ADMINISTRATIVE PROCEEDING
FILE NO. 3-11616

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of	)
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AMERICAN ELECTRIC POWER COMPANY, INC.	)
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INITIAL BRIEF OF PUBLIC CITIZEN, INC. IN SUPPORT OF PETITION FOR REVIEW OF INITIAL DECISION ON "INTERCONNECTED AND COORDINATED" ISSUE ON REMAND

Lynn N. Hargis, Counsel
Tyson Slocum, Research Director
Public Citizen, Inc.
215 Pennsylvania Ave. S.E.
Washington, D.C. 20003
(202) 454-5183

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INITIAL BRIEF OF PUBLIC CITIZEN, INC.
IN SUPPORT OF REVIEW OF INITIAL DECISION
REGARDING "INTERCONNECTED AND COORDINATED" ISSUE
ON REMAND

INTRODUCTION

This case comes before the Securities and Exchange Commission (the Commission) at a critical moment in the history of utility regulation in the United States. The U.S. Congress appears poised in the pending Energy Bills to repeal the statute at issue here, the Public Utility Holding Company Act of 1935 (PUHCA), whose enforcement has been called the single most significant achievement of this Commission.[1] Since the two huge utility holding companies, American Electric Power Company (AEP) and Central and SouthWest Corp (CSW), whose merger is at issue here, may well operate in a post-PUHCA regulatory world, the Commission must take that post-PUHCA world into account in deciding whether this merger should be allowed.

Without PUHCA, oil companies—including oil companies owned by the Peoples' Republic of China—will be free to own and control vertically integrated U.S. electric and natural gas utilities. Section 11 of PUHCA, which requires utility owners to divest their non-utility businesses, has prevented this for the past seventy years. Investment bankers are not allowed under PUHCA to even sit on the boards of utility holding companies without express Commission approval, because of their past history of abusing utility connections. (*See*, *e.g.,* Enron Corporation No Action Letter, March 11, 2004, File No. 132-3.) Without PUHCA, such investment bankers and other financial

[1] See, Background, below at p. ll.

speculators will be allowed to *own and control* vertically integrated utilities, just as they now own many of the PUHCA-exempt merchant power plants and electric power contracts. Without PUHCA, electric equipment suppliers such as GE and Westinghouse, and construction companies such as Halliburton and Bechtel, can once again as similar companies did in the 1920s, acquire and control a string of utilities to promote their other business interests, such as the sale of electric turbines or construction of plants.

Without PUHCA, there will be no limits on the geographic spread or the economic coordination of such huge utility systems, just as in the days of Samuel Insull. [See, Background, below.] Even if the Federal Energy Regulatory Commission (FERC) gets the slight additional merger authority proposed in the Senate Energy Bill, the Federal Power Act contains, and will contain, no geographic or size limitations on utility mergers as does PUHCA. And the antitrust laws will provide no more help limiting utility holding company size than they did in the 1920s and 30s, when three companies owned approximately half the electric utilities in the country.

There will be no limits on the number of holding companies above utility companies, as there are under PUHCA. There will be no conceivable way for state regulators, with their limited resources, +or even the Federal Energy Regulatory Commission (FERC) to track through the complex accounts of massive layers of multistate and international parent companies that will quickly build up once PUHCA's restraints are gone. Utility owners will be able not only to return to, but to outstrip the myriad abuses that occurred in the 1920s and early 1930s, when there were 53 utility holding company bankruptcies and 23 bank loan defaults, causing the Great Depression to deepen and widen.

Without PUHCA, there will be no federal body with jurisdiction over the financial transactions between holding companies and their subsidiary utilities.

There will be nothing to prevent such mammoth utility owners from investing captive utility revenues in whatever the current version of the "savings and loan" bubble may be, as PUHCA prevented the utility holding companies from investing in the last savings and loan debacle. And the debt assumed by such utility owners to pay for their more interesting business opportunities can only be paid in one way: by higher electric and natural gas utility rates.

