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North American Power Acquisition deal of the year

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1999 was a busy year for Edison Mission Energy ? and for its bankers. The company went on a buying spree in both the US and the UK ? picking up choice generating assets which were being sold as part of regulatory driven disposal sales aimed at freeing up competition in the liberalizing power markets in both countries.

The biggest of these acquisitions was the $5 billion purchase in mid-November of Commonwealth Edison's fossil-fuel generating assets in the deregulating Illinois power market. Edison bought some 9,510MW of generating capacity through this deal involving 12 assets situated at 9 sites ? Crawford, Fisk, Joliet, Powerton, Waukegan, Will County, Collins and two off-site peaking plants.

As with its earlier 1999 acquisition of Homer City, Edison opted for a four strong bank group to equally underwrite and arrange the deal ? Chase Manhattan, Citibank, SG and WestLB. These banks were given an unyielding timetable to close all elements of the deal, as the asset disposal laws relating to the transaction required Edison to pay for its acquisition within 10 working days of the all the regulatory approvals being granted. And with year-end looming, the arrangers were unwilling to be sitting on large positions on the deal so syndication needed to be complete in time for funding. As such the coordination of the timing of the deal was impressive with all the key elements closed more or less simultaneously ? including the actual purchase, the funding and the launch of syndication. ?An issue for us as arrangers was that we wanted to get the deal into the market as soon as possible to minimise the need to pay a premium to get the deal away given any year-end concerns for a deal of this size. On the other hand, we did not want to launch syndication until we were able to give the market a strong indication that investment grade ratings were expected,? says Mark Aplin, Vice President, Global Project Finance, at Citibank.

Structural complexity

The deal was also perhaps the most structurally innovative and complex of Edison Mission's acquisition deals of 1999 ? involving loans to various levels within the overall group, incorporating leasing facilities and relying on the US commercial paper (CP) to actually fund while at the same time tapping into the bank market's appetite to supply potentially unfunded facilities.

The debt arranged for the purchase amounts to some $3.1 billion. Despite the overall deal amount being $5 billion, from a non-recourse perspective the deal still has a debt-to-equity capital structure of 50:50. This is because some $500 million of the $3.1 billion was lent to Edison Mission Energy, the unregulated business entity of Edison International, and redeployed into the deal as equity. This facility is priced at 10 basis points over Libor undrawn and at 75bp fully drawn based on the A- rating of Edison International. Of the remaining $2.5 billion of debt some $1.8 billion was structured into various tranches directed towards Edison Mission Energy Midwest Holdings, the holding company which owns the operating company ? Edison Mission Energy Midwest Generation ? which in turn owns the acquired assets.

There were three tranches at this level. The first tranche is a $840 million, 364 day revolver which is priced at 25bp over Libor undrawn and at 125bp fully drawn. The second tranche is an $840 million, five year facility which is priced at 30bp undrawn and at 125bp fully drawn. The last element of this portion of the deal is a $150 million, five year working capital facility which carries a margin of 30bp and a fully drawn margin of 125bp. All of these tranches are priced on the basis of their existing ratings of BBB/Baa2.

The final piece in the deal's architecture is a $774 million, five year leveraged lease priced at 40bp through Funding LLC. Babcock & Brown provided the lease's $112 million of equity. The lease relates to the Collins oil/gas-fired plant which was carved out of the remaining portfolio of assets to realize economic benefits, in terms of earnings and tax treatment, at the parent level. While this type of lease has been seen in a number of other US power acquisitions these have all been financed in the capital markets. ?We underwrote probably the first lease for this type of deal to be financed through the bank market,? says Aplin at Citibank. ?But we were able to overcome many of the issues associated with the lease structure in the US with an extremely strong credit story of the overall transaction and by the short tenor of five years.?

Through the lease, syndicate banks were effectively asked to provide a liquidity commitment to several USCP conduits administered by Citibank. And although syndicated liquidity backstops are well-known they are usually sold as distinct entities rather than as part of a larger credit structure which made the arrangers anxious that the added complexity may put off some banks. ?We expected there would be many enquiries over the structure and that a lot of time would be spent explaining the complexities of the deal,? says Aplin at Citibank. In the end, though, these concerns were misplaced. ?While one of the plants was put into a leasing arrangement, the overall deal was structured to be a homogenized credit story and the banks seemed comfortable with it,? says a spokesperson at Chase.

Syndication success

Edison is used to the bank market and the bank market is used to Edison. Relationships are carefully managed and that is a big benefit when asking the market for serious amounts of debt finance. But there is no doubt that Edison had a lot of paper in the market when the arrangers looked to sell-down some $3.1 billion more of Edison debt. However, the company had skillfully refinanced the bank debt used to finance its purchase of Homer City through the capital markets earlier in the year, which both gave banks pressure and opened up some further capacity for the name.

?There were a confluence of factors which made the deal so successful,? says Frank Sacr, director of project finance at SG in New York. ?Firstly, Edison Mission is an excellent sponsor with a strong bank following. Secondly the refinancing of the Homer City bank facilities exactly as planned gave the market a lot of confidence. Both of these factors helped to prepare the ground for the deal. And the deal itself benefited from tapping into the current market pricing dynamic operating between funded and unfunded loans.?

Indeed, the overall deal was targeted at the growing appetite for short-term unfunded facilities in the bank market ? which from a pure bank accounting and capital-adequacy perspective can provide an infinite return although it is still at-risk money.

The deal evolved, and was directed, to attract a broad cross-section of the bank market ? drawing in support from both the traditional project finance banks and from those banks more usually interested in corporate lending. ?The deal is almost a completely unfunded transaction,? says Sacr. ?However, the challenge was to blend the balance between the benefits of unfunded facilities and the desire of some banks for income through funded assets.?