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.	)

REPLY BRIEF

OF

PUBLIC CITIZEN, INC.

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Dated: February 28, 2005

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Scope of Review

AEP contends that the Court of Appeals "left undisturbed" some of the Commission's findings. This is legally incorrect. The Court *vacated* the prior order, which does not leave anything standing. Moreover, the Court could not—as a matter of law-- have found that Commission's findings under other provisions of Section 2(a)(29)(A) of PUHCA were consistent with the statute without having the benefit of the missing two key findings regarding what constitutes "interconnection" and "a single region." The Holding Company Act, at

section 1(c), requires that all the provisions be interpreted together "to meet the problems and eliminate the evils" as enumerated in the statute.

For example, neither the Commission nor the Court could have found that the "region" is "not so large as to impair," etc. without knowing what the "region" is. Similarly, neither the Commission nor the Court could have determined that AEP's system was economically operated "under normal conditions" as a "single interconnected and coordinated system" without knowing whether or how the utility assets are interconnected.

Since the Court vacated the order, the Commission must go back and review the merger question *de novo,* once it has made new evidentiary findings (unless, of course, this hearing is just a "show trial" pretending to collect evidence to support a pre-determined result, as the Division's Preliminary Statement might suggest.)

Much has changed in the electric utility world since 2000, much of it for the worse, and the Commission must take such changes into account in reviewing this merger application. For example, the Federal Energy Regulatory Commission (FERC) has found that its previous test for "market power" was inadequate* and is now attempting to find a new test that will work, while continuing to allow "the market" to determine wholesale electric rates and requiring such rates to be passed through to retail consumers. Under this latest attempt, FERC has found that AEP might indeed have "market power" in one of its regions (for FERC's purposes, AEP operates in several "regions"), the ERCOT region of Texas.*

In addition, as argued in Public Citizen's Initial Brief, since the Commission supports conditional PUHCA repeal, the Commission must take into consideration in its decision what will happen to "effective regulation" of huge, interstate holding companies once PUHCA is gone.

Standard of Review

To the surprise of no one who read its Preliminary Statement, the Division of Investment Management concludes in its Brief that AEP has introduced "significant" evidence into the record and that the Division—which was completely open-minded up to this point, mind you (but see Public Citizen brief at pp.10-15) has decided that AEP and CSW have met their burden of proof in this proceeding. The fact that the result would be the largest, most scattered, most uncoordinated and non-integrated electric utility holding company in history, since the enactment of the Holding Company Act, and would read the geographic restrictions of Section Eleven out of the Act, is just, apparently, too bad.

Public Citizen has already expressed at length its disappointment with the lack of any utility engineering or utility operational in-house expertise in the Division; its refusal, nonetheless, to hire anyone with such expertise; its refusal to even ask Mr. Casazza why he disagreed with AEP's witnesses on vital utility systems questions; and the Division's total reliance on FERC policies, of which it equally has no practical experience. The Division's counsel put into the record that FERC is *not* the federal agency responsible for PUHCA enforcement. [T. pp. 181-2.]

But there is far worse in the brief. For example, the Division asks the Law Judge to make a finding of *fact* that AEP "operates on a coordinated basis in a manner intended to serve its load, in general, with lowest-cost available power" and cites for support to self-serving statements by AEP's executives *and to AEP Exhibits 6 and 7.* See Div. Brief, pp. 10-11. These exhibits, however, simply present numbers that summarize, as their titles indicate, transfers of energy (megawatt hours) and "AEP Transactions" that occurred over a period of four years. These exhibits show nothing about "intent" or when "lowest-cost available power" was available and/or was needed, or anything else other than to record on a summarized basis the energy transfers or transactions that AEP says it completed over this long time period. The Division has taken a summary of the megawatt hours that AEP says it actually transferred and has translated this into a "factual" finding that these transfers represent—by their very existence--what the systems needed at the time. They occurred, therefore they, and only they, were needed. By this logic, anything that AEP does proves that it doing exactly what needs to be done. The word "tautology" comes to mind.

It should also be noted that AEP makes no such claim for Exhibits 6 and 7.

Far more troubling is the Division's wholehearted ideological argument supporting "the market" as constituting a huge, single region that negates the need for single, integrated systems. Div.Brf., pp. 41-44. What the Division fails to say is that "the market" to which it refers is only a market for *wholesale* power and energy (generation), while PUHCA also covers public-utility systems for retail generation, wholesale and retail transmission, and retail electric distribution, as

well as natural gas distribution. (The Division genuinely appears not to understand that high voltage transmission lines constitute classic monopoly, bottleneck facilities whose regulation even FERC has acknowledged cannot be simply left to "the market." At p. 42 of its Brief, the Division refers to "a single market for the purchase, sale and *transmission* of electricity…." (Emphasis supplied.) This notion of the "market" assigning "monopoly rents" for bottleneck transmission is not only well ahead of even FERC's market ideology, but it also conflicts directly with AEP's claim that FERC Order No. 888 makes transmission utilities "common carriers.")

The transmission and distribution public utility systems that must serve retail load (*e.g.*, electricity consumers) are the concern of the statute, and Section Eleven requires that they must be economically operated as a "single interconnected and coordinated system confined within a single region… ." Even if the public utility systems were only distribution systems, without transmission, the statute would still require that they be economically "operated as a single interconnected and coordinated system…." Moreover, the region must not be so large as to impair the advantages of localized management, …and effective regulation, as well as efficient operations. Only the States can regulate retail electricity rates, and "the market" is not a retail market.

Of even more critical importance, "the market" that the Division refers to is not a regulated body but a *deregulated* one. FERC has allowed utilities to simply negotiate rates among themselves, on the theory that they don't have "market power." Even where flagrant manipulation of "the market" is uncovered,

such as that by traders such as Enron (exempted from PUHCA by "no-action" letters from the Division) or by gas marketers such as AEP's (see Attachments to last briefs), there is no relief for consumers, according to FERC, because of the "filed rate doctrine." The Supreme Court last week asked the Solicitor General to prepare a memorandum on whether the Court should take a case that challenges the idea that FERC, having decided to do without filed rates, can then allow the filed rate doctrine to keep retail consumers from pursuing other avenues of compensation for blatantly manipulated rates.* There are also various challenges in the Courts of Appeal contending that FERC has abdicated its statutory duties by simply leaving the determination of wholesale rates to "the market."

