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

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

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February 14, 2005

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The National Rural Electric Cooperative Association (NRECA) and the American Public Power Association (APPA) submit this initial brief, with the appended proposed findings of fact and conclusions law, in accordance with the post-hearing scheduling order of January 18, 2005. By order of September 17, 2004, NRECA and APPA are parties to this proceeding under Rule 210(b)(1)(i) of the Commission's Rules of Practice.[1]

STATEMENT OF THE CASE

I. Nature of the Proceeding on Remand

This matter is before the Commission on remand from the United States Court of Appeals for the District of Columbia Circuit. On January 18, 2002, the court vacated the Commission's order of June 14, 2000, which had approved under sections 9 and 10 of the Public Utility Holding Company Act ("PUHCA" or "the Act")[2] the acquisition by American Electric Power Company, Inc., (AEP) of the common stock of Central and South West Corporation (CSW) and the interests in the assets and businesses of CSW's subsidiary public-utility companies.[3]

Section 9(a)(1) of the Act makes it unlawful for a registered holding company "to acquire, directly or indirectly, any securities or utility assets or any other interest in any business"[4] absent Commission approval under section 10 of the Act.[5] Section 10(c)(1) requires that the Commission not approve an acquisition that "would be detrimental to the carrying out of

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

[2] 15 U.S.C. §§ 79i & 79j (2000).

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

[4] 15 U.S.C. § 79i(a)(1) (2000).

[5] 15 U.S.C. § 79j (2000).

the provisions of section 11."[6] Thus, section 10(c)(1) prohibits approval of an acquisition by a registered holding company that would not be permissible under section 11(b)(1) of the Act.[7] Under section 11(b)(1), the utility properties of a registered holding company are limited, with exceptions irrelevant here, to a "single integrated public-utility system."[8] Section 2(a)(29)(A) defines an "integrated public-utility system," as applied to electric utility companies, to mean:

> a system consisting of one or more units of generating plants and/or transmission lines and/or distribution facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operations, and the effectiveness of regulation . . . . [9]

The Commission has interpreted this language to impose four requirements for a proposed acquisition: (1) the interconnection requirement—the post-acquisition utility assets must be "physically interconnected of capable of physical interconnection"; (2) the coordination requirement—the assets must be capable of economic operation "as a single interconnected and coordinated system"; (3) the region requirement—the system must be confined to a "single area or region"; and (4) the localization requirement—the system must not be "so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operations, and the effectiveness of regulation . . . ."[10]

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[6] 15 U.S.C. § 79j(c)(1). (2000)

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

[8] 15 U.S.C. § 79k(b)(1).(2000)

[9] 15 U.S.C. § 79b(a)(29)(A) (2000).

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

The court of appeals vacated and remanded the Commission's June 14, 2000, order in the instant proceeding because the Commission had "failed to explain its conclusions regarding the interconnection requirement" and had "failed to justify its finding that the proposed acquisition will satisfy the single-area-or-region requirement."[11]

As to the former, the court found that "the Commission's acceptance of a unidirectional contract path to 'interconnect' AEP and CSW" was unexplained.[12] The court stated that "interconnection" of utility assets "seems, on its face, to require two-way transfers of power."[13] 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."[14] 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."[15]

The court also 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."[16] The court found the Commission's prior statements "sufficiently explicit to obligate the Commission to provide some rationale for its current contrary view."[17]

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[11] 276 F.3d at 610.

[12] *Id.* at 615.

[13] *Id.*

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

[15] *Id.*

[16] *Id.*

[17] *Id.*

As to the single-area-or-region requirement, the court found that the Commission's earlier order "cannot withstand even the most deferential review," because the Commission "failed to make any evidentiary findings on the issue" and "erroneously concluded that a proposed acquisition that satisfies PUHCA's other requirements also meets the statute's region requirement."[18] The court held that the Commission had essentially read the single-area-or-region requirement out of the Act when it found that satisfying the other integration requirements meant the utility system necessarily operated in a single area or region. The court found that the Commission's "analysis conflicts with PUHCA's express requirement that an electric utility system be 'confined in its operations to a single area or region . . . not so large as to impair . . . the advantages of localized management, efficient operation, and the effectiveness of regulation.'"[19] The court found that the Commission had applied this requirement as if it omitted the word "single."[20] "Technological improvements may well justify ever-expanding electric utilities," the court noted, "but PUHCA confines such utilities to a 'single' area or region."[21] The court concluded that "[t]he Commission may have some legitimate basis for concluding that AEP's service territories in Indiana, Kentucky, Michigan, Ohio, Tennessee, Virginia, and West Virginia fall in the same 'region' as CSW's service territories in Arkansas, Louisiana, Oklahoma, and Texas, but we cannot find it in the record before us."[22]

Neither AEP nor the Commission sought further review of the court's decision to vacate the Commission's earlier order. Because that order is now a legal nullity, AEP has not obtained

[18] *Id.* at 617.

