UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

AMERICAN ELECTRIC POWER COMPANY, INC. — Administrative Proceeding File No. 3-11616

BRIEF IN SUPPORT OF CROSS-PETITION FOR REVIEW OF THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION AND THE AMERICAN PUBLIC POWER ASSOCIATION

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INTRODUCTION

In accordance with Rule 450 of the Commission's Rules of Practice,[1] and the Commission's amended order of June 7, 2005, the National Rural Electric Cooperative Association (NRECA) and the American Public Power Association (APPA) submit their brief in support of their cross-petition for review of the Initial Decision in this proceeding.[2] By order of September 17, 2004, NRECA and APPA are parties to this proceeding under Rule 210(b)(1)(i) of the Commission's Rules of Practice.[3]

NRECA and APPA petition for review of the Initial Decision's conclusion[4] that the proposed merger of American Electric Power Company, Inc., (AEP) and Central and South West Corporation (CSW) satisfies the "interconnection" requirement of section 2(a)(29)(A) of the Public Utility Holding Company Act of 1935 (PUHCA or the Act).[5] That section provides that the utility assets of a "single integrated public-utility system" must be "physically interconnected or capable of physical interconnection." Although the Initial Decision correctly denies AEP's application to acquire CSW because the merged utility system would not be "confined in its operations to a single area or region" as required by section 2(a)(29)(A),[6] AEP's application should also be denied for failure to satisfy the Act's interconnection requirement.

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[1] 17 C.F.R. § 201.450 (2004).

[2] Initial Decision Release No. 283 (filed May 3, 2005).

[3] 17 C.F.R. § 201.210(b)(1)(i) (2004).

[4] Initial Decision at 6-12.

[5] 15 U.S.C. § 79b(a)(29)(A) (2000).

[6] Initial Decision at 12-23.

STATEMENT OF THE CASE

I. Nature of the Proceeding on Remand and the Initial Decision

This matter is before the Commission on remand from the United States Court of Appeals for the District of Columbia Circuit. On January 18, 2002, the court vacated the Commission's order of June 14, 2000, which had approved under sections 9 and 10 of the Act[7] AEP's acquisition of CSW's common stock and the interests in the assets and businesses of CSW's subsidiary public-utility companies.[8]

Section 9(a)(1) of the Act makes it unlawful for a registered holding company "to acquire, directly or indirectly, any securities or utility assets or any other interest in any business"[9] absent Commission approval under section 10 of the Act.[10] Section 10(c)(1) requires that the Commission not approve an acquisition that "would be detrimental to the carrying out of the provisions of section 11."[11] Thus, section 10(c)(1) prohibits approval of an acquisition by a registered holding company that would not be permissible under section 11(b)(1) of the Act.[12] Under section 11(b)(1), the utility properties of a registered holding company are limited, with exceptions irrelevant here, to a "single integrated public-utility system."[13] Section 2(a)(29)(A) defines an "integrated public-utility system," as applied to electric utility companies, to mean:

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[7] 15 U.S.C. §§ 79i & 79j (2000).

[8] *Nat. Rural Elec. Coop. Ass'n v. SEC*, 276 F.3d 609 (D.C. Cir. 2002), *vacating and remanding Am. Elec. Power Co.*, 54 SEC 697, 2000 SEC LEXIS 1227 (2000).

[9] 15 U.S.C. § 79i(a)(1) (2000).

[10] 15 U.S.C. § 79j (2000).

[11] 15 U.S.C. § 79j(c)(1) (2000).

[12] *See New Century Energies, Inc.*, 1997 WL 429612 (S.E.C. Aug. 1, 1997); *Elec. Bond & Share Co.*, 33 S.E.C. 21, 31 (1952).

[13] 15 U.S.C. § 79k(b)(1) (2000).

> a system consisting of one or more units of generating plants and/or transmission lines and/or distribution facilities, 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 operations, and the effectiveness of regulation . . . . [[14]]

The Commission has interpreted this language to impose four requirements for a proposed acquisition: (1) the interconnection requirement—the post-acquisition utility assets must be "physically interconnected of capable of physical interconnection"; (2) the coordination requirement—the assets must be capable of economic operation "as a single interconnected and coordinated system"; (3) the region requirement—the system must be confined to a "single area or region"; and (4) the localization requirement—the system must not be "so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operations, and the effectiveness of regulation . . . ."[15]

The court of appeals vacated and remanded the Commission's June 14, 2000, order in the instant proceeding because the Commission had "failed to explain its conclusions regarding the interconnection requirement" and had "failed to justify its finding that the proposed acquisition will satisfy the single-area-or-region requirement."[16]

As to the former, the court found that "the Commission's acceptance of a unidirectional contract path to 'interconnect' AEP and CSW" was unexplained.[17] The court stated that

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[14] 15 U.S.C. § 79b(a)(29)(A).

[15] *See Nat. Rural Elec. Coop. Ass'n v. SEC*, 276 F.3d at 611; *Elec. Energy, Inc.*, 38 S.E.C. 658, 668 (1958).

[16] 276 F.3d at 610.

[17] *Id.* at 615.

"interconnection" of utility assets "seems, on its face, to require two-way transfers of power."[18] The court noted that "PUHCA itself requires that the interconnected system be one 'which under the normal conditions may be economically operated as a single interconnected and coordinated' whole."[19] Thus, the court concluded that "[a]bsent some explanation from the Commission, we cannot understand how a system restricted to unidirectional flow of power from one half to the other can be operated in such a manner."[20]

The court also found that "the Commission failed to follow its own prior reasoning regarding interconnection of distant utilities," where the Commission "has clearly indicated that a contract path cannot alone integrate distant utilities."[21] These statements were "sufficiently explicit to obligate the Commission to provide some rationale for its current contrary view."[22]

As to the single-area-or-region requirement, the court found that the Commission "failed to make any evidentiary findings on the issue" and "erroneously concluded that a proposed acquisition that satisfies PUHCA's other requirements also meets the statute's region requirement."[23]

Neither AEP nor the Commission sought further review. Because the court of appeals vacated the Commission's order of June 14, 2000, AEP has not to date obtained the requisite Commission approval for its proposed acquisition of CSW—an uncertain state of affairs that has persisted for over three years.

