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PSEG Global acquires last half of two plants totaling 2,000 MW in Texas from TECO

PSEG Global said July 27 that it had signed an agreement to acquire the other halves of two 1,000-MW gas-fired merchant power plants in Texas from TECO Energy, the plants' co-owner.

The deal is expected to close by the end of August. The purchase price was not released, but both companies said it was "nominal" and it was reported to be $500,000.

The Odessa plant in Ector County and the Guadalupe plant in Guadalupe County are identical combined-cycle facilities that sell their output into the Electric Reliability Council of Texas' wholesale market through energy marketer BP Energy.

Robert Dougherty, president of PSEG Energy Holdings said that owning 100% of both facilities "will allow us to manage these plants in a manner that takes maximum advantage of opportunities provided by a rebounding Texas energy market."

A TECO Energy spokeswoman said that company was selling its half-stakes in the plants as part of its strategy to minimize its exposure to the vagaries of the merchant market. TECO said it would write off its investment in the plants, resulting in an after-tax charge of about $99 million it would take in the

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Australian regulator warns that increased M&A activity could thwart competition

Increased merger and acquisition activity in the Australian power sector could undo reforms intended to increase competition, according to the Australian Competition and Consumer Commission.

ACCC Commissioner Ed Willett said the agency was concerned about horizontal mergers between generators; vertical mergers between transmission, distribution, generation and retail entities and vertical mergers between generation and retail sectors.

"Recently the commission has received several applications for informal clearance for proposed acquisitions that would bring many of the elements of the electricity supply chain back together and would re-aggregate the contestable generation and retail sectors," said Willett.

Earlier this month the commission cleared the way for Singapore Power to acquire TXU's Australian assets for $3.72 billion (GPR, 22 July, 7). The commission said it would not intervene in the deal after Singapore Power agreed to abide by court enforceable undertakings requiring it to separate TXU's transmission and generation businesses. TXU owns the electricity distribution business in eastern Victoria, gas distribution in western Victoria and South Australia's largest

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As generation acquisitions by financial players accelerate, holdings reach $13 billion, 37 GW

The shakeout in the United States' power generating business over the past three years has prompted financial players to snap up generating assets at an accelerated pace over the past several months, hitting a total value of nearly $13 billion of announced and closed deals this month (see table, "Filling the Vacuum," page four).

As one banker said, financial players have come to "dominate the space." Just last week the largest generation sale to date was announced. A consortium of four private equity finds—The Blackstone Group, Hellman & Friedman LLC, Kohlberg Kravis Roberts & Co. LP, and Texas Pacific Group—became a mid-sized player in the generation game by agreeing to pay CenterPoint $3.65 billion for Texas Genco's 14,174 MW of generating assets (GPR, 22 July, 1).

Meanwhile other private equity concerns continue to raise money to plow into power assets. Just how much longer they will remain active buyers remains to be seen. Some industry observers argue that the supply of assets could soon begin to dwindle. Others say that traditional players will continue to feel

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pressure to sell assets.

Keith Martin, an attorney for Chadbourne & Parke, argues that there is still more pain in store for the traditional players, which argues for a steady supply of assets on the block, while the number of private equity firms investing power assets continues to rise. Some private equity funds may "just be starting" to enter the sector, he said.

A survey of the industry found that over the past year-and-half at least 17 financial groups have announced or closed 26 deals to acquire or invest in generating assets totaling 37,244 MW. By comparison, the purest of the merchant power firms, Calpine, has a portfolio totaling 26,203 MW.

In addition, the pace of deals has accelerated. In January, ABN AMRO estimated that there were 56,600 MW of generating capacity for sale in the U.S., with 33,000 MW classified as distressed merchant assets. In a report entitled "Digging for Diamonds'' ABN analysts reasoned that the 23,000 MW of the 56,600 MW was comprised of qualifying facilities and other plants that benefit at least partially from power purchase agreements. Since January, however, that list has shrunk by about 20%. A total of 11,686 MW of the 56,647 MW of plants itemized by ABN have either been sold or the owners have announced plans to sell them. That leaves 44,961 MW of capacity still on the block. In July alone four deals were announced or closed representing about 17,000 MW with a value of just over $4.6 billion.

Traditional players, both merchants and utilities have been unable or unwilling to step in and buy assets on the block. If they were not preoccupied with reducing heavy debt loads or maintaining, or restoring, credit quality, they were not satisfied with the asking prices sought by sellers.

But as gas prices rose and power prices fell, the pain got worse. Meanwhile the banks that had so readily extended credit during the boom were having their own problems. Citigroup and JP Morgan Chase were both embroiled in investigations of their transactions with Enron. Banks were also bumping up against limits on how much they could lend to one industry sector, and they were still working through the impending maturation of $90 billion of mini-perm loans that were set to expire within about five years. At that point, hedge funds stepped in to fill the vacuum.

