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

REPLY BRIEF FOR THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION AND THE AMERICAN PUBLIC POWER ASSOCIATION

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In accordance with the post-hearing scheduling order of January 18, 2005, the National Rural Electric Cooperative Association (NRECA) and the American Public Power Association (APPA) submit this brief in reply to the Post-Hearing Brief Submitted by American Electric Power Company, Inc. ("AEP") and the Post-Hearing Brief and Statement of Position of the Division of Investment Management ("the Division").

SUMMARY OF ARGUMENT

The Commission instituted this hearing to provide the "further supplementation of the record" needed "to determine on remand whether the combined AEP and CSW systems meet the relevant standards of sections 10(c)(1) and 11(b)(1) of the Act and in particular, what specific facts about AEP's and CSW's electric systems and the geographic area covered by their systems are relevant to the required determinations."[1]

In its post-hearing brief, AEP argues that it has met its burden of proof of demonstrating that with its proposed acquisition of Central and South West Corporation ("CSW"), the utility assets of the combined AEP and CSW systems constitute a "single integrated public-utility system" under section 2(a)(29)(A) of the Public Utility Holding Company Act ("PUHCA" or "the Act")—namely, a system (1) "whose utility assets . . . are physically interconnected or capable of physical interconnection" and (2) that is "confined in its operations to a single area or region . . . ."[2]

In its brief, the Division also takes the position that AEP has met its burden of proof. At the hearing, the Division cast off the mantle of objectivity and attempted—over NRECA and APPA's objection—to adduce further testimony from AEP's witnesses to support AEP's case,

[1] *Am. Elec. Power Co.*, PUHCA Release No. 35-27886, slip op. 1-2 (S.E.C. Aug. 30, 2004).

[2] 15 U.S.C. § 79b(a)(29)(A) (2000).

which the Division now cites in its brief and proposed findings of fact.[3] NRECA and APPA reiterate their objections to this improperly elicited testimony.

Moreover, the Division—but not AEP—cross-examined the witnesses of Public Citizen, Inc., which submitted testimony opposing AEP's application. And now on brief the Division argues that Public Citizen's testimony, as well as the cross-examination testimony of AEP's witnesses elicited by NRECA and APPA, fails to rebut the evidence supporting AEP and the Division's position.[4]

The Act imposes on the Commission an obligation to protect investors, consumers, and the general public and to effectuate the policy of the Act.[5] The Division's affirmative efforts on AEP's behalf are inimical to those purposes. The Division emerges as simply another special-interest group advancing its institutional agenda—in this case, a decade-long effort to obtain the repeal of the Act[6] and, pending that repeal, the preservation of the line of Commission precedent it has amassed in recent years effectively eviscerating the Act's requirements limiting the size of holding companies.

This last point should not be overlooked. The court of appeals has vacated the Commission's earlier order of June 14, 2000, approving AEP's acquisition of CSW.[7] But that now-vacated order became the basis for Commission rulings later that year approving at least four other acquisitions subject to PUHCA. Rather than questioning the viability of this line of

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[3] Div. Br. 10-15.

[4] Div. Br. 43-44.

[5] *See* 15 U.S.C. § 79a (c)

[6] Division of Investment Management, The Regulation of Public-Utility Holding Companies (June 1995).

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

precedent in light of the court of appeals' decision—surely the more sensible approach—and possibly seeking to reopen those cases, the Division (like AEP) cites those cases as if they somehow support the result here. But bootstrap arguments by AEP and the Division will not provide the reasoned decision that the court found wanting when it vacated the Commission's earlier order.

In some respects, the Division is following the script that AEP developed three years ago and privately provided to the Division in the apparent hope of containing the damage caused by the court of appeals' decision. Shortly after the court's decision, but before the court had issued its mandate or the period for requesting rehearing or *certiorari* had expired, AEP—represented by a former Division lawyer who co-authored the 1995 Division report recommending PUHCA's repeal—provided the Division a lengthy memorandum with a "proposed approach" to the remand proceeding, detailing the evidence and arguments that AEP said it could present to the Commission in order to satisfy the court of appeals' concerns. Months later, NRECA and APPA obtained this apparently lawful *ex parte* communication in response to a request under the Freedom of Information Act.[8] A copy of that memorandum is attached to this brief.[9] The Commission inexplicably took several months to provide this single document and apparently would not have shared it in this highly contested proceeding absent the FOIA request.

With respect to the interconnection requirement, the Division's brief marches in lockstep with the approach AEP had previously suggested, tracking the arguments and the authorities cited in AEP's memorandum. As for reading the single-area-or-region requirement out of the

[8] 5 U.S.C. § 552 (2000 & Supp. 2003).

[9] American Electric Power Company, Status of Matters Following D.C. Circuit's Decision in NRECA v. SEC Memorandum, February 8, 2002 ("AEP Memo.").

Act, the Division's brief builds on but goes even further than AEP proposed then or presents now on brief.

But the extraordinary tactics of AEP and the Division are, in the end, only testimony to the fact that the AEP-CSW merged company, by any reasonable measure, flouts the Act's central requirement that a registered holding company constitute a single integrated public-utility system. The post-hearing briefs of AEP and the Division present a vague, contradictory, and unsupported pastiche of arguments that do not provide a reasoned basis for finding that the proposed acquisition satisfies the requirements of the Act.

The proposed findings of fact and conclusions of law AEP and the Division have presented should be rejected. The Division's proposed findings of fact, in particular, are replete with errors and should not be the basis for a proposed decision in this case. NRECA and APPA have therefore appended to this brief a list of errors in the Division's proposed findings of fact.

Interconnection requirement. The court of appeals' decision correctly apprehended the key fact that AEP and the Division concede: AEP has a contract right to firm (uninterrupted) transmission service in only one direction—from AEP to CSW.

AEP speculates that the court did not understand AEP's other contractual and tariff rights to obtain transmission service in the opposite direction; but AEP still points to no right to move power except in one direction.

AEP argues that Commission precedent does not require it to obtain a two-way firm contract path; but the only precedent it cites are decisions that followed the now-vacated order in this case, which therefore proves nothing. General statements from other cases will not provide a basis for a reasoned decision in this case.

AEP argues that it does not need two-way firm transmission rights to operate as a single system. But AEP's argument assumes its conclusion: if AEP is willing to operate with only unidirectional firm contract rights, then AEP is interconnected and integrated under the statute's standards. By defining interconnection however it chooses, AEP guarantees it meets the standard every time. By AEP's analysis, it could drop even the unidirectional firm contract path if it wanted, and still meet the interconnection requirement.

AEP's evidence of the meager transfers of energy between AEP and CSW since 2000 proves nothing, and in fact calls into question the extent to which these two systems are actually operating as a single system. Two unaffiliated companies could trade power and energy using open-access transmission tariffs ("OATTs"), but that obviously does not make them a single integrated public-utility system.

In the end, AEP's test would eliminate the interconnection requirement and allow the development of holding companies with scattered systems throughout the country.

The Division accepts AEP's arguments *in toto*, but its brief has so many factual errors that it is difficult to give much credence to its analysis.[10] The Division contends that it is "critical" for purposes of meeting the interconnection requirement that AEP have the "ability" to use transmission capacity to move power in all directions throughout its system. The Division mistakenly concludes that AEP has shown that ability; but AEP merely showed it *may* be able to move power from west to east and was sometimes able to do so in the past—although it was unable to show that it will have that ability in five of the next 24 months.

The Division ultimately concludes that AEP needs to prove nothing at all about its contracts or power flows: AEP and CSW are "capable of physical interconnection" if there

[10] See the attached list of errors in the Division's proposed findings of fact.

appear to be alternative transmission paths between them, even though the physical availability of service is unknown and AEP has not investigated them because they are in fact likely to be too expensive.

The court of appeals also required the Commission to explain why it was departing from precedent stating that contract paths cannot be used to integrate distant utilities like AEP and CSW. AEP's main response is to dispute the court's premise and argue that AEP and CSW are no more distant from one another than other holding companies recently approved by the Commission. In this regard, AEP obscures the fact—acknowledged in AEP's application and the Commission's earlier order—that AEP has to rely on multiple transmission contracts to create a "path" from AEP to CSW. Thus, its "Contract Path" is longer than the 250 miles of the "Ameren Path." This distinction is lost on the Division, which uses the two terms interchangeably; it this type of fundamental misunderstandings that undercuts any persuasiveness of the Divisions' arguments. If AEP's transmission contracts to use the portions of the MOKANOK line owned by other utilities are included in the "Contract Path," then AEP concedes the path is approximately 400 miles long, although it provides no support for this number and the actual number would appear to be greater.

In any event, AEP notes that one of the co-owners of the MOKANOK line has given notice to terminate its MOKANOK transmission contract with AEP. This termination demonstrates why—until this case came along—distant utilities did not rely on transmission contracts to integrate their operations and the Commission had declared they could not do so. Such contracts can be terminated and leave distant utilities with no economic alternative means of interconnection. The potential availability of transmission service over the lines of another utility or an RTO is not interchangeable with contractual rights to such service.

Looking ahead, the AEP-CSW holding company would cross two Interconnections, and the AEP-CSW companies would be members of three RTOs and contract for service over a fourth. Multiple contracts involving multiple utilities or RTOs will be inevitable.

Given the facts, AEP and the Division do not provide a convincing reason for the Commission to depart from its precedent. All the cases they cite involve either utilities that were not distant, holding company systems that were within a single power pool, or the four decisions that followed in the wake of this case and thus perpetuated its error.

