Public Service Enterprise Group Incorporated (PEG) CEO Ralph Izzo on Q3 2019 Results- Earnings Call Transcript

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Q3: 10-31-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.98 beats by $0.03 | Revenue of $2.3B (-3.84% Y/Y) misses by $-366.08M

Earning Call Audio

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Public Service Enterprise Group Incorporated (NYSE:PEG) Q3 2019 Earnings Conference Call October 31, 2019 11:00 AM ET

Company Participants

Carlotta Chan - VP, IR

Ralph Izzo - Chairman, President and CEO

Daniel Cregg - EVP and CFO

Conference Call Participants

Julien Dumoulin-Smith - Bank of America

Praful Mehta - Citi

Greg Gordon - Evercore

Christopher Turnure - JPMorgan

Shahriar Pourreza - Guggenheim Partners

Travis Miller - Morningstar

Paul Patterson - Glenrock Associates

Michael Lapides - Goldman Sachs

Paul Fremont - Mizuho

Sophie Karp - KeyBanc

Operator

Ladies and gentlemen, thank you for standing by. My name is Sylvia and I will be your event operator today. I would like to welcome everyone to the Public Service Enterprise Group's Third Quarter 2019 Earnings Conference Call and Webcast. [Operator Instructions]

As a reminder, this conference is being recorded today, October 31, 2019 and will be available for telephone replay, beginning at 1:00 PM Eastern Standard Time today until 11:30 PM Eastern Standard Time on Friday, November 8, 2019. It will also be available as an audio webcast on PSEG's corporate website at www.pseg.com.

I would now like to turn the conference over to Carlotta Chan. Please go ahead.

Carlotta Chan

Thank you, Sylvia. Good morning, and thank you for participating in our earnings call.

PSEG's third quarter 2019 earnings release attachments and slides, detailing operating results by company are posted on our website at investor.pseg.com and our 10-Q will be filed shortly. The earnings release and other matters discussed during today's call contain forward-looking statements and estimates that are subject to various risks and uncertainties. We also discuss non-GAAP operating earnings and non-GAAP adjusted EBITDA which differ from net income as reported in accordance with Generally Accepted

Accounting Principles in the United States. We include reconciliations of these financial measures and a disclaimer regarding forward-looking statements on our IR website and in today's earnings material.

I'll now turn the call over to Ralph Izzo, Chairman, President and Chief Executive Officer of PSEG. Joining Ralph on today's call is Dan Cregg, Executive Vice President and Chief Financial Officer. At the conclusion of their remarks, there will be time for your questions.

Ralph Izzo

Thank you, Carlotta, and thank you all for joining us this morning.

PSEG reported non-GAAP operating earnings for the third quarter of 2019 of $0.98 per share versus $0.95 per share in last year's third quarter. Our GAAP results for the third quarter were $0.79 per share compared with $0.81 per share in the last year's third quarter.

Our results for the third quarter bring non-GAAP operating earnings for the year-to-date to $2.64 per share compared with $2.56 per share for the first nine months of 2018. That is up 3%. Regulated operations are on track to contribute approximately 75% of total op earnings for the year, and reflect PSE&G's ongoing investment in New Jersey's energy infrastructure.

Slide 6 and Slide 7, summarize the results for 2019's third quarter and year-to-date. In September, the New Jersey, Board of Public Utilities and I'll refer to them as the BPU approved PSE&G's Energy Strong II settlement authorizing continued investment in electric and gas system reliability and resiliency improvements, over the next four years.

We expect to begin the first of these projects in the current quarter, which will continue the important economic engine associated with PSE&G's investments in New Jersey's energy infrastructure.

We continue to eagerly pursue PSE&G's Clean Energy Future filings to bring the benefits of energy efficiency, electric vehicles, energy storage and Advanced Metering Infrastructure or AMI, at scale, to our entire customer base which is consistent with Governor Murphy's clean energy goals.

Our filing is designed to achieve the 2% electric and 0.75% gas savings contained in the 2018 New Jersey Clean Energy Act. And this represents an order of magnitude increase from the level of spending in our existing Energy Efficiency Program.

In September, the BPU approved the extension of the procedural schedule in the case to March 2020, to provide the opportunity for additional discussions. We expect that the BPU's review of our energy efficiency proposal and Clean Energy filing, will be informed by their Energy Master Plan proceedings, which are targeted for conclusion at year-end, and an ongoing energy efficiency stakeholder process, which will continue into 2020.

In parallel, we continue to engage with key stakeholders to develop the supporting policy framework, on the role for utilities, decoupling or loss revenue recovery and key metrics to measure Energy Efficiency Program effectiveness. Because our energy efficiency proceeding is ongoing, the BPU's review of it will occur prior to those of New Jersey distribution companies that have yet to file their energy efficiency proposals, to satisfy the Clean Energy Act requirements.

Though PSE&G remains on track to invest $2.7 billion in infrastructure upgrades to its transmission and distribution system this year, the forecast to direct over 90% of PSEG's $13 billion to $15.5 billion of planned capital investment to the regulated business over the next five years, remains intact. As this PSE&G's compound annual growth and rate base of 7.5% to 8.5%, starting from the $19 billion level at year-end 2018.

And now over to PSEG Power. Power closed on the sale of its 776 megawatt interest in the Keystone and Conemaugh generating units during the quarter, the sale continues the elimination of coal from PSEG Power's fuel mix by mid 2021, when we will retire our only remaining coal unit located at Bridgeport Harbor.

