

107 FERC ¶ 61,044
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Aquila, Inc.

Docket Nos. ES03-43-000
ES03-43-001
ES03-43-002
ES03-43-003
ES03-43-004
ES04-13-000

ORDER CONDITIONALLY AUTHORIZATING ISSUANCES OF SECURITIES

(Issued April 16, 2004)

1. In this order, the Commission will conditionally grant Aquila, Inc.'s (Aquila) request to issue (1) \$150 million of convertible, long-term debt securities, (2) \$100 million of common stock, and (3) \$500 million of short-term indebtedness, including financial guarantees of subsidiaries' or affiliates' securities. This order benefits customers by ensuring that the authorization of a public utility to issue securities is in accordance with the requirements of section 204 of the Federal Power Act (FPA).¹

Background

2. On July 25, 2003, in Docket No. ES03-43-000, Aquila submitted an application pursuant to section 204(a) of the FPA² seeking authorization to issue (1) \$150 million of long-term debt securities which may be convertible into shares of common stock not less than two years but no more than six years from the date that Aquila issues the debt and (2) \$100 million of common stock (Long-term Proposal). Aquila also requests a waiver of the Commission's competitive bidding and negotiated placement requirements at 18 C.F.R. § 34.2 (2003).

¹ 16 U.S.C. § 824c (2000).

² 16 U.S.C. § 824c(a) (2000).

3. On August 21, 2003, and November 18, 2003, the Director of the Office of Markets, Tariffs, and Rates' Division of Tariffs and Market Development-Central requested additional information from Aquila. Aquila responded to the first request on August 27, 2003, and supplemented its response on August 28, 2003, and September 9, 2003. Aquila filed its response to the second request on February 3, 2004, and supplemented its response on February 13, 2004. In these various responses, Aquila provided information related to its financial condition, debt-reduction plan, existing soon-to-mature debt securities, and proposed issuance of securities.
4. On February 3, 2004, Aquila amended its filing to remove the specific time period related to the convertible debt. Instead of converting the long-term debt into common stock between the second and sixth years after issuance, Aquila requests authorization to convert the debt at any time that the underlying debt is still outstanding to ensure that its convertible debt offering is consistent with other convertible debt offerings in the market.
5. On February 9, 2004, in Docket No. ES04-13-000, Aquila requested authorization to issue up to and including \$500 million of secured and unsecured debt, including financial guarantees of subsidiaries' or affiliates' securities, with maturities of one year or less (Short-term Proposal).

Notices, Interventions, and Motions

6. Notices of the applications, amendments, and data request responses were published in the Federal Register, 68 Fed. Reg. 47,559 (2003); 69 Fed. Reg. 7,924 (2004); 68 Fed. Reg. 55,044 (2003); 69 Fed. Reg. 10,018 (2004), and 69 Fed. Reg. 8,399 (2004), with interventions and protests due on or before March 5, 2004, in Docket No. ES03-43-000, et al. and March 1, 2004, in Docket No. ES04-13-000.
7. The Kansas Corporation Commission (Kansas Commission) filed notices of intervention and protests for both the Long-term and Short-term Proposals. The Kansas Commission raises the same arguments in both protests. First, the Kansas Commission states that Aquila's foray into energy trading and other non-utility businesses have placed captive ratepayers at financial risk. It also states that Aquila must not be permitted to manipulate its debt load to exacerbate these risks and that utility ratepayers must not be asked to pay off debt incurred for the benefit of non-utility activities. The Kansas Commission also states that Aquila should not be able to use any of the proceeds for non-utility purposes and that the Commission should prohibit Aquila from paying dividends while the debt is outstanding. Finally, the Kansas Commission states that the Commission should review the adequacy of the data kept by Aquila regarding the proposed and actual uses of the proceeds of its securities issuances. Aquila filed answers to the protest of the Long-term Proposal.

8. On October 28, 2003, Aquila submitted a motion to lodge an order from the Kansas Commission approving a stipulation and agreement with Aquila. In this settlement, the parties resolved issues related to Aquila's Long-term Proposal. The parties agreed on the amount of common stock and convertible debt that Aquila can issue. The parties also agreed that Aquila must use the proceeds of the issuances to reduce debt, replace existing liabilities, or to maintain working capital and may only issue the convertible debt if the issuance results in a reduction to interest expense. In addition, the issuance of the convertible debt can not result in an increase in Aquila's consolidated debt ratio. The Kansas Commission filed an answer, seeking to put its approval of the settlement "in context," and indicates that, this settlement notwithstanding, it is still concerned about the risk to ratepayers.