Hedge funds were among the first new financial players to enter the ailing power industry. Vulture funds swooped in to take positions in firms teetering on the brink of bankruptcy in the wake of the collapse of Enron and the wash-trade revelations that decimated the power trading industry. Firms such as Dynegy, Williams and Xcel needed quick infusions of cash without a lot of regulatory hurdles. Hedge funds were particularly suited to the task.

By mid-2003 hedge funds held as much as 30% to 40% of the stocks and bonds of more than a half dozen of the industry's once-dominant firms. MatlinPatterson Asset Management, for instance—formed by David Matlin and Mark Patterson, who ran Credit Suisse First Boston's distressed debt desk—took a stake in NRG Energy as it was heading into Chapter 11 bankruptcy court protection. The firm still has a 21% equity holding in NRG. But as stock values and bond prices began improving, the hedge funds began to bail out and look elsewhere for their next investment opportunities. While the hedge funds still retain positions in a variety of power companies, their overall holdings are now believed to be well below 5%. Still, as one insider said recently, groups such as Carlson Capital LP, Luminus Capital Management, Perry Capital and Zimmer Lucas Partners LLC did extremely well betting on the securities of downtrodden power firms like Dynegy and NRG Energy.

By now the large private equity firms such as Kohlberg Kravis Roberts and Texas Pacific Group were also sniffing around for opportunities. Initially they did what they know best: they sought large stake in large assets. KKR has a pending $3 billion bid for UniSource Energy, an integrated utility in Arizona. Texas Pacific, a diversified private equity firm with $13 billion under management, is heading up the effort to buy Portland General Electric from Enron for $2.35 billion (GPR, 15 July, 12).

Texas Pacific is also expected to join with KinderMorgan Energy Inc. to bid for CrossCountry Energy, the natural gas pipeline company that Enron wants to sell. The battle for CrossCountry began in June when a consortium of ArcLight Capital Partners, Citigroup, Kelso & Co. and Oscar Wyatt, Jr. formed NuCoastal and submitted a $2.2 billion bid for the assets (GPR, 27 May, 4). Southern Union Company and its financial backer, GE Commercial Finance, quickly stepped in with the backing of the creditors committee (GPR, 24 June, 1). Since then, MidAmerican Energy Holdings Inc., part of Warren Buffett's Berkshire Hathaway group of companies, has also been named as a potential bidders. The auction for CrossCountry is slated for September.

Low Hanging Fruit

By the spring of 2003, a second wave of investment had begun. Early on, the financial players went for the low-hanging fruit, contracted assets. Goldman Sachs announced its plans to buy El Paso's 940-MW Linden, N.J., cogeneration facility in April 2003, and closed the $456 million deal six months later, in October 2003, the same week it announced an agreement to buy Cogentrix Energy, with 4,100 MW, for $2.4 billion (GPR, 23 Oct '03, 1). Linden has a power supply contract with Consolidated Edison that runs to 2017. It also sells power under contract to a ConocoPhillips refinery.

Goldman's strategy, one that fits well with it commodities trading groups' capabilities, is to "optimize" assets, in many cases by restructuring the contracts that come with those assets.

Many players were already actively looking and some, presumably, were close to deals, but Goldman's Linden deal, by its timing and its prominence served to break the ice. In November 2003, Reservoir Capital Group closed on the purchase of 50.1% of the Sithe North American assets from Exelon, 889 MW for $113 million (GPR, 14 Aug '03, 16). Reservoir recently carved out some of those assets and sold

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FILLING THE VACUUM: Financial Players Buying Power Assets

