ADMINISTRATIVE PROCEEDING
FILE NO. 3-11616

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)
AMERICAN ELECTRIC POWER COMPANY, INC.	)

INITIAL BRIEF

OF

PUBLIC CITIZEN, INC.

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INTRODUCTION

The legal theories and supporting testimony of American Electric Power Company (AEP) in this proceeding—if accepted by the Commission—would carve out the heart of the statute, rendering meaningless Section 11 of the Public Utility Holding Company Act of 1935 (PUHCA). The Court of Appeals in vacating, as well as remanding, the Commission's prior order in this case, has already held—echoing a long line of court decisions—that the Commission may not interpret the statute so as to render meaningless one of its central provisions.[1] The Commission therefore may not accept AEP's legal theories and testimony as meeting its burden of proof to support its merger with Central and Southwest Corporation (CSW), and must find that the requirements of Section 11 of PUHCA have not been met and that the merger may not be approved.

BACKGROUND

"The greatest showdown between Washington and Wall Street did not concern the Securities act of 1933 or the Securities Exchange Act of 1934, but, rather, the Public Utility Holding Company Act of 1935," according to the unofficial historian of the SEC, Dean Joel Seligman of the Washington Law School in his book, *The Transformation of Wall Street,* Northeastern University Press, Boston (revised edition at p.127).[2] The passage of the Holding Company Act was described by another historian as "the most bitter legislative battle of Roosevelt's first term." Michael E. Parrish, *Securities Regulation and the New Deal,* p. 145 (Yale University Press, 1970).

[1] NRECA v. SEC, 276 F.3d 609, 618 (2002).
[2] There is a third edition published in 2003, but these cites are from the second edition published in 1995.

As Parrish retells the history: “Between 1900 and 1930 improved generating equipment and other engineering advances permitted interstate electric transmission over hundred of miles.” Makers of electrical equipment had pioneered the development of the holding company device to electric utilities in 1905, the better to sell their products. Soon, Electric Bond and Share, organized by General Electric, directed—through eight intermediate holding companies—utilities in twelve states, Mexico, Cuba, and Latin America. Parrish, pp.145-7.

Many utility holding companies followed. The most famous, or infamous, was Samuel Insull. Consolidation of independent operating utilities proceeded rapidly during the 1920s. “The furious scramble for operating companies produced a national holding company map more irregular than many legislative gerrymanders.” Parrish, p. 149.

Investigations into the holding company abuses were instigated by both the Federal Trade Commission, ultimately filling 101 volumes, and the House Commerce Committee from 1928 to 1934. The collapse of the stock markets in September 1931 toppled the heavily indebted Insull utility system. According to Parrish, “Newspapers claimed that the fall of the $3 billion empire was ‘the biggest business failure in the history of the world.’” Parrish describes Insull as an early advocate of “customer ownership,” but who took down with him 600,000 shareholders and 500,000 bondholders. Insull fled to Greece. Parrish at 22. Between 1929 and 1936, there were 53 utility holding company bankruptcies and 23 utility bank loan defaults. 1995 Division Report to Congress, p.5 and notes 16 and 17.]

President Roosevelt had a number of skirmishes with utilities as governor of New York. He had little success in lowering New York’s utility rates, even though he made

superb appointments to the Public Service Commission and created a Power Authority to plan state hydroelectric developments. But, of far greater importance, according to Parrish:

> "was Roosevelt's zest for personal education in the nuances of regulation and his success in recruiting men who were experts in public utility finance, valuation, rate-making, and law….In no other area of public policy was the President's experience so rich or his commitment so complete." (pp. 152-3)

As a result, Roosevelt became an uncompromising advocate of *abolishing* holding companies altogether for utilities and created a National Power Policy Committee in 1934 to formulate his administration's legislative proposals. The Committee's general counsel was Benjamin Cohen, later the primary drafter of PUHCA. According to Seligman:

> "The recommended concept of geographic integration was similar to Senator Burton Wheeler's oft-quoted sentiment 'A utility is essentially a local institution. It should be locally controlled and locally owned.'" Seligman, p. 129.

The utilities mounted a formidable opposition, beside which the campaign against the Securities Exchange Act "paled in comparison." They even began a whispering campaign that the president was suffering from mental instability, and organized a letter-writing campaign in which the letters and telegrams turned out to be from nonexistent constituents. Roosevelt was greatly alarmed, calling the utility lobby "the most powerful, dangerous lobby that has been created by any organization in this country." David McKean, "Tommy the Cork," p. 59, Steer Forth Press, 2004.

The compromise on Section 11 reached in conference on the bill was drafted by Felix Frankfurter, the future Supreme Court Justice, and a Senator Barkley. Parrish at 175. This was the most far-reaching provision of the act, the controversial death sentence provision, which limited each holding company system to a single integrated system and to businesses that are reasonably incidental or economically necessary or appropriate to

the operations of such integrated system. A second system could be retained only if it met certain strict requirements. PUHCA was signed into law in August of 1935. Part II of the same legislation gave jurisdiction to the Federal Power Commission over rates and mergers for electric transmission in interstate commerce and wholesale electricity sales. Jurisdiction over both electric generation and distribution facilities and retail rates were reserved to the States. Parrish, p. 173, Federal Power Act Section 201(b)(1).

William O. Douglas became Chairman of the SEC when the initial Supreme Court constitutional challenge to the registration provision of Section 5 of PUHCA had failed.[3] When he left the Commission to join the Supreme Court, Chairman Douglas reported to the President his views on the statutes administered by the Commission.

