

Wolf Hollow: No fire sale

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Stark Investments and Sequent Power Partners have closed financing for the acquisition of the Wolf Hollow power project. While many power financings, and distressed assets, claim to be the victim's of Enron's collapse, Wolf Hollow has more claim than most – Enron was its construction contractor. But the deal also had to contend with a fire on-site and a sponsor's credit crunch.

The \$400 million B loan financing, led by Goldman Sachs and WestLB, follows the now-familiar template for plant acquisitions in North America. It features an anchor power purchase agreement that underpins the project's economics, as well as enhancement from an investment bank as trading counterparty.

Wolf Hollow is a 730MW natural gas-fired combined cycle power project located in Granbury, Texas. It dispatches power into the Electrical Reliability Council of Texas (ERCOT) power pool. It uses Mitsubishi MHI501G turbines and runs on gas supplied by El Paso Corporation.

The developer of the plant was AES Corporation, which had decided at the end of the 1990s to become a major player in the US merchant power market. It developed several power assets and set up a subsidiary, AES NewEnergy, to market plant output. Another facility, the 720MW Granite Ridge project, financed using a \$294 million loan from ABN Amro, was also part of this strategy.

In February 2001, AES broke ground on Wolf Hollow's site, 30 miles southwest of Dallas, and mandated Scotia Capital to provide a debt facility. By August however, AES switched arrangers to KBC, and said that it was looking to contract half of the plant's output out. By October 2001, when KBC closed and underwrote the \$285 million deal, Exelon had confirmed a 20-year power purchase agreement for half the project's output.

Two months later the project's engineering, procurement and construction (EPC) contractor went bankrupt. NEPCO was among the Enron subsidiaries that filed, just as KBC attempted to launch syndication. Wolf Hollow was one of the first recognisably distressed assets to be created as a result of Enron, although many other projects, with much worse fundamentals, followed.

AES was among the sponsors to experience difficulties after corporate lenders became more wary of power producers. It shut down NewEnergy, and effectively wrote off its investment. It had contributed \$177 million in equity to Wolf Hollow, although the debt financing may have lessened this contribution a little.

Stone & Webster (S&W), part of Shaw Group, succeeded NEPCO as EPC contractor, and in November 2002 filed a suit against AES. The suit was the result of a fire at the site, which S&W claimed was a force majeure event, but AES contended entitled it to payments for delays in construction and to draw down on letters of credit posted by the contractor. Shaw claimed it was owed \$49 million of a \$99 million contract price.

This litigation substantially prevented KBC from finding a buyer for the project. It was only when Stark Investments approached both KBC and the contractor that a settlement looked possible. As part of the August 2005 settlement, Shaw gets a subordinated note of \$9.2 million, although its most recent 10-k still lists outstanding claims against AES. KBC got

the debt off its books with only a small write-down.

With tangled history straightened out, in March 2005, the new sponsor, Stark, and its equity partner Sequent, mandated WestLB and Goldman Sachs as lead arrangers for an acquisition financing. J Aron & Co, Goldman's commodities arm, is to be the purchaser of the remaining 50%, or 330MW, of the plant's output for five years.

This covers the debt very strongly for the first five years, and in the years following the expiration of that contract, the sponsor will hope that the market will improve to such a degree that it will be able to sign another more advantageous agreement.

The sponsor's other main chance at improving its returns will be an improvement in the plant's heat rate. The project currently burns more gas per kWh of electricity than the Exelon contract, which allows for a limited pass-through of fuel costs, anticipates. Sources familiar with the asset say that this high heat rate is a legacy of the plant's rapid succession of owners and contractors, and could be improved over time.

A Fluor/Mitsubishi joint venture will be providing operations and maintenance services, while Mitsubishi is also providing technical support, replacement parts and repair services to the project under a 12-year contract. Competitive Power Ventures is the plant's manager.

The financing breaks down into a 6.5-year \$130 million first lien B loan, a seven-year \$110 million second lien B loan, a 6.5-year \$110 million synthetic letter of credit, and a five-year \$50 million working capital facility. The last two are fully funded by the lenders, and the project must meet the difference between the Libor that the two earn on deposit, and the spread payable to the lenders.

The lead arrangers launched the deal on 1 December, and anticipated close on 15 December. In the event, the deal did not close until 27 December, but was oversubscribed on both the first and the second lien tranches. Both came in at close to their price talk – 225bp over Libor for the first and 450bp for the second.

The financing bears a little comparison with WestLB and Morgan Stanley's earlier financing for the La Paloma project, which did not have as strong a set of contracts, but a better operating history and a more advantageous location in California. Wolf Hollow's financing also featured a novel business interruption insurance package, to compensate for the fact that the project does not consist of a spare unit that can be used to compensate offtakers for outages at other units.

The debt issue also contended with a split rating – Moody's gave the issue B1 for the first lien and B2 for the second, while S&P assigned the first lien BB- and the second B flat. This, combined with a year-end flood of paper onto the market (the revived Mirant was among the culprits), explains the spread, as much as a divergent risk profile.

Wolf Hollow

Status: Closed 27 December 2005

Size: \$400 million

Location: Granbury, Texas

Description: Acquisition of a 730MW gas-fired project

Sponsors: Stark Investments, Sequent Power Partners

Bookrunners: WestLB, Goldman Sachs

Offtakers: Exelon, J Aron & Co

Bookrunner legal: Latham & Watkins

Sponsor legal: Baker & McKenzie

Market and fuel consultant: PA Consulting

Independent engineer: E3

Insurance: Moore-McNeil

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