

The Moral Hazard Marches Forward

March 1, 2004

From the Arizona Republic newspaper we read the following . . .

A new \$700 million power plant near Gila Bend is the latest casualty of the boom-or-bust Western electric power market.

Tampa-based Teco Energy Inc. said Thursday that it would turn the power plant over to lenders after it failed to garner enough customers to operate the plant profitably.

Three years ago, operators of such plants reaped huge profits selling electricity for prices that, in some cases, were 20 times higher than the year before.

Teco said the Gila River Plant, powered by natural gas, would continue to operate through the transition.

Analysts expect the plant eventually to be sold to another utility or investment group. If sold substantially below replacement cost, it would enable a new owner to sell electricity at below-market prices. Eventually that could lower energy costs for consumers.

The Teco plant is the second recently completed power plant in the state abandoned by developers.

If you may remember a year ago or so, in writing about the huge amount of “junk” debt that was and is still being marketed, we suggested that the buyers of such will soon “own the company.” Our point was simply that with all the company buybacks of common stocks, junk bonds are taking their place as equity dressed up in bond clothing. We believe one will increasingly see articles of this nature as we go through this year.

The article went on to say Warren Buffet and Carl Icahn are picking up these properties at – you guessed it – bargain basement prices. Obviously they are buying these properties well below cost so who is taking the hit? The banks, if any, will be first in line, then the mortgage holders, if any, and finally the junk bond owner, who by definition is the lowest man on the credit totem pole. Oh yes, the equity owner will lose but in all probability they borrowed the equity without recourse as in this day and age lenders will lend to the least of us. We just received an unwanted e-mail promising 1 ¾% interest even if we had bad credit. There are many organizations that through “charity” will loan down payments on to housing projects if, of course, you use certain predetermined builders.

Maybe we are just too old fashioned. Maybe the world has passed us by, but we know who is going to get hit the most – the unsuspecting public. The financial institutions will have CYA’ed their initial risk but an avalanche will put some or most of them at risk – unless they are too big to fail. If that be the case, then it will come full circle as we, the unsuspecting public, will see our taxes increase all, of course, for the “public good.”