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Largest LBO Puts Energy Future-Backed Bonds at Risk: Muni Credit.

OppenheimerFunds Inc. and Nuveen Asset Management LLC lead municipal-bond investors that may see as much as \$1 billion of combined holdings wiped out as Energy Future Holdings Corp. teeters on the brink of bankruptcy.

The Texas utility, previously known as TXU Corp., borrowed through three river-management agencies more than a decade ago to pay for pollution control equipment. The company was bought in 2007 in the largest leveraged buyout in history, which added debt to its balance sheet and bumped holders of its munis below other creditors in payment priority. The owner of Texas's biggest electricity provider has struggled as natural-gas prices sank, and some of the bonds have lost 97 percent of their value.

"It could get pretty ugly," said Triet Nguyen, managing partner with Axios Advisors LLC, a research firm in Lake Forest, Illinois, who predicts nearly total losses for holders of Energy Future-backed munis. "They don't rank very high in the capital structure."

The muni obligations are part of the \$45.6 billion of debt that the Dallas-based company is trying to restructure after losses in 10 of the past 11 quarters. Warren Buffett, chairman of Berkshire Hathaway Inc., said the utility will "almost certainly" file for bankruptcy this year, unless natural-gas prices soar and raise the cost of electricity. Berkshire suffered an \$873 million pretax loss on Energy Future corporate debt and exited the holding last year, Buffett said March 1.

Largest Holders

OppenheimerFunds, Nuveen and Federated Investors (FII) Inc. were the largest institutional holders of Energy Future munis, with about \$240 million combined, according to the most recent company filings to Bloomberg. About \$400 million was held by mutual funds and banks.

The positions may have changed since the release of the filings, some of which date to 2012. Some of the debt, including holdings of Federated Municipal Obligations Fund (MFCXX), is backed by letters of credit from Citigroup Inc. that expire Sept. 1. The letters give bondholders a backstop.

Kathleen Cardoza, spokeswoman for Chicago-based Nuveen, didn't respond to a request for comment. Kaitlyn Downing at OppenheimerFunds in New York declined to comment, as did Scott Helfman, a spokesman for New York-based Citigroup, and Allan Koenig of Energy Future in Dallas.

Meghan McAndrew, a spokeswoman for Pittsburgh-based Federated Investors, confirmed that debt the company owned is backed by a letter of credit.

Safety Record

Local-government bonds are typically safer than corporate securities. The default rate for munis graded by Moody's Investors Service averaged 0.03 percent for the five years through 2012,

according to the firm. Company-bond default rates averaged 1.3 percent in 2012, according to Moody's.

The potential for losses on Energy Future munis shows the risk of the segment of the \$3.7 trillion municipal market where companies borrow through local authorities.

Such securities, called industrial-revenue bonds, have produced about 9 percent of muni defaults since 2009, fourth behind land-secured debt, multifamily housing and retirement projects, said Matt Fabian, an analyst with Concord, Massachusetts-based Municipal Market Advisors.

Standing Back

Richard Larkin, director of credit analysis at Iselin, New Jersey-based Herbert J. Sims & Co., said he soured on munis backed by the utility as the company took on debt and its management structure changed.

"It was a good, well-run utility" before the changes, he said. "After 2008, I wouldn't touch it with a 20-foot pole."

Standard & Poor's predicted in October that investors wouldn't recover any money on the utility's unsecured and subordinated bonds, while Moody's predicted in a September report that holders of unsecured debt would see "very low recoveries."

Prices of the bonds have come close to reflecting that expectation. Bonds sold through the Brazos River Authority and maturing in October 2038 traded at about 2.7 cents on the dollar on Feb. 12, data compiled by Bloomberg show.

The munis were sold through local agencies, including the Brazos agency, and authorities for the Sabine and Trinity rivers.

Peak Purchase

The buyout of TXU in 2007 for \$48 billion came at the peak of the private-equity boom that ended a year later with the financial crisis.

Energy Future may become the biggest failure of a private equity-backed company since Chrysler Group LLC in 2009.

Auditors may raise doubts about the company's ability to remain a going concern at the end of this month. Such a qualification would constitute a default under terms of the company's secured debt, Fitch Ratings analysts Shalini Mahajan and Philip Smyth wrote in a December note.

Energy Future assumed muni debt that TXU had taken on early in the decade.

The buyout — led by KKR & Co. (KKR), TPG Capital and Goldman Sachs Capital Partners — was a bet that natural gas prices would rise, allowing the company to charge more for electricity. Instead, they have fallen 67 percent from their 2008 peak amid the development of hydraulic fracturing.

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