In the last five years, PSEG Power has retired early or sold about 2,400 megawatts of coal-fired generation, which has reduced the carbon intensity of what was already a low carbon fleets. In addition, earlier this week, PSEG exercised an option on Orsted's Ocean Wind project, resulting in a period of exclusive negotiation for PSEG to potentially acquire a 25% equity interest in the project, subject to negotiations toward a joint venture agreement, advanced due diligence and any required regulatory approvals.

The Ocean Wind project was the winner of New Jersey's recent offshore wind solicitation, and is an important part of Governor Murphy's clean energy agenda. The project scheduled to come online in 2024, will be located off the coast of Atlantic City and will benefit from Orsted's experience in developing offshore wind projects in the US, and internationally.

I'm pleased with the opportunity to apply PSEG's expertise in developing energy infrastructure in New Jersey to expanding the state's resources of zero carbon generation, toward our goal of reducing carbon emissions. And speaking of carbon emissions, PSEG continues to advocate for a national price on carbon. While we understand the significant challenges to advancing climate legislation in the current congress, we recognize the increasing focus on this topic.

So, I hope that remarks I made, yesterday before the Energy subcommittee of the House Energy and Commerce Committee, will only add to the growing call for meaningful action and thoughtful discussion, on how to best address climate change. On a related note, I'm pleased to report that PSEG was again named to the Dow Jones Sustainability Index North America for the 12th consecutive year.

And one last item, we continue to await our final order from the Federal Energy Regulatory Commission to shorten that to FERC in their effort to reform the PJM Capacity Auction with the approval of replacement rules.

We are optimistic that this will occur once the FERC achieves a quorum of three voting commissioners on this particular docket, which could happen after November 29 when Commissioner Glick will be eligible to vote on this matter or when the Senate confirms a new FERC Commissioner.

Given our results in the first nine months of the year, we're narrowing the full-year forecast of PSEG's non-GAAP operating earnings to $3.20 to $3.30 per share, from our original guidance of $3.15 to $3.35 per share. The midpoint of the guidance is unchanged and represents over 4% growth in earnings on the $3.12 per share posted in 2018.

Utility earnings continue to benefit from rate relief and a mid-year re-measurement of the pension plan has raised PSE&G's expected full-year results, to a range of $1,225 million to $1,250 million, up from the utility's original guidance range of $1.2 billion to $1,230 million.

Weak power prices have affected PSEG Power's results to a range of $395 million to $420 million, where we've lowered the upper end of its original guidance, which had originally been proposed $395 million to $460 million.

Guidance for Enterprise and Other is $5 million for the full year. Thank you to our employees for delivering another solid quarter on the operations front, and to recognize the tremendous work that goes into maintaining system reliability and generation availability during the summer.

I'll now turn the call over to Dan for more details on our operating results, and make sure that I'm available for your questions after his remarks.

Daniel Cregg

Excellent. Thank you, Ralph and good morning everyone.

As Ralph mentioned, PSEG reported non-GAAP operating earnings for the third quarter of 2019 of $0.98 per share versus $0.95 per share in last year's third quarter. We've provided you with information on slide 11 regarding the contribution to non-GAAP operating earnings, by business for the quarter and slides 12 and 14 contain waterfall charts that will take you through the net changes in non-GAAP operating earnings, by major business, for the comparable quarter and year-to-date periods versus the prior year.

And now, I'll review each company in more detail starting with PSE&G. PSE&G as shown on Slide 11 reported net income for the third quarter of 2019 of $0.68 per share, compared with $0.54 per share for the third quarter of 2018. For the first nine months of the year, net income was $1.92 per share up 18% from $1.63 per share earned in 2018.

PSE&G's third quarter results were driven by expanded investments in transmission, the settlement of the 2018 distribution rate review, and changes to our pension plan that took effect on July 1 that lowers pension expense during the second half of 2019.

PSE&Gs growth in transmission investment added $0.06 per share to quarter-over-quarter net Income comparisons, including a $0.01 per share positive adjustment for an estimate of the 2019 year-end true up. Electric margin was $0.03 higher than the year ago quarter, driven by rate relief, and higher weather normalized volume. And gas margin was $0.03 higher than the prior year quarter, driven by rate relief. Weather was lower by $0.01 per share, compared to the significantly warmer summer experienced in 2018.

An increase in depreciation and interest expense of a $0.01 per share each, related to PSE&G's expanded capital base, reduced net income comparisons versus the prior year's third quarter. Lower O&M expense was a $0.01 per share favorable comparison, and changes to post retirement benefit or OPEB expenses as well as the split of the pension plan associated with re-measurement of pension expense, effective July 1 at a combined $0.03 per share positive impact on net income compared to the year ago quarter.

The effective tax rate for the quarter, recorded based upon the average annual effective tax rate resulted in a positive $0.01 per share impact, and this effect is just timing between quarters, it's related to the flowback of excess deferred taxes and it will reverse in the fourth quarter.

The New Jersey economy continues to experience positive growth evidenced by the low state unemployment rate in the last 20 years. PSE&G reached a 2019 system peak of 9,753 megawatts this past July, compared to 2018 system peak of 9,978 megawatts.

The Temperature Humidity Index or THI which is used to measure the impact of summer weather on sales was 10% lower in the 2019 third quarter than one year ago or nearly 12% higher than a normal. Weather normalized sales for the trailing 12 months, which provides a longer-term trending data remain relatively flat for electric and was 1% higher for gas.

Residential electric and gas customer growth continues to trend higher at approximately 1% per year. Earlier this month, PSE&G filed with FERC an update through its formula rate for transmission. The annual update is expected to go into effect January 1, 2020 and our transmission investment includes projects that will replace aging infrastructure with modern equipment, including replacing many of our 26 KV lines to extend 69 KV power throughout the state. These projects will improve reliability, resiliency, address voltage issues and increase capacity on the system.

