

TO: David Wittig

FROM: Larry D. Irick, Ext. 1625
10th Floor, Topeka G.O.

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SUBJECT: Hypothetical Questions



INTERNAL
CORRESPONDENCE

CC:

- A. Do the KCC investigation docket orders prohibit conversion of the remaining balance of the intercompany receivable into WR stock?
1. There is no such express prohibition in the May 9 and July 20 orders.
 2. However, the KCC staff likely would view conversion as inconsistent with the intent of the orders.
 - paragraph 16 of the May 9 order criticizes the conversion of the \$350 million portion of the receivable
 - paragraph 67 of the July 20 order discusses reasons that Westar ownership of WR stock is inconsistent with the public interest
 - paragraph 90 addresses the harms related to the receivable and Westar ownership of WR stock and notes that no action requiring the dividend of the stock or receivable to WR is being taken at this time but that the KCC could revisit the issue
 3. The KCC may argue that this action is not valid since it was provided for in the allocation agreement. We would argue the conversion is not taking place pursuant to the agreement.
 4. The KCC may attack the authority for issuance of WR stock. We relied on the "ADT order" for the initial issuance, and they may claim the order was not valid for this purpose.
- B. Does the PNM merger agreement prohibit the conversion of the remaining balance of the receivable into WR common stock?

1. The merger agreement does not limit the amount of WR common stock that can be issued upon conversion of the receivable. Thus, the better argument is that conversion would not be a breach of the agreement. I note some inconsistent language in the PNM stockholder agreement on which PNM might try to base an argument for breach.
2. We initially converted a portion of the receivable into the number of WR common shares that would convert into approximately 9.9% of PNM common because Westar would become a holding company under PUHCA and the New Mexico statute if the ownership exceeds 9.9%. This was a practical but not a legal limit on the conversion of the receivable into common stock.
3. The merger agreement does not permit the receivable to be converted into WR preferred until the 9.9% level of common is reached. We do not currently have regulatory authority to issue the preferred. A draft application for filing at FERC has been prepared but not filed. The expectation has been that the KCC would intervene in this FERC docket.
4. Under the stockholder agreement with PNM, "mirror" voting provisions apply to all PNM common shares held by Westar.

C. Evaluate an acquisition of Guardian as a means for creating a public market in Westar stock.

1. An acquisition of Guardian with Westar stock would require an effective Westar registration statement. We would need the KCC to remain on the sidelines for the registration statement to go effective.
2. We would have to resolve whether it is possible to complete the transaction without an allocation agreement that the KCC claims it has the authority to approve. We could finalize any pending any asset transfers to Westar, but the uncertainty about the status of the intercompany receivable is problematic for structure and disclosure purposes.
3. The KCC staff may make the same arguments against this transaction that it makes against a stand-alone rights offering in the July 20 order. For example, there will be a public stub and the shares will be issued at a discount to book value.