

U.S. Climate Policy: Toward a Sensible Center

June 24, 2004

Excerpt: John Rowe, Chairman and CEO, Exelon Corporation

MS. CLAUSSEN: I just want to tell you in general how we're going to run this session, and I'm going to start by telling you that Senator McCain had a 4 o'clock vote, but he is coming here as soon as he votes. So hopefully John Rowe will fill the space beautifully, and then Senator McCain will be here. And after both have spoken, we'll sit down here and we'll have questions for both.

So let me start by introducing John Rowe. John Rowe has had a distinguished career in the utility industry. He's now Chairman, President and CEO of Exelon. In addition to that, John serves as one of the Tri-Chairs of the National Commission on Energy Policy, a group of 18 distinguished and bipartisan experts who are working to develop a long-term U.S. energy strategy that promotes national security, economic prosperity and environmental safety. Their report is due out in early 2005, and I think I can say that I'm looking forward both to what the Commission says in 2005 and what John Rowe says now.

[Applause.]

MR. ROWE: The genius of the American public utility is of course that we are there before others come.

[Laughter.]

MR. ROWE: I say that in jest, but in reality much of what you see in the activities of utilities has to do with the day-to-day, hour-to-hour, minute-by-minute obligations that you have in this business as you try, as Mike Morris said, to do some useful long-term things, and also keep things together in the here and now.

Recently the New York Times, I think the Post as well, ran extensive articles on how industry won the battle of pollution control at EPA, and the articles suggested that the utility industry is unified in opposing any sort of carbon emissions limitations. As I think you could tell from Mike Morris's remarks earlier, that is not literally true. Moreover, it is the case, however, that some utilities, in fact a substantial number, are intransigent on the point, and we at Exelon want to stake out a difference.

We accept that provisional or not, the science on global warming is for the present overwhelming. We believe that there should be mandatory carbon constraints. We believe that the U.S. can do something without waiting for China. We support small, increasing ratcheting limits. We support higher energy efficiency standards in both buildings and appliances, and if anyone cared, we would also support tighter and more extensive CAFE standards.

Since we are the largest nuclear generator in the country, our position could be characterized as self-interested, and in the short term we do have such an interest, but one should remember that we purchase a very large amount of our electricity from coal-fired power plants, and controlling the price of that is very important to us. One should also realize that on the margin the next capacity we add will probably be wind, and what follows that is more likely to be a pulverized coal plant than a nuclear plant, simply a matter of time and need.

What we have tried to do at Exelon is look at all of the 3-P and 4-P bills that are about and try to discern what seems to catch the knee of the curves. That is, where do we think the economics is best for getting the maximum amount of pollution control, including carbon, with the least amount of cost?

The bill that we have supported as a result of this analysis is the so-called Carper Bill. It is supported not only by Exelon but by a group of utilities called Clean Energy Group. We think it is a good balance of realistic carbon legislation, and 3-P standards, which are tighter than the Clear Skies Bill, but not as costly as the Jeffords-Waxman Bill. Do we have it exactly right? I doubt it, but it is the result of a very intensive analysis of what we think the industry can afford and can collect in the

short run.

Taking carbon by itself, if I look at it as a one-pollution matter, one is constantly teased by the efficiency of tax mechanisms. A low, but ratcheting, and increasing consistently and predictably, carbon tax, would have the advantage of being able to measure its cost very clearly, to determine its course very certainly, and to avoid a great deal of allocation issues. We have observed, however, that tax suggestions are welcome regardless of the number of economists one brings along.

[Laughter.]

MR. ROWE: There is a joke about the destructive power of economists, but it seems that it's less when taxes are involved. There's a lesson there somewhere.

As a result of this I have been working with my colleagues on the somewhat self-entitled National Commission on Energy Policy in an effort to develop an intensity-based cap and trade system with a safety valve which would provide teeth in the goals that have been set by the Bush administration, and real progress in terms of setting the U.S. as a country that is willing to bear its part of these global obligations.

The concept we're working on includes a safety valve, that is, a level at which additional emissions could be adopted. That is very important, indeed essential, to some of us, because we do not know whether this will be an area where creativity brings about vast improvement at costs lower than those which are anticipated, or one in which the costs will be very much greater, and a safety valve that ratchets itself. That means it goes up year after year, allows one to keep a relatively sure handle on the cost.