After incorporating these investment plans, and reflecting the completion of returning certain excess deferred taxes during 2019, cost to residential customers will increase by approximately 2%. And I should highlight that PSE&G has been proactive in returning tax reform benefits to transmission and distribution customers, which in total have lowered rates by over $300 million in 2019.

PSE&G invested approximately $2 billion for the nine months ended September 30 in electric and gas transmission and distribution capital projects. For the year, PSE&G expects to invest $2.7 billion to enhance reliability and increase resiliency.

PSE&G's projected capital spending range remains at $12 billion to $14.5 billion over the 2019 to 2023 period, which translates into expected rate based growth at a compounded annual rate of 7.5% to 8.5% applied to $19 billion year-end 2018 rate base. PSE&G's forecast of net income for 2019 has been updated to a range of $1,225 million to $1,250 million from the original range of $1.2 billion to $1,230 million.

Now moving to Power. Power reported non-GAAP operating earnings for the third quarter of $0.29 per share and non-GAAP adjusted EBITDA of $322 million. This compared to non-GAAP operating earnings of $0.39 per share and non-GAAP adjusted EBITDA of $360 million for the third quarter of 2018.

PSE&G Power's net income in the third quarter was impacted by a decline in realized energy prices and lower capacity revenues, that were partially offset by zero emission certificate revenue earned in the quarter.

PSEG Power closed the sale of its interest in the Keystone and Conemaugh coal-fired generating stations during the third quarter, which resulted in a pre-tax loss of $402 million on the nine months ended September 30. Non-GAAP adjusted EBITDA excludes the same items as our non-GAAP operating earnings measure, as well as income tax expense, interest expense, depreciation and amortization expense.

The earnings release and Slide 20 provides you with detailed analysis of the items having an impact on PSEG Power's non-GAAP operating earnings, relative to net income, quarter-over-quarter and we have also provided you with more details on generation for the quarter and for the year-to-date period on slides 21 and 22.

PSEG Power's results for the third quarter reflect a full quarter's impact of the expected reduction in capacity revenues in PJM that offset higher capacity revenues in New England from the addition of Bridgeport Harbor 5.

On a net basis, capacity revenues lowered results by $0.10 per share compared with the third quarter of 2018. Our full quarter ZEC revenues contributed $0.07 per share. Recontracting and the impact of lower spark spreads, which reduced results by $0.05 per share were offset by lower cost to serve load, resulting in no net impact. This reflects an approximately $3 per megawatt hour decline in the average hedge price, compared with your ago quarter.

Gross margin in the third quarter declined to $31 per megawatt hour from $33 per megawatt hour in the year ago quarter. Power prices and natural gas prices were lower across PJM New York and Maryland despite summer weather that was warmer than normal.

Turning to PSEG Power's operations. Total generation output declined by 2% to total 13.3 - 16.3 terawatt hours in the third quarter, reflecting lower market demand and reduced output at Hope Creek, which included a close down of that unit into its scheduled fall refueling outage.

We continue to see weaker wholesale energy prices, resulting from declines in the price of gas and lower loads which also limits the dispatch of older, less efficient CCGTs in an increasingly efficient PJM market.

For the third quarter, PSEG Power's gas-fired CCGT fleet operated at capacity factor of 63% and produced 7.2 terawatt hours of output during the third quarter, up by 3% over the year ago quarter primarily reflecting production from the three new combined cycle gas turbines at Keys, Sewaren and Bridgeport Harbor.

For the quarter-end year-to-date periods, PSEG Power's nuclear fleet operated at a capacity factor of 91% reducing 7.8 terawatt hours and 23.1 terawatt hours respectively, representing 53% of total fleet generation for the year-to-date period.

For the year-to-date period generation production volumes increased by 1.9 terawatt hours to 43.5 terawatt hours, driven by higher combined cycle output of 3.2 terawatt hours, largely due to the three new units, partially offset by lower nuclear and coal output. This difference in generation reflects the one month outage extension at Salem 1 in the second quarter for reactor vessel bulk replacements as well as the decline in Hope Creek's output that I referenced earlier.

Lower prices for power and natural gas continued to dampen generation volumes. In addition, the completed sale of PSEG Power's interest in the Keystone and Conemaugh units will lower forecasted generation volumes by 1.2 terawatt hours in 2019 and by 5 terawatt hours in each of 2020 and 2021, and were reflected in our second quarter 2019 volume updates.

PSEG Power continued to forecast full year output for 2019 of 57 terawatt hours to 59 terawatt hours. The remainder of expected production for the year of 13 terawatt to 14 terawatt hours is hedged at an average price of $37 per megawatt hour. 2020's forecast output of 52 terawatt to 54 terawatt hours is hedged approximately 85% to 90% at an average price of $37 per megawatt hour.

The 2021 PSEG Power has hedged 40% to 45% of forecasted output of 52 terawatt to 54 terawatt hours at an average price of $35 per megawatt hour. The forecast for 2019 to 2021 volumes includes production, consistent with current market conditions and reflects the sale of Keystone and Conemaugh during the third quarter of 2019.

Spark spreads in the third quarter were lower than a year ago, reflecting lower power and gas prices across the region. And while our generation volumes approximated last year's levels, the increment we saw in our new combined cycle unit in Bridgeport was more than offset by reductions across the balance of the portfolio, driven by declines in load across the region.

