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Power Project Workouts From A Lender's Perspective

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Today's Presenters

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Topics

- Market Overview Leading to Financial Distress
- Workout Strategies and Options

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Contracting Demand due to COVID-19 Pandemic

- Lockdowns, work stoppages, and resulting reductions in general commercial & industrial activity have caused significant reductions in demand across U.S. power markets.
- Low spark spreads for natural gas-fired generation due to decreased demand.
- Low fuel costs haven't been enough to offset low demand; fuel hedging arrangements for merchant conventional generating assets may not have accounted for fuel prices falling as low as they have in recent years. Conventional projects can't rely on historic low fuel costs for profitability.
- Even prior to shut downs due to the pandemic, weaker demand during a mild winter coming into 2020, followed by the declines from March through May have led to significant pressure on generation assets and lower profitability that is not being made up through capacity payments.

Lower Capacity Prices across U.S. Markets

- Even prior to reductions in demand due to the pandemic, capacity prices were declining due to flat to declining load growth, due to factors such as:
  - greater energy efficiency,
  - outsourcing of heavy industry, and
  - distributed (customer-owned) energy generation/customers generating their own power on site.
- Combination has led to lower capacity auction clearing prices.
- Weak capacity markets coming into 2020 – certain markets have had low capacity pricing or, most recently, postponed capacity auctions due to proposed rule changes (e.g., PJM postponed the 2022/23 capacity market auction and subsequent auctions).

Summer Months May Improve Performance, but Project Debt Burdens Key

- Demand is expected to improve as pandemic lockdowns lift and commercial and industrial activity increases as the worst of the contraction may be behind us.
  - Effect of second wave/additional lockdowns could be severe
- Along with expected demand increases due to warmer weather, may see improved performance.
- Depending on the financial health of a given generating asset, that may be enough to weather the storm; however, for certain underperforming or highly-levered assets that may not be enough.

Projects with High Debt Burdens at Higher Risk

- Even with improved spark spreads over the summer months, it may not be sufficient to generate adequate returns for existing merchant generation.
- Generating assets that are highly-levered expected to be at higher risk than those with lower debt service burdens, due to greater pressure on cash flows.
- May see increased discounted sale activity or restructuring activity for weaker assets.

Projects with High Debt Burdens at Higher Risk

Recent examples:

- Panda Patriot and Liberty facilities (two 829 MW combined-cycle gas turbine plants in Pennsylvania) – mezzanine lenders/upstream equity Carlyle Group and EIG Global Energy Partners on June 17 closed on the acquisition of the projects in combination with a Term Loan B financing to take out existing financing.
- Athens (994 MW in NY) and Millennium (335 MW in MA) projects, owned by Northeast Gas Generation, LLC, a subsidiary of Talen Energy, filed for Chapter 11 bankruptcy protection June 18. Combined outstanding debt of $585.2 million.

Financial Distress In The Market

- Contracting demand on account of COVID-19 lockdown
- Merchant power plants unable to generate projected revenue given low power prices
  - Brief overview of demand and price changes in key markets (PJM, ISONE, NYISO, ERCOT, MISO, CAISO)
  - Projections on price changes
  - Stresses from capacity market rule changes
- Impending maturities of funded debt with few refinancing opportunities
- Offtake agreement expiring or offtake counterparty in an insolvency proceeding
- Hedging contracts inadequate

Workout Strategies and Options

- Anticipating defaults under lending agreement
  - Due diligence
  - Proactive discussions re modifications/forbearance
- Defaults under lending agreement
  - Payment default
  - Covenant default
  - Cross-default
  - Insolvency of credit support party
  - Default by offtake counterparty
    - Bankruptcy of offtake counterparty
    - Failure of offtake counterparty to pay
    - Rejection of offtake agreement
    - Cross-default to default under the offtake agreement

