

# power finance & risk

The exclusive source for power financing and trading news

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A PUBLICATION OF INSTITUTIONAL INVESTOR, INC.

AUGUST 9, 2004

VOL. VII, NO. 32

## Investec Hires SG Banker For Project Finance Push

South Africa's Investec has hired **Mark Henderson**, director of power sector project finance at **Société Générale**, to head up power project finance for Europe and the Middle East.

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## CALPINE TARGETS PROJECT FINANCE MART FOR CONSTRUCTION FINANCING

Calpine is prepping \$450 million of project-level bank debt to finance new plant construction by year-end and company officials say there are several other contracted power plant projects in the works. After successfully tapping the B loan mart for \$661 million for its Rocky Mountain and Riverside projects early this year (PFR, 5/24), some bankers were expecting little in the way of new non-recourse debt deals. But, CFO **Bob Kelly** told analysts last Thursday, "We're in the latter stages of completing a number of projects financings."

The 550 MW Fox Energy Center in Kaukauna, Wis., will be the first to hit the market, followed by the 600 MW Metcalf facility in San Jose, Calif. Calls to **Brian Harenza**, Calpine's v.p. of finance, who handles non-recourse financing, were not returned.

*(continued on page 12)*

## RWE TRADING LOSES U.K. EXEC

**Brian Senior**, managing director and head of U.K. energy at **RWE Trading**, is set to leave the giant wholesale energy operation. Swindon-based Senior announced his resignation at the end of last month and will step down at year-end, according to spokesman **Leon**



*Brian Senior*

**Flexman**. He will be replaced by **Peter Kreuzberg**, head of risk management at parent company **RWE AG**. Senior was on vacation last week and could not be reached for comment.

Senior's departure has caught many observers by surprise, not least because of his long-standing tenure at RWE and its forebears in the U.K. Senior, 44, joined the U.K.'s state-owned **Central Electricity Generating Board** in 1986, and at privatization in 1990 transferred to one of the country's two new independent generators, **National Power**.

*(continued on page 12)*

## MERCHANT ASSETS SET TO TAKE THE LIMELIGHT AS PLANT SALES SOAR

After three years of meager sales activity, the flow of power plant deals turned from a trickle to torrent in July with a staggering 31 GW plus of net generating capacity changing hands, mostly in the U.S. and U.K. A total of more than 70 plants are being sold for a combined price tag north of \$7.5 billion (see chart, page 11).

One common theme in these deals is the success financial players have enjoyed in prizing assets from the traditional IPP market. Private equity heavyweights **Kohlberg Kravis Roberts** and **Texas Pacific Group** (PFR, 7/19) were part of the consortium that landed this past month's biggest acquisition, **Texas Genco**, while financial players **ArcLight Capital** and **Mitsui** both picked up more than a dozen plants each.

London-based **International Power** was the only IPP to really gorge at the feast,

*(continued on page 11)*

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



## At Press Time

### Babcock Launches Italian Sale

A joint venture between Babcock & Brown and **Infrastrutture**, an Italian power plant developer, last week disseminated a 38-page information memorandum regarding the sale of a 98 MW portfolio of Sicilian wind farm projects and has asked interested parties to file indicative bids by Sept. 13.

The pair is selling **IDAS Srl**, a wind farm development vehicle that owns the 32.3 MW Trapani project, the 38.55 MW Palermo project and the 23.8 MW Vizzini project (PFR, 8/2). **Max Battisti**, a financier at Babcock in Milan, declined comment.

## USGen New England Auction Edges Forward

Second round bids on two portfolios of **National Energy Gas & Transmission** USGen New England power plants are due within two weeks, says a banker close to the process. The bulk of the interest is coming from strategic investors, he adds.

This spring **Lazard Frères** split the auction of USGen New England between fossil fuel plants and a collection of hydroelectric assets in an attempt to attract a wider range of bidders (PFR, 5/17). Officials at Lazard declined comment.

## HSBC Adds Syndicator In NYC

HSBC has hired a project finance and corporate loan syndicator to its Big Apple desk and the move has left rivals pondering how the giant bank is looking to position itself in the North American non-recourse debt market. **Kavita Bogdon**, who joined after a brief spell with **HSH Nordbank**, confirms her arrival, declining further comment.

The London-headquartered bank has been looking at building up its U.S. lending operations for some time (PFR, 10/7), but is still relatively inactive, say rivals. One banker says the word on the street was that HSBC was focusing on project finance advisory roles, but the addition of a syndication staffer suggests it may be taking a different tack. **Michael Whalen**, senior v.p. and head of project finance, was out of the office last week and unavailable for comment.

## Calpine Debt Slides On New Credit Concerns

Concerns that a new letter of credit facility could divert collateral away from existing lenders caused **Calpine** debt to soften in the secondary market late last week. Its \$742 million second-lien B loan weakened three points to 84, according to *PFR* sister publication *Loan Market Week*.

Calpine announced last Thursday it has entered into a new \$250 million letter of credit facility with **Deutsche Bank** under a newly created entity called **Calpine Energy Management**. The facility, which expires October 2005, will use receivables generated from power sales as collateral for the LCs, explains one loan trader. "Since the new facility will be taking all of the receivables the second-lien is in a worse situation," he says.

**Richard Barraza**, Calpine's v.p. of investor relations, did not return calls.

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### EDITORIAL

**TOM LAMONT**  
Editor

**STEVE MURRAY**  
Deputy Editor

**VICTOR KREMER**  
Executive Editor [London]  
(44 20) 7303-1748

**WILL AINGER**  
Managing Editor [London]  
(44 20) 7303-1735

**PETER THOMPSON**  
Senior Reporter [Chicago]  
(773) 525-6978

**ANGELA SALVUCCI**  
Reporter [New York]  
(212) 224-3226

**CHRIS GAUDIO**  
Development Editor  
(212) 224-3278

**ARADHNA DAYAL**  
Hong Kong Bureau Chief  
(852) 2912-8009

**STANLEY WILSON**  
Washington Bureau Chief  
(202) 393-0728

**JANA BRENNING, KIERON BLACK**  
Sketch Artists

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Associates

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Web Production & Design Manager

