

# power finance & risk

The exclusive source for power financing and trading news

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## Southern Eyes Plant Acquisitions

**Southern Co.** is looking to acquire power plants in the Midwest and Pennsylvania, New Jersey and Maryland power pool, says **Gale Klappa**, cfo, but will hold its fire until valuations fall further.

*See story, page 4*

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## RELIANT RESOURCES SEEN PUTTING ITSELF ON THE BLOCK

Houston-based Reliant Resources, the unregulated and partially floated affiliate of **Reliant Energy**, has begun shopping itself, says a Wall Street banker who has spoken to senior management about its plans. He adds the independent power producer hopes to find a buyer following a full spinoff, which is expected to occur shortly. The banker says the recent series of body blows to Reliant Resources—notably its admission of engaging in round-trip power trading, its struggle to replace or extend existing bank debt and its

*(continued on page 12)*

## TRADERS LOOK TO DERIVATIVES MARKET FOR DEFAULT COVER

Energy traders are turning to the derivatives market to hedge against the risk of counterparties going bust, driving them to consider everything from credit default swaps to equity puts on counterparty stock. "In the past we relied on corporate guarantees. What we are looking at [now] is derivatives," said **Frank Hilton**, chief credit officer at **American Electric Power**, on his

*(continued on page 11)*



## Flying Solo

## CALPINE STEPS BACK FROM HUNT FOR TRADING PARTNER

San Jose, Calif.-based Calpine is backing away from the search for a partner to bolster its trading operation partly because of regulatory difficulties associated with a tie-up. **Peter Blood**, director of marketing and transmission, told attendees at a trading conference in Houston last week, "We were in the throws of discussing an alliance [but] we've put that on the back burner." He continued, "We think we will go it alone now."

*(continued on page 12)*

## BAHRAIN INDUSTRIAL CONCERN READIES \$1.5B LOAN

**Aluminium Bahrain (Alba)**, one of the world's largest aluminum smelters, last month hired U.S. consultant **Taylor DeJongh** to advise on raising roughly \$1.5 billion in debt financing. Part of the proceeds will be used to build a 625 MW inside-the-fence combined-cycle gas-fired power plant. Alba is adding the generation facility because it is looking to increase smelting capacity by some 33% to 750,000 tons of aluminum per annum.

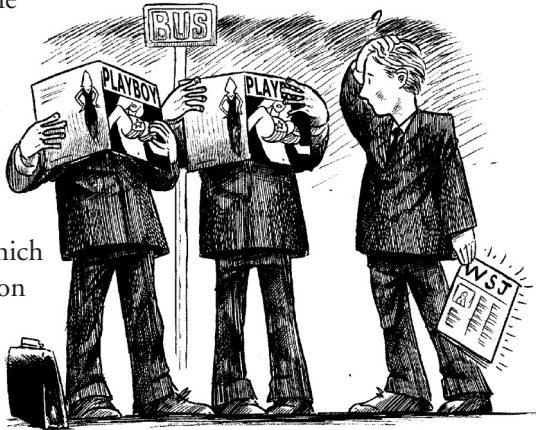
**Osman Shahenshah**, director for Europe, Middle East and Africa at Taylor DeJongh in

*(continued on page 11)*

Check [www.iipower.com](http://www.iipower.com) during the week for breaking news and updates.

## Enron Employees Expose Hidden Assets For Playboy

*Playboy* magazine's long awaited 'Women of Enron' issue, which features 10 former and current employees of the bankrupt Houston trader, is expected to prove a hot commodity when it hits Wall Street and Houston newsstands today. Michael Carr, president of Playboy Publishing in New York, told *PFR* the newsstand print run is 800,000 copies, a 20-25% jump over the regular Playboy monthly issue. The company, which also has 2.7 million regular subscribers, is expecting strong sales in Houston and New York, as well as the hometowns of the models, he says. "There is no romance without finance," observes Carr.



Aside from admin and IT staff, Playboy's Enron feature includes four employees from the energy sales desk: Carey Lorenzo, Janine Howard, Cynthia Coghlan and Lori Hodges. Gail Parenteau, a publicist for the magazine, said none of the models were available for interview late last Thursday. "We've been going at it for three days," she revealed, referring to the busy schedule of publicity events in the run-up to the July 1 release of the issue.

## Quartet Preps Indian Wires Bid

Four companies are preparing to submit technical and commercial bids to India's state-owned transmission company, **Power Grid Corp. of India (PGC)**, in August to build a \$100 million transmission project, according to a PGC official in New Delhi. The companies are **BSES India**, **Tata Power**, **Kalpadar India** in association with Malaysian utility **Denaga National Berhad**, and **Emirates Trading Agency** in association with Korean utility **KEPCO**. The winning bidder will provide financing for the project, which is expected to take around three years to construct. The PGC hopes to activate another seven transmission projects once the Dina-Nagda-Dehgam project is underway, the official adds.

## Goldman Loses Power Honcho

Tony Gordon, a managing director in **Goldman Sachs'** London-based energy group, has left the firm. Gordon had been charged with seeking out hard assets in the European power sector, say market watchers, who add his departure could signify a change of strategy for Goldman. Calls to Gordon, who left the firm earlier this summer, and **Isabelle Ealet**, managing director and head of commodities, were not returned.