Single-area-or-region requirement. The Division concedes that from a geographic perspective, simple common sense tells us that AEP and CSW are not in the same area or region. To escape that result, the Division misreads the statute and Commission precedent to render geography—and especially geographic proximity—irrelevant to the single-area-or-region requirement. In the Division's view, all that matters is theoretical economics, and for this purpose it proposes a curious "economic, market-based" test: Does the holding company system operate like a market? But this test is created out of whole cloth and has absolutely no support in the statute or case law, which clearly call for an examination of geography. The Division's test is tailor-made, however, for the approval of holding companies with geographically distant, separated systems like AEP-CSW. This test would place no limit on the size of holding companies and thus read the single-area-or-region requirement out of the Act, just as the court forbade the Commission from doing again. The Division may earn a mark for creativity, but its proposed "system-as-market" test should be rejected.

For its part, AEP tries a shotgun approach, proposing four theories under which it claims one can find a region large enough to accommodate its sprawling operations. None of its theories survives scrutiny.

The common theme of three of these theories is that the regulatory policies of the Federal Energy Regulatory Commission ("FERC") require OATTs and encourage the formation of RTOs to facilitate trading of wholesale electricity between utilities. AEP outlined these arguments for the Division in the memorandum with AEP's "proposed approach" to the remand proceeding, and they also find their way into the Division's brief.

First, AEP proposes that the Eastern Interconnection—a 40-year-old, voluntary group comprising all utilities in the eastern half of North America, except part of Texas—is a single region because it has "evolved" into a single market under FERC's recent policies. Assuming *arguendo* and contrary to the available evidence that the Eastern Interconnection has evolved into a single market, it remains unclear why a single market should define the single region that confines the allowable size of a holding company under PUHCA. In any event, it is clear that the Eastern Interconnection is not a single market. Since AEP's proposal would render the region requirement virtually a dead letter and has no empirical support, it should be rejected.

In any event this "region" is still not big enough for AEP, since it would exclude CSW's operations in the Electric Reliability Council of Texas ("ERCOT"). In a leap of illogic, AEP argues for including CSW's ERCOT operations anyway, since they are geographically proximate to CSW's operations in the Eastern Interconnection. But such as pastiche of inconsistent arguments cannot save this merger.

AEP's next theory is only slightly less audacious: define three RTOs in the Eastern Interconnection as a single region. The RTOs are the Pennsylvania-New Jersey-Maryland Interconnection ("PJM"), the Midwest Independent System Operator ("MISO"), and the Southwest Power Pool ("SPP"). AEP argues that these three RTOs have, or soon will have, similar operating rules, which will facilitate transactions among them, and this will make them a

single market. AEP's theory leaps ahead of the facts, however. FERC—and even AEP in filings with FERC—acknowledge that these three RTOs remain separate markets. AEP presents no data about the extent of electricity trading between these RTOs. And once again, AEP has the nettlesome problem that part of CSW remains outside this defined region.

Third, AEP proposes to define a region consisting of AEP, CSW, and all utilities with which they are directly interconnected. While this size comparison may be useful for other purposes, it serves no purpose here, since it produces an absurd result: it would automatically define a single region larger than AEP and CSW—or any other two holding companies that wanted to combine. This proposal would place no limits on holding company size and makes the single-area-or-region requirement a dead letter.

Fourth, AEP proposes a region comprising virtually the entire Eastern United States because of various *non-electrical* economic patterns—*e.g.*, shipping and trading of goods between the South and the Midwest. But this data is so imprecise and general that it proves very little and defines very little; indeed, the boundaries of the resulting diffuse region remain undefined. It would again spell the end of enforcement of the single-area-or-region requirement.

ARGUMENT

I. The merged company does not satisfy the interconnection requirement.

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

The statute requires that the utility assets of AEP and CSW be "physically interconnected or capable of physical interconnection." The court of appeals found that "the Commission's acceptance of a unidirectional contract path to 'interconnect' AEP and CSW" was unexplained.[11] The court stated that "interconnection" of utility assets "seems, on its face, to require two-way

[11] *Id.* at 615.

transfers of power."[12] 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."[13] 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."[14]

AEP concedes on brief that its only firm transmission contract right is to one-way service from AEP to CSW.[15] The Division correctly describes the consequence of this truth: "there is not a single bi-directional path upon which AEP can rely . . . ."[16]

Boxed in, AEP contends that that the court of appeals did not require a two-way firm contract path.[17] AEP says the court only required "'two-way transfers of power'" and did not require firm transmission service.[18] There is no reason for the Commission to embrace this suggestion.

Implicit in the court's analysis is a willingess to allow a bi-directional "contract path" to satisfy the interconnection requirement. The word "contract" bears emphasis, because in the immediately preceding discussion the court held that the Commission reasonably could allow the interconnection requirement to be satisfied by "*contractual rights to use* a third-party's transmission lines or [that] physical interconnection is contemplated or . . . possible within the

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[12] *Id.*

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

[14] *Id.* at 615.

[15] AEP Br. 8-10.

[16] Div. Br. 19.

[17] AEP Br. 10.

[18] *Id.* (quoting 276 F.3d at 615).

reasonably near future."[19] Thus, contractual rights to use another utility's physical lines were 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,[20] the ineluctable conclusion is that the contingent availability of non-firm transmission service is not an acceptable substitute for building a physical line, which is surely a reasonable result.

The Division's brief states that "[i]nterconnection, as the word itself clearly implies, is fundamentally about whether transmission capacity exists that will permit a holding company system to transmit power or cause power to be transmitted between various parts of is system. This ability is critical . . . ." But without ownership of the lines or the legal, contractual rights to use the lines at will, this "ability" "to transmit power or cause power to be transmitted" is absent—it is only a hope.

Similarly, the statute's use of the word "capable" to define the alternative test—"physically interconnected or capable of physical interconnection"—implies in the context of electric utilities ownership rights or the "availability of service as a matter of contractual right,"—not merely the availability of service "as a practical matter."[21] This accords with the standard dictionary definitions of "capable," which as applicable here include "susceptible," or "having attributes (as physical or mental power) required for performance or accomplishment" or "having legal right to own, enjoy, or perform."[22] Capable does not imply contingent or possible or uncertain or interruptible—all of which are characteristics of non-firm transmission service.

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[19] 276 F.3d at 615 (quoting *Madison Gas & Elec. Co.*, 168 F.3d 1337, 1340 (D.C. Cir. 1999) (emphasis added).

[20] 276 F.2d at 612.

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

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

Thus, the court correctly recognized that AEP only had contractual *rights* to transmission service in one direction—the very point AEP and the Division concede.

AEP claims to have "presented substantial evidence showing the Contract Path acquired to move power between the AEP east (initial AEP) and AEP west (formerly CSW) zones is not limited to unidirectional flow of power."[23] AEP contends that the court of appeals did not understand the extent of AEP's bundle of rights.[24] But as NRECA and APPA noted in the opening brief, that statement is misleading, because AEP's contract and tariff rights gave it no assured right to transmission service except in one direction. The Division, however, blindly accepts AEP's representations, erroneously concluding that with non-firm transmission service, "[p]ower is capable of being transmitted rapidly between AEP East and AEP West as needed."[25] This is simply not the case.

AEP also contends that Commission precedent does not require two-way firm transmission service in cases like this.[26] But the only cases AEP cites are the series of Commission orders from late 2000 that followed the Commission's earlier order in this case.[27] This is not precedent, but simply repeated error. It suggests the Commission should reconsider the result in those cases, not attempt to use them after the fact in circular fashion to bless a previously but erroneously approved proposed acquisition.

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[23] AEP Br. 8.

[24] AEP Br. 11 n.4.

[25] Div. Br. 13.

[26] AEP Br. 10.

[27] *Id.* (*CP&L Energy, Inc.*, Holding Co. Act Release No. 27284, 54 S.E.C. 996 (Nov. 27, 2000); *Exelon Corp.*, Holding Co. Act Release No. 27256 (Oct. 19, 2000); *Energy East Corp*., Holding Co. Act Release No. 27224 (August 31, 2000); *New Century Energies*, Holding Co. Act Release No. 27212 (August 16, 2000).

The Division similarly claims that "implicit" in Commission precedent is an understanding that interconnection depends not on contract rights over a specific path, but rather "the predictable ability to move power."[28] The Division claims that this can be satisfied by an OATT or power pool—but the cases the Division cites concern holding companies within a single power pool or RTOs, or cases that erroneously relied on the now-vacated order in this case.[29]

AEP's central argument is that it does not require two-way firm transmission rights to operate as a single system.[30] From this assertion, AEP somehow reaches the conclusion that PUHCA must accommodate AEP's business plans: if AEP is willing to operate with only a one-way contract right, then who is Congress or the Commission to stand in its way? If AEP deems itself to be "integrated," how can PUHCA require otherwise? The Division accepts this argument: AEP "needs" only non-firm service.[31] But by allowing the whims of the holding company to define the integration requirement—and by extension the interconnection requirement—AEP and the Division guarantee that AEP will satisfy the requirements every time. In this vein, AEP asserts that it would "ironic" if PUHCA required them to obtain an expensive two-way contract path in order to be integrated.[32] But registered holding companies are not allowed to redefine the integration requirements of the Acts to fit their business plans.

AEP's exhibits showing it has transferred relatively small amounts of energy between AEP and CSW—and much smaller amounts of energy between CSW and AEP—prove nothing

[28] Div. Br. 25.

[29] Div. Br. 25-30.

[30] AEP Br. 11-12.

[31] Div. Br. 13.

