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Duke's merchant sale may set value benchmark

ANALYSIS Duke Energy's announcement on Monday that it will sell about 6,600 MW of generation assets in the PJM Interconnection could set the valuations for further generation sales expected by other utilities.

Financial analysts say that the Duke portfolio could fetch anywhere from $1.5 billion to $2 billion.

Duke's announcement came after the Public Utilities Commission of Ohio ruled against the company's request to recover $729 million in capacity costs as part of a transition to a more competitive market in the state.

Under the transition plan, Duke is receiving an average of about $66.06/MW-day for the capacity it provides PJM. But the company told the PUC its cost of providing capacity is $224.15/MW-day. Duke was seeking to recover the $158.08/MW-day

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Duke seeks growth while down-sizing generation

GENERATION Duke Energy is considering expansions in several areas—new utility-owned generation, more solar power, new transmission lines and new natural gas pipelines among them—that would help offset the planned sale of its merchant generation units in the Midwest, Duke officials said Tuesday.

Duke announced Monday that it "has initiated a strategic process to exit its Midwest commercial generation business," which includes 3,400 MW of capacity fueled by coal or oil and 3,200 MW fueled by natural gas.

Duke is planning several "incremental growth projects" to support the company's projected 4% to 6% growth in earnings per share, Duke President and CEO Lynn Good and Executive Vice President and CFO Steve Young said Tuesday during an earnings

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FERC defends authority in suit against Barclays

ENFORCEMENT The Federal Energy Regulatory Commission is asking a federal district court to reject calls to dismiss the commission's lawsuit against Barclays Bank for allegedly manipulating power markets in California.

Saying that the trades involved in the case are "at the core of the commission's jurisdiction," FERC in its February 14 brief called Barclays' "claim that their sales are not really 'sales' because Barclays purchased and resold—but did not generate or transmit—electricity, a proposition both irrelevant and contrary to decades of case law holding that power marketers such as Barclays that buy and resell electricity fall squarely within the commission's jurisdiction."

FERC told the US District Court for the Eastern District of California (*FERC v. Barclays Bank, et al.*, 2:13-cv-02093) that a key

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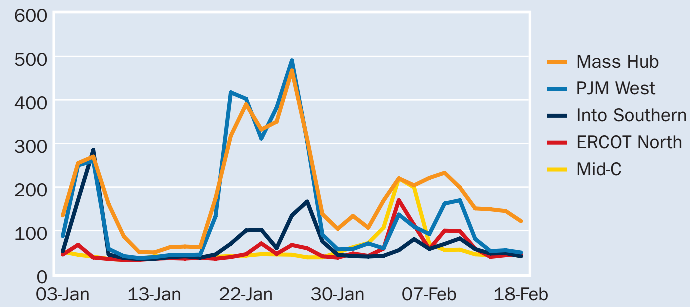
Price trends at key trading points ($/MWh)



Source: Platts

Low and high average day-ahead LMP for Feb 19 ($/MWh)

	On-peak low	On-peak high	Off-peak low	Off-peak high
ISONE	123.90	128.82	86.78	90.07
NYISO	41.76	125.65	31.39	84.25
PJM	44.67	79.95	25.54	58.42
MISO	30.95	81.95	20.07	57.01
ERCOT	42.05	42.72	24.01	24.19
CAISO	50.45	51.74	42.13	42.73

Note: Lows and highs for each ISO are for various hubs and zones. A full listing of average LMPs are availible for the hubs and zones inside this issue.

Day-ahead bilateral indexes and spark spreads for Feb 19

	Index	Marginal heat rate	Spark spreads @7k	@8k	@10k	@12k	@15k
Northeast							
Mass Hub	121.75	9151	28.62	15.31	-11.30	-37.91	-77.83
N.Y. Zone-A	69.75	8365	11.38	3.04	-13.63	-30.31	-55.33
PJM/MISO							
PJM West	49.75	9076	11.38	5.90	-5.07	-16.03	-32.48
Indiana Hub	45.00	7525	3.14	-2.84	-14.80	-26.76	-44.70
Southeast & Central							
Southern, Into	41.00	7244	1.38	-4.28	-15.60	-26.92	-43.90
ERCOT, North	44.89	8103	6.11	0.57	-10.51	-21.59	-38.21
West							
Mid-C	41.74	8015	5.29	0.08	-10.34	-20.75	-36.37
SP15	55.25	10027	16.68	11.17	0.15	-10.87	-27.40

Note: All indexes are on-peak. Spark spreads are reported in ($) and Marginal heat rates in (Btu/kWh). A full listing of bilateral indexes and marginal heat rates are inside this issue.

Inside this Issue

generation was unreliable, Lincoln said. The company said FERC's allegations are based on a "novel interpretation" of the commission's anti-manipulation rule "that stretches the rule to cover lawful, non-fraudulent conduct like Lincoln's."