Gordon moved to London last year after a successful spell as head of power marketing at former Goldman affiliate **Constellation Energy** in the U.S. Market watchers say he transferred to London to replicate Goldman's highly successful strategy of buying U.S. generation assets in the late 1990s. One market watcher says Gordon's departure reflects his inability to find any suitable acquisitions in Europe and the move likely means that Goldman believes Europe will not prove a fruitful investment environment any time soon.

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## Dominion Eyes Dynegy Pipeline

**Dominion Energy** has held preliminary discussions with **Dynegy** about buying Northern Natural Gas, the U.S. pipeline it acquired from **Enron** only last November for \$2.45 billion, says an official familiar the matter. However, he played down the chance of any sale being reached. He says talks between the two companies have not progressed far and adds Dominion's initial offer has not proved rich enough for Dynegy.

The banker adds another factor that has hampered the sale is a call option held by Enron allowing it to repurchase the pipeline from Dynegy. The option, which was set to expire June 30, gives Enron the right to repurchase NNG for \$1.5 billion in cash and \$950 million of debt (PFR, 2/25).

**Thomas Farrell**, executive v.p. at Dominion, declined to comment on the matter, except to say that Dominion is actively looking to buy both pipelines and power plants in the MAIN to Maine region of the U.S., an area including the Northeast quadrant, Missouri, Illinois, Wisconsin, Michigan and Indiana. Officials at NNG referred all calls to **Steve Stengel**, a Dynegy spokesman, who would not discuss the matter, except to say that Dynegy is considering the sale of NNG. **John Ambler**, an Enron spokesman, did not return calls.

Market watchers say NNG is considered a highly attractive pipeline business, adding that pipelines in general have become sought after assets because they are natural monopolies, generate constant revenue streams and are not dependent on commodity prices (PFR, 3/4).

Dynegy took control of NNG as part of its failed takeover of Enron last November as the latter teetered on the brink of collapse. When entering the merger talks Dynegy injected \$1.5 billion of capital into Enron to protect its credit rating and secured this investment against the gas pipeline. When Dynegy terminated the merger it retained NNG. The Houston energy trader announced last week that it is looking to sell either all or part of the pipeline as part of a broad-ranging attempt to bolster its liquidity.

NNG is a 16,500-mile pipeline network stretching from Texas to the Great Lakes.

## Banks Wrap Up Conectiv Loan

Bookrunner **Credit Suisse First Boston** and co-lead **Scotia Capital** have signed up 11 banks during syndication of a \$365 million, four-year non-recourse loan on behalf of Conectiv and could sign up a further four lenders shortly.

**Abbey National**, **HypoVereinsbank** and **Mizuho Financial** each landed co-arranger titles with \$75 million tickets, according to a market official. He adds **Arab Banking Corp.**, **Bank of Scotland**, **CIT**, **DZ Bank**, **Erste Bank**, **Landesbank Baden-Wurtemberg**, **Nord LB** and **Sumitomo Bank** also joined at a lower tier.

Wilmington, Del.-based Conectiv is using the proceeds to finance the construction of a gas-fired combined-cycle power plant in Bethlehem, Pa. (PFR, 5/12). The deal, which was oversubscribed and closed last Tuesday, may still find room for a further four players, who are still looking to commit, probably by the end of next week, the official says.

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## MORGAN STANLEY HONCHO JOINS TOP-RANKING HEDGE FUND ...

**Andy McMillan**, head of European power and gas trading at Morgan Stanley in London, has left the bank to join **Tudor Investment**, one of the world's largest and most renowned hedge funds managers with more than \$6 billion in assets.

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**THE FINANCIAL TIMES**

**GLOBAL INVESTING: Hedge funds move in on distressed energy sector**

By Robert Clow in New York  
Financial Times; Jun 07, 2002

Smart investors love a little carnage, so it should come as no surprise that some of the smartest hedge fund investors are getting into the energy market following the collapse of Enron and the admission by its competitors of bogus trades to boost revenues.

June 7

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## EDF Trading Taps Bank Market

Barclays Capital, Credit Agricole Indosuez and Deutsche Bank last week launched an EUR250 million three-year facility loan on behalf EDF Trading. Bankers say the loan will be used to support the London-based trading shop's credit lines and marks the joint venture's first foray in the bank debt market. Neither EDF nor the lead arrangers returned calls.

## Southern Eyes PJM, Midwest Assets

Atlanta, Ga.-based Southern Co. is on the lookout to acquire generation assets in the New Jersey, Pennsylvania and Maryland (PJM) power pool and the Midwest region, according to Gale Klappa, chief financial officer. He says that Southern plans to take advantage of the low valuation of assets in the marketplace.

However, Klappa says that the company is being very cautious in its hunt for assets, explaining that Southern doesn't need to "get big quickly" and is happy growing at a moderate pace of approximately 5% annually. Therefore, it will only purchase assets that it deems to be quality additions to the company's portfolio, he notes. Klappa explains the utility giant is holding its fire in the belief that better assets will come on the block in due course as some of its beleaguered rivals become forced sellers. "We think there will be better assets coming on the block. We just don't believe that all of the blood is on the floor yet."

## Pipeline Loan Draws In 28 Banks

MidAmerican Energy Holdings' \$875 million loan funding the Kern River natural gas pipeline expansion closed June 21 with a strong line up of 27 banks signing on at the co-arranger level and an early retail ticket from MetLife. The deal was led by Credit Suisse First Boston, Union Bank of California and Commerzbank. Market officials say the deal—which was expected to be met strong demand from the outset (PFR, 5/15)—will now move into retail syndication, where a further two to three players are expected to take commitments.