Hundreds of thousands of utility investors lost their life savings after the financial collapse of the utility holding companies after 1929. Even the partial PUHCA repeals of 1992 and by this Commission's staff—which exempted "power marketers" from PUHCA by issuing them no-action letters—have led to numerous PUHCA-exempt utility bankruptcies.[2] In contrast, there has never been a PUHCA-regulated electric utility holding company that has gone bankrupt.

This merger application should cause the Commission to rethink it support for PUHCA repeal, and the potentially catastrophic results for the nation and the national economy, not to mention for utility ratepayers and investors, that such repeal will almost inevitably engender. At a bare minimum, this Commission must consider that the AEP/CSW merged holding companies could exist in a post-PUHCA regulatory world, with none of the financial safeguards and consumer and investor protections that PUHCA provides, and evaluate the public interest aspects of the merger accordingly.

The Commission should also rethink it's "flexible" interpretation of the statue, which in 2000 resulted, as the court of appeals pointed out in vacating and remanding the

[2] These include, among others, Mirant, NRG, Enron, and NEG.

Commission's order, in virtual administrative repeal of the protective limitations found in Section 11 of the statute. 15 U.S.C. 79k. Section 11 is called the "heart of the Act" or the "death penalty," depending on whether you side with the consumers, investors and the public interest or with the utility owners. The Commission must make that choice here, and history will have reason to note it.

INITIAL DECISION BEING APPEALED

Public Citizen hereby appeals and requests the Commission to reverse the May 3, 2005, Initial Decision of Presiding Administrative Law Judge Robert G. Mahony in this proceeding insofar as such Initial Decision finds that Merger Applicants, AEP and CSW, have carried their burden of proving that their merged utilities meet the statutory requirement of Section 11 of PUHCA that the combined utility assets form a "single integrated public-utility system." Specifically, the statutory definition of "Integrated public-utility system" found in Section 2(a)(29)(A) that the merged utility assets: "are physically interconnected or capable of physical interconnection and may be economically operated as a single interconnected and coordinated system…." 15 U.S.C. 79b(a)(29)(A).

REQUEST FOR ORAL ARGUMENT

Public Citizen requests the Commission grant oral argument regarding this Initial Decision pursuant to "Rule 451(a). That rules states:

> Motions for oral argument with respect to whether to affirm all or part of an initial decision by a hearing officer shall be granted unless exceptional circumstances make oral argument impractical or inadvisable.

Counsel for Public Citizen states that it is aware of no such circumstances in this case.

BACKGROUND

"The greatest showdown between Washington and Wall Street did not concern the Securities act of 1933 or the Securities Exchange Act of 1934, but, rather, the Public Utility Holding Company Act of 1935," according to the unofficial historian of the SEC, Dean Joel Seligman of the Washington Law School in his book, *The Transformation of Wall Street,* Northeastern University Press, Boston (revised edition at p.127).[3] The passage of the Holding Company Act was described by another historian as "the most bitter legislative battle of Roosevelt's first term." Michael E. Parrish, *Securities Regulation and the New Deal,* p. 145 (Yale University Press, 1970).

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

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

Investigations into the holding company abuses were instigated by both the Federal Trade Commission, ultimately filling 101 volumes, and the House Commerce Committee from 1928 to 1934. The collapse of the stock markets in September 1931

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[3] There is a third edition published in 2003, but these cites are from the second edition published in 1995.

toppled the heavily indebted Insull utility system. According to Parrish, "Newspapers claimed that the fall of the $3 billion empire was 'the biggest business failure in the history of the world.'" Parrish describes Insull as an early advocate of "customer ownership," but who took down with him 600,000 shareholders and 500,000 bondholders. Insull fled to Greece. Parrish at 22. Between 1929 and 1936, there were 53 utility holding company bankruptcies and 23 utility bank loan defaults. 1995 Division Report to Congress, p.5 and notes 16 and 17.