**MARIA JODICE**  
Advertising Production Manager  
(212) 224-3267

### ADVERTISING

**MIKE McCAFFERY**  
Publisher, Director of Advertising Sales  
(212) 224-3534  
mmccaffery@iinews.com

**NAZNEEN KANGA**  
Publisher  
(212) 224-3005  
nkanga@iinews.com

**PAT BERTUCCI, MAGGIE DIAZ, TAMARA WARD**  
Associate Publishers

**JENNIFER FIGUEROA**  
Media Kits  
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### PUBLISHING

**ELAYNE GLICK**  
Publisher  
(212) 224-3069

**BRIAN McTIGUE**  
Marketing Manager  
(212) 224-3522

**JON BENTLEY**  
European Marketing Manager [London]  
(44-20) 7779-8023

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(212) 224-3019

### REPRINTS

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### CORPORATE

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**Customer Service:** PO Box 5016, Brentwood, TN 37024-5016.  
Tel: 1-800-715-9195, Fax: 1-615-377-0525  
UK: 44 20 7779 8704  
Hong Kong: 852 2842 6950  
E-mail: customerservice@iinews.com

**Editorial Offices:** Nestor House, Playhouse Yard, London, EC4V 5EX, England. Tel: (44 20) 7303-1735  
Email: wainger@euromoneyplc.com

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**Institutional Investor NEWS**  
INTELLIGENCE FIRST

## Leads Set To Wrap Shell, Mitsui Wind Financing

Lead arrangers **ANZ Investment Bank** and **Dexia Crédit Local** were set to wrap **Shell WindEnergy** and **Mitsui & Co. (USA)**'s Texas wind farm financing late last week. The \$87.5 million loan for the Brazos wind farm refinances a facility that went live last December and so qualifies for federal PTCs (PFR, 7/12). One financier says four banks are definitely in and two further lenders may come in as well.

The loan is a 9.5-year facility with pricing starting off at LIBOR plus 175 basis points. It then bumps up to a 1 7/8% margin in year four and 200 basis points in year seven. The financing is structured with a guarantee from an affiliate of offtaker **TXU Portfolio Management Company** and a conservative 48.7:51.3 debt-to-equity ratio.

## Dexia Adds Two Banks In PTC-Free Wind Financing

**Dexia Crédit Local** has signed up **CoBank** and **NordLB** to close the first wind generation financing without production tax credits being in place. The \$31 million, 16-year loan finances **Invenergy**'s 27 MW Buffalo Mountain Wind Energy Center in Anderson County, Tenn. (PFR, 7/24). One financier says there is some form of contingent structure in the financing for the eventual adoption of PTCs, which are expected to be renewed this year.

CoBank and NordLB each took small \$8 million tickets in the deal. Alongside Invenergy there is a equity tax investor who will use the PTCs when they are renewed and the facility starts operation. The farm is expected to be finished in the fourth quarter and has a 20-year offtake agreement with the Tennessee Valley Authority.

## CMS Places \$800M Secured Bank Package

**CMS Energy** and its Michigan utility operation **Consumers Energy** have wrapped a \$800 million three-year loan package secured against first-mortgage bonds and company stock.

Bankers were expecting strong lender support for the deal given the relative turnaround in sentiment for the Midwest player (PFR, 7/5). One financier says the planned \$400 million loan for Consumers drew in \$600 million in tickets from 19 banks and was upsized to \$500 million.

**Bank One**, **J.P. Morgan Chase** and **Barclays Capital** co-led the Consumers loan, which was secured against first-mortgage bonds and carried pricing of LIBOR plus 125 basis points and a

22.5 basis point commitment fee. **Citigroup**, **Wachovia** and **Union Bank of California** came in as co-documentation agents.

The \$300 million loan for CMS was secured against the stock of **Consumers Energy** and **CMS Enterprises** and is led by Citigroup and Wachovia. Pricing is LIBOR plus 275 basis points with a 50 basis point commitment fee. One banker says the lending group is smaller on this deal, but further details could not be ascertained.

## Alliant Plots Private Placement For 300 MW Plant

**Alliant Energy Generation** will look to the private placement market to finance a 300 MW facility outside Sheboygan Falls, Wis., if state regulators approve a proposed long-term lease under which sister company **Wisconsin Power & Light** will operate the facility. **Mark Condon**, cfo at AEG, says the aim would be to tap the 20-year part of the curve with an issue of around \$75 million once the lease is approved and finalized.

AEG recently took up its option to buy the site for the simple-cycle, natural gas-fired power plant, which will cost \$140-150 million to construct. Initial preparation work at the site has started and is being financed by parent **Alliant Energy Corp.**, Condon notes. The company is expecting a decision from the **Public Service Commission of Wisconsin** during the first quarter (PFR, 7/31).

Condon says it hasn't been determined whether the bonds will be non-recourse or corporate level. "Pricing will be the issue," he says, adding AEG will look at the terms and conditions on offer in both markets.

## Constellation Lures El Paso Attorney

**Constellation Power Source** has hired **Andrew Kidd**, senior v.p. and deputy general counsel at **El Paso Corp.** in Houston. Kidd, who was between positions, was most recently providing legal support on corporate finance, mergers and acquisitions, litigation, and environmental matters for El Paso. Prior to joining El Paso in 1999, Kidd was v.p. and associate general counsel for **Covanta Energy Group**.

One former El Paso staffer described Kidd as a "highly sought-after" deal attorney.

**Kim Wallace**, a spokeswoman at El Paso in Houston, confirmed that Kidd has accepted a position at another company, in a voicemail message to *PFR*, declining further comment.

Calls to officials at Constellation Power Source, the wholesale energy arm of **Constellation Energy**, were not returned by press time.



## Investec Hires SG Banker To Lead Project Finance Push

Mark Henderson, director and senior U.K. power sector project financier at **Société Générale** in London, has left the French bank to take up a new position as head of power project finance for Europe and the Middle East at **Investec**. Market watchers say Henderson joins Investec later this month.

"It's a great move that really recharges his career," says one market watcher, noting the decision to incorporate SocGen's power team into a new combined energy team last summer under the leadership of **Robin Baker**, formerly head of oil and gas, limited Henderson's prospects for running a power team there (PFR, 8/12). Henderson could not be reached and Baker declined comment.

Investec has become an increasingly active player in both the PFI and project finance market, but until now has only had a relatively minor presence in the power sector, say market watchers. Late last year Investec formed a joint venture with **Mountside Properties**, called **Tynagh Energy**, that won an Irish government contract to develop a 400 MW gas-fired power plant in County Galway (PFR, 12/16).

## IDB Preps Hydro Projects In Panama, Brazil

The **Inter-American Development Bank** is looking to develop and provide financing for several new hydroelectric projects in Brazil and Panama.

