

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.<sup>8</sup>

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.<sup>9</sup>

## Discussion

### *Procedural Matters*

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 CFR 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 CFR 385.213, prohibits answers to protests unless otherwise permitted by the decisional authority. We 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.<sup>10</sup> 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.<sup>11</sup>

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.<sup>12</sup> 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.<sup>13</sup> 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 appropriate, giving Westar, a non-investment grade issuer,<sup>14</sup> 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.<sup>15</sup> 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.<sup>16</sup>

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.<sup>17</sup> 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 years<sup>18</sup> and states it will be used to further reduce company debt.<sup>19</sup>

17. The Commission has considered all the above information concerning Westar's financial viability.<sup>20</sup> 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.<sup>21</sup>

<sup>16</sup> See Westar Response 6.

<sup>17</sup> See Westar Response 12.

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

<sup>19</sup> See Westar Response 12.

<sup>20</sup> The 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.

<sup>21</sup> The scope of the Commission's jurisdiction over securities issuances is limited. For example,

Continued

<sup>8</sup> See Motion to Lodge Order No. 51 at 1-2.

<sup>9</sup> See Motion to Lodge Order No. 55 at 2-3.

<sup>10</sup> See 18 CFR 385.212 (2002).

<sup>11</sup> 16 U.S.C. 824c(a) (2000).

<sup>12</sup> See Application at 2-3; Westar Response 7.

<sup>13</sup> See Westar Response 7.

<sup>14</sup> See 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.

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