Lead[1]	Acquiring entity	Seller	Asset(s)	MW (net)	Price ($M)	Status	Date
American International Group Inc.	Northern Star Generation	El Paso	stakes in 15 QFs	1,679	892[2]	announced[3]	Jan 04
ArcLight Capital Partners	Teton Power Funding	Aquila	stakes in 12 plants in 6 states and Jamaica	627	257	completed	Mar 04
ArcLight Capital/ Caithness Energy LLC	Denali Power LLC	National Energy & Gas Transmission	stakes in 12 QFs and one gas pipeline	1,082	558	announced	Jul 04
ArcLight Capital Partners	Pomifer Power Funding	Calpine	Auburndale, Fla., cogen	105	86	closed	Sep 03
ArcLight Capital Partners		York Power Funding	Big Springs, Tex. wind plant	34	na	closed	Jan 03
Bear Stearns	Houston Energy Group	American Electric Power	stakes in 4 plants in Florida & Colorado	276	156	announced	Mar 04
Blackstone Group, Hellman & Friedman, Kohlberg Kravis Roberts, Texas Pacific Group	GC Power Acquisition	CenterPoint Energy	Texas Genco	14,174	3,650	announced	Jul 04
Carlyle Group/ Riverstone Holdings	Carlyle/Riverstone & Sempra Energy Resources	American Electric Power	10 plants in Texas	3,813	430	closed	Jul 04
Coal and Gas Electric Power		International Power	Deeside and Rugeley plants in U.K.	1,500	na	failed[4]	May 04
Coal and Gas Electric Power		creditor group	Killingholme plant in U.K.	665	585	failed[5]	Jun 04
Coal and Gas Electric Power		creditor group	Damhead Creek plant in U.K.	800	684	failed[6]	Jun 04
Complete Energy Partners		NRG Energy	Batesville, Miss, plant	837	330.5[7]	announced	May 04
Credit Suisse First Boston	CSFB Private Equity	United American Energy	13 plants	539	225	closed	Dec 03
Energy Investors Funds Group	Black River Energy	Jones Capital/TECO	60-MW Hamakua plant in Hawaii, 100% of 50-MW Fort Drum plant in N.Y.	80	na[8]	closed	Jun 04
GE Commercial Finance		Calpine	King City QF plant in Calif.	69	82	closed	Apr 04
GE Commercial Finance		Cogentrix Energy Inc.	Green Country, Jenks, Okla.	729	97	closed	Apr 03
GE Commercial Finance		Mirant	Birchwood, Fredrickburg, Va.	121	71	closed	Nov 03
GE Commercial Finance		Dynegy	Oyster Creek QF, Freeport, Texas	212	79	closed	Jul 04
Goldman Sachs Group Inc	GS Linden Power Holdings	El Paso Corp.	East Coast Power LLC's Linden, N.J., cogeneration plant	940	456	closed	May 03
Goldman Sachs Group Inc.		Cogentrix Energy Inc.	26 cogeneration facilities	3,300	2,415[9]	closed	Mar 04
GTCR Golder Rauner	Invenergy and GTCR Golder Rauner	TECO Energy	Hardee plant in Bowling Green, Fla.	370	115	closed	Sep 03
Lightyear Fund	Lightyear Capital	Tractebel	Ripon Cogeneration (two cogen plants in Calif.)	88	na	closed	Jan 04
MatlinPatterson Asset Management	KGen Partners	Duke Energy	8 merchant plants in Southeast U.S.	5,290	475	announced	May 04
Reservoir Capital Group		Exelon Generating	50.1% of 24 Sithe North America plants	889[10]	112.8	closed	Nov 03
Rockland Capital Energy Investments	Rockland Prime Holdings owner of a 65-MW cogen plant in Elmwood Park, N.J.	Aquila Corp.	50% of Prime Energy,	33	na	closed	Jan 04
Texas Pacific Group	Oregon Electric Utility Co.	Enron Corp.	Portland General Electric	1,957	2,350	announced	Nov 03
U.S. Power Generating	U.S. Power Generating	na	assets in Calif., ERCOT, & New England			pending	June 04
TOTALS				**37,244**[11]	**12,837**		

[1] Lead is the parent company, controlling partner, or majority partner.
[2] Includes the assumption of $174 million of debt.
[3] Northern Star has been closing the purchases in phases with six done so far.
[4] International Power has retained the plants.
[5] Centrica bought Killingholme in July 2004.
[6] Scottish Power closed on Damhead Creek in June 2004.
[7] Includes the assumption of $304 million of debt.
[8] EIF purchsed 50% of the Hamakua plant from TECO for $12 million; details of the other transactions were not released.
[9] Includes the assumption of $2.3 billion of debt.
[10] Reservoir has sold 270 MW to Primary Energy Holdings for $190 million.
[11] Failed deals excluded.
na - not available or not applicable

Source: Platts Global Power Report

As acquisitions by financial players quicken, holdings hit $13 billion, 37 GW

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them to Primary Energy, at about $700/kW (see story, page 16).

In January, two deals closed and one more was announced. Lightyear Capital LLC closed on the acquisition of the 88-MW Ripon Cogeneration from Tractebel. Lightyear, a New York-based private equity firm that manages the $750 million Lightyear Fund LP, was set up in November 2000 by Donald Marron, the former chief executive officer of Paine Webber and former chairman of UBS America. The Ripon plants have long-term power purchase agreements with Pacific Gas and Electric and Southern California Edison.