> First, as to the Public Utility Holding Company Act of 1935. Over the years minor amendments may be desirable in light of administrative experience. But in my opinion none is now necessary. The statute has proven to be workable and sound. Substantial progress has already been made under it. There is still some desire in the industry to alter the provisions of the "death sentence", particularly Section 11(b)(1). Any such attempt should be vigorously opposed. That section is soundly conceived. It is practical and workable. When fully executed it will provide a large degree of decentralization in the utility industry and cause a return of that industry from Wall Street to Main Street.
>
> P.C. Ex. 3,p.1.

Parrish, however, reports (p. 219) that during the Roosevelt administration, the commission made "painfully slow progress" toward the simplification and geographical integration of major holding company systems under section 11.

> By 1946 the thirteen largest systems had only reduced their corporate entities from 670 to 446. The total assets of the thirteen systems remained virtually unchanged. Commonwealth and Southern still controlled operating properties in ten states; American Power and Light, the major subsidiary of Electric Bond and Share, functioned in thirteen states; Middle West Corporation I fourteen; North American Company in twelve; Standard Gas and Electric in fifteen."
> Parrish, p. 220.

[3] Electric Bond and Share Co. v. SEC, 303 U.S. 419 (1938).

The completion of the restructuring of the public utility industry was the predominance concern of the Commission during the Truman years, according to Seligman. After Supreme Court decisions in 1945 and 1946 held that subsections 11(b)(1) and 11(b)(2) were constitutional and approved SEC interpretations of these subsections, voluntary compliance increased and between 1934 and 1948, holding companies divested themselves of assets worth approximately $7 billion. Seligman concludes that:

> "the SEC's geographic integration and simplification of the utility holding companies historically has been the agency's single most significant achievement." *Transformation*, p. 247.

Seligman goes on to credit the SEC's senior staff with the restructuring of the utility industry and concludes the "the enforcement of Section 11 of the Holding company Act was the most effective antitrust enforcement program in United States history…." *Id.*

After the restructuring, there were only 12 active registered holding companies in the United States for many years; nine electric and three gas. Their financial and corporate structures were comprehensively regulated by the SEC's PUHCA staff. The United States and its economy enjoyed the most reliable electric system in the world. However, with the oil embargo in the 70s coupled with the construction of extremely expensive nuclear central station plants, rates went up.

The utility industry, which had been trying to get rid of PUHCA since 1934, saw its chance under the deregulatory policies of the Reagan administration. That administration's SEC went on record as supporting PUHCA repeal. Consumer support saved the statute. In 1992, the industry achieved partial PUHCA repeal, for wholesale generating plants and foreign utility companies. In 1994, the SEC staff began issuing a

long line of "no-action" letters that effectively exempted "power marketers" and "gas marketers" from PUHCA enforcement actions. No statutory interpretations of PUHCA were given, so none could be challenged, and a large industry grew up trying to make a profit in-between the generators and distributors of electricity. Some succeeded, and some—like Enron Corp—failed spectacularly.

In 1995, the Clinton administration SEC sent a Division report to Congress recommending partial PUHCA repeal. At that point, there were 15 registered holding companies. Given the Division's encouragement that the Commission should be "flexible" in its administration of the statute, the number of registered holding companies grew to 56 by year-end 2004, with 31 top registered companies. The hard-achieved restructuring of the electric and natural gas holding companies is effectively being reversed.

Many consider that a low point in the administration of the Holding Company Act was reached on June 14, 2000, when the Commission approved the merger of two giant holding companies, AEP and CSW, that had escaped restructuring in the initial enforcement of the Holding Company Act, to create a massive holding company covering eleven states from the Canadian to the Mexican border, from Virginia in the East to the Texas Big Bend in the west, separated by hundreds of miles at their nearest point, and "interconnected" by a relatively tiny 250 MW, one-way firm transmission contract. Many felt the SEC had successfully reversed enforcement of the Act back to the 1940s (see Parrish, p. 220, decrying systems that covered ten states), by ignoring the purposes of the statute and focusing on disparate parts of the definition of a "single integrated public-utility system" in order to approve the merger. The court of appeals, to the

surprise of few familiar with the statute, vacated the Commission's order and sent it back, along with a map in the Federal Reporter, apparently to show just exactly what kind of merger the Commission had approved under a statute designed to break up, and prevent the reoccurrence of, giant utility holding companies. NRECA v. SEC, 276 F.3d at 619.

The Commission cogitated over the court's decision for nearly three years before setting the matter for hearing in this proceeding. Release No. 35-27886. Meanwhile, AEP and CSW went forward with their merger—apparently willing to bet billions of dollars that they could continue to avoid Section 11's limitations.

STANDARD OF REVIEW

Although the question of standard of review is normally reserved for an appellate court, it needs to be raised here because it will almost certainly be raised in any appeal of an order resulting from this proceeding. An appellate court normally gives deference to the expertise of an administrative agency. Where issues turn on the accounting and financial behavior of public-utility holding companies, the Division of Investment Management and the Commission itself can appropriately claim such expertise. However, the instant proceeding does not turn on such questions, but on the electrical operations and regulation of operating electric utilities. Sadly, the Division has no expertise in either.

Public Citizen was rejected in its attempt to subpoena the Division staff to establish for the record that the Division has no in-house electrical engineers or experienced utility employees—and apparently has not had any such in-house utility experts since at least the 1960s. With or without a subpoena, it is an unavoidable fact, admitted at the pre-hearing conference, that the Division currently has no such in-house

experts and has declined to hire any for the purposes of this case. The one "technical expert" that the Division brought forward to conduct some cross-examination is Mr. Robert Wasson, who is indeed an experienced expert in the financial regulation of utility holding companies. What the Division lacks is someone with even a passing engineering knowledge of the way that electric utilities actually operate, as can be seen from the Division's naïve assumptions in its Preliminary Statement (Div.P.S.) regarding the use of non-firm transmission and "open access" to integrate an electric utility system. Div.P.S.p.8. As will be explained below, this is like saying that American Airlines could run its airline without owning any planes, but instead by relying on the hoped-for availability of flights on its competitors' airlines.

