

How Washington Impacts Investments in Energy

Christine Tezak, Principal
Electricity, Natural Gas, Environment
Washington Research Group

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charles SCHWAB

Who we are...

- Schwab's Washington Research Group provides “top down” analysis on how Washington (D.C.) impacts publicly-traded equities through
 - Regulation,
 - Legislation, and
 - Politics.

- My primary focus –
 - Federal electricity policy
 - Federal pipeline policies
 - Federal environmental policy

Energy Bill in Limbo

- Our prospects on passage in the 108th – negative
- Limited investment impact even if passed
- Provisions of most interest today
 - Wind production tax credit reinstatement
 - Reinstatement of certain non-conventional drilling credits
 - PUHCA repeal
 - Establishment of investment credits for clean coal investments
 - Changes to IRS code to widen ownership of MLPs
- Federal legislators fatigued!
 - No fun doing something that doesn't go anywhere!

Electricity

- The stabilization of a regionalized status quo
- Fuels ok
 - Coal not a tight as feared
 - Natural gas pricing not a big problem
- Winter price run-ups resolved
- Summer passed without incident
- Asset transfer proceedings
- Policy changes in market-based rate assessments

Lull Before the Storm?

- Asset transfers slow, but moving
 - Perryville pending at FERC, Arizona ratebasing looms
 - Overcapacity still around

- Eve of FPA §206 investigations into market power at integrated utilities
 - Political push back expected, but will it change anything this round?

- State rate freeze roll-offs
 - The industry is doing “back to basics” are state regulators ready to return to rate cases

- Interest rates – no where to go but up?
 - State regulators pushing ROR’s down

Wall Street's New Darling?

- LNG – If Greenspan says it's the answer...
- Widespread political support at federal level
- Federal oversight where there is regulation
 - Siting process improved at FERC
 - FERC, Coast Guard and other agencies cooperating
- Siting concerns headed to court (California)
- Positive legislative language proposed, not yet moving
 - New catalyst for revisiting intractable energy legislation next session?

Pipelines Caught in the Middle?

- Higher sustained natural gas pricing...
 - Less gas processing
 - More gas liquids – more operational issues for pipes

- LNG in downstream market areas
 - More Btus – more operational issues for pipes and LDCs
 - Customers raising issues

- FERC's *ad hoc* approach already being tested

- What will the NGC task forces say?
 - Policy or problem definition
 - Another possible legislative catalyst?

Gas Quality & Interchangeability

- Standards are helpful, but may be only part of the answer...
 - Where in the delivery chain will they be checked?
 - Who is responsible for meeting them?
 - How will standards be enforced?

- Impacts... especially if resolution is slow
 - Uncertainty and risk
 - Lag in recovery of investments
 - Margins for both regulated and unregulated market members

Flexible Solutions in an Open Access World?

- Do “premium” services make sense in open access construct?
- How much “flexibility” is enough?
- Standards seem like a good idea, but agreeing on what they should be is harder...
 - How narrow should they be?
 - How much variation can the consumer really tolerate?
- Will these issues start to hamper natural gas infrastructure investment?

Markets

- “Regionalism” a reality – like it or not
- For now, things are quiet
- Index reporting improved in electricity and natural gas trading
 - But every time the markets move politicians go into a tizzy
 - Politicians quick to blame volatility on “speculators”
- Big banks owning trading desks
- Clearing proposed for Mid-Atlantic electric market
- What will come of the storage numbers flap?

Not Your Father's Utility Investment

- Pipelines doing well – shippers grumble about over-earning
- E&P returns healthy
- Electricity no longer homogenous
 - Integrated (bundled) utilities
 - Unbundled utility holding companies
 - Pure play power producers troubled
 - Regulatory risk still seems high relative to returns
 - Some investors still haven't returned
 - Competition with telecoms in a recovering economy looms

Environmental Policies

- Greatest area of differentiation between presidential candidates
 - Air pollution control regulations for coal-fired utility boilers
 - What role for nuclear?
 - Land access issues for drillers
 - Infrastructure siting
 - New technologies, renewables – will it ever come to anything?

- Congress likely to remain Republican
 - How much could a new administration do?
 - Internal Republican strife (fiscal conservatives and an unmanageable Senate may not change)
 - House leadership nervous about revisiting Clean Air legislation

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