[32] AEP Br. 12-13.

with respect to the interconnection requirement. Any two unaffiliated companies could trade small amounts of energy over third-party transmission lines; but that obviously does not make them an integrated public utility system that can transfer power and energy as needed as a matter of right. The Division nonetheless deems them determinative evidence of interconnection.[33]

Both AEP and the Division rely on general changes in the industry as an argument for relaxing the interconnection requirements of PUHCA in this case. This was the central theme of AEP's memorandum laying out for the Division its proposed approach to the remand proceeding.[34] But generalities will not suffice. As the Division concedes, the interconnection requirement is a factual issue.[35] Yet AEP and the Division devote pages of their briefs to descriptions of general policy changes—or mere proposals—by FERC, with little discussion of how they relate to the *facts* demonstrating the interconnection of AEP and CSW.[36] It is not self-evident that the mere adoption by FERC of open-access transmission policies to accommodate electricity trading *between* utility companies—and indeed to encourage the market entry of new suppliers and remedy undue discrimination by transmission-owning public utilities like AEP and CSW—should translate into a relaxation of PUHCA's requirements for a "single integrated public-utility system" so as to permit the indefinite expansion of such holding companies throughout the grid.

The Division concludes with three arguments for why AEP has satisfied the interconnection requirement. First, the Division contends the "Contract Path" amounts to "actual

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[33] Div. Br. 31.

[34] AEP Memo. ____.

[35] Div. Br. 2.

[36] AEP Br. 16-18; Div. Br. 8-9, 19-20.

physical interconnection" used to transfer power in both directions.[37] As shown above, however, AEP only has a contractual path that provides service as a matter of right in one direction, a point the Division conceded elsewhere in its brief.[38]

Second, the Division claims that AEP and CSW are interconnected by unspecified, unidentified transmission service contracts under OATTs.[39] The Division claims that this meets the standard of a "right to use" a third party's transmission lines, but AEP has presented no evidence of its contractual rights to use any line except its unidirectional Contract Path with Ameren and its MOKANOK contracts.

Third, the Division says that AEP and CSW are "capable of physical interconnection" because there are "alternative paths that AEP has not pursued because they were viewed as more expensive than the Contract Path" but "were available as backup." Thus, the Division in the end would require AEP to have no contracts at all. AEP would not even have to show that physical capacity is available if it wanted to enter into a contract. And AEP would not have to show that the price of such a transmission contract would enable AEP-CSW to operate economically as a single integrated public-utility system. Under this test, the interconnection requirement would become a dead letter.

The arguments of AEP and the Division would permit AEP to dispense with the fig leaf of a unidirectional contract path in favor of no contract path. AEP and CSW would be automatically interconnected without lifting a finger. AEP and CSW would not have to show the ability to transfer any energy between them, because that would be presumed. This would

[37] Div. Br. 31.

[38] Div. Br. 19.

[39] Div. Br. 31.

effectively dispense with the interconnection requirement and allow the development of giant holding companies with scattered operating companies within the vast regions that AEP and the Division also claim are proper under the Act. This interpretation would effectively end the enforcement of the Act.

B. AEP and CSW are distant utilities that cannot be interconnected by a contract path under Commission precedent.

The court of appeals correctly noted that "AEP and CSW's systems are neither contiguous nor physically interconnected—indeed, at their closest point, they are separated by hundreds of miles."[40] This made them "distant utilities."[41]

The court found that "the Commission failed to follow its own prior reasoning regarding interconnection of distant utilities"—decisions in which the Commission "has clearly indicated that a contract path cannot alone integrate distant utilities."[42] The Commission's prior statements were "sufficiently explicit to obligate the Commission to provide some rationale for its current contrary view."[43]

AEP's response is to dispute the court's premise and argue that AEP and CSW are no more distant from on another than other holding companies recently approved by the Commission.[44]

In this regard, AEP obscures that fact—acknowledged in AEP's application[45] and the Commission's earlier order[46]—that AEP has to rely on not just a contract with Ameren, but also

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[40] 276 F.3d at 612.

[41] *Id.* at 615.

[42] *Id.* at 612.

[43] *Id.*

[44] AEP Br. 14.

contracts to use the MOKANOK line, to create a "Contract Path" from AEP to CSW.[47] Thus, the "Contract Path" is longer than the 250-mile "Ameren Path." This distinction is lost on the Division, which uses the two terms interchangeably,[48] although it elsewhere notes that AEP also needs a transmission contract with Western Resources, one of the other owners of the MOKANOK line.[49] As stated in AEP's application and in the Commission's prior order, AEP does not own the segments of the MOKANOK line outside Oklahoma.[50]

If AEP's transmission contracts to use the portions of the MOKANOK line owned by other utilities are included in the "Contract Path," then AEP concedes the path is approximately 400 miles long, although it provides no support for this number.[51] Any atlas will indicate that it is more than 150 miles from St. Louis—the putative Western terminus of the Ameren Path—to any point in the state of Oklahoma. So the reliability of this 400-mile number is suspect. It may be based on AEP continuing to use the Western Resources portion of the MOKANOK in Kansas; but in that case the Western Resources portion is still part of the contract path. Thus the true length of the contract path appears to be more than 400 miles.

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[45] U-1/A Amendment No.5, at 23-24 (Item 1(B)(3)(b)). The NRECA/APPA Initial Brief cited AEP's Amendment No. 2 to its application in this case, a restated application filed in March 1999. The Division and AEP cited AEP's Amendment No. 5 to its Application, an amended and restated application filed in May 2000. For present purposes, the two amendments are identical.

[46] *Am. Elec. Power Co.*, 54 S.E.C. 697, 722-23, 2000 SEC LEXIS 1227 (2000).

[47] NRECA/APPP Initial Br. 6-7.

[48] Div. Br. 12.

[49] Div. Br. 19 n.22.

[50] NRECA/APPA Initial Br. 54.

[51] AEP Br. 19 n.14.

In any event, AEP notes that one of the co-owners of the MOKANOK line has given notice to terminate its MOKANOK transmission contract with AEP.[52] That demonstrates why—until this case came along—distant utilities did not rely on transmission contracts to integrate their operations and the Commission had declared they could not do so. The reasons are fairly obvious: such contracts can be terminated and leave distant utilities with no economic alternative means of interconnection.

Looking ahead, the picture is no different in its essentials: the AEP-CSW holding company would cross two Interconnections, and the AEP-CSW companies would be members of three RTOs and contract for service over a fourth. Multiple contracts involving multiple utilities or RTOs will be inevitable.

Given the facts, AEP and the Division do not provide a convincing reason for the Commission to depart from its precedent. All the cases they cite involve either utilities that were not distant, holding company systems that were within a single power pool, or the four decisions that followed in the wake of this case and perpetuated its error.

Neither the hearing in this case nor AEP's submissions provide any basis for reversing the Commission's long-standing policy. The Commission's commitment to this policy is embedded in several decisions,[53] and the evidence AEP submitted does not provide any reason for the Commission to depart from this precedent. First, the cases that AEP relies upon are the same cases that rely on the now-vacated earlier order in this case. They are part of the same

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[52] AEP Br. 19 n.14.

[53] *WPL Holdings, Inc.*, 53 S.E.C. 501, 517 (1998), *aff'd sub nom. Madison Gas & Elec. v. S.E.C.*, 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.").

unexplained departure from precedent, not an explanation for it. And the *Energy East* case is not comparable at all, since it involved utilities in New England and upstate New York—much shorter distances than in this case.

Instead of focusing on instances where the Commission glossed over the issue on the distance of a contract path connecting two distant utilities, the Commission should remain committed to what the court found were the "several prior orders in which the Commission expressly indicated that contract rights cannot be relied upon to integrate two distant utilities."[54] While AEP asserts that these opinions fail to address the "given changes in industry conditions[,]" any changes in industry conditions were contemporaneous with the Commission's prior decisions. As AEP's witness, Paul Johnson, noted, electric line development capacity has stalled since the late 1960s or early 1970s.[55] The Commission, however, reiterated in a *1998* order its determination that electric utilities may not be interconnected by means of contractual rights where the utilities are separated by significant distances.[56]

The Division has not supplied any reasoned analysis that would support a sudden shift in policy. Indeed, it appears that the Division's reasoning is based on a faulty understanding of the factual underpinnings of the electric industry. While the Division claims that during the 1990s "the technology that underlay the country's transmission system became more sophisticated and larger amounts of power could be transmitted over long distance," they fail to point to any evidence or authority for this proposition, which is understandable because there is no support

[54] 276 F.3d 615 (internal citation omitted).

[55] Tr. 63, lines 8-13.

[56] *WPL Holdings, Inc.*, 53 S.E.C. at 517 ("[t]he Commission has stated that contract rights cannot be relied upon to integrate two distant utilities.").

for this proposition.[57] During the Division's "cross-examination" of Mr. Johnson, he was asked about technological advances from the 1900s and today.[58] While Mr. Johnson's response is quite thorough, his answer does not note any technological advances past the 1970s.[59] There is therefore no basis for the Division's contention that any recent advance in the electric industry now moots prior Commission precedent holding that contract rights cannot be relied upon to integrate distant utilities.[60] Furthermore, neither the Division nor AEP has addressed the court's concern that, "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."[61]

AEP and the Division have not shown that the decision in this case accords with Commission precedent that heretofore had not allowed such distant utilities to integrate their operations by using lengthy contract transmission pathways. The Commission's subsequent cases, moreover, merely followed the departure from precedent begun in this case and did not justify it. AEP and CSW are hundreds of miles apart by any measure. The evidence shows energy can be transferred between AEP and CSW only by a series of complex transmission

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[57] Div. Br. 23.

[58] Tr. 57, lines 2-6.

[59] Tr. 57, lines 7-24.

[60] *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.").