The Division's reliance on FERC's *deregulation* policies is therefore particularly contrary to its duties to enforce a regulatory statute.

Basically, the Division, without even bothering to argue that AEP's or its own arguments that read the "region" requirement out of the statute, could possibly satisfy the purposes of PUHCA to limit concentration of economic control over utilities, is simply arguing instead that PUHCA is outdated and can be ignored with impunity. The Court of Appeals has said (as the Division, of course, well knows) that repeal of PUHCA or of Section Eleven is a decision for the Congress of the United States to make, not the Commission and certainly not its staff. 276 F.3d at 618.

Moreover, if the Congress repeals PUHCA, as the Division has recommended (with certain meaningless rights given to States and FERC to review the "books and records" of multinational corporations like Enron or

ExxonMobil), the Division offers no recommendations or views as to how "effective regulation" of retail electric rates could be effectuated for a widespread, multistate holding company such as AEP. Moreover, without PUHCA, a multinational oil company—they have a lot of spare cash on their hands just now, according to reports—could acquire AEP. How that would advance "effective regulation" is outside the considerations offered by the Division.

Since Chairman Donaldson has properly assured Congressmen Dingell and Markey that this Commission will enforce PUHCA as long as the Commission has the responsibility to do so, the position of the Division here is both legally untenable and disrespectful to the Commission itself.

A. AEP HAS FAILED TO CARRY ITS BURDEN OF PROVING THAT ITS TWO WIDELY SEPARATED SETS OF UTILITY COMPANIES ARE "INTERCONNECTED" OR "OPERATED AS A SINGLE INTERCONNECTED AND COORDINATED SYSTEM" FOR PURPOSES OF PUHCA.

1. AEP claims that its Exhibits 6 and 7 describe substantial amounts of power that have been transferred in each direction over the contract path since the merger. This statement is false for two reasons.

First, AEP's Exhibits 6 and 7 do *not* show transfers of power (megawatts), but rather transfers of energy (megawatt hours) as shown on the exhibits themselves and as discussed in Public Citizen's Initial Brief (p.23). Energy transfers can be spread over a large period of time and may represent very small amounts of power. And, as discussed in PC's Initial Brief, pp. 25-6, the amounts of *energy* transfers shown—particularly from East to West—are tiny not only in relation to the size of AEP's systems, but by any objective standard.

AEP's own witness, Mr. Johnson, described what a reliable electric system would have to do, including backing up power plants that go down, and

otherwise providing for the various utilities in the system to ensure their ability to reliably meet retail load (customers.) Tr. Pp.96-100. AEP has completely failed to show a capability to transfer the hundreds to thousands of megawatts that would be necessary for such system integration, or even to back up a single outage of its largest plant in either East or West. Tr. P. 99. AEP claims that it can rely on RTOs and other systems for this back-up, but that does not constitute a showing that AEP's own systems are operated as a "single interconnected and coordinated system." AEP has made a showing, at best, that it owns *two* vertically-integrated utility systems that occasionally exchange megawatt hours of energy, but that otherwise do not provide back-up or coordination to each other.

Second, AEP has submitted no evidence showing that the Contract Path itself, as opposed to other parallel paths, has been used in any of these transfers of energy. The exhibits simply tally the final transfers of megawatt hours; they do not show how the power actually traveled. As Mr. Johnson agreed (T.p 96), power flows according to the laws of physics, not according to the agreements of lawyers. As the Supreme Court discussed in the *Florida Power* case back in 1972,* the actual tracking of power can be done, but it has not been done in this case. This means that we do not know what other electric systems outside the Contract Path may have been affected, even by these small amounts of electric energy transfers, and whether those systems may be willing to allow such impacts in the future for the larger transfers that will be required. Although AEP may be part of an RTO that charges for such impacts, the other parallel systems still may refuse to transmit energy when it interferes with their own transmission needs.

2. AEP has failed to make a *prima facie* case that its Combined System can be operated, economically or otherwise, as an "interconnected and coordinated" single electric utility system "under normal conditions."

At best, AEP has shown that it can make sporadic transfers between its two groups of utilities, of electric energy, not power, of a type non-integrated systems have made with each other for decades. This is a "factual showing" that is so broad that if it were accepted here, it would render completely meaningless the definition of an "integrated" system under Section 11 of PUHCA, contrary to law and to the Court of Appeals decision remanding this case.

Even setting aside the fact that AEP has shown only a few sporadic exchanges of energy, not power, over a four-year period, and has not shown whether they actually traveled over the Contract Path, the best that AEP can say is that its contract path "has been used consistently" for two-way transfers. The statute does not require "consistent" use; it requires that "under normal conditions," an integrated system can be economically "operated as a single interconnected and coordinated single system." AEP has made no attempt to show that the circumstances under which megawatt hours were transferred in Exhibits 6 and 7 constitute "normal conditions" of public utility system operation. Public Citizen submits that the requirement that operations be "interconnected and coordinated" under "normal conditions" is not satisfied by sporadic use of a contract path during one hour or so, at some point during a month, for various months over a number of years. The idea that these sporadic exchanges, perhaps whenever transmission was briefly available, could be considered to constitute

operation of an "integrated and coordinated" system under "normal conditions" is totally unsupported by the evidence.

As well, there is nothing to distinguish this "operation" from that of all *non-integrated* electric utility systems that exchange electric energy (usually more than this) with neighboring utility systems whenever it is economically worthwhile. There is nothing in AEP's definition of "interconnection" that would distinguish it from a simple description of how non-integrated electric utility systems operate monthly, exchanging occasional energy supplies. As such, this definition would interpret the "single integrated system" referred to in Section 11 of PUHCA out of existence. If a "single system economically operated in an interconnected and coordinated" manner is defined to be identical to the operations of multiple, non-integrated systems, then the "single" definition is rendered meaningless. Neither the statute (see section 1(c)) nor the court of appeals decision permits this.