The impact of these lower prices and volumes as well as locational power price differences between where we generate power and where the load resides, resulted in margin declines at Power versus expectations.

And as a result we've updated our forecast of Power's 2019 non-GAAP operating earnings to $395 million to $420 million versus the original range of $395 million to $460 million, and have lowered the guidance for PSEG Power's non-GAAP adjusted EBITDA to $1 billion to $1.50 billion from our original guidance of $1.30 billion to $1,130 million.

Now, I'll briefly address operating results for Enterprise and Other, and for the third quarter, we reported income of $6 million or a $0.01 per share, compared to net income of $9 million or $0.02 per share in the third quarter of 2018. And the decrease in net income year-over-year reflects higher interest expense at the parent, continues to benefit from ongoing contributions from PSEG Long Island.

For 2019, the forecast of PSEG Enterprise and other net income has been narrowed from a range of $5 million to $10 million to simply $5 million. Our financial position remains strong. PSEG closed the quarter with $120 million of cash on the balance sheet with debt at the end of September representing 52% of our consolidated capital.

Debt at PSEG Power represented 33% of its capital at the end of the quarter. During the quarter, PSE&G issued $400 million of 30-year, secured medium term notes at an interest rate of 3.2% and retired $250 million of maturing 2% medium term notes. We continue to expect to fully fund PSEG's existing five year $13 billion to $15.5 billion capital investment program over the 2019 to 2023 period without the need to issue equity.

As Ralph mentioned, we've narrowed our forecast of PSEG's non-GAAP operating earnings for the full year at $3.20 to $3.30 per share keeping the midpoint unchanged.

That concludes my comments. So, we are now ready to answer questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from Julien Dumoulin-Smith from Bank of America. Please proceed.

Julien Dumoulin-Smith

So, a couple of questions, first off, just strategically, if you could address some of the media articles out there would be curious on how you think about the fate of the Power business, and I know you - typical practice isn't to talk about media articles per se, but I'm curious how you think about it strategically, some of the assets there in the future and to any extent that you do evaluate assets, how do you think about paying down debt versus reinvesting back in the business, as evidenced by potentially some of this offshore wind investment - or at least some of the inaugural investment?

Ralph Izzo

Well, on the fate of the Power business, Julien, I think it's going to be around a while, I'm sorry, I don't mean to flip, but it seems like electricity is still highly regarded in value and used by people and we have a really strong bleed from the point of view of proximity to load, and environmental signature.

So, I think we're quite happy with its cash flow generation and its overall operational performance. We're always open to the suggestion that others may be able to extract greater value from our assets than we can, and when that's the case, they come talk to us and they suggest commercial terms that we find interesting, and that's kind of what's happened with Keystone/Conemaugh as you're well aware.

But, I'm not quite sure how else to respond to your question. I mean, we've got a good fleet. They run well, they're financially sound, they're operationally sound and we're always open to commercial discussions with others about whether we can maximize the value or they can maximize the value. Dan, you can help me out here.

Daniel Cregg

Yes, I mean if there is a specific article that you're referencing Julien, we're not recognizing exactly what it is, but I think Ralph has kind of laid it out.

Julien Dumoulin-Smith

Or perhaps, if I can frame it this way, should we be thinking about more asset sales, following on your first asset sale this quarter with respect to the - with respect to the interest in Key/Con.

Ralph Izzo

As we've said in the past, Julien, we always are active in the market. We both look to purchase and look to engage with others, although candidly, we have made a net zero pledge that said, we will not be building or expanding our fossil fleet in any way that we can envision at this point in time. But, yeah, we're always engaged in commercial discussions with interested parties. I mean that doesn't change.

Ralph Izzo

Okay, all right, well, let's move on then just quickly, if I could pivot to the other side. On offshore wind, if you will, how do you think about the stake versus being involved more narrowly in the transmission side of this business. It seems like potentially a little bit of a pivot in terms of where you all want to be involved. But, without the details on our side, how do you think about the risk profile of the decision to be involved, sort of outright ownership interest?

Ralph Izzo

Yes. So, we've looked at this industry, as best we can and estimates are that there is a potential for up to 80 gigawatts of offshore wind developable along the Eastern United States, and that's a number that comes out of I believe an EIA or NOAA, I forgot exactly which. And there has been an announced desire to develop about 35 gigawatts, so there is a potential for growth in this industry.

We're not experienced in building offshore wind and we have a full year ahead of us in terms of due diligence and further analysis to do. It does appear Julien that you're right, that one cannot completely extricate themselves from the risk associated with the timing of the construction. But, it's conceivable still that one could protect oneself from the cost associated with the construction.

So, we're learning as we go along how to balance that risk of the total project versus the components. But yeah, you're not going to be able to build a wire to know where and get paid for it. That is an option that isn't available to us. Maybe it's available to others, but I don't think that's the case.

So, we're trying to learn in a measured way in an industry that we think is going to continue to grow, and we're pretty proud of the person that is willing to help us learn and do some of the teaching. I mean, they are a world leader in offshore wind projects, and we think we know this part of the country, fairly well from a permitting point of view, from a market point of view. From a workforce point of view and various other characteristics that matter a lot to a project like this.

Daniel Cregg

Yeah. And I think Julien, Ralph referenced in his prepared remarks that there are skills that we can bring to this kind of a project, but obviously they are not - all of the skills that are needed for this project.

So, I think that for that reason you see an interest in potentially partnering, I think certainly that's the case, if you think about the existing solicitation at Orsted 1 from a New Jersey standpoint that all of that is linked. And, as we step forward to the extent that, that things are done on a more differentiated basis, there may be more transmission specific oriented work that, that could come from.