President Roosevelt had a number of skirmishes with utilities as governor of New York. He had little success in lowering New York's utility rates, even though he made superb appointments to the Public Service Commission and created a Power Authority to plan state hydroelectric developments. But, of far greater importance, according to Parrish:

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

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

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

The utilities mounted a formidable opposition, beside which the campaign against the Securities Exchange Act "paled in comparison." They even began a whispering campaign that the president was suffering from mental instability, and organized a letter-

writing campaign in which the letters and telegrams turned out to be from nonexistent constituents. Roosevelt was greatly alarmed, calling the utility lobby "the most powerful, dangerous lobby that has been created by any organization in this country." David McKean, "Tommy the Cork," p. 59, Steer Forth Press, 2004.

The compromise on Section 11 reached in conference on the bill was drafted by Felix Frankfurter, the future Supreme Court Justice, and a Senator Barkley. Parrish at 175. This was the most far-reaching provision of the act, the controversial death sentence provision, which limited each holding company system to a single integrated system and to businesses that are reasonably incidental or economically necessary or appropriate to the operations of such integrated system. A second system could be retained only if it met certain strict requirements. PUHCA was signed into law in August of 1935. Part II of the same legislation gave jurisdiction to the Federal Power Commission over rates and mergers for electric transmission in interstate commerce and wholesale electricity sales. Jurisdiction over both electric generation and distribution facilities and retail rates were reserved to the States. Parrish, p. 173, Federal Power Act Section 201(b)(1).

William O. Douglas became Chairman of the SEC when the initial Supreme Court constitutional challenge to the registration provision of Section 5 of PUHCA had failed.[4] When he left the Commission to join the Supreme Court, Chairman Douglas reported to the President his views on the statutes administered by the Commission.

> First, as to the Public Utility Holding Company Act of 1935. Over the years minor amendments may be desirable in light of administrative experience. But in my opinion none is now necessary. The statute has proven to be workable and sound. Substantial progress has already been made under it. There is still some desire in the industry to alter the provisions of the "death sentence", particularly Section 11(b)(1). Any such attempt should be vigorously opposed. That section is soundly conceived. It is practical and workable. When fully

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

> executed it will provide a large degree of decentralization in the utility industry and cause a return of that industry from Wall Street to Main Street.
> P.C. Ex. 3,p.1.

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

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

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

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

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

After the restructuring, there were only 12 active registered holding companies in the United States for many years; nine electric and three gas. Their financial and

corporate structures were comprehensively regulated by the SEC's PUHCA staff. The United States and its economy enjoyed the most reliable electric system in the world. However, with the oil embargo in the 70s coupled with the construction of extremely expensive nuclear central station plants, rates went up.

The utility industry, which had been trying to get rid of PUHCA since 1934, saw its chance under the deregulatory policies of the Reagan administration. That administration's SEC went on record as supporting PUHCA repeal. Consumer support saved the statute. In 1992, the industry achieved partial PUHCA repeal, for wholesale generating plants and foreign utility companies. In 1994, the SEC staff began issuing a long line of "no-action" letters that effectively exempted "power marketers" and "gas marketers" from PUHCA enforcement actions. No statutory interpretations of PUHCA were given, so none could be challenged, and a large industry grew up trying to make a profit in-between the generators and distributors of electricity. Some succeeded, and some—like Enron Corp—failed spectacularly.

