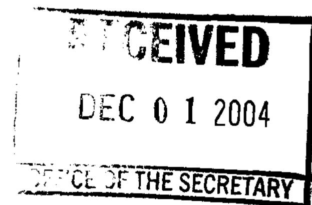


**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

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| In the Matter of | ) | |
| | ) | |
| AMERICAN ELECTRIC POWER COMPANY, INC. | ) | Administrative Proceeding |
| | ) | File No. 3-11616 |
| | ) | |

## RESPONSE OF PUBLIC CITIZEN, INC. TO NARRATIVE SUMMARY OF THE CASE SUBMITTED BY AMERICAN ELECTRIC POWER COMPANY, INC.

Pursuant to the ruling of Administrative Law Judge Robert Mahoney at the prehearing conference held in the above-captioned proceeding on October 4, 2004, Public Citizen, Inc. ("Public Citizen"), through undersigned counsel, hereby files this Response to the Narrative Summary of the Case Submitted by American Electric Power Company, Inc., in this docket on November 15, 2004.

AEP relies heavily in its Narrative Summary for support on policies and actions of the Federal Energy Regulatory Commission (FERC) under the Federal Power Act. As discussed below, most of these FERC actions are inapposite, and where they deal with similar matters, the Congress has made it quite clear that the Public Utility Holding Company Act ("PUHCA" or the "Holding Company Act") trumps the Federal Power Act, not the other way around. AEP's other arguments as to why Ohio and Texas are in the same region of the country are pure sophistry and would clearly gut the heart of the statute if accepted.

Public Citizen believes that the Presiding Administrative Law Judge will determine on the basis of the evidence proffered by AEP, and that offered by other parties, that the Commission's initial decision should be reversed, and that AEP should be required to divest all of the properties of CSW acquired through the merger.

## I. The Commission May Not Abdicate its Responsibilities Under the Public Utility Holding Company Act (PUHCA) by Relying on Actions of the Federal Energy Regulatory Commission, Under an Entirely Different Statute, as AEP Suggests in its Narrative Summary

### A. FERC's "Open Access" Transmission Program Relies on the 1935 Federal Power Act and Cannot Change this Commission's Enforcement Responsibilities Under its Own 1935 Statute.

AEP's primary arguments, both in support of its theory of interconnection and in support of its theory of a single region, rely on actions of the Federal Energy Regulatory Commission (FERC) under the Federal Power Act. Public Citizen will argue, and will cite court and FERC precedent to show, that such abdication of this Commission's responsibilities under one statute to another agency that enforces a very different statute, is inappropriate and contrary to this Commission's statutory mandate. AEP states in its Narrative Summary ("NS") that the Commission "should not hesitate to recognize the impact of changes in engineering and technology – ***or the policies of other regulators, such as the FERC***—on its determination of whether a system satisfies the 'single area or region' requirement." NS at p. 14. AEP states that "in other contexts, the Commission and the courts have deemed it appropriate for the Commission to look to the FERC for its expertise in resolving anticompetitive operational issues," citing *Northeast Utilities,* Holding Co. Act Release No. 25273, 50 S.E.C. 511 (Mar. 15, 1991), *aff'd sub nom. City of Holyoke Gas & Electric Department v. SEC,* 972 F.2d 358 (D.C. Cir. 1992). However, reliance on *City of Holyoke* is not appropriate in this case. For one thing, the municipals there did not contest the question of whether the SEC could "watchfully defer" to

FERC, according to the court. "The Munis concede that '[w]atchful deference seems permissible'"... (972 F.2d at 364). The court therefore did not have to decide the issue of whether the SEC could, under its statute, "watchfully defer" to FERC. In this case, Public Citizen strongly contends that this Commission may not "watchfully defer" to FERC regarding whether holding companies that wish to merge are operating as an integrated system or are in a single "region" under the PUHCA statutory requirements.

Moreover, the court in *City of Holyoke* relies on *Wisconsin's Environmental Decade v. SEC,* 882 F.2d 523 (D.C.Cir. 1989), which states: "we are not prepared to say that the Commission abdicates its duty in an *exemption determination* by deciding to rely, watchfully, on the course of *state* regulation" on its determination as to whether a single state exemption is appropriate. 882 F.2d at 526-7, emphasis supplied. Public Citizen submits that relying on *state* determinations as to whether a "single state" exemption is appropriate is an entirely different matter from this Commission's reliance for its own determinations on anticompetitive or merger determinations or challenged deregulatory policy decisions by the FERC under the Federal Power Act. The primary purpose of the PUHCA 3(a)(1) exemption at issue in *Wisconsin Environmental Decade* is to exempt utility holding companies where the state commission has adequate jurisdiction to regulate the actions of such companies over their regulated utility subsidiaries. The appropriateness of relying on *state* determinations regarding *state* authority under a statutory provision designed to support effective state regulation has no bearing whatsoever on activities of the FERC under the Federal Power Act.

