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Utilities at risk from debt timebomb

- Richard Wachman
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About this article

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Britain's utilities have racked up £30bn of debt and could be the next casualties of the credit crunch, according to a report out today.

Some companies are so highly leveraged they may be unable to fund repairs if storms or flooding disrupt electricity and water supplies, warns Reynolds Partners, an independent investment bank.

John Reynolds, its chief, says: 'I think that it is only a matter of time before there is a major shock and we find that a utility can't afford to restore power to homes, hospitals or businesses. At that point the regulator would have to allow bills to rise to pay for the damage, or customers will have to wait longer than they should for normal service to resume, or both.'

Ofgem, the power regulator, admits that it too is concerned and has ordered an investigation as part of a wider review of regulation that is already under way.

Both Ofgem and Ofwat (the water regulator) say that if a company ran into financial trouble, customers would be afforded protection. However, Ofgem director Steve Smith warns: 'We are clear that if something goes wrong, we wouldn't be there to bail a company out. It would be a matter for the company's shareholders and bondholders.'

Utilities have been prime targets for highly leveraged buyouts as they offer a steady cash flow against which to raise large amounts of debt. But the credit squeeze means that additional funding could be hard to come by, leaving some firms financially stretched in the event that they need to pay for repairs.

Reynolds says: 'Last summer saw widespread flooding across many parts of the UK. Fortunately, the utilities affected were owned by well-capitalised holding companies.'

But the bank's research highlights 11 indebted companies - including Thames Water, Wales & West Utilities and Electricity North West - that have borrowed tens of billions via securitisations and could be at risk from the credit crunch. These companies are predominantly owned by buyout firms, rather than businesses with huge balance sheets such as EDF, which controls London Electricity.

Reynolds blames utility regulators for pinning their trust on credit rating agencies, which have invariably given investment-grade status to debt drawn down by water and power groups. He says this was always a misuse of ratings, but it now flies in the face of increasing evidence that ratings can be dangerously wrong, as was the case with Northern Rock.

Reynolds says: 'Regulators have allowed increasing debt levels at a time when extreme weather and global warming is causing severe financial shocks to utilities. [But] leveraged finance structures ... should not involve seeking permission from creditors to spend money. Regulators who have transferred their responsibilities to rating agencies should be held to account. Sooner or later there will be a major disaster, so now is the time to do something about it.'

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