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[18] *Id.*

[19] *Id.* (quoting 15 U.S.C. § 79b(a)(29)(A)).

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.* at 617.

By order of August 30, 2004, the Commission instituted the hearing in this proceeding. It found that "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 and CSW's electric systems and the geographic area covered by their systems are relevant to the required determinations."[24]

Pursuant to this order, a hearing was held on January 10, 2005, and the administrative law judge filed the Initial Decision on May 3, 2005. The Initial Decision concludes that the combined AEP/CSW system meets PUHCA's interconnection requirement but not the single-area-or-region requirement. Accordingly, the Initial Decision denies AEP's application for approval to acquire CSW.

AEP and the Division of Investment Management filed petitions for review of the Initial Decision. NRECA and APPA jointly filed a cross-petition for review.

II. Statement of Facts

A. Interconnection Requirement

The court of appeals found that "AEP and CSW's systems are neither contiguous nor physically interconnected—indeed, at their closest point, they are separated by hundreds of miles."[25] AEP is not planning to build a physical transmission line connecting AEP and CSW.[26] The company presented testimony by Mr. J. Craig Baker (AEP Exhibit No. 5) to attempt to show that its acquisition of CSW satisfies the Act's interconnection requirement.

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[24] *Am. Elec. Pwr. Co.*, Release No. 35-27886 at 3 (S.E.C. Aug. 30, 2004).

[25] 276 F.3d at 612.

[26] Tr. 59:22-24 (testimony of Paul Johnson).

Mr. Baker testified that to meet the interconnection requirement, AEP had acquired a "Contract Path"—a contract for transmission service—with an unaffiliated transmission-owning utility, Ameren.[27] Under this contract, Ameren provided transmission service to AEP pursuant to an open-access transmission tariff (OATT) that is substantially the same as the *pro forma* OATT promulgated by the Federal Energy Regulatory Commission (FERC) in Order No. 888 and modified by later FERC orders.[28]

Under the Ameren contract and Ameren's OATT, AEP reserved a "contract path" for 250 megawatts (MW) of firm point-to-point transmission service in one direction, from east to west, across Ameren's transmission facilities.[29] The eastern terminus of the Ameren Contract Path is the Breed-Casey interconnection between AEP and Ameren near the Illinois/Indiana border.[30] The western terminus of the Ameren Contract Path is the interconnection between Ameren and the "MOKANOK" transmission line in eastern Missouri.[31]

Although Ameren is directly interconnected with AEP (what AEP today calls the AEP East Zone), Ameren is not directly interconnected with CSW (or what AEP now calls the AEP West Zone). To complete the rest of its contractual transmission path to CSW, AEP has used the

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[27] AEP Exh. 5, pp. 10:20-21, 19:16 (Direct Testimony of J. Craig Baker).

[28] *Id.* at 9:13-15; 10:20 to 14:21; 15:14-16. *See* Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274, FERC Stats. & Regs. ¶ 31,048, *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002) ("Order No. 888").

[29] AEP Exh. 5, pp. 10:21-22; 15:14-16 (Baker).

[30] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, No. 070-09381, Form U-1, Amend. No. 5 at 34-35 (May 24, 2000).

[31] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, No. 070-09381, Form U-1, Amend. No. 5 at 34-35.

MOKANOK line. This transmission line runs from an interconnection with Ameren in eastern Missouri, westward through Missouri, through southeastern Kansas, and into northeastern Oklahoma to an interconnection with a CSW subsidiary, Public Service Company of Oklahoma (PSO). Four utilities—Ameren, PSO, Western Resources, Inc., and Associated Electric Cooperative, Inc.—own and operate the four discrete segments of the MOKANOK line. PSO owns the southernmost leg of the MOKANOK line, the portion terminating in northeastern Oklahoma. These four utilities are parties to an agreement that allows each party to use a portion of the transmission capacity along the entire length of the line. This agreement did not provide PSO with rights to 250 MW of firm transmission service over the MOKANOK line. So AEP was required to enter into additional contracts with other MOKANOK owners (Western Resources and Ameren) to acquire additional contractual rights to a total of 250 MW of firm transmission service over the MOKANOK line.[32]

Under FERC's OATT, firm transmission service is an assured contractual right to transmission service, equal in priority to the transmission provider's use of its facilities to provide service to its "native load" customers, and thus can be curtailed only in emergency circumstances.[33] Mr. Baker testified that AEP has not reserved a contract path for any firm point-to-point transmission service from west to east under its transmission contract with Ameren or Ameren's OATT.[34] When AEP decided to acquire CSW, it decided not to reserve a contract path for firm transmission service from west to east over the Ameren system, because the cost of reserving such a firm path, in AEP management's opinion, would have been

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[32] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, No. 070-09381, Form U-1, Amend. No. 5 at 34-35.

[33] FERC *pro forma* OATT, sec. 13.6 (Appendix B to Order No. 888-A).

[34] AEP Exh. 5, p. 10:20 to 11:11; 16:1-7 (Baker).

imprudent and unnecessary.[35] Mr. Baker stated that the cost of such a firm path would have been $3 million per year.[36]

AEP decided that it would instead rely on non-firm point-to-point transmission service for any west-to-east transmission service over the Ameren system.[37] Under FERC's OATT, non-firm transmission service is subject to curtailment or interruption by the transmitting utility.[38] Non-firm transmission service is available only from excess transmission capacity that is not needed to provide firm transmission service or service to the transmission provider's "native load" customers.[39] Short-term non-firm service—the kind that AEP indicates it uses for west-to-east transfers—can be displaced by longer-term non-firm service.[40] The transmission provider has no obligation to plan or build transmission facilities to provide non-firm transmission service.[41] Accordingly, Mr. Baker testified that non-firm point-to-point transmission service is lower in priority than firm point-to-point transmission service and can be curtailed by the transmission provider before higher-priority service.[42] He noted that Ameren is not required to plan its transmission system to provide non-firm point-to-point transmission service for AEP, and Mr. Baker provided no indication that Ameren was doing so.[43] To the contrary, Ameren can

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[35] *Id.* at 10:20 to 11:11 & 16:1-4.

