Back on track

01/09/1999

It nearly didn't happen. Legal action and environmental protests nearly derailed the Redbank power project in New South Wales. But innovation shone through. Along with new technology and forward deals, the project even turned a litigation case into a first.

In May 1992, the Australian government, wanting clean up coal waste in Hunter Valley approached National Power to suggest using Combustion Power Company's FI CIRC, fines circulating technology to dispose of the large amounts of coal tailings generated every year by the Australian coal industry. Following on from this conversation plans for a 130MW power station, in Hunter Valley, New South Wales, developed. The project will be fuelled by coal tailings and high ash coal from Warkworth Mine, managed by Peabody Resources.

National Power established an office in Australia and started negotiations with Warkworth Mine and off-take party EnergyAustralia. It also brought in ABB and Babcock & Brown as co-sponsors on the project.

But the development of the project has not been smooth. In June 1994 Greenpeace Australia made a legal challenge contending that no additional coal-fired power stations should be built in New South Wales. The New South Wales land and environmental court comprehensively dismissed Greenpeace's claims and issued the development consent for the project in November 1994.

The deal sets a number of precedents. Says Warren Murphy of Babcock & Brown's project finance division in Sydney: "The off-take project signed with Energy Australia in 1996 was the first contract for differences agreement executed for a new power station in the then newly established pool market. The New South Wales pool started in mid 1996.

There deal sets other benchmarks. Murphy believes that the project, which will sell its coal to the Warkworth mine, will involve the first use of a long-term forward sale for coal in a limited recourse project financing in Australia.

Stefan Robertson, head of finance of the pacific group at ABB in Zurich agrees. He says the idea arose from negotiations, and was tailor made for the deal. "It was a win-win situation," he says. "The mine loved it because it mitigated upfront financial exposure." Tim Whitehead, associated director of structured finance at Dresdner Kleinwort Benson in Sydney says the bank was attracted to the project by the quality of the sponsors and the hedge contract. "It removes market risk," he says.

The technology is also new to Australia. It incorporates world-leading fuel benefication equipment developed at the University of Newcastle in Hunter Valley. Robert McDonnell, banking and finance partner at Sydney-based Allen Allen & Hempsey law firm, who advised the lenders, explains. "It's the first in Australia to use fluidised bed boiler technology to combust coal fuel. It is also the first project financing of an independent power project completed in New South Wales since 1995. By using a waste product, coal tailings, previously stored in unsightly tailings dams, the project has an environmental feel.

The project and financing are underpinned by a long-term power price hedge agreement (PPHA) entered into in 1996 with EnergyAustralia. Another first. "This was the first project to use this structure," explains Michael Karlsson, who worked on the project from ABB's offices in Zurich. When negotiations started there was no established electricity pool. "We had to make sure we had an off-ticket agreement," he says.

However, in late 1997 litigation between the parties on whether time had run out for satisfying certain conditions ended in a judgement for the sponsors. In March 1998 a further litigation interrupted progress toward financial close. National Power started legal proceedings against EnergyAustralia on March 28 1998. On July 24 1998, the NSW supreme court delivered a judgement in favour of National Power Australia finding EnergyAustralia to have breached the PPHA which was a material factor in the failure of the financial close to take place. As part of the settlement between the parties, EnergyAustralia confirmed it would abide by the contract. This resulted in a successful financial close on March 31 1999. This too is unusual. Few projects survive litigation cases before the close of financing. "This was surprising. It doesn't happen very often," says Robertson from ABB.

The financing itself is not unusual. The $320 million project is to be financed entirely by debt during construction with 25% equity coming in at substantial completion. The construction finance will then convert to a 15-year, fully amortising term loan.

The equity investors contributed equity of approximately $51.5 million. Subordinated debt providers provided a subordinated loan of approximately $28.5 million, underwritten by ABB Energy Ventures. The project is fully debt financed during the construction period, expected to be two years. On the conversion date, outstanding under the construction debt facility will be $320 million. The balance will be reduced to $240 million through the investment of equity and the subordinated loan. The term debt facility will be repaid over 17 years and three months from the conversion date.

Dresdner Kleinwort Benson was selected as the debt arranger. In January this year four other banks, KBC, BankWest/Bank of Scotland, HypoVereinsbank and ING were appointed along with Dresdner as the lead underwriters. Syndication was successful with 13 banks joining as underwriters and senior managers. Successful offshore syndication by the underwriters took place in May 1999 and used a structure pioneered by Allen's to ensure the funding was free of interest for withholding tax. Robertson from ABB explains: "We made a distinction between onshore and offshore notes to avoid paying withholding tax.".

Australia remains attractive to investors and financiers alike, with plenty of room for further innovation. Law firms are beginning to recognise the amount of work available, and not just in litigation. Indeed the market looks set for further investment and increasing innovation. As Marcus Kleiner, head of transport and industry at HypoVereinsbank in Munich says the company is looking at a number of deals in the region "The outlook is positive," he says.

Redbank Power

Location: Hunter Valley, Queensland Australia

Purchase Price: $212.6 million

Borrower: Redbank Power Party Ltd.

Sponsors: ABB Energy Ventures (49.9%), AIDC, an affiliate of Babcock & Brown (30.1%) and National Power Australia LLC (20%).

Arrangers: Bank of Scotland, Dresdner Kleinwort Benson, Hypovereinsbank, Ing and KBC

Debt arranger: Dresdner Kleinwort Benson

Financing: First stage underwriting closed March 31 1999. General syndication for the A$320 million, ($212.6 million) 19-year debt facility at the end of April.

Repayment period: 17-and-a-quarter-years

Pricing starts at 110 basis points over Libor during construction. The margin steps up from 110bp to 145bp and then 175bp. Repayment is in 72 quarterly equal instalments. The deal is 100% funded through construction and features some irrevocable and unconditional letters of credit.

Constructor: ABB. The contract covers the design, supply, construction and commissioning of the power plant. The plant will incorporate two low-emission fluidized bed boilers, high efficiency fabric filter, a turbine generator, electrical equipment, air pollution monitoring and control systems.

Construction start date: April 1999

Construction period: two years

Operation start date: April 1 2001.

Lawyers: Dunhill Madden Butler represented the sponsors. Allen, Allen & Hemsley represented the sponsors.

EPC Contractor: ABB Power Generation Ltd.

Independent engineer for the lenders: Stone & Webster