

Humber's new wave

The £520m (\$800m) Humber power project in the UK signals the beginning of the new wave of UK independent power projects (IPPs) following the dash-for-gas in 1992. Humber's innovative structure – with contractual guarantees and gas supply provided by non-UK companies – cracked the market dominance of UK regional electricity companies, and British Gas as fuel supplier.

The deal was co-arranged by NatWest Markets and UBS, with CIBC and ABN AMRO coming in as co-underwriters. NatWest Leasing & Asset Finance also structured the lease arrangements.

Gary Griffiths, director, NatWest Capital Markets syndications, played a key role in structuring and syndicating the transaction. Andrew Kinloch, vice president project finance at UBS, brought the Swiss bank's expertise to bear on structuring the deal.

What do you think are the most significant innovations behind the Humber deal?

GG: The major innovation is that the contracts for differences (CFDs) are taken out solely with shareholders and that some of the shareholders are not UK regional electricity companies (RECs). UK RECs – until now – were the only corporates willing to take out CFDs.

Could you explain briefly how a CFD works?

AK: The CFD is essentially a hedge. It is similar conceptually to an interest rate hedge. The project earns a revenue from the pool. That revenue varies dramatically depending on the price – which, in turn, can vary every half-hour. The CFD means that the counterparties pay or receive the difference between the pool and the pre-agreed price. So CFDs are basically financial instruments.

Would you agree that it is also important to bring in non-UK sponsors, because the trend among RECs is towards concentrating on their core activity?

GG: Sure. Although you can't have a template for all regional electricity companies – we still see them getting involved in IPPs.

As a trend, however, this is something which has opened up the market. The market has previously relied on RECs,



Now we see RECs going back to their core business of distribution, where they are safe and they have a monopoly.

RECs are not the only customers. In the market for large industrial users, any intermediary can supply electricity. Also the RECs won't have a franchised market after 1998. So, the market will get more fragmented and more complex.

The other key innovation is the non-interruptible gas supply contract. What is the advantage of this over the traditional British Gas contracts used in the first wave of UK IPPs?

AK: This is a real cost saving. Both in terms of not having to build the facilities

for storing gas and oil, and also in terms of operating performance. British Gas, for example, can interrupt gas supply for something like 30 days a year – a significant period. Previously, we may have assumed that they would not exercise those rights too often, but maybe they will.

In the case of Humber, the supply from Elf Exploration and Total Oil Marine is non-interruptible.

Leasing plays a large part in the financing. How important was this aspect to the structure of the deal?

GG: Humber really had to go for a lease, because it only had one sponsor – possibly two – with sufficient tax capacity in the UK to absorb its share of the tax allowances coming out of the project. As such, with the lease, it proved to be pretty efficient for the consortium. Therefore it was always on the cards that they would appreciate the advantages of a leasing.

Did the leasing arrangement work well?

AK: Yes, very much so. The most difficult negotiations are always going to be between the banks and the lessor, over the inter-creditor agreement. But that is where it helps to have a lessor who has been through this process before. NatWest Leasing & Asset Finance had done the last four leases for projects in the UK – that helped a lot.

The syndication also reflects the considerable appetite in the banking market for UK IPPs. Do you think there is an equivalent appetite on the corporate side to develop them?

AK: No. I think there will be a few more, but they will change each time in terms of how they will be structured.

Between 1990 and 1992 the greenfield gas-fired IPP became a pretty homogeneous commodity. Humber has brought in several innovations, and there will be further innovations for each IPP. For example, can you finance it so that it runs maybe for just nine months of the year? Can banks take some pool price risk?

We placed a fair amount of reliance in Humber on where it was going to be placed in the unconstrained merit order. In future it might be possible to finance IPPs with a degree of pool price risk, if the project is sufficiently high in the merit order. ♦

HUMBER

Sponsors: IVO (30%), Midlands Electricity (25%), ABB (20%), and Tomen (25%).

Advisers: Babcock & Brown

Total cost: £520m (\$800m)

Pricing: tranche A (£44m) Libor plus 75bp; tranche B (£396m) Libor plus 125bp pre-completion and 110bp post-completion; tranche C (£36m) Libor plus 135bp; tranche D (£28m) Libor plus 125bp pre-completion and 110bp post-completion; tranche E (£63m) Libor plus 62.5bp; and tranche F (£16m) Libor plus 135bp.

Maturity: 15 years

Arrangers: NatWest Markets, UBS