[36] *Id.* at 16:2-3.

[37] *Id.* at 15:19-23; *Am. Elec. Power Co.*, Form U-1, Amend. No. 5 at 35.

[38] See FERC *pro forma* OATT, sec. 14.7 (Appendix B to Order No. 888-A).

[39] FERC *pro forma* OATT, sec. 14.2 (Appendix B to Order No. 888-A).

[40] *Id.* An existing short-term non-firm customer has the right to match the term and price of competing offers to take service. *Id.*

[41] FERC *pro forma* OATT, sec. 14.5 (Appendix B to Order No. 888-A).

[42] *Id.* at 13:14-15.

[43] *Id.* at 13:15-16.

sell non-firm service to AEP knowing that it can recall the transmission capacity and curtail non-firm service to AEP to protect reliability.[44]

Mr. Baker testified that in order for AEP to obtain firm point-to-point transmission service from west to east over the Ameren system, AEP must make a new request for transmission service from Ameren, which Ameren must evaluate to determine if capacity is available to provide such service.[45]

Mr. Baker testified that for the two-year period beginning January 1, 2005, monthly non-firm transmission service for west-to-east transfers of energy across the Ameren system is not available in five of the 24 months.[46] Moreover, AEP cannot determine whether daily or hourly non-firm transmission service for west-to-east transfers of energy across the Ameren system will be available for the next two years, because the data do not exist.[47]

Mr. Baker testified that during the years 2001, 2002, 2003, and the first nine months of 2004 (through September), the amount of energy transferred by AEP across the Ameren system from west to east has averaged approximately 4000 megawatt-hours (MWh) per month, or about 2% of the amount of energy transferred by AEP across the Ameren system from east to west.[48]

Mr. Baker testified that FERC has approved the PJM Interconnection (PJM), the Southwest Power Pool (SPP), and the Midwest Independent System Operator (MISO) as "Regional Transmission Organizations" (RTOs).[49] An RTO offers transmission service over the

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[44] *Id.* at 14:15-18.

[45] *Id.* at 10:20 to 11:11; 12:5-10.

[46] *Id.* at 17:12-13.

[47] *Id.* at 17:17-18.

[48] *Id.* at 16:19-21.

[49] *Id.* at 18:6-8; 29:14-23.

combined transmission facilities of a number of utilities that are its transmission-owning members.[50] The utility companies in AEP's East Zone operate in the PJM RTO.[51] Part of AEP's West Zone companies operate in the SPP RTO.[52] But other AEP West Zone companies operate in the Electric Reliability Council of Texas (ERCOT), a separate portion of the nation's electric grid that is regulated by the state of Texas rather than by FERC.[53] Moreover, the PJM and SPP RTOs are not contiguous; they are separated by a third RTO, the MISO.[54] Ameren is a member of the MISO.[55]

At the time of the hearing, AEP's transmission contract with Ameren was set to expire in June 2005 and AEP had not requested firm transmission service east-to-west across the Ameren system for periods after June 2005.[56] Mr. Baker testified that because Ameren had joined the MISO, AEP would have to pay transmission charges under the MISO OATT to reserve new firm transmission service over Ameren's facilities beginning in June 2005, and as a result, a 250-MW firm point-to-point transmission reservation for east-to-west service over the Ameren system would now cost about $9 million per year, rather than the $3 million it cost under the Ameren OATT.[57]

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[50] *Id.* at 18:10-11.

[51] *Id.* at 29:14-15.

[52] *Id.* at 29:15-16.

[53] *Id.* at 21:22-23.

[54] *Id.* at 19:21-23.

[55] *Id.* at 19:7.

[56] *Id.* at 19:16-21.

[57] *Id.* at 16:4.

Mr. Baker also testified that after June 2005, transfers of power from AEP East to AEP West over the 250-MW contract path will require AEP to obtain transmission service from the SPP as well as the MISO. [58] He stated that AEP has not pursued alternative paths for transferring power between AEP East and AEP West, because they are likely to be more expensive than transmission service over MISO and SPP.[59]

On June 1, 2001, Associated Cooperative notified the other owners of the MOKANOK line that it would terminate the MOKANOK agreement as of June 1, 2005.[60] Accordingly, both AEP and Ameren have filed with the FERC notices of cancellation of the MOKANOK agreement (as required by FERC regulation) and requested that the termination be effective June 1, 2005. In their FERC filings, AEP and Ameren noted that Associated Cooperative had provided notice of termination in 2001 in accordance with the advance-notice requirement of the MOKANOK agreement.[61] The record in this proceeding does not disclose whether AEP has made alternative arrangements for firm transmission service from Ameren to CSW to replace service under the now-terminated MOKANOK agreement. The Initial Decision notes that AEP had stated that if the MOKANOK agreement is terminated, the needed Contract Path between AEP and CSW would be over 400 miles long.[62]

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[58] *Id.* 19:16-18.

[59] *Id.* at 20:1-9.

[60] *Am. Elec. Power Serv. Corp.*, FERC Docket No. ER05-1072 (filed June 3, 2005) (notice of cancellation as agent for PSO); *Union Elec. Co. d/b/a Ameren UE*, FERC Docket No. ER05-1012 (filed May 24, 2005) (notice of cancellation). The Commission can take official notice of the filing of these notices of termination of the MOKANOK agreement pursuant to Commission Rule 323.

[61] *See* n. 54. The applicable FERC regulation is at 18 C.F.R. § 35.14 (2004). Associated Cooperative is not regulated by FERC and did not have to file such a notice with FERC.

