Puget Energy: Macquarie pays up

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Foreign and financial buyers of US utilities can expect a tough time from state regulators. Sceptical regulators have derailed at least one acquisition, Babcock & Brown's tilt for Northwestern. The only major financial sponsor's acquisition to go through has been a Macquarie-led consortium's $3.15 billion purchase of Duquesne Light.

The bid by a consortium led by Macquarie to acquire Puget Energy has progressed to the point where the parties and all but one of the objectors have agreed to a settlement, and the trade agreement has reportedly been signed. Puget Energy owns Puget Sound Energy (PSE), Washington State's largest regulated utility. The negotiations have resulted in the buyers having to put additional equity into the deal and include some restrictions on dividends from the utility.

The consortium consists of Macquarie Infrastructure Partners (31.8%), the Canada Pension Plan Investment Board (28.1%), British Columbia Investment Management Corporation (14.1%), Alberta Investment Management (6.3%), Macquarie-FSS Infrastructure Trust (3.7%) and Macquarie Bank (15.9%). They agreed on 26 October 2007 to buy Puget, which was publicly-traded, for $30 per share, in a deal that, including debt, gave the target an enterprise value of $7.4 billion. In the middle of April 2008, Barclays Capital and Dresdner Kleinwort launched retail syndication of $3.6 billion in debt for the acquisition, at around the time that Puget's shareholders approved it.

The consortium was hoping for final approval from the Washington Utilities and Transportation Commission (WUTC) by September, but the proposed buy-out is still facing stiff opposition from Simon ffitch, the chief of the public counsel section in the Washington State Attorney General's office. Ffitch will get another opportunity to voice his objections in hearings scheduled for August 25 through 27, and the public will be allowed to comment as well.
"This deal will get done," says one banker working on the financing. The political opposition is "nothing out of the ordinary," he says, "and nothing has deviated from the original time line." But the public consultation process has led to some significant modifications to the deal.

Ffitch's objections focused on the $1.6 billion increase in both the holding company and the utility's bank debt, from its existing base of $2.6 billion, and, in response, the buyers have agreed to inject another $200 million of equity to reduce the term facility from $1.425 billion to $1.225 billion, bringing the total equity contribution to $3.4 billion.

"The signing parties felt that between that and all the additional commitments, rate payers will not be harmed by the transaction," says Michael Parvinen, the WUTC's assistant director for energy. The staff of the WUTC originally opposed the acquisition, but has now agreed to it.

In particular, Parvinen notes, under the proposed structure, the term debt would be at the level holding company, Puget Energy, although this provision is unchanged from the original financing. There would be, however, additional restrictions on dividends to the holding company. PSE can pay a distribution to the parent to service that debt, but only if its common equity ratio is at least 44% after making the distribution. "If its equity ratio gets too low, it keeps its cash," he says.

As an additional condition, PSE will be allowed to make that distribution only if one of two other criteria are met: The ratio of its Ebitda to its interest expense for the most recently ended four fiscal quarter period prior to the distribution date is equal to or greater than 3 to 1, or it has managed to maintain an investment grade rating from both S&P and Moody's.

As part of the settlement, the consortium also agreed to provide a total of $100 million in rate credits, spread out in equal instalments over ten years. Of that, $8.8 million will not be offsettable, resulting in "lower utility bills for customers," Parvinen says.

There were a number of other commitments that were made as part of the settlement package, including a one-time $5 million contribution to the Puget Sound Energy Foundation, and an increase in the total aggregate funding cap for PSE's low income customer bill assistance program from $10.25 million to $15 million a year. In all, the number of commitments grew to 63 by the time the settlement was announced, compared to the 34 that were included in the initial filing on 17 December 2007.

The sponsors already said they would make $1 billion per year for five years in capital expenditures at the operating company level. On top of the original $1.425 billion term debt financing for the holding company, Barclays and Dresdner syndicated $1 billion in delayed-draw holding company debt to fund this capex. Both loans, which have five-year tenors, are priced at 225bp over Libor, following a 25bp flex in syndication that also saw the financing's commitment fee reach 37.5bp. The two leads also arranged $1.15 billion in working capital debt, which priced at a more reasonable 100bp.

Bookrunners Barclays, the administrative agent, and Dresdner, syndications agent, had brought in Scotia and RBS as documentation agents, CoBank as syndications agent, and Westpac as co-agent, and Bayerische Landesbank, CaixaBI, EDC and Wells Fargo as participants on the term debt, and Bayerische, Caixa and EDC gained documentation agent titles on the working capital debt.

Lenders will now await anxiously news of whether the settlement will be accepted. They have already used tightened credit conditions to extract higher margins from the sponsors, though the settlement has also reduced their access to cashflows from the operating company. For Macquarie and its partners the review process has so far been bruising, but not fatal.

Puget Energy
Status: Acquisition announced 29 October 2007, syndicated May 2008, still awaiting local approvals
Size: $7.4 billion
Location: Washington State
Description: Acquisition of regulated utility with 1 million electric customers and 735,000 gas customers
Sponsors: Macquarie Infrastructure Partners (31.8%), the Canada Pension Plan Investment Board (28.1%), British Columbia Investment Management Corporation (14.1%), Alberta Investment Management (6.3%), Macquarie-FSS Infrastructure Trust (3.7%) and Macquarie Bank (15.9%)
Debt: $3.6 billion
Bookrunners: Barclays Capital, Dresdner Kleinwort
Financial adviser to seller: Morgan Stanley
Financial adviser to sponsors: Macquarie Securities
Legal adviser to sellers: Dewey & LeBoeuf and Perkins Coie
Legal adviser to sponsors: Latham & Watkins
Legal adviser to lenders: Shearman & Sterling