UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Administrative Proceeding No. 3-11616

In the Matter Of	)
American Electric Power Company, Inc.	)

DIVISION OF INVESTMENT MANAGEMENT'S PETITION FOR REVIEW

The Division of Investment Management submits this Petition for Review in accordance with Rule 410(a) of the Commission's Rules of Practice, seeking Commission review of an administrative law judge's Initial Decision in the above captioned proceeding. The specific findings and conclusions to which the Division takes exception are outlined and discussed below. While we believe that Commission review of the Initial Decision is mandatory pursuant to Rule 411(b)(1), we also believe this is clearly a matter that, in the terms of Rule 411(b)(2)(C), involves a "decision of law or policy that is important" and that the Commission should grant this petition for review, irrespective of whether Commission review is characterized as mandatory or discretionary.

Introductory Statement

This matter arises from an application-declaration filed jointly by the American Electric Power Company, Inc. ("AEP") and the Central and South West Corporation ("CSW") in 1999 (the "Application"). The Application sought the Commission's authorization pursuant to the Public Utility Holding Company Act of 1935 ("Act") for AEP to acquire CSW. At the time, AEP was a registered public utility holding company with utility operations in Ohio, Michigan, Indiana, Kentucky, Tennessee, Virginia and West Virginia; CSW was a registered public utility holding company with utility operations in Arkansas, Louisiana, Oklahoma and Texas.

Among other things, AEP and CSW argued that the utility system that would result from the acquisition (the "combined system") would be integrated, as required by sections 10 and 11 of the Act. More specifically, they argued that, in the terms of section 2(a)(29)(A), the combined system (i) would be "physically interconnected or capable of interconnection," (ii) would be capable of economic operation "as a single interconnected and coordinated system," (iii) would be "confined to a single area or region," and (iv) would be "not ... so large as to impair ... the advantages of localized management, efficient operation, and the effectiveness of regulation."

The Commission ultimately agreed, and on June 14, 2000, it issued an order ("Order") approving the merger and denying the hearing requests it had received with respect to the

Application.[1] The companies merged shortly thereafter. The National Rural Electric Cooperative Association ("NRECA") and the American Public Power Association ("APPA") sought review of the Commission's decision in the D.C. Circuit. The D.C. Circuit affirmed many of the findings and conclusions in the Commission's original order, but vacated the Order and remanded the matter to the Commission, seeking further explanation for the Commission's conclusions that the combined system met the interconnection and the single area or region requirements.[2]

In response, the Commission set the matter down for an evidentiary hearing.[3] The Notice and Order for a Hearing ("Notice and Order") in this matter directed that a hearing be held:

> for the purpose of determining whether the AEP and CSW systems are interconnected, through a unidirectional contract path or otherwise, and whether the resulting combined system operates in a single area or region, and hence satisfy the requirements of sections 10(c)(1) and 11(b)(1) of the [Public Utility Holding Company] Act....

Administrative Law Judge Robert Mahony conducted the evidentiary hearing on January 10, 2005, held oral argument on March 7, 2005, and issued an initial decision ("Initial Decision") on May 3, 2005. The Division of Investment Management ("Division" or "we") argued, as did AEP, that the record evidence supported a finding that both of these statutory requirements were met. APPA and NRECA, joined by intervenor Public Citizen, argued that neither requirement was met.

In his Initial Decision, the Law Judge concluded that, based on the record evidence, the combined system satisfied the interconnection requirement.[4] The Division agrees with this conclusion.

However, the Initial Decision also held that the single area or region requirement is not met. The Division disagrees with this conclusion.

As discussed below, the Law Judge's interpretation of the single area or region requirement as one that is analyzed predominately based on a so-called "geographic test"[5] is both reductionist and incorrect. Due to this misinterpretation, after noting that parts of

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1 Holding Co. Act Release No. 27186 (June 14, 2000).

2 NRECA v. SEC, 276 F.3d 609 (D.C. Cir. 2002).

3 Holding Co. Act Release No. 27886 (Aug. 30, 2004).

4 Initial Decision at 12.

5 *Id.* at 21.

the AEP system are "located in separate, disparate regions of the national map,"[6] the Law Judge concluded that the single area or region requirement was not satisfied.[7]

Based on his determination that AEP had not satisfied the "single area or region" requirement, the Law Judge denied the Application.[8] The Division also disagrees with this conclusion.

