

# RS Cogen: Entergy takes a bow

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The first concrete sign of the future direction to be taken by the US powerhouse created by the FPL/Entergy merger comes with the close of the RS Cogen deal. The project is a clear statement of a renewed focus on the domestic power market and suggests that Entergy's Wholesale Operations team will try to take the lead in bringing new capacity to market ahead of their Floridan suitors. They will probably find an amenable bank market bringing up the rear.

RS Cogen is a joint venture between Entergy and PPG Industries (formerly Pennsylvania Plate Glass). PPG has diversified into optical components as well as more basic chemicals. The plant is a 425MW cogeneration facility designed to operate inside the fence of the PPG Lake Charles factory in Louisiana. Lake Charles produces a large number of products in the chlor alkali sector, including chlorine, caustic soda, solvents, amorphous, silicas, vinyl chloride monomer, hydrogen and muriatic acid in a series of energy intensive processes.

Entergy's interest in the project stems from the opportunities offered by overaggregation on an inside-the-fence plant. That the Power Purchase Agreement (PPA) signed by the off-taker is a useful hedge against merchant risk and provides base case comfort for lenders ? with the excess capacity sold by a smart marketing arm ? is an enormous upside. The deal is presented as a chance for Entergy's own marketers to show their worth.

The ground was laid by the formation on April 24 2000 of a joint venture with privately-held Koch Industries to form an energy trading and marketing arm. The arm includes a sizeable proportion of Koch's pipeline interests, and the only way to leverage them properly would be to create a separate wholesale generating arm. There has as yet been no firm plan to separate utility generating and retail assets, suggesting that the plan for Entergy is to grow the new unit organically, much as FPL has decided to proceed outside of its footprint.

But the marketing arm does not have form ? lead arrangers SG have been consciously presenting the deal as an introduction of the capability to an unfamiliar market. Whilst the main off-taker, PPG, is a blue-chip company (and a leader in coatings production), half of the plant's output is exposed to marketing risk in the as-yet nascent regional market. Moreover, the south of the United States, home to much of the country's downstream activities, is a hot area for the type of cogen projects proposed by Entergy. Calpine's move on cogen specialist SkyGen is a clear signal of how seriously the big developers treat these assets.

Lake Charles will also supply 250,000 lb/hour of steam to the PPG plant and a further 525,000 lb/hr to the nearby Lyondell Chemical Company. PPG reckons that its savings alone will amount to between 15% and 18 %. The US tax authorities tend to look fairly favourably on the efficiencies, but it is believed that none of the range of incentives, including tax-free bonds, was utilised here.

Instead, SG has assembled a \$242 million financing package along fairly traditional non-recourse lines. The deal is split into a \$166.6 million term loan to cover construction on the plant, as well as a \$5 million working capital facility and a \$15.5 million debt service reserve facility. Two equity bridges, one of \$30.2 million for Entergy, and another of \$25 million for PPG, substantially meet the sponsors' commitments, reflecting the latter's smaller spread of investments and

less committed balance sheet. Also included is a \$75 million institutional tranche provided by Teacher's Insurance

What is most interesting about the loan is its tenor ? at eighteen years, with no tranching, this is a real take-it-or-leave-it offer to the merchant lending community. Other deals have come close to this maturity, most notably the Pine Bluff deal where some of the financing went as far as 17 years. Pine Bluff and its sibling, however, tended to be smaller and had benefited from a marketing agreement with a Shell affiliate. Those shy of the longer tenor could put their money in elsewhere, leaving the institutions and insurers to take up the long-life strain.

The big incentive for lenders is the chance to get alongside what will become the largest utility in the country, and one which, according to market rumour, plans a larger number of deals in the next twelve months. Entergy wants to establish a decent generation base so that it can have some leverage in the marketing arena, rather than relying on an (admittedly respectable) pipeline network. And indications are that cogen will be the niche that the wholesale group wants to fill since it is a good source of low cost peaker capacity. Lake Charles uses f Class turbines, particularly suited to cogen capacity.

Nevertheless, supporters of the deal have been offered a good reason to come in at retail level: fees for a co-manager title and a take of \$35 million stand at 75bp, whilst the managing agent's take of \$25 million will bring in 50bp. SG held a bank meeting at the end of August for around 30 banks and says that it has had a good reception. As Project Finance went to press SG had received its responses and will be looking to put together allocations shortly. Syndications at the bank report a good subscription level, at about the right timetable given at financial close.

Pricing on the institutional tranche has not emerged, but is likely to have been set to keep a useful source of long-dated debt on-side. On the construction loan pricing is 137.5bp over Libor during the two-year construction phase, staying at this level for the first four years of operation. Years 5-8 it rises to 162.5bp, then to 187.5bp years 9-12, 225bp for years 13-14 and finally 237.5bp for the final two years up to maturity. The loan's average life is 12 years.

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