Rockland Capital Energy Investments LLC bought 50% of a 65-MW cogeneration facility in Elmwood Park, N.J., from Aquila. And Northern Star Generation, an equity fund formed by American International Group, announced plans to buy stakes in 25 qualifying facilities totaling 1,849 MW from El Paso for $746 million and the assumption of $174 million in debt. Since then, Redwood LLC, an affiliate of John Hancock Life Insurance Co., exercised its first-right-of-refusal and has closed on 10 El Paso plants in California with 170 MW of net equity for $28 million or about $165/kW (see story, page 16). That leaves Northern Star with 15 plants totaling 1,679 MW with a value of about $892 million, including debt assumption. Earlier this month Northern Star closed on four of the plants (GPR, 8 July, 14). Later in the month it closed on two more—the 104-MW Orange combined-cycle gas turbine in Bartow, Fla., in which El Paso had a 50% stake, and the 114-MW Polk Power cogeneration station, also in Bartow, in which it had a 46.25% stake—for about $97.4 million.

In March, Goldman Sachs closed on its $2.4 billion purchase of Cogentrix Energy, giving the investment banking firm 4,100 MW of mostly contracted assets to back up its trading operations. Also that month, Bear Stearns' Houston Energy Group announced plans to buy four qualifying facilities totaling 276 MW, two in Florida and two in Colorado, from American Electric Power for $156 million (GPR, 18 March, 1). HEG closed that acquisition this month (see story, page 17).

The Goldman and HEG deals both have several elements in common. They are both financial institutions known for their trading capabilities. Both were buying contracted assets. And both are seeking to optimize the assets they were buying. One way to do that is by restructuring the underlying power sales contracts, a strategy HEG is pursuing with contractual assets, as well as with physical assets. HEG paid $21 million to take over El Paso's Utility Contract Funding LLC, a special purpose entity created by El Paso, as a pass-through vehicle under which Morgan Stanley buys power in the market and sells it to UCF, which then sells it to PSEG at a markup. The supply contract with PSEG calls for 1.6 million MWh per year.

A second deal announced in March was very different from both the Goldman and HEG transactions. A consortium of Sempra Energy Resources and Carlyle Group/Riverstone Holdings announced plans to buy 10 merchant plants, totaling 3,813 MW, from American Electric Power for $430 million (GPR, 18 March, 1).

The Sempra/Carlyle/Riverstone-AEP deal closed on July 1, but not before nailing down a power purchase agreement for the largest plant in the deal, the 632-MW Coleto Creek coal-fired plant in Goliad County, Texas (see story, page 15). The buyers said they have contracted with purchasers for 90% of Coleto Creek's output, which helped facilitate non-recourse financing by a consortium led by CitiGroup, JP Morgan Chase and Goldman Sachs.

The Sempra/Carlyle/Riverstone-AEP deal was not the first announced deal for merchant assets. That distinction went to Calpine Corp. which in February reached an agreement to buy the 570-MW gas-fired Brazos Valley plant outside of Houston for $175 million, or roughly $307/kW, or 68% of actual cost. The project was developed by NRG Energy, but in 2003 NRG transferred it to a group of lenders headed by ABN AMRO. The Brazos deal closed in April. Calpine plans to fold the plant into its Texas portfolio and use it to serve both its contracted load in Texas and to sell power into the state's day-ahead market.

In some respects, the Sempra/Carlyle/Riverstone deal represented more of a milestone than Brazos because it was the first major deal for a large group of merchant plants.

Two months later, in May, another big merchant deal was announced. MatlinPaterson Asset Management ventured outside its typical investing pattern, moving away from owning stock in a power companies to taking direct ownership of power assets. MatlinPaterson, through a vehicle known as KGen Partners LLC, announced an agreement to buy eight gas-fired merchant plants in the Southeast United States for $475 million (GPR, 6 May, 1). At 5,290 MW, it represented the biggest merchant deal to date. MatlinPatterson has since signed a seven-year power purchase agreement with Southern Company affiliate Georgia Power.

Also in May, Complete Energy Partners—formed by Peter Daily, formerly of Allegheny Energy, and Milton Scott and Hugh Tarpley, formerly with Dynegy—announced plans to buy the fully contracted 837-MW Batesville plant in Mississippi from NRG Energy for $26.5 million and the assumption of $304 million of outstanding debt. Complete Energy is getting financial backing from Sandell Asset Management and Stonehill Capital Management.

Then this month the biggest deal yet was announced. Four private equity firms banded together to form GC Power Acquisition and offer $3.65 billion to win the bidding for Texas Genco, which owns 14,174 MW of merchant capacity in Texas, mostly around Houston (GPR, 22 July, 1). That was followed by yet another portfolio deal. Denali Power LLC, formed by affiliates of ArcLight Capital Partners and Caithness Energy LLC, late on July 27 announced they would pay National Energy & Gas Transmission $558 million for 12 plants in seven states with a total net capacity of 1,082 MW. The deal also includes NEGT's 5% stake in the 375-mile Iroquois natural gas pipeline.