Lincoln also argued that FERC's action against it is time-barred, given that the last alleged violation occurred in February 2008 and FERC did not file with the court by February 2013. In doing so, Lincoln noted that the commission last month responded to a similar argument made by CES and Silkman in their motion to dismiss, wherein FERC argued that there are actually two five-year clocks in play — one for administration action from the time of the violation, and the second when "the district court enforcement action was ripe."

But Lincoln claimed that FERC is basing this view on a precedent that does not apply in the federal district court in Massachusetts. The company said the case FERC is relying upon "emphasized that an additional limitations period applies only where an agency" holds an adjudicatory hearing consistent with the Administrative Procedures Act and has both discovery and appeal rights.

In a separate filing, Lincoln asked the court to stay discovery in the case until acting on the motion to dismiss. "Good cause exists for the court to temporarily stay discovery because the motion to dismiss is likely to completely resolve this action, or narrow the issues in dispute," the company said.

— Bobby McMahon

Duke's sale may set benchmark

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shortfall, and when PUC denied its request, Duke said it would put the plants up for sale.

Without that "missing money" Duke says its Ohio generation business will operate at a "significant loss."

That raises the question of who would want to buy a portfolio of power plants currently losing money. If recent sales are any guide, the keenest interest could come from financial players in the power sector or strategic players hungry to expand.

In December 2012, Raven Power Holdings, a portfolio company of private equity firm of Riverstone Holdings, closed on the $400 million acquisition of 2,648 MW of plants in Maryland from Exelon in a deal that included $80 million of coal inventories. The sale valued the assets at $151/kW, even though initial expectations had been as high as $800 million to $1 billion, which would carry a valuation of $300/kW or higher.

Some bidders who participated in the sale, but eventually dropped out, said that the main valuable asset was the 1,273-MW Brandon Shores coal plant. The other two plants, the 399-MW C.P. Crane (coal and oil) and the 976-MW H.A. Wagner (coal, oil and natural gas), would require as much as $500 million of capital expenditures to bring them into environmental compliance.

An earlier private equity deal showed a similar pattern. In August 2013, a unit of Energy Capital Partners bought three plants totaling 3,398 MW from Dominion Resources. A source close to the deal said the purchase price was about $450 million, yielding a valuation of $132/kW.

The star asset of that deal was the 1,158-MW Kincaid coal plant in Illinois that came with an attractive coal transportation contract. Of the other plants, the 1,424-MW gas-fired Elwood station outside of Chicago, which was only 50% owned by Dominion, does not run frequently but has a tolling agreement, and the Brayton Point plant in Massachusetts was struggling with a low capacity factor and low capacity prices. Earlier this month, Energy Capital Partners said it plans to retire the plant by June 2017.

If the Brayton plant is excluded from the valuation, ECP paid about $240/kW for the two plants in Illinois. If just the Kincaid plant is included, ECP paid about $388/kW.

Duke is selling stakes in 13 plants totaling 6,600 MW, but one of them, the 765-MW Beckjord coal plant, is slated for retirement by mid-2015. Excluding Beckjord brings the total to 5,835 MW.

Valuing the 6,600-MW portfolio at the top and bottom valuations for the ECP and Ravens Power deals yields valuations ranging from $766 million and $2.25 billion.

But the valuation of the Duke merchant assets is complicated. "These are not homogenous assets; they are unique," said Paul Patterson, an analyst with Glenrock Associates.

Other analysts, among them Julien Dumoulin-Smith at UBS, say the bulk of the value is in the gas-fired plants. As Hugh Wynne at Sanford C. Bernstein noted in a February 14 report, five of the 13 plants in the Midwest portfolio account for over 85% of the fleet's output and 65% of its capacity, and three of those plants are gas-fired stations that came online in 2002 and 2003: the 1,226-MW Hanging Rock and 617-MW Washington, both in Ohio, and the 614-MW Fayette in Pennsylvania.

The valuation of Duke's portfolio is complicated by the fact that Duke does not wholly own all the plants. Duke has stakes in six of the Midwest coal plants that range from 33% to 100%.

As financial players have done in the recent past, if the assets are sold at a low enough price, the buyer could discount the value of the coal assets and keep them for the option value of the sites on the hope of that the operating environment for coal assets will improve. That strategy could work best for private equity players if the portfolio is broken up either into individual assets or into smaller packages.

Duke has not yet given any details on how the sale will be structured, but several analysts expect the plants to be sold as a package. If the assets could fetch a price north of $1 billion, that would be a "very big bite of the apple" for a financial player, said Dumoulin-Smith.

He believes Dynegy will be the likely buyer. Unlike financial players, Dynegy has a corporate cost structure that could enable it to realize the synergies that can come with an acquisition. The acquisition would be "very accretive" for Dynegy, and "they need to grow," Dumoulin-Smith said.

In December, Dynegy closed on the acquisition of Ameren Energy Resources' 4,119 MW of coal plants in Illinois, but that deal involved the assumption of debt, and no cash value, so there is no straightforward valuation on those assets.

