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Exelon's purchase of FitzPatrick likely to boost profitability, analysts say

The sale of zero-emissions credits will make Entergy's 849-MW FitzPatrick in New York profitable for its potential owner, Exelon Generation, but a finalization of plans for the Chicago-based company to buy the unit could be threatened by provisions in the agreement that would void it if the credits are not assured, analysts said.

The purchase agreement the companies jointly announced August 9 is contingent on the state next year implementing a 12-year zero-emissions credit, or ZEC, plan, an uncertain scenario given the possibility the plan could be challenged in court by rival, non-nuclear generators in the state, one of the analysts said.

Exelon said in the statement it “has committed to refueling FitzPatrick in January 2017," the target date Entergy had set in July for permanently shutting the unit unless a sale were completed. The statement added that Exelon "will reinvest ... [about] $400 [million]-$500 million in operations, integration and refueling expenditures for the upstate plants in spring of 2017."

The New York Public Service Commission plan, adopted August 1, created a Clean Energy Standard, or CES, specifying that FitzPatrick, as well as Exelon's 597-MW Ginna, 640-MW Nine Mile Point-1 and 1,362-MW Nine Mile Point-2, will receive a ZEC of $17.48 for each megawatt-hour produced during the first of six two-year periods beginning April 1, 2017 to March 31, 2019. ZECs paid to designated nuclear generators would increase with time, tentatively reaching $29.15/MWh for the period from April 1, 2027 to March 31, 2029.

The ZEC is an off-take agreement to buy power to ensure the continued operation of an electricity generator. The ZEC sets a price to buy power that may be above prevailing rates to provide financial support to a power generator, according to a July 8 proposal by the PSC to create ZECs.

The plan requires that designated nuclear power plants participate in the program through all six two-year periods and sell the ZECs to the New York State Energy Research and Development Authority. All entities providing electric service to end-users and wholesale customers will be required to purchase ZECs from the authority and may not trade them.

Noting the “Exelon acquisition of FitzPatrick is a direct result” of the PSC’s approval of ZECs, Edward Kee, CEO of Nuclear Economics Group, said in an August 9 email, “Additional revenue from the sale of ZECs should mean that FitzPatrick is profitable, and Exelon may be able to integrate FitzPatrick with the Nine Mile Point units to better manage operating costs.”

The two plants are about one-quarter mile apart, Jackie Zaborowski, a market coordinator with the Oswego, New York, Chamber of Commerce, said in an August 10 interview.

“The same ZEC revenue should also mean profitable operation of the Ginna and Nine Mile Point units,” Kee said.

The aggregate cost of the proposed zero-emissions credits, or ZECs, during the first two years beginning April 1, 2017, “amounts to nearly $1 billion in costs to ratepayers and this is a staggering amount,” Michael Ferguson, an analyst with S&P Global Ratings, said in a July 12 interview. S&P Global Ratings, like Platts, is owned by S&P Global.

Ferguson said in an August 10 interview “from a credit perspective, it’s a net positive for Entergy,” as the company “further limits its [deregulated market] merchant plant exposure and FitzPatrick was not a cash cow. That’s why Entergy was planning on closing it.” In addition, Ferguson said that since “Entergy has written down [the value of FitzPatrick for accounting purposes], anything it can get for the plant is gravy.”

The $110 million Exelon has agreed to pay for the unit “would seem like a reasonable price tag to buy a plant” whose operating license is valid through 2034, he said.

In addition, he said, “for Exelon there is some hope that it will see operating benefits in cost savings by having two plants operating in close proximity to each other.”

Risk that payments could 'walk back'

However, Ferguson said “there is some risk” associated with Exelon’s acquisition of FitzPatrick, based in part on the additional income the ZECs would produce. “With the ZEC program going out for 12 years, you do have to wonder whether or not there will be some willingness at some point after the first [two-year] period to walk this back, revise it,” he said. “It’s a policy decision, governors change and the ZECs are not etched in stone,” he said.

The PSC, in a July 8 report soliciting public comment on the plan, said that "the total attribute payments are calculated to be up to $965 million” during the first two years of the ZEC program and estimated economic and environmental benefits are $5 billion, “for a net benefit of $4 billion."

Margaret Harding, president of consulting company 4 Factor Consulting, said in an August 9 email that nuclear “plants that are struggling the most in today’s unregulated electricity markets tend to be the single unit plants like FitzPatrick. So, it was a natural push for Exelon to pick up the plant," Harding said, "and bring all three plants in that location into a single site management plan. The potential cost savings could be quite significant in terms of plant security personnel and maintenance staff."

"There are too many variables" to quantify the savings, Harding said in an August 10 email, but noted that "multiunit sites see lower $/MWhr in Operation and Maintenance" costs.

Harding categorized the adoption of ZECs as "a watershed moment" for nuclear energy, saying it constitutes a "recognition that nuclear is a major source of carbon free electricity," even though the ZECs are lower than the $23/MWh subsidy the state makes available for renewable generation and a federal renewable production tax credit of $22/MWh.