Mixed Fruits

Comparisons of bundles of power plants can be flawed because of variations in fuels, locations and plant characteristics, but the GC Power deal, in addition to being the largest acquisition yet announced, also carries the highest valuation for a portfolio of merchant plants (see table, "Rising

Tide," page 24).

MatlinPatterson is paying about $90/kW for Duke Energy's Southeast assets. The plants had a book value of roughly $2.5 billion, but sold for only $475 million. Duke, however, noted that if $500 million of tax benefits are added included, the value of the deal rises to about $1 billion or $190/kW. Sempra/Carlyle/Riverstone paid about $113/kW for AEP's Texas assets. While GC Power is paying about $258/kW for the 14,174 MW it is buying in Texas.

Based on those deals, it would appear that valuations are rising, but it would be misleading to draw too many hard conclusions from such a short track record across such different classes of assets. One analyst commented that sellers prefer to "mix the cats and dogs" in a portfolio because it is the only way they can sell off their poorer assets.

One of the biggest and most obvious differences among the assets that have sold or that have pending sales is whether or not the power plants have contracts. Contracted plants fetch a handsome premium. Even a rough evaluation shows a significant spread between contracted and merchant assets. At the upper end of the valuations is Goldman's purchase of Cogentrix at an average price of $732/kW. At the bottom,

Who's Who Among Financial Players Buying Power Assets

ArcLight Capital Partners LLC	ArcLight, based in Boston, was founded in 2001 by former John Hancock executives, including Daniel Revers, to invest in the power and energy sectors. Hancock put up $500 million as seed money for the fund.
Bain Capital	Bain in April 2003 formed a $550 million partnership with Tenaska Energy to buy generation assets.
Bear Stearns/Houston Energy Group	The Houston Energy Group was formed in 2003 within Bear Stearns by five former El Paso executives and one Dynegy executive. The group says that in its first year of operation it has invested $200 million of equity in four power transactions.
Carlyle Group/Riverstone Holdings	Carlyle is a private equity fund with $18.3 billion under management. Riverstone Holdings is a private equity firm focused on power and energy with over $1.2 billion under management. It was formed in 2000 by Pierre Lapeyre, Jr., and David Leuschen, both former Goldman Sachs bankers.
Coal and Gas Electric Power	CGE was founded by former Eastern Energy and Scottish & Southern Energy executives, with financial backing from British and German banks. The group has not won any bids and has disbaneded.
Complete Energy Partners LLC	CEP was formed in 2003 to buy power assets by Peter Daily, formerly of Allegheny Energy, and Milton Scott and Hugh Tarpley, formerly with Dynegy, with financial backing from Sandell Asset Management and Stonehill Capital Management.
CSFB Private Equity	CSFB's DLJ Merchant Banking Partners III LP closed in November 2001 with $5.3 billion in committed capital and has invested $3.5 billion in various industries, but recently lost three top bankers.
ElectroVest LLC	Power Management Partners LLC and Big Pier Energy LLC formed ElectroVest in May 2003 to acquire distressed power assets in the U.S. Many ElectroVest principals came from the PG&E National Energy Group (now known as National Energy & Gas Transmission.
Energy Investors Funds Group	EIF, founded in 1987, says it has mobilized over $1 billion in capital and currently manages five private equity funds.
GE Commercial Finance	GE is a long standing investor in the power sector, particularly through its Energy Finance Services unit, formerly known as GE Structured Finance and GE Capital.
Goldman Sachs Group Inc	Investment bank Goldman Sachs has made power industry investments through its global commodities division.
GTCR Golder Rauner	GTCR, a private equity firm, was formed in 1980 by Bruce Rauner and manages $6 billion in equity capital. It turned to the power industry in 2003.
Lightyear Fund	The Lightyear Fund was founded in 2003 by Donald Marron, former CEO of PaineWebber.
MatlinPatterson Asset Management	MatlinPatterson Asset Management was formed in 2002 by David Matlin and Mark Patterson, former bond traders at CSFB. The fund focuses on distressed debt.
Miller, McConville, Christen, Hutchison & Waffel	MMC was founded in 2002 by former Enron executives Karl Miller and Kevin McConville.
Reservoir Capital Group	Reservoir is a diversified $1 billion private equity fund whose main partners, Craig Huff, Van Stern, and Gregg Zeitlan, came from Ziff Brothers Investments.
Rockland Capital Energy Investments LLC	Rockland was formed in 2003 by three former El Paso executives.
Soros Private Equity Partners	Soros Private Equity Partners hired Nick Baldwin, former chief executive of U.K. energy company Powergen, to look for investment opportunities in the utilities sector.
U.S. Power Generating	USPG was founded in 2003 by former Societe Generale banker Jacob Worenklein.

Source: Platts Global Power Report

hovering around $100/kW are the three merchant deals already mentioned, and Reservoir Group's purchase of 889 MW for $112.8 million from Exelon for about $127/kW.