Indeed, the *City of Holyoke court* found that: "[T]he SEC may not rely upon the FERC's concurrent jurisdiction over an acquisition as a reason to shirk its own statutory mandate to determine the anticompetitive effect of that transaction. *See, e.g., Municipal Elec. Ass'n,* 413

F.2d at 1059-60...." 972 F.2d 358 at 363. Similarly, Public Citizen believes that the SEC may not rely upon FERC's deregulation programs, all of which are currently under challenge and are being changed by FERC in any event, to determine what constitutes a "region" or "a single, integrated system" under PUHCA.

Unlike section 3(a)(1) of PUHCA, there is no statutory purpose of PUHCA to grant exemptions where the Federal Energy Regulatory Commission has concurrent jurisdiction. To the contrary, section 318 of the Federal Power Act specifically provides that where the two agencies have jurisdiction over "the same matter," PUHCA trumps the FPA. 16 U.S.C. §825q; *cf., Arcadia, Ohio v. Ohio Power Company,* 111 S.Ct. 415 (1991).

In any event, as the SEC's staff 1995 report to Congress promptly points out when asserting a right of this Commission to "watchfully defer" to FERC, where this was done, the outcome was not good, since the FERC merger approval relied upon by this Commission was promptly reversed and remanded to FERC by the Court of Appeals. [p. 68 of Report].

We believe it would have been an imprudent action of this Commission to rely on FERC in a merger case in any event, even if the statutes permitted it (which they do not as shown above) since the standards for mergers of holding companies under PUHCA and of utilities under the FPA are completely different. Moreover, FERC has instigated a merger policy under the Federal Power Act that encourages merging utilities to be far enough apart that they allegedly do not increase concentration of ownership in the same "market" areas. Section 11 of PUHCA, on the other hand, requires holding company utility acquisitions to constitute a single integrated system operating within the same "region" of the country.

The two standards are essentially opposites; one requires the merging utilities not to be "concentrated," while the other requires them to be geographically integrated and operating in a

single region. This makes its all the more interesting that AEP has advocated, and continues to advocate, that it complies with both of these opposing standards. What is more alarming, this Commission has chosen to approve under PUHCA a merger that complies with FERC's "non-concentrated" merger requirements.

Finally, in regard to FERC's "interconnection" orders under Order No. 888, we will show that Order No. 888 was promulgated under sections 205 and 206 of the Federal Power Act, sections that have not changed in their relevant provisions since 1935, when the Federal Power Act was the second, and far less important, part of the Public Utility Act of 1935. The first part of that legislation was the part that gave rise to the fiercest legislative battle of FDR's first term, and the law whose enforcement has been called the "most effective antitrust enforcement program in U.S. history"[1]: the Public Utility Holding Company Act of 1935. Since the Congress in 1935 clearly anticipated that the non-discrimination provisions of sections 205 and 206 of the Federal Power Act would be enforced by the then Federal Power Commission, as they are in Order No. 888, AEP cannot successfully argue that Order No. 888 can have changed in any way the congressional interpretation of the concurrent 1935 provisions of PUHCA requiring the merged companies to operate as a single, integrated utility system. In short, this Commission cannot rely on FERC's enforcement, however belated, of the 1935 nondiscriminatory transmission access provisions of sections 205 and 206 of the Federal Power Act, as a reason to fail to enforce the provisions of its own 1935 statute requiring operation as a single integrated system.

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[1] Dean Joel Seligman of Washington Law School, the unofficial historian of the Securities and Exchange Commission, has said that:"[T]he enforcement of Section 11 of the Holding Company Act was the most effective antitrust enforcement program in United States history…." Seligman, *The Transformation of Wall Street; A History of the Securities and Exchange Commission and Modern Corporate Finance,* Northeastern University Press, Boston, First Edition, p.247

B. This Commission Cannot Rely on Changing and Statutorily Challenged Orders of the FERC that Create Electricity Markets under the Federal Power Act in Carrying Out the SEC's Own Statutory Responsibility to Determine "Regions" for Purposes of the Public Utility Holding Company Act.