[19] *Id*. (citing 15 U.S.C. § 79b(a)(29)(A) (ellipsis in original)).

[20] *Id.* at 618.

[21] *Id.*

[22] *Id.* at 618-19.

the requisite Commission approval for its proposed acquisition of CSW—an uncertain state of affairs that has persisted for over three years.

The Commission's order of August 30, 2004, instituted the hearing in this proceeding because of the Commission's view that "further supplementation of the record is required for us to address the issues identified in the Court's opinion and to determine on remand whether the combined AEP and CSW systems meet the relevant standards of sections 10(c)(1) and 11(b)(1) of the Act and in particular, what specific facts about AEP and CSW's electric systems and the geographic area covered by their systems are relevant to the required determinations."[23] Pursuant to this order, a hearing was held in this proceeding on January 10, 2005, and the instant post-hearing briefs are being filed.

II. Statement of Facts

A. Interconnection Requirement

AEP presented testimony by Mr. J. Craig Baker, AEP Exhibit No. 5, to attempt to show that AEP's acquisition of CSW satisfies the Act's interconnection requirement. He testified that AEP has a contract with Ameren for transmission service, but this contract expires in June 2005.[24] AEP has not requested firm transmission service east-to-west across the Ameren system for periods after June 2005 to accommodate transfers of energy to CSW.[25]

Ameren provides transmission service to AEP under an open-access transmission tariff (OATT) that is substantially the same as the *pro forma* OATT promulgated by FERC in Order

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

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

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

No. 888 and modified by later FERC orders.[26] Under Ameren's OATT and AEP's transmission contract with Ameren, AEP has reserved a contract path for 250 megawatts (MW) of firm point-to-point transmission service from east to west across Ameren's transmission facilities.[27]

The eastern terminus of the Ameren contract path is the Breed-Casey interconnection between AEP and Ameren near the Illinois/Indiana border.[28] The western terminus of the Ameren contract path is the interconnection between Ameren and the "MOKANOK" transmission line in eastern Missouri.[29]

The MOKANOK line runs from an interconnection with Ameren in eastern Missouri, westward through Missouri, through southeastern Kansas, and into northeastern Oklahoma to an interconnection with Public Service Company of Oklahoma (PSO), a CSW subsidiary, near PSO's Northeastern Generating Station. Ameren, PSO, Western Resource, Inc., and another unaffiliated entity jointly own the MOKANOK line, but each of the owners owns and operates a discrete segment of the line. AEP does not own or operate the segments of the MOKANOK line outside Oklahoma. By long-term contract with the other owners of the MOKANOK line, AEP has rights to 212 MW of firm transmission service over the entire length of the line. In order to increase its firm transmission service rights on the MOKANOK line, PSO entered into an

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

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

[28] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

[29] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

agreement with Western Resources to provide firm point-to-point transmission service for the transfer of 38 MW of power from Ameren's interconnection with the MOKANOK line to PSO's interconnection with the MOKANOK line near PSO's Northeastern Generating Station in northeastern Oklahoma.[30]

Mr. Baker testified that AEP has not reserved a contract path for any firm point-to-point transmission service from west to east under its transmission contract with Ameren or Ameren's OATT.[31] When AEP decided to acquire CSW, it also decided not to reserve a contract path for firm transmission service from west to east over the Ameren system because the cost of reserving such a firm path, in AEP management's opinion, would have been imprudent and unnecessary.[32] Mr. Baker stated that the cost of such a firm path would have been $3 million per year.[33]

Mr. Baker testified that in order for AEP to obtain firm point-to-point transmission service from west to east over the Ameren system, AEP must make a new request for transmission service from Ameren, which Ameren must evaluate to determine if capacity is available to provide such service.[34]

Non-firm point-to-point transmission service, on the other hand, is lower in priority than firm point-to-point transmission service and can be curtailed by the transmission provider before

[30] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

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

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

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

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

higher-priority service.[35] Ameren is not required to plan its transmission system to provide non-firm point-to-point transmission service for AEP, and Mr. Baker provided no indication that Ameren was doing so.[36] To the contrary, Ameren can sell non-firm service to AEP knowing that it can recall the transmission capacity and curtail non-firm service to AEP to protect reliability.[37] During the years 2001, 2002, 2003, and the first nine months of 2004 (through September), the amount of energy transferred by AEP across the Ameren system from west to east has averaged approximately 4000 MWh or about 2% of the amount of energy transferred by AEP across the Ameren system from east to west.[38]

Mr. Baker testified that for the two-year period beginning January 1, 2005, monthly non-firm transmission service for west-to-east transfers of energy across the Ameren system is not available in five of the 24 months.[39] Moreover, AEP cannot determine whether daily or hourly non-firm transmission service for west-to-east transfers of energy across the Ameren system will be available for the next two years, because the data do not exist.[40]

Mr. Baker noted that in a power pool, such as the Southwest Power Pool (SPP), multiple non-affiliated utilities agree to coordinate the planning and operation of their power supply and delivery facilities.[41] And in a "tight" power pool, such as the Pennsylvania-New Jersey-

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

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

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

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

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

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

[41] *Id.* at 8:10-12.