[61] 267 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.)). As discussed in Section II, since AEP and CSW are not confined to a single area or region, they cannot be in a tight power pool or a small area with unique geographic characteristics.

arrangements with a changing cast of third-party utilities. These arrangements are apparently so uncertain that AEP has no contracts in place for any transmission service after June 2005. If ever there were case in which distant utilities should not be allowed to interconnect and integrate by contracts with third-party transmission owners, this would appear to be that case.

II. The initial briefs demonstrate that the merged company is not "confined in its operations to a single area or region."

The court of appeals, in vacating the Commission's earlier decision, identified the infirmities in the Commission's consideration of whether the merged company would meet the single-area-or-region requirement of section 2(a)(29)(A) of the Act, which requires that a registered holding company must comprise a single integrated public-utility system "confined in its operations to a single area or region." The court noted that the Commission's decision could not stand "both because the Commission failed to make any evidentiary findings on the issue and because it erroneously concluded that a proposed acquisition that satisfies PUHCA's other requirements also meets the statute's region requirement."[62] On the first point, the court went on to cite prior opinions[63] where the Commission, in analyzing the region requirement, had addressed "such factors as the geography and socioeconomic characteristics of the areas covered by the system."[64] By contrast, the court noted, the Commission here "[n]ever mention[ed] whether the territories served by AEP and CSW have common geographic or geologic traits."[65] Rather, the court noted, the Commission found the region requirement satisfied

[62] 276 F.3d at 617.

[63] The court quoted from *Middle West Corp*., PUHCA Release No. 4846, 15 SEC 309, 336 (Jan. 25, 1944) and *American Natural Gas Co*., PUHCA Release No. 15620, 43 SEC 203, 206 (Dec. 12, 1966). *See* 276 F. 3d at 617.

[64] 276 F.3d at 617.

[65] *Id*.

> not because of any identified similarities between the areas currently served by AEP and those served by CSW, but because New AEP satisfies all *other* PUHCA requirements . . . . The Commission applies the requirement as if it did not include the word "single" but instead read: "confined to an area *or areas* not so large as to impair . . . ." Technological improvements may well justify ever-expanding electric utilities, but PUHCA confines such utilities to a "single" area or region.[66]

Notwithstanding this clear direction from the court of appeals, AEP has failed to produce any evidence concerning common geographic or geologic traits shared by the AEP and CSW service territories. AEP urges the Commission again to read the statute as requiring only that the holding company operate in "an area *or areas* not so large at to impair . . .," since AEP's own testimony acknowledges that the merged companies sprawl across the South, Midwest and East.[67] Once again, AEP is unable to identify the supposed "single area or region" that includes the footprint of the entire merged company, unless the entire Eastern Interconnection – "virtually the North American continent east of the Rocky Mountains"[68] – is labeled a "region," a revision of history clearly at odds with the Act's concern for local control of utilities.

Ultimately, AEP urges that its sprawling, disconnected service territories be considered to be within a single area or region on two separate bases. First, AEP argues that there is considerable commerce in products other than electricity among the various areas served by what AEP now, instructively enough, refers to as AEP East and AEP West, and that these service territories, separated by hundreds of miles, are therefore part of a single "functional" region. Next, AEP argues that, as a result of both technological developments and federal regulatory policy, barriers to trading in electricity within the different regions of the Eastern Interconnection

[66] *Id*. at 618 (emphasis in original).

[67] AEP Ex. No. 1, page 26, lines 4-7.

[68] AEP Ex. No. 2, page 6, lines 14-15.

have been lowered, and that a large region has therefore been created. Ironically, AEP is unable actually to define the parameters of this large region, and it therefore invites the Commission to find that the single area or region may be the entire Eastern Interconnection; or it may be only PJM, SPP, and MISO—the three RTOs in which AEP, CSW (outside ERCOT), and some utilities between them operate; or it may be the service territories of AEP, CSW, and all utilities interconnected with either of them.

Ultimately, AEP and the Division urge the Commission to depart from seventy years of precedent and to find that the region requirement may be met merely by finding that disparate and widely separated geographic localities are connected economically through trade, either in electricity or in commodities generally. This simply ignores the fact that large amounts of trade can and do occur between regions, and even between countries. The North American Free Trade Agreement may have increased the amount of Mexican produce in Washington, D.C., area supermarkets, but it did not put Washington in the same region as Mexico City. Moreover, AEP's claim that PJM, MISO and SPP now constitute one large, seamless market for electricity trading, largely as a result of regulatory actions undertaken by FERC, is unsupported by any empirical evidence, contradicts the empirical evidence AEP submitted in its application, and runs counter to FERC's own view of how electricity markets actually work.

A. Contrary to the Division's claim, Commission precedent does not divorce the single-area-or-region requirement from considerations of geography.

Seizing on the fact that the Act confines a holding company system only to "a single area or region" and not—redundantly—to a single *geographic* area or region, the Division tries to justify the proposed acquisition by arguing that Commission precedent looks to the characteristics of electricity markets and broader economic markets rather than physical distance,

geologic features, or "common sense and culturally-determined notions."[69] AEP suggested this argument to the Division in its proposed approach for the remand proceeding[70] and also advances it here, albeit in a slightly different form than presented by the Division. While there is perhaps something refreshing about the Division's willingness tacitly to concede that its position requires the abandonment of common sense, the fact is that the Division's proposed definition of "region" would require the Commission to ignore both its own precedent and the opinion of the court of appeals.

The Division neglects to note that the Commission's August 30, 2004, order instituting this proceeding specifically directed a broader inquiry into the "geographic area" in which AEP-CSW would operate:

> We believe further supplementation of the record is required for us … to determine on remand whether the combined AEP and CSW systems meet the relevant standards of sections 10(c)(1) and 11(b)(1) of the Act and in particular, what specific facts about AEP's and CSW's electric systems and the *geographic area* covered by their systems are relevant to the required determinations. … We also recognize that the parties may wish to introduce further facts - demographic, economic, and otherwise - regarding the *geographic area* in which the combined AEP-CSW system operates that they believe are relevant to this determination.[71]

The Division also neglects to point out that in *American Gas & Electric Company*, cited by the Division for other purposes, the Commission referred to the provisions of section 11(b)(1) of the Act as the "*geographical* integration provisions."[72]

Nonetheless, both AEP and the Division pretend that the Commission has not addressed the region requirement in geographic terms for decades. AEP made this assertion in its

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[69] Div. Br. 33-35.

[70] AEP Memo. 14-15.

[71] *Am. Elec. Power Co.*, Release No. 35-27886 (Aug. 30, 2004) (emphasis added).

[72] *Am. Gas & Elec. Co.*, Release No. 35-6333, 21 SEC 575, 576 (1945) (emphasis added).

proposed- approach memorandum to the Division.[73] AEP's brief states outright (and incorrectly) that "[t]he Commission has not addressed the single area or region requirement with any specificity in four decades."[74] The Division likewise distorts the role geographic considerations have historically played, arguing that the Commission has focused "less on what makes the specific region distinct than on why the underlying nature of the market for electricity leads to the conclusion that the single area or region requirement is satisfied."[75]

In fact, both the language of the Act and the Commission's precedent enforcing the Act acknowledge the central role played by geographic factors (including considerations of culture and geology). The language of the Act requires, as the court of appeals explicitly reminded the Commission, that the merged company operate in a "single" area or region, not in disparate service territories united only by the fact that commercial transactions between them are technologically feasible. Even Congress' choice of verb—"*confined* in its operations to a single area or region"—demonstrates that its concern was with preventing holding companies from spreading across large disparate areas, not with facilitating the growth of ever-larger companies, so long as commerce between the disparate parts was feasible.

Until issuing its now-vacated decision approving the proposed acquisition in this case, the Commission had likewise looked to geographic considerations to determine whether the region requirement would be met. In this regard, the court of appeals rightly pointed to such cases as *Middle West Corporation* and *American Natural Gas Company*.[76] The same analysis

[73] AEP Memo. 14-17.

[74] AEP Br. 22.

[75] Div. Br. 36.

[76] 276 F.3d at 617 (citing *Middle W. Corp.,* PUHCA Release No. 4846, 15 SEC 309, 336 (1944); and *Am. Nat. Gas Co.*, PUHCA Release No. 15620, 43 SEC 203, 206 (1966)).

turns up in more recent cases as well. Thus, in 1990, the Commission determined that a proposal by Northeast Utilities ("Northeast") to purchase Public Service Company of New Hampshire ("PSNH") met the region requirement: "We conclude that the Northeast-PSNH system may be operated as a single interconnected and coordinated system confined in its operations to a single region, New England . . . ."[77] Two years later, the Commission granted an application by UNITIL Corporation to acquire Fitchburg Gas and Electric Light Company, again citing the fact that the merged company would be confined to a recognized, geographically compact region: "[T]he system electric operations will be confined to north central Massachusetts and southern New Hampshire. The service territories are sufficiently close to be confined 'to a single region or area . . . .'"[78]

Indeed, the Commission issued two orders as recently as 2000—after its earlier order in this case—that looked to the existence of traditional geographic regions to determine whether the region requirement was met. In *Energy East Corp.*,[79] the Commission found the region requirement met based on a finding that "the Energy East Primary Electric System will operate in a single area or region in four states in the New York-New England region."[80] The Commission specifically noted that New England and New York constitute "an area commonly considered a single region of the country."[81] Similarly, in *CP&L Energy, Inc.*, the Commission found the region requirement to be met because "[t]he retail service area of the CP&L Energy Electric System will be confined to three states, North Carolina, South Carolina and Florida, in

[77] *Northeast Utils.*, PUHCA Release No. 25221, 50 SEC 427, 449 (1990).

[78] *UNITIL Corp.*, PUHCA Release No. 25524, 50 SEC 961, 967-968 (1992).

