

**THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS**

Before Commissioners:                      John Wine, Chair  
    Cynthia L. Claus  
    Brian J. Moline

In the Matter of the Investigation of Actions                      )  
of Western Resources, Inc. to Separate its                      ) Docket No. 01-WSRE-949-GIE  
Jurisdictional Electric Utility Business from                      )  
its Unregulated Businesses.    )

**No. 51  
ORDER REQUIRING FINANCIAL  
AND CORPORATE RESTRUCTURING BY WESTERN RESOURCES, INC.**

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The State Corporation Commission of the State of Kansas (Commission) finds that financial and corporate restructuring of Western Resources, Inc. (WRI)<sup>1</sup> is necessary to: (1) achieve a balanced capital structure within the public utility business controlled by or affiliated with WRI; (2) reduce the excessive debt accumulated due to investment in nonutility business ventures; (3) prevent interaffiliate accounting practices and relations that are harmful to WRI’s public utility business; and (4) protect ratepayers from the risks of WRI’s nonutility business ventures in the corporate family controlled by WRI.

By this Order, the Commission (1) rejects the plan proposed by WRI; (2) directs WRI to reverse certain accounting transactions; (3) directs WRI to transfer its KPL utility division to a utility-only subsidiary of WRI, after Commission review and approval of a plan to be submitted by WRI within 90 days of this Order; (4) institutes interim standstill protections to prevent harm to WRI's utility businesses as a result of their affiliation with WRI's nonutility businesses pending adoption of final requirements relating to such affiliation; and (5) institutes an

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<sup>1</sup> All references to WRI refer to the entity now known as Westar Energy, Inc. All references to Westar Industries refer to Westar Industries, Inc. a wholly owned subsidiary of WRI.

investigation into the appropriate type, quantity, structure and regulation of the nonutility businesses with which WRI's utility businesses may be affiliated.

## **I. Introduction and Overview**

1. WRI is a holding company, providing electric service and owning stock in utility and nonutility businesses. At the holding company level, WRI provides retail electric service in parts of Kansas as KPL. WRI also provides retail electric service through its wholly owned subsidiary, Kansas Gas & Electric Company (KG&E). In total, WRI, including its subsidiary KG&E, provides retail electric service to approximately 636,000 customers in the state of Kansas. WRI and KG&E are both certificated electric public utilities subject to the jurisdiction of the Commission pursuant to K.S.A. 66-104 and 66-131. Collectively, WRI's electric businesses have been referred to in this proceeding as Western Resources Electric Business or WREB. WRI also owns 100 percent of Westar Industries, Inc., a holding company which owns several nonutility businesses, most prominently ONEOK and Protection One.<sup>2</sup>

2. Prior to 1996, WRI was almost exclusively an electric and natural gas public utility. As of December 31, 1995, WRI employed approximately \$3.4 billion in total capital. WRI's capitalization at that time consisted of long-term debt in the amount of \$1.4 billion, short-term debt in the amount of \$0.2 billion and \$0.1 billion in quarterly income preferred securities (QUIPs).<sup>3</sup> At that time, WRI had equity of \$1.7 billion, which represented approximately 50 percent of its total capital structure. Proctor Direct at 7, 12-13, 20 and Staff Exhibit No. JMP-5.

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<sup>2</sup> Additional information on WRI's corporate structure is contained in this Commission's Order of July 20, 2001.

<sup>3</sup> QUIPs are obligations to securities holders which have both debt and preferred equity characteristics. For example, WRI may deduct for income tax purposes the dividends payable to the securities holder as interest expense.

3. Since 1996, WRI has employed incremental capital to invest in nonutility businesses. As of December 31, 2001, after taking into consideration and adjusting for an impairment charge of \$0.65 billion during the first quarter of 2002 for two of its nonutility subsidiaries, Protection One, Inc. (Protection One) and Protection One, Europe, WRI's consolidated debt and equity were \$3.6 billion and \$1.2 billion, respectively, for a total of \$4.8 billion in capital. Without the impairment charge, WRI's total capital would have been \$5.4 billion, including \$1.8 billion of equity. Consequently, the equity component of WRI, on a consolidated basis, fell to approximately 25 percent of total capital. Proctor Direct at 7, 12-13, 20 and Staff Exhibit No. JMP-6.