The first scheme to get the go-ahead will likely be the Bonyic Hydroelectric Project in Panama, says **Leandro Alves**, an investment officer at the IDB in Washington, D.C. The IDB is evaluating the development of 30 MW of generation capacity at the site and is conducting due diligence ahead of giving final approval. If it gets the go ahead, the IDB will likely provide around \$25 million in financing for the project in the form of a two-tranche A/B loan, says Alves.

In Brazil, the IDB is looking to approve construction of a hydro project in the order of 800 MW by the end of the year. "We're going to be looking at similar deals as Campos Novos. And with a similar shareholder structure," says Alves.

Last month the IDB approved the disbursement of a \$75 million loan to help finance the 880 MW Campos Novos Hydroelectric Power Project on the Canoas River in Santa Catarina State.

Sponsors for the projects could include those who are sponsoring the Campos Novos construction, says Alves. These include **CPFL Geração de Energia**, **Companhia Brasileira de Alumínio** and **Companhia Estadual de Energia Eléctrica**.

## PacifiCorp Launches Pollution L/C Facility

Portland, Ore.-based **PacifiCorp** is looking to tap the bank loan market for a \$296 million letter of credit facility that will backstop pollution-control bonds. The loan is a new deal replacing a number of bi-lateral lines, says one banker. LC facilities are often used as a backstop to pollution bonds to enhance credit quality and liquidity for fixed-income investors.

The **Barclays Capital**-led \$296 million loan carries a spread of LIBOR plus 87.5 basis points. There is also a three-year maturity, a tenor which has almost become the baseline for solid power deals, says a banker. Commitments are due Aug. 19.

## Cinergy Closes On Energy Management Mandates

**Cinergy** is close to signing an agreement to become the third-party energy manager for a portfolio of eight merchant power plants in the southeast U.S. that **Duke Energy** agreed to sell to a unit of **MatlinPatterson** in May. **KGen Partners**, a unit of **MatlinPatterson Global Opportunities Partners II**, was set to close the acquisition Friday and the energy management agreement is likely to be announced today, according to an official familiar with the deal. Officials at Cinergy and MatlinPatterson could not be reached for comment.

The portfolio consists of Hot Spring in Arkansas; Murray and Sandersville in Georgia; Marshall in Kentucky; and Hinds, Southaven, Enterprise and New Albany, all in Mississippi. The plants have a combined capacity of some 5,325 MW.

## London Exchange Hires TXU Marketer

**Jeremy Hall**, v.p. of structured transactions at **TXU Europe**, is set to join the **UKPX**, a London-based power exchange, as director responsible for running the business. Hall says he joins today after spending the past year-and-a-half helping administrators **Ernst & Young** and **KPMG** unwind TXU Europe's trading book and other contracts.

The appointment of Hall follows the acquisition of the **UKPX** by **APX**, operator of the **Amsterdam Power Exchange**, this June, says spokeswoman **Miranda Barham**. The **UKPX** was established in 2000 and has 49 members. Between January and May some 14,608 GWh of power were traded on the exchange.

Hall joined TXU Europe's predecessor, **Eastern Electricity**, in 1997 and was v.p. of trading in its Geneva office before leading the utility's European structured transactions team. Before that Hall spent three years at **Enron Europe** and four years at **British Gas**.

## Corporate Strategies

### Puget Sound Redeems Notes To Cash In On Lower Rates

**Puget Sound Energy**, Washington State's largest electric utility, is redeeming \$55 million outstanding in 7.35% long-dated notes to cash in on lower interest rates. The notes, which were due to mature in 2024, will be refinanced with part of a recent \$200 million two-year variable-rate note issue, says **Lisa Rice**, assistant treasurer at Puget Sound.

The issue is refinancing portions of other maturities as well, says Rice. Rice declined to reveal the pricing on the FRNs or estimate how much the company will save in the refinancing, given the apples-to-oranges comparison between a fixed-rate issue and floating-rate debt. "It is economical to call them," she says. **Merrill Lynch** led the \$200 million note offering on July 15. The notes mature in July 2006.

Puget Sound has an additional \$50 million maturing in December, which it will refinance with its short-term liquidity facilities and then in 2005 the company will address longer term financing, says Rice, and will consider a long-term bond issue at that time.

The refinancing will have no net impact on the company's credit quality, says **Leo Carillo**, **Standard & Poor's** analyst. "This is part of their overall plan to reduce interest costs and refinance their debt," he adds. Puget Sound Energy is rated BBB minus by S&P.

### Yankee Bonds

### Foreign Borrowers Flock To U.S. Debt Mart

A rash of non-U.S. utilities and energy companies have tapped the U.S. bond mart over the past month, lured by the depth of the market, attractive swap rates and the voracious appetite of U.S. institutional investors for Yankee offerings—U.S. dollar-denominated debt issued by foreign companies.

"We expect the trend of robust Yankee issuance to continue this year," says **Peter O'Malley**, head of debt capital markets for North America at **ABN AMRO**, which recently led U.S. offerings for Spain's **Iberdrola**, Russia's **Gazprom** and Canada's **EnCana**.

O'Malley says that in some cases, the U.S. private market provides cheaper pricing on what a European company could land in euros, while also giving it the advantage of broadening and diversifying its investor base and the ability to execute a quick deal. "If you are looking at a pure LIBOR basis, it makes sense to look at the dollar market," says O'Malley. "Swaps are in your favor."

Many U.S. institutional fund managers have an almost

insatiable appetite for Yankee deals because they're hungry for credits they aren't over-exposed to, O'Malley says. This bodes well for foreign utilities making a debut in the U.S. market or entering it for the first time in years, he explains.

Since issuance in general in the U.S. market is down to around 30% on last year's volume, and 40% of this year's deals are from financial credits, investors are even more eager to buy non-financial issuers such as energy companies.

Spanish utilities **Iberdrola** and **Endesa**, which recently issued U.S. bonds of \$450 million and \$575 million, respectively, have the added incentive of avoiding recent legislation in Spain that makes issuing debt in Europe a more time consuming affair.

**Gazprom**, the world's largest natural gas producer, recently sold \$1.25 billion of bonds into the U.S. market, marking the first investment-grade offering from a Russian corporate borrower.

Late last month **EnCana** issued \$1 billion in senior notes, in a deal that was five times oversubscribed within hours, says O'Malley.

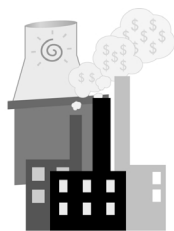
### Wisconsin Power Taps Into Lower Coupon

**Wisconsin Power and Light** has tapped the fixed-income market for \$100 million in 6.25% debt, allowing the utility to refinance a chunk of 7.25% first-mortgage bonds that matured June 1. **Karen Whitmer**, spokeswoman for parent **Alliant Energy Corp.**, says WP&L was waiting for favorable market conditions and "had the flexibility under other short-term facilities to wait."