[79] *Energy East Corp.*, PUHCA Release No. 27224, 2000 SEC LEXIS 1970 (Aug. 31, 2000).

[80] *Id.* at 45-46.

[81] *Id.* at 48.

the Southeastern United States." The Commission further noted that CP&L made wholesale sales in another Southeastern state, Georgia, and that the putative merger partners owned generation assets in Florida, Georgia, and Alabama, another contiguous Southeastern states. In neither of these cases did the Commission discuss the nature of electric markets.

Thus, contrary to the claims of the Division, the Commission has not looked primarily to electric markets in judging whether the region requirement was met. Indeed, all of the above cases were decided since 1990, yet none discussed the nature of markets in New England, New York or in the Southeast in considering the region requirement.

The cases the Division cites in support of its claim that the Commission has relied primarily on "the underlying market for electricity" in determining whether the region requirement was met do not in fact support the Division's argument. For instance, the language quoted by the Division from the Commission's opinion in *American Gas & Electric Company*[82] describes the Commission's rationale for determining that the holding company in question there was an integrated system, but contains no analysis, or even mention, of electricity markets.[83]

The Division nonetheless claims to find an "approach" in *American Gas* that examines whether "*the system* is designed in such a way that is a *market for electricity*," in which case "the statutory requirement is satisfied."[84] But the Division creates this "system-as-market" test out of whole cloth, since there is no hint of it in the text of the Commission's opinion. The statute

[82] *American Gas & Electric Co*., 21 SEC 575 (1945).

[83] "The central system… has a long historical record of having been planned, developed and operated as a highly coordinated system…. Moreover, it does not appear to be so large in any of the States in which it operates as to impair the effectiveness of regulation…. In the instant case, the relatively high degree of coordination of the system's utility facilities and their relatively economical operation… have led us to conclude that the system, as presently constituted, constitutes a single integrated system within the meaning of Section 2(a)(29)(A) of the Act. 21 SEC at 595-96 (quoted in Div. Br. 37).

[84] Div. Br. 37 (emphasis added).

defines a "single integrated public-utility system" as " … a single interconnected and coordinated *system* confined in its operations to a single area or region … ." The Division would amend that definition to "a single interconnected and coordinated *market* confined in its operations to a single area or region." That transformation of the statutory test would appear to allow for much larger holding companies, since markets are usually larger than companies, even in the utility industry. Indeed, the Division's test appears tailor-made for holding companies like AEP-CSW, which claims to be "integrated" because the two halves of the company trade relatively small amounts of energy with each other much like they were separate companies.

Moreover, the Division's test would also appear to suffer from the same flaw that led the court of appeals to vacate the Commission's earlier order in this case. If the Commission were to deem a holding company to be "confined to single area or region" if the system can operate as a market, then the region requirement would impose no independent limitation on holding-company size, since any holding company that could meet statute's coordination requirement would also satisfy the region requirement. The court of appeals rejected that very approach: "Technological improvements may well justify ever-expanding electric utilities, but PUHCA confines such utilities to a 'single' area or region."[85]

In any event, in fashioning its quotation from *American Gas*, the Division eliminated, through the use of ellipses, the Commission's observation that it was not being asked to approve the formation of a new holding company, but merely whether the status quo could be maintained.[86] This observation is significant, however, because the Commission was addressing section 11(b)(1)(A) of the Act, pursuant to which the Commission is directed to permit the

[85] 276 F.3d at 618.

[86] *Id*. at 595.

retention (not, as here, the acquisition) of one or more *additional* integrated public-utility systems if it finds, *inter alia*, that "(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system."[87] In interpreting section 11(b)(1)(A), considerations of economics are thus explicitly made paramount by Congress.

The Division also relies on *Middle West Corporation*, which it describes inaccurately as "looking to the nature of the underlying market for electricity" and "reaching a conclusion about a particular electricity market."[88] In fact, no discussion of electricity *markets* is to be found in that opinion—and no equation of "system" with "market." Rather, the Commission noted that

> the geographic characteristics of the territory encompassed by this sector of properties are fairly homogeneous. The area is more or less typical throughout, relying largely on oil and other minerals, agriculture, and relatively light industry for its subsistence. The rendition of satisfactory service in arid and sparsely-settled areas frequently requires the stretching of lines over long distances to connect small population centers with generating facilities strategically placed near suitable water and feel suppliers. In view of these facts we believe that the properties in question lie within a single area or region.[89]

Thus, far from analyzing markets, the *Middle West* opinion noted that the area in question was geographically and economically similar, and that those particular similarities made it necessary to provide electric service through a combination of strategically placed generating facilities and relatively long transmission lines. By contrast, AEP and the Division have presented no evidence that the AEP-CSW area "is more or less typical throughout," or that the stretching of lines from Canton, Ohio, to Brownsville, Texas, is "required" for a utility system to

[87] 15 U.S.C. § 79k(b)(1)(A) (2000).

[88] Div. Br. 38.

[89] 15 SEC at 336.

render satisfactory service. Indeed, in addressing the interconnection requirement, AEP has argued that the proposed acquisition should not require it to stretch any new transmission lines.

Finally, the Division cites *Connecticut Yankee Atomic Power Company*[90] and *Vermont Yankee Nuclear Power Corporation*[91] as somehow supporting its system-as-market test.[92] The Division's discussion omits the fact that all of the applicant companies in those cases were located in New England, which the Commission has elsewhere described as "a single region."[93] The Division also omits any discussion of the Commission's earlier related decision in *Yankee Atomic Electric Company*,[94] in which the Commission first approved an application by New England utilities to cooperate in the construction of a nuclear power plant, noting that the applicant companies served "the highly industrialized New England area which is remote from conventional fuel sources . . . ."[95] In short, cases in which the Commission determined that New England qualifies as a "single area or region" can hardly be cited as precedent for the notion that Virginia, Michigan and Texas are all in the same area or region.

After positing a test that would ask whether "*the system* . . . is a *market* for electricity,"[96] the Division shifts gears and claims that AEP's evidence demonstrates that the AEP and CSW systems are in a single area or region essentially because they operate within a single wholesale

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[90] *Conn. Yankee Atomic Power Co.,* 41 SEC 705 (1963).

[91] *Vt. Yankee Nuclear Power Corp.*, 43 SEC 693 (1968).

[92] Div. Br. 39-40.

[93] *Northeast Utils.*, PUHCA Release No. 25221, 50 SEC 427, 449 (1990).

[94] *Yankee Atomic Elec. Co.*, Release No. 35-13048, 36 SEC 552 (1955).

[95] *Id*. at 554.

[96] Div. Br. 37.

electric market—in other words, the *region* is a *market.*[97] Like the Division's "system-as-market" test, these arguments were also presaged in AEP's proposed approach for the remand proceeding.[98] Because AEP makes the same arguments on brief, it is appropriate to turn directly to AEP's arguments and show why they should be rejected.

B. None of AEP's theories supporting the notion that the merged company's operations are confined to a single area or region withstands scrutiny.

AEP advances a multitude of theories about the single area or region that allegedly includes the merged company. Each of these theories, if accepted, will effectively render the statute a dead letter, and none comports with the court's instruction to the Commission on remand.

The overriding theme of AEP's theories is the notion that "region" is a synonym for "market." As explained above, this notion is incorrect, since the Commission's cases have not discussed electricity markets when determining whether holding companies have met the region requirement. Rather, the language of the statute and this Commission's precedent demonstrate that the region requirement is one which involves considerations of geography, geology and culture – precisely the "common sense" considerations that demand rejection of the application, as the Division implicitly concedes.[99] Consequently, even if AEP were correct in its claim that the entire merged company is within a single market, this would not suffice to demonstrate that the company is "confined in its operations to a single area or region."

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[97] Div. Br. 41-42.

[98] See AEP Memo. 19-22.

[99] The absurdity of this theory was demonstrated, ironically, by AEP's witness Dr. Harrison, who testified that for certain purposes, such as trading in crude oil, the entire world constitutes a single market, and therefore a single functional region. AEP Ex. No. 1, page 20, line 7-9. Clearly, if the region requirement means nothing more than "confined to the planet Earth," then it truly means nothing at all.

In fact, however, AEP's case for locating the merged company within a single market is itself unconvincing. AEP spends a good deal of time reviewing FERC policy over the past ten years and claiming that FERC has created a single market for electricity covering – well, neither AEP nor the Division is entirely certain whether the single market encompasses the entire Eastern Interconnection, three FERC-approved RTOs, or the three RTOs plus the portion of AEP in ERCOT, or both sections of the merged company plus all interconnected utilities, but they are nonetheless certain that a single market exists. FERC itself, however, defines markets in a much more limited way, requiring merger applicants, or applicants for market-based rate authority, to examine each utility control area or RTO footprint as a separate market.

1. The Eastern Interconnection cannot be considered a single area or region.

AEP's first effort to define the region that includes the entire territory of the merged company involves the claim that "[t]he Eastern Interconnection has evolved into a region . . . ." In its brief, AEP defines the Eastern Interconnection as "most of the eastern half of the United States."[100] Although even this territory would be far too large to qualify as a single area or region within the meaning of the Act, the fact is that this definition does not include the entire Eastern Interconnection as it was defined by AEP's own witness: "The geographic boundary of the Eastern Interconnection is virtually the North American continent east of the Rocky Mountains excluding the area of the ERCOT Interconnection."[101] Thus, if the Commission agrees that the entire Eastern Interconnection is a single region, it will have found that Amarillo, Texas, and Halifax, Nova Scotia, are in the same region. To put it mildly, nothing in the

[100] AEP Br. 25.