Again, in its Preliminary Statement, the Division speaks confidently about how "the nature of today's transmission markets" affects this case. Div.P.S.p.8. But what, indeed, are "transmission markets"? Do they sell space on monopoly transmission lines to the highest bidder on a "first come, first served" basis as the Division says at P.S. p.7? The Division does not explain how a "market" for monopoly electric transmission makes the line owners "common carriers" as AEP's witnesses assert. AEP Ex. 2, p. 24, line 6; AEP Ex. 5, p. 11, line 17. The Division had a chance to expand on its utility operations knowledge at the hearing. Public Citizen presented an unpaid, disinterested, technical witness who is a long-time utility operator and executive and an experienced electrical engineer with extremely impressive credentials, including authorship or co-authorship of several electric utility text books. With his help, Public Citizen's counsel got AEP's witness, Mr. Johnson, to admit that there exists a definition of an "integrated utility" that electrical engineers themselves use. T.pp.91-96. Public Citizen's expert witness, Mr.

Casazza, testified from his long experience why AEP could not integrate its system with that of CSW by using only non-firm transmission and simply relying on the potential availability of open access transmission capacity. PC Exhibit No. 1, pp. 8-9.

The Division did not explore these contradictions in the testimony. The Division did not ask either AEP's engineering witness or Mr. Casazza about the electrical definition of an "integrated utility," The Division did not ask Mr. Casazza, with his vast utility experience, why he disagreed with AEP's conclusions. The Division simply asked Mr. Casazza if he was denying that AEP had shipped a few megawatthours of electric energy east to west. This was apparently all the expert utility information the Division felt that it needed to know.

Since the Division lacks any engineering or utility experts of its own, the Division is apparently content to rely on the experts presented by utility holding companies seeking merger approval before the Commission. Indeed, the Division asked AEP's witness non-engineering witness if what engineer, Mr. Casazza, had testified changed his mind in any way (T.p. 31), but did not ask Mr. Casazza whether anything AEP had said on the stand changed Mr. Casazza's expert views.

The Division's lack of interest in any testimony contradicting AEP's, even from AEP's own witness, unfortunately does not describe the extent of its failure to pursue questions concerning the public interest or enforcement of the statute in this proceeding. The Division's questions were repeatedly challenged as "friendly cross-examination" by counsel from NACREA/APPA, as trying to supplement the record on AEP's behalf by asking leading questions that apparently resulted from what the Division had learned at

the so-called "technical conference" it held with the parties on January 6, 2005. T.pp. 25-31. The Presiding Judge had to finally tell the Division to "move on" because "you're really not cross-examining him." T.p. 30.

In this proceeding, where the Division has no comparable engineering or utility experts, other than accounting and financial ones, (and Public Citizen's utility engineering expert was unable to attend for health reasons) the "technical conference" was apparently an expensive tutorial of the Division by AEP's utility technical staff in support of its case. The Division then attempted to place some of what it had learned from AEP into the record on AEP's behalf, and was only prevented from doing so by counsel representing consumers. T.p.108-112. The Presiding Law Judge again had to caution the Division that there were objections that the Division was back-dooring direct testimony where it had failed to call a witness of its own. T.p. 112.

The Division, to Public Citizen's knowledge, also has no expertise in utility practice under the Federal Power Act. This is not surprising, since the Division does not enforce the Federal Power Act, and has no reason to be expert in such matters. This lack of expertise in FERC and utility practice would not be alarming, except that the Division's narrative statement relies heavily on FERC orders and policies and the Division's own views of how these affect operating utilities. Div.P.S. pp. 7-12. The Division calls these regulatory changes "contemporary realities," yet, given its lack of familiarity of utility practice under the Federal Power Act, its knowledge of "realities" is entirely theoretical. And when confronted with a Public Citizen witness with ten years' experience working at FERC, including six years as FERC assistant general counsel for electric rates and corporate regulation, and seventeen years' private law firm practice

before FERC, the Division's sole cross examination appeared designed to discredit the witness by making it clear on the record that FERC is not the agency that administers the Public Utility Holding Company Act. T.p. 181-2. Public Citizen's witness was happy to agree, since even a brief look at the statutes themselves make it clear that PUHCA is a law with a far broader reach, dealing with the owners of all electric utility companies, not just transmission utilities and wholesale sales like the Federal Power Act, and that PUHCA trumps the Federal Power Act wherever they may overlap. See, PUHCA section 21(2), (15 U.S.C. 79u); FPA Section 318 (16 U.S.C. 825q).

However, shortly thereafter, the Division sat by in silence as AEP submitted a nearly four-inch-high stack of FERC orders to the Presiding Administrative Law Judge in support of its case. T.p. 185-7. Of course, the Division could not have protested the delivery of such orders to the Presiding Judge very strongly, since its own narrative statement relies heavily on the same FERC orders as constituting "contemporary realities." Div.P.S..pp. 7-12. The Division also did not challenge the *bona fides* of Mr. Baker, although his testimony has a heading, on p. 36 of 37 pages, that reads: "Thus Far Your Testimony has Focused on FERC Policy…." AEP Ex.5, p.36. Apparently, knowledge regarding FERC policy and practice under the Federal Power Act is only relevant to PUHCA enforcement proceedings when it is being invoked by AEP or the Division.