AEP relies even more heavily on the FERC's actions under the Federal Power Act to claim that Ohio and Texas could somehow, conceivably, have been considered the same "region" of the country by the congress that enacted the Public Utility Holding Company Act of 1935. AEP's entire "Section iii" of its argument details actions of the FERC, including Order No. 888 discussed above. As we have shown, the 1935 sections 205 and 206 of the Federal Power Act have not changed in their relevant provisions since the two statutes were enacted and therefore orders under them cannot be said to somehow change the 1935 definition of a "single, integrated system;" the same is true for the 1935 definition of a "single area or region."

Some of FERC's deregulatory actions cited by AEP, as we will show, are being successfully challenged in the U.S. Courts of Appeal as being outside the statutory authority of the FERC. For example, the Ninth Circuit Court of Appeals has recently found that the FERC cannot interpret its statute so as to eliminate the primary consumer protections of section 205 of the Federal Power Act by allowing "markets" to determine rates without any FERC review or remedy. *California ex rel. Lockyer v. FERC,* 383 F.3d 1006 (9th Cir. 2004). The decision is being challenged on rehearing by some generators, but not by FERC.

Even broader statutory challenges to FERC's entire market rate program have been filed in the D.C. Circuit Court of Appeals challenging the statutory basis for FERC's market rate regime in two different cases, both entitled *Colorado Office of Consumer Counsel, et al.,* No. 04-1238 and No. 04-1303.

And there is good reason to believe that these statutory challenges will be successful. The D.C. Circuit has issued several recent decisions reversing and remanding FERC orders on

the ground that FERC was acting outside its statutory mandate, and reminding that agency that it is a creature of statute that has no powers beyond those that the statute gives it. ("As a federal agency, FERC is a 'creature of statute,' having 'no constitutional or common law existence or authority, but *only* those authorities conferred upon it by Congress.'" *California ISO v. FERC*, __F.3d __ (2004), citing *Atlantic City Elec. Co. v FERC,* 295 F.3d 1 (D.C. Cir. 2002). (emphasis original.) "Therefore, 'if there is no statute conferring authority, FERC has none.'" *Id.*)

In addition, FERC's "de-tarrificking" of electric rates under a statute that requires the filing of all such rates would appear to be expressively forbidden under a line of D.C. Circuit and U.S. Supreme Court cases, several of which were written by (now) Supreme Court Justice Antonin Scalia. *MCI Telecomm. Corp. v. AT&T Co.,* 512 U.S. 218 (1994)(rates are required by statute to be filed, even by non-dominant competing carriers); *Maislin Industries v. Primary Steel,* 497 U.S. 116 (1990)(individualized rates not permitted by statutory scheme); *FPC v. Texaco, Inc.,* 417 U.S. 380 (1974)(agency could not rely on market forces to contain unfilled rates of small gas producers within just and reasonable limits). While the D.C. Circuit has approved certain limited FERC market rate orders, it has made clear that it was NOT deciding an attack on FERC's entire market rate regime. *Louisiana Energy and Power Authority v FERC,* 141 F.3d 364 (D.C. Cir. 1998).

Of course, the FERC SMD program on which AEP would have this Commission base its decision (NS at p.19-21) has not even made it out of the FERC, because of the outrage of state commissioners and their Congressional Members over what has been perceived as a patent power grab attempt over electric generation by the FERC. Despite the fact that jurisdiction over generating plants (and distribution) was specifically withheld from FERC in the Federal Power

Act[2] and left with the States, FERC has continued to try to leverage its jurisdiction over transmission and wholesale sales to attempt to gain control over electric generation. Given the uproar over the cited SMD rulemaking, it appears that FERC will be unlikely to accomplish this power grab over power plants without a change in its statute. Unlike the Federal Powr Act, PUHCA gives this Commission clear jurisdiction over the owners of electric generation and distribution, as well as of transmission facilities, both in this country and abroad. The far broader reach given by Congress to this Commission under the Holding Company Act cannot be cabined within FERC's inferior and far more limited statutory authority under the Federal Power Act.

Thus, even if this Commission had the statutory authority to rely on FERC's policies in enforcing the very different Federal Power Act (which it does not), such policies would currently appear to be a very uncertain support on which to rely. In addition, FERC is constantly changing its "market power" tests, as each one fails to deter actual market power, as has become painfully clear in California, the west and across the nation.