According to Jeff Bodington of Bodington & Co. in San Francisco, the average price for contracted projects in 2003 was roughly $750/kW, which includes some unusually high prices paid for geothermal and wind projects. The average sale price for contracted natural gas-fired assets, the bulk of the 2003 sales, was $700/kW.

In a recent analysis of seven merchant plant sales, Bodington noted that prices ranged between $89/kW for Duke's Southeast plants to $1,170/kW for Reliant's sale of its 769-MW Orion portfolio to Brascan for $900 million (GPR, 20 May, 1).

In general, said Bodington, contracted plants are selling for above replacement costs while merchant plants are selling for under replacement cost. For five plants sales for which Bodington had full data, merchant plants sold on average for about 65% of construction cost.

Bodington said that the sellers seem to be "getting more realistic" as exhibited in the increased pace of deals. There were almost no deals done in 2003 and there have already been five or six done in the first half of 2004, he noted.

In their January report, "Digging for Diamonds," ABN AMRO analysts Margaret Jones and Wen-Wen Lindroth Chen also noted that contracted plants fetched the highest valuations, with contracted QFs going for between $400/kW and $500/kW.

Few, if any, sales of uncontracted gas-fired merchant plants closed in 2003, Jones and Chen said, noting that there were still wide differences between bid-ask spreads with sellers asking for $300/kW to $350/kW, while bidders were offering around $200/kW to $275/kW.

In the upper range of valuations, were coal and nuclear plants that benefited from high gas prices. They tended to fetch prices in the $600/kW to $800/kW range. The analysts also noted that gas-fired generation valuations in 2003 varied widely according to location. Gas plants sales in 2003 in the Mid-Atlantic region on average fetched $880/kW. The highest valuation was $1,188/kW in the Western Electricity Coordinating Council. The lowest valuation was $278/kW for a plant in the Midwest. Virtually all of the sales involved plants that benefited from power purchase agreements.

Noting that the largest recent sales—Sempra/Carlyle/Riverstone-AEP and GC Power Acquisition-Texas Genco—were both in Texas, Jones said that one clear trend is the rising valuations of non-gas plants in Texas.

The recent Texas transactions are a good example of how anomalous different transactions can be. Sellers in Texas, mainly utilities, have an impetus to sell in order to establish a base for stranded costs valuations. On the other side, Texas has a clear and well formulated regulatory structure. And, finally, the marginal fuel in Texas is natural gas, which allows coal and nuclear plants to compete very effectively in that market. And while potential buyers might have been sitting on the sidelines as gas prices spiked in 2003, many are now showing more confidence that gas prices will remain relatively high. All these factors contribute to attract buyers, but they are not necessarily replicable. In addition there are now simply much fewer assets

Financial players cut a wide swath

The financial players now active in the power sector represent a wide variety of players, with varied strategies and expectations (see table, "Who's Who," page 22). They include hedge funds, private equity firms, investment banks, and boutiques, some of which have recently been acting like financial players rather than developers.

Some are well known, such as Kohlberg Kravis Roberts Co. LLC, Carlyle Group, and Goldman Sachs, and have long track records. Others are start-ups put together specifically to invest in distressed power assets, such as ArcLight Capital Partners and the Houston Energy Group within Bear Stearns, an investment bank best known on Wall Street for its trading prowess.

Many of the firms formed specifically to invest in distressed power industry assets were founded by executives with long histories in developing power projects at companies that have drastically reduced or completely eliminated their merchant power businesses. Many of the principals at ElectroVest LLC, formed in May 2003, came from PG&E National Energy Group (now National Energy & Gas Transmission) (*GPR*, 8 May '03, 1).

El Paso alone, in particular its merchant energy group, has provided seed talent to three start-ups: the Houston Energy Group, Miller, McConville, Christen, Hutchison & Waffel, and Rockland Capital Energy Investments LLC.

Karl Miller, the founder of MMC, was formerly an executive at El Paso, as well as at Enron, as was Kevin McConville. Rockland, based in Houston, was started in 2003 by Scott Harlan and David Yeager, both formerly of Cinergy Capital and El Paso Merchant Energy, and Martin Pickard, formerly of National Power, who runs the group's London office. The Houston Energy Group was formed by Pamela Baden and David Field, both formerly of El Paso's Merchant Energy Group, and Robert Jordan from Mirant Corp. (*GPR*, 5 June '03, 1).

Some of the recently formed investment firms have been founded by power industry bankers and financiers seeking new opportunities. ArcLight Capital Partners LLC was founded by former John Hancock executives. U.S. Power Generating was formed by veteran power industry lawyer and banker Jacob Worenklein, most recently head of project and sectoral finance at Societe Generale. Other investors have stated their intentions to invest in power assets but have not yet announced deals.