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

Many consider that a low point in the administration of the Holding Company Act was reached on June 14, 2000, when the Commission approved the merger of two giant

holding companies, AEP and CSW, that had escaped restructuring in the initial enforcement of the Holding Company Act, to create a massive holding company covering eleven states from the Canadian to the Mexican border, from Virginia in the East to the Texas Big Bend in the west, separated by hundreds of miles at their nearest point, and "interconnected" by a relatively tiny 250 MW, one-way firm transmission contract. Many felt the SEC had successfully reversed enforcement of the Act back to the 1940s (see Parrish, p. 220, decrying systems that covered ten states), by ignoring the purposes of the statute and focusing on disparate parts of the definition of a "single integrated public-utility system" in order to approve the merger. The court of appeals, to the surprise of few familiar with the statute, vacated the Commission's order and sent it back, along with a map in the Federal Reporter, apparently to show just exactly what kind of merger the Commission had approved under a statute designed to break up, and prevent the reoccurrence of, giant utility holding companies. NRECA v. SEC, 276 F.3d at 619.

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

STANDARD OF REVIEW

Although the question of standard of review is normally reserved for an appellate court, it needs to be raised here because it will almost certainly be raised in any appeal of an order resulting from this proceeding. An appellate court normally gives deference to the expertise of an administrative agency. Where issues turn on the accounting and financial behavior of public utility holding companies, the Division of

Investment Management and the Commission itself can appropriately claim such expertise. However, the instant proceeding does not turn on such questions, but on the electrical operations and regulation of operating electric utilities. Sadly, the Division has no expertise in either.

While conceding its lack of any utility engineering or utility operational in-house expertise, the Division nonetheless declined to hire a witness with such expertise for this hearing. In addition, the Division declined to even ask Public Citizen's highly credentialed and experienced volunteer expert witness, Mr. John A. Casazza, why he disagreed with AEP's witnesses on vital and relevant utility systems questions. Instead, the Division ignored Mr. Casazza's testimony, and relied totally on AEP's witnesses. The Division also relied on its own views of various policies of the Federal Energy Regulatory Commission (FERC), regarding which the Division also has no practical experience or expertise. The Division's counsel even placed on the record the fact that FERC is *not* the federal agency responsible for PUHCA enforcement (in an apparent attempt to discredit the expertise of Public Citizen's volunteer expert witness, Lynn N. Hargis, a former FERC Assistant General Counsel for Electric Rates and Corporate Regulation and seventeen-year private law firm regulatory attorney). [T. pp. 181-2]. Nonetheless, the Division consistently relied on its own (and AEP's) understanding of FERC's policies to support its pro-merger position in this case.

Wisely, the Presiding Administrative Law Judge did not rely on the arguments of the Division in reaching his decision on the "interconnected and coordinated" issue. Similarly, the Commission should not rely on any briefs or arguments by the Division in this matter. The Division has no expertise on the technical issues in question, and simply

offers the views of securities lawyers and accountants on points of utility operation. Similarly, the Division has no expertise or experience with FERC's policies, which in any case, do not control matters arising under PUHCA as the Division has recorded. However interesting the views of securities lawyers and accountants may be, they can hardly be called "expert" for any purposes relevant to the technical and utility operation questions and FERC regulatory policies at issue in this proceeding.

Similarly, the Presiding Administrative Law Judge candidly acknowledged at the pre-hearing conference in this proceeding that he would have no in-house or hired technical experts to help him in evaluating the technical and utility operations at issue. Under these circumstances, the standard of review of the Initial Decision by the Commission must be *de novo*, with no deference to the technical expertise of its hearing staff, which has none.

STATEMENT OF ERRORS

1. The Initial Decision erred in finding that the legal standard for determining whether utility assets are "interconnected and coordinated" under "normal conditions" can be satisfied by merely showing that electric energy was "consistently" transferred between two sets of utility companies after their merger, on a sporadic and unexplained basis.

2. The Initial Decision erred in finding that AEP has carried its burden of proving that its two distant and noncontiguous sets of utilities "may be economically operated as a single interconnected and coordinated system."

a. The evidence at hearing shows only that electric energy, not power, moved in a miniscule, sporadic and episodical fashion from AEP West to AEP East over various contract paths for a four year period, making it impossible for a system operator to have "coordinated" the two huge groups of utilities "under normal conditions."

b. AEP's own evidence, that it was not economical for it to obtain *firm* transmission between its two distant sets of utilities--which might have allowed their coordinated operation--directly undermines its argument that its merger meets the statutory requirement that the utility systems "may be *economically* operated as a single integrated and coordinated system."

