

**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 into)
the Affiliate Transactions between) Docket No. 02-UTCG-701-GIG
UtiliCorp United, Inc. (UCU) and its)
Unregulated Businesses.)

ORDER INITIATING INVESTIGATION

For the reasons stated below, the State Corporation Commission of the State of Kansas (Commission) initiates this investigation into the standards and criteria for affiliate transactions involving the regulated utility businesses and the unregulated businesses of UtiliCorp United, Inc. (UCU). The investigation is necessary given the recent downgrade of UCU's debt rating by Fitch Ratings (Fitch) which, according to Fitch, was attributable, in part, to UCU's unregulated businesses. The purpose of this investigation is to create an opportunity to better understand how UCU will meet its statutory obligation to serve its utility customers in light of its impetus for diversification into unregulated business activities. This investigation will assess the impact of and risks associated with UCU's interest in or affiliations with unregulated businesses on UCU's jurisdictional electric and natural gas public utility businesses and determine whether any guidelines or criteria should be established regarding the relationship between the regulated business and the unregulated activities.

I. FACTUAL BACKGROUND

1. UCU, through its operating divisions of WestPlains Energy Kansas, Kansas Public Service and Peoples Natural Gas Company, provides electric and natural

gas public utility service to approximately 165,000 retail customers in Kansas. *See* UCU Supplement to 2000 Annual Report at 13. UCU's retail electric and natural gas operations in Kansas are regulated businesses subject to the jurisdiction of the Commission.

2. UCU participates in a variety of unregulated business activities through its affiliates. In particular, Aquila, Inc. (Aquila), which is presently a wholly owned subsidiary, buys and sells wholesale natural gas, electricity and other commodities outside of the direct regulatory oversight of the Commission. Aquila also deals in a wide range of energy-related financial and risk management products and services in North America and Western Europe. In addition, Aquila owns and operates electric power generation assets, natural gas gathering, transportation, processing and storage assets, and a coal blending, storage and handling facility. *See* UCU's Registration Statement and Amendment No. 1, No. 333-74362 (UCU's Registration Statement), filed at the Securities and Exchange Commission (SEC) on December 26, 2001.

II. INITIAL PUBLIC OFFERING OF AQUILA SHARES

3. In April 2001, Aquila, which was then a wholly owned subsidiary of UCU, issued 14.2 million shares of Class A common stock to the public at an initial offering price of \$24 per share. Aquila received net proceeds of approximately \$316 million after deducting underwriting discounts, commissions and other expenses. In connection with Aquila's initial public offering (IPO), UCU sold 5.7 million shares of Aquila's Class A common stock at \$24 dollars per share and retained the proceeds. In connection with the IPO, UCU and Aquila entered into a revolving credit agreement under which UCU agreed to lend money to Aquila. UCU also announced its intention to

complete a spin-off of its remaining interest in Aquila within twelve months of the IPO but indicated at the time that it would not complete the spin-off if its board of directors determined that doing so was no longer in the best interests of UCU and its stockholders. *See* Aquila's Registration Statement and Amendment No. 4, No. 333-51718 (Aquila's Registration Statement), filed at the SEC on April 18, 2001.

III. RECOMBINATION OF UCU AND AQUILA

4. In a meeting held November 7, 2001, UCU's board of directors determined that proceeding with the spin-off was no longer in the best interests of UCU and its stockholders. In lieu of the proposed spin-off, the board of directors authorized UCU to pursue a recombination of UCU and Aquila. The board's decision was based on a variety of factors, which are set forth in detail in the Registration Statement section entitled "Background and Reasons for the Offer and Merger; Our Change in Strategy." *See* Amendment No. 1 to UCU's Registration Statement at 1.

5. On January 4, 2002, UCU issued a news release which states that it accepted the approximately 76 percent of Aquila Class A common shares that were tendered by Aquila shareholders prior to the January 4, 2002 deadline under UCU's exchange offer. On January 7, 2002, UCU issued a news release which announced that it has completed a short-form merger of Aquila with a UCU subsidiary. The short-form merger enabled UCU to acquire the shares of Aquila that were not tendered in the exchange offer and regain 100 percent ownership of Aquila, which was an approximately 80 percent owned subsidiary prior to the exchange offer. UCU has also announced its intent to adopt Aquila as its corporate name later in the first quarter. *See* Amendment No. 1 to UCU's Registration Statement at 24.

IV. RECENT DEVELOPMENTS WARRANTING INVESTIGATION

6. On February 19, 2002, UCU filed a petition to intervene in Docket No. 01-WSRE-949-GIE in which it acknowledged the importance of cost allocations and affiliate transactions. Docket No. 01-WSRE-949-GIE is an investigation initiated by the Commission into the actions taken by Western Resource, Inc. (WRI) to separate its jurisdictional electric public utility business from its unregulated businesses. In that docket, the Commission is considering, *inter alia*, whether current accounting guidelines or criteria can effectively evaluate, measure and monitor the impact of the financial condition of the holding company on the regulated electric operations; whether accounting procedures and practices are in place to correctly and equitably record and disclose affiliate transactions; whether accounting procedures and practices are in place to accurately report assets owned and liabilities attributable to the electric operations; and whether the Commission should adopt guidelines for affiliate transactions to avoid subsidization of unregulated services or products by the regulated operations.

7. On February 27, 2002, Fitch issued a press release stating it downgraded UCU's debt rating from BBB to BBB-, which, according to Fitch, is its lowest investment grade. Fitch stated that the downgrade reflects the cash flow drain from Aquila's energy business and the reliance of the unregulated businesses on UCU for funding. Fitch also noted that the potential capital spending of \$600 million per annum for 2002-2004 and the commitment to acquire Avon Energy in the United Kingdom make UCU dependent on additional long-term debt and equity financing over the next several years.