The final allocation was around \$30 million for each of the following:

Abbey National	Fortis Bank
ABN AMRO	Helaba
ANZ Investment Bank	HypoVeriensbank
Bank of Montreal	ING
Bank of Nova Scotia	John Hancock Insurance
Bank of Scotland	KBC Bank
Bank One	Landesbank
BNP Paribas	Baden-Wuerttemberg
CoBank	Lloyds TSB
Credit Agricole Indosuez	MetLife
Credit Lyonnais	Natexis Banque Populaires
NIB Capital	NordLB
Dexia	Royal Bank of Scotland
Export Development	Sumitomo Bank
Corp. of Canada	Toronto Dominion Bank



## Latin America

### EdF Mexican Financing Faces Delays

A \$217 million, 16-year project loan earmarked for the construction of Rio Bravo III, a 500 MW gas-fired plant in northern Mexico, being developed by Electricité de France, is facing delays. A project financier familiar with the matter says that Société Générale has been struggling to pull the deal together and will likely not close it until Q4. He adds that SocGen intended to launch syndication at the end of June, but now will probably delay launch until late August. The financier declined to comment on the reasons for the delay except to say there are some "due diligence issues" that need to be sorted out. Calls to bankers at SocGen and officials at EdF in Paris were not returned.

The generation facility is forecast to cost \$290 million to build and EdF will provide the remaining \$73 million of the costs with internal cash (PFR, 6/3). Once operational, Rio Bravo III will supply all of its output to the Comisión

Federal de Electricidad, Mexico's national power company, under a 25-year U.S. dollar-denominated power purchase agreement.

## El Paso Selects SocGen For Brazilian Refinancing

El Paso has selected Société Générale to arrange a non-recourse loan to refinance the \$700-800 million construction costs of Macae, a 400 MW gas-fired power plant in Rio de Janeiro. A New York project financier familiar with the matter says the deal is progressing smoothly and he expects it to close within the next few months. He declined to comment on the size and terms of the loan. Officials at El Paso in Houston and bankers at SocGen did not return calls.

El Paso originally financed the construction of the project last year with equity capital (PFR, 3/11). The financier says the company is refinancing the project with a loan to leverage its investment and share the development risk with banks.

## IDB, BofA Syndicate Brazil Loan

The Inter-American Development Bank and Bank of America closed syndication a couple of weeks ago on a \$173 million loan being used to develop Thermo Bahia, a 187 MW gas-fired power project in Brazil's Bahia state, says one syndicator. The firms signed up six lenders with \$15-20 million commitments: **ANZ Bank, Intesa BCI, HypoVereinsbank, Société Générale, Credit Agricole Indosuez** and **ABB Structured Finance**. He declined to comment on the fees. Bankers at the IDB and BofA declined to comment on the matter and calls to the lenders were not returned.

The non-recourse loan consists of a \$115.5 million 12-year tranche arranged by BofA and a 14-year piece for \$57.7 million from the IDB (PFR, 4/8). The project's developers, which include **ABB Equity Ventures, Petrobras** and **A&A Electricity Investment**, provided a further \$32 million as equity capital.

## Citi, Mizuho Near Close Of Altamira Financing

Lead arrangers Citibank and Mizuho Financial are putting the final touches to a \$210 million long-term non-recourse loan being used to help finance the construction of Altamira (495 MW), a \$300 million combined-cycle gas-turbine plant in northeastern Mexico. A New York project financier says project sponsors **Electricité de France (51%)** and **Mitsubishi (49%)** should receive the construction funds next month. The financier adds that **Bank of Tokyo-Mitsubishi** and **ING Barings** have come on board as co-arrangers, but declined comment on their commitment levels. Calls to bankers at BoTM, ING, Citibank and Mizuho were not returned. Officials at EdF and Mitsubishi also did not return calls.

The project sponsors will jointly provide \$100 million in equity financing for Altamira (PFR, 5/13). The facility will sell all of its output to the **Comision Federal de Electricidad**, Mexico's national power company, under a 25-year PPA.

## Latin American Power Financing Calendar

*Following is a directory of upcoming projects and related financing in the Latin American power sector. To report new deals or provide updates, please call **Amanda Levin**, Reporter, at (212) 224-3292 or email: [alevin@iinews.com](mailto:alevin@iinews.com)*