For example, it seems clear that it would be even more foolhardy for this Commission to rely on FERC's competitive analyses for purposes of PUHCA since these continue to change. In AEP's "section iv" of its Summary Narrative, AEP quotes orders of this Commission relying on relevant energy "regions" by application of the concept of the service areas of "first-tier utilities" to determine competitive "markets." This "first-tier utility" concept came from FERC's long discounted and outmoded "hub and spoke" theory of merger analysis. FERC itself has found, on the record in its recent market rate case (that is the subject of the appeal in D.C.Circuit No. 04-

[2] Section 201(b)(1) of the Federal Power Act provides in pertinent part: "The Commission shall have jurisdiction over all facilities for such [interstate]transmission or [wholesale] sale of electric energy, but shall not have jurisdiction, except as specifically provided in this Part and the Part next following, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce.... 16 U.S.C. 824.

1238, described above) that this hub and spoke analysis cannot be relied upon to produce "just and reasonable" rates, and FERC itself has abandoned it.

This Commission would look fairly foolish if it relied on the "competitive" analysis of another agency that has, itself, discarded that analysis as unsuccessful, although this is what AEP urges this Commission to do in citing to FERC's former "first tier utility" analysis. This is simply one more stark example of why this Commission cannot rely on FERC's actions under a very different statute for purposes of its own enforcement under the Public Utility Holding Company Act, as AEP's entire Narrative Summary urges this Commission to do.

## II. Aside From Urging This Commission to Rely on FERC Policies and Orders, AEP has Made no Offer of Proof that Would Enable this Commission To Approve its Merger with CSW Under PUHCA

Most of AEP's arguments rely on FERC orders and actions under the Federal Power Act to support AEP's arguments under the very different and far broader statutory purposes and requirements of PUHCA. As we have shown, both the statutes and the court cases cited do not support such an abdication or shirking of this Commission's responsibilities under its own statute, PUHCA, that clearly trumps the Federal Power Act where the two intersect. AEP's other arguments are equally weak.

In terms of the use of a unidirectional transmission contract, AEP simply argues that—if the need arises—it can use its transmission rights in the opposite direction instead. Whether or not it is true as AEP states that "from time to time" it can use its transmission contract in two directions (NS at p. 6), this hardly constitutes the type of interconnection that allows an electric utility system to be operated as a single, integrated system on an ongoing basis. Nearly every utility in the country can exchange power on an occasional basis with other, distant utilities; AEP's argument would clearly read section 11's core requirement of operation as a "single,

integrated system," within a single region, out of the statute, and the courts have clearly said that this cannot be done. *National Rural Electric Co-op Ass'n v. S.E.C.,* 276 F.3d at 618.

AEP also argues that AEP and CSW are not "distant," based on other SEC orders. (NR at pp. 9-10.) While such recent orders may offer the virtue of consistency, none of these determinations was appealed so no court has agreed that they correctly interpret the Holding Company Act, and Public Citizen submits that they do not.

In terms of whether the AEP and CSW companies constitute a "single area or region," Public Citizen believes that this may be a place where the Commission should take into account changed circumstances. The 1944 and 1945 *Middle West* orders appear to have allowed the different parts of the CSW holding company to remain combined because those areas were "arid and sparsely-settled," and the combination was necessary to provide adequate service, even though it would otherwise not be permitted. (See, NS at p. 12.) Public Citizen believes that these facts no longer are valid, and that the Commission should not only disapprove the AEP/CSW merger, but should also consider breaking up the CSW companies, which appear to no longer comply with the statutory requirements of constituting a "single, integrated" system in the same region or area.

Finally, AEP argues that section 2(a)(29)(A) must be interpreted as a whole and in light of the overall purposes of the Act. (NS at p. 14.) Public Citizen could not agree more. The purpose of PUHCA was to break up the huge holding companies whose abuses had filled 101 volumes of the Federal Trade Commission, and more volumes of congressional hearings, and had led to 53 utility holding company bankruptcies and 23 utility bank loan defaults within a short six year period. Since AEP's approach would permit the mergers of holding companies of any size and any location in the name of "advanced technology"—even though the concern of

PUHCA was for "local management" and "effective state regulation," regardless of technology—AEP's arguments supporting its merger with CSW cannot be accepted by this Commission without destroying the heart of the Act. As the CSW orders cited by AEP demonstrate, that system was "huge" to begin with. Public Citizen believes that the fact that AEP's own huge system survived was probably simply a failure of political will. The idea that the framers of PUHCA would actually sanction the creation of this combination of two, huge, distant holding companies based in Ohio and Texas is, frankly, ludicrous (to choose one of the nicer terms that could be applied.)

