THE WEAKNESS OF POWER

COLLATERALIZED HEDGING PROGRAMS FOR THE ENERGY MARKET

TRUTH BE TOLD, the power industry is not all that powerful. Volatile prices plague raw materials as well as the electricity and refined products in which they result, leaving power plants and refineries to contend with uncertain operating margins. New project developments face long and unreliable lead times, while operating facilities are vulnerable to unplanned shutdowns for a host of reasons ranging from climate catastrophes to mechanical failures. Thus, it should be no surprise that, despite the superficial allure of energy production, providing financing to the power industry can be a challenge.

Enter the commodity hedge provider who, through the provision of long-term hedges, can help power plants and refineries blunt the ill-effects of price volatility, both for operating facilities and development projects. Often the ability of a power plant or refinery to obtain financing depends on the existence of an acceptable hedging program. In other words, lenders find it easier to lend when hedges are in place. What lenders don't like, however, is the need to forge an intercreditor relationship and share their collateral with a hedge provider whose claims against the borrower will fluctuate based on the hedge provider's mark-to-market exposure under the long-term hedges it provides. In this context, we have worked closely with our commodity dealer clients in structuring, negotiating and implementing collateralized hedging programs for various energy market participants. Our experience includes representing dealers who have implemented hedging programs prior to, at the same time as, or after a new secured credit facility is established and even prior to the date on which a facility commences commercial operations. We have worked on programs where the counterparty is the corporate parent of a multi-facility energy company, as well as programs for stand alone project companies or subsidiary project companies with limited or no recourse to upstream parent entities. Our experience covers facilities ranging from oil refineries and LNG regasification plants to natural gas fired facilities and renewable energy facilities using wind or solar power.

Our success in representing our clients across this array of deals depends on a coordinated effort by our capital markets, derivatives and secured finance practices.

Documenting the basic elements of these hedging transactions, particularly given the highly customized and long-term nature of many hedging programs, can itself be a complicated task, involving transaction structures geared to hedging refining or production margins rather than single commodity prices. The level of complexity is only heightened when it becomes necessary to mesh the dealer's fluctuating exposure under its hedges with substantial credit facilities through shared collateral and intercreditor arrangements, particularly where the collateral consists of illiquid fixed operating assets and real estate rather than liquid cash equivalents, which traditionally have served as collateral for volatile derivative transactions. An intimate understanding of the interplay between derivative documentation and exposure, customary secured lending covenants and collateral structures and the use of intercreditor and subordination arrangements to create interfaces among these various elements are critical to the negotiation and documentation of these transactions. Such structures also call for sophisticated knowledge of bankruptcy and insolvency law, energy regulation and multi-jurisdictional tax issues. Our experience and depth of knowledge, and the seamlessly integrated work among the attorneys from each of our relevant practices, enables us to provide our dealer clients with a distinctly effective level of service as they structure and negotiate their participation in these complex arrangements.