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Supreme Court limits but upholds EPA GHG rule

GENERATION The US Supreme Court on Monday upheld the main thrust of the Environmental Protection Agency's efforts to restrict greenhouse gas emissions from new stationary sources, such as power plants and factories.

Even though the court ruled that EPA over stepped its authority when it crafted its "tailoring" rule to exert its jurisdiction over GHG emissions, the court gave the agency another means to achieve that end.

- **Decision seen as victory for EPA**
- **May affect Clean Air Act 111(d) rule**

The court's ruling applies to EPA new source performance standards, or NSPS, that seek to limit GHG emissions from new

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Wisconsin Energy buying Integrys for $9.1 billion

MERGERS & ACQUISITIONS The $9.1 billion acquisition of Integrys Energy Group by Wisconsin Energy creates "the leading electric and natural gas utility in the Midwest," Wisconsin Energy Chairman and CEO Gale Klappa said Monday, and continues the trend of utilities moving away from unregulated businesses.

The transaction calls for Wisconsin Energy to buy Integrys for $71.47/share, which represents a 17.3% premium to the June 20 closing price.

- **Market capitalization of $15 billion**
- **Sale of Integrys Energy Services in the works**

The merged company, to be known as WEC Energy Group,

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PJM capacity auction may spur M&A activity

ANALYSIS The doubling of prices in PJM's recently concluded capacity auction and strength in energy prices in the region could be serving as a catalyst for power sector asset sales.

At least three deals have been announced since the capacity auction closed at the end of May. To be clear, recent market fundamentals did not provide the rationale for those deals, which have been in the works for quite some time, but they could have contributed to the timing.

"I think it is fair to say that sentiment around merchant assets may have improved, bringing in more buyers and valuations to a level where sellers are willing to sell," Swami Venkataraman, vice president and senior credit officer, global project and infrastructure finance at Moody's Investors Service, said.

That is a view shared by market participants who also say that

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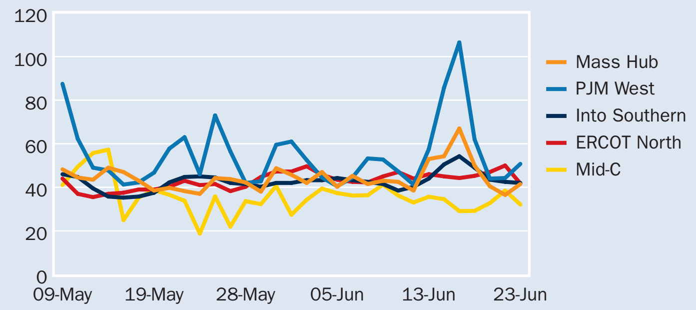
Price trends at key trading points ($/MWh)



Source: Platts

Low and high average day-ahead LMP for Jun 24 ($/MWh)

	On-peak low	On-peak high	Off-peak low	Off-peak high
ISONE	44.06	48.76	27.26	29.60
NYISO	40.10	48.03	24.35	27.85
PJM	44.03	59.01	23.54	30.05
MISO	42.59	50.38	22.01	36.11
ERCOT	41.90	45.29	31.77	32.06
SPP	40.17	43.92	18.80	26.21
CAISO	45.90	49.61	32.41	33.13

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 Jun 24

	Index	Marginal heat rate	Spark spreads @7k	@8k	@10k	@12k	@15k
Northeast							
Mass Hub	41.50	12242	17.77	14.38	7.60	0.82	-9.35
N.Y. Zone-A	42.50	12599	18.89	15.51	8.77	2.02	-8.10
PJM/MISO							
PJM West	50.75	15704	28.13	24.90	18.43	11.97	2.28
Indiana Hub	43.25	9569	11.61	7.09	-1.95	-10.99	-24.55
Southeast & Central							
Southern, Into	42.00	9412	10.76	6.30	-2.63	-11.55	-24.94
ERCOT, North	41.75	9543	11.13	6.75	-2.00	-10.75	-23.88
West							
Mid-C	32.11	7489	2.10	-2.19	-10.77	-19.34	-32.20
SP15	51.50	11123	19.09	14.46	5.20	-4.06	-17.95

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

technology make it essential that accurate assessments of energy consumption are used, and that many categories of electronics are inappropriate for government efficiency standards.

"If older data is used to analyze potential energy policy decisions, such as voluntary or mandatory regulatory programs, it can lead to less effective policy decisions that may not achieve the end goals," Doug Johnson, CEA's vice president of technology policy, said in a statement.

"The Environmental Protection Agency applauds the electronics industry for the efficiency innovation that underlies the findings of this new study," said Ann Bailey, director of the Energy Star Products Program.

— Tom Tiernan

Supreme Court limits but upholds rule ...from page 1

stationary sources. It does not apply to the draft rules EPA released June 2 that cover GHG emissions from existing stationary sources.

The agency was ordered to write the rule as a result of a 2007 Supreme Court decision, Massachusetts v. Environmental Protection Agency, that held that GHG emissions are subject to Clean Air Act regulation.

