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ELECTRIC UTILITY BONDS ARE NOT ALL CREATED EQUAL

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In municipals, there are three types of bonds paid from electric utility operations. The safest are city/state operated retail systems, which are basically legal monopolies selling an essential service. Some of these systems can see ratings as high as "AAA".

Then there are privately owned generation and retail sale corporations (such as Con Edison of NY) that can sell tax free debt for pollution control facilities. An old-time bond trader with over 40 years' experience once told me that he had never seen an investor lose money on a regulated corporate retail system that had mortgage backing. While regulators are charged with keeping prices low for normal residential and commercial users, the regulators are also charged with making sure the system is in good repair and can provide stable and continuous service. Ratings tend to fall within the "A" to "BBB" range.

Then, there are the wholesalers, also called "merchant power providers". These systems are totally competitive and usually unregulated. As was described in last week's column, these are pure industrial revenue bonds, subject to competitive risks. The business is to provide large power requirements on a wholesale and totally competitive environment. Generation plants are costly, and merchant providers make big bets on long term demand for electricity. Prior to its bankruptcy, ENRON was one of the world's largest unregulated power producers in the world.

On November 4, the rating agencies downgraded FirstEnergySolutions' (FES) unsecured debt to just above default, based on the company's decision to shut down or sell its generating facilities. Recent low energy prices have made this part of FirstEnergy's business unprofitable over the long run. FirstEnergy's retail operations, such as West Penn Power, however, remain stable.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.

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