The unique structure of the Dynegy-Ameren deal, which included an option for Dynegy to also buy Ameren's gas plants, could also hint at a deal in which the partial owners of some of Duke's Midwest assets are also brought in to the transaction.

American Electric Power and Dayton Power & Light have varying stakes in six of Duke's coal plants, and both are facing the same poor outlook for coal plants in PJM that Duke is facing. AEP and DP&L also are working through Ohio's restructured market and are moving their generation assets into separate businesses.

AEP recently moved its 11,500 MW of plants in Ohio into an unregulated subsidiary. The company says it has no current plans to sell those assets, but has not ruled out the possibility.

Meanwhile, analysts are awaiting the results of AES Corp.'s earnings call next week to see what the company decides to do with its DP&L generating assets. If AEP and DP&L join the ranks of integrated utilities that are shedding merchant assets to focus on regulated returns, the Duke asset sale could provide the price benchmark for those sales.

— Peter Maloney

Duke to down-size generation ...from page 1

conference call.

The decision to divest the company's merchant generation in the Midwest followed the Ohio Public Utilities Commission February 13 rejection of Duke Energy Ohio's request to recover additional cost associated with the fleet. Duke expects it will take at least 12 months for Duke to find a buyer, secure needed regulatory approvals, and close on the sale of its Midwest merchant units.

Duke suggested that the 6,600 MW of merchant units in the Midwest will sell for between $1.5 billion and $2.5 billion. Young did not provide that sale-price estimate, but acknowledged that the net book value of the merchant units is $3.5 billion, and that Duke expects to take a pre-tax impairment charge of between $1 billion and $2 billion in the first quarter of 2014 to reflect the difference between the units' book value and the expected sales price.

Duke Energy Progress is in talks with North Carolina Eastern Municipal Power Agency about acquiring the municipal utility group's minority interests in five nuclear and coal-fired units that are operated and primarily owned by DEP. NCEMPA's stakes in the units total about 700 MW.

Good and Young also said DEP is seeking regulatory approval to build a 750-MW, gas-fired combined-cycle unit in South Carolina that would begin commercial operation in 2017, and that—depending on the outcome of an ongoing request for proposals—Duke Energy Florida may build additional gas-fired capacity in Florida.

DEF in October 2013 issued an RFP for combined-cycle capacity deliverable starting in 2018, and said it would compare the responses it receives to a plan to self-build a 1,640-MW combined-cycle plant in Citrus County, near DEF's existing Crystal River station. The RFP netted six power supply responses from six bidders by the December 9 bid deadline, and DEF has said it plans to identify a short list of favorable proposals in March, with finalists named in May and a winner announced in August.

"An additional growth opportunity is the potential for gas infrastructure investments across our regulated jurisdictions," said Young. "We intend to explore the viability of additional pipeline capacity into various jurisdictions to expand the infrastructure necessary to continue to support our expanding gas-fired generation fleet."

Good said the likely focus for possible gas pipeline development would be in the Carolinas, where DEC and DEP added gas-fired generation in recent years. "This is something that is on our radar screen for strategic growth … that we would like to achieve. We also think it's important for reliability for customers and so we will be exploring that over the next year or two to see if an investment makes sense," she said.

Good said Duke also sees "opportunities to continue to grow our renewables platform … and expect a greater mix of solar in our capital deployment. We are targeting $400 million of renewables capital annually and we have the potential to deploy more if opportunities arise."

The company also sees commercial transmission options through its joint venture with American Transmission Co. "We expect a project from this venture to mature over the next several years," said Good.

She provided an update on the new Edwardsport integrated gasification combined-cycle unit, which is owned by vertically integrated utility Duke Energy Indiana and not part of the planned merchant generation sale. The utility completed General Electric's new product introduction testing and is "working towards conducting required performance tests. Testing has been delayed in early 2014 because of the extreme cold weather in the Midwest, which has decreased plant output, but we expect to continue tuning and systems optimization and preparation for final testing. All major technology systems have been validated," Good said, and the project cost estimate remains at $3.5 billion.

— Housley Carr

FERC defends authority against Barclays ...from page 1

appeals court decision finding that the Commodity Futures Trading Commission has exclusive jurisdiction over futures markets does not apply in this case, noting that the CFTC itself gave FERC the go-ahead to pursue the case.

FERC and Barclays are on opposite sides of a closely watched federal court suit over allegations that the bank and four of it its former energy traders — Daniel Brin, Scott Connelly, Karen Levine, and Ryan Smith — manipulated electricity prices in California between 2006 and 2008. Specifically, FERC alleged that Barclays and the traders built and then flattened substantial monthly physical index positions at four of the then-most liquid trading points in the West for what the commission said was the fraudulent purpose of manipulating a daily IntercontinentalExchange index price to benefit the bank's financial swap positions.

The commission ordered the parties to pay roughly $488 million in fines and disgorged profits. The court is hearing the