1. AEP is wrong in saying that "RTOs have expanded the economically effective distance of contract paths…"

Contrary to AEP's brief at p. 17, the capability of transmission systems was exactly the same before FERC's recent changes in policy as afterwards. Transmission depends on the laws of physics, not on institutional arrangements. The fact that long-distance contracts may be somewhat easier to negotiate under RTOs does not expand the "state of the art" of utility operations. Moreover, Mr. Casazza's unchallenged testimony stated that RTOs are actually more complicated, more expensive and less effective than long-standing tight power

pools at making such arrangements, and he cites two recent studies that concur with this assessment. [PC Exhibit 1, pp. 4-7.]

2. AEP is wrong is claiming that "No testimony was presented to rebut AEP's showing that the use of contract paths to interconnect distant utilities is now appropriate *given changes in industry conditions*." Mr. Casazza's testimony contradicted this alleged "showing."

Contrary to AEP's statements ("Brf. P. 18) that no testimony rebutted AEP's showing" that use of contract paths to interconnect distant utilities is appropriate given changes in industry conditions, Mr. Casazza testified that the "physical natures of the systems have not changed," but the problems in their operation have *increased* because of the large increase in the number of participants and the increased complexity of transactions" in RTOs. PC Ex.p. 7, lines 9-13.

When asked if RTOs and ISOs allow utility systems to operate economically at large distances, such as from Ohio to Texas, Mr. Casazza testified:

"Such operation as a single integrated utility system would have very serious consequences for all intervening and surrounding systems, seriously affecting both costs and reliability. The availability of sufficient capacity at all times to handle all the requirements of the integration of two large systems would involve a great many lines, would depend on many uncertainties involving many parties, such as when transmission and generation facilities would be returned to service, would be questionable."

Mr. Casazza also testified that long distance transfers would also greatly increase transmission losses in the intervening systems, significantly harming the systems and consumers they supply." Pp.,7 -8, AEP's own witnesses testified that the "contract path convention" is just that, a convention, and that the electricity flows where the laws of physics take it. T. pp.96 .

In summary, what Mr. Casazza's testimony shows is that the longer the distance, the greater the likelihood of consequences to intervening systems that could cause such systems to refuse to allow the transmission, even where contract damages must be paid. Thus, if anything, the "changes in industry conditions" relied on by AEP to support its case (Brf., p. 18) have made it even *more difficult*, not less, to rely on mere contract path conventions, must less on the possibility of finding non-firm transmission at the right moment (PC Ex. 1, p.8) or on a hope and a prayer that "open access" transmission will provide the answer.

AEP may not have liked Mr. Casazza's testimony, but it cannot plausibly deny that this testimony exists when it has, after all, been placed in the record. See., P.C. Ex.1.

3. AEP has Misled the Commission in claiming that the ability to transmit electricity over very long distances is a new phenomenon.

AEP claims at p. 18 of its Brief that "it would be unsound from a technological standpoint" for this Commission to rely "Notions of 'distance' that may have been relevant decades ago. AEP would have the Commission believe that it is only in recent years that technology "now permits transfers over very long distances, AEP Exhibit No.2 at 13." However, the following description of the nation's interconnected electric grid was given by the United States Supreme Court in a decision thirty years ago:

> "The electric systems of [respondent] and all other interconnected systems are essentially alike as to electrical, electromagnetic and electromechanical characteristics. Because they are alike, it is possible to have ***presently existing interconnected operations*** on a very large scale, ***extending from the Rocky Mountains to the Atlantic Ocean and from the Canadian to the Mexican border."*** *Federal Power Commission v. Florida Power & Light Company,* 404 U.S. 453 (1972) at 647.

AEP has simply misled the Commission in claiming that the possibility of electrical interconnections from border to border, mountains to coast is something new. As Mr. Casazza's unchallenged testimony stated (P.C. at pp. 6-7):

> Over the years I have been involved in reviews of the cost and benefits of interconnection and coordination among power systems throughout the country. The results of these reviews have been published. I have also been involved in the National Power Surveys made by the Federal Government, particularly the 1964 survey that led to the national transmission grid we currently have and very large savings….**The physical natures of the systems have not changed and their basic technical functioning and capabilities have not changed."**

As discussed in PC's Initial Brief, pp.29-30, high voltage transmission lines have been in operation since the 1950s, the highest voltage since the early 1960s.

4. In any event, PUHCA is not concerned with "distance" solely as regards to electric transmission, as AEP suggests; PUHCA is concerned with "distance" in preserving the advantages of localized management, efficient operation, and the effectiveness of regulation."

In the context of an "interconnected and coordinated" system, distance has to do with whether the different parts of the system can be economically and efficiently backed up by the other interconnected parts of the system. This cannot be achieved where the distance is great, and the means of interconnection uncertain because it is only by contract path or by non-firm transmission, or worst of all, by the fact that open access transmission is a theoretical possibility.

AEP states that the "fundamental objective of Order 888 and the FERC OATT is to achieve "comparability" between the rights enjoyed by the owners of transmission facilities and the rights acquired by third parties to such facilities." Brf. p.17. Similarly, the "fundamental objective" of Section Eleven of PUHCA,

the heart of the Act, is to break up huge utility holding companies in many, widely separated states and prevent them from reforming, but the objectives of both these rules and this statute are not met unless and until they are successfully enforced. Various exhibits have shown that FERC's Order No. 888 has not yet achieved its goals. However, even if successfully enforced, FERC's Order No. 888 does not guarantee anyone that transmission will be available at just the moment it is required. And that is exactly the kind of guaranteed transmission that an integrated system needs to back up "interconnected and coordinated" utility assets.