We commend--and it's a little early but I'll do it again later--Senator McCain and Senator Lieberman for the work that they have done on developing a cap and trade system for carbon and proposing it in legislation. We do believe they need to address allocation issues and also safety valve issues to make a truly--

[Tape change.]

MR. ROWE: Now, what I'm trying to say is that even as a company which has to look toward future energy requirements in a world that's still largely fossil based, we are willing to accept the challenge of real legislation and real mandates, but we have to issue a challenge at the same time.

When Secretary Abrams described his faith in technological innovation, there were more than a few smiles in the room, and I was reminded of one of my environmentalist friends saying only 48 hours ago, "That's what they call faith-based technology."

[Laughter.]

MR. ROWE: But when you stand up and say, "We will require it and innovation will develop it from renewables of efficiency," that is simply a different fate, and one which has even less of a book.

The challenge that I would issue to everyone here is if you really want a world that deals with carbon, we have to make it easier to build and to run low-carbon energy sources and those will not be confined to each one of our favorite sources.

The principal bridge in our decade from where we have been to where we ought to be is natural gas, and much of the policy established by the government in my industry for the last 15 years has been based on cheap natural gas, and it's no longer cheap, and few of us think it's going to be cheap for a while. So those of you who want to see real carbon reductions, I suggest that you support a new pipeline from Alaska where there is gas--and I'm told it doesn't have to be ANWR--I suggest you help find ways to get LNG terminals because the only war we're going to be able to keep a handle on gas prices in the next few years is LNG terminals.

Now, along with gas we ought to be doing more on efficiency. Foy hammered that into me over the years. He found that utility executives hammer well, but they perform better when they're bought.

[Laughter.]

MR. ROWE: But to my way of thinking, we have innumerable areas, starting with his example of

three-year paybacks and 10-year paybacks in long-life government buildings, where we ought to be doing much more on efficiency. And most of that should be done either through the economic forces of prices at work or the regulatory forces of real standards and requirements. There is probably a role for utilities inefficiency. I think it is not as large as some would say, but it is large in terms of our work. We are very proud of having expanded the output of our nuclear fleet by more than 1,000 megawatts, by simply making our machines better.

The next challenge I want to lay down is nuclear power and nuclear waste. I have looked many, many times at the different sources of energy that can make up a low carbon future. Yes, I think good efficiency measures can cut growth and should often come first. I hope that the Secretary and my friend Mike Morris are right when they talk about cleaner coal in the future, but zero-carbon coal sounds like a long way away to me. We are, I believe, the leading purchaser of wind power in the Eastern half of the United States. Mike may be second. We're not as big as several in the West. We will end up buying more wind power. But I cannot see any energy future in which we can have lower carbon without an expanded nuclear base.

I say that as someone who does not believe that lots of nuclear plants are right around the corner. I want to see high prices stably for a very long time before I make such an investment. My company lost between 5 and 10 billion dollars on the last round, and we're making a little of it back now but not a lot. But this is not a matter of John Rowe's portfolio. John will have diversified his portfolio in time. This is a matter of whether you really believe it's important to have low-carbon energy. I don't see that you can have it without a new generation of nuclear plants, and I don't see that we can have that if the government will not keep its 50-year-old promise on waste disposal.

So what I am here to say--and I'm trying to say it relatively briefly because of the hour--is that, yes, the carbon threat is real. Yes, I believe carbon climate change is probably real. Yes, I accept that it must have mandates to bring about the kind of change we need. But I say to the rest of you, if you really have this concern, you've got to be for something that's real and things that really work and we won't do it all with windmills.

Trying to end that on a more cheerful note, I am reminded that in the 1930s the WPA paid a lot of brilliant people to do creative work, which at the time was controversial, and in the '50s became more controversial because they identified the political connections of some of those brilliant people, but now is a very important part of our cultural legacy.

One of the most profound parts of that legacy to folks like me is Woody Guthrie singing "The Greatest Thing that Man Has Ever Done," about the Grand Coulee Dam. I'm not sure we could resurrect Woody to sing about a dam today, but if you really want a low-carbon future, we need Woody Guthrie singing "This Land is Your Land" in front of an LNG terminal, or in front of a nuclear waste depository, or in front of something that allows us to meet this need.