Still, Harding said the ZECs "will keep all of those [upstate New York] plants running at least a few more years," but said she could not be specific about for how long, noting that regulatory and market changes and natural gas prices going forward are "uknowns."

"Exelon would be unlikely to enter into a deal for FitzPatrick unless it sees a lifetime greater than 5 years," she added.

However, Kee said in his August 9 email, "A key issue is whether challenges to the New York ZEC approach will slow or stop the revenue to New York nuclear power plants."

Change in economic prospects

Paul Patterson, an analyst with Glenrock Associates, said in an August 9 email that "the FitzPatrick sale announcement appears to provide tangible evidence that New York's sizable nuclear subsidy has substantially changed the economic prospects for some of the upstate nuclear plants."

Patterson, in an August 2 interview, said he expects the PSC plan will face legal challenges, noting 11 New York state electricity generators said in a July 22 brief filed with the PSC that an April decision by the US Supreme Court ruled illegal Maryland's plan to incentivize new generating facilities with targeted subsidies.

The court ruled in Hughes v. Talen Energy Marketing that Maryland's electricity plan illegally pre-empted the Federal Energy Regulatory Commission's jurisdiction over wholesale interstate electricity rates.

Tyson Slocum, energy program director with consumer advocate group Public Citizen, said in an August 9 interview that the anti-nuclear group is considering whether to file objections with FERC to the ZEC plan and to challenge Exelon's purchase of FitzPatrick, saying, "We think New York giving these subsidies violates FERC's rules."

The 11 companies said the Federal Power Act prevents the PSC from approving the proposal because such approval "interferes with the FERC’s exclusive jurisdiction under the [Federal Power Act] to set rates for the wholesale sale of energy and capacity.”

Ari Peskoe, senior fellow in electricity law at Harvard Law School, said in an August 9 email: “Under Hughes a state may not invade FERC's regulatory turf by adjusting the rate of a sale of energy or capacity in a federally regulated market.”

However, Peskoe said, “New York has avoided that prohibition by setting compensation for attributes of the power that are not sold in the ISO markets. While I don't think that the ZEC program is preempted under Hughes, I have no doubt that challengers will deploy other legal arguments against New York.” For example, he said, “the challengers may argue [before FERC] that ZECs distort market prices.”

Sale depends on conditions

The FitzPatrick sale and license transfer is contingent "upon regulatory review and approval by state and federal agencies," including FERC, the US Department of Justice, NRC and the New York State Public Service Commission, the companies' statement said. It added that "the transaction is expected to close in the second quarter of 2017."

The FitzPatrick sales agreement contains provisions that could void the sale. It stipulates the deal "will automatically terminate on November 23, 2016, if certain conditions are not satisfied by November 17, 2016." These include "the continued effectiveness of the order" the PSC issued creating the ZEC, according to Entergy's 8-K filing August 9 with the US Securities and Exchange Commission.

In addition, Entergy's SEC filing said that if prior to refueling FitzPatrick any condition in the sale agreement "is overturned, reversed or enjoined, either buyer or [Entergy] can terminate the Asset Purchase Agreement."

Entergy spokeswoman Patricia Kakridas said in an August 9 email that Entergy "will initiate application filings with the New York Public Service Commission, FERC, and the NRC related to the transfer of ownership of FitzPatrick and the transfer of the plant's operating license and decommissioning trust fund. The first such filing will be with the NY PSC to seek approval of the transaction."

In addition, the agreement provides that the New York Power Authority, which previously owned FitzPatrick and retained the unit's decommissioning trust fund, "has agreed to transfer the decommissioning trust fund and liability for FitzPatrick to Entergy, and if regulatory approvals are obtained and the transaction closes, Entergy would then transfer the fund and associated liability to Exelon," the statement said.

Bill von Hoene, Exelon's senior executive vice president and chief strategy officer, said during the company's analysts day in Philadelphia August 10 that Exelon plans to refuel FitzPatrick in January subject to three conditions. First, the New York state Clean Energy Standard order must be "in full effect. That is essentially happening," he said. Second, the 12-year contract for ZECs with the New York State Energy Research and Development Authority must be executed, which "would ensure a regular, regulated income stream for operation" of FitzPatrick, Nine Mile Point and Ginna during that period, von Hoene said. Third, the PSC must have issued its order approving the FitzPatrick purchase, he said.

"We do not anticipate there will be any issues with any of those" conditions, and "are looking forward to having FitzPatrick in our fleet," he said.

Program resembles renewable credit one

Von Hoene acknowledged that legal challenges to the ZEC plan are possible in court and before FERC, but he said Exelon is confident the plan will withstand such challenges.

The ZEC program "is essentially indistinguishable" from renewable energy credit, or REC, programs in other states that have withstood legal challenges, he said. No REC program in the country based on similar principles to the ZEC approach have been successfully challenged, he noted.

FERC ruled a few years ago that sales of RECs "are outside its jurisdiction," von Hoene said.

An analysis of adding FitzPatrick to the Exelon fleet appears to show it meets anti-trust requirements, "so we don't think there will be any basis under which this regulatory approval will not swiftly go through," he concluded. The analysis is based on an index used to measure market concentration, he said.