AEP's brief, at p.11, n.6, brushes off Mr. Casazza's testimony that non-firm transmission cannot be used to integrate two parts of a public utility system (as providing "no support or basis for his conclusion" either as a general matter or as to AEP. To the contrary, Mr. Casazza testified:

> Integration requires that adequate transmission be available at all times as loads vary, equipment is removed for maintenance, and generator dispatch changes in the two parts of the system. An integrated system should have the ability to handle the outages of large generator units, to share spinning and standby generator reserves, and to dispatch generation economically within the system. This requires that dependable firm transmission capacity be available to allow integrated operation at all times. Non-firm transmission could not have the necessary capacity when needed.
> Public Citizen Exhibit No. 1 at 8)

I will not belabor here our American Airlines analogy—that you can't rely on your competitor airlines' having space available on their planes just when you need it to run a reliable system—but note that elsewhere Mr. Baker admitted that with non-firm transmission, a system could simply throw you off their lines. AEP Ex. 5, p. 14:

> "The sale of non-firm service allows the transmission provider to protect reliability both in the long term, because non-firm service can be sold knowing that it can be recalled to protect reliability,…."

This of course means that the *purchase* of non-firm service would hardly provide the required reliable service to AEP's millions of distribution customers in either of its widely separated sets of utility companies.

And, since no one cross-examined Mr. Casazza, his opinion remains unchallenged on this record. The Division asked AEP's hired *economist*, David Harrison, whether Mr. Casazza's testimony changed his own, and Mr. Harrison said "No." But Mr. Harrison is an economist, whose "energy" work appears to deal with utility emissions, and Mr. Casazza is a long-time public utility executive and engineer. There is nothing in the record to support a view that Mr. Harrison's views on engineering matters are "expert."

7. FERC's Order No. 888 is Based on Sections of the Federal Power Act that Date to 1935 and Are in No Way Inconsistent with Full Enforcement of the Geographic Provisions of PUHCA.

As Ms. Hargis testified (PC Exhibit 2, p. 10), and as the order itself clearly states (Attachment A), the legal basis for FERC's Order No. 888 is parts of the Federal Power Act—sections 205 and 206—that date to 1935, when the statute was enacted as a lesser part of the Public Utility Act of 1935, of which the first and major part was PUHCA. Moreover, the legal theory behind Order No. 888, as FERC acknowledged (and Ms. Hargis testified), was recognized by the D.C. Circuit in 1978. There is thus nothing "revolutionary" about the provision of "open access" transmission, nor anything about it that is inconsistent with full enforcement of PUHCA. It provides the opportunity to use another system's

transmission, but the transmission capacity still has to be available at the time and place needed.

In any event, even full open access transmission would no more eliminate monopoly behavior in electric generation and distribution services than does allowing all trucks onto the highways eliminate antitrust concerns where products are provided.

8. The Commission Itself Was In Error in Finding that Electric Restructuring Eliminates the Requirement that Remaining Vertically Integrated Systems Must be Integrated and Coordinated.

Perhaps misled by the Division's lack of understanding of utility systems, the Commission has apparently found that the definition of an integrated public utility system does not require that it be a vertically integrated system, and that because of restructuring in the electric industry, all systems are no longer vertically integrated. Public System has no disagreement with this finding, but notes that it does not result from the recent "restructuring" of the industry and questions its relevance to this case, where AEP's systems ARE vertically integrated.

Many, even most, municipal systems and many electric cooperatives have long been T&D (transmission and distribution) systems only and have always bought their power at wholesale from others. Nonetheless, to the extent that cooperatives may own transmission and distribution systems, these systems must be coordinated if they are to comprise a "single" system.

As far as Public Citizen can tell, AEP's two groups of utility companies are each vertically integrated systems. As such, they must together be operated

"as a single interconnected and coordinated system…"under Section Eleven. To the extent that AEP *also* owns a wolesale generation public-utility "system," then that must also be "integrated and coordinated." However, that would indicate that AEP owns at least *two* systems: one for generation at wholesale, and one vertically-integrated system for providing electricity to retail customers. Even if the latter are only vertically integrated transmission and distribution systems (or even just distribution systems), the statute requires that they must be operated "as a *single* interconnected and coordinated system" or AEP's application to acquire the CSW utility companies must be denied.

The Commission cannot have it both ways. The statute does not call for integration of "part" of a system or coordination of "part" of a system; it says that the utility assets must be operated, and economically, "as a single interconnected and coordinated system." Either AEP has an "integrated" system that is "operated as a *single* interconnected and coordinated system" or it has two or more interconnected and coordinated systems, one for wholesale (and retail?) generation, and another for transmission and distribution of retail electricity. In the latter case, AEP could not meet the "single integrated system" requirement of Section Eleven because it owns and controls more than one public utility system.

9. AEP erred when it said the Court of Appeals "left undisturbed" the Commission's finding that the combined system "may be economically operated as a single interconnected and coordinated system."

AEP's brief claims (p. 21) that the Court "left undisturbed" the Commission's finding that the combined system may be "economically operated as a single interconnected and coordinated system." This is clearly legal error,

since the Court vacated the entire decision and thus left no part of it "undisturbed." In addition, since the Court found that the Commission had not explained how AEP's two groups of utilities are "interconnected," it could not as a matter of law have found that these two groups "operated as a single *interconnected* and coordinated system," whether economically or not, since the character of the "interconnection" was not known.

The Division, in its Preliminary Statement, tries to eliminate the second use in the statute of the term "interconnected," but it cannot do so. Public Citizen believes that the Commission has erred as a matter of law in dismissing the "single interconnected and coordinated system" requirement of the statute by mere reference to a "restructured" utility industry.* Nor can the Court of Appeals be said to have approved this Commission finding since it clearly found that the "interconnected" requirement had not been explained (so that the "operated as a single interconnected and coordinated system" could also not have been explained), and because the Court vacated the Commission's decision. Even if the Court had accepted the Commission's finding in this regard, it would have been legal error. Where there is ambiguity, the clear language of a statute prevails.

II. AEP HAS FAILED TO CARRY ITS BURDEN OF SHOWING THAT ITS WIDELY SEPARATED UTILITY COMPANIES OPERATE WITHIN A SINGLE AREA OR REGION

AEP apparently believes that this case will never return to a Court of Appeals because the "single region" arguments it is making would get the

Commission's appellate division laughed out of court. Actually, on the second time around, the Court is not likely to be laughing.