Sponsor	Project	Project Type	Size (MW)	Cost (\$mil)	Country	Advisor/Financier	Status	PFR Issue
Alcoa	Santa Isabel	Hydro	1,087	700	Brazil	Citi	Has hired Citi to lead deal	2/11/02
Ceran	-	Hydroelectric	360	111	Brazil	BNDES	Will launch the loan shortly	10/8/01
Compahnia Energetica de Pernambuco	Termopernambuco	Gas-fired	520	403.5	Brazil	IADB/BBVA/BNDES	Syndication due shortly	12/24/01
Corporacion Venezolana de Guyana	Tocoma Dam	Hydroelectric	-	2,100	Venezuela	-	Expects to bring project on line by 2006	6/25/01
Duke Energy International	Pederneiras	Gas-fired	500	270	Brazil	-	Will finance with equity capital.	3/11/02
EdF, Mitsubishi	Altamira	Gas-fired	495	300	Mexico	Citi/Fuji	Expects to seal financing shortly.	7/1/02
Electricite de France	Rio Bravo III	Gas-fired	500	290	Mexico	SocGen	Arranging a \$217M project loan	3/4/02
El Paso	-	Gas-fired	200	200	Mexico	-	Expects to bring project on line by 2003	4/16/01
El Paso	Araucaria	Gas-fired	469	340	Brazil	Dresdner	Closing \$340M in financing	3/4/02
El Paso	Macaes	Gas-fired	400	700-800	Brazil	SocGen	Financing due shortly	7/1/02
Iberdrola	Vera Cruz	Gas-fired	800	700	Mexico	-	IADB has offered assistance to relaunch the stalled project	6/9/01
Iberdrola, Banco de Brazil, Previ	Termo Pernambuco	Gas-fired	540	350	Brazil	IDB, BBVA	Expects to bring project on line by 2002	3/26/01
InterGen	Carioba	Gas-fired	945	670	Brazil	-	Project delayed until Q1 of 2003	2/25/02
PSEG Global	SAESA	Distribution company	N/A	450	Chile	J.P. Morgan	Considering taking out a \$300M loan to fund the acquisition	9/24/01
PSEG Global	Electroandes	Hydroelectric	183	227	Peru	J.P. Morgan	Considering taking out a \$100M loan to fund the acquisition	9/27/01
Sempra Energy Resources	Mexicali	Gas-fired	600	350	Mexico	SocGen	In the process of arranging a corporate loan	3/11/02
Union Fenosa	La Laguna II	-	450	-	Mexico	-	-	7/2/01
Union Fenosa	Tuxpan III & IV	Gas-fired	938	600	Mexico	Deutsche Bank BOTM	Expects to bring plant on line by 2003	6/4/01

## Viewpoint

# THERE IS GOOD NEWS IN POWER MARKETING

*You just have to look hard to find it*

The last 12 months have been characterized by an unprecedented wave of bad news in the power industry. To summarize:

First there was the demise of the ill-planned California deregulation program, and the assumption by the state of the electricity purchasing responsibilities from all three major West Coast utilities.

Then the collapse of **Enron** and the resultant loss of confidence on the part of the financial community in the concept of merchant energy marketing untied from a larger parent company. Stock values, credit ratings and liquidity are down and many of the formerly largest market players are in a situation where few will "take their name".

Senior trading officers of some of these companies, such as **CMS**, **Dynegy**, **Aquila** and **Reliant Energy**, have either resigned or been forced out amidst reports of market manipulation in the West or "wash trading" scandals.

Quite a few of the largest merchant marketers (**Aquila**, **Mirant**, **Dynegy**, **El Paso**, **Calpine**, **AEP**, etc.) have already or are currently announcing the lay off of substantial numbers of employees in their trading and marketing groups. In addition, many have sold or are engaged in the sale of substantial assets, many of which were relatively recently purchased or developed.

And the once powerful accounting giant, **Andersen**, is on the brink of bankruptcy and ruin as a result of its involvement with **Enron**.

Yet there are number of positive aspects to this situation that lead us to believe that this industry can bounce back stronger than ever and on a more secure financial and profitable footing than existed during the growth years.

## Regional Power Marketers and Conservative Traders Faring Better

Like a two-by-four between the eyes, the current malaise has certainly gotten the attention of the companies that have pursued aggressive speculative trading and asset acquisition strategies. They have responded by promising they will clean up their accounting and trading problems (both natural gas and electricity) and return the companies to financial stability and greater cash profitability.

Power marketers that have always chosen a more conservative path, perhaps combined with limiting their

ambitions to being regional, rather than national or international players, have fared better. Also doing relatively well are those larger companies with a well-diversified asset portfolio and conservative trading philosophy (i.e. **Duke**), which have seen smaller impacts from the financial markets in their share values.

In the end, to the extent that the more aggressive marketers adopt more conservative strategies, reduce debt, increase profitability and reduce risk, this can stabilize the industry as a whole and allay the concerns of the financial markets.

The dispersion of the ownership of generation and transmission mitigates against the return to a regulated market. Instead, many of the more conservative shops will prosper and the larger and formerly more aggressive companies will take a page from their business plan and be revitalized.

## Creation Of Large RTOs Will Help Lower Energy Costs

The fragmentation of the retail deregulation picture has been exacerbated by the fragmentation and bottlenecks in the national and regional transmission system. However, one glimmer of hope is the recent activism on the part of FERC Chairman **Pat Woods** in forcing the creation of large RTOs as well as a willingness to use the club of market pricing to force some of the large and recalcitrant utilities to join. This can begin to standardize transmission pricing and potentially bring down energy costs to the end-user, which was the desired goal of deregulation in the first place.

The same market-pricing club is being used to force some of the largest utilities to truly address open access in their regions, which can only help in the normalization of markets and the rationalization of their regions in terms of the siting of plants and the flow of power. Continued transmission congestion in the regional transmission grids is also leading to the development of a merchant transmission market. Pricing for these transmission services (capacity) would be based on negotiated prices determined by actual and projected regional conditions (i.e. degree of line congestion).

While there is still a lack of standardized procedures, one merchant project bringing power from Connecticut to Long Island is currently being implemented, three more have been approved by FERC for the East Coast and the Midwest. In

the West the FERC has also recently approved a joint venture in California between **Pacific Gas & Electric Co.** (which owns the two existing lines), the federally-owned **Western Area Power Administration** (WAPA) and **Trans-Elect** to construct a third line in California.