Under the circumstances, Public Citizen finds that it must challenge the Division's expertise regarding most of the matters at issue in this proceeding. Public Citizen suggests that the Presiding Administrative Law Judge give the views of the

Division deference in accounting and financial matters, but not in any matters relating to actual electric utility operations, engineering questions or to FERC policy and practice.

SUMMARY OF ARGUMENT

Because the Court of Appeals vacated the Commission's prior order, the Commission must review *de novo* the question of whether the AEP/CSW merger application meets the standards of Section 11 of the Holding Company Act. While the Commission's order setting the matter for hearing limits the factual issues to be determined to those of interconnection and what constitutes a single region or area under the statute, the statute itself requires that the interpretation of *all* provisions of the statute must meet the problems and eliminate the evils as enumerated in Section 1(c) of PUHCA.

AEP has the burden of proof in this proceeding, and has failed to carry it in regard to the three central questions set for hearing.

First, AEP has failed to prove that its two widely distant groups of utility assets are "interconnected" so that "under normal conditions," they can be economically "interconnected and operated" as a single utility system. At most, AEP has shown that there are sporadic transfers of relatively small amounts of electric energy from its West to its East systems, using "rented" contract path transmission service. It also has had tiny and occasional transfers of megawatt hours from East to West using "as available" transmission service. As AEP's own witnesses agreed on cross-examination, there exists a long-standing electrical systems definition of an "integrated" utility system, as one that provides back-up for outages of its own generation to ensure reliability. T.p.91. AEP/CSW does not meet this definition. AEP argues that it doesn't matter that it owns no transmission lines connecting these widespread utility assets, since it can use the

"contract path convention" and "non-firm" transmission service, and that FERC requires "open access" transmission. This is akin to saying that an airline need not buy planes, but can sell reservations on its airline by simply relying on competitors' space being available on their airplanes at whatever times the first airlines' customers wish to travel.

Second, AEP has failed to carry its burden of proving that its two widely distant groups of utility assets are in a "single" area or region of the country. This is hardly surprising, since these utilities range from Michigan, on the Canadian border, to Texas, on the Mexican border, from Virginia in the east to the Texas Big Bend in the west. As the Court of Appeals put it, they are "noncontiguous and seemingly dissimilar regions…." 276 F.3d at 618. The Court of Appeals even went to the rare extreme of including in the Federal Reporter, along with its decision, a map of the two widely distant utility groups. *Id.* at 619. AEP simply hired a consultant to testify that trade in various products transported by boats, trains, and trucks has increased over the years since 1935 in the United States, including in the parts of the country where AEP's eleven widely distant groups of utilities are located. AEP's version of the movie "Planes, Trains and Automobiles" hardly complies with the court's direction that evidence must be provided to show that these widely divided states are in a "single" area or region of the country for purposes of the Holding Company Act.

Finally, the court required that the Commission determine anew (since the prior order was vacated) whether the merger of two huge registered holding companies, AEP and CSW, meets the statutory purposes of Section 11 of PUHCA. This section was designed to break up the huge holding companies that gained massive economic control over electric and natural gas holding companies in the 1920s and 1930s, subjected utility

customers to absentee management and distant financial control over their utilities, and made effective State regulation of distant and multi-state utility holding companies virtually impossible. Public Citizen believes that the record in this proceeding fully demonstrates that the acquisition of CSW by AEP does not and cannot meet the standards of Section 11 or otherwise comply with the purposes of the Public Utility Holding Company Act of 1935.

ARGUMENT

Scope Of This Proceeding

Because the court of appeals vacated the Commission's prior decision, the scope of this proceeding must include a *de novo* review on the Commission's part regarding whether AEP's application to acquire CSW can meet the standards of PUHCA, particularly those of Section 11, which has often been called "the Heart of the Act."[4] Applicant AEP—and oddly, the Division of Investment Management—would, in their narrative statements, have the Presiding Administrative Law Judge believe that this proceeding is merely a *pro forma* gathering of a few, narrow, and obvious facts needed to supply "evidence" to justify the Commission's prior order approving the merger. This is far from the case.

Not only did the court of appeals make it clear that the Commission may not read the Act so "flexibly" as to read important parts of Section 11 out of the Act, [5] but the statute itself requires that:

> "it is hereby declared to be the policy of this title, *in accordance with which policy all the provisions of this title shall be interpreted*, to meet the problems and eliminate the evils *as enumerated in this section*, connected with public-utility

[4] S.Rep. No. 621, 74th Cong., lst Sess. (1935).
[5] NRECA v. SEC, 276 F.3d at 618.

holding companies which are engaged in interstate commerce…." (emphases supplied.) Section 1(c) of PUHCA, 15 U.S.C. 79(a).

Among the evils enumerated in Section 1 is:

"(4) when the growth and extension of holding companies bears no relation to…the integration and coordination of related operating properties; ….
Section 1(b)(4) of PUHCA; 15 U.S.C. 79(a).

The Commission must interpret *all* the provisions of the statute so as to eliminate the evils that the statute was enacted to prevent. The heart of the statute, which carries out the remedy for the "evil" of widespread, unrelated utility acquisitions, is Section 11, which requires the Commission to limit the operations of a holding company system to a *single integrated* public-utility system.

Section 2(29)(A) of PUHCA further defines an integrated system for electric utilities as one:

"whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation;…" 15 U.S.C. 79b(a)(29).

