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Efforts to re-regulate utilities may harm credit

Current political efforts to return electric utilities to 1980s style cost-of-service "regulation is a risky proposition that could threaten utility balance sheets, destroy value and impair credit ratings," Standard & Poor's said Tuesday.

S&P, like Platts, is a division of The McGraw-Hill Companies.

In a new report, "Re-Regulation of US Electric Utilities: The Toothpaste Challenge," the rating agency compared efforts to reregulate with "trying to put toothpaste back into the tube," something it said "not only approaches the impossible, but makes for a pretty messy affair," S&P said.

"It is not our position to advocate one regulatory model over another - others fill that role. But, as we cautioned in 1996, if electric utility deregulation...did not deliver the promised benefits, regulators and politicians would quickly step in and reverse course."

Eleven years later, "it is not definitively clear whether liberalization has succeeded or failed. Skilled debaters can convincingly make either point. Yet, in places such as the Pacific Northwest, Virginia, and Connecticut, the political winds have turned against competition. And that could foretell credit deterioration."

S&P said that when the utility industry "liberalized," it "dramatically created a new structure that now serves almost two-thirds of the US population. Many utilities sold their generating assets to new generating companies. Others sold transmission assets. Over time, independent developers invested countless billions of dollars to build new generation that utilities might otherwise have built," the report said, describing such expenditures as a "lot of expensive toothpaste squeezed from the tube."

While the report said it could not say whether a return to traditional regulation will lower electricity prices, it said the "introduction of competition into generation resulted in greater efficiencies, lower heat rates, greater reliability, lower nonfuel operating costs, and in general, more widely adopted best practices."

"Consider how nuclear power plant operations have dramatically improved in competition's short tenure. Would a reversion to regulation preserve these gains? Absent the pressure of competition, it is hard to believe so, given cost-of-service regulation's history," the report said. As for the credit implications of re-regulation, the report called "repatriating generation" to utilities a "troubling proposition," saying "questions about which power plants go to which utilities and what cost have yet to enter the debate. Given the rarefied prices of recent assets sales, these could be costly acquisitions - purchases that could threaten credit strength."

Further, S&P said "some utilities could end up with a suboptimal mix of

generation, with too much exposure to one fuel."
And the report also warned that lenders to assets being sold "or transferred could similarly see credit surprises, depending on whether regulation seeks to protect investors - not something S&P would expect in the current environment."