Operator

Your next question comes from Praful Mehta from Citi. Please proceed with your question.

Praful Mehta

So, maybe just a little bit more on the offshore wind side. I just wanted to understand the nature of the agreement. So, is the 25% ownership reflective of your investment into the transmission or is that a upfront payment of 25% to get the 25% and then subsequently, there will be cash outflow to invest in the transmission side. Just, if you could give us any color you can on how that option that you have right now. How will that actually play out?

Daniel Cregg

Yes, I think the way to think about it Praful is that the solicitation that New Jersey did represented the project as a whole. What I mean by that - it would represent the turbines at sea, it would represent the substation at sea, the line in between and substation on land.

So, all of those are an indistinguishable project that is - it was put forth to New Jersey and was awarded to Orsted. So the interest would be an interest in that project, what we still have in front of us is the advanced due diligence and the partnership structuring with respect to that type of an investment.

Praful Mehta

So, you're paying an upfront 25% something - to get the 25%, and then as a partner you would put in money to kind of build out that project, as approved?

Daniel Cregg

No. What we have is an opportunity over the ensuing number of months and Ralph referenced roughly a year's period to make a determination, whether or not an interest in 25% of the project is something that we would want to do. So, that's currently what we are exploring, but it would be a - the 25% is not anything immediate, it is more about what the ultimate interest in the project could become.

Praful Mehta

And then just on the generation side, I know. Ralph, you mentioned, everything is going great, but if you just look at from a - like for example 2021 curve's perspective, your hedging for the baseload generation is down about $4 a megawatt hour versus last quarter's disclosure. Capacity factors are down and clearly markets are challenging.

So, just wanted to understand, given you've been in this business for so long and these assets for so long, is there anything different that needs to be done to kind of better deal with the current market situation; like more retail or anything else that you think would help or is the current plan and this current quarter is more of a blip than anything else?

Ralph Izzo

So, that's fair Praful. I didn't mean to suggest it's going great. I meant to - what I meant to say is that we're still in a business that is essential and has natural customer segment, namely the whole population and the particular assets that we're putting to that business are quite strong in terms of where I think, our future is headed as a collective society, let me be more specific. We tried retail, we couldn't get the scale and the profitability that we wanted; we gave it a good effort for 1.5 years to two-years and stepped away from that.

Clearly, something we need is resolution of the PJM capacity market. If reliability is going to continue to be served from the point of supply, then FERC has to do something other than, say, the current PJM RPM, is not just reasonable. They have to have to replace that with rules and hopefully they will replace with the rules that meet the two objectives they've set forth; namely to eliminate price oppression and number two, to allow states to access the resources that they want to.

Another thing that needs to happen is that we need to get a recognition for the attributes of different power plants the society appears to value, but the market doesn't price in. The one that's most glaring is carbon. I think if we can do one or both of those things, then our fleet is extremely well positioned; in the meantime, it continues to generate some healthy positive cash flows for the utility to make use of, but if somebody else can make better use of them, we're willing to listen.

Until that time, we're quite happy to run these good assets and await further progress in price formation, further progress on capacity markets and further progress on the pricing of carbon. But, your observations are spot on. I did not mean to suggest that spark side expanded, and that everything was fixed in wholesale power market design.

Operator

Your next question comes from Greg Gordon from Evercore. Please proceed.

Greg Gordon

Two questions. Not to beat a dead horse on the power side of the house. The willingness to enter into negotiation with Orsted, to take a position in the project itself, feels like a bit of an evolution of your thinking in that - correct me, if I'm wrong and I may be wrong. The last time we talked about this publicly, you had said that your interests would lie, primarily and mainly in building the infrastructure to support that kind of investment and that you weren't primarily interested in taking direct equity interest in offshore wind. So, can you talk about the evolution of your thinking there, and do you think that, that could be given the quantum of the size of the potential market that you just quoted - a bigger part of your strategic vision going forward, and then I'll switch over to the utility side.

Ralph Izzo

Yes. So Greg, I think it is fair to say there has been some evolution. I don't know that I would characterize it the way you did, but it definitely is fair to say there's been some evolution. The evolution really is the recognition that whatever skills one brings to the table, and there, there's been no evolution about what our skills are in terms of this particular project.

It is an integrated whole. And the project doesn't stand - it doesn't meet its own financial expectations if one side successfully brings their skills to the table, and the other side doesn't, and what's most challenging of course is, how do you extricate yourself from the schedule risk, for example.

I mean, there may be ways, and we'll explore them every year to protect oneself from cost risk, but at the end of the day if Orsted builds transmission - if we build transmission online, but turbines aren't there on time, then how on earth does the project succeed and vice versa. If the wind turbine is out there on time and we don't build transmission line on time, how do they get paid? So, these relative risks and returns are all part of the calculation going forward a year from now.

But yes, it is fair to say that as we've had further discussions and grown in confidence in the skills and ability of our partner to do this and do this well, that we've been a little bit more open-minded about overall project risk and what that means for us..

Greg Gordon

My second question is, can you just take us into a little more detail on the adjustment you have made on pension, and why now and how that flows to the bottom line - the accretion level that you've articulated?

Ralph Izzo

Yes. Kind of simple in concept, I think Greg. What we did without changing any of the benefits within the pension - a split of the pension among the different participants, enabled a little bit of volatility to come off of the overall expense, and that all being what it is - one outcropping of that was that, that process during the year - and it was a mid-year this year - prompted a remeasurement.