AEP's legal theories and supporting testimony, if accepted, would result in precedent finding that any utility that can reach another utility *via* a transmission contract--apparently of any size, where the contract can accommodate some reverse transmissions of electric energy, apparently of any amount--would meet the statutory integration and coordination requirements of Section 11. The requirement that they be "related operating properties" (and "under normal conditions" economically "interconnected and operated" in a "single area or region, in one or more States,") would apparently be simply assumed to follow from the first two findings, as long as there

existed increased trade of various products among the affected states by means of boats, trains, trucks, and natural gas pipelines. AEP Exhibit 1. Such increased trade among all the continental States and with Alaska is certainly to be anticipated in both the near and long term future. In short, AEP's legal theories and related "evidence" would support a finding under Section 11 approving a merger involving every utility in the United States (with the exception of Hawaii, since underwater cables do not yet go nearly that far). AEP's witness, Mr. Baker, admitted as much in his testimony and on cross examination. T.pp.140-5.

The scope of this proceeding cannot, therefore, be limited to a narrow focus on a few, selected "facts" that might satisfy a few portions, taken out of context, of a layperson's definition of a "single integrated system." The Commission must instead take into account the actual engineering impacts of AEP's theories and their real-life impact on the larger question of whether the purposes of the statute are being met by the criteria that the Commission adopts. It is clear from the statute itself, as from the court of appeals decision, that the Presiding Administrative Law Judge, and the Commission in its turn, must review anew the totality of the question of whether AEP has met its burden of proving that its acquisition of CSW is legal under Section 11 of PUHCA when all of its provisions are interpreted in light of the purposes of the Holding Company Act.

I. AEP Has Failed to Carry its Burden of Proving that its Two Distant Sets of Utility Companies are "Interconnected" as Required by PUHCA.

AEP has failed to carry its burden of establishing that it has interconnected its widely distant electric systems by means of a transmission contract, a contract for far less capacity than that required to replace any one of most of its generating units, with occasional transmissions of electric energy going in the opposite direction. AEP appears

to believe that any amount of transmission of energy is enough to show that it is interconnected, even though the statute also requires that the two distant sets of utilities "under normal conditions" may be economically "operated as a single interconnected and coordinated system…." Public Citizen believes that AEP's view defies not only common sense, but also fails to square with the utility definition of what an "integrated" utility system is, a concept that has a well-known definition in the electric utility industry, as acknowledged by AEP's own witness, Mr. Johnson, on cross-examination. T.pp. 91-96. The fact that the statute does not specify a particular amount of interconnection required to coordinate an electric system does not mean that the amount cannot be quantified or at least approximated, particularly since the concept of an "integrated" utility system is one that public utility engineers have dealt with for a long time, as Mr. Johnson testified on cross-examination. T.p. 91-6**.** Mr. Johnson explained how an electrically integrated vertically integrated system (like AEP) would operate:

> "But bottom line, it is…at any particular point in time, we have to assume that the worst possible contingency, or worst possible outage, will, indeed, occur, and the system will be operated – will remain reliable. And following that outage, should it occur, in short order, we have to re-position the system. That means moving generation, or doing – reconfigure the transmission system, as the need b, such that we can anticipate, then, the next worst contingency. T,p. 96.

When asked if AEP could back up the loss of even a single unit in Texas, Mr. Johnson testified:

> In a very short term? No. In the long term, to the capacity of the transmission – as limited by the transmission system, yes. T.p. 98.

Mr. Johnson then agreed that the "transmission system" of AEP between East and West is the 250MW transmission contract, and that Texas has larger units than 250MW.

T.p.99. But, he contended, this is not a problem because under FERC's open access system, "if the capacity was available in the transmission system, that "

Q.. If the capacity was available.

A. -– capacity could be purchased. T.p. 99.

And there's the catch; if AEP/CSW doesn't actually control the needed amount of transmission capacity between East and West, at the least through a contract for firm capacity, it would have to rely on the availability of the needed amount of such capacity, at the particular moments it is needed, from its competitors. This is why saying one can coordinate a reliable single "integrated" electric system by relying on "space available" on one's competitors' lines is like saying that American Airline could be run without purchasing planes, but simply relying on space being available on Southwestern at precisely the time American's customers needed it. This is an absurd concept, and it is equally absurd to anyone familiar with how electric utilities actually operate – which category, unfortunately, apparently doesn't include the Division of Investment Management—to assume that an "integrated" electric system could simply rely on non-firm transmission, because FERC says that utilities must provide "open access."

Airlines also provide "open access," but if you don't have a reservation (and sometimes, as Mr. Johnson pointed out, even if you do), you cannot be assured that space will be available when you need it. In the AEP/CSW case, they don't even have an airplane that flies between the two groups of utilities. This is even more critical when we are talking about non-firm transmission because—as pointed out on cross-examination and by Mr. Baker in his testimony, in the case of non-firm transmission, the owner can curtail you (actually throw you out of the plane if he needs to) by "recalling" your

transmission service. AEP Ex.5, p. 13, line 14; p. 14, lines 15-18. No reasonable business could be run with its critical components subject to such haphazard availability, particularly when that availability is required from one or more of its competitors. AEP itself compares it to offering airline seats or hotel rooms on a discount basis. AEP Ex.5, lines 18-21. But AEP must provide *firm* electricity to its own customer load, and cannot count on such discount space being available whenever there is a power plant outage or other system need arises. PC Ex.1, p.8, lines 15-22.

And even if non-firm transmission and open access were sufficient, which they aren't, they wouldn't work if the outage is at a plant in Texas, because Texas has only a very few, constrained, DC ties joining the state to the entire Eastern Interconnection.

