

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Westar Energy, Inc.

102 FERC ¶ 61,186
Docket No. ES02-51-000

ORDER CONDITIONALLY GRANTING AUTHORIZATION TO ISSUE LONG-
TERM UNSECURED DEBT AND ANNOUNCING NEW POLICY ON
CONDITIONING SECURITIES AUTHORIZATIONS

(Issued February 21, 2003)

1. In this order, the Commission will grant Westar Energy, Inc.'s (Westar, formerly Western Resources, Inc.) request to issue long-term, unsecured debt, but will do so conditionally with restrictions on this authorization. In addition, the Commission intends that all future issuances of secured and unsecured debt authorized by the Commission will be similarly conditioned. This order benefits customers by ensuring that the authorization of a public utility to issue securities accords with the requirements of section 204 of the Federal Power Act (FPA).¹

Background

2. On September 6, 2002, Westar submitted an application pursuant to section 204(a) of the FPA² seeking authorization to issue long-term, unsecured debt in an amount not to exceed \$650 million at any one time. Westar also requests a waiver of the Commission's competitive bidding and negotiated placement requirements at 18 C.F.R. § 34.2 (2002).

3. On November 1, 2002, the Director of the Office of Markets, Tariffs, and Rates' Division of Tariffs and Market Development-Central requested additional information from Westar. Westar filed its response on November 15, 2002 (Westar Response). Westar, among other things, provided details related to its existing soon-to-mature debt

¹16 U.S.C. § 824c (2000).

²16 U.S.C. § 824c(a) (2000).

securities,³ its proposed debt issuance and why it believes the proposed issuance of the long-term, unsecured debt is in the public interest.

Notice, Interventions and Motions

4. Notices of the application and the data request response were published in the Federal Register, 67 Fed. Reg. 59,058 (2002) and 67 Fed. Reg. 70,725 (2002), respectively. The Kansas Commission filed a notice of intervention and comments on October 2, 2002. MBIA Insurance Company (MBIA) submitted timely motions to intervene and comments on October 3, 2002, and December 11, 2002.

5. The Kansas Commission states that the Commission should view Westar's application in the context of concerns about the capital structure and debt obligations of Westar and its affiliates.⁴ The Kansas Commission also states that the Commission should not construe its filing as a request to deny Westar financing. However, the Kansas Commission emphasizes that its decision not to protest is based and conditioned upon Westar's declarations that the proceeds will be used solely to retire existing debt and that any debt issued will be "unsecured."⁵

6. MBIA insures approximately \$500 million of bonds secured by the first mortgage pledge of Westar and its subsidiary, Kansas Gas and Electric Company, and closely tracks Westar's financial health. MBIA states that it has become alarmed at what it views as recent indications regarding troubling financial and management issues with Westar,⁶ and that Westar's application contains scant information on how Westar's proposed issuance will relate to Westar's strained financial status. MBIA encourages the

³Westar's pre-existing debt issuances were authorized by either this Commission or the Kansas Corporation Commission (Kansas Commission) with no conditions imposed on how much of the borrowings could be used for non-utility businesses or the amount of Westar's assets that could be used to secure the debt.

⁴See Kansas Commission Notice of Intervention at 2.

⁵Id. at 3-4.

⁶MBIA notes: (1) an anticipated Kansas Commission order requiring a comprehensive restructuring, (2) reports of grand jury investigations of company executives and (3) Westar's efforts in seeking an exemption from limitations imposed by the Investment Company Act of 1940.

Commission to exercise appropriate due diligence to ensure that the standards of section 204 are met and that the issuance of the securities will not lead to further deterioration.⁷

7. On October 18, 2002, Westar submitted an answer in response to the Kansas Commission's and MBIA's comments.

8. On November 26, 2002, the Kansas Commission filed a motion to lodge its Order No. 51, requiring financial and corporate restructuring by Westar. This order requires Westar to obtain Kansas Commission approval before the issuance of any debt, to structurally separate its utility subsidiaries from its non-utility businesses and to reverse certain accounting transactions among its affiliates. Order No. 51 also provides that Westar should take steps to reduce its debt, utilizing available cash flow from electric operations to reduce non-utility debt secured by utility assets. The Kansas Commission states that Westar should consider the sale of subsidiaries Protection One, Inc. and ONEOK, Inc. stock, and a reduction of dividends.⁸