[101] AEP Exh. No. 2, p. 25, lines 13-15.

language of the Act, the legislative history of the Act, or the Commission's precedent interpreting the Act, supports such a finding.[102]

In support of the notion that the entire Eastern Interconnection is a single region, AEP offers two theories. First, it claims that the Eastern Interconnection can be considered a homogeneous region because

> it is the only common electric transmission and distribution infrastructure in the eastern portion of North America. The Eastern Interconnection is defined as the collective interconnected electric transmission and distribution lines that operate in synchronism in the area east of the Rocky Mountains (excluding some of Texas).[103]

Here AEP repeats one of the errors that led to the vacating of the Commission's earlier order in this matter. Because the Eastern Interconnection consists of transmission and distribution lines that are interconnected in a way that requires utilities to coordinate some activities, AEP claims that the Eastern Interconnection can therefore be considered a single region. The court of appeals, however, has already determined that the region requirement is separate from the interconnection requirement of the Act. "Technological improvements may well justify ever-expanding electric utilities, but PUHCA confines such utilities to a 'single' area or region."[104] The claim that the Eastern Interconnection is a single region because it constitutes a single interconnected network cannot be reconciled with the court's determination.

AEP next claims that the Eastern Interconnection can be considered a functional region, "because there is interdependence among all of the participants in the Interconnection."[105]

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[102] Of course, even if the Commission could find that the Eastern Interconnection is a single region, that would not help AEP, which in fact is not located entirely within the Eastern Interconnection.

[103] AEP Br. 25.

[104] 276 F.3d at 618.

[105] AEP Br. 25. AEP's witness Dr. Harrison identified "economic interdependence" as the defining characteristic of functional regions. AEP Exh. No. 1, p. 4, lines 3-4.

Interdependence, however, is equally consistent with the concept of participants in multiple regions that depend on each other. A single region cannot be economically interdependent. Thus, AEP's definition of functional regions leads to reading the statute to say "confined to a single area *or areas*," a reading the court of appeals has already rejected.

AEP notes in this regard that the Eastern Interconnection could not have been considered a single area or region when the Act was passed in 1935. AEP's own witness, however, testified that the Eastern Interconnection was created in 1962.[106] AEP provides no explanation for the fact that only in 2005 has it discovered that events in 1962 so drastically changed the meaning of a law enacted in 1935.

AEP next runs through an abbreviated version of Mr. Baker's overly optimistic version of the extent to which FERC actions over the last ten years have created broad markets for energy in the Eastern United States. For the most part, these matters were addressed in the Initial Brief of NRECA/APPA[107] and need not be repeated here. It should be noted, however, that, contrary to AEP's claim, FERC does not require that RTOs establish "broad regional markets for electric power."[108] PJM has established energy markets; MISO expects to initiate such markets in April; SPP is not committed to operate broad regional energy markets. In any event, given that much of the Eastern Interconnection remains outside of RTOs, this statement could not support a finding that the Eastern Interconnection is a single area or region even if it were true. Similarly, AEP's statement that FERC "has moved toward the elimination of rate pancaking"[109] is inaccurate in the context of AEP's argument that the Eastern Interconnection is a single region.

[106] AEP Exh. No. 2, p. 13, line 15.

[107] *See* NRECA/APPA Br. 43-48.

[108] AEP Br. 26.

[109] *Id*. at 27.

FERC has moved to eliminate rate pancaking within RTOs, and between PJM and MISO, although only for transactions that both source and terminate in either PJM or MISO. It has not eliminated rate pancaking through the remainder of the Eastern Interconnection, including between MISO and SPP. (SPP and PJM, of course, are not directly interconnected.) Thus, transactions sourcing in PJM and sinking in SPP, or vice versa, must pay three separate transmission charges.

2. PJM, MISO and SPP cannot be considered a single area or region.

AEP's arguments here are virtually identical to those that support its argument regarding the Eastern Interconnection. The three RTOs are said to be a homogenous region because they are a subset of the Eastern Interconnection, thus repeating the error of conflating the region requirement with the interconnection requirement. Additionally, AEP claims the three RTOs are a homogenous region because of the existence of Joint Operating Agreements ("JOAs").[110] In this regard, AEP points to FERC's order directing SPP to file a JOA with MISO,[111] but ignores the fact that this agreement simply governs certain discrete issues, such as congestion management, that is, how SPP and MISO will jointly handle transactions in one RTO that might cause congestion on transmission facilities in the other RTO. Despite AEP's repeated reference to a "joint and common market," SPP has no current plans to operate energy markets (with the limited exception of an imbalance market),[112] and will not be involved in the MISO energy

[110] AEP refers to "substantially identical Joint Operating Agreements [that] establish rules for market transactions within and between PJM, MISO and SPP." AEP Br. 29. In fact, however, as AEP witness Baker implicitly acknowledges, there are JOAs between MISO and PJM and between MISO and SPP, but none between PJM and SPP. AEP Exh. No. 5 at 30-31. This is hardly surprising, as the distance separating those two RTOs makes it unlikely that transactions in one would cause congestion in the other.

[111] *Southwest Power Pool, Inc*., 106 FERC ¶ 61,110 at P 64 (2004).

[112] *Southwest Power Pool, Inc.,* 109 FERC ¶ 61,010 at P 32 (2004).

markets currently scheduled for implementation April 1. Nor have SPP and MISO agreed on the terms of their JOA.[113]

Next, AEP invokes a series of arguments supporting its claim that the three RTOs constitute a functional region. Even putting aside for the moment the fact that AEP itself defines a functional region as being characterized by interdependence, implying mutual dependence by two or more constituent regions, AEP's arguments here cannot stand up under scrutiny, for they depend upon an interpretation of actions taken by FERC that is at odds with FERC's own view of electric markets.

AEP starts with the assertion that "in recent years FERC has pursued a policy of expanding the scope and scale of electric industry institutions and markets."[114] As far as it goes, that is an accurate statement. From there, however, AEP exaggerates the extent to which FERC's policies have so far been successful at expanding those markets, leading it to claim that the merged company, from Texas to Michigan to Virginia, is now part of a single seamless electric marketplace. To pursue this claim, however, AEP is forced to ignore FERC's own actions defining markets, which focus on much smaller geographic areas than the three RTOs plus ERCOT, let alone the entire Eastern Interconnection.

In general, FERC considers each entity directly and indirectly interconnected with either merger applicant as a separate destination market.[115] (This is essentially the mirror image of one of AEP's alternate theories, wherein the merging companies and all interconnected utilities are treated as part of a single market.) In particular cases, FERC permits applicants to propose

[113] *See* NRECA/APPA Br. 46.

[114] AEP Br. 29.

[115] Order 642, 65 Fed. Reg. 70992-93 (Nov. 28, 2000).

broader market definitions, but the burden is then upon the applicants to explain and support their proposal.[116] Broader markets may be appropriate, FERC has explained, in particular types of circumstances: "Where there are no transmission constraints between markets and where there is a demonstrated lack of price discrimination, similar prices across destination markets generally indicate a larger, single geographic market."[117] These characteristics clearly do not apply to the large area covered by the three RTOs, and FERC itself has certainly never approved treating these three RTOs as a single market. Mr. Baker himself admitted that AEP engages in separate trading within three separate hubs, in different locations throughout the Eastern Interconnection. Specifically, AEP trades at the PJM Hub, the Cinergy Hub, and the Entergy Hub.[118] Significantly, Mr. Baker also admitted that prices are not uniform across the hubs, and that transmission constraints "cause price differentials between and even within the Hubs."[119] Thus FERC itself would not consider the large swath of the Eastern Interconnection dominated by AEP to be a single market; accordingly, there is no justification for this Commission to point to FERC's actions as grounds for finding the three RTOs to be a single market, much less a single area or region.

That FERC does not view the three RTOs as a single large, seamless market is also clear from its current, ongoing investigation into AEP's own ability to exercise market power in the various markets in which it sells power.[120] There, FERC has summarized AEP's own filing:

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[116] *Id.* at 70996-97.

[117] *Id.*

[118] AEP Ex. No. 5, p. 33.

[119] *Id*.

[120] *AEP Power Mktg., Inc*., 109 FERC ¶ 61,276 at P1 (2004).

> The filing, as amended, indicates that AEP passes the pivotal supplier screen and the wholesale market share screen in the PJM market. AEP also states that it passes both screens in the Electric Reliability Council of Texas (ERCOT). AEP states that, in the AEP-Southwest Power Pool, Inc. (AEP-SPP) control area, AEP passes the pivotal supplier screen but fails the wholesale market share screen for each of the four seasons considered. The filing indicates that in each of the control areas directly interconnected to AEP-SPP, AEP passes the pivotal supplier screen and the wholesale market share screen. Intervenors have filed protests alleging that AEP has generation market power in the AEP-SPP control area and requesting customer protection.[121]

Thus, in FERC's view, PJM is a market. ERCOT is a market. The portion of AEP in SPP is a market. Each additional control area interconnected to AEP-SPP is a market. FERC itself thus provides no support for AEP's self-serving theory that the three RTOs comprise a single giant market.

Based upon AEP's own filing, FERC instituted a proceeding pursuant to section 206 of the Federal Power Act and established a rebuttable presumption that AEP has generation market power in the AEP-SPP market. (That AEP might have market power in its own SPP control area, but not in MISO or PJM, is itself clearly contrary to the notion that the three RTOs constitute one seamless market.) In response, AEP just last week offered to accept cost-based price caps, again, only in the SPP-AEP market. As noted earlier, while AEP's response is not an admission by the company that it has market power, it certainly implies that AEP lacks confidence in its ability to convince FERC of AEP's lack of market power,[122] and is also clearly at odds with the notion that the three RTOs constitute a single market.