Because a strict interpretation of carbon dioxide emissions would have included a multitude of sources at great cost to the economy, EPA crafted its tailoring rule, which created a 100,000 tons/year threshold for GHG emissions. That emission level was far higher than the 250 tons/year threshold for stationary sources under the Clean Air Act's "prevention of significant deterioration" provisions or the 100 tons/year threshold under Title V of the law.

The Supreme Court ruled that EPA lacked authority to tailor the Clean Air Act's "unambiguous numerical thresholds." And the court said that the tailoring rule would give EPA newfound authority to regulate CO2 from millions of small sources such as shopping centers and apartment buildings. "We are not willing to stand on the dock and wave goodbye as EPA embarks on this multiyear voyage of discovery," Justice Antonin Scalia wrote for the majority in the 5-4 decision.

However the Supreme Court upheld EPA's authority to regulate GHG emissions under its authority to require "anyway" sources seeking a PSD permit to use best available control technology to restrict emissions of pollutants.

The "anyway" limitations refers to EPA's proposed phase in of its NSPS rules under which no source would be newly subject to PSD or Title V based solely on their GHG regulations, but sources that would be required to obtain permits anyway because of their emission of conventional pollutants would have to comply with BACT for GHG if they emitted those gases in significant amounts defined as at least 75,000 tons/year of CO2 equivalent.

In its analysis, the Supreme Court said anyway sources cover 83% of stationary sources of GHG emissions, while including non-anyway sources would have expanded EPA's jurisdiction by only three percentage points to 86% of stationary sources.

So even though the Supreme Court said EPA's methodology in its tailoring rule was wrong, "it gave EPA a different methodology with the same outcome," Benjamin Salisbury, senior vice president with FBR Capital Markets, said in an interview.

"In terms of practical effect, this is still a win for EPA," said Andrew Skroback, counsel with Chadbourne & Parke.

But at least one observer of EPA rules sees some practical implications of Monday's decision that favor industry. Jeffrey Holmstead, a partner with Bracewell & Giuliani, says he knows of at least four projects – two refineries, one chemical plant and a natural gas-fired power plant – that will likely withdraw their Title V permit applications as a result of the decision.

All four were making modifications to existing facilities that did not trigger the need for a permit for conventional pollutants, but under the tailoring rule had to file a permit application. Under the Supreme Court's decision, the Title V trigger would also be the NSPS trigger, so the developers of those projects would not need a permit, Holmstead said.

The decision (Utility Air Regulatory Group v. Environmental Protection Agency, 12-1146) comes in the wake of a pair of victories for the EPA. In April, the Supreme Court upheld EPA's Cross-state Air Pollution Rule, and in December, the US Court of Appeals for the District of Columbia Circuit upheld EPA's Mercury and Air Toxics Standards rule. But Monday's decision could signal that the tide could turn EPA CO2 rules, according to Holmstead.

On June 2, the EPA released its draft rules limiting CO2 emissions from existing sources. The rule uses Section 111(d) of the Clean Air Act as its basis for limiting CO2, and relies on best system of emission reductions as opposed to BACT.

"The language in the decision shows that EPA could have an uphill battle with 111(d)," Holmstead said. He cited a section of the decision treating EPA's interpretation of PSD and Title V triggers that calls that interpretation "unreasonable because it would bring about an enormous and transformative expansion in EPA's regulatory authority without clear congressional authorization."

The decision goes on to say, "When an agency claims to discover in a long-extant statute an unheralded power to regulate 'a significant portion of the American economy,' … we typically greet its announcement with a measure of skepticism."

That language certainly seems to apply to the wide scope of EPA's 111(d) rules, Holmstead said, and at a minimum shows that at least the five justices who agreed on that view are likely to challenge EPA's CO2 rules for existing sources.

— Peter Maloney

Wisconsin Energy buying Integrys ...from page 1

would boast a $15 billion market capitalization and serve 1.5 million electric and 2.8 million natural gas customers in Illinois, Michigan, Wisconsin and Minnesota. It would control more than 8,800 MW of generation, more than half coal-fired, and it would own 60% of American Transmission Co., based in Pewaukee, Wisconsin.

The deal is scheduled to close in June 2015, assuming it secures regulatory approvals from the four states as well as from the Federal Energy Regulatory Commission and Federal Trade Commission.

Klappa, who would head the merged company, said the merged company is expected to grow earnings by at least 5% annually, with 99% coming from the regulated side of the business.

Chicago-based Integrys is in the late stages of spinning off its Integrys Energy Services competitive subsidiary, currently operating in 23 states. IES supplies electricity to more than 1 million residential and 6,000 commercial and industrial customers in 14 states and natural gas to 200,000 residential and 2,500 C&I customers in 23 states, according to company spokeswoman Jennifer Block.

Charlie Schrock, Integrys' chairman and CEO who intends to retire once the transaction is final, said as his company evaluated its existing operations, "we realized Integrys Energy Services would be better served under a different owner." Who that owner will be, neither Schrock nor other Integrys officials would say.

IES is in the third and final year of supplying power to the city of Chicago under the nation's largest government electric aggregation. Partly for that reason, David Kolata, executive director of the Citizens Utility Board, said he is concerned about the possible impact of the merger on the Chicago power arrangement.