The \$98.6 million in net proceeds is divvied up into \$62 million to repay short-term debt run up as a result of the first-mortgage bond maturing. The balance is partially earmarked to fund infrastructure improvements, according to Whitmer, who was unable to add further details. **Eliot Protsch**, cfo, told a recent analyst earning call that Alliant's utility operations will soak up some 90% of the holding company's \$700 million forecast capital expenditure budget this year.

The new 30-year notes, which landed a 95 basis point spread over comparable Treasuries, were placed by **Banc of America Securities** and **Wachovia Securities** as joint lead managers and joint book managers. **ABN AMRO**, **Robert W. Baird & Co.** and **The Williams Capital Group** were co-managers. Whitmer says the leads were selected through a competitive bid process.

Alliant raised \$318.4 million via an equity issue last year specifically to fund generation and distribution upgrades in its utility business (PFR, 7/15/03).



## Generation Auction & Sale Calendar

Following is a directory of ongoing generation asset sales. The accuracy of the information, which is derived from many sources, is deemed reliable but cannot be guaranteed. To report new auctions or changes in the status of a sale, please call Will Ainger, managing editor, at (44-20) 7303-1735 or e-mail [wainger@euromoneyplc.com](mailto:wainger@euromoneyplc.com).

Seller	Plants	Location	MW	Plant Type	Advisor	Status
AEP	El Bajio	Mexico	600 (50%)	Gas	WestLB	
AES	Wolf Hollow	Texas	730	Gas	N/A	Ongoing.
	Granite Ridge	N.H.	720	Gas		
	Termomamonal	Colombia	90	Gas	None	Ongoing.
	Ottana	Italy	140	Gas		
Allegheny Energy Supply	Armstrong	Penn.	356	Coal	J.P. Morgan	Ongoing.
	Hatfield	Penn.	1,600 (75%)	Coal	Citibank	
	Mitchell	Penn.	442	Coal	J.P. Morgan	
BP	Great Yarmouth	U.K.	400	Gas	J.P. Morgan	Intention to sell.
Black Hills Energy	Pepperell	Mass.	40	Gas	-	Intention to sell.
BNP -led bank group (Exelon developed plants)	Mystic River 7	Mass.	560	Oil/Gas	Lazard	Ongoing.
	Mystic River 8	Mass.	832	Gas		
	Mystic River 9	Mass.	832	Gas		
	Fore River	Mass.	832	Gas		
Citi & SocGen-led creditor group (TECO Energy developed plants)	Union	Ark.	2,200	Gas	Goldman	Ongoing.
	Gila River	Ariz.	2,300	Gas		
CMS Energy	Ensenada	Argentina	128	Gas	Not chosen	Announced intention to sell.
	CT Mendoza	Argentina	520	Gas	J.P. Morgan	
	El Chocon	Argentina	1,320	Hydro	J.P. Morgan	
Citi-led bank group (NEG developed plants)	Lake Road	Conn.	840	Gas	Lehman Bros.	Separate auction for each plant.
	La Paloma	Calif.	1,121	Gas	Lehman Bros.	
ConocoPhillips	Ingleside	Texas	440 (50%)	Gas	None	Looking to sell stake by June.
Damhead Power	Damhead	U.K.	800	Gas	E&Y	Has agreed sale to ScottishPower.
Delta Power	Lowell Power	Mass.	82	Gas	None	Actively pursuing a sale.
Duke Energy North America	Lee Energy	Ill.	640	Gas	J.P. Morgan	Ongoing.
	Bridgeport Energy	Conn.	480 (67%)	Gas		
	Grays Harbor (in construction)	Wash.	650	Gas		
	Deming Energy (in construction)	N.M.	570	Gas		
	Griffith Energy (50%)	Ariz.	600	Gas		
	Maine Independence	Maine	520	Gas		
El Paso Europe	Enfield	U.K.	396 (25%)	Gas	No Advisor	Looking to exit Europe.
	EMA Power	Hungary	70	Coal		
	Kladna	Czech Rep.	350	Coal		
El Paso North America (Merchant assets)	Bayonne	N.J.	186	Gas		Final bids due.
	Berkshire	Mass.	261 (56.41%)	Gas		
	Camden	N.J.	149	Gas		
	CDECCA	Conn.	62	Gas		
	Eagle Point	N.J.	233	Gas		
	Fulton	N.Y.	45	Gas		
	Newark Bay	N.J.	147	Gas		
	Pawtucket	R.I.	67	Gas		
	Rensselaer	N.Y.	79	Gas		
	San Joaquin	Calif.	48	Gas		
El Paso North America (Contracted assets)	Midland Cogen	Miss.	1,500 (44%)	Gas	Citigroup	Has sold majority of QF portfolio to ArcLight.
	Prime	N.J.	66 (50%)	Gas		
Endesa	Conatillor	Chile	172	Hydro	N/A	Ongoing.
EnCana	Cavalier	Alberta	106	Gas	HSBC	Launched sale in April. Looking to exit generation business.
	Balzac	Alberta	106	Gas	HSBC	
	Kingston	Ontario	110 (25%)	Gas	HSBC	
Energy Investors Fund	Multitrade	Va.	79.5 (60%)	Biomass	None	Intention to sell.
	Crockett	Calif.	240 (24%)	Gas	None	