Clearly, if the entire Eastern Interconnection, or even the three RTOs, were considered a single, seamless market, AEP would not control enough generation to exercise market power anywhere in that market. How, then, can AEP's own application of FERC's market power

[121] *Id.* at P1.

[122] *See* AEP compliance filing, FERC Docket No. ER96-2495 (Feb. 15, 2005).

screen lead to a presumption that AEP does have market power? The explanation is clear. Neither the entire Eastern Interconnection nor the three RTOs does constitute a single market. Accordingly, even if one were to accept AEP's erroneous construct that the region requirement merely requires that a holding company's operations be within a single market, that requirement would not be met by the post-merger AEP.

Thus FERC's own actions and policies demonstrate that the three RTOs do not constitute a single market, much less a single area or region. Beyond FERC's actions, however, the fact is that AEP's own statements to FERC in recent years belie its current claims that PJM, MISO and SPP constitute a single market.

On a number of occasions, FERC sought comments on questions related to its Standard Market Design Notice of Proposed Rulemaking ("SMD NOPR").[123] For instance, in comments filed on November 5, 2001, AEP made clear its view that each RTO constitutes a separate market: "AEP strongly believes it is the role of FERC to provide only the basic framework for the market design, leaving details to be more fully developed by the participants and regional transmission organization (RTO) in any given market."[124] AEP also denied, in contrast to the arguments it makes now, that action by regulators such as FERC was the mechanism by which markets should be created: "[M]arket details that are prescribed by regulation run the risk of being a bad fit, a detriment to the market, all of its participants and quite possibly neighboring markets. Markets should be allowed to evolve naturally."[125]

[123] A proposed rule was published in Docket No. RM01-12 on July 31, 2002. FERC has never issued a final rule.

[124] Comments of American Electric Power Stemming from Presentations of FERC RTO Week, Oct. 15-19, FERC Docket No. RM01-12, at 1 (Nov. 5, 2001).

[125] *Id*. at 1-2.

Several months later, on March 12, 2002, AEP filed additional comments casting further light on AEP's view of what constituted a region for purposes of electricity markets: "A standardized market design should have the flexibility to take into account geographic/regional differences and allow for improvements as the market evolves. For example, the ECAR region[[126]] has ample generation with relatively few transmission constraints, multiple control areas and ITC/Transco business models, compared to the Northeast."[127] ECAR's geographic scope is confined to all or part of the eight AEP East states, plus western portions of Maryland and Pennsylvania – a far cry from the three RTOs AEP now claims as a single region.

The next month, in a further set of comments, AEP instructed FERC regarding the desirability of keeping regions as small and localized as possible: "The Commission [FERC] should also avoid requiring further consolidation of regions than is absolutely necessary to meet scope and configuration requirements . . . . Bigger is not always better unless a cost/benefit analysis show other wise."[128]

AEP filed additional comments with FERC on market design issues as recently as January, 2003. Far from touting the expansion of wholesale electric markets, AEP's message there was precisely the opposite: "Since the NOPR was issued on July 31, 2002, significant changes have occurred in the wholesale electric industry. Trading markets have contracted significantly, with many market participants, including AEP, either scaling back or completely

[126] The East Central Area Reliability Coordination Agreement ("ECAR") is one of the regional reliability councils created in the wake of the Northeast blackout in 1965. See AEP Exh. No. 2, p. 14, lines 13-17.

[127] Comments of American Electric Power Regarding Standard Market Design and Allocation of RTO Functions, FERC Docket No. RM01-12, at 1 (Mar. 12, 2002).

[128] Comments of the Companies of the American Electric Power System, FERC Docket No. RM01-12, at 19 (April 10, 2002).

eliminating their wholesale trading operations."[129] AEP therefore urged FERC to "reconsider its positions," and proceed with SMD only "on a reasoned, cautious track."[130]

It is noteworthy that, at the time these various comments were filed by AEP, the regulatory landscape looked very much as it does today. Order No. 888 and Order No. 2000 had been issued as final rules, and were fully in effect; SMD was proposed, but no final rule was in effect; PJM was operating energy markets, but MISO and SPP were not.[131] Moreover, this Commission had already approved the AEP/CSW merger, and the court of appeals had already vacated that approval. In short, the AEP/CSW merger was not predicated upon the status of FERC's regulation of the electric industry, and none of AEP's self-serving, *post hoc* rationalizations can obscure the fact that neither FERC nor AEP itself really consider the three RTOs to constitute a single market.

3. AEP, CSW, and all interconnected utilities cannot be considered a single area or region.

AEP next argues that the service territories of the Combined System and the utilities directly interconnected constitute a single region for purposes of section 2(a)(29)(A) of the Act. If this were the case, of course, it would be impossible to ever find that a merged company would not be within a single area or region, since company A and company B will always be contained within a universe consisting of company A, company B, and all utilities interconnected with either company A or company B. Under this theory, the region requirement would be read completely out of the Act. This would no doubt please AEP, but it does not comport with the

[129] Comments of the Companies of the American Electric Power System, FERC Docket No. RM01-12, at 1 (Jan. 15, 2003).

[130] *Id*. at 2.

[131] As stated earlier, MISO has delayed the date it intends to implement energy markets to April 1, 2005.

words of the Act or the court's instructions on remand that the region requirement demands more than interconnection. AEP made this same argument in its memorandum with the proposed approach to the remand proceeding,[132] and the Division blindly accepts it as valid.[133]

4. The non-electric economic interactions between the Midwest and the South do not demonstrate that the merged company is confined to a single area or region.

AEP's final argument, based on Dr. Harrison's testimony, is that there is a good deal of trade between the AEP East states and the AEP West states, and more generally between the two separate U.S. Census regions (out of four) in which these states are located, so all of these states should be defined as a single functional region. What is most significant about this argument is that, even if one divides the entire United States into only four regions, as the Census Bureau does, the merged company is not within a single region. In fact, as Dr. Harrison himself acknowledged, the "functional region" that includes the entire merged company is the entire eastern United States.[134]

Nor does Dr. Harrison's testimony demonstrate very much about linkage between AEP East and AEP West. On brief, AEP makes much of Dr. Harrison's conclusion that the linkage coefficient[135] between the Midwest and South is stronger than between any other two Census regions.[136] Nothing in Dr. Harrison's testimony, however, demonstrates particularly strong links

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[132] AEP Memo. 22-24.

[133] Div. Br. 41.

[134] Tr. 33, lines 5-7.

[135] According to Dr. Harrison, a linkage coefficient measures the fraction of two areas total trade accounted for by trade between the two areas. AEP Exh. No. 1, p. 38, lines 16-17.

[136] Of course, if one starts with any group of four regions, and measures the coefficient linkages between each pair, there will always be one pair with the highest linkage. This does not demonstrate that those two regions somehow become a single region.

between AEP East and AEP West. The linkage could demonstrate strong commercial ties between southern and Midwestern states in AEP East – between Ohio and Michigan on the one hand, and Kentucky, Virginia and West Virginia on the other. Or it could demonstrate strong commercial ties between non-AEP states, for example Florida and Illinois.

In the end, AEP is simply inviting the Commission to redefine the word "region" to mean "any expanse of land that includes both AEP East and AEP West." The court of appeals, however, has noted that prior decisions considering the region requirement have addressed "the geography and socioeconomic characteristics of the areas covered by the system," and directed the Commission on remand to consider "the noncontiguous and seemingly dissimilar regions served by New AEP." The fact that there is trade in non-electric commodities between these noncontiguous and dissimilar regions does not make them part of the same region.

C. The merged company would not be confined to a single area or region.

Ironically, the best summary of the state of the record regarding the region requirement comes from the Division's brief:

> Considered from the perspective of geography, there appears to be a simple, common sense answer to the question of whether the AEP system is in a single area or region. The AEP system extends from Virginia to Michigan to Texas. There is simply no way that those three states are in a single area or region. Hence, it seems "obvious" that the AEP system fails that test.[137]

Unfortunately, the Division then goes on to conclude that, since geography and common sense dictate that the AEP merger application must be rejected, geography and common sense must be ignored. The court of appeals, however, has indicated that the Commission should consider geography, not ignore it. If considerations of geography, and geology, and culture, are applied, as they traditionally have been in the Commission's consideration of the region

[137] Div. Br. 33.

requirement, they lead to the same conclusion compelled by the application of common sense and by the court's remand. AEP East and AEP West are noncontiguous and dissimilar regions, and AEP fails the region requirement.

CONCLUSION

The proposed acquisition does not satisfy the Act's integration requirements. The proposed merged company would not be an "integrated public-utility system." Its assets would not be "physically interconnected or capable of physical interconnection." Its operations would not be "confined to a single area or region." The proposed acquisition should not be approved.

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February 28, 2005

SPECIFIC OBJECTIONS OF NRECA AND APPA TO CERTAIN OF THE DIVISION'S PROPOSED FINDINGS OF FACT

The following particular objections to the Division's proposed findings of fact are not intended to be an exhaustive list of objections. NRECA and APPA do not waive their rights to object to any proposed finding of fact (submitted by any other party) not specifically objected to here. Indeed, many of these specific objections also apply to the proposed findings of fact submitted by AEP.

The Division's proposed findings are in plain type; NRECA and APPA's responses are in bracketed bold italics.