Exceptions to Findings and Conclusions of the Initial Decision

1. In concluding that the combined system is not "confined to a single area or region," the Initial Decision erroneously misinterpreted and elevated the importance of a so-called "geographic test," contrary to Commission precedent.

The Initial Decision applies a "geographic test," utilizing a simplistic conception of "geography," in concluding that the combined system is not "confined to a single area or region."[9] The Law Judge's interpretation of "geographic" is not in accord with the statutory purpose, the Commission's prior decisions analyzing the single area or region requirement, and the evidence in this proceeding.

Specifically, relying heavily on *CP&L Energy, Inc.*,[10] the Initial Decision concludes that a utility system must be confined within a traditionally designated national region in order to pass muster under the Act, reducing Commission precedent into a "geographic test."[11] Yet, nothing in the Act, and nothing in the Commission's extensive precedent supports the Initial Decision's crabbed reading of the single area or region test. An appropriate resolution to this matter must be based on an understanding of all the important cases that the Commission has decided in this area – many of which approve utility systems extending well beyond "traditional designations of national regions" – and not a carefully selected case or two.[12]

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6 *Id.* at 23.

7 The Law Judge also equated "single region" with "homogeneity" and, apparently on that basis, rejected the substantial unrebutted evidence in the record submitted by AEP that the combined system fell within a functional region. *Id.* at 22.

8 *Id.*

9 *See Id.* at 21 (finding that the Commission predominantly relies on "geographic and traditional designations of national regions" in analyzing the "single area or region" requirement).

10 54 S.E.C. 996 (2000).

11 Initial Decision at 21.

12 In this regard, the Initial Decision also fails to account for the Commission's authority to refine or redefine its interpretation of the Act's requirements in order to further the Act's purposes and goals. Although the legislative history, statutory language, and Commission precedent support a finding that the combined system is within a single area or region, the Initial Decision erred in that it did not recognize that the Commission may, in the alternative, change

While we agree that the single area or region requirement is intended to define the geographic expanse within which a particular holding company system should be confined, the manner in which this "geographic" limitation is interpreted and administered has been and must be informed by an underlying understanding of the purpose and intent of the Act in order to give any meaningful content to the term. After all, "a continent" and "an island" are both geographic terms, but neither is obviously helpful in interpreting the "single area or region" requirement. While an approach that does little more than apply convenient geographic labels may be sufficient for certain cases – systems, such as that described in *CP&L Energy*, that involve a small number of states very close together – that approach does little to give meaningful content to the term "single area or region" as that term operates in the Act, and hence does not provide a substantive basis for deciding cases involving utility systems that cover a broader area. In cases such as this one, one must give more content to the term than simply applying an arbitrary geographic label to the system's footprint.

Moreover, throughout its administration of the Act, the Commission has held that numerous large utility systems satisfy the "single area or region" requirement. For example, as early as 1945, in *American Gas & Electric Co.*,[13] the Commission approved a system that included utility operations in Virginia, Tennessee, Michigan and Ohio. In recent years, the Commission has continued to approve fairly large systems. Most notably, in the case of *New Century Energies Inc.*,[14] the Commission found a system that included utility operations in Colorado, Wyoming, Texas, New Mexico, Oklahoma, Kansas, Minnesota, North Dakota, South Dakota, Michigan and Wisconsin satisfied the requirement. Likewise, in *Exelon*,[15] the Commission found that a utility system with utility operations in the Chicago and Philadelphia areas satisfied the statutory requirement.

The Initial Decision erred in failing to derive from these key decisions the Commission's flexible approach to the single area or region requirement which examines numerous factors on a case by case basis. The ultimate goal of the analysis is to further the purpose and intent of the Act. To further that goal, the Commission's decisions often consider an array of factors (including, specifically, economic and population factors) in analyzing the single area or region requirement. The approach is not rigidly prescribed by assumed concepts of geography; nor

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the way it analyzes merging systems to determine if they are an integrated public-utility system and within a single area or region. As the D.C. Circuit Court order pointed out, the Commission may do so as along as it can support its policy change. The Commission should not be bound by past decisions if, as a result of changes in the industry, other approaches to interpreting statutory requirements would better achieve the Act's goals.