## Generation Auction & Sale Calendar (cont'd)

Seller	Plants	Location	MW	Plant Type	Advisor	Status
Entergy Asset Management	Robert Ritchie	Ark.	544	Gas/oil		Ongoing.
	Warren Power	Miss.	314	Gas		
	Top of Iowa	Iowa	80	Wind		
	RS Cogen	La.	425 (49%)	CHP		
	Roy S. Nelson	La.	550 (20%)	Coal		
	Harrison County	Texas	550 (70%)	Gas		
	Independence	Ark.	842 (15%)	Coal		
EPRL	Glanford	U.K.	14	Poultry Litter	Rothschild	Ongoing.
	Thetford	U.K.	39	Poultry Litter		
	Ely	U.K.	13	Poultry Litter		
	Westfield	U.K.	10	Poultry Litter		
	Elean	U.K.	38	Straw		
Ernst & Young Corporate Finance (representing secured creditors)	Bear Swamp	Mass.	599	Hydro	E&Y	Exploring sale.
HSBC-led creditor group	Attala	Miss.	526	Gas	HSBC	Ongoing.
InterGen	Larkspur Energy	Calif.	90	Gas	Citi	Ongoing.
	Indigo	Calif.	135	Gas	Citi	
	El Bajio	Mexico	600 (50%)	Gas	N/A	Ongoing.
KBC-led creditor group	Milford	Conn	542	Gas	Lazard	Ongoing.
LG&E Power	Roanoke Valley	N.C.	178 (50%)	Coal	N/A	Ongoing.
	Gregory Power	Texas	550 (50%)	Gas		
	Palm Springs	Calif.	42 (50%)	Wind		
	Tyler	Minn.	27 (50%)	Wind		
	Van Horn	Texas	41 (33%)	Wind		
	Tarifa	Spain	30 (46%)	Wind		
Mirant	Kendall	Mass.	270	Oil	CSFB BofA	Ongoing.
	Shady Hills	Fla.	474	Gas		
	West Georgia	Ga.	640	Gas		
	Bosque County	Texas	538	Gas		
	Wichita Falls	Texas	77	Gas		
Morrow Power	Boardman	Ore.	28	Gas	Marathon Capital	Looking to select bidder by June.
Nations Energy	Bayport	Texas	80	N/A		Considering liquidating the company.
	Mungo Junction	Ohio	32			
	Southbridge	Mass.	7			
National Energy Gas & Transmission (USGen New England)	Salem Harbor	Mass.	745	Coal/Oil	Lazard	Ongoing.
	Brayton Point	Mass.	1,599	Coal		
	Manchester St.	R.I.	495	Gas		
	Connecticut River	N.H.	479	Hydro		
	Deerfield River	Mass.	89	Hydro		
Oman (Ministry of Housing, Electricity & Water)	Rusail	Oman	730	Gas	CSFB	-
	Ghubratt	Oman	507	CHP		
	Wad AlJazzi	Oman	350	Gas		
Reliant Energy	Carr Street	N.Y.	95	Oil	Goldman	Ongoing.
	Astoria	N.Y.	1,276	Gas		
	Gowanus	N.Y.	549	Gas		
	Narrows	N.Y.	281	Gas		
SG-led bank group (NEG developed plants)	Athens	N.Y.	1,080	Gas	Blackstone	Assessing bids.
	Covert	Mich.	1,170	Gas		
	Harquahala	Ariz.	1,092	Gas		
	Millennium	Mass.	360	Gas		
STEAG	Iskenderun	Turkey	1,320	Gas	Morgan Stanley	Ongoing. Set to sell Guadalupe and Odessa to PSEG.
	Termopaipa IV	Philippines	185	Gas		
TECO Energy	Frontera Power Station	Texas	477	Gas	Goldman	
	Dell Power Station	Ark.	540	Gas		
	McAdams Power Station	La.	599	Gas		
	Commonwealth Chesapeake	Va.	315	Gas		
Tractebel North America	Chehalis	Wash.	520	Gas	N/A	Looking to sell or swap.
United Utilities	Landfill Generation Portfolio	U.K.	50 MW	Landfill	RBC Capital Markets	Set to launch sale in May.

## Viewpoint

## Moral Hazard: The Implications Of Enron Australia v TXU Electricity

*The outcome of a recent Australian court case between Enron Australia and TXU Electricity over the termination of some electricity swaps reveals some serious flaws in standard swap contraction documentation, argue Gary Walker and Guy Usher, partners at Field Fisher Waterhouse in London.*

### The Facts

Enron Australia (Enron) and TXU Electricity (TXU) were party to a large number of electricity swaps governed by a 1992 ISDA Master Agreement (the Master). For early termination purposes, “Market Quotation” and “Second Method” were stated to apply while “Automatic Early Termination” was disapplied.

In late 2001/early 2002, at a time when the swaps were net out-the-money to TXU, Enron was placed first into administration and then into liquidation. Each occurrence was an event of default under the Master. Although contractually so entitled, TXU chose not to designate an early termination date pursuant to s.6(a) of the Master, since that would have had the effect of crystallising its contingent liability—the net out-the-money amount—under the swaps. At the same time, relying on the standard “no default as a condition to payment” provision set out in s.2(a)(iii) of the Master, it ceased making payments to Enron.

Enron’s liquidator sought leave of the court to have the swaps disclaimed in such a way as to compel TXU concurrently to designate an early termination date. The court declined, refusing to rewrite the Master so as to deprive TXU of its contractual entitlement (i) to choose whether and when to designate an early termination date and (ii) not to pay while Enron remained in default.

From TXU’s perspective, the decision was welcome. From Enron’s, it was anything but. Not only was it insolvent and therefore unable to realise value in the swaps by continuing to perform its side of the bargain; it had no means, either, to bring about designation of an early termination date that was a contractual prerequisite to that value being immediately crystallised in its favour.

### Moral hazard—A New Low

Moral hazard is ever-present in today’s financial markets. One need only consider the position of a bank holder of credit default protection on a distressed reference entity—to which the bank is at the same time a relationship lender—to see that this is so.

At the macro level, *Enron v TXU* compounds the dilemma. For if such a credit protection holder is concurrently net out-the-money to the reference entity under a series of ISDA-governed derivative transactions to which Automatic Early Termination is stated not to apply, it has more incentive than ever to leave the reference entity to its fate (rather than accommodate it in restructuring), call in its credit protection

and “walk away” from its net obligations under the derivatives.

There is a disquieting consequence at the micro level too. By electing Second Method, Enron and TXU had expressly agreed that on designation of an early termination date, neither would walk away from its obligations, irrespective of whichever was out-the-money and whichever was in default at the relevant time. It seems unprincipled, therefore, that TXU should be able subsequently to disregard that agreement, on the technical ground that an early termination date had not been designated, when TXU itself was the sole arbiter of the decision to designate and had a great deal to gain from not exercising its discretion. TXU’s inaction is a classic example, in fact, of moral hazard in operation!

### Credit/Systemic Risk—A New High

Creditors, back-to-back counterparties and shareholders in any entity that undertakes significant derivative activity ought to be deeply troubled by *Enron v TXU*. For it illustrates that, even if Second Method is elected, net in-the-money amounts attributable to such an entity (*qua* defaulting party) may nevertheless not be realisable.

If the defaulting entity is sizeable, the systemic implications are equally significant. Indeed, it is precisely a policy desire to mitigate systemic risk of this nature that predisposes e.g. the Financial Services Authority in its approach to walkaway provisions in netting agreements entered into by and between regulated entities. It is to this—perhaps the most disturbing—aspect of *Enron v TXU* that we now turn.