It must also be noted that, since some needed grid transmission expansions are less economically viable from a merchant perspective there will likely be a mix of regulated and unregulated transmission projects in the future to minimize congestion. Nevertheless, the transmission market could be a lucrative area of expansion for power marketing companies and could potentially lower energy costs, which would be a major boost to the whole deregulation concept.

### **New Financial Strength Coming From Banks & Financial Institutions**

A number of new, financially strong and credit worthy players are entering/re-entering the market. On the financial side **Bank of America** (PFR, 6/24), **Goldman Sachs**, **Deutsche Bank** and **Louis Dreyfus** have recently or are planning to launch operations. Most are going to be working in the financial and risk management markets initially. However, there is reason to believe they will expand into the physical markets either through the acquisition of assets or by partnering with existing marketers in need of a larger balance sheet and a large credit guarantor.

### **Potential New NYMEX Futures Contracts**

Since many of the financial houses and banks do not yet have permission to trade electricity physically there may be pressure to develop a better electricity futures contract than existed previously with appropriate size (25 MW contracts instead of 2 MW) and underlying indices in which companies can believe.

In the meantime the **New York Mercantile Exchange** (NYMEX) has started providing a credit clearing capacity for natural gas through an EFS contract (Exchange-of-Futures-for-Swaps). This contract "lets a market participant shift his risk from an OTC position, where he is exposed to counter-party risk, onto the Exchange, where the clearinghouse is the ultimate counter-party," (Volume 1 2002, "Energy In The News", Page 3, NYMEX).

The NYMEX also provides a variant of this procedure for the power markets that utilizes NYMEX energy futures contracts for hedging purposes.

Many power marketers who, due to lowered credit ratings, have fewer counterparties willing to trade with them can utilize this system to get back in the game. This should increase overall liquidity and reduce losses associated with losing positions in an illiquid market.

### **International Players Continue To Invest In U.S. Power Companies**

Lowered asset costs, reduced volatility and a large pool of talent will continue to attract overseas players like **E.ON**, **RWE** and **Ontario Hydro**. The U.S. is, after all, an extremely financially and politically stable country with the largest electricity market in the world.

### **Committee Of Chief Risk Officers Formed**

The power marketing industry as a whole, punished by Wall Street rating agencies, has responded with the creation of a new trade organization, the Committee of CROs (Chief Risk Officers of more than a dozen of the largest power marketing companies). This body will address collateral requirements and create a set of standardized risk management procedures and disclosure practices. Such standardization can only help to further reassure the financial community.

### **Long-Term Forward Price Curves**

A number of traders are telling us that if one compares the current forward price curves for power to the embedded costs of regulated generation they are actually lower than in the "good old days" under regulated prices and monopoly regions. This factor, which of course is open to change, can also be seen to provide a boost to the deregulation concept and may result in relatively lowered energy prices to residential retail consumers and end-users.

### **Market Correction Will Bring Renewed Strength In The Future**

In the end one may look at the current contretemps as a painful but needed market correction that will, I believe, lead to a stronger, more focused, transparent and profitable power/energy marketing industry. While the growth in demand for electricity has slowed, all analysts foresee a faster pace of growth in electricity demand as the economy becomes re-invigorated. Someone has to provide this power and the deregulated model, nationally at the wholesale level and to a lesser extent regionally at the retail level, is the current system in place. The power marketing community is swiftly looking for, and implementing, modifications to satisfy the financial, regulatory, and public communities. I believe that they will succeed.

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*This week's Viewpoint was written by **Steven McAleavy**, director-energy division at **Search Consultants International**, an executive recruiting firm specializing in the power marketing and trading industry (tel. 713-403-3855 or e-mail: [steve@searchconsultants.com](mailto:steve@searchconsultants.com)).*



## Energy Trading Conference

*Some 60 energy trading officials gathered in Houston last Monday and Tuesday for The Center For Business Intelligence's inaugural Current Challenges in Energy Trading Conference. With sentiment among energy traders becoming decidedly bearish in the wake of recent cutbacks, industry players tackled the key issues of credit, clearing and risk, against the usual backdrop of consultants sniffing for business. Senior Reporter Peter Thompson filed the following stories:*

### Firms Flesh Out Contract Terms

Some trading counterparties are meeting face-to-face to hammer out the precise meaning of contracts and ensure that both sides of a trade understand what is and isn't allowed.

Jeff Shorter, v.p. energy trading at TXU Energy, says he used the trip to the Houston conference to call on two counterparties to make sure there was no room for misinterpretation about what trading behavior was allowed under contractual agreements. He didn't elaborate on what behavior could be open to disagreement. He suggested however, that market players should feel comfortable trading with each other given that most traders have to sign internal contracts to bind their code of behavior. "I don't believe there is a lack of trust in this industry," he declared.

### Rivals Jockey For Position As Clearing Takes Center Stage

Market participants are viewing the emergence of new clearing platforms as a primary solution to the issue of counterparty credit risk presently undermining energy trading, but determining which platforms will emerge as the industry standard is still shrouded in doubt, they say.

Sailesh Ramamurtie, assistant global risk control officer at Mirant, told delegates there are a number of competing players looking to become the dominant clearing houses. He noted these include NYMEX and Intercontinental Exchange, which are developing exchange-like clearing systems for over-the-counter contracts, and EnergyClear, which is developing an industry-owned clearing house. He added that the counterparty-owned trading platforms, such as EnronOnline and Dynegydirect, also in effect acted as credit clearing houses when they were both live.