In April 2003, Tenaska Energy formed a $550 million partnership with Bain Capital of Boston to invest in power projects (*GPR*, 17 April '03, 6). And Soros Private Equity Partners has hired Nick Baldwin, former chief executive of Powergen, to scout for investment opportunities.

Many of the investment groups, as well as the deals, are being formed by or done as partnerships. Riverstone Holdings joined up with Carlyle Group and formed a partnership with Sempra Energy Resources to buy 4,400 MW in Texas from American Electric Power (*GPR*, 18 March, 1).

Still other firms, known as boutiques, while not strictly speaking financial players, are worth mentioning. Many of them were also founded by executives from disbanded or shrunken merchant power firms. Their main aim is to develop power projects, but absent a strong need for new capacity, they are building their portfolios by taking stakes in distressed assets, often with backing from financial players.

Delta Power, for instance, took a 50% stake in the 315-MW Brooklyn Navy cogeneration plant from Edison Mission Energy this May with the private equity backing of Morgan Stanley Dean Witter Capital Investors. And Primary Energy Holdings LLC (Private Energy at the time), formed in 2001 by Thomas Casten, founder and former head of Trigen Energy, and William Rockford, former head of project finance at Chase Manhattan, is also building its portfolio via acquisitions rather than greenfield development. With the backing of American Securities Capital partners LLC, a New York private equity investment firm, Primary Energy bought 444 MW of inside-the-fence cogeneration plants from NiSource for $335 million (*GPR*, 23 Oct '03, 1). Primary further expanded its portfolio with a recent deal to buy 270 MW of qualifying facilities from Reservoir Capital Group for $190 million. Reservoir bought those plants, along with others that originally belonged to Sithe Energies Inc., from Exelon for $112.8 million in November 2003 (*GPR*, 14 Aug '03, 16).

available in Texas. Since January, three deals have taken 18,544 MW off the block in Texas, representing nearly 24% of ERCOT's 78,000 MW of installed of capacity and nearly half of all the deals announced in the past year and a half.

Jones and Chen both expect to see more sales, but not necessarily at the same pace as recent months. The level of recent activity in Texas is not repeatable, they said, except if assets are resold. Chen said that the next deals to hit the market could be "trading between investment banks" as financial players begin to swap assets. She also noted that Duke's 650-MW Gray Harbor plant in Washington and the 2,200-MW Union station in Arkansas and the 2,300-MW Gila River plant in Arizona, which TECO Energy has walked away from, could be the next to be sold.

Underscoring the Chen's point about banks swapping assets is the fact that ABN's list of major sellers of generating assets includes two banks: Citibank, which is holding 1,961 MW that used to belong to PG&E National Energy Group, and Societe Generale, which has 3,702 MW that used to belong to NEG.

Sellers, and the banks in particular, appear to be waiting for a return to more normalized values in the $600/kW to $700/kW range and are hoping that these higher valuations will return by 2005, Chen and Jones remarked in their report. The question, asked by many in the market, is how long can they hold out.

Many players seem to be waiting for the banks to throw in the towel, as if the sale of those assets were a cork in a thin necked bottle holding back the deal flow. One person with knowledge of the pending bank sales said that even more important than establishing a price, the sale of the Citi and Soc Gen plants would establish a process that could be used in the sale of other bank-held assets. There are another roughly 6,400 MW of power plants held by banks in addition to the 5,600 MW held by Citi and SG.

That process has to cover issues such as the transfer or retention of tax benefits. And, of course, this person said, the banks would have to feel comfortable with the price and not think they would look bad in a year or two if the markets recover. Nonetheless, he said those assets may move in the next month or two.

Regardless of when the banks sell, there is no shortage of assets for sale, and they aren't only merchant plants. "There is the impression that there are no contracted plants left to buy, but that's not correct," said Daniel Revers, founder of ArcLight Capital. "We are currently assessing about a dozen such assets."

In addition, it is arguable that the 37,244 MW of announced and closed deals has shrunk the pool of assets available for sale. Meanwhile there are more players and more money chasing those deals.

Hedge funds, for example, have a lot of cash on hand, prompting them to chase deals that they typically would not look at. In short, they are acting more like private equity by taking longer term, less liquid positions. Normally hedge funds would stick to liquid securities, stock and bonds, but several—Cerberus Capital Management, Caxton Associates and Seneca Capital—bid for Texas Genco.