Interconnection

1. The combined AEP-CSW system has been operated under unified control since 2000. ***[This statement is so general as to be irrelevant.]***

2. The combined AEP-CSW system operates on a coordinated basis in a manner intended to serve its load, in general, with lowest-cost available power. Consistent with this goal, the combined AEP-CSW system transmits significant quantities of electric power between the components that previously formed the separate AEP and CSW systems (referred to as "AEP East" and "AEP West"). ***[AEP and CSW cannot transmit power over third parties' lines; they can only contract for third parties to do it for them. This statement implies more control than AEP and CSW have.]*** The majority of the power transfers take place from AEP East to AEP West, as AEP generally transfers less expensive coal-fired generation electric power to AEP West, which has a predominance of more-expensive gas-fired generation facilities. However, when economical to do so, AEP does transfer power from west to east. ***[This statement is not supported in the evidence, and AEP has not made this blanket statement. There may be times when it is economical to do so and AEP fails to do it or AEP is unable to do it, e.g., because***

there is no transmission capacity available.] Testimony of J. Craig Baker ("Baker") at 101:3-102:7; 103:4-105:8; AEP Exhibit 5 at 15-17, Exhibit 6 and Exhibit 7.

3. Technological progress in the electrical industry, and in particular, the development of higher transmission voltages, has allowed electricity to be transmitted farther from its generation point than was possible or economical in the 1930s. Potential transmission voltage has increased with the construction of transmission lines able to handle increasing voltages: from the 1920s (132 kV lines) through the 1950s (345 kV lines) and the 1970s (765 kV transmission lines). As transmission voltage increases, the corresponding electrical impedance over distances decreases. In tandem with this increase in transmission voltages has been an increase in generation capacity. Long distance transmission of electricity regularly occurs over distances of many hundreds of miles, and, in some cases, over a thousand miles. AEP Exhibit 2 at 11:12-12:1-2; 12:18-13:6; Testimony of Paul B. Johnson ("Johnson") at 51:25-52:12, 53:13-54:6; 55:11-20; 57:1-58:4.

4. AEP East has a substantial amount of high voltage transmission lines, including approximately 2,000 miles of 765 kV lines, and about 4,000 miles of 345 kV lines. AEP East also has larger power generation capacity than does AEP West. This infrastructure facilitates efficient transmission of AEP East power generation to satisfy the AEP customer load in AEP West. Johnson at 54:15-55:10 and 61:12-25; Baker at 124:4-12; AEP Exhibit 5 at 15:8-10 and 16:21-23. ***[The 765kV lines do not link AEP East and AEP West. Baker at 61:19-20.]***

5. AEP has employed a contract with Ameren by which it may transmit electricity in both directions between AEP East and AEP West. This connection is known as the "Contract Path" or "Ameren Path." ***[The Contract Path includes more than the Ameren Path; it also includes the use of the MOKANOK line, as explained in NRECA and APPA's opening brief and AEP witness Baker at 95:8 to 96:23.]*** Under this contract, power transfers between AEP East and

AEP West occur in two ways. First, AEP has, under the contract, secured a firm 250 megawatt transmission path for power from AEP East to AEP West. Secondly, AEP has, under the contract, secured certain non-firm rights to use the Contract Path to transfer power from AEP West to AEP East. Consequently, AEP has contract rights to use the Ameren transmission path in either direction, from east to west and west to east. ***[AEP does not have contractual rights to use the Ameren system to transmit power from west to east whenever AEP wants to; since AEP has not reserved transmission capacity on the Ameren system to transfer power from west to east, AEP has no assured right to use Ameren's transmission system for this purpose.]*** The Ameren Path is approximately 250 miles long, running from AEP's service territory in Oklahoma to the city of St. Louis, Missouri. ***[This statement is incorrect. The Ameren Path runs from AEP's facilities west to a point near St. Louis, and AEP witness Baker says it is 250 miles long. The cited testimony describes AEP's contract path over the MOKANOK line in these terms. Baker 95:25 to 96:16.]*** AEP Exhibit 5 at 9:11-17, 10:18-11:2, 11:3-12-12:20; AEP Exhibits 6, 7, 11; Baker at 95:8-96:23.

6. The Ameren Path has been in place since the merger of AEP with CSW. AEP has renewed the contract after the initial three-year period and intends to renew it again. Presently, AEP's Contract Path utilizes the Midwest ISO ("MISO"), which is a regional transmission organization ("RTO") in which Ameren is a member and which provides for a much broader transmission capability than the original Ameren path. Baker at 95:8-23; 102:8-16; 145:12-25

7. AEP also has contracts in place with other parties for non-firm transmissions that it can use to transfer power from AEP West to AEP East. Power is also transferred from AEP West to AEP East through these other parties' transmission paths by these non-firm contracts. All transfers from AEP West to AEP East occur via non-firm contracts under the Open Access

Transmission Tariffs ("OATTs") implemented by FERC Order No. 888, which requires intermediate utilities to offer both firm and non-firm point-to-point transmission service and transmission access to all eligible parties (including AEP). All transfers from AEP West to AEP East occur via non-firm contracts under the OATTs rules, as AEP does not have a firm contractual path for west to east power transfers. Power is capable of being transmitted rapidly between AEP East and AEP West as needed. ***[There is no evidence in the record for this last statement, since "capable" and "as needed" implies the ability or the existence of transmission capacity at all times. Indeed, the evidence submitted by AEP is that in five of the 24 months AEP checked, power cannot be transmitted between AEP West and AEP East.]*** AEP Exhibit 5 at 9:11-17, 11:3-12:4; 16:1-17:5; AEP Exhibit 6, 7, 8 and 11 at 1-2; Baker at 129:4-130:5.

8. Non-firm capacity for power transfers from AEP West to AEP East has been sufficient for AEP's needs and will be sufficient for AEP's needs through January 1, 2007. AEP Exhibit 5 at 17:6-13.

9. AEP also has the ability to contract with parties other than Ameren to transfer power in either direction by making contracts for firm or non-firm transmission. ***[The ability to contract is one thing; the ability actually to move power or energy—and at an economical price—is quite another, and there is no evidence that AEP has that ability over parties other than Ameren.]*** These transfers occur by transmitting the power through intermediate utilities, and this ability to contract for transmission rights and obtain transmission access has been assured to, and is open to, all eligible parties (including AEP) under OATTs implemented by FERC Order No. 888, which requires intermediate utilities to offer both firm and non-firm point-to-point transmission service and access. ***[OATTs do not provide legal rights or the assured ability to move power or energy; only reservations of firm service by contract pursuant to an OATT can do that. And***

there is certainly no evidence that OATTs provide an assured ability to move power or energy with respect to AEP and CSW.] These other potential methods of interconnecting AEP East with AEP West have been enhanced by the development of RTOs. ***[This statement is so general that it proves nothing. There is no evidence concerning the availability of transmission capacity or transmission rates to support the truth of this general statement when applied to AEP and CSW; indeed, the cost of the Ameren Path will initially triple when AEP must pay the rates under the MISO OATT, and after 2008 will settle back to double the former cost.]*** Although AEP has not used these connections due to cost considerations, these alternative paths are available to AEP in the event that the availability or economics of its Contract Path should change. ***[There is no evidence of the availability of transmission capacity over these alternative paths.]*** AEP Exhibit 5 at 20:1-9; AEP Exhibit 8; Baker at 105:16-108:7.

Single Area or Region

11. The combined AEP-CSW system is located within a single wholesale power market. AEP Exhibit 5 at 33:1-10. ***[This is incorrect. Mr. Baker is not an economist. FERC views markets much more narrowly than this. AEP's expert economist witness, Dr. William Hieronymus, testified to the contrary—that AEP and CSW are in different markets and are unlikely ever to be in the same market. His testimony is attached to AEP's amended application in this proceeding and is summarized and cited in NRECA and APPA's initial brief.]***

12. The combined AEP-CSW system is directly interconnected with and embedded in a system of interconnected operating and utility companies. AEP Exhibit 5 at 37:5-16; AEP Exhibit 11.

13. The OATTs regime, and the evolution of the electricity industry to include RTOs, has greatly expanded the practical scope of electricity transmission and the geographic scope of markets for electric power. AEP Exhibit 5 at 25:5-31:16 and 35: 9-16. ***[This statement is so general that it proves nothing relevant to this proceeding. One cannot infer anything about the markets in which AEP and CSW operate from this statement.]***

14. The combined AEP system, with the exception of those portions of the former CSW system located in Texas (Texas Central Company and most of AEP Texas North Company), is located within the larger Eastern Interconnection, a large-scale power grid that permits all the utilities in the eastern and mid-western United States to operate at the exact same frequency. AEP Exhibit 2 at 2:2-7:17; AEP Exhibit 3; AEP Exhibit 5 at 20:20-22:4.

15. Those portions of the former CSW system located in Texas are situated in the ERCOT (Texas) Interconnection. AEP Exhibit 2 at 6:7-12; AEP Exhibit 5 at 21:20-22:4. [***This is incorrect; portions of the CSW system in Texas are in the Southwest Power Pool as well. Southwestern Electric Power Company is in the SPP and part of its service territory is in Texas.]***

16. The Commission has previously held that those portions of the former CSW system situated in ERCOT were interconnected and within a single area or region with the rest of CSW. Central and South West Corp., 47 SEC 754 (April 11, 1982), Holding Co. Act Release No. 22439 ("Central and South West").

17. In terms of homogenous regions, that is, regions demarcated on the basis of internal uniformity, the combined AEP system falls within a number of broad regions defined in terms of manufacturing types. AEP Exhibit 1 (Prepared Direct Testimony of David Harrison, Jr., Ph.D.) at 3:25-7:5; Testimony of David Harrison, Jr. ("Harrison") at 17:18-18:19.

18. In terms of functional regions, that is, regions characterized by economic interdependence, the combined AEP system falls within a broader region as characterized by natural gas production, transportation and consumption, petroleum products transportation and consumption, and rail, waterway and highway transportation networks. AEP Exhibit 5 at 41:19-42:5; Harrison at 19:4-21:4; 22:17-23:9; 25:19-23; 33:16-34:2.

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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