### What Now For Regulatory Capital Netting?

The minimum contractual features that the FSA considers a close-out netting agreement (such as the 1992 ISDA Master Agreement) should possess in order for it to be recognised for supervisory (including netting for capital adequacy) purposes are set out in section 6 of Chapter NE (Collateral and Netting) of *The Interim Prudential Sourcebook for Banks*. Parallel regulatory requirements, all of which have their genesis in the Basle Capital Accord, exist in many other jurisdictions. Section 6.4 of Chapter NE deals with walkaway clauses and provides as follows:

“The netting agreement should not contain a walkaway clause.

A walkaway clause is a provision which permits a non-defaulting counterparty to make limited payments, or no payments at all, to the estate of the defaulter, even if the defaulter



is a net creditor. In other words, the walkaway clause would have the effect of taking away or limiting the right to receive payment, which a party which is a net creditor would otherwise have, by virtue of the fact that such party is a defaulting party.”

As we have intimated, the policy reason behind the FSA's dictat in relation to walkaway clauses is a desire to limit risk in the financial sector—the systemic implications of large numbers of non-defaulting parties walking away from net out-the-money positions to an insolvent counterparty being obvious. The “reward” for regulatory compliance in this regard is that, subject to meeting various other criteria, regulated entities are permitted to allocate capital in respect of mastered derivative exposures on a net, as opposed to gross, basis.

It is instructive to consider the effect of regulatory attrition in this regard. Whereas the 1987 ISDA Interest Rate and Currency Exchange Agreement embeds a walkaway provision as standard (see s.6(e)(i)(1)), the 1992 ISDA Master Agreement allows parties to make a positive election one way or the other (compare First Method with Second Method under s.6(e)(i)(1)-(4)). The 2002 ISDA Master Agreement does away with First Method as a concept altogether.

The key point is that the debate has hitherto centred exclusively on s.6(e). *Enron Vs. TXU*, on the other hand, moves the goal posts and brings into sharp and unpalatable focus the fact that s.2(a)(iii) and 6(a) (ISDA Master ‘ever-presents’, whatever the vintage) are capable, when working in tandem, of behaving in similar ‘walkaway’ fashion. In effect, they reintroduce First Method via the back door. If that is the right conclusion—and looking at the final paragraph of section 6.4 of Chapter NE as set out above, we think it must be—then netting for capital adequacy purposes is catastrophically undermined pending at the very least (i) a change to ISDA documentation and (ii) related clarification from the FSA.

Regulated entities that seek to net under Chapter NE are required to obtain *reasoned independent legal opinions* that confirm the absence of walkaway provisions from their netting agreements. It is a further requirement that those same opinions are updated annually and that their validity is confirmed by the relevant entity to the FSA. Since no law firm will be able to give an opinion that is not materially qualified as a result of *Enron v TXU*, reporting entities and the FSA will be forced to act. Opinion providers, reporting entities and regulators in many other jurisdictions will be confronted by a similar conundrum.

## Back To The Future With IAS 39

IAS 39, in particular the provisions dealing with fair value and hedge accounting, runs into similar difficulties. For what is the point in marking derivatives to market (or recognising their effectiveness as hedging instruments) if, on an insolvency of the reporting entity, any positive value is either non-realizable or does not wash through in cash-flow terms? As *Enron v TXU*

demonstrates, accounting for derivatives in either of these ways will, in certain circumstances, be entirely unreflective of the contractual and commercial realities.

There is a further consequence insofar as the facts of the case are relevant only to insolvent counterparties that are net in-the-money. Insolvent counterparties that are net out-the-money can expect the liability to be crystallised and to be subject to a creditor's proof. The result is that net in-the-money amounts ought perhaps to be reported at zero while net out-the-money amounts continue to be reported at fair value.

If contractual integrity in the context of IAS 39 has never been high on the ASB's/IASB's agenda, *Enron v TXU* more than suggests that it now should be.

## Some Good News

If anything good comes out of *Enron v TXU*, it is the support that it lends to the enforceability of flawed asset provisions on insolvency. It is to be remembered that First Method is an example of a flawed asset provision insofar as it subjects the contingent rights of an in-the-money party to the condition (or “flaw”) that such rights are only enforceable if the in-the-money party is not itself in default. In this regard, *Enron v TXU* not only upholds the principle of flawed asset provisions generally but also illustrates that the “flaw” attaching to a flawed asset cannot be disclaimed unless the asset to which it is attached is also disclaimed. Those venerating ISDA documentation for this reason alone in the aftermath of *Enron v TXU* would, however, do well to consider some of the wider issues to which the decision has given rise.

## Solutions & Next Steps

There are some obvious solutions to the difficulties presented by *Enron v TXU*. Electing for Automatic Early Termination would have saved Enron in relation to its insolvency (although not in relation to most other events of default - see s.6(a) of the 1992 ISDA Master Agreement). Equally, had Enron held sufficient collateral, particularly if under an ISDA CSA, TXU may well have been persuaded to act differently.

Perhaps the most simple and compelling solution, however, would have been a pre-trading amendment to s.6(a) of the Master that had the effect of obliging TXU to designate an early termination date within a certain number of days of the occurrence of Enron's insolvency. Certainly, the latter suggestion has been made in more than one quarter subsequent to the decision; and the fact that it runs counter to conventional bias against defaulting counterparties does not diminish its practical value in circumstances such as those that arose in *Enron Vs. TXU*.

Any solution will, however, require industry examination and consensus that ought readily to be forthcoming given the imperatives discussed in this article.

## 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.*

### Asia & Australasia

- **TXU Corp.** has closed the sale of its Australian energy assets to **Singapore Power** for about \$3.6 billion. TXU said it expects to record a third-quarter, pretax gain of about \$375 million for the sale to the Singapore government-owned concern and the company plans to use the deal's proceeds of about \$1.9 billion to repay debt (*Dow Jones*, 7/30).

### Europe & Middle East

- **Endesa Italia** has signed an agreement to purchase a 90% stake in the Florinas wind farm from **Gamesa**. The farm has a capacity of 20 MW (*Bloomberg*, 8/2).

- **Edison**, Italy's second-largest power company, has agreed to sell its natural gas network to **Clessidra**, an Italian buyout fund, for EUR195 million. Edison, which is controlled by **Electricité de France** and **Fiat**, will continue to operate the network (*Bloomberg*, 8/2).