9. On March 1, 2004, the Kansas Commission filed comments on Aquila's amendment that removes the specific time period related to the convertible long-term debt. The Kansas Commission is concerned that Aquila's amendment increases the risk of harm to Kansas ratepayers. The Kansas Commission states that the public interest may be better served if Aquila issues common stock to de-leverage its balance sheet than if Aquila issues long-term debt. The Kansas Commission argues that issuing debt that would convert to common stock in a relatively short period of time would be a reasonable alternative to issuing common stock immediately because it offers an assurance that the debt will be retired in the near future and that the amendment offers less certainty that Aquila will issue common stock to pay off debt anytime in the near future.

10. On March 8, 2004, Aquila filed a response to the Kansas Commission's answer to its amendment stating that the Kansas Commission's concerns are simply unfounded. Aquila explains that the change in the dates was necessary to ensure that the Aquila convertible debt offering is consistent with other convertible debt offerings currently in the market. Aquila also states that the conditions it has agreed to in the settlement approved by the Kansas Commission, discussed above, will ensure that the issuance of the convertible debt will not harm Aquila's ratepayers.

Discussion

Procedural Matters

11. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the notice of intervention serves to make the Kansas Commission a party to these proceedings. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2003), prohibits answers to protests unless otherwise permitted by the decisional authority. We are not persuaded to allow Aquila's answers to the protests. The Commission will grant Aquila's motion to lodge the order from the Kansas Commission approving the settlement.

Proposed Issuance of Securities

12. The Kansas Commission does not object to Aquila issuing the long-term or short-term securities; rather, the Kansas Commission states that the Commission should impose conditions on Aquila's proposed issuances in order to protect the public interest. The Kansas Commission's primary concern, as discussed below, is that ratepayers could end up paying for debt without securing any benefit from that debt.

13. 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.³

14. The Commission finds that the Long-term and the Short-term Proposals are for lawful objects within Aquila's corporate purposes and are necessary, appropriate and consistent with Aquila's performance as a public utility. In the Long-term Proposal, Aquila states the proceeds will be used to reduce liabilities through the repayment of long-term and short-term debt or working capital consistent with Aquila's corporate purpose.⁴ In the Short-term Proposal, Aquila states that the proceeds will be added to its general funds and may be applied to reduce liabilities through the repayment and/or refinancing of short-term debt or working capital consistent with Aquila's corporate purpose and/or used for general corporate purposes.⁵ Refinancing or retiring debt and adding the proceeds to working capital are lawful objects and are routinely practiced in the electric industry. The Commission further finds that the authorization, as conditioned below, is necessary and appropriate, giving Aquila, a non-investment grade issuer, the flexibility necessary to refinance its debt securities with the most favorable terms, and should not impair its ability to provide service as a public utility.

15. In reviewing filings under section 204, the Commission also evaluates a utility's financial viability based on a review of the financial statements submitted in the

³ 16 U.S.C. § 824c(a) (2000).

⁴ See Long-term Proposal at 4.

⁵ See Short-term Proposal at 3.

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.⁶ Aquila's pro forma interest coverage ratio is less than what the Commission would typically prefer due to restructuring charges, impairment charges and net losses within discontinued operations. Margin losses incurred during the wind-down of its merchant trading portfolio contributed the majority of the loss.⁷

16. In evaluating Aquila's financial viability, the Commission also reviewed Aquila's projected financial statements and coverage ratios, debt restructuring and reduction plan, debt maturities and cash flow projections for the next four years. While Aquila has a significant amount of debt maturing between 2004 and 2006, Aquila expects to have adequate liquidity to meet these obligations as they come due.

17. While we recognize that Aquila's financial condition has deteriorated, in large part due to its merchant trading business activities, we also recognize that Aquila has a business plan in place and has taken measures to return to its core utility business with potentially an investment grade rating. The Commission has taken the Kansas Commission's concerns seriously; however, given the specific facts of the case, without the proposed authorization to refinance soon-to-mature debt, Aquila could face a liquidity crisis, ultimately harming the public interest.