Doing loss of load probability calculations, or other methods of preparing for outages, is something that utility systems do, and must do, as Mr. Johnson concurred. T, p. 94**.** It would therefore not be difficult to come up with figures assessing the order of magnitude required to integrate a system. For example, Public Citizen's witness, Mr. John A. Casazza, authored a book published in 1993 by the Institute of Electrical and Electronics Engineers[6], entitled: "The Development of Electric Power Transmission." That book indicated that the transmission capacity that would be required to integrate two systems is between 7% and 11% of the total generation capacity of the smaller system. ("Development," Table 1, pg.11.)

The 1993 book also found that past experience has shown there is a maximum size of an integrated, alternating current (AC) system covering a large geographic area, limited by:

- The effects of the loss of large units;

[6] The book is currently available from www.lulu.com.

- The physical ability to operate and manage such networks;
- The methods of physical regulation and control in each of the systems.

AEP has presented no information to indicate that it has analyzed these potential concerns or otherwise attempted to show how a one-way 250MW transmission contract, with sporadic energy exchanges in the opposite direction, could cause the two groups of utilities "under normal circumstances" to be "economically operated as a single interconnected and coordinated" whole, as required by the statute and the Court of Appeals' decision. 276 F.3d at 615. AEP's exhibits 6 and 7 at best show sporadic transfers of energy East to West (megawatt hours) instead of any ability to back up 500 MW units with actual generating capacity (megawatts) East to West "under normal circumstances: and only 250MW West to East, even though AEP East's biggest unit is 1300 MW. T.p. 153. One cannot provide reliable electric service to firm "load," *e.g.*, firm customers, by sending them a few hundred or a few thousand megawatts of energy whenever transmission happens to be available. Mr. Baker actually appears to brag that exhibits 6 and 7 show that "in one hour during January of 2004, we shipped about 1,000 MWh using non-firm service from west to east." Tr. p. 108. Public Citizen does not believe that one hour in a month meets the statutory test that "under normal circumstances" a system can be economically integrated and coordinated. Certainly AEP can send electric power and energy when there is space available; the question is whether that is "normal circumstances" for backing up the reliability of a huge, "single" integrated electric system.

According to Mr. Casazza, the type of minimal contract path "interconnection" that AEP currently has has been compared to "tying two elephants together with a string

and hoping they will work together." Certainly the small size of the 250MW "string" in this case cannot cause the two elephantine systems to work together, even in one direction.

In addition, if the transmission is by "contract path," rather than over a committed transmission line, Mr. Johnson admitted that the electrons will not necessarily flow over that path. Tr. P. 96, lines 14-19. Mr. Baker called it the "contract path convention." AEP Ex.5, p. 18, line 15. Mr. Casazza testified that the large number of transmission facilities intervening between AEP's two groups of utilities (See AEP Exhibit 8) actually "increases the probability that constraints will occur somewhere, limiting AEP's ability to operate as an integrated system." PC Ex. 1, p. 9. If transmission constraints exist regarding a "contract path," the would-be sender may collect contract damages, but electrons will not flow. Going back to our airplane analogy, you may get a ticket for a free plane trip in the future, but you aren't going anywhere today. A reliable, integrated electric system obviously cannot be operated on such a happenstance basis.

But there is even more uncertainty here. The most that AEP can tell the Commission today is that it has the *right* to "roll over" its long-term reservation, and "capacity is *likely* to be available…." Ex. B. line 19, emphasis supplied. AEP says it is "likely" because its hoped-for contract "will merely replace the current reservation." AEP Ex. 5, lines 19-20. But demand and line constraints are growing substantially on the other systems' lines, and what is available today may well not be available tomorrow. The best that AEP can promise this Commission is that it "will make a formal renewal *request* in 2005." AEP Ex. 5, p. 19, lines 20-21., emphasis supplied. So, not only does

AEP have no guarantee that "open access" transmission will actually be available when it needs it, but at the moment it doesn't even have its small, 250 MW firm "contract path" guaranteed.

The Division, which appeared in its narrative and on cross examination to "buy" AEP's reverse transmission of energy argument, may simply be confused by the difference between megawatts and megawatt hours, a difference those who work with the industry would call "power" or "capacity" versus "energy." A description of the two in very abbreviated terms is that electric power or capacity (measured in megawatts[7]) is the ability to produce or use or send electric energy at any given instant, whereas electric energy can be thought of as the amount of power used during a given period of time. That is why energy is measured in hours: kilowatt hours, megawatt hours, or gigawatt hours.

A comparison of magnitude of the two is illustrated by Attachment A, which is a recent press release from Consolidated Edison of New York describing the new records it recently set for winter electric use in terms of both megawatts and megawatt hours. The Saturday, January 22, 2005, peak-load record of 7,934 megawatts (power) was followed by a Sunday peak-load record of 7,846 megawatts (power) on January 23, 2005. On the other hand, the customer consumption over the same weekend of January 22-23, 2005, was 327,169 megawatt hours (energy), topping the 318,528 MWh (energy) record of the previous year. Since Con Edison's system is much smaller than AEP's (which has a maximum capacity of 36,000 MW according to its website, Attachment B**,** it gives a sense of how little electric energy the megawatt-hours (MWh) recorded on AEP Exhibits No. 6 and 7 actually represent. Although they appear to cover an entire month's worth of

[7] or kilowatts or gigawatts

energy transfers (the chart is not at all clear on this), not a single transfer even from West to East would equal, over a month, the number of megawatt hours of energy used by Con Ed's customers in a single winter weekend.

The number of AEP's MWh sent East to West is, of course, tiny. Without any indication of what AEP East or West's peak loads are, the figures are totally meaningless in terms of showing interconnected coordination, other than to show that some tiny actual amount of electric energy has flowed in both directions. If compared to the overall system MWh, it would relatively be even smaller. If that is all it takes to show an "integrated" system that "under normal circumstances" is "interconnected and coordinated in its operations," than any distant utilities anywhere in the continental United States (and probably in Alaska as well) can meet this test. This interpretation of Section 11 clearly does not promote the purposes of the Act, as a valid interpretation of the statute must.

