Plum Point coal-fired power plant

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During the initial merchant power boom at the start of the millennium, coal had become a dirty word synonymous with the old faults of the state utilities - inefficiency, pollution, reliance on organised labour and entanglement in long-term supply contracts

But while the merchant boom came and burst, the coal plants stayed open and then thrived as gas prices spiralled upwards.

Now LS Power, one of the original merchant power players, is attempting to go the IPP route again through the 650MW Plum Point plant in Arkansas - but this time powered by domestic coal.

And like the other emerging North American energy trends, ethanol and oil sands, Wall Street institutions are leading the race to finance the return of coal.

The plant signed a complex US$1.075 billion financing last month with B loan debt raised by Goldman Sachs, CSFB, Merril Lynch and WestLB.

Moreover, Plum Point is at the wedge of a massive revival in coal power across the United States. The National Energy Technology Laboratory reports that 140 plants have been announced across 41 states, representing 85 gigawatts and US$119 billion of investment.

Drivers

On a federal level, the US government has increasingly indulged coal plants as a way of ensuring independence from international oil and gas.

Unlike in Europe where new coal proposals have centred on low-carbon technologies such as IGCC or carbon sequestration, US legislation is much more lenient only requiring plants to limit sulphur and mercury emissions under the 'Clean Air' act.

While this indulgence might not stretch beyond the 2008 election, US new build plants remain economically viable without installing carbon-cutting technologies.

The local drivers for the Plum Point plant were also compelling. Hurricane Katrina badly damaged natural gas terminals on the Gulf Coast, pushing the mounting consumer energy prices higher still.

No coal power plant had been built in Arkansas for 20 years and the hurricane crudely exposed the areas dependence on gas-fired plants.

This April, Arkansas utilities passed on a six per cent month-on-month increase in electricity costs to consumers and prices are set to rise until the Plum Point plant becomes operational in 2010.

Finally the coal plant was key to LS Power's new strategy. The IPP specialist has championed the resurgence of the merchants through coal power - five of their seven latest projects.

LS Power would avoid repeating the mistake of over-reliance on one energy source by acquiring a 3,000MW portfolio of natural gas powered stations from Duke Energy

The project

With electricity prices rising through 2004 and 2005, local utilities including Missouri Joint Municipal Electric Utility Commission (MJEUC) and Empire District Electric Company turned to an existing proposal from LS Power.

LS Power had been considering the construction of a 1000MW to 1600MW coal power plant at the strategic Plum Point location since 2001, but had been frustrated by state regulations and a lack of financing appetite for a coal-fired plant.

The plant would be located strategically to respond to market demand in five energy regions across the southern United States.

Eventually LS Power inked an agreement whereby it would provide a smaller plant of - with EDEC, MJEUC and the East Texas Electric Coperative signing offtake agreements and taking equity into the project.

Offtake agreements were also signed with other regional utilities or sold on the spot market hedged by financial advisor Goldman Sachs.

The project received environmental approval under the Clean Air Act in October 2005, but still had to gain the approval of the market.

Sources of funding and financial flows

Joint lead arrangers Credit Suisse, Goldman Sachs and Merrill Lynch launched syndication on 21 February of a US$760 million debt package to finance the plant.

Financing consisted of a US$590 million term B loan maturing in 8 years; a US$65 million 6-year revolver and a US$105 million 8-year synthetic letter of credit. Pricing for all three tranches was around LIBOR + 325bp.

However, the market's appetite for project finance debt was limited with institutional investors expressing concerns about the project's future cash-flow which will only begin in 2010 when the plant is up and running.

Some US investors are risk averse to project finance by nature, while others are restricted from investing in an unfamiliar asset class.

Last time a project finance term B loan for a coal plant was offered was in November 2003 for the financing of the Springerville project lead arranged by Credit Suisse.

Concerns about the market in which the plant will be operating, further undermine investors' interest in the deal.

Arkansas is part of the Southeast Electric Reliability Council (SECR) region, an area with one of the highest levels of coal-fired plants and dominated by companies with significant market power.

Furthermore, according to EIA electricity demand in the SERC region will increase 51 per cent by 2025. With public opinion heavily in favour of more non-emitting plants, particularly nuclear power, no wonder there was little demand for the deal.

The term B loan was reduced to US$423 million; the revolver to US$50 million and the synthetic letter to US$102 million. The tenors and spreads remain the same and the deal was signed on 14 March.

The new package also features an additional US$175 million second-lien term loan that carries an 8.5 tenor priced at LIBOR + 525bp, including a 200bp payment in kind option.

S&P gave the deal a recovery rating of 3 and a credit rating of B, while Moody's rated it at B1. The second-lien loan was not rated.

Since the City of Osceola features as the owner of the plant, which in turn is lease back to the SPV, the project benefits from payment-in-lieu of taxes and is eligible for an additional US$100 million in tax-exempt bonds to be underwritten by Goldman Sachs.

The sponsors' investment in the project amounts to US$226 million, which represented a US$76 million increase from the original equity structure.

The project has signed long-term power purchase agreements (PPA) with Empire and the Municipal Energy Agency of Mississippi for 50MW and 40MW respectively. Empire has also another PPA for an additional 50MW with an option to swap its 50MW for a stake in the project in 2015.

Further offtake agreements are likely to be signed with other municipalities in the near future. Meanwhile, J. Aron, the commodities division of Goldman Sachs, is hedging some of the project's output until these additional PPAs are signed.

Conclusion

Financing for the project had some features of a leverage lease but it was less complex.
Institutional investors have not seen these types of deals for many months but have reacted with some interest in the aftermarket.

Trading of the US$423 million term B loan has being fairly active with the debt trading above par between 100 3/4 and 101 1/4.

It is unlikely conventional project finance will respond to merchant coal plants as enthusiastically as to merchant gas plants at the start of the decade. Instead, the growing B loan market will likely dominate new build coal for the foreseeable future.

But as the performance of Drax in the UK has highlighted, coal power still has genuine market potential and risk averse investors might well consider a return to American IPPs - even if it means returning to the scene of the accident.

If LS Power strategy can establish a precedent, coal power could be the smelling salts that will revive the dormant US merchant power market from its slumber.

The project at a glance

Project Name	Plum Point power project
Location	Osceola Arkansas
Description	665MW coal-fired power station
Sponsors	Plum Point Energy Associates: • LSPower - 63 per cent • Missouri Joint Municipal Electric Utility Commission - 22.11 per cent • East Texas Electric Cooperative - 7.52 per cent, • The Empire District Electric Company - 7.52 per cent
Operator	LS Power
EPC Contractor	Black & Veatch
EPC Sub Contract 1	Zachry Construction Corporation
EPC Sub Contract 2	Gilbert Central Corporation
Construction Stage	2006 to late 2009
Offtake arrangements	EDEC (50MW) MJEUC (40MW) Goldman Sachs under hedging agreement
Total Project Value	US$1.075 billion
Total equity	US$326 million
Equity Breakdown	US$226 million sponsor equity US$100 million tax-exempt bonds to be raised by Goldman Sachs
Total senior debt	US$575 million
Senior debt breakdown	US$423 million 8-year first lien loan US$102 million 8-year synthetic letter of credit facility US$50 million 6-year revolver
Senior debt pricing	First lien loan 325 bps
Subordinated debt	US$175 million
Sub-debt pricing	525bps
Debt:equity ratio	70:30
Mandated lead arrangers	CSFB Goldman Sachs Merril Lynch WestLB
Legal Adviser to sponsor	Chadbourne & Parke
Legal adviser to banks	Latham & Watkins

Date of financial close	14 March 2006