13 21 S.E.C. 575 (Dec. 26, 1945) and related order, Holding Co. Act Release No. 5591 (Feb. 8, 1945).

14 Holding Co. Act Release Nos. 26748 (Aug. 1, 1997) and 27212 (Aug. 16, 2000).

15 Holding Co. Act Release No. 272904 (Oct. 28, 2004).

does the Commission's analysis assign preeminence to or require that deference be given to any one factor (geography) in the matrix.

2. In concluding that the combined system is not "confined to a single area or region," the Initial Decision erroneously fails to consider economic factors.

The Initial Decision erroneously held that using "broad-based economic considerations" to assist it in interpreting the single area or region requirement "would be contrary to the Commission's traditional method of analysis."[16] As we argue below, however, many key Commission decisions discussing the "single area or region requirement" use a variety of economic factors, particularly factors that impact how efficiently a given utility system can be operated, to delineate the appropriate size of the region to which a utility holding company system should be combined.[17]

There is a reason why Commission decisions have historically looked to economic factors in defining an appropriate area or region. Given the emphasis placed by the Act in general and the legislative history – and particularly by the text and history of section 2(a)(29)(A) – on the ability of a utility system to be operated economically and efficiently, it makes sense to interpret the "single area or region" requirement in terms of an area that can be served effectively and efficiently by an integrated, coordinated utility system.[18]

Similarly, section 10(c)(2) of the Act directs the Commission not to approve a merger unless it "will serve the public interest by tending towards the economic and efficient development of an integrated public-utility system." This language demonstrates that Congress was not concerned with the size and scope of a utility system *per se*, but rather was concerned about those factors that would limit the ability of a

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16 Initial Decision at 21.

17 *See Post-Hearing Brief and Statement of Position of the Division of Investment Management (Corrected)*, Administrative Proceeding File No. 3-11616 (Feb. 15, 2005) at 33-40, discussing relevant cases.

18 The integration requirement of section 2(a)(29)(A) under the Act concerns both geographic and economic considerations. "[S]ection 10, as enforced through section 9 of the Act, was 'designed to give the Commission supervision over the future development of utility holding systems so that the systems will be subjected to the limitation of geographic and economic integration laid down in section 11,'" quoting S. Rep. No. 621, 74th Cong., 1st Sess. 32 (1935) (Report of Sen. Wheeler from the Committee on Interstate Commerce). *See also* sections 1, 2(a)(29)(A), 10(c) and, by reference, 11(b)(1) of the Act.

system to operate economically and efficiently. Given the importance of the integration requirement, which includes the "single area or region" requirement, in achieving this goal, the nature of the area or region within which the system was found was clearly one of those factors. Therefore, to determine what the appropriate area or region is, one must look to economic factors – as well as any other relevant factors – that define the area within which a utility system can be operated economically and efficiently. By rejecting out-of-hand "broad-based economic considerations," the Initial Decision fails to engage in an essential part of the analysis necessary to the single area or region requirement.

The use of economic factors in administering the "single area or region" requirement has permitted flexible application of the Act in a manner that both has a consistent underlying interpretive principle and is responsive to changes in the way that the electric industry itself operates. The Initial Decision's express refusal to consider economic factors is, therefore, both inconsistent with Commission precedent and contrary to good policy.

3. In concluding that the combined system is not "confined to a single area or region," the Initial Decision erroneously failed to credit substantial evidence in the record concerning the market for electricity which supported the existence of the factor.

AEP's witnesses, as well as other evidence in the record, describe an electricity market today that is much different than the market when the Act was created and for much of the time since then. The testimony and evidence provide substantial and unrebutted evidence of the presence of various forces at work in the contemporary electricity industry, including Congress, the FERC, and the States, which have been and are promoting competition in the U.S. retail and wholesale electricity markets. Since at least 1990 and the enactment of the Energy Policy Act, these forces have been transforming what was until recently a monopolistic market. The Applicants undertook the merger, in part, to position themselves for efficient participation in the emerging competitive market. *See, e.g.*, U-1 at 10-11 (noting, among other things, that the "Combined Company will operate more efficiently and be better equipped to keep rates low in an increasingly competitive electric utility industry"). This evidence, while clearly relevant to demonstrating that the combined system operates within a single region for the purchase, sale and transmission of electricity, was largely ignored in the Initial Decision.[19] In addition, the Initial Decision fails to consider testimony describing a number of homogenous and functional regions that broadly overlay the combined system and underscore the conclusion that it is within a single area or region. The testimony of AEP's witnesses and the other evidence submitted by AEP was virtually unrebutted. Thus, the Initial Decision should have credited this testimony and used it as a central part of its analysis of whether the combined system is in a single area or region.