9. On January 6, 2003, the Kansas Commission filed a motion to lodge its Order No. 55, clarifying Order No. 51. Among other things, Order No. 55 clarifies Westar's financial and corporate restructuring requirements; establishes an August 1, 2003, restructuring deadline; requires monthly progress reports on Westar's debt reduction; affirms that Westar must reduce secured utility debt by \$100 million per year from cash flow; affirms that the appropriate amount of debt after the restructuring is \$1.47 billion; and affirms the Kansas Commission's authority to require Kansas Commission approval before the issuance of any additional debt.⁹

Discussion

Procedural Matters

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2002), the notice of intervention and timely, unopposed motion to intervene serve to make the parties that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, prohibits answers to protests unless otherwise permitted by the decisional authority. We

⁷See Motion to Intervene at 1-2.

⁸See Motion to Lodge Order No. 51 at 1-2.

⁹See Motion to Lodge Order No. 55 at 2-3.

do not find that good cause exists to allow Westar's answer, as it does not provide additional information assisting us in the decision-making process.

11. Rule 212(a)(2) of the Commission's Rules of Practice and Procedure allows motions to be filed by participants who have filed timely, interventions that have not been denied.¹⁰ Accordingly, the Commission accepts, and the Commission will grant, the Kansas Commission's motions to lodge Order Nos. 51 and 55.

Westar's Conditional Securities Authorization

12. Section 204(a) of the FPA provides that requests for authority to issue securities or to assume liabilities shall be granted if the Commission finds that the issuance:

(a) is for some lawful object, within the corporate purposes of the applicant, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility and which will not impair its ability to perform that service, and (b) is reasonably necessary or appropriate for such purposes.¹¹

13. The Commission concludes that Westar's requested authorization, as conditioned below, meets the standards of section 204.

14. The Commission finds that the proposed issuance of long-term, unsecured debt is for a lawful object within Westar's corporate purposes and is necessary, appropriate and consistent with Westar's performance as a public utility. Westar states it will issue the proposed debt in the second quarter of 2003 and use the proceeds to refinance debt that effectively matures in August 2003 by virtue of a put/call agreement.¹² Westar also states it is refinancing the unsecured debt in order to meet the requirements of a bank credit agreement requiring the debt to be retired 60 days prior to maturity and that without the ability to refinance Westar could potentially face a liquidity crisis.¹³ Refinancing or retiring debt is a lawful object and is routinely practiced in the electric industry. The Commission further finds that the authorization, as conditioned below, is necessary and

¹⁰See 18 C.F.R. § 385.212 (2002).

¹¹16 U.S.C. § 824c(a) (2000).

¹²See Application at 2-3; Westar Response 7.

¹³See Westar Response 7.

appropriate, giving Westar, a non-investment grade issuer,¹⁴ the flexibility necessary to refinance its debt securities with the most favorable terms.

15. In reviewing filings under section 204, the Commission evaluates a utility's financial viability based on a review of the financial statements submitted in the application and the utility's interest coverage ratio. An interest coverage ratio is a measure of the utility's ability to meet future debt and interest payments.¹⁵ Westar's pro forma interest coverage ratio is less than what the Commission would typically prefer due in large part to approximately \$657 million of non-cash charges from its non-utility subsidiaries that negatively impacted Westar's financial statements. However, Westar has a bank covenant requirement in place, similar to the Commission's interest coverage ratio, whereby Westar must attain a minimum ratio of consolidated earnings before interest, taxes, depreciation, and amortization to consolidated interest expense of 2.0 to 1.0. Westar's ratios on an actual and pro forma basis are 2.7 to 1.0 and 2.5 to 1.0, respectively, and as these ratios show, Westar meets the bank covenant requirement both before and after the proposed financing.¹⁶

16. In evaluating Westar's financial viability, the Commission also reviewed Westar's debt maturities and cash flow projections over the next five years. While Westar's debt maturities between October 2002 and December 2007 total more than \$2.7 billion, Westar projects it will be able to meet these obligations as they come due.¹⁷ Westar also projected a free cash flow remaining after the payment of interest and dividends in excess of \$115 million for each of the next four years¹⁸ and states it will be used to further reduce company debt.¹⁹

¹⁴See Westar Response 7. Independent credit agencies, such as Standard and Poor's and Moody's Investors Services, rated Westar's unsecured debt securities as BB- and Ba2, respectively, with negative outlooks. See Application at 2.