Guy Chapman, managing director at Dominion Energy Clearinghouse, in a presentation on broking, said that while the establishment of one dominant clearer would be the ideal outcome for the industry, it is more likely that at least two rivals will come out on top. In terms of the exchanges, he noted that contract standardization is needed for those systems to take off and that will likely leave a role for multi-lateral netting.

### AEP Adopts Credit Modeling

American Electric Power has started using counterparty value-at-risk modeling (CVaR) to better manage its risk exposure and identify the need for counterparties to post collateral. The Columbus, Ohio energy concern has begun using the technique to help determine when it should begin scaling back counterparty trading, explained Frank Hilton, chief credit officer. CVaR is an estimate of possible future movements in counterparty exposure. "In the past we've not been a big user of CVaR, but there are lots of good reasons [for using it]," he told the conference.

At this stage in the evolution of CVaR, Hilton characterized it more as a useful internal tool rather than a definitive indicator. He explained that divergent methodologies for calculating CVaR, including the basic question of how to use implied versus historical volatility data, mean that getting a counterparty to post collateral on the basis of the measure is virtually impossible.

### Regulated Affiliates To Prosper

Energy trading shops that are part of a larger group with a significant weighting towards safe, regulated utility earnings are likely to emerge as the leading players in the energy trading market going forward. Peter Blood, director marketing & transmission at Calpine, said the players who have weathered the equity market heat over recent months have the common thread of a "safe piece" of regulated earnings. He cited American Electric Power, FPL Group and Progress Energy as examples. He added Calpine has been aiming for this type of earnings safety through its large California supply contracts.

Merchant companies will increasingly look to link up with utilities or, as Calpine has done, look at linking up with companies with strong balance sheets (see related story, page one). Blood also said the integrated energy players are likely to be strong, noting that while the big oil players are still largely on the sidelines they are keeping an eye on how the power market is developing.

Blood said the other successful players will be those that can carve out niche areas and sustain a strong competitive advantage, as PacifiCorp's has done with its wind generation portfolio.



## TXU, PG&E Make The Case For Trading

While many U.S. power companies have begun pulling back from trading, officials from **TXU Energy** and **PG&E National Energy Group** told delegates their trading operations are here to stay as they form an integral part of managing their portfolio of generations assets.

**Jeff Shorter**, v.p. of energy trading at TXU, told the conference the Dallas-based energy giant has definitely not contemplated withdrawing from trading, because it views trading as a risk clearing function given the company's heavy asset orientation. He noted the different load curves of each TXU asset need to be managed and trading is the most efficient way of doing this.

**Bachar Samawi**, v.p. of trading at NEG, also reaffirmed the Bethesda, Md., IPP's commitment to energy trading. In a separate presentation he said, "There is no way we can make the most of the opportunities in a lot of our assets without trading."

Samawi continued, "The concept of energy trading is a sound one." The only option to replace it would be to revert to a fully regulated marketplace, he added.

## Seen 'N' Heard

- Soup-like humidity, temperatures in the 90s and midday thunderstorms gave local attendees the chance to impress the out-of-towners with their best Pythonesque routines. "This is mild," was the definitive phrase for the networking breaks. "If you can see the other side of the road, it ain't raining," one Houston local said of the midday downpours, which clearly weren't in the Texas big leagues.

- The wave of firings in the sector over the last few weeks deflated organizers' projections for attendance numbers. "There is a lot of fear out there," said **Jeff Shorter**, v.p. of energy trading at **TXU Energy**, who commended people for taking the time out to attend. The fear factor clearly has a grip at **Dynegy**, which pulled officials who had planned to speak at the event. All such appearances for the troubled trading shop are on ice for the time being, according to one observer.

- "You're all that stands between a large group of people and alcohol."—**Tom Franklin**, conference chair, giving **Javier Vega**, president of **CapTrades**, a friendly dig before his end of the day presentation.

## Corporate Strategies

### Con Ed Issues Notes To Help Fund Cap Ex Program

New York-based **Consolidated Edison** tapped the bond mart last Monday with a \$300 million issue of 10-year senior notes and plans to use the proceeds to help fund its five-year, \$5.7 billion capital expenditure program. **John Perkins**, director of financial services, says the capital from the program will primarily be used to explore new business opportunities and maintain existing electric facilities. He adds the utility decided to issue the notes to take advantage of attractive interest rates and low spreads.

A recent research report from **Fitch Ratings** explains that it rated the notes A plus based on the utility's stable cash flow from its transmission and distribution businesses, its limited exposure to supply risk, and a constructive regulatory environment. The report states that Con Ed's business risk has decreased because it sold off most of its generating assets, thereby limiting its exposure to energy price volatility.

The notes were priced at 99.507 to yield 5.69%, a spread of approximately 95 basis points over comparable Treasuries. **Salomon Smith Barney** led the deal.

### ComEd Refinances \$200M Debt With Mortgage Bonds

**Commonwealth Edison** plans to use the proceeds from a \$200 million offering of 10-year first-mortgage bonds to refinance an equal amount of first-mortgage bonds that mature July 15. According to a banker involved in the deal, Commonwealth Edison was able to shave 2.35% off the coupon by refinancing. **Trent Frager**, a spokesman at ComEd in Chicago, declined to comment.