18. The Commission finds that Aquila's requests to issue (1) \$150 million of convertible, long-term debt securities, (2) \$100 million of common stock, and (3) \$500 million of short-term indebtedness, including financial guarantees of subsidiaries' or affiliates' securities, meet the standards of section 204. Therefore, we will authorize Aquila's requests to issue securities, subject to the following conditions.

19. First, the securities in both the Long-term and Short-term Proposals are subject to the restrictions the Commission imposed on secured and unsecured debt in the Westar Order.⁸ If Aquila issues debt that is secured or backed by utility assets then Aquila must

⁶ The interest coverage ratio is a calculation of income before interest and taxes divided by total interest expense.

⁷ August 27 Response 7 (2002 Annual Report at i).

⁸ In Westar Energy, Inc., 102 FERC ¶ 61,186, order on reh'g, 104 FERC ¶ 61,018 (2003) (Westar Order), the Commission imposed conditions on all future issuances of secured and unsecured debt to prevent, among other things, public utilities from borrowing substantial amounts of monies and using the proceeds to finance non-utility businesses to the detriment of utility customers.

use the proceeds of the debt for utility purposes only. If Aquila spins-off or divests any utility assets that secure a debt issuance, then Aquila must spin-off or divest a proportionate amount of debt. If Aquila spins-off or divests assets financed with unsecured debt, then the associated unsecured debt must follow the assets. Specifically, if the proceeds from unsecured debt are used for non-utility purposes, the debt 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. With respect to unsecured debt used for utility purposes, if Aquila “spins-off” or divests utility assets financed by unsecured debt, then Aquila must divest or “spin-off” a proportionate share of the debt.

20. Second, consistent with Aquila’s stated goal of improving its balance sheet and reducing its debt load, the securities in the Long-term and Short-term Proposals must meet conditions agreed to in the settlement approved by the Kansas Commission. Aquila may not issue any securities if the issuance will increase its consolidated debt ratio. Aquila may only issue securities to refinance an equal or lesser amount of existing debt, in conjunction with the issuance of an offsetting amount of common stock, or to replenish cash on hand or existing working capital, as long as the end result of these various transactions is that the amount of leverage in Aquila’s consolidated capital structure does not increase.

21. Third, in order for the Commission to monitor Aquila’s progress in implementing its debt restructuring and reduction plan, Aquila must file quarterly informational status reports detailing its financial condition and debt-reduction efforts within 30 days of the end of each calendar quarter until Aquila is deemed investment grade once again by at least one credit rating agency.

22. Fourth, Aquila must file a Report of Securities Issued within 30 days after the sale or placement of any long-term debt or equity securities, as stated in the Commission’s regulations.⁹

Conditions on Previously-Issued Securities

23. The Kansas Commission argues that Aquila must honor the spirit, as well as the letter, of the Westar Order and ensure that obligations of its previously-issued securities follow the proceeds. Specifically, the Kansas Commission is concerned that, if Aquila divests or spins-off assets without divesting or spinning-off a proportionate amount of

⁹ See 18 C.F.R. §§ 34.10, 131.43 (2003).

previously-issued debt associated with the assets, ratepayers could ultimately end up paying off debt incurred for non-utility activities providing no benefit to them.

24. As explained in the Westar Order, 102 FERC ¶ 61,186 at P 20, the Commission intended to impose the restrictions on secured and unsecured debt on future securities issuances. Therefore, as in the Westar Order, the Commission imposes no further restrictions on prior authorizations to issue securities. However, the Commission has taken the Kansas Commission's concern into consideration. In evaluating the Long-term and Short-term Proposals and ultimately finding that they meet the standards of section 204, the Commission sought additional information and relies here not only on the applications themselves but on the additional information provided in and the representations that Aquila made in its data responses, as well as the conditions set forth in the settlement approved by the Kansas Commission and the further conditions imposed in this order. In particular, with respect to the Kansas Commission's concern, the Commission relies on Aquila's stated intention to take necessary actions to reduce its debt load, improve its capital structure, and return to investment grade status.

Issuance of Non-Utility Debt

25. The Kansas Commission asserts that the Commission should prevent Aquila from using the proceeds from the proposed issuances for non-utility purposes and order Aquila to prescribe protocols distinguishing between debt incurred for utility and non-utility purposes.