Neither AEP nor this Commission can simply throw up its hands and say that since the statute does not specify a particular amount of energy or power transfers that are required to integrate an electric system of a certain size, the question can simply be ignored, because in fact these numbers can be determined or at least approximated as discussed above. AEP, of course, has no wish to determine such numbers, when it can apparently get the Division to agree that any movement of electrons from one direction to the other is adequate to show "interconnection." But, as we and the statute have said at the outset, each provision of the statute must be interpreted in accordance with the policy of advancing the purposes of the Act. . [See, Section 1(c), 15 U.S.C. 79a.]

Where the statute actually envisions and specifies a single system that under normal conditions can be economically operated as an interconnected and coordinated system, some attempt must be made to ascertain what size of interconnection is necessary to permit meaningful coordination of that particular system, not to simply show that a few megawatt hours of energy have flowed from one group of utilities to another.

II. AEP Has Not Met its Burden of Proving that its Distant, Noncontiguous Utilities, Bordering in one case on Canada and in the Other on Mexico, Are In a "Single" Area or Region of the United States Within the Intent of Section 11 of PUHCA

AEP's witness, David Harrison, Jr. (AEP Exh. No. 1) provides testimony on trade patterns of certain products that has no relevance whatsoever to this proceeding. Electric power systems do not provide a product; they provide a service. They are mechanisms for taking an energy source in one form, at one location, and converting it into an electron vibration, and transmitting this vibration to other locations where it is changed back into other forms of energy. One of the chief characteristics of electricity that distinguishes it even from other energy forms such as natural gas is that electricity cannot be stored. Thus, all of witness Harrison's analogies comparing electric power systems with other economic production and distribution systems are totally inaccurate. They are also irrelevant to determining what a "single" region or area is to promote the purposes of PUHCA, which is one that is "not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation." Witness Harrison's testimony says nothing "expert" about the advantages of localized utility management, the efficient operation of utilities, or about the effectiveness of utility regulation. Although the Division of Investment Management would apparently have the Presiding Administrative

Law Judge believe that all the phrases of the statutory definition can be broken apart and need not be considered as a whole, this is incorrect. Section 1(c) of PUHCA requires that *all* parts of the Act must be read to meet the purposes of PUHCA.

William O. Douglas, the third SEC Chairman who presided over the critical, early years of enforcement of PUHCA, found:

> "The policy of the Act in restricting holding companies to single integrated systems is not difficult to divine. In the first place, it reflects the desire to *diminish concentration of control in the electric and gas utility industries*. In the second place (and as a corollary of the first) it is designed to promote the formation of strong regional or local operating systems—*rid of absentee management and remote financial control."* (emphasis supplied).

Chairman Douglas goes on the quote from the National Power policy Committee, whose recommendations resulted in the legislation to create PUHCA. The Federal Trade Commission findings stated that the concentration of control in the electric and gas industries through the device of the holding company "has assumed tremendous proportions."[8] Chairman Douglas goes on to find:

> "Section 11 places a natural limitation upon concentration of control, for as different systems map out their single integrated service areas and in the process acquire the scattered properties of other systems, each system's boundaries impose a limit upon the future expansion of its neighbors."
>
> In contrast, when a holding company system could pick up properties anywhere and such properties did not have to be geographically related, *there was no effective limitation upon the size of a holding company system or the number of units which it might control." Id.* Emphasis supplied.

It is clear that this important early enforcer of Section 11 did not think that a merger of two giant holding companies such as AEP and CSW, covering eleven states that border on both Canada and Mexico and are separated by a number of other states, could ever be

[8] Douglas, "Scatteration v. Integration of Public Utility Systems: A Significant Statement of Official Attitude," American Bar Association Journal, vol. 24, No. 10, p. 800, 802. (October 1938).

approved under the "single region" requirement of PUHCA. Moreover, as Chairman Douglas points out, where there are no geographic limits, there are no size limits.

AEP's legal theory that distant utilities can be connected merely by a transmission contract of small size, even if it does provide for sporadic two-way transmissions, clearly removes any size limitation from the operation of the statute, and does nothing to remove absentee management or distant financial control. It also fails to place any limitation on concentration of economic control over public utilities. As shown by Public Citizen's Exhibit 6, AEP's current CEO has already proposed to acquire additional utilities within AEP's "footprint." If that footprint is allowed in this case to stretch from Michigan to Texas, AEP can clearly acquire utilities in a lot more than just 11 states. AEP's witness, Mr. Johnson, said the "footprint" includes at least the entire Eastern Interconnection. AEP Ex. 2, p. 24. This is exactly the kind of gutting of the geographic limits of the statute that this Commission cannot permit, as the Court of Appeals has made clear. 276 F.3d. at 618.

AEP claims (or infers, at least) that "new" technologies now allow transmission over thousands of miles, thereby changing the "state of the art" dramatically. This is simply incorrect. On cross-examination, AEP's engineering witness, Mr. Johnson, admitted that in the early 1930s there were 135kv and 230kv transmission lines, and in the early 1950s, 345kv and 500kv lines. T.pp. 74-76. Even the 765kv, the highest voltage lines used today, came into use in the late 1950s, early 1960s. This is not "new" technology. However, now as then, longer transfers of power result in increasingly

higher "line losses" of electric energy, as Mr. Johnson concurred on cross examination, T. pp 76-78, and Mr. Casazza testified PC Ex. 1, p.8.