Take the argument that the Eastern Interconnection is a "single machine" and thus a "single region" for purposes of PUHCA. Even assuming it weren't based on totally false representations that the ability of utilities to interconnect widely is something new (see, above, p. 14 , *Florida Power & Light, supra,* etc.), consider the logic for a moment. If the Eastern Interconnection were accepted as a single system, it would allow all utilities east of the Rockies (except the ERCOT region of Texas) to be owned by one holding company. Since the purposes of PUHCA are to break up huge holding companies, prevent their recurrence, and limit concentration of control over public utilities, this is a joke as an argument.

Even worse, this argument would cause AEP to lose this case, because the CSW companies are not even in the Eastern Interconnection, meaning that, at a minimum, AEP/CSW operates in *two* regions of the country.

That's okay, says AEP; the Commission has already accepted the CSW companies as all being in one region, so the fact that this argument is both nonsensical and totally antithetical to the purposes of the statute will be acceptable to the Commission.

The fact that AEP has even written down this argument in a brief is highly, highly insulting to this court's intelligence and to the intelligence and character of this Commission. Both the Presiding Administrative Law Judge and the Commission should treat it accordingly.

1. AEP has misled the Commission in claiming that the possibility of electrical interconnections from coast to coast is something new, since the U.S. Supreme Court noted this capability thirty years ago.

AEP's brief, p.20, footnote 17, quotes the U.S. Supreme Court saying that the Federal Power Act should be interpreted in light of current industry conditions and realities. *New York v. FERC, 535 U.S. at 23 (2002).* As discussed above (p 14), the U.S. Supreme Court in 1972, thirty years before *New York,* found that utilities were presently interconnected: "from the Rocky Mountains to the Atlantic Ocean, and from the Canadian Border to the Mexican border." *Florida Power & Light v. FERC,* 404 U. S. 453 at 647 (1972).

2. However, even if AEP's statements about new changes in technology were true, relying on such changes to determine a "region" of the country is misplaced under the purposes of PUHCA, as the Court of Appeals noted.

AEP"s brief, at 20, says Section Eleven must be interpreted in light of the "'state of the art'" of technology." That's not true; the term "technology" does NOT appear in the statute, and besides, as the Court of Appeals has already pointed out, considering technology alone could allow the whole country to be considered one region and that's clearly not what section 11 has in mind. 276 F.2d at 618: "Technological improvements may well justify ever-expanding electric utilities, but PUHCA confines such utilities to a "single" area or region." The purpose of PUHCA is to prevent the over concentration of economic control of public utilities, regardless of where technology make such concentration of control easier to accomplish.

Indeed, consideration of the "state of the art" of public utility systems need not mean that the more advanced the "art," the bigger the systems should be.

The very description of what can constitutes a "single" system quoted by the Court of Appeals and by AEP in its Brief at pp.22-23 indicates that in *Middle West Corp.,**, the Commission only allowed the large area of the holding company there to be considered in a "single" region *because* of the un-advanced "state of the art" in the area. The Commission found:

> *In well-settled and economically developed territory such a finding might be impossible*….The rendition of satisfactory service in arid and sparsely-settled areas frequently requires the stretching of lines over long distances to connect small population centers with generating facilities strategically placed near suitable water and fuel supplies.
> 276 F.3d at 617; PUHCA Release No. 4846, 15 S.E.C. 309, 336 (Jan. 24, 1944.) (Emphasis supplied.)

In other words, it appears that it was the *lack* of development in the area that allowed the Commission to find that such a large area was acceptable under PUHCA. Since, as AEP points out in its brief (at pp. 22-23):

> The Commission has not addressed the single area or region requirement with any specificity in four decades. The decisions I this area cited by the Court were made in the mid-1940s (*Middle Western* decisions) and the mid-1960s (*American Natural Gas)*. The electric industry and the national economy have changed dramatically since that time.

What this means under the logic of *Middle Wester*, above, clearly appears to be that most areas of the country are now "well-settled and economically developed" so that the large "region" allowed in the *Middle Western* case would no longer be allowed.

According to the Division's own Report to Congress in 1995 at p. 3, text and note 8, in describing the events that led to PUHCA:

> "The **vast size of public-utility holding companies** and **the increased concentration of control over the nation's electric power** aroused concern at the federal and state government levels.*

> *During the period 1929-1932, for example, 16 major holding company systems produced 76.4 percent of the electric energy generated by privately-owned utility plants, and **three systems produced 44.5 percent of the electric output.**

AEP's legal theory in this case claims that the entire Eastern Interconnection is "one big machine," and therefore one big "region" under PUHCA. Brief, p. 25. Under this theory, if even just each of three major Interconnections were said to be a "region," there could be only three electric systems producing all of the electric output of the country and this would be consistent with Section Eleven of PUHCA, according to AEP. Not satisfied with that, AEP also throws in the ERCOT region of Texas, so we could have just TWO holding companies that own 100 percent of the electric generation in the country, one in East and West of the Rockies, and Section Eleven of PUHCA is satisfied. And, of course, as counsel for NRECA/APPA showed on cross-examination [T.p.], the Western Interconnection has also been joined to the Eastern Interconnection when Excel's acquisition of Public Service Company of Colorado (Minnesota and Colorado) was approved. The end result: a legal interpretation under which Section Eleven is satisfied even when only ONE public-utility holding company owns all the electric (and gas) public utilities in the United States, except Hawaii.

And, under other statutory interpretations made by this Commission (see, Foreign Utility Companies), it need *not* be an *American* holding company. So much for localized management and effective regulation.

If this argument is accepted as interpreting all the provisions of the Act so as to fulfill its purposes--limiting concentration of control over electric utilities and making effective state regulation possible--then the Act has become a joke.

The Courts of Appeals, however, are more likely to find that it is the purported enforcement of Section Eleven that has become the joke, were the Presiding Administrative Law Judge or the Commission to accept such an interpretation, contrary to the Court's explicit finding that the geographic restrictions of Section Eleven may not be read out of the Act 276 F.3d at 618.

3 "Regions" for Purposes of PUHCA do Not Depend on Trade in Other Products; Even if they Did, This Commission and Others Have Chosen Very Different "Regions" for Regulating Trade.