3. Contrary to the Initial Decision's finding, the record evidence fails to prove the AEP will be able to purchase non-firm transmission services or arrange alternative contract paths with other electric suppliers "whenever necessary," but only that they can get it "whenever available."

4. The Initial Decision therefore erred in finding that AEP has met its burden of proving that its two non-contiguous and distant utility systems constitute a single system with utility assets that are "physically interconnected or capable of physical interconnection *and* which under normal conditions may be economically operated

as a single interconnected and *coordinated* system…." (emphases supplied), and the Initial Decision must be reversed on this remanded issue.

SUMMARY OF ARGUMENT

The Initial Decision applies the wrong legal standard to determine whether AEP's two distant utility systems were "physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system…." The Initial Decision found that this statutory standard could be met as long as the record showed "consistent energy transfers in both directions since the merger." ID at p.9.

However, the statute requires not that transfers of energy or power between distant utility assets be "consistent," a term nowhere mentioned in the Holding Company Act. The statute requires that the utility assets not only be physically interconnected but, as the court of appeals noted, NRECA, 276 F.3d at 615, that they *also* "may be economically operated as a single interconnected and coordinated system…." The system operator must be able to *coordinate* the operations of its two--in this case, distant--groups of utilities in order to economically transfer power when it is beneficial to the combined system. One utility group could send power or energy to the other "consistently" once a year, or once every two years, yet this would hardly demonstrate an ability to "coordinate" the utility assets so that they can economically operate as a single system. The Initial Decision has thus used the wrong legal standard for finding that the "interconnection" requirement of PUHCA has been met.

In addition to using the wrong legal standard, the Initial Decision erred in finding that the evidence supports AEP's factual claims. AEP failed to demonstrate that it could transfer electric energy, much less power, from west to east *when* it would benefit its combined system. Instead, AEP simply offered evidence that certain miniscule, sporadic and episodic transfers of electric energy occurred over a four year period, although for certain months there were no transfers at all. The evidence does not show *why* the transfers occurred when they did; it may well be that these were the only times that non-firm transmission was available east to west. Nothing in the record demonstrates otherwise.

This evidence certainly fails to support AEP's claim that it could "coordinate" its two distant systems "under normal conditions." In addition, AEP's own witness testified that it would not be economical to obtain the firm transmission that would be necessary to "coordinate" its system. Thus, the ALJ found that AEP made a "business decision" not to do so. ID at p. 12. A "business decision" that it is not economical to provide the firm transmission necessary to coordinate its two systems directly conflicts with the statutory requirement that the interconnected and coordinated operation of the various utility assets must be "economical." AEP's testimony thus subverts, rather than supports, its case.

The Initial Decision erroneously found that AEP had carried its burden of proving that it, in the absence of a firm transmission contract, AEP could obtain non-firm transmission services from Ameren "whenever necessary" or arrange alternative contract paths. To the contrary, the testimony of Public Citizen's witness, Mr. John A. Casazza, clearly states that non-firm transmission is exactly that—not firm—and cannot be relied

upon by a utility system operator. Far from being able to get transmission "whenever necessary," the record evidence shows that AEP can only get transmission west to east "whenever available." No FERC policies or rules create a different result.

In summary, AEP has not only failed to carry its burden of proving that its two widely distant utility groups are "interconnected" and "may be economically operated as a single interconnected and coordinated system," but in fact, the record evidence shows directly the opposite. The Initial Decision therefore erred in finding that AEP had met its burden of proof, and the Initial Decision must be reversed on this point.