AEP's witness, Mr. Baker, said that AEP was divesting its exempt wholesale generators and adopting a "back-to-basics approach and we're looking and trying to focus on our regulated business." Tr.p.161. Mr. Baker testified that AEP has companies that have been approved as power marketers, but that "is done as part of our operating companies, and it's for the benefit of our native load customer. T.p. 162. Perhaps part of this desire to return to "basics" is based on AEP's recent $81 million in penalties paid to several federal agencies to settle investigations into false gas reporting and attempted market manipulations of AEP Energy Services. Attachment C. Since AEP/CSW's operating companies are traditional, vertically-integrated regulated utilities, they must be economically operated on an "interconnected and coordinated" basis as such under normal conditions and in a single region or area as required by Section 11.

If this huge AEP/CSW consolidation of distant utility holding companies, each arguably a failure of the initial enforcement of PUHCA, is allowed to be treated as a "single" interconnected and coordinate system in a "single" region of the country, then the purpose of Section 11 to prevent excessive consolidation of economic control over electric and gas utilities is clearly not being met. Moreover, the effectiveness of "localized management" and regulation cannot be met where eleven, distant states are involved. Perhaps, having never had much control over either AEP or CSW, which have been registered holding companies for decades, the states involved may have felt that they didn't have that much left to lose by having these holding companies merge. Of

course, that logic would allow all the registered holding companies in the country (and those outside the country) to merge under section 11.

And what if there is PUHCA repeal, as the current energy bill proposes and this Commission conditionally supports? FERC has no jurisdiction over holding companies, although it is trying to assert some in the context of "changes of control." But what if there is no "change in control?" What if AEP/CSW already own utilities in 11 states, and then acquire more new generators? FERC has no jurisdiction over either generation plants or their mergers, or over the financial activities or corporate structures of utility holding companies such as this Commission has under PUHCA. If PUHCA is repealed, no regulatory body will have financial or utility corporate control over the multistate AEP/CSW holding companies. As long as this Commission supports such repeal, it must take into consideration before it can approve this merger the consequences to "effective regulation" of AEP/CSW if PUHCA is gone.

Finally, can this Commission defer, watchfully or otherwise, to FERC to determine whether a merger should be approved? Absolutely not. For one thing, the court case suggesting that watchful deference might be appropriate was talking about state regulation, a primary concern of PUHCA. *City of Holyoke Gas & Electric Department v. SEC*, 972 F.2d 358 (1992). At the federal level, FERC only has jurisdiction over the owners of transmission facilities and filed wholesale rate contracts. Section 201(b)(1); 16 U.S.C. 824. FERC has no jurisdiction, for example, over the mergers of generating units, whether exempt from or fully regulated under PUHCA. Section 11 of PUHCA sets out specific structural standards for utility holding company mergers and acquisitions, whereas FERC has merely a "consistent with the public

interest" standard for mergers. FERC has NO jurisdiction over mergers of electric transmission with gas utilities, foreign utilities, or non-utilities. PUHCA gives the Commission jurisdiction over mergers and acquisitions of all of these.

Here's how FERC dealt with the AEP/CSW merger: It required AEP to join some RTO and AEP volunteered to divest 550 MW of capacity, the equivalent of a medium-sized merchant plant or EWG. T.p. 81. Although it was still the largest generator in the country, with 36,000 MW of capacity left, and with distribution monopolies in eleven states, AEP/CSW couldn't affect competition, according to FERC. Public Citizen believes that no further comment is required regarding FERC as antitrust regulator.

CONCLUSION:
REQUESTED FINDINGS OF FACT AND LAW

For the reasons set forth above, Public Citizen asks the Presiding Administrative Law Judge to find that: (1) AEP has failed to carry its burden of proving that its two distant groups of utilities are "interconnected" so that "under normal conditions" the systems can be economically operated as an "interconnected and coordinated" single system, since AEP has shown that the East to West energy transfers are only sporadic and tiny, in relative to the size of the systems and the generating units that could go down, and are only connected by non-firm, as-available transmission. Firm transmission from its 250 MW contract path is also far too small and uncertain to back-up unit outages necessary for a reliable "integrated" utility system. Further, Public Citizen asks the Presiding Administrative Law Judge to find that AEP's "factual" theory of the case would allow any utility to merge with any other utility in the country that could be reached by transmission lines to exchange a few megawatt hours of energy, thereby rending meaningless the geographic restrictions of the Act which the Court of Appeals has said the Commission may not do. 276 F.3d at 618.

(2). AEP has filed to carry its burden of proving that its two distant groups of utilities, even if they could be operated under normal conditions as a "single" system, are not located in a "single" area or region of the country under any definition that is relevant to the purposes of Section 11 of the Public Utility Holding Company Act, as Section 1(c) of the Act requires. The Presiding Administrative Law Judge should find that AEP's "evidence" that movement of products by boats, trains and trucks has increased since 1935 if irrelevant and immaterial to any of the announced purposes of the Holding Company Act, and would again render the geographic limits of Section 11 null and void

(3) AEP has completely failed to carry its burden of proving that a statute designed to break up huge utility holding companies and prevent their recurrence could possibly be satisfied where two such distant, huge holding companies have contrived to throw the "footprint" of their system over eleven states from the Canadian border to the Mexican border, from Virginia to West Texas by means of a relatively tiny transmission "contract path," with a handful of sporadic transmissions in the opposite direction, and that the merger of AEP/CSW cannot be approved under any meaningful interpretation of the provisions of Section 11 of the Public Utility Holding Company Act of 1935.

Respectfully submitted,

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February 14, 2005
Attachments

Presiding Administrative Law Judge
Service List