

Thursday, October 22, 2015 2:51 PM ET  Extra

AEP expects PPA decision by year-end; still no decision on merchant sale

By Darren Sweeney

American Electric Power Co. Inc. expects Ohio regulators to decide by the end of the year whether to grant its controversial request to guarantee income for certain power plants, which will be followed by a decision on the sale of AEP's merchant fleet.

"It certainly should be settled by the end of the year," AEP Chairman, President and CEO Nicholas Akins told analysts and investors Oct. 22 during the company's third-quarter earnings call.

Akins said it has been nearly two years since AEP subsidiary AEP Ohio filed its proposed electric security plan and power purchase agreement, or PPA, with the Public Utilities Commission of Ohio.

"I certainly believe there's recognition by the commission that they do need to make this decision," he said. Akins noted that AEP and FirstEnergy Corp., which also has filed a PPA with the state, "need to get on with the investment and the decisions that need to be made relative to these assets."

AEP Ohio, the trade name of Ohio Power Co., is seeking an income guarantee for its share of two Ohio Valley Electric Corp., or OVEC, coal plants and four coal plants owned by AEP Generation Resources. While the company's original PPA proposal tied to the OVEC assets was rejected by PUCO, it is involved in a lengthy hearing on its expanded PPA plan in which it hopes that regulators will ultimately approve income guarantees for all six plants. (Case No. 14-1693-EL-RDR)

"We've given the recipe. The recipe is there and certainly it drives a positive solution for the customers, for Ohio, and the commission certainly has the track record to be able to put that kind of thing in place that holds up," Akins said.

The PPA is expected to be a vital part of what AEP decides to do with its Midwest generation assets since the AEP Generation units tied up in the PPA are part of the strategic evaluation process.

"We'll have a result pretty soon and the PPA is very, very important to our standing in Ohio overall and whether we keep that portion of the generation or not, but it doesn't change the objectivity and the measured approach that we're using to go through this process to ensure that we're making the right decisions for our shareholders," Akins said. "Because we get a PPA doesn't mean, certainly, that the process is off for any of the remaining generation that's not covered by that type of PPA. We're looking at this very straightforward and we've been very consistent in our discussions."

"I think there's still a set of buyers out there," Akins said in response to an analyst's question about the impact of weakness in IPP stocks on a potential sale of generation assets.

The CEO added that while a spin option is "still on the table," it is more difficult because of "the paper involved" in that type of deal.

Akins, however, also said the timing of a PPA decision and the decision itself "won't negate the discussion" about a merchant sale.

"We're sort of ambivalent whether — assuming the PPA addresses our concerns as certainly being long-term ... and as well some of the other provisions to ensure that we're able to make it quasi-regulated — then we're somewhat ambivalent as to whether we hold those units or not," he said. "I think it certainly bodes well for our ability to hold on to those units and still be a regulated utility. For the remaining assets that aren't covered by the PPA, there's still a process ongoing."

Potential settlement

While many industry observers believe PUCO and its staff have basically laid out the guidelines for a potential settlement in the PPA cases, AEP is not yet willing to amend its contract term that seeks income guarantees for the life of the assets.

"The term has to be substantial because we have to have a feeling that we can invest, and with the large capital investments that we make in generation, we need to know that we can do that and be secure from a future perspective," Akins said. "When we talk about long term, it has to be substantial enough for us to make that kind of investment. I'm not going to say an actual number at this point because we have life of plant sitting out there, and that's what we believe [is] what it takes. We'll wait and see what it winds up being, but I can tell you this, three years, which is the length of the capacity deal in PJM ... that's not long enough. That's a problem within PJM, and the state has an opportunity to fix that."

The CEO said there has been "a lot of chatter and a lot of discussion with multiple parties in this case."

"It's a complex issue," Akins said. "Certainly, we continue to have conversations and certainly, [FirstEnergy] can speak for themselves, but we both have the firm belief that there needs to be some kind of support for this generation in Ohio, and it's really a discussion around what those mechanisms would look like."

Akins added that it is "not likely" that AEP would execute a sale of its generation business before the PPA issue is resolved.

"We're looking for an overall answer to this," Akins said. "Obviously, if the PPA is not put in place, then we have a larger amount of generation that we have to go through this process with."

Akins also indicated that AEP is unlikely to put the other generation units into a new income-guarantee proposal if its PPA request is approved.

"I would say that the open units that are not included in the PPA, we're not going to assume that they're going to be brought back in at some later time," Akins said. "We really don't have the time for that."

Guggenheim Securities LLC said it believes AEP management "is engaged in settlement discussions, and expect an agreement will ultimately be reached."

"This confirms our view that strategic decisions in Ohio will come very soon," analyst Shahriar Pourreza wrote in an Oct. 22 research report. "In our view, AEP would agree to a settlement as long as the terms were at least reasonable, so we estimate potential earnings impacts using an 11% ROE on the 3GW. We assume AEP sells the remaining 5GW (which is more marketable) at a transaction value of \$1.9 [billion]-[\$]2.3 billion, or \$376-[\$]450 per KW."