ARGUMENT

I. The Initial Decision Used the Wrong Legal Standard.

The Initial Decision used the wrong legal standard to determine whether AEP's two distant groups of utilities may be economically operated as a single "interconnected and coordinated" system. The best that AEP could claim is that its contract path "has been used consistently" for two-way transfers of energy. However, the statute does not require "consistent" transfers; it requires that the utility assets be "physically integrated or capable of physical integration," but, as the court of appeals noted, the statutory definition *also* requires that "under normal conditions," an integrated system "may be operated economically as a single interconnected and coordinated system…." NRECA, 276 F.3d at 615. The court concluded, as the Initial Decision noted, that it could not "understand how a system restricted to unidirectional flow of power from one half to the other can be operated in [an interconnected and coordinated] manner." *Id.*

The legal test, then, is whether there is "coordination" of the utility assets under normal conditions, not merely "consistent" transfers of energy in two directions. There

are, after all, consistent transfers of energy between almost all the non-integrated utilities in the country, on a regular basis. AEP's definition of "interconnected" accepted by the Initial Decision, as simply providing for such "consistent" transfers of energy between utilities, would result in a finding that virtually every utility in the entire country is "interconnected" and operating as a "single" system. This is clearly not only absurd, but would read the "interconnected and coordinated" requirement out of the statute, which the court has said the Commission may not do.

Coordination, on the other hand, indicates that a utility system operator can cause the system to operate for the mutual benefit of its parts "whenever necessary," to use the Initial Decision's words. Id. at 12. The proper legal standard under the statute must thus be a finding that utility assets are interconnected in a manner that allows their operation to be coordinated as a single system.

II. The Initial Decision Erred in Finding that AEP Carried its Burden of Proving that its two distant and noncontiguous sets of utilities "may be economically operated as a single interconnected and coordinated system."

The Initial Decision erred in finding that AEP carried its burden of proof in the proceeding below on whether its two distant and noncontiguous sets of utilities, AEP West and AEP East, "may be economically operated as a single interconnected and coordinated system" as required by the statute. AEP simply submitted summaries of energy transfers that it had supposedly made from West to East, but made no attempt to show what the circumstances were for each of these transfers. There is thus no evidentiary basis for determining exactly when or why megawatt hours of energy were transferred west to east, as summarized in Exhibits 6 and 7, or whether these these transfers reflected normal conditions of "coordinated" public utility system operation.

Public Citizen believes 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.

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 AEP East or AEP 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.

A. Even if all that AEP had had to show was that it made sales from West to East *whenever it was beneficial for its system to do so*, as AEP claims, it has made no such showing.

AEP claimed that at hearing 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, the amounts of *energy* transfers shown—particularly from AEP West to AEP East—are tiny, not only in relation to the huge size of AEP's systems, but by any objective standard.

Moreover, the transfers were sporadic; in some months, there were no transfers at all. Even when there were energy transfers, the amounts varied widely, although none was particularly large. There is nothing on the Exhibit 6 or 7 to indicate at what hours these energy transfers were made or why they were made at these times, and not at others. The answer may well be that the transfers occurred because that was when non-firm transmission capacity to carry energy was available to AEP. The Exhibits are mute as to this, or any other interpretation of the summary data. AEP's 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.

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 energy actually traveled. As Mr. Johnson agreed (T. 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,[5] 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

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[5] 404 U.S. 453 at 647.

may be part of an RTO that charges for such impacts, the other parallel systems may still be unable to transmit energy when it interferes with their own transmission needs.

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.

This evidence certainly fails to support AEP's claim that it could "coordinate" its two huge and distant systems "under normal conditions." As Mr. Cassaza testified, using a firm transmission contract path of only 250 MW to coordinate utility systems as large as AEP's and CSW's is like tying two elephants together with a string and hoping they will operate together. However, in the case of West to East transfers, AEP has dispensed with even the string.

B. In addition, AEP's own witness testified that it would not be economical to obtain the firm transmission that would be necessary to "coordinate" the operation of its system in any meaningful way.