- **International Power** and **Mitsui & Co.** have joined together to buy **Edison Mission Energy's** remaining 5,381 MW international power generation portfolio. The \$2.2 billion purchase covers 13 generation projects in nine countries: the U.K., Italy, Spain, Turkey, Australia, Indonesia, Thailand, Philippines and Puerto Rico. Edison Mission recently sold its 51.2 % holding in **Contact Energy** for around \$750 million (*Financial Times*, 7/30).

- A group of fund managers and hedge funds including **Polygon Investments** and **Invesco Perpetual** are looking to block a U.K. government-backed restructuring of **British Energy** that would leave shareholders with just a 2.5% equity stake in the company. Polygon with a 5.6% stake have put forward an alternative plan that would hand back 30% to shareholders and pay bondholders GBP750 million in cash (*Financial Times*, 8/2).

- The U.K. government has announced plans to provide the Marine Research Development Fund with an additional GBP50 million to invest in the development of wave and tidal renewable energy technologies, bringing the total government support for renewables over the next four years to \$350 million. The announcement came as **Wavegen** launched its bid to raise GBP10 million from the City to fund developments including

the construction of a wave power turbine built into the cliff face on the Faroe Islands (*The Independent*, 8/3).

- The municipal utility of Reggio Emilia in Northern Italy, **Agac**, is planning to merge with neighboring utilities **Amps** of Parma and **Tesa** of Piacenza, in an attempt to cut costs. The merger will take effect Jan. 1, and as much as 49% of the combined company will be sold on the stock market by late 2005 (*Bloomberg*, 8/5).

### Latin America

- **Petrobras** is in talks to buy a 380 MW thermoelectric plant owned by **Enron** called Eletrobolt in the state of Rio de Janeiro, Brazil. The state-owned oil company already owns a stake in the plant and has a current strategy of pulling out completely or taking control of thermoelectric projects in which it has invested over the last several years (*Bloomberg*, 8/5).

### U.S. & Canada

- In its second quarter earnings call, **Entergy** said it is in advanced negotiations with a potential buyer for its **Entergy-Koch Trading** operation, and that it will also sell its **Gulf South Pipeline** business. Earnings at Entergy overall rose \$1.14 per share, while earnings at the trading unit declined \$0.04 per share (*Bloomberg*, 8/2).

- **Edison International** reported a second quarter loss of \$374 million, but expects 2004 profits to surpass analyst estimates in part because of its agreement to sell its power plants in Europe, Asia and Australia to **International Power** and **Mitsui & Co.** for \$2.3 billion in cash and the assumption of \$3.2 billion in debt. The portfolio consists of 13 power plants and 5,400 MW (*Bloomberg*, 7/30).

- The ex-head of **Enron's** broadband Internet business has admitted to a single count of securities fraud. **Ken Rice** pleaded guilty to making misleading statements during a Jan. 20, 2000, meeting with analysts where he and others at the company touted the capabilities of Enron's broadband network. Six other former Enron Broadband Services employees were set to go to trial with Rice on Oct. 4. The plea agreement with prosecutors requires him to cooperate in ongoing investigations and forfeit \$13.7 million in cash and property (*Houston Chronicle*, 7/31).

## Financing Record (JULY 29 - AUGUST 4)

### M&A

Date Effective	Date Announced	Target Name	Target Advisors	Target Country	Acquiror Name	Acquiror Advisors	Acquiror Country	Value (\$mil)
-	7/29/04	Biodiesel Schwarzheide	-	Germany	Biodiesel Holding	-	Germany	-
-	7/29/04	Hidrocantabrico	JP Morgan Rothschild	Spain	EDP	Morgan Stanley	Portugal	2,646.17
-	7/29/04	Ottogas Rete	-	Italy	Enel Gas	Lazard	Italy	37.938
-	7/29/04	Ottogas Vendita	-	Italy	Enel Gas	Lazard	Italy	-
7/29/04	7/29/04	Progress Energy Solutions	-	U.S.	Energy Systems Group	-	U.S.	-
-	7/29/04	SWB	-	Germany	EWE	-	Germany	-
7/30/04	7/30/04	AEP-Power Stations	Citigroup Lexicon Partners	U.K.	Scottish & Southern Energy	Lazard	U.K.	247.058
-	7/30/04	CMS Energy-Parmelia	-	Australia	Australian Pipeline Trust	ABN Amro	Australia	-
7/30/04	7/30/04	Elejor	-	Brazil	COPEL	-	Brazil	-
-	7/30/04	Edison T&S	Banca IMI	Italy	Clessidra Capital	Mediobanca	Italy	234.516
-	7/30/04	Edison Mission Energy	Lehman Brothers	U.K.	Investor Group	Morgan Stanley/ Cazenove	U.K.	3,900.00
-	-	-	Credit Suisse First Boston	-	-	-	-	-
7/30/04	7/30/04	Kolenergo	-	Russian Fed	MMC Norilsk Nickel Group	-	Russian Fed	-
-	7/30/04	Southern Cross Pipelines	-	Australia	Australian Pipeline Trust	ABN Amro	Australia	144.653
7/30/04	7/30/04	Willow Creek-Wastewater	-	U.S.	Aqua North Carolina	-	U.S.	-
-	8/2/04	Bembibre-Water Utility	-	Spain	UTE Hidrogestion Socamex	-	Spain	4.209
8/2/04	8/2/04	Michigan Power	-	U.S.	Delphi Power Partners	-	U.S.	-
8/2/04	8/2/04	Servizi Energia e Ambiente	-	Italy	Toscana Partecipazioni	-	Italy	13.229
8/3/04	8/3/04	Smedigas	-	Italy	Gas Natural	-	Spain	84.368
8/3/04	8/3/04	Tele-Gest, Michel Bellerose	-	Canada	Ameresco Canada	-	Canada	-
-	8/4/04	Monongahela Power	-	U.S.	Investor Group	-	U.S.	228
-	8/4/04	Mountaineer Gas	JP Morgan	U.S.	Investor Group	-	U.K.	228Source:

Thomson Financial Securities Data Company. For more information, call Rich Peterson at (973) 645-9701.

## MERCHANT ASSETS

(continued from page 1)

acquiring the bulk of Edison Mission Energy's international portfolio as well as RWE's Tapada plant in Portugal (PFR, 7/12).

### What Next?

The recent flurry of asset sales draws to a close the high-profile auctions of contracted power plants, a move that likely paves the way for a renewed effort among distressed sellers and their advisors to offload merchant plants, predict market

watchers. "In generation, a lot of the QF deals have been done," says Dan Revers, managing partner at Arclight Capital in Boston. Instead, he says, a lot of the merchant assets that have been pitched over the last two years may get another spell on the auction block. "We're seeing a lot of those come to market again," he notes.