AEP's witness argues that products that can be carried on boats, trains and trucks for purposes of trade establish that the widely spread states in which AEP operates are a "single area or region." Exhibit 1. The Division happily concurs. Div.Brief at p. 15. This argument, of course, proves far too much, that the entire globe is a "single area or region" in our global economy. As noted above, electricity is not a "product" but a "service," one that cannot be stored and that cannot be moved by boat, train, truck or gas pipeline.

Comparing electric systems to general "trade" of products is therefore not at all relevant to determining a "region" under PUHCA. Even if "trade" were relevant to electric systems, a look at how U.S. federal agencies that must regulate such "trade" organize their own "regions" gives a lie to AEP's arguments as to what constitutes a "trade" region. The Federal Trade Commission (FTC) has seven regional offices, according to its website. See, Attachment B. This is far too few regions for PUHCA purposes, since the statute is designed to eliminate concentration of economic control over public utilities. (See, Division Report, p.3.) Even so, AEP's utility companies would fall within **four** of these seven

regions. Perhaps David Harrison knows something about trade in the U.S. that the Federal Trade Commission doesn't.

Or take securities regulation. The United States Securities and Exchange Commission, according to its website (Attachment C), has only *five* regional offices. Again, this would be far too few for PUHCA regions, but even so, AEP's utility companies would fall within no fewer than **four** of these five SEC regions: Virginia and West Virginia in the Northeast Region; Louisiana and Tennessee in the Southeast Region; Kentucky, Indiana, Michigan and Ohio in the Midwest Region, and Arkansas, Oklahoma and Texas in the Central Region. One wouldn't think that securities regulation would require as tight integration and localization of management as utility systems do, but apparently this Commission finds that the widespread reach of the AEP system would cause it to be subject to regulation in four separate "regions" of the country.

And, finally, we could look at the corporate decision of AEP itself to divide its utilities into **seven** regional utilities. Attachment D. This seems a wise choice, because as one of its region's managers said, "What constitutes an issue in Indiana is not necessarily the same in Texas." (See Attachment __ to Public Citizen's.) Indeed, this kind of regional division appears to be the kind that the enactors and enforcers of PUHCA had in mind. (See PC Exhibit , "Scatterization and Integration….").

5. Aside from the Embarrassment of Citing its Own Staff's Report for Legal and Policy Support, The Commission Should be Aware that that the Division's 1995 Report is Out of Date and Misguided Since it Assumed that "The Conduct that Gave Rise to the Act Has All But Disappeared," but was Followed by Enron, WorldCom, Tyco, Health South, Etc., Etc., Etc.

As Public Citizen lobbies for support of PUHCA, the most frequent comment we get is: "How can Congress even consider repealing PUHCA after Enron?" Public Citizen has yet to find an intelligent but non-cynical answer to that question.

The industry will, as usual, argue that PUHCA had nothing to do with the Enron catastrophe. But Enron was exempted from PUHCA under several different exemptions granted or allowed by this Commission or its staff, not the least of which was a 1994 "no-action" letter from the Division allowing Enron as a power marketer to be exempt from the Holding Company Act. 1994 WL 6730, Enron Power Marketing, Inc., Publicly Available January 5, 1994. The charm of "no-action" letters for their recipients is that they cannot be appealed because they clearly state on their face that they don't represent any legal determination. Indeed, the Commission can disavow them at any time. This is unlikely to be of comfort to the electricity consumers in California, the West, the Mid-West and elsewhere who have been fleeced by energy traders known to have manipulated markets—many of them bragging while they did so—only to be told that no refunds or other remedy is available under the statutes enacted to protect them. And, of course, the traders and power marketers who were more discrete and haven't gotten caught yet may be legion.

PUHCA was designed to prevent accounting frauds and manipulation by utility holding companies, just like those Enron employed. PUHCA was designed to prevent the use of affiliates and subsidiaries to defraud consumers and investors, just like those Enron employed. PUHCA was designed to protect

utilities so that they wouldn't wind up on the auction block for sale to investment bankers, just as Enron's Portland General Electric has. PUHCA was designed to stop utility holding companies from investing ratepayer monies in non-regulated businesses; because of PUHCA, Enron was actually limited in this regard, and, moreover, could only own one utility and enjoy a "single-state" exemption from PUHCA

The "conduct that gave rise to the Act" has NOT "all but disappeared." The business section of the newspapers reads like a police blotter many days, tracking indictments, trials, bankruptcies. If PUHCA is repealed, either administratively by this Commission or legally by the Congress, those with pensions, 401K plans, mutual fund investments, etc. may live to see what their parents and grandparents experienced in the 1930s when the utility holding companies collapsed: 53 bankruptcies and 23 bank loan defaults and a serious deepening of the Great Depression. The crash of Enron will then be seen as what it may have become: just an appetizer.

Conclusion

For the reasons set forth above and in the Initial Briefs of Public Citizen and NRECA/APPA, Public Citizen respectfully requests that the Presiding Administrative Law Judge find that AEP has failed to carry its burden of proving that its two widespread groups of utility companies, East and West, are "interconnected" or "operated as a single interconnected and coordinated system" or that they are so operated in a "single region or area" for the purposes of the Public Utility Holding Company Act of 1935.

Respectfully submitted,

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Attachments
Service List

Attachment A

thority, then discuss and respond to the legal arguments raised by the commenters.

1. Bases for Legal Authority

a. Undue Discrimination/Anticompetitive Effects

In upholding the Commission's order requiring non-discriminatory open access in the natural gas industry, the court in Associated Gas Distributors v. FERC stated that the Natural Gas Act "fairly bristles" with concern for undue discrimination.[193] The same is true of the FPA. The Commission has a mandate under sections 205 and 206 of the FPA to ensure that, with respect to any transmission in interstate commerce or any sale of electric energy for resale in interstate commerce by a public utility, no person is subject to any undue prejudice or disadvantage. We must determine whether any rule, regulation, practice or contract affecting rates for such transmission or sale for resale is unduly discriminatory or preferential, and must prevent those contracts and practices that do not meet this standard. As discussed below, AGD demonstrates that our remedial power is very broad and includes the ability to order industry-wide non-discriminatory open access[194] as a remedy for undue discrimination. The AGD court reached this decision even in the face of prior cases that acknowledged that Congress did not mandate common carriage or explicitly empower the Commission to order direct access for either gas transporters or electric utilities. Moreover, the Commission's power under the FPA "clearly carries with it the responsibility to consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations pursuant to (FPA) sections 202 and 203, and under like directives contained in sections 205, 206, and 207."[195]

Therefore, based on the mandates of sections 205 and 206 of the FPA and the case law interpreting the Commission's authority over transmission in interstate commerce, we conclude that we have ample legal authority—indeed, a responsibility—under section 206 of the FPA to order the filing of non-discriminatory open access transmission tariffs if we find such order necessary as a remedy for undue discrimination or anticompetitive effects.[196] We discuss below the primary court decisions that touch on our wheeling authority under sections 205 and 206.