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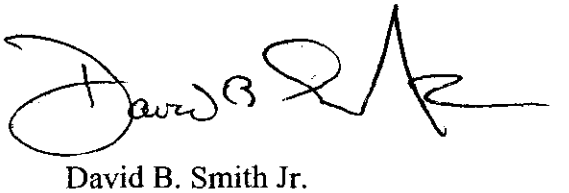
[19] *See* Initial Decision at 21-22 (brief discussion of the effect of regional transmission organizations).

4. The Initial Decision erroneously denied the Application.

The Initial Decision's denial of the Application is erroneous because of an incorrect analysis of "single area or region requirement" and a failure to consider substantial unrebutted evidence in the record supporting a finding that the combined system operates in a single area or region.[20]

Respectfully submitted,



David B. Smith Jr.
Catherine A. Fisher
M. Cathey Baker
Catherine P. Black
Andrew P. Mosier, Jr.
Ronald E. Alper
Arthur S. Lowry

Attorneys for Division
of Investment Management
U.S. Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549

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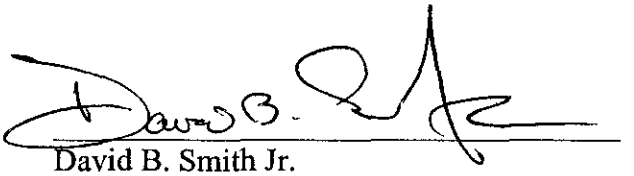
[20] Moreover, the Law Judge may have erroneously exceeded the scope of the Notice and Order for Hearing by ruling on the Application itself. The Commission's Order for Hearing identifies only the two issues for determination by the Law Judge (interconnection and single area or region), seemingly reserving the determination of the Application itself to the Commission:

> We believe further supplementation of the record is required for us to address the issues identified in the Court's opinion and to determine on remand whether the combined AEP and CSW systems meet the relevant standards of sections 10(c)(1) and 11(b)(1) of the Act and in particular, what specific facts about AEP's and CSW's electric systems and the geographic area covered by their systems are relevant to the required determinations.

Notice and Order for Hearing; *see also* Rule of Procedure 200(b) ("content of order").

CERTIFICATE OF SERVICE

I certify that on May 24, 2005, I caused true and correct copies of the foregoing document, captioned The Division of Investment Management's Petition For Review, to be sent by Federal Express, overnight delivery, to counsel at the addresses indicated below.



David B. Smith Jr.
Associate Director
Division of Investment Management
Securities and Exchange Commission

John B. Keane, Esquire
Jeffrey D. Cross, Esquire
Edward J. Brady, Esquire
Thomas G. Berkemeyer, Esquire
Kevin F. Duffy, Esquire
William E. Johnson, Esquire
American Electric Power Co., Inc.
1 Riverside Plaza
Columbus, OH 43215

J.A. Bouknight, Jr., Esquire
David B. Raskin, Esquire
Steptoe & Johnson LLP
13330 Connecticut Ave., N.W.
Washington, D.C. 20036

Lynn N. Hargis, Esquire
Tyson Slocum
Public Citizen, Inc.
215 Pennsylvania Ave., N.W.
Washington, D.C. 20003

Randolph Lee Elliott, Esquire
William Walker Benz, Esquire
Miller, Balis & O'Neil, P.C.

Wallace F. Tillman, General Counsel
Richard Meyer
National Rural Electric Cooperative Association
4301 Wilson Boulevard
Arlington, VA 22203

Richard Geltman
Susan Kelly, Esquire
Allan Mosher
American Public Power Association
2301 M Street N.W.
Washington, D.C. 20037

1140 19th St., N.W.
Suite 700
Washington, D.C. 20036