V. JURISDICTION

8. UCU is a certificated electric and natural gas public utility subject to the regulatory jurisdiction of the Commission pursuant to K.S.A. 2001 Supp. 66-1,202, K.S.A. 2001 Supp. 66-101b and K.S.A. 66-131. The Commission has plenary authority to supervise and control all electric and natural gas public utilities doing business in Kansas and is empowered to do all things necessary and convenient for the exercise of such power, authority and jurisdiction. K.S.A. 66-101 *et seq.* and K.S.A. 66-1,201 *et seq.* The Commission also has clear authority to examine and inspect the condition of each electric and natural gas public utility and the manner of its conduct and its management with reference to the public safety and convenience. K.S.A. 66-101h, K.S.A. 66-1,208 and K.S.A. 2001 Supp. 66-129. Further, the Commission has the jurisdiction and authority to investigate, on its own initiative, any act or practice of a public utility that affects its ability to provide efficient and sufficient service at just and reasonable rates and to make substitution for such act or practice as are just and reasonable after investigation and hearing. K.S.A. 2001 Supp. 66-101d, K.S.A. 2001 Supp. 66-1,204. These provisions, by themselves, create sufficient authority to carry out this investigation, because the actions, events and relationships described above may affect UCU's ability to provide efficient and sufficient service at just and reasonable rates.

9. UCU has not made any filing with the Commission which purports to notify the Commission of its corporate restructuring, notify the Commission of its pledge of credit to Aquila or seek approval of the agreements made with Aquila. *See, e.g.*, Application filed in Docket No. 01-KCPE-708-MIS. Even though approval of the issuance of UCU common stock and acquisition of Class A Common stock of Aquila

pursuant to the offer and subsequent merger was granted by the Federal Energy Regulatory Commission (FERC), this Commission has the statutory responsibility to safeguard the interests of Kansas consumers and to ensure that each public utility authorized to do business in Kansas maintains its ability to provide efficient and sufficient service in accordance with its certificate.

VI. COMMENCEMENT OF THE INVESTIGATION

10. Accordingly, the Commission finds that the matters set forth in this Order warrant an investigation into the standards and criteria for affiliate transactions involving the regulated utility businesses and the unregulated businesses of UCU to ensure that the regulated public utility businesses are not harmed by the unregulated business activities of UCU. The Commission further finds that it has jurisdiction to conduct this investigation.

11. In light of the foregoing, the Commission orders as follows:

- (A) UCU shall provide a report describing and explaining its standards and practices for affiliate transactions by no later than Friday, June 14, 2002. UCU should also explain why the actions, events or relationships described in this order, or actions, events or relationships related to those described herein and known to UCU, will not adversely affect the ability of UCU to provide efficient and sufficient service at just and reasonable rates to its certificated electric and natural gas customers in the State of Kansas. This report shall be accompanied by all relevant documents, which constitute, explain or justify the actions, events or relationships.
- (B) UCU shall provide to the Commission, on a continuing basis, 7 copies of all documents filed with the SEC or transmitted to its investors, including any disclosures made concerning the Commission's investigation.
- (C) Commission Staff (Staff) shall begin an investigation to review:
 - (i) What standards and practices are in place to govern affiliate transactions and to avoid subsidization of unregulated services or products by UCU's regulated utility businesses, whether the standards and practices are adequate and if not, what standards and practices should be instituted;

- (ii) What accounting procedures and practices are in place to correctly and equitably record and disclose affiliate transactions and to accurately report assets owned and liabilities attributable to UCU's electric and natural gas businesses, whether such procedures and practices are adequate and if not, what procedures and practices should be instituted;
- (iii) What is the impact on UCU's financial health and ability to provide efficient and sufficient service at just and reasonable rates from UCU's interest in or affiliations and associations with unregulated businesses; and
- (iv) How are UCU's utility customers protected from the risks associated with UCU's investments in or relationships with unregulated activities, whether such protections are adequate and if not, what protections should be instituted.

(D) Staff shall present a report to the Commission on its findings by no later than Friday, September 13, 2002, unless the Commission extends this date. To carry out such investigation, Staff shall have authority to issue discovery consistent with the Commission's rules

12. Staff, UCU, and other interested parties which might be granted intervention may suggest additional issues or questions for the Commission to include in this investigation and submit such suggestions in writing to the Commission by no later than April 15, 2002.

13. After receiving the suggestions described in the preceding paragraph, the Commission will hold a prehearing conference to discuss the additional issues or questions and the procedures that will be utilized to conduct this investigation. Notice of the prehearing conference shall be given by separate Order.

IT IS, THEREFORE, BY THE COMMISSION CONSIDERED AND ORDERED THAT:

(A) This docket shall be initiated to examine affiliate transactions between UCU's regulated utility operations and its unregulated businesses, to assess the impact of

and risks from UCU's unregulated businesses on its regulated utility operations and to determine whether any guidelines or criteria should be established for transactions between the regulated utility operations and the unregulated businesses.

(B) UCU and Staff shall make written reports, as directed herein.

(C) This order is effective upon service. Any party may file a petition for reconsideration of this order within fifteen days of the date this order is served. If service is by mail, service is complete upon mailing and three days may be added to the above time.

(D) The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order or orders as it may deem necessary.

BY THE COMMISSION IT IS SO ORDERED.

Wine, Chr.; Claus, Comm.; Moline, Comm.

Dated: **MAR 11 2002**

ORDER MAILED

MAR 11 2002

 Executive Director

Jeffrey S. Wagaman
Executive Director