And what we're likely to get if we're not careful is Arlo Guthrie singing "Alice's Restaurant" in front of a carousel at Disney World, and that's no substitute.

[Laughter.]

MR. ROWE: Thank you very much.

[Applause.]

MR. ROWE: I am told to take some questions, so I can defer to the Senator when he arrives. Yes, Bill?

QUESTIONER: Bill Nitze at Gemstar Group.

John, I take it you would be prepared to see a so-called level playing field, and you make the portfolio choices that make sense to you at Exelon based on a uniform pricing structure that reflects social and environmental externalities, no subsidies, no special favors, nice level playing field.

MR. ROWE: I have never wanted a level playing field in my life.

[Laughter.]

MR. ROWE: Nor have I met anyone else who did. I would be prepared to accept that, but I have observed that the game of deciding what an environmental externality is is a grand one, and I will even accept a slightly unlevel playing field if you'll let me write the externality about this.

Yes?

QUESTIONER: I'm Louis Cabot [ph]. Could you talk a little bit more about what it might take for this country to begin to take a serious look at more nuclear power?

MR. ROWE: First, I think it's inevitable, and I think the worst thing that we could do as an industry to bring it about is to try to do it too soon and too fast with too much arrogance. We tried that.

But what it will take, in my view, is the following. A shortage of base-load generating capacity which does not exist across most of the country at the present time, but will exist in a 5- to 10-year period. Gas prices that have stayed over \$6.00 for an extended period of time. A simplified more passive reactor design, which will exist in that time period. And a publicly-accepted response to the problem of waste disposal. I believe the fundamental sin of the nuclear industry--and frankly the government sinned first so we were just in the wrong bed--is going to the public without facing the nuclear waste squarely. Those would be my preconditions.

Yes, sir?

QUESTIONER: I'm Frank Loy [ph]. My question relates to your remarks about the McCain-Lieberman Bill. If I heard you correctly you said that you could accept that, but you thought that there needed to be some changes in the allocation and in the--you wanted to see some sort of safety valve. I wonder if you could expand on that?

MR. ROWE: Sure. As I understand the current version of McCain-Lieberman, and you'll have the man who knows here shortly, but I believe they are fleshing some things out and making some changes so I don't know that it's a standing subject at the moment. But the current version leaves to EPA the whole issue of allocations. That's like taking one of the major property right questions in the United States and deferring it to an energy without guidelines.

Most of my colleagues who burn a lot of coal will think most of the entitlement should go to the existing coal burners. Some of my friends think none of the entitlement should go to the existing coal burners. I think we ought to start with most of them going there, but slowly ratchet it down just because--you'll note I use the word "ratchet" a lot. I think when we're doing big things like this we should start slow, make changes in a direction, and do them consistently and repeatedly so that the market knows that the result is inevitable. Markets respond very well to inevitability.

And also I think that there should be some kind of safety valve, meaning some level at which the government will sell additional permits if it turns out that the costs of compliance are excessive.

Yes, sir? It sure does help to have the guest of honor late. It gives me a lot of time.

[Laughter.]

QUESTIONER: Dan Goldberg [ph], Center for International Environmental Law. On a similar point to the one that Frank just asked, I thought just before you talked about--or in the same paragraph, I guess, that you talked about the safety valve, I thought you mentioned intensity-based cap and trade, I think was the term you used. And that's a little different than McCain-Lieberman as I understand it.

MR. ROWE: You're correct.

QUESTIONER: I wonder if you could also elaborate a little bit on that point.

MR. ROWE: Well, you can get to the same end either way, but in the positions that I have been advocating in our National Energy Commission work--and there are no consensuses on anything in that body till there's a report--but in our work on that, we think using an intensity measure is a bridge to make it more bipartisan, and by just gearing the numbers right you can get the same result either way. It's simply an effort to try to build a bridge between two differing views of how to do this.

Yes, Bill?

QUESTIONER: [Off microphone, inaudible] -- and you then addressed the McCain-Lieberman Bill. I'm trying to understand how you see the relationship between them. And also ask a question, are not the same uncertainties about the cost of using [inaudible]?