And so, if you think about what year-end looked like from the standpoint of overall returns and what it looked like from a market recovery, more generally that remeasurement ended up in kind of a recognition within the overall components of the pension of the fact that markets had come back a little bit, and so that prompted an uptick from the standpoint of overall P&L impact or a reduction of expense increase of income in total from the pension standpoint.

So, it's really nothing more than the overall management of the pension, in general, but the outcropping of that was a remeasurement which prompted a lift because market prices had come back from where they were at the turn of the year.

Operator

Your next question comes from Christopher Turnure from JPMorgan.

Christopher Turnure

I was wondering, if you can give us a update on the Energy Master Plan finalization coming up pretty soon here. Just, where are maybe stakeholder discussions around this and kind of what the impact might be on the CEF and Energy Efficiency finalization next year?

Ralph Izzo

So Chris, as far as we know, we're still expecting a year end conclusion to the master plan. I'm going to stick with what's been publicly reported, because I think that's A, what we're allowed to say, and B, probably all we know. There has been some debate over the future of continued use of fossil fuels.

There is a desire to decrease that as soon as greatly as possible, but there is a recognition that fossil fuels in particular, natural gas play a very important role in heating and various other users in the state. And therefore, given the housing infrastructure and the building infrastructure, that would not immediately lend itself to moving away from natural gas. One has to be reasonable about its continued use.

So, it was I think just last week that the BPU announced the details for a public review of the plan, and there they did repeat that it would be available by the end of the year. There's been a little bit of discussion around how aggressive the state should be in encouraging electric vehicles, and there seems to be some enthusiasm for that.

But, every draft we've seen continues to espouse the importance of nuclear, and which is important to us. I think those are the issues at a high level that matter and that we've been paying careful attention to.

Christopher Turnure

And, I mean clearly, the governor has stated his position on the PennEast pipeline which you're no longer a part of but is I guess more broadly, the debate in New York State on gas availability having an impact on the discussions or the Energy Master Plan so far?

Ralph Izzo

Yes. So, I think that, that conversation in general is not quite a specific in New Jersey as in New York when it comes to permitting of specific projects and the ability to hook up customers. But that general topic of continued reliance on fossil fuels has made its way into New Jersey Energy Master Plan, not in this immediate timeframe, is my interpretation, given what we're witnessing in New York versus what we're witnessing in New Jersey.

Christopher Turnure

And then, my second question is just a follow-up on the offshore wind announcement from the other day. It looks like you had an option to have exclusive negotiations, why did you kind of have to do this now, if you have a year to make a final decision or just what was the impetus behind coming out now as opposed to kind of keeping things going on in the background?

Ralph Izzo

Yes. So, the option to have exclusive negotiations required that we decide whether or not we wanted to preserve that option for an exclusive negotiations for this next phase, so we chose. I know, it's a little strange, yes indeed it does select an option for an option, but that we had - and we exercised that option at this point, we have an option to participate where there's no third option through option, through option. I'm just stuttering there, I'm actually articulating something accurately, believe it or not, still frightening.

Christopher Turnure

And with that you had to specify the 25%.

Ralph Izzo

No, that was - we had an option, once you specify, we could have gone higher than that, but we chose to focus on entering this space in a more measured way, at this point.

Christopher Turnure

Okay. Thanks for the color Ralph.

Ralph Izzo

And Chris that obviously, I mean as we learn more about the space, that number can be different, right. I mean we'll keep getting educated.

Operator

Your next question comes from Shahriar Pourreza from Guggenheim Partners. Please proceed.

Shahriar Pourreza

So, just a couple of follow-ups on the prior questions, just first on the 21, on the power hedges. Looked like, it was a bit more of a pronounced downward move in the hedges versus what you guys disclosed in the second quarter, and you only kind of modestly increased your hedges. Course in Sparks had some strength this quarter for Cal 21. So, I'm kind of curious what drove the downward move, which looks to be a little bit more pronounced than what the dictate markets, as you think about second and third quarter. Is there any other regional dynamics that we should be thinking about?

Daniel Cregg

I mean, I think one thing to think about Shahriar, is to the extent that low deals are a bigger part of what's included there, you're going to see some of those costs end up coming through because they are offset within the revenue mix.

So, we tend to see a little bit of an uptick, as we go through BGS which is one of the biggest load contracts that we have, and then as we go through the year, you'll see a little bit more of a decline, so it's a little bit of a sawtooth from that perspective, and that's maybe what you're seeing there.

Shahriar Pourreza

And then, just on asset sales and Dan, specifically there has been reports around Bethlehem Energy Center and sort of you marketing the assets, so I'm kind of curious is there any updates there? Can you confirm that? And then it's your only asset left in New York, so sort of how you're thinking about that exposure?

Daniel Cregg

I think, you're right. And I think that with your follow on to the question, actually you captured some of that concept as well. It's just a single asset in that area. So, years ago, there was thought processes around maybe expanding a little further, that did not happen. So, we are out and really checking value with respect to that, it is a situation where we will go through the process and make a determination as to whether or not we want to do something based upon what we see coming out of that process.

Shahriar Pourreza

Got it, got it. Thanks helpful.

Ralph Izzo

Shahriar, as Dan was referring to earlier about, we're always engaged in commercial conversations, but that doesn't necessarily mean that there is any sort of requirement or commitment or decision that's been made on these assets.

Shahriar Pourreza

That's helpful, and thanks just want to be a little bit more specific. And then just lastly, around sort of the offshore wind ventures and I know you're taking sort of a proof of concept kind of dipping your toes in the water, no pun intended. But, there has been some sort of negative dialog from rating agencies, we've seen some downward movement in ratings with some of your peers and certainly around the New England region who have taken a much bigger role in this process.

