

Texas Hold'em high

THE TXU DEBATE SHOULD NOW DISCUSS WHAT "CAPTURE READY" MEANS FOR A PULVERIZED COAL PLANT

It has been interesting to follow the continuing saga of Texas Utilities (TXU). Two private equity firms, Kohlberg Kravis Roberts & Company and the Texas Pacific Group, have proposed to buy TXU in what would become the largest leveraged buyout ever. The process has been described as unusual in that the two equity firms engaged in discussions with environmentalists before the deal. This is a reflection of the change in the investment climate for coal-fired power plants.

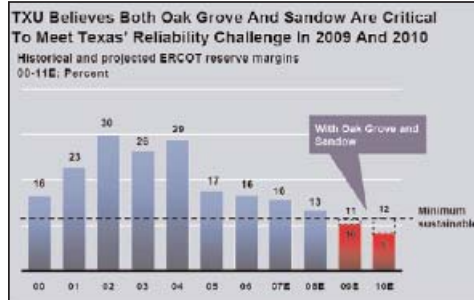


Figure 1: TXU believes that two of its proposed coal plants will help close the Texas supply-demand gap in 2009 - 10

I think what really happened is that GE wanted a launch order for 11 of their standard design IGCC plants and they did not get one. I have no insight on the details, but it seems obvious that the proposed TXU schedule was too aggressive to decide on a yet-to-be-demonstrated IGCC configuration, and probably compounded by the lack of information, operating experience, or performance guarantees on lignite.

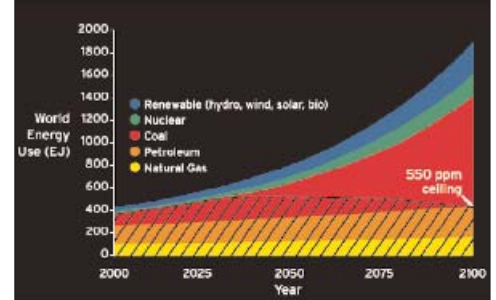
The ERCOT [1] reserve margin projections require a commitment well before any IGCC could reasonably be available (Figure 1). Of course, there is also the competitive issue with 72% of ERCOT "net dependable generation" capacity based on natural gas, and 20% based on coal. However, 37% of the actual power production was based on coal and a substantial portion of these plants are 40 and 50 years old.

I think that someone engaged the court of public opinion in an attempt to redirect efforts toward a cleaner coal solution. The press picked up on the issue and then it got out of control. You can decide if this is the case and who might have done it. I can only observe that a number of the articles written on the TXU issue have used the term "Cleaner Coal," which has been used consistently by GE since PowerGen 2005 as a more legally defensible claim. To me the logical outcome of all this public discourse would have been a much better definition of what CO₂ "capture ready" for a pulverized coal power plant really means, since this seems to represent the middle ground in the debate.

I was concerned that the spill-over would affect the image of all coal projects and

engage environmentalists in counterproductive efforts at a time when substantial use of coal seems inevitable, and is the only way that the industrialized economies of the world can insure their energy independence.

I guess the new TXU investors felt the same way. Forty-five-billion-dollar deals normally do not happen over night, and surely they are betting on the growth of coal (Figure 2). They must have sensed the same thing I did, and engaged the environmentalists in a form of damage control.



Source: Harvard Science Magazine

Figure 2: Coal will supply most of future increases in energy consumption, making global warming a 'coal problem'

TXU's 1.5 MW new wind projections appear to be contract purchases already in TXU's planning documents as of August 2006. I like wind, but the public commentary looks more like spin than substance.

However, scaling back to three plants is not really shifting away from coal to renewables as has been portrayed. It is simply scaling back the deployment rate of coal. Obviously, this then allows for the IGCC configurations to be considered for plants 4 through 11, and it does moderate the capital requirements to support this more modest build schedule, a no-brainer for any discounted cash flow analysis. This represents a good outcome, overall, provided we demand more definition on "capture ready" and also implement either a Cap & Trade or the Investment Tax Credit program for CO₂.

Footnote:

[1] The Electric Reliability Council of Texas (ERCOT) operates the electric grid and manages the deregulated market for 75% of the state. [1]

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