The A3/A minus rated bond offering, which closed on June 20, offers a coupon of 6.15% and was priced at 102.139 to yield 5.857%, a spread of 95 basis points over comparable Treasuries. **Barclays Capital** and **Wachovia Securities** co-led the deal.

Commenting on the timing of the issuance, the banker says, "With all of the uncertainty in the utility sector, highly rated operating utilities like Commonwealth Edison have a great opportunity to refinance debt at lower rates because the rating agencies view them as safe havens."

Commonwealth Edison, a subsidiary of **Exelon**, serves more than 3.4 million electricity customers in northern Illinois.

## Weekly Recap

*The Weekly Recap is a summary of publicly reported power news stories. The information has been obtained from sources believed to be reliable, but PFR does not guarantee its completeness or accuracy.*

### Europe

- A Dutch bank sued **Royal Bank of Canada** over a \$517 million loan that it took on from an affiliate of collapsed Houston energy concern **Enron**. In a complaint filed in New York state court **Rabobank** said RBC “was one of **Enron**’s collaborators, and as such fraudulently facilitated Enron’s business dealings” at a time when the Canadian bank “knew Enron was a corrupt organization liable to implode at any time” (*The Wall Street Journal*, 6/25).

### U.S.

- **Florida Power & Light** is considering buying power from **El Paso** and **Florida Power Corp.** rather than expanding its Martin and Manatee power plants (*The Palm Beach Post*, 6/20).
- **Utility Portland General Electric** received a subpoena last week from the U.S. **Commodity Futures Trading Commission** seeking records related to “wash trades” that may have occurred since January 2000, a company spokesman said. **Avista**, a Spokane, Wash.-based power company, also received a subpoena from the CFTC last week (*Reuters*, 6/23).
- **Xcel Energy**, whose debt was downgraded last Monday, said the board would shortly examine its closely watched dividend policy. “I will not prejudge what the outcome will be, but we understand and will consider the importance of dividends to our investors,” **Wayne Brunetti**, chairman, president and ceo, said in a statement (*Reuters*, 6/24).
- The U.S. needs to get moving to protect nuclear plants and the power grid against future attacks and may need to reorganize the way government agencies work together, said a report from the **National Academy of Sciences**, an independent organization that advises the government (*Reuters*, 6/24).
- **Xcel Energy**, whose debt was downgraded last Monday, said the board would shortly examine its closely watched dividend policy. “I will not prejudge what the outcome will be, but we understand and will consider the importance of dividends to our investors,” **Wayne Brunetti**, chairman, president and ceo, said in a statement (*Reuters*, 6/24).
- **Dynegy**, facing mounting worries about its financial health, unveiled a \$2 billion plan to bolster liquidity and reduce debt. It plans a raft of asset and bond sales, interim financings, a 50% reduction in its shareholder dividend and other steps to meet the target. The Houston-based energy trader said the moves assure that it has adequate liquidity to meet obligations even if it loses its investment-grade credit rating. Dynegy said its plan includes agreements that remove requirements for \$301 million of immediate repayments in the event of such a downgrade (*The Wall Street Journal*, 6/25).
- Houston-based **CMS Energy** will eliminate speculative trading and cut headcount in its energy marketing unit (*Reuters*, 6/26).
- **FPL Energy** plans to build, own and operate the largest wind energy project in the eastern U.S. The entire 66 MW output of the Mountaineer Wind Energy Center in West Virginia will be sold to **Exelon Power Team** over a 20-year period (*Business Wire*, 6/26).
- Hoping to advance its criminal case against **Enron** the U.S. Justice Department is investigating the role of several former employees of a London based bank, **Greenwich NatWest**, who were involved in structuring some of the energy company’s most controversial off-balance sheet partnerships. An indictment isn’t believed to be imminent. However, the government is hoping the participation of the U.K. executives will help unravel some of the complex financial dealings that led to the demise of the Houston energy company (*The Wall Street Journal*, 6/26).
- **Arthur Andersen** asked a federal judge to reverse this month’s jury verdict that it criminally obstructed an investigation into its former client **Enron**, saying the verdict was “insupportable,” and that at the least, it should be granted a new trial. In papers filed in a Houston federal court, attorneys for the auditing firm argued that statements by several jurors in the case after the verdict was rendered indicate they misunderstood the law and ended up convicting the firm for conduct that Andersen insists was legal (*The Wall Street Journal*, 6/26).

## BAHRAIN

(continued from page 1)

London, says Alba is looking to fund 90% of the \$1.7 billion project through non-recourse bank debt and hopes to have funding in place by year-end. Taylor DeJongh, which does not provide financing itself, could launch a bidding process to select banks as early as this month, note financiers in Manama. Shahenshah declined to comment on the exact timetable. Calls to Alba's press office were not returned.

Taylor DeJongh beat rival bids from ANZ Investment Bank, HSBC, BNP Paribas and two consortia of Arab Banking Corp./Ernst & Young and Gulf International Bank/PricewaterhouseCoopers to land the advisory mandate. Rival bidders say Alba retained Taylor DeJongh in part because it wanted a financial advisor that did not have a lending arm.

Alba already owns 1,504 MW of generation capacity in Bahrain and sells 275 MW of its output to the national grid during the summer when demand for power is highest. It could not be determined by press time whether excess output from the new plant would also be sold into the market.

