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Sizing Up the Utilities, if Carbon Caps Take Hold

Abby Schultz – The New York Times

Fuel prices and dividends are usually big drivers of the share prices of utilities. Now there is a new variable to consider: how much carbon their power plants emit.

Federal regulations over the next few years could limit the carbon emissions of these companies, and Wall Street analysts have begun compiling lists of potential winners and losers, based on that possibility.

All of the leading presidential candidates say they favor such measures, and some kind of legislation affecting utilities is likely at some point after the November election, Citi Investment Research said in a January report.

If “carbon caps” — limits on carbon emissions — eventually become law, the winners may include operators of nuclear power plants (which don’t emit carbon), while the losers may include power companies that mainly burn coal, analysts say. Beyond that, who wins and who loses will depend on the details of possible future regulations, which can’t be predicted with certainty.

Still, a cottage industry on Wall Street has begun to evaluate these questions.

“I think the time when you can keep your head in the ground is just over,” said Hugh Wynne, a senior analyst at Sanford C. Bernstein & Company.

Some analysts have begun to evaluate the potential impact of carbon caps on stock prices.

“Carbon has been an ongoing issue for the investment community for the last three or four years,” said Brian Chin, an equity analyst at Citi Investment Research.

Federal carbon rules might be similar to regional efforts in the Northeast and California. These plans are to place emission limits on plants that emit carbon dioxide, and, in the case of California, on other greenhouse gases as well. Allowances or credits to emit a certain level of greenhouse gases are either auctioned or granted free.

Under such a system, called “cap and trade,” utilities that stay below emissions quotas can hold credits for the future or sell them on the open market. In Europe, the cost of one credit has averaged $25 a metric ton of carbon dioxide since January 2005, when the European Union’s emissions trading plan began.

Companies like the Exelon Corporation, the Constellation Energy Group and the Entergy Corporation, which operate nuclear power plants, would benefit from cap-and-trade plans under consideration, like the Lieberman-Warner Climate Security Act, which is pending in Congress, Mr. Chin said.

“They all potentially get a very large benefit from higher power prices being pushed up by carbon,” he said.

If emission credits are auctioned in a cap-and-trade system, there may be particular problems for coal-fired generators of electricity in markets where natural gas is a major fuel. Burning natural gas generally emits 40 percent less carbon dioxide than coal, and coal-fired plants in gas markets might have a hard time passing along the costs of carbon credits to consumers, some analysts say. NRG Energy, Reliant Energy and Dynegy could feel the sting, Mr. Wynne of Sanford C. Bernstein said.

While regulated utilities would seek permission to pass on their added costs to ratepayers, state public utility commissions might balk, having already raised the average retail price of electricity nearly 30 percent in the last five years, Mr. Wynne said. Even if states allowed utilities to recover the cost of carbon credits, he said, they might reduce the permitted return on equity. The potential expense of complying with carbon emission limits, in addition to rising construction costs, led several commissions to cancel plans for coal-fired power plants last year, he said.

Eric Kane, a senior analyst at Innovest Strategic Value Advisors, a research firm that analyzes the effects of environmental, social and governance issues on stocks, also warned that many companies would have to shoulder an increased burden.

“It’s unlikely these companies will be able to pass all the costs down to consumers,” he said. In the end, he said, there will be an effect on shareholders.

Innovest rates companies on management of carbon emissions. It gives its highest rating to three utilities — including the FPL Group, which, it says, has a strategy to reduce greenhouse gas emissions and make huge investments in wind power; and PG&E, for developing energy efficiency initiatives and renewable power. The third company in the group, Consolidated Edison, got the highest rating for taking measures to reduce emissions. Innovest’s lowest rating goes to four companies that it says have done relatively little in this area, Allegheny Energy, the Southern Company, the Ameren Corporation and the Scana Corporation.

Ceres, a coalition of investors and environmentalists based in Boston, has argued that electric utilities around the world should provide more financial data on the potential costs of managing carbon emissions.

The issue is becoming “more and more material for investors,” said Dan Bakal, director of electric power programs at Ceres. He said national regulations on carbon emissions “are getting closer and closer to reality.”