AEP would need to have firm transmission that could be counted on even to ensure that economic sales could be made by providing West to East transmission "whenever necessary," much less to be able to back up its system units. The Initial Decision acknowledged that AEP made a "business decision" not to provide such firm transmission from west to east. ID at p.12. A "business decision" that it is not economical to provide the firm transmission necessary to coordinate its two systems directly conflicts with the statutory requirement that the interconnected and coordinated operation of the various utility assets must be "economical." AEP's testimony thus subverts, rather than supports, its case.

III. The record evidence does not support the Initial Decision's finding that AEP will be able to purchase non-firm transmission services or arrange alternative contract paths with other electric suppliers "whenever necessary," but only that they can get such service "whenever available."

Contrary to the Initial Decision's finding, the record does not support the asserted ability of AEP to purchase non-firm transmission capacity "whenever necessary." For one thing, non-firm transmission may or may not be available at any given time, particularly where, as in AEP's case, the distance is large and numerous utility systems must be covered. FERC's Order No. 888 merely requires utilities to offer transmission when it is available; they are not required to have it available.

AEP's own witness, Mr. Baker, testified that not only is "non-firm" transmission service not necessarily available, but it can be recalled even after it has been sold to protect the system reliability of the seller. 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*,…."

Not only is relying on a competing utility's transmission lines comparable to relying on a competing airlines' having space available on their planes just when you need it, but with non-firm transmission, another utility could simply throw you off their plane! This of course means that the purchase of non-firm service—even if available--would not provide the reliable service required to coordinate AEP's widely separated sets of utility companies.

In addition, if the transmission is by "contract path," rather than over a committed transmission line, Mr. Johnson admitted that the electrons will not necessarily flow over that parth. Tr.p. 96, lines 14-19. Mr. Baker called this the "contract path convention." AEP Ex.5, p. 18, line 15. Mr. Casazza testified that the large number of

transmission facilities intervening between AEP's two groups of utilities (see AEP Exhibit 8) actually "increases the probability that constraints will occur somewhere, limiting AEP's ability to operate as an integrated system." PC Ex. 1, p.9. If transmission constraints exist regarding a "contract path," the would-be transmitter may collect contract damages, but electrons will not flow. Going back to our airplane analogy, you may get a ticket for a free plant trip in the future, but you aren't going anywhere today. A reliable, integrated electric system obviously cannot be operated on a "coordinated" basis when it cannot control its ability to transmit between its distant utilities.

Since no one cross-examined Mr. Casazza, his expert 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 air pollution, whereas Mr. Casazza is a long-time public utility executive and engineer who has written a number of textbooks on utility operations. He is also currently participating on the U.S./Canadian Blackout Investigation Committee.

As Ms. Hargis testified (PC Exhibit 2, p. 10), and as the order itself clearly states, 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, of rectifying "undue discrimination," was--as FERC acknowledged (and Ms. Hargis testified)--recognized by the D.C. Circuit as long ago as 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.

Order No. 888 provides electricity sellers with the opportunity to use another system's transmission system, but the transmission *capacity* still has to be available at the time and place needed. Firm contracts are still required to ensure that such capacity will be available whenever needed.

Conclusion

For the reasons set forth above and in the Initial Briefs of NRECA/APPA, Public Citizen respectfully requests the Commission to reverse the Initial Decision insofar as it finds that AEP has carried its burden of proving that its two widespread groups of utility companies, East and West, are "physically interconnected or capable of integration and which may be economically operated as a single interconnected and coordinated system" as required by the Public Utility Holding Company Act of 1935.

Respectfully submitted,

Lynn N. Hargis
Counsel
Public Citizen, Inc.
215 Pennsylvania Ave. S.E.
Washington, D.C. 20003
(202) 454-5183

Administrative Law Judge Robert G. Mahony
Service List