¹⁵The interest coverage ratio is a calculation of income before interest and taxes divided by total interest expense.

¹⁶See Westar Response 6.

¹⁷See Westar Response 12.

¹⁸Westar calculates free cash flow by adding depreciation and amortization to net income, then subtracting capital expenditures and stock dividends.

¹⁹See Westar Response 12.

17. The Commission has considered all the above information concerning Westar's financial viability.²⁰ While we recognize that Westar's financial condition has deteriorated, in large part due to its non-utility business activities, without the proposed authorization to refinance soon-to-mature debt Westar could face a liquidity crisis, ultimately harming the public interest.

18. We also note that authorization can be granted only if doing so will be consistent with Westar providing public utility service and will not impair its ability to provide such service. We believe that with the conditions ordered below we can make this finding.

19. Therefore, the Commission will conditionally authorize Westar's request to issue long-term, unsecured debt in an amount not to exceed \$650 million, subject to the following conditions.²¹ First, the proceeds of the debt must be used solely for the purpose of retiring outstanding indebtedness, including accrued and unpaid interest due at maturity. Second, Westar is required to file quarterly informational status reports

²⁰The Division of Regulatory Audits in the Commission's Office of the Executive Director performed an audit and found that since 1995 Westar has issued substantial amounts of new debt and used the proceeds to finance non-utility business ventures and to cover operating losses incurred by non-utility businesses. The audit report identifies the following adverse consequences: the credit rating for Westar securities is "junk status;" Westar debt is more costly and more difficult to obtain on economically favorable terms; Westar's ratepayers are at risk for paying the increased cost of debt if Westar cannot generate enough cash flow from utility operations to cover the increased debt costs; and Westar will be left with a disproportionate amount of debt if it "spins off" some or all of its non-utility businesses.

²¹The scope of the Commission's jurisdiction over securities issuances is limited. For example, section 204 of the FPA does not apply to a public utility organized and operating in a state where its securities issuances are regulated by a state commission. See, 16 U.S.C. 824c(f) (2000). The Kansas Commission follows a similar statute whereby it must authorize the issuance of long-term securities unless the issuance requires a registration statement to be filed with the Securities and Exchange Commission or the public utility obtains authorization from another state or federal agency. See K.S.A. § 66-125 (2001). As directed in Order Nos. 51 and 55, for all future securities authorizations Westar must receive Kansas Commission approval before the issuance of any future debt. Thus, as long as Westar complies with this requirement it will not need our approval prior to such issuance. Westar should, however, file with us an informational copy of any future securities issuance applications that are subject to approval by the Kansas Commission.

detailing its financial condition and debt-reduction efforts within 30 days of the end of each calendar quarter. Third, Westar must file a Report of Securities Issued within 30 days after the sale or placement of the long-term, unsecured debt, as stated in the Commission's regulations.²² Finally, Westar must also abide by the following restrictions on secured and unsecured debt.

20. The Commission will impose four additional restrictions and it is the Commission's intention that these restrictions will be applied to all future public utility issuances of secured and unsecured debt authorized by this Commission.²³ First, public utilities seeking authorization to issue debt that is secured (*i.e.*, backed) by utility assets must use the proceeds of the debt for utility purposes only. Second, with respect to such utility asset-secured debt issuances, if any utility assets that secure such debt issuances are divested or "spun off," the debt must "follow" the asset and be divested or "spun off" as well.