The construction of the new plant and additional smelting facilities, dubbed the Potline 5 project, is expected to take two and a half years to complete and be fully commissioned during 2005. The government of Bahrain owns 77% of Alba. The Saudi Public Investment Fund controls 20% and Breton Investments owns the remaining 3%.

—Will Ainger

## TRADERS

(continued from page 1)

company's approach to dealing with potential defaults. PG&E National Energy Group has also been active in tapping Wall Street dealers on default protection prices, according to Bachar Samawi, v.p. of trading, though he said the cost of protection is holding back many trades. Both were speaking at the *Current Challenges in Energy Trading* conference in Houston last week.

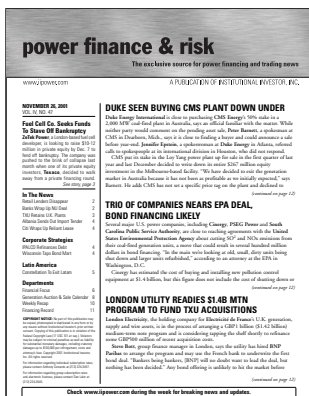
Enron's rapid descent into bankruptcy was the catalyst sparking interest in hedging counterparty credit risk. While the Houston energy trader was the most widely quoted underlying name in the energy credit derivatives sector, Hilton told conference attendees that not many of Enron's corporate counterparties held protection against it going belly up. Samawi added a key reason was that many counterparties did not begin evaluating their exposure to Enron early enough. By the time they became concerned, the cost of credit derivative protection was prohibitively high, he explained. In the wider trading industry, Samawi said the view that protection is expensive holds back many power players, but he advised firms to look at each deal on a case-by-case basis to assess the risk and the hedging costs.

Hilton noted credit insurance is another alternative, though he added AEP doesn't buy insurance cover because of the time lag between a default event and the actual payout: 60 days as opposed to five days for a credit default swap.

Although AEP has yet to pull the trigger, it has also looked

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at buying puts on the stock of counterparties that were in danger of being dragged down by the bankruptcy of a sister company. He told the audience that while the bond markets are generally more fundamentally driven, stock prices are increasingly indicative of future problems. "You have to get a little bit creative to protect the value in your book," he observed.

—Peter Thompson

## CALPINE

(continued from page 1)

The beleaguered independent power producer has been hunting for much of this year for ways of bolstering the credit worthiness of its power trading and marketing operations after the company was downgraded to junk status, and teaming up with a highly-rated partner was a central plank of its strategy.

One senior trading official says any company considering farming out its balance sheet to a cash-starved energy trader is in a strong position because of the high number of shops looking to juice up their credit status through an alliance. He adds, however, that Calpine's Western region exposure might make it less of an attractive candidate than other trading houses.

Atlanta-based **Mirant** is among the other rating-hit traders that have looked to form a partnership this year (PFR, 2/11). No such link-ups have been consummated as yet. In a separate presentation at the *Current Challenges in Energy Trading* conference **Sailesh Ramamurties**, assistant global risk control officer at Mirant, told attendees lawsuits are one issue impeding outside entities from entering the market (for full conference coverage, see page 8).

—P. T.

## RELIANT

(continued from page 1)

tumbling share price—prompted it to seek a buyer. As of last Thursday, Reliant Resources' share price stood at \$8.28, a fraction of its \$28.60 52-week high and not far off its \$7.28 low. It has a market capitalization of \$2.4 billion.

**David McClanahan**, president and coo of Reliant Energy, declined to comment on the matter, except to say that he was unaware of Reliant Resources' plans. Calls to **Steve Letbetter**, chairman and ceo of Reliant Resources, and **Sandy Fruhman**, a company spokeswoman, were not returned.

"Reliant Resources is looking at being acquired as a quick fix to its problems," says the New York banker. However, he believes that achieving a quick sale won't prove an easy task. "A lot of companies are afraid to get involved with power producers because of all of the troubles they've been having. It

will be very difficult to find a buyer," argues the banker.

It could not be determined by press time whether Reliant Resources has appointed an advisor to conduct a potential sale, but bankers familiar with the company say that **Deutsche Bank** and **Banc of America Securities** are likely candidates as both have worked with the IPP in the past. Bankers at both firms either declined to comment or did not return calls.

The timing of any potential sale depends on Reliant Energy's ability to float its remaining stake in Reliant Resources. McClanahan says Reliant Energy recently sought the approval of the **Securities and Exchange Commission** to fully spin off Reliant Resources and adds he hopes the SEC will act by early this month.

Reliant Energy spun off 20% of Reliant Resources through an initial public offering in May, 2001. The remaining 80% will be transferred to Reliant Energy shareholders as a special dividend, once the move receives SEC approval.

Reliant Resources has more than 21,000 MW of generation capacity in the U.S. and 3,500 MW in Western Europe. At the retail level, it provides electricity to 1.7 million customers in Texas.

—Amanda Levin

## Quote Of The Week

"There is no romance without finance." —**Michael Carr**, president of **Playboy Publishing**, commenting on its "Women of Enron" feature in its flagship magazine (see story, page 2).

## One Year Ago In Power Finance & Risk

**International Power** was looking to tap the project finance market to fund its acquisition of the Rugeley power plant in the U.K. and was close to hiring **TD Securities** to arrange the loan. [ING and TD launched a GBP175 million mini perm last November to fund the deal, the first such loan in Europe. They closed syndication in March with the addition of six banks.]

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