The Commission's authority to order access as a remedy for undue discrimination under the Natural Gas Act (NGA) was upheld and discussed in detail in AGD. In AGD, the court upheld in relevant part the Commission's Order No. 436.[197] That order found the prevailing natural gas company practices to be "unduly discriminatory" within the meaning of section 5 of the NGA (the parallel to section 206 of the FPA) and held that if pipelines wanted blanket certification for their transportation services, they must commit to transport gas for others on a non-discriminatory basis; in other words, they must provide non-discriminatory open access.

In upholding the Commission's authority to require open access, the court first noted that the opponents' arguments against such authority must proceed "uphill." The statute contains no language forbidding the Commission to impose common carrier status on pipelines, let alone forbidding the Commission to impose "a specific duty that happens to be a typical or even core component of such status." The court found that the legisla-

[193] *Associated Gas Distributors v. FERC*, 824 F.2d 981, 998 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) (AGD).

[194] We use the term "open access" to refer to a public utility's obligation to put a tariff on file offering service to eligible customers. Access is not open to all. Specifically, the tariff is not an offer to serve retail customers if state law does not permit retail wheeling.

[195] *Gulf States Utilities Company v. FPC*, 411 U.S. 747, 758-59 (1973).

[196] In most situations, discrimination that precludes transmission access or gives inferior access will have at least potential anticompetitive effects because it limits access to generation markets and thereby limits competition in generation. Similarly, it is probable that any transmission provision that has anticompetitive effects would also be found to be unduly discriminatory or preferential because the anticompetitive provision would most likely favor the transmission owner *vis-a-vis* others.

[197] Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, *FERC Statutes and Regulations* ¶ 30,665 (1985).

tive history cited by the opponents came nowhere near overcoming this statutory silence. Rather, the legislative history supported only the proposition that Congress itself declined to impose common carrier status.[198] Emphasizing Congress' deep concern with undue discrimination, the court found that the Commission had ample authority to "stamp out" such discrimination:

The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress in 1906 and 1914 and 1935 and 1938 itself refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.[199]

The AGD court found that court decisions under the FPA did not support the view that the Commission's authority to "stamp out" undue discrimination is hamstrung by an inability to require nondiscriminatory open access as a remedy. These decisions are discussed below.

One of the earliest cases on wheeling is Otter Tail Power Company v. United States (Otter Tail).[200] In that case, the Supreme Court rejected the argument that the District Court, in a civil antitrust suit, could not order wheeling because to do so would conflict with the FPC's purported wheeling authority.[201] The Court explained that Congress had decided not to impose a common carrier obligation on the electric power industry and noted that the Commission was not at that time expressly granted power to order wheeling.[202] In effect, it concluded that because Congress did not include common carrier provisions in the FPA, the Commission must not have any express authority to order wheeling that would preclude the District Court from imposing a wheeling remedy. Nowhere, however, did the Court say that the Commission lacked authority under section 206 to remedy undue discrimination. Indeed, that was simply not a matter before the Court or of any consequence to its decision.

In the FPA, while Congress elected not to impose common carrier status on the electric power industry, it tempered that determination by explicitly providing the Commission with the authority to eradicate undue discrimination—one of the goals of common carriage regulation.[203] By providing this broad authority to the Commission, it assured itself that in preserving "the voluntary action of the utilities" it was not allowing this voluntary action to be unfettered. It would be far-reaching indeed to conclude that Otter Tail, which was a civil antitrust suit that raised issues entirely unrelated to our authority under section 206, is an impediment to our achieving one of the primary goals of the FPA—eradicating undue discrimination in transmission in interstate commerce in the electric power industry.

In Richmond Power & Light Company v. FERC (Richmond),[204] the FPC, in reaction to the 1973 oil embargo, was attempting to reduce dependence on oil. The FPC requested that utilities with excess capacity wheel power to the New England Power Pool (NEPOOL). In response, several suppliers and transmission owners filed rate schedules with the FPC that provided for voluntary wheeling. Richmond Power & Light Company (Richmond) objected to these filings, claiming that they were unreasonable because they did not guarantee transmission access. The FPC refused to compel the utilities to wheel Richmond's power, stating that it did not have the authority to order a public utility to act as a common carrier.

The D.C. Circuit upheld the Commission. It acknowledged that Richmond's argument was persuasive in some re-

[198] *AGD, supra*, 824 F.2d at p. 997.

[199] *Id.* at p. 998.

[200] 410 U.S. 366 (1974).

[201] 410 U.S. at pp. 375-76.

[202] *Id.* at pp. 374-76.

[203] *See AGD*, 824 F.2d at p. 998.

[204] 574 F.2d 610 (D.C. Cir. 1978).

spects, but stated that any conditions the Commission might impose could not contravene the FPA. The court examined the legislative history of the FPA and stated that "[i]f Congress had intended that utilities could inadvertently bootstrap themselves into common-carrier status by filing rates for voluntary service, it would not have bothered to reject mandatory wheeling * * *."[205]

However, the D.C. Circuit in no way indicated that the Commission was foreclosed from ordering transmission as a remedy for undue discrimination. Richmond also had argued that the alleged refusal of the American Electric Power Company (AEP) and its affiliate, Indiana & Michigan Electric Company (Indiana), to wheel Richmond's excess energy was unlawful discrimination because AEP and Indiana wheeled higher-priced electricity from other AEP affiliates. The court acknowledged that Richmond's claim of unlawful discrimination was theoretically valid, but found that Richmond had failed to prove its case. It noted that if Richmond had argued that the rates were unjustifiably discriminatory, or that Indiana's failure to use its transmission capability fully or to purchase less expensive electricity for wheeling resulted in unnecessarily high rates, a different case would be before the court.[206] The case thus does not in any way limit the Commission's authority to remedy undue discrimination.

