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Industry Continues to Grapple with Uncertainty after Bush Releases Air Regulatory Initiatives

President Bush recently unveiled two proposals aimed at controlling air pollution emissions in the United States. The *Clear Skies Initiative* calls for reductions in sulfur dioxide (SO_2), nitrogen oxide (NO_X) and mercury emissions to be achieved in two phases over the next 20 years. These pollutants are targeted because of their potential to pose environmental and public health risks. For example, SO_2 and NO_X contribute to acid rain and fine particulate (soot) formation and smog problems. Mercury deposition in lakes, rivers, and streams can contaminate fish, potentially leading to nervous system disorders in humans who consume them.

The *Global Climate Change Initiative,* calls for a gradual reduction in greenhouse gas (GHG) emissions intensity, or the ratio of emissions to economic activity, over the next 10 years. Increasing emissions of GHGs, including carbon dioxide, contribute to global climate change.

The Clear Skies Initiative

The President's *Clear Skies Initiative* comes at a critical time when some electric power companies are supporting comprehensive air legislation for the first time. These power companies are calling for air legislation, due in part to the realization that under current law further regulation of mercury, SO_2, and NO_X is likely to occur, but in a piecemeal fashion.

This incremental approach to air emissions regulation under current law creates uncertainty and risks stranding billions of dollars of air pollution control investments. For example, a power company may spend $500 million to install control equipment on its coal-fired electric generation units in order to comply with a recently promulgated NO_X regulation. Investments of this magnitude could result in a loss in earnings of five to ten percent. That same company may discover two years from now that it is faced with spending an additional $1.5 billion on pollution control equipment as a result of new mercury and SO_2 regulations. Faced with these additional costs, the power company may decide to retire some of its marginal generating units rather than incur the additional investment cost, thereby leaving the company "stranded" with no asset on which to recover part of the original NO_X control investments.

While the President's multi-pollutant approach may be intended to reduce uncertainty by establishing comprehensive, long-term emissions reduction requirements, it primarily serves to intensify the debate over future air regulation.

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The President's initiative is just one of several widely ranging proposals put forward recently by members of government and industry. Industry proposals from groups such as the Clean Energy Group and Energy for a Clean Air Future vary in the timing and stringency of their required reductions. A multipollutant proposal sponsored by Senator James Jeffords (I-VT) calls for significant cuts in emissions beginning in 2007. The President's approach calls for smaller cuts than Jeffords' and delays the most significant cuts until 2018.

The Global Climate Change Initiative

The Administration's *Global Climate Change Initiative* sets a modest voluntary goal for U.S. GHG emissions reductions over the next 10 years. The initiative delays

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any further action until 2012, and even then only if justified by "sound science." Based on the Energy Information Administration projections, the President's voluntary goal, if achieved, would result in carbon dioxide emissions levels substantially higher than those allocated to the U.S. under the Kyoto Protocol. Carbon dioxide emissions under the Administration plan also will far exceed those allowed under other proposals, including the Jeffords and Clean Energy Group proposals.

Unlike the *Clear Skies Initiative,* the *Global Climate Change Initiative* delays definitive action on the climate change issue, thereby forcing U.S. businesses to continue making costly, long-term decisions while faced with significant uncertainty.

The Way Forward

While some in the power industry are supporting multi-pollutant legislation, in part as a way to reduce uncertainty, there remains a great deal of uncertainty as to what will be the ultimate scope, stringency, and timing of future air regulations. Power companies must also grapple with the prospect that further reductions in carbon emissions, beyond the voluntary program proposed by the Bush Administration, still might occur as most developed countries in the world move toward ratification of the Kyoto Protocol.

Given the renewed focus of Wall Street rating agencies on energy company financial performance as a result of the Enron debacle, ICF Consulting recommends that power company executives pursue air emissions compliance strategies that minimize near-term earnings and debt impacts while preserving flexibility to respond to the continuing uncertain air regulatory outlook.