[62] Initial Decision at 8 n.11.

B. Initial Decision

The Initial Decision states that the court of appeals held that PUHCA "requires a two-way transfer of electric power" but the court "believed the Contract Path was unidirectional and only transferred electric power from east to west."[63] The Initial Decision, however, finds that "the Contract Path meets [the interconnection] requirement because it has always been bi-directional."[64]

As evidence of this, the Initial Decision cites Mr. Baker's testimony that "AEP has the right to redirect the Contract Path 'at any time at no additional charge.'"[65] The Initial Decision notes, however, that Mr. Baker also testified that "AEP made a business decision not to reserve long-term firm transmission capability from west to east because the cost of such an endeavor would be 'an unnecessary and imprudent expenditure of money.'"[66] The Initial Decision finds that Mr. Baker's testimony "establishes that ninety-eight percent of the electric power transfers along the Contract Path is from east to west, and two percent of the flow is from west to east."[67] Although "the west-to-east flow is clearly a miniscule amount in relation to the east-to-west flow," the Initial Decision concludes that "the Act does not require any particular amount to establish the bi-directional nature of the Contract Path."[68]

The Initial Decision concludes that if AEP does not renew the Contract Path with Ameren in June 2005, AEP "may also purchase non-firm transmission services from Ameren whenever

[63] *Id.* at 11.

[64] *Id.*

[65] *Id.* (quoting Baker, AEP Exh. 5, at 10).

[66] *Id.* (quoting Baker, AEP Exh. 5, at 15-16).

[67] *Id.* (citing Baker, AEP Exh. 5, at 10-11).

[68] *Id.* at 12.

necessary or arrange alternative contract paths with other electric providers to meet the requirement of a bi-directional electric power flow for establishing interconnection."[69] If AEP fails to find a way of integrating the companies, the Initial Decision notes, the Commission retains authority to require AEP to divest the CSW system.[70]

Based on Mr. Baker's testimony and exhibits, the Initial Decision concludes that "energy has been consistently transferred in both directions since the approval of the merger" and, "therefore, … the interconnection requirement of Section 2(a)(29(A) has been met."[71]

SUMMARY OF ARGUMENT

The Commission should reverse the Initial Decision's conclusion that AEP meets the Act's interconnection requirement. That conclusion is based on clearly erroneous findings of fact and erroneous conclusions of law. None of the three rationales offered by the Initial Decision withstands close analysis. Moreover, the Initial Decision fails to show how its decision accords with Commission precedent holding that distant utilities cannot use a contract path to meet the Act's integration requirements.

The Initial Decision's finding that AEP's "Contract Path … has always been bi-directional" is clearly erroneous: contrary to the record, the Commission's earlier order, and the court of appeals' decision. The record demonstrates that AEP has a contract that provides transmission service as a matter of right in one direction only. Indeed, AEP submitted evidence, which the Initial Decision credits, that AEP made a business decision to reserve transmission service in only one direction because bi-directional transmission rights were too costly—in other

[69] *Id.*

[70] *Id.*

[71] *Id.*

words, AEP determined it could not economically be interconnected by means of a contract providing two-way rights to transmission service.

Second, the Initial Decision errs as a matter of fact and law in concluding that, because AEP has transferred a "miniscule amount" of energy between CSW and AEP from west to east in the last four years, AEP meets the Act's interconnection requirement. That AEP has transferred miniscule amounts of short-term energy west-to-east says nothing about AEP's contractual rights to two-way transmission service and does not overcome AEP's admission that it purposely did not acquire contractual rights to two-way transmission service. The fact that AEP and CSW have transferred a miniscule amount of energy from west to east when non-firm transmission service was available does not demonstrate that the AEP and CSW systems are "capable of physical interconnection" under the Act.

Third, the Initial Decision erroneously concludes that the general availability of non-firm transmission service or open-access transmission service over third parties' transmission systems can be used to satisfy PUHCA's interconnection requirement. The Initial Decision cites no valid, applicable Commission precedent for this conclusion, and there is none. The potential availability of transmission service over third-party transmission systems, without any clear contractual rights to such service, is insufficient to establish that utility assets are capable of physical interconnection as required by the Act.

Finally, the Initial Decision does not justify its holding that AEP could use a lengthy contract path to satisfy the Act's interconnection requirement so long as AEP also meets the Act's "single area or region" requirement. The Commission's clear precedent holds that distant utilities such as AEP and CSW cannot use a contract transmission path—even a bi-directional path—to satisfy the Act's integration requirement. The Initial Decision provides no explanation

for its contrary reading of the Act and departure from Commission precedent. The record in this case demonstrates why that precedent is correct: it is difficult physically and economically to maintain a lengthy contract transmission path—even a facially inadequate unidirectional path—so that utility assets are "capable of physical interconnection" and "may be economically operated as a single interconnected and coordinated system" as required by the Act.

ARGUMENT

I. AEP does not have transmission contracts in place satisfying the Act's interconnection requirements under Commission precedent.

The Act requires that the utility assets of AEP and CSW be "physically interconnected or capable of physical interconnection." It is undisputed that AEP is not planning to build a transmission line physically interconnecting the utility assets of AEP and CSW.[72] Although the Commission, with judicial approval, has sometimes allowed (non-distant) utilities to demonstrate that their assets are "capable of physical interconnection" by means of contractual transmission rights,[73] the court of appeals found in this case that "the Commission's acceptance of a unidirectional contract path to 'interconnect' AEP and CSW" was unexplained.[74]

The Initial Decision proffers three reasons why AEP satisfies the Act's interconnection requirement, but none of them withstands close analysis.

[72] Tr. 59:22-24.

[73] See *Madison Gas & Elec. Co. v. SEC*, 168 F.3d 1337, 1340 (D.C. Cir. 1999). As the court of appeals held in this case, neither the Commission nor the courts have sanctioned reliance on a contract path to interconnect distant utilities. F.3d at 615-16.

