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Transmission Infrastructure By Public-Private Model

Law360, New York (November 06, 2009) -- Transmission infrastructure in the United States has traditionally been built by vertically integrated utility companies that constructed transmission lines to deliver power from their generators to their load located in their service territories.

With the advent of United States government policies promoting the creation of independent power producers not affiliated with traditional utilities, the need to allow open access to use existing transmission infrastructure arose.

In recent times, independent power producers have increased their development of renewable generation resources in remote areas of the country. This phenomenon has highlighted the need to construct new transmission infrastructure to deliver the power generated by these resources to congested load centers in urban regions.

Although various financing mechanisms have been used to provide multimillion dollar funding for transmission infrastructure projects, a new public-private partnership model has emerged in this decade. An analysis of projects that have utilized this new model brings to light the advantages and challenges that financing transmission infrastructure projects presents.

Path 15 Project

The Path 15 Project is an 84-mile 500 kV transmission line to connect two substations controlled by Pacific Gas & Electric Company: the Los Banos substation in northern California and the Gates substation in southern California.

The transmission line went into service in December 2004 and allows 5,400 MW of generation capacity to flow along a previously bottlenecked path between northern and southern California.

The project was the nation's first public-private partnership in the transmission arena, among Trans-Elect (an independent transmission company), Western Area Power Administration (a federal power marketing administration that operates its own transmission system) ("WAPA") and Pacific Gas & Electric Company ("PG&E").

WAPA owns the physical transmission line, PG&E will construct upgrades at both ends of the transmission line, Trans-Elect will retain ownership of the transmission system rights (the rights to schedule transmission of power over the line), and the California Independent System Operator Corporation (the transmission grid operator in the region) will operate the line.

The $220 million financing facility for the project closed in September 2003 and involves four components.

The first consists of approximately $95.5 million in takedown bonds to the Trans-Elect NTD Path 15 operating company. The second consists of $56 million in bonds to the Trans-Elect NTD Holdings Path 15 holding company.

The third consists of a $19.5 million construction overrun facility. The fourth consists of a $38.3 million equity bridge facility provided by the Energy Investors Funds Group, ArcLight Energy Partners Fund and KB Transmission.

Four banks served to provide financing for these facilities: Citigroup served as the co-placement agent on the bonds and an underwriter on the construction facility and equity bridge; DZ Bank served as the lead arranger and an underwriter on the construction facility and equity bridge; Macquarie served as the co-placement agent on the bonds; and Societe Generale served as an underwriter on the construction facility and equity bridge.

The Path 15 Project was named the North American Power Infrastructure Deal of the Year in 2003 by Project Finance magazine.

Trans Bay Cable Project

The Trans Bay Cable Project is a 53-mile high-voltage transmission line submerged along the bottom of the San Francisco bay to connect two substations controlled by Pacific Gas & Electric Company, one located near the City of Pittsburg, Calif., and the Potrero substation in the City of San Francisco.

The transmission line will allow approximately 400 MW of generation capacity to flow to the transmission-constrained City of San Francisco. The line is expected to be constructed by March 2010.

Trans Bay Cable is a public-private partnership among the city of Pittsburg, Calif., Pittsburg Power Company and Steel River Infrastructure Partners.

Once the transmission line is completed, Pittsburg Power Company will own the physical transmission line and equipment, Trans Bay Cable LLC will retain ownership of the transmission system rights, and the California Independent System Operator Corporation (the independent transmission grid operator in the region) will operate the line. After 99 years, the transmission system rights will be transferred to the City of Pittsburg.

The $515 million financing facility for the project closed in August 2007 and involves three components.

The first consists of a $267 million senior debt facility to Trans Bay Cable LLC as borrower arranged by Bayerische Landesbank and insured to AAA/Aaa (S&P/Moody's) by Ambac Assurance Corporation.

The second consists of a $198 million subordinated debt facility also provided by Bayerische Landesbank. The third consists of $50 million in equity provided by Steel River Infrastructure Partners.

Trans Bay Cable LLC recently requested approval from the Federal Energy Regulatory Commission to issue five tranches of securities totaling $371 million in order to refinance its existing debt facilities. FERC has yet to rule on this request.

The Trans Bay Cable Project was named the North American Infrastructure Deal of the Year in 2007 by Project Finance magazine.

Wyoming-Colorado Intertie Project

The Wyoming-Colorado Intertie Project is a proposed 345 kV transmission line designed to run from southeast Wyoming to Colorado's front range.