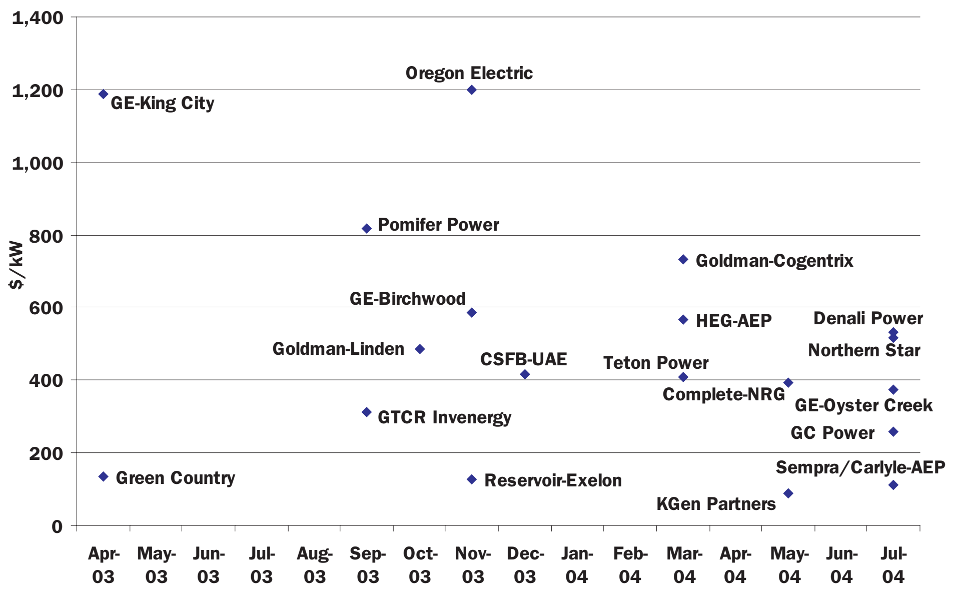
For their part, private equity firms have amassed large pools of capital that are waiting to be put to work. In February, Energy Investors Funds closed the United States Power Fund with $250 million in commitments. In April, Carlyle/Riverstone raised a $1.1 billion buyout fund, Carlyle/Riverstone Global Energy & Power Fund II LP. And last month, ArcLight raised $1.6 billion for a second, 10-year equity fund, ArcLight Energy Partners Fund II LP, from some 75 investors.

ArcLight's first fund invested $950 million in 18 portfolio deals over the last 24 months. Roughly 60% of all of ArcLight's investments have been contracted power facilities. Revers said he expects roughly 40% of the second fund to be similarly invested, though it could go higher. Between the two funds, ArcLight has a position in some 60 plants, with a net generating capacity of 2,000 MW, according to Revers. But he added that the firm is not interested in pure merchant plants. The owners of merchant plants, including banks, are "still not ready" to sell at the "right price," he said.

Traditional utilities and merchant power firms are still sometimes mentioned as possible buyers. Indeed, firms such as Constellation, NRG Energy and Reliant Energy have recently said they might be buyers, at the right price. But many analysts do not expect utilities or merchant firms to become active

RISING TIDE

announced and closed deals with stated prices (includes assumed debt)



Source: Platts Global Power Report

buyers. They have too much to lose. Many have only now returned their credit ratings and stock prices to healthy levels, and they will be very reluctant to risk those gains by returning to the merchant market.

"The larger and more powerful players will be deprived of this market because they don't want to get hit by the rating agencies," said Jean-Louis Poirier, senior strategist with GF Energy LLC in Washington, D.C.

The combination of more money—and money emboldened by recent activity and perhaps worried that it might miss the boat—and fewer assets could mark a shift from a buyer's market to a seller's market.

"The momentum is moving toward more buyers, and that is going to increase the leverage of sellers in this market," said John Anderson, managing director and head of the power and project finance team at John Hancock. Anderson also noted that there are Canadian power trusts that could be preparing to make investments in the U.S.

Overall, it seems clear that there will be more asset sales and most of them will be done by financial players. To date about $25 billion, representing nearly 45,000 MW—half of it contracted assets—has changed hands since autumn 2001, said Poirier. He expects to see continued "portfolio rebalancing" and continued consolidation that will result in another 30,000 MW to 45,000 MW of sales between 2005 and 2007.

"In many cases, financial institutions will become the big arbitrager because they will own about 45% of the transacted capacity and/or because they can offer enabling or 'bridge' structured financing for periods of two to four years," said Poirier, but he added, "the surviving merchants will be back buying in 2005-2006."

In the 2005-2007 time frame, Poirier expects to see "the next wave of the secondary market," which would include partial fire sales, representing 8,000 MW to 12,000 MW; resales by banks, 10,000 MW to 18,000 MW; two or three large portfolios sales, accounting for 5,000 MW to 9,000 MW, and possibly two or three mergers accounting for 10,000 MW to 15,000 MW. By 2008, he said, about over 80,000 MW may have changed hands since the fall of 2001, with a total value of in the range of $24 billion to $28 billion.

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