[74] 276 F.3d at 615.

A. The Initial Decision's finding that AEP has a bi-directional contract path is clearly erroneous; AEP has a contractual right to transmission service in only one direction.

The first rationale offered by the Initial Decision is that the court of appeals was simply wrong, because AEP's "Contract Path … has always been bi-directional."[75] But this finding is clearly erroneous, since the record demonstrates that AEP's transmission contract with Ameren provides transmission service as a matter of right in one direction only, as the court of appeals found. The Initial Decision does not refer to any evidence of a change in circumstances from the situation in the record before the court of appeals. The Initial Decision merely re-labels as "bi-directional" the same contractual rights that were before the court of appeals, which the court correctly found are unidirectional.

The Initial Decision is not based on an examination of AEP's contract with Ameren or Ameren's OATT—neither of which AEP placed in the record—but rather on the testimony of AEP's witness Mr. Baker, who characterizes the Ameren contract and FERC's *pro forma* OATT without quoting or citing any of the relevant contractual or tariff language.

Mr. Baker testified that AEP had a contract with Ameren for "firm" transmission service, under which AEP had "reserved a contract path of 250 MW" for transfers from east to west.[76] But he also testified that AEP has not reserved any firm transmission service for transfers from west to east over Ameren's transmission system.[77] Mr. Baker speculated that the "fact that AEP has only reserved *firm* transmission service from east to west led the court mistakenly to believe that AEP has only a unidirectional contract path across Ameren and that the flow of power under

[75] Initial Decision at 11.

[76] AEP Exh. 5, p. 10:20-22 (Baker).

[77] *Id.* at 10:26-11:1.

AEP's contract is restricted to a unidirectional flow of power."[78] He asserted, however, "AEP's contract rights can be, and are, used to move power in both directions."[79]

Mr. Baker's characterizations notwithstanding, it is clear that AEP has the contractual *right* to move 250 MW of power only from east to west over the Ameren Contract Path. AEP reserved firm point-to-point transmission service under Ameren's OATT. That service is available to AEP on a firm basis—*i.e.*, uninterruptible under normal conditions and on equal priority with Ameren's "native load" customers—only over the specific path over which AEP has reserved service. That path is defined by the point of receipt and the point of delivery specified in AEP's transmission reservation with Ameren.[80] AEP does not have the contractual *right* to move a single megawatt of power west to east over the Ameren system: all it has under its Ameren contract and the applicable OATT is the ability to move power from west to east on a non-firm basis—i.e., if the transmission capacity is available at the time. That is the same tariff right that any non-firm transmission customer has under the OATT of a public utility regulated by the FERC.[81]

The Initial Decision relies on Mr. Baker's assertion that "AEP has the right under applicable FERC rules, to redirect its contract path from west to east at any time at no additional charge."[82] Although AEP did not file the Ameren contract or tariff, and Mr. Baker did not cite the applicable FERC rules, it appears he was referring to the provision of FERC's *pro forma* OATT that allows a firm transmission customer to designate an alternative point of receipt and

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[78] *Id.* at 10:26-11:1 (emphasis original).

[79] *Id.* at 11:1-2.

[80] FERC *pro forma* OATT, sec. 13, 17, 22.2 (Appendix B to FERC Order No. 888-A).

[81] *Id.*, sec. 22.

[82] AEP Exh. 5, p. 11:23-24 (Baker). See Initial Decision at 11.

point of delivery—including changing the direction of point-to-point service—at no additional charge *on a non-firm basis*.[83] Under those FERC rules, AEP cannot reverse its contract path on a firm—i.e., non-interruptible—basis at will. To obtain *firm* transmission service from Ameren from west to east, AEP must make a new application for transmission service under Ameren's OATT, as Mr. Baker testified.[84] Until AEP makes that request and Ameren grants it, AEP may only obtain non-firm transmission service west-to-east over Ameren.[85] In short, under its "firm" transmission contract with Ameren and its reservation of "firm" transmission service under Ameren's OATT, *AEP has no contractual rights to firm transmission service from west to east*. AEP's legal right to firm transmission service is unidirectional.

Calling AEP's Contract Path "bi-directional" does not change these operative facts, all of which were before the court of appeals. Although AEP has suggested that the court did not understand AEP's full panoply of rights, the record belies that claim. In its amended application to the Commission in this proceeding, AEP defined the "Contract Path" as a unidirectional path:

> Contractual reservation of 250 MW over the Ameren system providing firm point-to-point transmission service from AEP's Breed-Casey interconnection with Ameren to CSW's MOKANOK line interconnection with Ameren.[[86]]

AEP acknowledged that it had no contractual right to transmission service in the other direction, but would rely on its ability to designate secondary points of receipt and delivery—which under FERC's rules are available only on a non-firm basis. Thus, after describing the "Contract Path," AEP's application described its contemplated "Additional Power Transfers":

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[83] FERC *pro forma* OATT, sec. 13.7(a) & 22.1 (Appendix B to FERC Order No. 888-A).

[84] FERC *pro forma* OATT, sec. 17, 19, & 22.2 (Appendix B to FERC Order No. 888-A). See AEP Exh. 5, pp. 10:20 to 11:11; 12:5-10.

[85] *Id.*, sec. 22.1.

[86] *Am. Elec. Power Co.*, No. 070-09381, Form U-1, Amend. No. 5 at 2. *See also id.* at 34.