There are only three electrical interconnections in the United States, and AEP cannot even claim that its merged utilities are within only one of them (even though this standard would still mean that PUHCA could sanction the existence of only three utilities in the nation, if AEP's arguments prevailed, a result that PUHCA was clearly designed to prevent.) Indeed, the Texas interconnection of ERCOT is not even subject to the jurisdiction of the FERC, since Texas has refused to integrate its system with the rest of the United States except by order and with DC interties, as we will show.

These utilities are NOT in the same region of the country by any common sense standard. By electrical standards, they are even less so. As the Ninth Circuit recently stated, the U.S. Supreme Court has held that courts (and agencies) are required not only to analyze provisions in the context of the entire governing statute, but also "we must be guided to a degree by common sense as to the manner in which Congress is likely to delegate a policy decision." *Lockyer v. FERC,* 383 F.3d at 1016-17, quoting *Brown v. Williamson Tobacco Corp.,* 529 U.S. 120, 125-26. As one of AEP's employees recently stated in explaining why an AEP utility had gone back to its original name of Indiana Michigan Power, as part of AEP's own recent decision to split its

distribution and customer service operations into seven "regional" utility divisions: "The advantages of a decentralized system....is that [the regional COO] is better able to assess the region's energy needs....and also in a better position to work with the utility regulatory commissions in Indiana and Michigan....What's important to us might be different than what's important to folks in Texas." See, Attachment A.

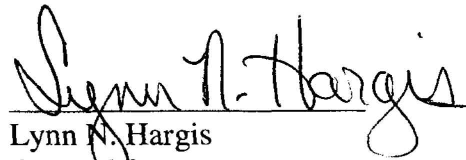
Public Citizen suggests that AEP's departmental "regions" are probably exactly the type of "regions" that the draftors of PUHCA had in mind for ownership and control of utilities in order to ensure "local" management and control and "effective" state regulation, and prevent the giant consolidations of utility ownership known as the "power trusts" that created the problems and abuses that PUHCA was supposed to correct and prevent on an forward-going basis.

Instead, AEP would have this Commission administratively repeal the heart of PUHCA by essentially defining the same "region" of the country as including any location in which AEP is able to purchase a utility system that can be reached by an existing AEP utility system via a transmission line. AEP's arguments, for all their legalistic or engineering language, boil down to no more than this. Employing common sense in the context of the purposes of the Holding Company Act, these arguments make no sense. As the court stated in remanding this case: "The Commission may not interpret the phrase 'single area or region' so flexibly as to read it out of the Act." 276 F.3d at 618.

## Conclusion

As described above, Public Citizen will show that AEP's arguments fail both the statutory and common sense tests and cannot be sustained.

Respectfully submitted,



Lynn N. Hargis
Counsel for
Public Citizen, Inc.

Date: November 30, 2004
Attachments
Cc: Administrative Law Judge Robert G. Mahoney
All Persons Identified in Attached Certificate of Service

Attachment A

South Bend Tribune (Indiana)

November 17, 2004 Wednesday

HEADLINE: AEP's going back to old name I&M; Corporatewide reorganization prompts move

BYLINE: By CAROL ELLIOTT; Tribune Staff Writer

Local customers of American Electric Power are about to go back to the future.

The utility recently decided to change its name back to Indiana Michigan Power, which it last used in the 1990s.

Customers will start seeing the new name on their bills in December or January.

"What we are saying is that not only do we have the advantages of a big-name utility, but we're also a local utility," said Indiana Michigan Power spokesman David E. Mayne.

The change resulted from a corporatewide reorganization of AEP's distribution and customer service operations into seven regional utility divisions.

Indiana Michigan Power is based in Fort Wayne and includes about 575,000 customers in the two states.

Logos on maintenance and repair trucks will be replaced in four to six months, as will signs in front of the utility's area service centers, said Mayne. But customers won't see other big changes in operations.

Customer service numbers will stay the same. Electric rates are not scheduled to change, either, said Mayne.

"What customers should see is a more focused approach on the maintenance of our distribution system," said Mayne.

The utility plans to continue its aggressive tree-trimming program in the Michiana area. AEP spent about $10 million to $15 million for tree-trimming since spring 2002 in the Michiana district in an effort to head off outages.

The stepped-up effort came after the utility suffered from one of the worst outage records in the state in the late 1990s.

Marsha Ryan, the president and chief operating officer of the regional office, has full authority over regional operations.

The advantage of the decentralized system, said Mayne, is that Ryan is better able to assess the region's energy needs.

Ryan and her staff are also in a better position to work with the utility regulatory commissions in Indiana and Michigan, said Mayne.

"What is important to us might be different than what's important to folks in Texas, said Mayne. "The purpose is for us to be closer to our customers, more responsive."