Workout Strategies and Options

- Enforcement options
  - Forbearance/reservation of rights
  - Declaration of default
  - Charging default interest
  - Blocking distributions/management contract payments
  - Termination of lending commitments
  - Acceleration of debt
  - Recourse to collateral consisting of project assets
    - Exercise of any "step-in" rights
    - Foreclosure sale, including "strict" foreclosure
    - Practical problems with non-assignable contracts and permits and real estate
    - Regulatory approvals

Regulatory Barriers to Workout Strategies

- Many power projects in the US are subject to regulation by federal and state agencies
  - Federal Energy Regulatory Commission
  - State Utility Commissions/Public Service Commissions
  - Nuclear Regulatory Commission and Agreement States
    - Direct and indirect license transfers require prior approval
    - Restrictions are placed on foreign ownership
    - Opportunities for hearing

Regulatory Barriers to Workout Strategies

- Depending on the project and sometimes the lender, certain workout strategies can implicate a need for prior regulatory authorizations
  - Noncompliance could result in financial sanctions or unwinding workout steps
- A need for prior regulatory authorization could make some strategies difficult to implement
- Lenders should identify whether prior authorization are necessary for proposed remedies
  - Understand regulatory status of project and the licenses/authorizations it holds
- As discussed in the subsequent slides, some workout strategies do not typically require regulatory authorizations or the workout strategy can be designed to work around these restrictions
- Important lender protections can often be achieved without triggering these authorizations

Workout Strategies and Options

- Recourse to collateral consisting of equity interests in the project company
  - Assuming governance control
    - Exercise of “step-in” rights
    - Possible “change of control” provisions of contracts, licenses, and permits
  - Selling the equity interests under UCC 9-610
    - Private sale to a third party
    - Public sale at which the lender may credit bid
    - Commercial reasonableness requirement
    - Transferee regulatory approvals
  - Strict foreclosure under UCC 9-610
    - In whole or in partial satisfaction of the debt
    - Necessity of consent or failure to object by borrower or any credit support party

Note: Regulatory approvals often implicated, depending on the regulatory status of the project company, due to the change in equity control/ownership

Workout Strategies and Options

- Restructuring outside of bankruptcy
  - Extension of term
  - Reduction in scheduled amortization
  - Change in interest rate
  - Fees
  - Reduction of debt in exchange for equity participation
    - Regulatory authorizations can be triggered depending on the level/type of equity ownership
- Restructuring in bankruptcy, receivership or other court proceeding
  - DIP financing/use of cash collateral
  - Sale and milestones vs. restructuring
    - If sale, will lender be the "stalking horse' or credit bid?
    - If restructuring, see part (i) above

Note: For receiverships and similar restructuring proceedings, regulatory approvals can be necessary depending on the regulatory status of the company and the type of receivership

Workout Strategies and Options

- Sale of loan claim
- Sale of any offtake agreement rejection damages, BC 503(b)(9), or general unsecured clam constituting collateral
  - Before allowance of the claim
  - After allowance of the claim

  Note: These strategies typically would not require regulatory authorizations.

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Questions?

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Biography

Katie Ostman
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Katie Ostman represents equity investors, sponsors, lenders, developers, and utilities in connection with project finance, project development, and general corporate transactions related to electrical generation and infrastructure projects. She counsels clients through the development, construction, operation, acquisition, divestiture, and financing of natural gas, nuclear, wind, solar, and other alternative energy projects. Katie also represents companies in corporate and finance matters, including mergers and acquisitions (M&A), joint ventures, and debt and equity financings.

Biography

Julia Frost-Davies
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Julia Frost-Davies focuses her practice on the representation of creditors in complex Chapter 11 cases. A seasoned commercial litigator, she counsels clients facing commercial and bankruptcy litigation and appeals, and regularly represents investors and lenders throughout the capital structure on all aspects of restructuring and related litigation, including debtor-in-possession financing, distressed M&A transactions, claim and plan negotiation and litigation, and out-of-court work-outs. Julia works with companies in a variety of sectors and industries including retail, energy, and financial services.