> The Applicants expect that from time to time there will be opportunity to transfer energy economically in the Combined Company from west to east. In these circumstances, Applicants will make use of their rights to nominate secondary points of receipt and delivery under their transmission service agreements with [Western Resources] and Ameren.[[87]]

The Commission's June 2000 Order described the Contract Path in the same terms.[88] The Commission's order contained no suggestion that that the Contract Path was bi-directional. On the contrary, the Commission found that the Contract Path was unidirectional but concluded that this was sufficient under the Act:

> [Intervenors] suggest … that a one-way transmission contract is inadequate. We do not agree. … Applicants do not anticipate sufficient levels of west-to-east energy transfers to warrant a firm two-way contract path. In view of these consideration[s], the Contract Path is adequate to support these transactions and satisfy the interconnection requirement.[[89]]

On appeal, the parties briefed this issue to the court. In response to NRECA and APPA's arguments that a non-firm contract path was insufficient to satisfy the interconnection requirement, AEP asserted on brief:

> Petitioners also argue that the 250 MW interconnection is inadequate because it provides only east-to-west power transfers. However, as discussed above, the need for interconnection was primarily in that direction. Although firm transmission service from west to east was considered by the Applicants, they ultimately determined that there would be adequate transmission capacity on a non-firm basis to accommodate economic transfers from CSW to AEP, and therefore firm transmission would not be required.[90]

Therefore, the court of appeals understood full well that AEP might make use of tariff rights to non-firm transmission service from west to east, separate and apart from its one-way Contract

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[87] *Id.* at 35.

[88] 2000 SEC LEXIS 1227 at *65-66.

[89] 2000 SEC LEXIS 1227, at *50-51.

[90] Brief of Intervenor, No. 00-1371, p. 31.

Path. After describing the "unidirectional" contract path, the court noted that AEP would make other arrangements to transfer energy from west to east if and when it was economic to do so:

> [t]his 'contract path' will enable New AEP's western zone (the current CSW system) to make use of some surplus generating capacity … in the eastern zone (the current AEP system). … AEP and CSW apparently expect that there will be fewer 'opportunities to transfer energy economically' from west to east than from east to west, but when and if such opportunities arise, New AEP proposes to make use of its rights under pre-existing transmission service agreements.[91]

The court of appeals reasonably concluded that, for purposes of understanding the Act's interconnection requirement, a contract path that restricted firm transmission service to one direction (even with the availability of non-firm transmission options) constituted "a system restricted to unidirectional flow of power from one half to the other …."[92] The court remanded so that the Commission could explain why a unidirectional contract path—meaning a contractual *right* to transmission service restricted to one direction—could be used to interconnect two utilities. It is implicit in the court's opinion that a utility system may satisfy the Act's interconnection requirement by obtaining a contractual equivalent of an actual physical transmission line—a contract with a third-party utility providing rights to firm transmission service in both directions (at least if the two utilities are not too distant). But AEP did not have such a contract.

The court's focus on AEP's restricted contractual right to firm transmission service is consistent with Commission and judicial precedent analyzing the Act's interconnection requirement. As the court of appeals held in *Madison Gas and Electric Company v. SEC*, "[t]he SEC has reasonably construed this requirement [that assets be 'capable of physical interconnection'] to be satisfied in cases past 'on the basis of contractual rights to use a third–

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[91] 276 F.3d at 612 (citing *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *61, n.79, *65-66).

[92] *Id.* at 615.

party's transmission lines' or if physical interconnection is 'contemplated or … possible within the reasonably near future.'"[93] The Commission cited this language in its prior order in this case,[94] as did the court of appeals in its decision vacating the Commission's order.[95] Under this precedent, contractual rights to use another utility's physical lines are a substitute for building a physical line of one's own—an action that would entitle one to two-way use by definition. Since the court of appeals was well aware of AEP's plans to use non-firm service in the other direction,[96] the ineluctable conclusion is that the contingent availability of non-firm transmission service is not an acceptable substitute for building a physical line. Without ownership of the transmission lines or the legal, contractual rights to use the lines at will in both directions, the utility systems are not "capable of physical interconnection" as required by the Act.

This understanding accords with the standard dictionary definitions of the word "capable" used in the statute. "Capable" means "susceptible," or "having attributes (as physical or mental power) required for performance or accomplishment" or "having legal right to own, enjoy, or perform."[97] In the context of electric utilities, the Act's use of the word "capable" implies ownership rights or the "availability of service as a matter of contractual right"—not merely the availability of service "as a practical matter."[98] Thus, "capable of physical interconnection" does not imply contingent or possible or uncertain or interruptible—all of which are characteristics of non-firm transmission service.

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[93] 168 F.3d at 1340.

[94] 2000 SEC LEXIS 1227, at *49 n.60.

[95] 276 F.3d at 615.

[96] *Id.* at 612.

[97] Merriam Webster's Collegiate Dictionary 168 (10th ed. 1994).

[98] *Long Island Lighting Co. v. FERC*, 20 F.3d 494, 499 (D.C. Cir. 1994).

In any event, AEP has not demonstrated that non-firm transmission service from west to east will always be available over the 250-MW contract path. Mr. Baker testified that for a two-year period beginning January 1, 2005, monthly non-firm service would not be available for five of the twenty-four months reviewed.[99] Whereas the Act requires that the assets at issue be "physically interconnected or capable of physical interconnection," during these five months there is no evidence that AEP would be able to obtain contractual rights that would make it capable of moving energy in both directions between AEP East and AEP West. Thus, AEP has no present contractual rights to service in any of those twenty-four months, and it has provided no evidence that it would be even able to obtain such contractual rights during five of the months. Thus, it has provided no showing that the utility assets of AEP East and AEP West would even be "capable of physical interconnection" during those months. If that contractual path is not available, AEP has not committed to obtaining service over alternative paths and has not investigated them because they are likely to be too costly.[100]

In short, AEP has not complied with Commission and judicial precedent by demonstrating that it has contractual transmission rights or is committed to make alternative arrangements to ensure that the Act's interconnection requirement is satisfied

[99] AEP Exh. 5, p. 17:12-13 (Baker). While Mr. Baker goes on to attempt to qualify this admission by stating that non-firm service might be available once daily non-firm service availability data is released, this expectation is solely based on the premise that "long range projections of available capacity *are likely to* be conservative . . . ." *Id.* at lines 20-21 (emphasis added). Mr. Baker's qualification does not change the fact that, at the time his testimony was prepared, non-firm service was not available.