So, I'm kind of curious how the conversations are going with the rating agencies, especially as you start to take the step - a little bit more forward, as proof of concept starts to kick in there, and eventually we potentially could take a bigger piece, whether it's transmission or what have you? I'm curious, if there is any dialog right now, you've had with the rating agencies and if there is any concerns coming from their end?

Daniel Cregg

Yes. Shah, what I would say about that is that obviously - clearly we understand that aspect of what you're talking about from the standpoint of current exposure, as described by Ralph; where we are right now is in a situation where we will continue the dialog into the next number of months and into next year to make a determination as to what the ultimate path is going to be.

So, there is awareness, that this is a possibility for us to make that investment. There is an understanding as to the nature of the magnitude - relative nature, relative magnitude of the investment and it falls into the broader category of where we are in total, and where we come from, from the standpoint of financial strength as well.

So, it's not something that we're blind to, we're aware of and as are the rating agencies, but that's part of our overall diligence, as we go through the next year or so.

Operator

Your next question comes from Travis Miller from Morningstar. Please proceed with your question.

Travis Miller

I liked your options on options on options, I have a follow on follow-on and follow-on, on the offshore wind here. The 25% - I'm wondering how you're thinking about that as a percentage of the project or as a dollar amount? What are your thoughts there? Why not, leave it more open to a 10% or 50% and what's the capital at risk that you think about?

Ralph Izzo

Yes. So, that percentage is based upon the agreement, we have with Orsted and suffice to say, Travis that we've done some financial analysis that has a total project cost expectation built in and therefore a related return, and if during the course of the next year, we find out that the project - that the 25% dollar value that we expected isn't what the project is promising, then we have the option to not participate at all. So, those terms are still being negotiated with Orsted.

But yes, we do have some expectations of what that 25% amounts to in dollars and cents, and we'll spend a year making sure that those expectations are as solid as they can possibly be, and that there isn't some other realities that would cause us to basically walk away. We don't anticipate that, we're in good faith and with a fair amount of work done already, but a lot more to be done.

Travis Miller

And then, when you think about that amount of capital that you would put into offshore wind, how do you think about that in terms of bucketing return on capital across the two businesses here? The utility, in terms of returns versus putting more capital into the utility versus returns relative to, say, buying back stock or other kind of corporate level or even Power?

Ralph Izzo

So, our philosophy on that hasn't changed. We view share repurchase as value neutral that unless there is a dislocation in the market that the market is accurate, and therefore one, is not creating or destroying value and if the market is out of whack then you might be able to create value, if you purchase at the right time. And then we apply cost of capital to the regulated operations, which is lower than the cost of capital through the unregulated operations. This would be an unregulated operation, so therefore, we have a higher hurdle rate that we subject ourselves too because of the greater risk.

When we compare it to Power business writ large, I would say that we are trading off merchant risk for some operational risk. We just don't know the offshore wind business as well as we know, the nuclear business and the combined cycle business, but we like the contract that Orsted has received from the State of New Jersey. It's actually a regulatory order, and we like their experience base.

So, we are comfortable enough at this point to enter into this option agreement that says that trade off of commercial risk versus operational risk with this partner is worth taking, and over the course of next year, we have to turn that into even greater comfort as a result of the diligence that needs to be done. But yes, that was a lengthy speech, but the answer is, the return expectations on offshore wind would exceed the return expectations of the utility.

Having said that, we are still very much committed to the utility, representing over 90% of our capital deployment over the next five years. And Dan and the finance team have done a great job of making sure that all of these things are possible, within the investment potential of the enterprise.

Travis Miller

And just real quick on the utility side. I know, you guys just got through obviously a big rate case. But, given the spending plan and what's on the table in terms of Energy Master Plan, other possible - separate outside of general rate case, what is your thinking on timing of a general rate case?

Ralph Izzo

So, we have a requirement to go and buy in five years from our GSMP which is 2023 is what we would have - December of 2023 I think. So, we've got four more years before we need to worry about that.

Travis Miller

And nothing before that?

Ralph Izzo

Correct.

Operator

Your next question comes from Paul Patterson from Glenrock Associates. Please proceed with your question.

Paul Patterson

I have a question about transmission; in the last couple of months, we've been seeing, FERC put out a few orders trying to expand I guess competition or voice concern about competition out being in the specific areas of transmission development, and also PJM I think put a cost containment filing, not that long ago, that I think you guys have actually filed some stuff, and I'm just thinking when you look at these actions, how do you think about the potential impact on you guys, if it's possible, I know the variety of orders.

I mean, I'm not asking for any granularity or I guess, but what the potential impact might be in terms of transmission development from your perspective, if these things come to pass as I guess initially filed?

Ralph Izzo

So, I think what you're referring to Paul is an attempt by others and maybe even FERC to breathe some life into FERC Order 1000, which I have been an outspoken critic of, in terms of the tremendous cost and administrative burden, it has imposed upon customers, in exchange for a very, very little benefit in terms of creative and valuable solutions to transmission reliability issues.

What I will say today is what we said when FERC Order 1000 first came out, which is to the extent, it potentially introduces competition to our own service territory and projects that we would embark upon, then we would make ourselves available to other territories, where we will be allowed to compete.

Now, as long as that is indeed a level playing field across RTOs, I kind of like our skillsets and our ability to compete to the extent that other RTOs don't make it as open a playing field as perhaps PJM might, then that will be an issue, we'd have to raise at FERC and get fixed.