Biography

Edwin Smith
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Edwin Smith concentrates his practice in commercial law, debt financings, structured financings, workouts, bankruptcies, and international transactions. He is particularly knowledgeable on commercial law and insolvency matters, both domestic and cross-border. His representations have included those in major bankruptcies including Refco, Lehman, and the City of Detroit. He often advises financial institutions on documentation and risk management issues.

Biography

Dan Skees
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Dan Skees represents electric utilities before the Federal Energy Regulatory Commission (FERC) and other agencies on rate, regulatory, and transaction matters. He handles rate and tariff proceedings, electric utility and holding company transactions, utility financing, electric markets and trading issues, reliability standards development and compliance, and transmission development. In handling appeals of FERC decisions, Dan has successfully represented clients before both the US Court of Appeals for the District of Columbia Circuit and the US Court of Appeals for the Fifth Circuit.

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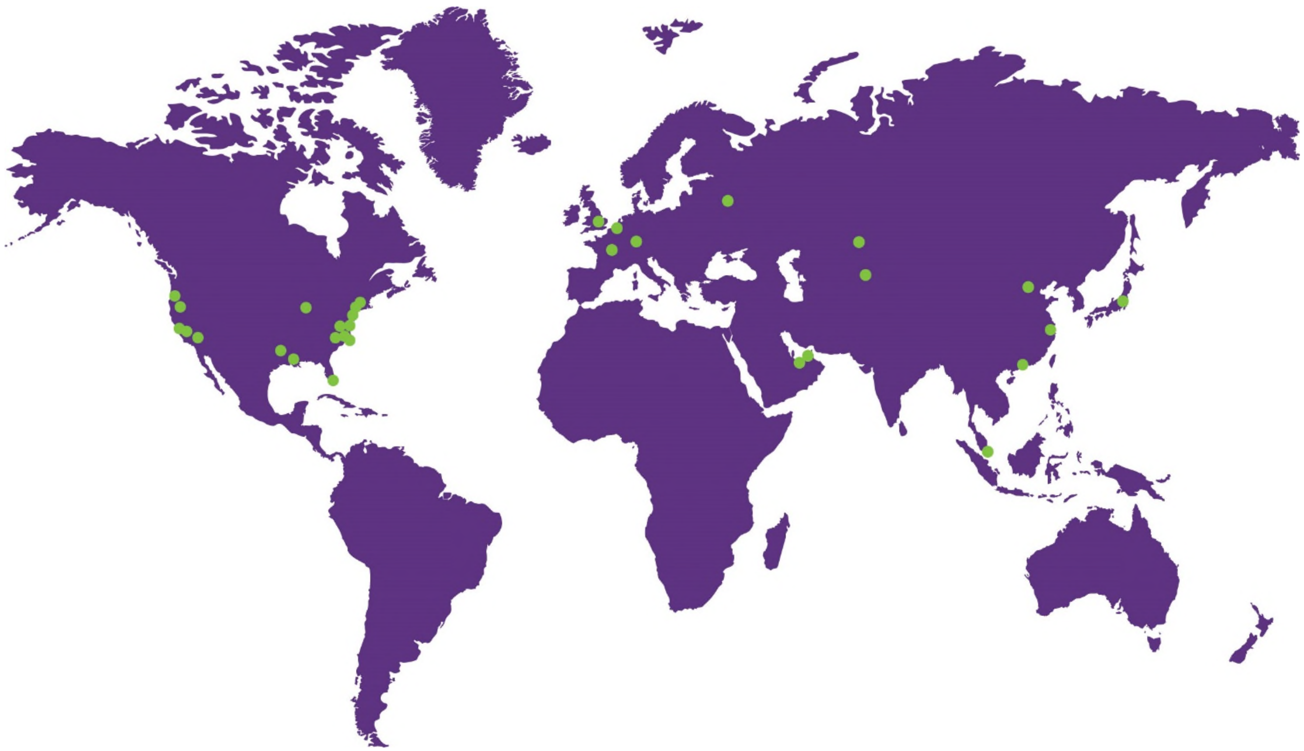

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