[100] AEP Exh. 5, p. 20: 1-9.

at all times.[101] Thus, AEP has not shown that AEP East and West will be "capable of physical connection and of supplying power to one another as needed."[102]

The court of appeals correctly recognized that AEP only had contractual rights to transmission service in one direction and asked for the Commission on remand to explain why it had found that such an arrangement was sufficient under the Act. Rather than provide that explanation, however, he Initial Decision simply re-labels AEP's contractual rights as "bi-directional." This response is nothing more than wordplay. The court of appeals considered the same set of facts and remanded the case for a fuller explanation, not a re-labelling of the same facts. AEP, the other parties in this case, the Commission, and the court of appeals have heretofore understood that AEP has a one-way right to firm transmission service. The Initial Decision's contrary finding is therefore clearly erroneous.

B. The Initial Decision erroneously concludes that the Act's interconnection requirement is satisfied on the basis of miniscule energy transfers from west to east.

The Initial Decision also concludes that because AEP has been able to transfer a "miniscule amount" of energy from west to east over the past four years, it satisfies the interconnection requirement.[103] In this regard, the Initial Decision concludes that the court of appeals simply held that the Act "requires two-way transfers of electric power."[104]

But as shown above, the court's focus was on AEP's lack of two-way contractual rights to firm transmission service—not on whether AEP might be able to accomplish two-way

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[101] *Madison Gas & Elec. Co. v. SEC*, 168 F.3d at 1341 (applicant "has committed to take measures to ensure that the interconnection requirements of section 2(a)(29) of the Act are satisfied" if planned FERC approval for the construction of interconnection tie-lines does not occur).

[102] *City of New Orleans v. SEC*, 969 F.2d 1163, 1165 (D.C. Cir. 1992).

[103] Initial Decision at 11-12.

[104] *Id.* at 11.

transfers of energy or power from time to time irrespective of its one-way firm contractual rights. The court understood full well that AEP contemplated moving small amounts of energy west to east using short-term, non-firm transmission service.

The fact that AEP has, in fact, transferred a miniscule amount of energy from west to east in the past four years does not trump the Act's requirements that the utility assets of AEP and CSW be "capable of physical interconnection." Indeed, the fact that the amount of east-to-west energy transfers has vastly exceeded the amount of west-to-east transfers is consistent with the court of appeals' conclusion that AEP has only a unidirectional firm contract path and provides no answer to the court's concerns. The transfer of a mere two percent of power in one direction shows that the operation of the AEP and CSW systems is more analogous to two unaffiliated utilities trading small amounts of energy over third-party transmission lines than to a single system economically operated as an interconnected and coordinated whole. The Initial Decision erroneously concludes that such miniscule energy transfers are definitive proof of interconnection under the Act.

C. The Initial Decision erred in finding that AEP may rely on non-firm transmission services from Ameren or an alternative contract path to satisfy the interconnection requirement

Finally, the Initial Decision concludes that, in lieu of relying on its existing Contract Path, "AEP may also purchase non-firm transmission services from Ameren whenever necessary or arrange an alternative contract path with other electric providers to meet the requirements of a bi-directional electric power flow for establishing interconnection."[105]

As already shown, however, the court of appeals was fully aware that AEP could use non-firm transmission service or not-yet reserved transmission service in addition to the Contract

[105] 276 F.3d at 12.

Path over Ameren. But the court found no basis in the Commission's earlier order for deeming AEP and CSW to be "capable of physical interconnection." The Initial Decision also provides no basis for such a conclusion.

Moreover, the record does not support a finding that other, undefined transmission paths can be used to demonstrate that AEP and CSW are "capable of physical interconnection." Mr. Baker testified that after June 2005, transfers of power from AEP East to AEP West over the 250-MW contract path will require AEP to obtain transmission service from the SPP as well as the MISO.[106] He stated that AEP has not considered alternative transmission paths between AEP East and AEP West, because they are likely to be more expensive than transmission service over MISO and SPP.[107] Since the Act requires that utility assets be "capable of physical interconnection" so that the utility system "under normal conditions may be economically operated as a single interconnected and coordinated system," AEP has not provided evidence that alternative transmission paths can meet the Act's interconnection requirement.

By concluding that AEP may purchase non-firm transmission services from Ameren or arrange an alternative transmission contract, the Initial Decision erroneously concludes that the general availability of non-firm transmission service or open-access transmission service over third parties' transmission systems can be used to satisfy PUHCA's interconnection requirement. The Initial Decision cites no valid, applicable Commission precedent for this conclusion, and there is none. Moreover, AEP has no transmission contracts, has not requested transmission service from the relevant transmission providers, and has not shown that the service would be available or economic if it were to request service.

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[106] AEP Exh. 5, p. 19:16-18 (Baker).

[107] *Id.* at 20:1-9.

Thus, the record affords no basis for the Initial Decision's finding that the utility assets of AEP and CSW system can be deemed to be "capable of physical interconnection" on this basis. The potential availability of open-access transmission service over third-party transmission systems, standing alone, is insufficient to establish interconnection.

II. The Initial Decision does not justify its holding that distant utilities like AEP and CSW may use a lengthy contract path to satisfy the Act's interconnection requirement so long as they meet the Act's single-area-or-region requirement.

The court of appeals held that AEP and CSW are "distant utilities."[108] As the court noted, "AEP and CSW's systems are neither contiguous nor physically interconnected—indeed, at their closest point, they are separated by hundreds of miles."[109] Because Commission precedent had held without exception that contract rights alone cannot be used to integrate distant utilities,[110] the court of appeals agreed with NRECA and APPA that in its earlier order in this case "the Commission failed to follow its own prior reasoning regarding the interconnection of distant utilities."[111] The court held that the Commission's clear previous policy "obligate[d] the Commission to provide some rationale for its current contrary view,"[112] but a "satisfactory explanation for [its] change in course" was "not evident" in the Commission's earlier order in this case.[113]

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[108] 276 F.3d at 615.