The line would deliver approximately 800 MW of generation capacity to Colorado and aims to eliminate a transmission constraint between Colorado and Wyoming. The projected completion date for the line is in 2011/2012.

The project is currently being developed as a public-private partnership among Trans-Elect Development Company LLC, WAPA and the Wyoming Infrastructure Authority.

The Wyoming Infrastructure Authority was created in 2004 by the State of Wyoming to diversify the state's economy through improvements to its transmission infrastructure and has received authorization to issue bonds to facilitate these investments.

The estimated cost of the project is $325 million. Interwest Energy Alliance, Western Grid Group and the Wyoming Infrastructure Authority have committed to funding 50 percent of project development costs.

GreenHunter Wind Company LLC and Duke Energy Ohio Inc. have already committed to ship a total of 585 MW of power on the proposed Wyoming-Colorado Intertie line.

If the project moves forward, the Wyoming-Colorado Intertie line would be the first transmission line to be built in the region in over five years.

Advantages of Financing Transmission Infrastructure Projects

Several distinctive aspects of transmission infrastructure projects often allows sponsors of these projects to obtain financing for the projects even in the midst of decreased access to capital markets.

One key advantage from a lender's perspective to financing transmission infrastructure projects is that since transmission lines are regulated by FERC, the long-term revenues streams of the lines are federally regulated.

Thus, payments to the operator of the line reflect the full recovery of costs and fixed return on equity. Cash flows from the project are stable and predictable, as well as being independent of fluctuating power prices and line utilization.

A second advantage of financing transmission infrastructure projects is that lenders are provided with a mortgage security over all tangible project assets and full security over the receivables from the project, including the transmission system rights.

Levels of security afforded to lenders can be further enhanced by pledges of stock in the entities owning the transmission line, as well as security interests in these entities.

A third advantage is that transmission lines generally require minimal operations and maintenance requirements through their useful life. Transmission lines also benefit from their reliance on proven technologies and a strong history of successful operations.

These characteristics of transmission projects provide lenders with a stable asset class for which they can predict future expenses and performance with a greater level of assurance as compared to other asset types.

Unique Challenges of Financing Transmission Infrastructure Projects

Although transmission infrastructure projects are often seen as "bankable" projects by lenders, these projects and the current state of the economy do present several unique challenges.

First, sponsors of transmission projects must obtain approval from FERC to transfer ownership of the transmission line to investors.

FERC must find that the transfer is consistent with the public interest and will have no adverse effects on competition or rates. Lenders generally require evidence of such FERC approval as a condition to extending loans for the transmission project.

Second, sponsors of transmission projects face a significant challenge in obtaining all of the required local, state and federal permits to allow them to access or obtain title to land over which the transmission line will run.

The Trans Bay Cable project spent four years obtaining these permits, which time frame can slow down a project's ability to obtain financing.

Third, the inclusion of public partners in a public-private partnership structure for ownership and operation of transmission lines imposes an additional burden on the projects to comply with government rules on contracting and financing.

Additionally, ownership or control of transmission lines by public partners may deter private entities from participating in the project.

For example, WAPA's ownership of the Path 15 Project's transmission line deterred some energy companies (Mirant, Williams, Kinder Morgan and PG&E NEG) from participating in the project.

Finally, the tight nature of credit markets often impedes otherwise credit-worthy transmission projects from obtain financing in this economic climate.

For example, Royal Bank of Scotland withdrew from the arranger group in the Trans Bay Cable Project citing poor market conditions.

Outlook for the Future

The outlook for the future of financing transmission infrastructure projects looks fairly bright even in an overall dim economic climate for several reasons.

The ability to obtain financing for transmission projects as opposed to other types of asset-backed projects is significantly benefited by the unique characteristics of transmission assets discussed above which lend themselves to receive favorable financing terms.

Additionally, obtaining initial financing for such projects may be aided by the possibility of obtaining loan guarantees under the U.S. Department of Energy's loan guarantee program for loans to certain transmission projects that utilize innovative technologies.

Likewise, the outlook for continued use of the public-private partnership model for constructing, owning and operating transmission lines appears to be on the rise.

The federal stimulus funds provided to WAPA have led it to state a commitment to continue pursuing public-private partnerships to build much-need transmission infrastructure in its region of the country.

Moreover, government officials in at least one state (Nevada) have called for legislative changes to tax code regulations to increase the state's ability to issue bonds to finance transmission infrastructure projects in the future.

If these trends continue, observers of the financing and energy markets can expect to continue to see future commitments to finance transmission infrastructure projects that may increasingly rely on public-private partnerships to finance, build, own and operate these projects.

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