"This raises a lot of questions," he said. At this point, it is impossible to know how, or even if, the Chicago aggregation contract might be affected. "Ultimately, you want to make sure consumers get a good deal," he added.

Kolata said he also was surprised Wisconsin Energy, at least initially, did not offer any concessions to sweeten the pot for customers. "Normally, you often see an acquiring company make some concessions to consumers. We have not seen that yet," he said.

Klappa said that unlike many utility mergers, the pending combination is not predicated on anticipated synergies. "But when you look at the combination, the rate base growth, free cash flow, and assuming normal return on equity, this is accretive, and we believe the combined company can grow at 5-7% annually," he said.

Before he pulled the trigger on the deal, Klappa said the sale was able to meet all of his company's acquisition criteria: accretive to earnings starting in the first calendar year of combined operations; largely credit neutral; and long-term growth prospects of the combined entity greater than or equal to the stand-alone company.

"The combination is compelling for our shareholders, who will receive an attractive premium for their investment," added Schrock.

The combined company is expected to maintain its "historic levels of community involvement and charitable contributions," Klappa said. WEC Energy Group would have corporate headquarters in Milwaukee, with operating headquarters in Chicago, Milwaukee and Green Bay, Wisconsin.

Klappa, in response to a question during a call with analysts, said there are no plans to sell ATC, of which Integrys currently owns 34% to 26% for Wisconsin Energy. ATC, he noted, is preparing for major investments between $3 billion and $3.6 billion over the next 10 years.

As the 60% owner of ATC, he conceded, WEC Energy Group will have "more flexibility" over ATC's future direction. "We've been pleased with everybody being on the same page" with ATC's investment plan, he said.

Paul Patterson, a Glenrock Associates analyst, said in an interview following the conference call that the corporate marriage involves two utilities "that are pretty well valued. They're approximate to each other." And while Klappa downplayed the notion that the deal is synergistic, Patterson said, "It's hard to believe there won't be some" synergies.

Integrys, he said, "has been moving away from unregulated and getting more and more regulated, and Wisconsin Electric for some time has already been there. This shows a continuing interest and value being associated with the regulated utility business."

— Bob Matyi

PJM auction may spur M&A activity ...from page 1

the auction results will spur sales of existing plants as owners look to take advantage of pricing and buyers looking for assets see prices as a sign of market strength.

Recently announced deals include agreement between PPL and Riverstone Holdings to combine their merchant generation assets into Talen Energy, a new publicly traded company that will have 15,320 MW of capacity, making it the third largest US independent power producer by installed generation.

More recently, Energy Investors Funds on Friday bought the 50% interest it did not already own in a controversial 705-MW gas-fired project under development in Newark, New Jersey, by Hess.

The Newark project, which is due to begin selling electricity into PJM in May 2015, was developed under a New Jersey law that provides subsidies for new in-state power plants. A federal court ruled against the law, but the state has appealed the ruling.

A third deal does not involve generation assets but calls for Exelon to buy Pepco Holdings' three electric and gas utilities in PJM: Atlantic City Electric, Delmarva Power, and Pepco.

The fundamentals providing the backdrop to the recent deals are the $120/MW-day clearing price in PJM's capacity market, which was twice the clearing price of the previous auction, and a spike in prices this winter during several weeks of extreme cold weather.

Historically power prices have peaked in the summer, but this winter's experience is causing some analysts to see a shift to a winter peak system or a double peak system.

That is also reflected in the expansion of heat rates, a measure of a power plant's efficiency and indicator of profitability. Platts one-year forward heat rates moved from 11,555 Btu/kWh at year end to 13,159 Btu/kWh at the end of last week.

"There is a floor being put in at $120," Aneesh Prabhu, senior director, Standard & Poor's Ratings Services, said. "And there is some certainty that we are not going to have significant volatility" in coming capacity auctions.

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Those stronger fundamentals could prompt a more favorable environment for reaching a deal on some of the many assets on the block in PJM.

On the top of any list of possible deals are the so-called "Ohio assets" of three utilities – American Electric Power, Dayton Power & Light, and Duke Energy – that are under regulatory mandates to transition their regulated generation to the merchant market.

AEP has already transferred 11,500 MW into an unregulated subsidiary. Duke has 6,837 MW of unregulated capacity in its commercial division, and DP&L has a 3,453-MW fleet that could be up for sale.

In addition there are also several utility owned coal plants that could be looking for a new home in the face of stricter emissions standards that begin to take effect next year.

Analysts say that other utilities would likely steer clear of those assets, but private equity could be interested buyers. And their appetite could be whetted by experience this winter when many coal plants enjoyed robust margins during the coal weather price spikes.

Among them are assets such as the 1,273-MW Brandon Shores coal plant that Exelon sold, along with two other coal plants in Maryland, to Raven Power Holdings, a unit of Riverstone.

Those three plants account for about half of the 5,325 MW that Riverstone is contributing to Talen and, if successful, could provide a format for other private equity players seeking exit strategies for their investments in PJM.

— Peter Maloney

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