In previous auctions potential buyers of merchant assets were scared away out by prohibitively high price tags, argues Revers. Now, though, many merchant assets are owned by bank groups and bondholders, who may be more willing to

Power Plant Sales In July						
Plant	Buyer	Seller	MW	Price	Output	Location
Texas Genco Portfolio (12 plants)	KKR/Texas Pacific/Blackstone/Hellman & Friedman	CenterPoint Energy	14,175	\$3.65 billion	Merchant	Texas
6 plant portfolio	Primary Energy	Reservoir Capital	270	\$190 million	Contracted	Calif.
Hartwell	Centennial Power	Dynegy	310 (50%)	Undisclosed	Merchant	Ga.
Oyster Creek	GE Commerical Finance	Dynegy	424 (50%)	\$79 million	Contracted	Texas
Michigan Power	Delphi Power	Dynegy	123 (50%)	Undisclosed	Contracted	Mich.
Commonwealth	Dominion Virginia Power	Dynegy	310 (50%)	\$15 million	Merchant	Va.
Ferry Bridge	Scottish and Southern Energy	AEP	1,995	\$250 million	Merchant	U.K.
Fiddler's Ferry	Scottish and Southern Energy	AEP	1,989	(sold with Ferry Bridge)	Merchant	U.K.
Hamakua Power	EIF	TECO Energy	60 (50%)	\$12 million	Contracted	Hawaii
Portion of 10-Plant El Paso portfolio	Arclight	John Hancock Life Insurance	5-51% of 620 MW	\$28 million	Contracted	Calif.
NEGT portfolio (12 plants)	Arclight/Caithness	NEGT	2,500 MW	\$558 million	Contracted	Various (U.S.)
Fifoots Point	Carron Energy Ventures	AES Fifoots Point	363		Merchant	U.K.
EME int'l portfolio (23 plants)	International Power & Mitsui	Edison Mission	5,381	\$2.3 billion	Varies	Europe, Asia, Australia, New Zealand
Odessa	TECO Energy	PSEG	1,000 (50%)	nominal	Merchant	Texas
Guadalupe	TECO Energy	PSEG	1,000 (50%)	nominal	Merchant	Texas
Tapada	International Power	RWE	990 (50%)	\$252	Contracted	Portugal

Source: PFR

sell at lower prices, he notes. "I think you're going to see a lot more of those deals get done," he says, although cautioning it may be difficult to get consensus among all the sellers on a credit committee.

Several bank-owned merchant assets have already been put on the block this summer. A **BNP Paribas**-led bank group recently put a former **Exelon**-owned 3 GW merchant portfolio in the Boston area on the block (PFR, 8/2). Meanwhile creditors led by **KBC Bank** put a 542 MW **El Paso Corp.**-developed plant in Milford, Conn., up for sale last month (PFR, 7/26), and **TECO Energy's** bank group, led by **Société Générale** and **Citibank**, is said to have hired **Goldman Sachs** to sell its Union and Gila River plants, 2.3 GW and 2.2 GW, respectively.

But merchant assets won't be the only M&A game in town going forward. One banker says he is advising clients to begin considering company-to-company mergers, although the key to closing those deals will be to get state regulators comfortable with the transactions. "I think the regulatory winds and political situation in certain states [are becoming more favorable]," says Revers, who predicts transactions involving regulated utilities may come down the chute soon.

As for buyers, market watchers predict that hedge funds, which have been final-round bidders in recent sales processes, will continue to be a factor. "The coming together of 10 hedge funds to put forth a leading bid on Texas Genco portends more of the same," says one banker. "These funds are sophisticated and agile," he adds.

—*Will Ainger & Angela Salvucci*

## RWE TRADING

(continued from page 1)

The U.K. business of NP was demerged into **Innogy** in 1999, where Senior was appointed head of trading and asset management. Three years later he took up a similar position when Innogy merged with Germany's largest utility, RWE.

One market watcher says Senior has long stated that he would only leave RWE Trading to take up a board-level position at a U.K. plc, and this has led him and other observers to speculate that Senior may be on his way to **Scottish and Southern Energy**. SSE announced two weeks back that **David Sigsworth**, director of generation, will retire at the end of this year. A spokesman for SSE says the Perth, Scotland-based utility has yet to make an appointment.

Others, however, suggest that Senior may simply be stepping down to take a well-earned breather. He's worked pretty much continuously since leaving university, says one official.

—*W.A.*

## CALPINE TARGETS

(continued from page 1)

One banker who tracks Calpine says the IPP might find it tough to go to the B loan market with construction debt, but in any case it likes to demonstrate it has access to bank funding. The Rocky Mountain project was financed with non-recourse bank debt for the final few months of construction (PFR, 3/1), even though Calpine was planning to tap the B loan market a matter of months later. Kelly also played up the company's access during the earnings calls. "We've seen healthy demand from the banking community to provide construction capital for all our new projects," he said.

New Contracted Plants			
Project Name	MW	Offtaker	PPA Tenor
Otay Mesa	593	San Diego Gas & Electric	10
Fox	550	Wisconsin Public Service	10
Valladolid III	525	CFE	25
Mankato	365	Xcel Energy	20
Freeport	250	Dow Chemical	25
Bethpage	80	LIPA	20

Source: Calpine

Chairman **Pete Cartwright** highlighted several power plant construction projects that have long-term offtake contracts attached to them (see table). Calpine plans to use turbines it has in its inventory as the equity component of the financing and lever the balance with project debt, he said.

**Union Bank of California** and **Bayerische Landesbank** were reportedly in position to lead the Fox deal a number of months ago (PFR, 4/19). Calls to officials at both banks were not returned. It could not be ascertained whether the leads have been assigned yet to the Metcalf deal.

—*Peter Thompson*

## Quote Of The Week

"Swaps are in your favor." —**Peter O'Malley**, head of debt capital markets at **ABN AMRO**, explaining the attractiveness of issuing U.S. dollar-denominated debt for foreign issuers (see story, page 5).

## One Year Ago In Power Finance & Risk

**Edison Mission Energy** was looking increasingly likely to file for bankruptcy, warned creditors working on a \$1 billion plus refinancing package for the embattled IPP. [Subsidiary **Mission Energy Holdings International** received a \$700 million secured three-year loan from **Citigroup**, **Credit Suisse First Boston**, **Lehman Brothers** and **J.P. Morgan** last November. The loan was to act as a bridge facility until EME could divest some international assets. Earlier this month EME sold the bulk of its international business to **Interntional Power** and **Mitsui** for \$2.3 billion.]