Having said, all of that, I still believe that FERC Order 1000 was a solution in search of a problem, and has created more problems than it has done anything else. So, we will continue to try to point that out to FERC through actual cases, where administrative costs and burdens have exceeded overall project costs, in certain jurisdictions and this notion is just - FERC would be far better off spending its time figuring out how to fix wholesale power markets than trying to fix something that isn't broken, namely transmission construction.

Paul Patterson

I hear you there. Any sense as to how some of these might - or is it just I guess too early to say maybe how some of these things might fall out, do you think?

Ralph Izzo

I think it's too early to say, Paul.

Operator

Your next question comes from Michael Lapides from Goldman Sachs. Please proceed with your question.

Michael Lapides

Ralph, very basic question. First of all, how are you thinking about, now that you're a few quarters behind the rate case or anyhow after the rate case, how are you thinking about the impact of regulatory lag in the coming years, and whether you think rate based growth and earnings growth at PSE&G will move in lockstep?

Ralph Izzo

Yes. So remember Michael, I think it's about 90% - I forget the exact number, but I will know by the time I get to EI, I'll do some more studying of our - the CapEx does get contemporaneous return at the risk of - in modesty, actually - there's no modesty, I am going to boast about our employees, they do a great job of controlling O&M.

So the EMEC load growth we have is enough to help us combat about the regulatory lag associated with the 10% that doesn't get contemporaneous return. It isn't enough to make up for all of it, and our clauses do have some back-end CapEx that does not get clause recovery, but candidly, it is back end and closer to the rate case test year.

So, we always have the ability to file for rate sooner, if we needed to, if the lag became too much. But, believe me all hands on deck are focused on earning our allowed return and quite candidly, Dave Daly and the team at the utility are doing a darn good job of making that happen. So...

Daniel Cregg

And Michael, the other thing to remember as well is that the transmission side of the business has a formula rate filing, which is through contemporaneous as well.

Michael Lapides

Right. And can you remind us, what is the formula rate increase in transmission for 2020 - starting in January 2020? What's the dollar amount for that?

Daniel Cregg

Aggregate amount, I think was in approximately the $300 million number. It's a year-over-year jump that's a little bit bigger than the norm, because if you think about the last year, there was some particular tax flow backs, which are not there. So, from a year-over-year standpoint, that's a little bit higher than the norm, because of the absence of that giveback, which will conclude at the end of this year.

Michael Lapides

Got it. So roughly $300 million step up from 2019 to 2020?

Daniel Cregg

Yes.

Operator

Your next question comes from Paul Fremont from Mizuho.

Paul Fremont

If you were not to take an equity interest in the offshore wind project, can you give us an idea of how much capital spending would be involved to connect up the project on your side?

Ralph Izzo

So Paul, I don't think any analysis has been done yet on what the land impacts are of the project. It is suffice to say the generator lead which is a transmission like - it's not FERC-regulated, it doesn't get a rate base treatment would be much bigger than any kind of on land adjustments that need to be made. And, it's probably not unreasonable to assume that, given that this lead would connect into someone else's service territory that the RTEP type of impact in our area would not be something that - materially change our capital budget.

Paul Fremont

And then, I guess I just wanted to follow up on something that you mentioned earlier the net-zero pledge, we shouldn't assume, for instance for Keystone and Conemaugh that you're looking to replace that capacity and if you were to dispose of let's say Bethlehem, you wouldn't be looking to sort of replace that, or would you?

Ralph Izzo

No. I'm not 100% sure I understood your question, but I think the answer there is no.

Daniel Cregg

Yes. In fact, almost the opposite of what we've said is that we would not be acquiring fossil driven generation. So, that would imply that replacing those would not happen.

Paul Patterson

I just wanted to sort of make sure that I understood what you meant by that. Okay, thank you.

Operator

Your final question comes from Sophie Karp from KeyBanc. Please proceed with your question.

Sophie Karp

I just wanted to go real quick, back to the offshore wind and if you were to take a 25% stake in that project, I'm presuming there would be a sizable chunk of cash involved, eventually as an investment. So, how should we think about your CapEx plan evolving and when would we get updates on that, as well as, how you plan to fund it as far as debt and equity mix et cetera?

Daniel Cregg

Yes. Sophie, I think the way to think about that, as we've been talking about a timeframe over the next number of months and for the year, to make an ultimate determination is to the investment that we may make, and I think that's the right time frame to think about some of those incremental details.

Sophie Karp

So, you took down there - at some point, on the Energy Strong II decision, you took down a little bit your CapEx plan, and so, is that fair to say that you have some headroom there versus your original plan, maybe that you contemplated at the Analyst Day?

Daniel Cregg

Yes, I think that's a fair way to think it.

Operator

Mr. Izzo, Mr. Cregg, there are no further questions at this time. Please continue with your presentation or closing remarks.

Ralph Izzo

Thanks everyone for joining us. Lots of questions about offshore wind, I guess that wasn't a big surprise. But, the real message we want to make sure we leave you with is that, we continue with just extremely steady performance where we're on track to deliver on everything we've told you about, earlier in the year and have been telling you about for many years.

Customer sat is solid, we're preserving our financial strength. This is giving us the opportunity to pursue some expanded clean energy future opportunities, and those are everything from the Clean Energy Future filing that is still very much alive of being discussed with the BPU and offshore wind, which we've now exercised the option to pursue an option. So, that's really where we want to leave you.

Wish you all a Happy Halloween. Have a safe and enjoyable holiday, and we look forward to seeing you in about 10 days in Florida. Thanks everyone for joining us on the call.

Operator

Ladies and gentlemen, that does conclude your conference call for today. You may disconnect, and thank you for participating.