North American Single Asset Power Deal of the Year 2008

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Kleen Energy Systems: Clean close

The collapse of the leveraged loan market in the US left power sponsors scrambling for new sources of debt. The institutional, or B, loan market, which offered a low debt service burden and limited restrictions, was the first victim of the credit crunch. But the $1.35 billion Kleen Energy financing managed to fashion a debt package around the remnants of the B loan market, as well as incorporating commercial bank debt.

The financing has yet to be replicated, because the commercial bank market, a short time after the deal's 13 June closing, collapsed. The bookrunner for the debt financing, Goldman Sachs, provided a fully-underwritten commitment, one of the last times a US power financing was syndicated on that basis. It says it could do so again, for the right asset, though that boast has yet to be tested.

Kleen benefits from contracts for capacity and energy, the former with Connecticut Light & Power, the latter with an unnamed tolling counterparty. The energy tolling agreement runs for seven years, while the capacity agreement runs for 15 years. Between them, they provide a surprisingly strong credit for a project located in the merchant ISO-New England power market.

Kleen is a 620MW combine-cycle dual-fuel power plant located in Middletown, Connecticut. It owes its existence to the state's desire to improve system reliability without depending on merchant capacity markets. These markets, ostensibly designed to provide pricing signals to potential plant developers, have not encouraged building.

Kleen's capacity contract, awarded by the Connecticut Department of Public Utilities Control, and mandated by the state's 2005 Energy Independence Act, is structured as a contract for differences. It provides for CL&P to reimburse the plant for any shortfall between the market price and the strike price of $13.40 per kW-month, and for Kleen to pass back any surplus to the utility.

The capacity contract accounts for 60% of the plant's revenues, and allowed the developer, White Rock Holdings, to bring in a heavyweight equity partner and access long-dated financing, Providing over 80% of the project's $361 million in equity is Energy Investors Funds, through its United States Power Fund II, and United States Power Fund III.

Following EIF's arrival, the developer mandated Goldman Sachs to provide $885 million in debt financing for the project, of which $255 million is an eight-year revolving loan, and the remainder is term debt. Goldman split the term debt into a $435 million term loan A, with a tenor of construction plus eight years, and a $295 million term loan B, with a construction plus 14 years.

The split between the A and B tranches corresponds to the coverages produced by the two contracts. The B tranche, which includes a floor on Libor, minimal amortization while the A tranche is outstanding, as well as prepayment penalties, has features in common with the defunct institutional loan market's terms. It exploits the fact that some of the participants in that market, in particular life insurance companies and money market funds, still have a little appetite for project debt. The resulting tranche looks a little like a B loan and a little like a private placement tranche.

The A tranche was priced at 175bp (as was the revolver) and the B tranche at 250bp and the deal attracted BNP Paribas, Dexia, ING, Natixis, Scotia, WestLB as mandated lead arrangers. The structure indicates that while Goldman could – and did – manage to get the financing away from a fully-underwritten position, having a phalanx of banks as subunderwriters helped.

The project gained a rating of BBB- from Fitch, in part on the strength of the offtake contracts and 33% equity component, as well as because it has a fixed-price, date-certain engineering, procurement and construction contract with O&G, a minority equity provider. The plant entered construction in February 2008, before financial close, and is set for completion in November 2010.

Kleen should operate at a much lower heat rate than many of its neighbours, several of which are elderly and inefficient. Lenders must take care that O&G builds the plant to a heat rate that matches Kleen's commitments under its contracts and allows the plant to undercut its competition effectively. The $760 million EPC contract price includes an $89 million contingency.

Kleen Energy's clean close clearly invites a pun, but whether it inspires imitators is very difficult to divine at this stage in the credit cycle. The financing straddled the end of the B loan market and the bank-dominated clubs of 2009. It also relies on a merchant energy trader for its tolling agreement, an arrangement that banks have become increasingly wary of as the remaining merchant power traders find capital harder to come by.

But Connecticut's approach to power procurement looks like one to watch. The state has turned to its utilities to support capacity additions, and has come up with a method that lenders, offtakers and developers can love. Coming to market soon will be a financing for the GenConn peaking power project, also located in Connecticut, for which commercial banks have won the appetite, but whose future will depend on the markets' ability to recover in the coming months.

Kleen provided a useful test of the old project finance cliche that in a down market only the best-structured projects get closed in a difficult market. It almost established a new one – that the best-structured projects are always too good to be left to commercial bank clubs. The continued role of the investment banks in power finance is hard to predict. Their attractiveness to commercial banks as hedge providers is diminished, but their distribution capabilities are still formidable.

Kleen Energy Systems LLC

Status: Closed 13 June 2008
Size: $1.4 billion
Location: Middletown, Connecticut
Description: Greenfield 620MW combine-cycle gas-fired power plant
Equity: $361 million
Sponsors: EIF, White Rock Holdings, O&G Industries
Debt: $885 million
Mandated lead arranger and sole bookrunner: Goldman Sachs
Mandated lead arrangers: BNP Paribas, Dexia, ING, Natixis, Scotia, WestLB
EPC contractor: O&G Industries
O&M contractor: North American Energy Services
Design engineer: WorleyParsons
Permitting engineer: PB Power
State's consultant: London Economics
Independent engineer: E3 Consulting
Insurance adviser: Moore-McNeil
Fuel consultant: Energy Market Decisions
Market consultant: ESAI

Developer financial adviser: Financial Management Group
Developer legal adviser: Chadbourne & Parke
Project legal advisers: Bingham McCutchen (transaction), Pullman & Comley (local)
Lender legal adviser: Gibson Dunn & Crutcher