PG&E NEG: Back from the brink

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Mandated lead arrangers SG and Citigroup have launched retail syndication on a $1.075 billion portfolio financing for PG&E's National Energy Group (NEG). The deal stands out on two counts. The first is that it reached primary close with commitments from eight further institutions at a time when several other jumbos have shifted close to this year. The second is that this is the first major project financing to follow the bankruptcy of the NEG's affiliate ? and PG&E's utility arm ? Pacific Gas & Electric.

The portfolio deal is not, strictly speaking, the first to emerge. That honour goes to the 111MW Plains End plant, a peaking facility located in the Denver area that supplies power under a ten-year power purchase agreement to Xcel Energy. The $70 million loan for this distributed generation facility came courtesy of Credit Lyonnais. Moreover, Citi and SG, joined by JP Morgan Chase, closed a $1.25 million corporate revolver in August. 2001, therefore, has been a long, slow recapitalisation process for the NEG.

Most of this process, aside from the issue of a $500 million corporate issue, has consisted of confidence building. The chief goal for the NEG and its advisors has been to erect a sufficiently sturdy ringfencing structure. This needed to be able to resist both the cash depredations by the parent company and the possibility that creditors would try to force it into bankruptcy alongside the affiliate. Psychologically the latter move was unlikely, however, given the NEG's marked fondness for non-recourse debt, which subordinated any claims that might have been made on it.

Another key builder was the ability of a club syndicate of Credit Lyonnais, ING, DG, BNP Paribas and Hypovereinsbank to syndicate a $454 million project financing for Cogentrix' Southaven deal, which had the NEG as a 20-year offtaker. The result of all of these steps is to create a market perception of the NEG as a sturdy and well capitalised merchant player. Indeed, the arrangers point out proudly that amid the slew of downgrades that followed Enron's bankruptcy the NEG held firm at BBB+.

This financing initially covers three plants ? one completed and two under construction. The first, the Millennium project, is 360MW plant located in Massachusetts that is now operating. The second is a 1080MW plant located in Athens, New York, whilst the third is the 1092MW Harquahala facility in Arizona. The last was initially meant to be a follow-up standalone synthetic lease financing to the La Paloma and Lake Road deals. SG was mandated, and extended some financing, but the deal was a casualty of the bankruptcy.

There is a fourth candidate for inclusion in the facility, the 1170MW Covert, Michigan plant. Ground has been broken on this project, but it will only be included in the financing if the deal raises sufficient commitments in the retail phase of syndication. This tactic is designed to ensure that hold levels for the two leads and their second tier associates stay at reasonable levels.

Such a tactic is likely to become much more popular in the coming months, as sponsors realise that flexibility in how they finance plants may prevent arrangers offering inflated fees to nervous co-arrangers. The ultimate size of the deal could be as high as $1.5 billion depending on how much appetite there is for NEG risk.

The plants all operate on a merchant basis, and there are no firm gas supply contracts in place. That this operating basis can still make lenders comfortable comes down partly to the NEG's asset-heavy trading strategy. Unless it has been making some uncharacteristically bold hires from the ranks of the ex-Enron, the NEG always trade around its assets.

The other key factor is the geographical diversity of the plants, spread from Arizona to the Northeast and all operating within different power pools. Nevertheless, the regions all have a strong NEG presence already, so the plants should complement and bolster an existing presence and trading strategy.

The plants use a mixture of Siemens Westinghouse and Mitsubishi 501G combined-cycle gas-fired turbines. The latter will come out of the $7.8 billion turbine warehouse trust that SG put together towards the end of 2000. There have been some issues with bringing the turbines up to spec at Millennium, but these are described by those close to the deal as the typical process in commissioning a turbine, and there have been few of the intensive technological tests that were associated with the ANP financing.

Indeed the high concept behind the NEG deal is that it is a broad continuation of the Panda/Teco deal. This is partly because the syndication on that deal was such a success, and also because of a few structural similarities. The most important of these is cross-collateralisation of both security interest and cashflows, using similar default provisions to the earlier deal. Retail syndication, which launched early January, should tell whether the comparisons are apt.

The deal has so far attracted additional arranging commitments from JP Morgan Chase, ABN Amro, and Royal Bank of Scotland. Co-arranger titles are believed to have gone to the Export Development Corporation, Credit Lyonnais, Barclays Bank, DZ Bank and Toronto-Dominion Bank.

It is too early to tell whether the financing marks an end to the synthetic leasing approach for which the NEG made such a name. The sponsor undoubtedly still has the credit rating to issue such debt, but may find that market conditions post-Enron will discriminate against such structures. Those close to the company say that it will never say never where EPS management is concerned.