In Central Iowa Power Cooperative v. FERC,[207] the FPC[208] reviewed the terms of the Mid-Continent Area Power Pool (MAPP) Agreement under its section 205 and 206 authority. The agreement contained two membership limitations. First, the agreement established two classes of membership, with one class being entitled to more privileges than the other. Second, the agreement excluded non-generating distribution systems from pool services. The FPC found the first limitation on membership—the two-class system—to be unduly discriminatory and not reasonably related to MAPP's objectives. The FPC conditioned approval of the agreement under section 206 on the removal of the unduly discriminatory provision. The FPC found that the second limitation, the exclusion of non-generating distribution systems, was not anticompetitive and did not render the agreement inconsistent with the public interest.

On appeal, the D.C. Circuit affirmed the FPC's decision. The court found that the FPC did have authority to order changes in the scope of the MAPP agreement, if the agreement was unjust, unreasonable, unduly discriminatory or preferential under section 206 of the FPA. The court stated:

> The Commission had authority, * * * under section 206 of the Act, * * * to order changes in the limited scope of the Agreement, including the addition of pool services, if, in the absence of such modifications, the Agreement presented "any rule, regulation, practice or contract (that was) unjust, unreasonable, unduly discriminatory or preferential."[209] However, the court agreed with the FPC's conclusion that the limited scope of MAPP was not unjust, unreasonable, or unduly discriminatory. The court recognized that a pool was not invalid under section 206 merely because a more comprehensive arrangement was possible.

The D.C. Circuit upheld the Commission's refusal to eliminate the second limitation on membership by ordering MAPP participants to wheel to non-generating electric systems.[210] However, neither the Commission nor the court was presented with the argument that wheeling was necessary as a remedy for undue discrimination.

In Florida Power & Light Company v. FERC (Florida),[211] the Commission ordered Florida Power & Light Company (FP&L) to file a tariff setting forth FP&L's policy relating to the availability

[205] *Id.* at p. 620.

[206] *Id.* p. 623, nn.53 and 57.

[207] 606 F.2d 1156 (D.C. Cir. 1979).

[208] While *Central Iowa* was pending, certain of the functions of the FPC were transferred to the FERC under the DOE Organization Act. Accordingly, the FERC was substituted for the FPC as the respondent in the case.

[209] 606 F.2d at p. 1168.

[210] *Id.* at p. 1169; *see also Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978).

[211] 660 F.2d 668 (5th Cir. 1981), *cert. denied sub nom. Fort Pierce Utilities Authority v. FERC*, 459 U.S. 1156 (1983).

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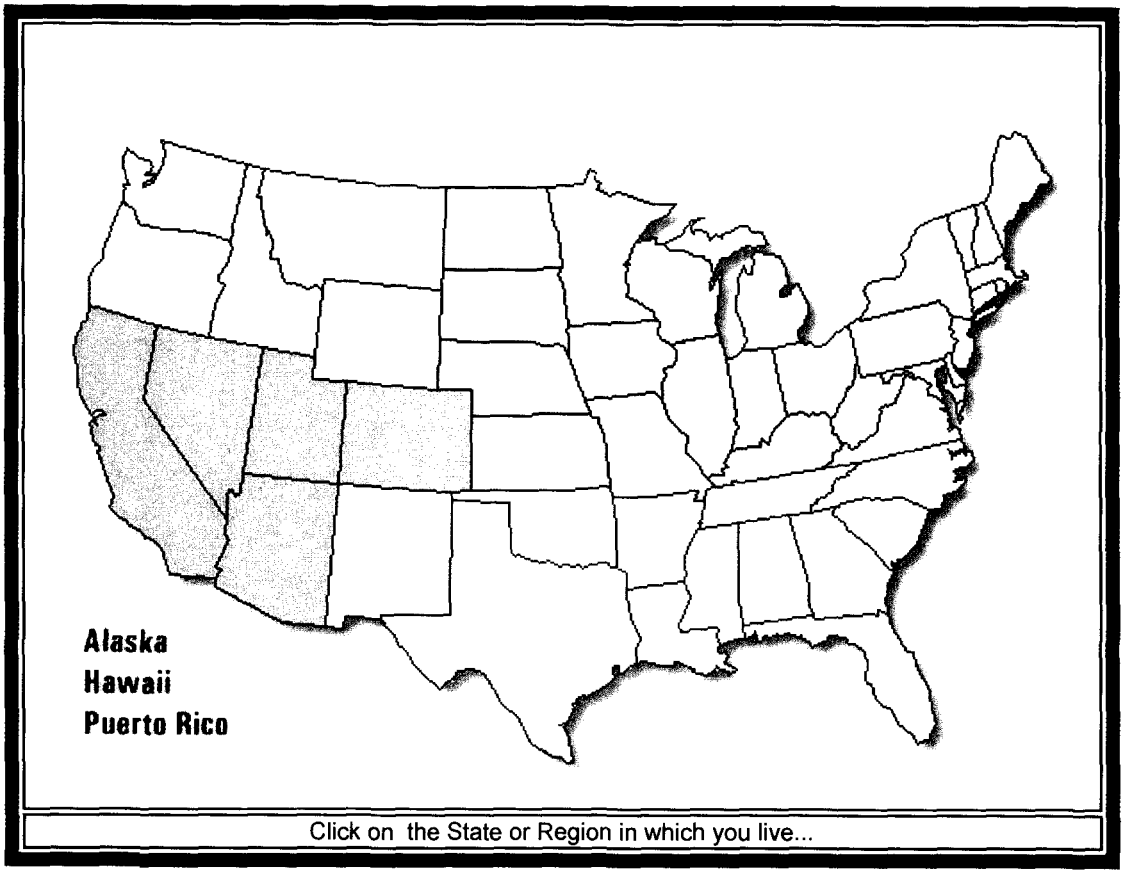

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