21. Third, if assets financed with unsecured debt are divested or "spun off," the associated unsecured debt must follow those assets. Specifically, if any of the proceeds from unsecured debt are used for non-utility purposes, the debt likewise must "follow" the non-utility assets and if the non-utility assets are divested or "spun off" then a proportionate share of debt must "follow" the associated non-utility assets by being divested or "spun off" as well. Last, with respect to unsecured debt used for utility purposes, if utility assets financed by unsecured debt are divested or "spun off" to another entity, then a proportionate share of the debt also must be divested or "spun off".

22. These restrictions should prevent public utilities from borrowing substantial amounts of monies and using the proceeds to finance non-utility businesses. These restrictions thus should ensure that future issuances of debt are compatible with the

²²See 18 C.F.R. §§ 34.10, 131.43 (2002).

²³MBIA recently testified at the Commission's January 16, 2003, technical conference on capital availability for energy markets, citing concerns that holding companies use assets of regulated utilities to keep shaky unregulated ventures afloat. MBIA requested that the Commission take a more active role in analyzing proposed securities issuances and use its section 204 authority to rigorously evaluate how debt will be used. See 16 U.S.C. § 824c(a) (2000).

public interest, will not impair a public utility's ability to perform in the future and provide appropriate ratepayer protection.²⁴

Information to be filed in Future Section 204 Applications

23. Part 34 of the Commission's regulations sets out the filing requirements for public utilities seeking Commission authorization of the issuance of securities or the assumption of liabilities.²⁵ In order for the Commission to determine if a security issuance is in the public interest, an application for authority to issue securities must contain, among other things, certain corporate information, a statement as to whether or not any state regulatory body requires an application for authorization to issue the securities, a summary of any rate changes that may apply during or after the period of the issuances, along with accompanying exhibits.²⁶

24. The Commission takes this opportunity to remind public utilities that they must include in their applications all information required in Part 34 of the Commission's regulations. Specifically, public utilities must include information on the amount, type, maturity date and whether any of the proposed debt issuances will be secured or unsecured. Public utilities also must provide a detailed explanation of the purpose for the requested securities and state if the issuance will be used for utility or non-utility purposes. Public utilities must explain how the proposed issuance meets the standards of section 204(a), rather than merely making a declaration that it does so. Finally, the board of directors' resolutions must include a discussion of the type, amount, and purpose of the proposed issuance and the financial statements should be calculated on both an actual and pro forma basis.

25. We also remind public utilities that section 204 gives the Commission the authority to issue supplemental orders, and modify the provisions of any previous order as to the particular purposes, uses, and extent to which, or the conditions under which, any security or the associated proceeds may be applied.²⁷ Westar as well as other public

²⁴These restrictions are also consistent with the audit report discussed above. See supra note 20.

²⁵See 18 C.F.R. Part 34 (2002).

²⁶Id. at §§ 34.3 through 34.9.

²⁷See 16 U.S.C. § 824c(b) (2000).

utilities are hereby put on notice that the Commission plans to review the required filings and reports, and may issue supplemental orders as necessary.

26. Finally, while state regulatory authorities may not have approval over a public utility's request for authority to issue securities or assume liabilities filed with the Commission pursuant to section 204 of the FPA, we recognize such matters can have a significant impact on the applicant's ability to perform its public utility obligations at the retail level. Thus, the Commission would find the views of the state commissions with retail rate jurisdiction over section 204 applicants helpful and we encourage those commissions to file comments in section 204 proceedings.

The Commission orders:

(A) Westar is hereby conditionally authorized to issue long-term, unsecured debt in an amount not to exceed \$650 million at any one time, under the terms and conditions and for the purposes specified in the application and this order, subject to the conditions discussed in the body of this order.

(B) Westar's requested waiver of the Commission's competitive bidding and negotiated placement requirements at 18 C.F.R. § 34.2 is hereby granted.

(C) This authorization is effective as of the date of this order and terminates two years thereafter.

(D) The authorization granted in Ordering Paragraph (A) above is without prejudice to the authority of the Commission with respect to rates, services, accounts, valuation, estimates, or determinations of cost, or any other matter whatsoever now pending or which may come before the Commission.

(E) Nothing in this order shall be construed to imply any guarantee or obligation on the part of the United States with respect to any security to which this order relates.

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(F) The Secretary is hereby directed to publish this order in the Federal Register.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.