MR. ROWE: Of course. But the at least initial steps in the Carper Bill are somewhat more modest than McCain-Lieberman, but we think McCain-Lieberman bringing in the trading system is in itself an immense improvement. So as you taught me 25 years ago when you were young--

QUESTIONER: [Inaudible].

MR. ROWE: Well, one, I wasn't quite so young.

Legislation is the making of sausage and we would like a little stir frying going on here.

QUESTIONER: [Inaudible].

MR. ROWE: No, not as they stand, not without a safety valve. You'll be the last person to ask me that too. It's not that world is waiting for my opinion on the subject.

Yes, sir?

QUESTIONER: Jimmy Segia [ph] from the Joyce Foundation, which is a business customer of Commonwealth Edison.

MR. ROWE: Right.

QUESTIONER: [Inaudible]. You expressed some skepticism about the ability of renewables and efficiencies to provide the ultimate solution to the problem, and I'm hoping you could elaborate a little bit about exactly what you think the limits are there, and what's the basis for that skepticism?

MR. ROWE: Well, I've spent a lot of time working in efficiency. I believe substantial improvements can be made. I've never seen any situation in which efficiency eats up all of the growth in energy demand, just haven't ever seen it, don't believe it. It could happen some day. All things are possible in an empirical world. Don't believe it.

On renewables, forewall(?) takes are still exceedingly expensive in nearly all applications. The ones we put in in Chicago are costing 40 cents a kilowatt hour. I'm sure there's something more efficient in the last three years, but that's a long way.

Wind is the most economic renewable available in substantial supply. It is an intermittent and erratic source of generation that has to be blended with some sort of backup power to cover. It competes economically against base load power, but tends to be priced against peaking capacity, which makes it look good. It's very clear that wind is the renewable of the day and we will make deals in both Illinois and Pennsylvania to add more wind to our system.

But I do not know what the limits are on public acceptance of wind, and I don't know how much wind a system can work with and be stable. I've heard some numbers from Europe on the order of 10 percent. We shall see. They're doing very heavy wind experiments there. We shall also see--if they get higher than that, they'll have to back it up with some other kind of capacity.

You know, renewables in the sense of biomass is, you know, where I would like to think the big hope is. I've just never seen somebody bring me a whole biomass fuel cycle that was close to economic under current circumstances. I mean no one would be happier than me to see it develop. I mean, I'd love to go buy 1,000 megawatts of biomass if I could do it competitively with pulverized coal. But I haven't seen such a proposal and the people who follow it for me have not either.

QUESTIONER: A follow up on that?

MR. ROWE: Sure.

QUESTIONER: The [inaudible] for your company is 2 or 3 percent. You don't think a real aggressive efficiency program could change that [inaudible]?

MR. ROWE: For a couple years. But the answer I think is no. I mean I had, when I was at New England Electric, thanks to Foy, the most aggressive utility-financed efficiency programs in the United States. Cabana [ph] got bigger ones in California because California is very big. They measure everything out there at--but we spent more money per customer and per revenue in

Massachusetts and Rhode Island. We had the biggest, and I think we had some of the best. And we didn't stop load growth till the economy stopped load growth.

I rarely met an efficiency project that I didn't like as long as the customer is paying for it, the government's paying for it, or it's being required. I have a little more trouble being required to pay for everybody else's myself. I'll pay for my own, like Foy. But I do not see any basis to accept the proposition that in any long term period you can get everything you need through efficiency. I mean someday there may be a technological innovation, but that's right up there with fusion in my judgment.

Yes?

QUESTIONER: If your supposition that nuclear is part of our ultimate strategy, low-carbon strategy for United States, wouldn't that also then be true for the local solution? And if that's so, what would be your thoughts about how the proliferation of nuclear plants in the world can be controlled or moderated or however, such that the ultimate potential dangers could be mediated?

MR. ROWE: I know virtually nothing about proliferation. The guest of honor has arrived. I'm saved from your question.

[Laughter.]

MR. ROWE: I think, Senator McCain, no one was ever gladder to see you.

[Laughter.]

[Applause.]

[End of excerpt.]