[109] 276 F.3d at 612.

[110] *WPL Holdings, Inc.*, 53 S.E.C. 501, 517 (1998), *aff'd sub nom. Madison Gas & Elec. v. SEC.*, 168 F.3d 1337 (D.C. Cir. 1999) ("The Commission has previously determined that combined electric properties can be interconnected, *where the utilities are not separated by significant distances*, by means of contractual rights to use the lines of a third party." (emphasis added)); *UNITIL Corp.*, 50 S.E.C. 961, 967 n.30 (1992) ("Contract rights cannot be relied upon to integrate two distant utilities."); *Northeast Utils.*, 50 S.E.C. 427, 449 n.75 (1990) (signaling that "the use of a third party cannot be relied upon to integrate two distant utilities.").

[111] 276 F.3d at 615.

[112] *Id.*

[113] *Id.* at 617.

In that earlier order in this case, the Commission claimed that its precedent did not hold that a contract path may be too long to meet the interconnection requirement, but instead merely stood for the proposition that a contract path cannot be used integrate utilities that are so distant they are not in a single area or region.[114] The court of appeals found the Commission's explanation "peculiar" and could find only one "rational interpretation" for the Commission's language: "Although a long transmission line may be sufficient to interconnect two distant utilities, the length of the line—that is, the distance between the connected utilities—may violate PUHCA's region requirement."[115] The court found that explanation wanting, however, because the Commission had made no evidentiary findings regarding the Act's region requirement.

The Initial Decision, however, simply reiterates the Commission's earlier holding without providing any analysis or other explanation. After quoting the court's opinion, the Initial Decision asserts that "[t]his issue is better addressed below in the 'single area or region" section as the court's language suggests."[116]

That response is inadequate on its face. As recently as 1998, the Commission reiterated its determination that electric properties may not be interconnected by means of contractual rights where the utilities are separated by significant distances.[117] The Commission's

[114] 2000 SEC LEXIS 1227, at *49-50.

[115] *Id.* at 616.

[116] Initial Decision at 7 n.9.

[117] *WPL Holdings, Inc.*, 53 S.E.C. at 517. In *WPL Holdings, Inc.*, the Commission found that "[t]he Commission has stated that contract rights cannot be relied upon to integrate two distant utilities." 53 S.E.C. at 517 n.39.

commitment to this principle is clearly and repeatedly expressed in its prior decisions.[118] The Initial Decision provides no justification for departing from that precedent.

In this case, not only are AEP and CSW hundreds of miles apart, but the 250-MW one-way contract path allows for the transfer of only tiny amounts of power relative to the size of the AEP and CSW systems. By comparison, the court noted, "the few cases in which the Commission has accepted transmission contracts as evidence of interconnection, unlike this case, have involved contracts for transmission of large amounts of power in both directions between relatively closely situated utility assets."[119]

The record in this case demonstrates why the Commission should adhere to that precedent. There are physical and economic barriers to the long-term use of a lengthy contract transmission path—even a facially inadequate unidirectional path like that secured by AEP—to meet the Act's requirements that utility assets be "capable of physical interconnection" so that they "may be economically operated as a single interconnected and coordinated system." AEP's initial Contract Path over the Ameren system has now expired, and the record is silent as to how AEP is now satisfying the Act's interconnection requirement. And the record indicates that the price of a Contract Path over the Ameren system will triple until 2008 and then remain double, as a result of the MISO becoming the transmission provider over Ameren's facilities.

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[118] *UNITIL Corp.*, 50 S.E.C.at 967 n.30 ("Contract rights cannot be relied upon to integrate two distant utilities."); *Northeast Utils.*, 50 S.E.C. at 449 n.75 ("the use of a third party cannot be relied upon to integrate two distant utilities.").

[119] 276 F.3d at 615-16 (citing *Conectiv, Inc.*, 66 S.E.C. Docket 1260, 1266 (CCH) (Feb. 25, 1998) (stating that "the physical interconnection requirement of the Act can be satisfied on the basis of contractual right to use third parties' transmission lines when the merging companies are members of a tight power pool"); *UNITIL Corp.*, 50 S.E.C. at 966 (deciding that contract rights were adequate because they were located in New England, a small area with "unique geographic characteristics"); *Centerior Energy Corp.*, 49 S.E.C. 472, 478 (1986) (approving use of third-party transmission lines to interconnect two formerly separate utility systems in light of a study showing that the transmission lines would be adequate even in an emergency in which one of the systems had to meet 100% of the other system's power demand.)).

The termination of the MOKANOK agreement as of June 1, 2005, is further evidence of why distant utilities should not be permitted to satisfy the interconnection requirement by stringing together multiple transmission contracts to create a contract path. The record is silent on whether and at what cost and on what terms AEP has been able to obtain alternative transmission service across the SPP since June 1, 2005, to bridge the gap between MISO and the CSW (or AEP West Zone) system.

The Act's interconnection requirement is an ongoing requirement, however, and not simply a snapshot test of whether a utility can at one time string together a daisy chain of limited-term contracts. The evidentiary gap is therefore a serious one. Even taken in the light most favorable to AEP, the record shows that AEP must rely on transmission service from two RTOs—the MISO and the SPP—in order for its utility assets to be capable of physical interconnection. Yet AEP has not shown that it has reserved transmission service over either the MISO or the SPP for this purpose.

While the record in this case precludes a finding that AEP and CSW operate in a single area or region, the record also independently precludes a finding that the utility assets of AEP and CSW are "capable of physical interconnection" by means of a contractual right to use the transmission lines of another utility. The Commission should follow and not abandon its precedent holding that a contract path may not be used to integrate distant utilities.

CONCLUSION

The Commission should reverse the Initial Decision's finding that AEP satisfies the Act's interconnection requirement.

Respectfully submitted,

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July 7, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document by first-class mail upon the persons and at the addresses listed below.

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