightness despite what other analysts are predicting. That carbon can either be seen as a cost center or profit center. Renewables now need to be aggressively married to energy storage. The plain fact is that global warming is going to cost electric utility and other energy companies more investment. Those costs will be passed on to consumers. There is no free lunch or technology silver bullet.

Efficiency Will Bring Some of the Benefits Needed

Light bulb changing is nice and needed, and it needs to be LED lamps, not compact fluorescents, but that will not move the needle as much as we need. Space heating, cooling, and refrigeration are much larger applications that will need major efficiency breakthroughs both to moderate higher prices and to reduce the growing carbon footprint.

The Lawyers Will Push This Forward

The end game is legal. Climate change is a real and rising risk on the balance sheet. It is a risk to coal burning utilities. It is a rising issue among pension funds who are now going green. But the real green is money; green as in new investment. Utilities are holding back from that spend as each delay in climate change legislation postpones the inevitable. The latest timetable for national climate legislation and implementation seems to be five to eight years out. That inevitable is to invest in cleaner and more efficient energy efficient technology and cleaner fuels, including coal. The day is coming but it is not here yet.

Peter C. Fusaro is pushing the carbon envelope and is holding multiple seminars through North America this fall (go to www.pgsenergy.com to see his latest webinars and seminars on carbon trading and finance). The next offering is on September 19, 2007 in New York. Only through education will the carbon market grow.



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