4. WRI currently files consolidated financial statements that include the results and standing of Westar Industries, one of WRI's wholly-owned subsidiaries which currently holds WRI's investments in most of its nonutility businesses. Both WRI's regulated electric utility operations and its nonutility business ventures are represented in its consolidated financial statements. WRI also prepares consolidated financial statements for Westar Industries, consisting of the financial results and standing for its investment in ONEOK, Inc. (ONEOK), Protection One and other miscellaneous nonutility investments.

5. In Westar Industries' consolidated financial statements, as of December 31, 2001, WRI attributed only \$0.5 billion of its \$3.6 billion of consolidated debt to nonutility businesses. Proctor Direct at 9 and Staff Exhibit No. JMP-6. However, Commission Staff witness James Proctor found that only \$1.5 billion of WRI's \$3.6 billion consolidated debt was necessary to finance WRI's electric utility operations. He came to this conclusion by employing recognized financial techniques to estimate sources and uses of cash. The remaining \$2.1 billion of consolidated debt, he found, was incurred and used to finance WRI's nonutility investments.

Thus, a large amount of debt sits on the books of WRI (which is the corporation in which the KPL utility division is located) that is properly attributable to Westar Industries and its nonutility businesses.

6. Under these circumstances, if there were a corporate reorganization in which Westar Industries was separated from WRI, the present allocation of debt and equity between the two entities would become permanent. The capital structure of WRI's nonutility businesses would have received \$1.6 billion of equity from WRI's regulated electric utility operations. Conversely, WRI's actions would have resulted in \$1.6 billion of consolidated debt attributable to nonutility businesses being charged to the regulated utility operations. Proctor Direct at 6-7 and Staff Exhibit No. JMP-1.

7. These were the circumstances, among others described in detail in the Commission's Order of July 20, 2001, that led the Commission to expand the scope of its investigation and require WRI to file a new financial plan, aimed at reducing debt, correcting the misallocation of debt between the utility and nonutility businesses, and reforming the manner in which WRI's affiliates interact.

## **II. Procedural Summary**

8. On May 8, 2001, the Commission entered its Order Initiating Investigation. The investigation would address

whether the participation by WRI and its affiliates in the transactions and relationships described herein, and any other transactions or relationships which may emerge from the investigation, is consistent with Kansas law, including WRI's and KG&E's statutory obligations to provide efficient and reliable service to Kansas customers at just and reasonable rates.

May 8, 2001 Order at 18.

9. On July 20, 2001, the Commission entered its Order that determined that WRI's participation in certain restructuring transactions described in that Order was not consistent with the public interest and contrary to Kansas law. The Commission made permanent the prohibition on consummating those transactions through a "Rights Offering" that would result in a permanent misallocation of the debt and assets within the WRI corporate family as set forth in the Commission's July 20, 2001 Order at 13-20. The Commission specifically declared that the Asset Allocation and Separation Agreement (Asset Allocation Agreement) between WRI and its wholly-owned subsidiary, Westar Industries, through which the misallocation of assets and debt was established was null and void. July 20, 2001 Order at Ordering ¶¶ (B)-(F).

10. The Commission's July 20, 2001 Order further required WRI to submit a financial plan to restore WRI to financial health, to achieve a balanced capital structure and to protect ratepayers from the risks of nonutility investments. July 20, 2001 Order at Ordering ¶ G. In judging the reasonableness of a proposed financial plan, the Commission proposed to evaluate not only financial plans but also accounting practices under the following two important criteria. That is, WRI and any financial plan must:

- i. include an equitable allocation of assets and liabilities among WRI, WREB and WRI's other unregulated