26. Aquila's authorization has not been conditioned such that Aquila must use the proceeds solely for utility purposes. If the Commission had directed Aquila to use the authorization solely for utility purposes, then Aquila might not be able to issue debt for refinancing and this could affect Aquila's liquidity and in turn harm its ability to provide public utility service and harm the public interest.

27. Section 204 of the FPA does not expressly prohibit utilities from issuing securities to finance non-utility activities, and we are not persuaded to adopt such a prohibition here. In the Westar Order, 104 FERC ¶ 61,018 at P 23-24, public utilities were not prohibited from issuing unsecured debt for non-utility purposes. In fact, in the past, public utilities have been authorized to issue securities for financing unrelated to utility operations.¹⁰ What is more critical is that the applicable statutory standard includes that

¹⁰ See UtiliCorp United Inc., 99 FERC ¶ 61,293 (2002); Connexus Energy, 99 FERC ¶ 62,142 (2002); Citizens Energy Company, 88 FERC ¶ 62,267 (1999) (the latter two delegated letter orders granted section 204 authorization where the application

the issuance cannot impair the utility's ability to perform as a public utility,¹¹ and here we have concluded that, on the information before us and given the conditions we have adopted, the issuance should not.

Payment of Dividends

28. The Kansas Commission argues, without any further justification, that the Commission should prohibit Aquila from paying dividends while the debt is outstanding. Aquila stated, however, that, in the fourth quarter of 2002, Aquila suspended its dividend payments until it could restore business stability and produce positive financial results. To date, Aquila has not paid dividends.

29. Given that Aquila has halted payment of dividends for the time being, the Commission need not address this matter.¹²

Convertibility of Long-term Debt

30. The Kansas Commission is concerned that the risk of harm to ratepayers increases with the removal of the requirement that the debt must be converted into common stock no more than six years from the date that Aquila issues the debt. The Kansas Commission argues that issuing debt that would convert to common stock in a relatively short period of time would be a reasonable alternative to issuing common stock immediately because it offers an assurance that the debt will be retired in the near future, while the amendment removing this time limitation offers less certainty that Aquila will issue common stock to pay off debt anytime in the near future.

31. In the settlement approved by the Kansas Commission, the parties agreed on the amount of common stock and convertible debt that Aquila may issue. Aquila also agreed

(...continued)

indicated that the securities would be used for either financing or guaranteeing investments in the telecommunications business.)

¹¹ See 16 U.S.C. § 824c(a) (2000).

¹² However, section 204(b) 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. 16 U.S.C. § 824c(b) (2000); see Westar Order, 102 FERC ¶ 61,186 at P 25.

to use the proceeds of the issuances to reduce debt, replace existing liabilities, or to maintain working capital and may only issue the convertible debt if the issuance results in a reduction to interest expense. In addition, the issuance of the convertible debt can not result in an increase in Aquila's consolidated debt ratio. These conditions should ensure that the issuance of the convertible debt will not harm Aquila's ratepayers. In light of these conditions, the Commission will allow Aquila the flexibility to convert long-term debt into common stock at any time that the long-term debt is outstanding.

The Commission orders:

(A) The Commission hereby authorizes Aquila to issue \$150 million of convertible, long-term debt securities; \$100 million of common stock; and \$500 million of short-term indebtedness, including financial guarantees of subsidiaries' or affiliates' securities, subject to the conditions set forth in the ordering paragraphs below and the text of this order.

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

(C) Aquila's requested waiver of the Commission's competitive bidding and negotiated placement requirements at 18 C.F.R. § 34.2 (2003) is hereby granted.

(D) This authorization is subject to the conditions specified in the body of this order, the restrictions in the Westar Order and the settlement approved by the Kansas Commission, as discussed in the text of this order.

(E) Aquila must file quarterly informational status reports detailing its financial condition and debt-reduction efforts within 30 days of the end of each calendar quarter until Aquila is deemed investment grade once again by at least one credit rating agency.

(F) Aquila must file a Report of Securities Issued, under 18 C.F.R. §§ 34.10 and 131.43 (2003), no later than 30 days after the sale or placement of any long-term debt or equity securities.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.