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# Ins and Outs of Purchasing Natural Gas-Fueled Power Plants

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Wholesale electricity prices in the market covered by the Electric Reliability Council of Texas (ERCOT), the operator and regional coordinator of electricity systems within Texas, move with the price of natural gas. That's because natural gas-fueled generation facilities generally supply marginal electricity demand.

For investors with a bullish view on the future price of natural gas, today's low natural gas prices may present an opportunity to purchase a natural gas-fueled generation facility at an attractive price. At the same time, increasingly strict environmental regulations are in some cases requiring modifications to coal-fueled generation plants, triggering additional expenditures. Natural gas-fueled power plants, on the other hand, are cleaner, and the regulatory burden on them has not been as heavy.

Acquiring facilities entails issues that, regardless of the attractive economics of the purchase or the pressure to move quickly to complete the transaction, should receive careful attention (particularly if the seller will not provide meaningful recourse for problems that arise post-closing).

From a due-diligence perspective, the following matters are critical:

- *Natural gas supply.* The facility must have an adequate, reliable supply of natural gas to fuel the plant. The buyer should have a firm understanding of how it will purchase natural gas, the means of delivery and the economics of the arrangement.
- *Water supply.* The facility must have long-term access to water for cooling and other purposes. If there is any doubt about continued access to water, the buyer should proceed with extreme caution.

- *Power purchase agreements.* The buyer must have a plan for selling power produced by the plant. Will the existing power purchase agreements stay in place, or will new agreements be negotiated with the same or different purchasers?
- *Regulatory implications for change in ownership.* A change in ownership of the facility could have far-ranging effects on regulatory matters such as tax abatements and permits relating to air, water or other matters. A change in ownership may also require approval by the Public Utility Commission of Texas, depending on the current operations of the buyer in Texas.
- *Real property.* Proper diligence of the real property in conjunction with obtaining a new title policy is crucial. Many of these facilities are in

rural areas where a neighbor could have a claim for ownership or easement based on use of a portion of the land. In the event the buyer contemplates expanding the facility, it is important to understand how such expansion could be accomplished given the layout of the property.

• *Equipment*. Knowledge about the condition of the equipment at the facility, and the related manufacturer warranties (and whether they are transferable), is key. If a planned outage or repair cycle can be scheduled to occur shortly prior to signing or closing, often many problems can be uncovered and addressed. The buyer should have a representative present for any such outage or repair.

• *Licenses*. Often there are licenses governing use of intellectual property at the plant, which the buyer should review to ensure that the sale will not create a problem.

• *Operating personnel*. Depending on the buyer's plans, it may be necessary to make arrangements with certain key personnel, such as the plant manager, for continued service post-closing. Alternatively, the buyer may engage a third-party provider to manage the plant, in which case such third-party provider should be involved in the due-diligence efforts.

In addition, the following aspects of the purchase agreement are noteworthy:

• *Included assets*. It is not uncommon for some assets used at the plant to be owned by a party other than the seller, such as an affiliate that owns another plant. In addition, if the seller owns multiple plants, the plants may share certain equipment that generally resides at another facility. As a result, the agreement should convey all the assets used at the facility or at least disclose which assets are not being conveyed that are used.

• *Metering, measurement and imbalance procedures*. The bifurcation of the fuel supply and energy production between pre- and post-closing periods, including any adjustments for taxes and fees, can be complicated. The appropriate commercial experts should be involved early so that they can develop a practical solution.

• *Title insurance*. Title insurance provisions, including the bases for objection to deficiencies, the efforts that must be expended to correct defects, applicable time periods and related termination rights, should receive close attention.

• *Interim operations*. The agreement will contain covenants governing operations between signing and closing. The parties frequently negotiate what standard of care should apply to interim operations — "prudent operating practices" often is the standard, with the devil being in how it is defined. Sometimes reference to the seller's operations manual (assuming it is sufficiently fulsome) can be a useful compromise.

Finally, a good understanding by the buyer's legal counsel of how the plant actually functions is invaluable to ensure that all necessary assets are accounted for and all risks are considered. TNL

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