Maryland Interconnection (PJM), a group of non-affiliated companies agree to have their facilities centrally planned and operated by an agent.[42]

Mr. Baker testified that FERC has approved the PJM, the SPP, and MISO as "Regional Transmission Organizations" (RTOs).[43] An RTO offers transmission service over the combined transmission facilities of a number of utilities that are its transmission-owning members.[44]

Mr. Baker testified that the utility companies in AEP's East Zone operate in the PJM RTO.[45] Some of AEP's West zone companies operate in the SPP RTO.[46] But the rest of the AEP West Zone companies are located in and operate in the Electric Reliability Council of Texas (ERCOT).[47] Moreover, the PJM and SPP RTOs are not contiguous; they are separated by a third RTO, the MISO.[48]

Ameren is a member of the MISO.[49] Therefore, Mr. Baker noted, AEP would have to pay the MISO transmission charge to reserve firm transmission service over Ameren's facilities today, and as a result a 250-MW firm point-to-point transmission reservation for east-to-west service over the Ameren system would now cost about $9 million per year.[50] Mr. Baker testified that after June 2005, transfers of power from AEP East to AEP West over the existing 250-MW

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[42] *Id.* at 8:14-17.

[43] *Id.* at 18:6-8; 28:6-8.

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

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

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

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

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

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

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

contract path will require AEP to obtain transmission service from MISO and the SPP. [51] He stated that AEP has not pursued alternative paths for transferring power between AEP East and AEP West, because they are likely to be more expensive than transmission service over MISO and SPP.[52]

B. Single-Area-or-Region Requirement

Mr. Baker testified that "[f]rom an electrical standpoint," utilities in the "Eastern Interconnection"—the entire Eastern United States outside ERCOT—can be said to be in a single area.[53] But he also testified that AEP trades power in at least three different market hubs in different locations in the Eastern Interconnection: PJM, the Cinergy Hub, and the Entergy Hub.[54] The AEP East zone is in PJM and is adjacent to the Cinergy Hub, and the AEP West zone is adjacent to the Entergy Hub.[55] He testified that AEP monitors prices at these hubs for purposes of trading, and because of transmission constraints between these hubs, they do not have uniform market prices.[56]

AEP's witness Dr. David Harrison, Jr., AEP Exhibit No. 1, did not examine electricity infrastructure, electricity trading, or electricity markets,[57] but concluded that AEP and CSW are part of a "functional region" because their respective areas of the country are, by various

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

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

[53] *Id.* at 21:18-19.

[54] *Id.* at 33:1-7.

[55] *Id.* at 33:8-10.

[56] *Id.* at 33:12-17.

[57] Tr. 35:20 to 36:1 (Harrison).

measures, economically interdependent.[58] Thus, he testified that "[f]or the most part, AEP West states are net suppliers of natural gas and AEP East states are net receivers of natural gas…."[59] He concluded that "[t]he information on natural gas suggests the existence of a broad functional region linking major natural gas production and consumption areas. The region encompasses the major gulf coast production areas and the Midwest and East consumption areas."[60] This region, he admitted, constitutes the entire Eastern United States.[61]

AEP's merger application to this Commission attached the testimony of an economist, Dr. William Hieronymus, which AEP had filed with FERC to secure that agency's approval of the merger. His testimony stated that historically, the utility subsidiaries of AEP and CSW have not traded with each other, or with utilities that are reached through the transmission system of the other.[62] The only historical overlap in the wholesale sales of AEP and CSW was in sales to utilities that lie between them, and in those cases the actual overlap was small.[63] AEP historically did not sell a significant amount of power to markets in Oklahoma, Arkansas, Louisiana, or Texas.[64] And AEP and CSW did not sell material amounts of energy to common buyers.[65] Dr. Hieronymus' testimony concluded that more competitive wholesale markets, reduction in pancaked (*i.e.*, additive) transmission rates, and improved transmission access

[58] *Id.* at 4:1-6.

[59] *Id*. at 10.

[60] *Id*.

[61] Tr. 33:3-7 (Harrison).

[62] *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2, Exh. AC-500, p. 3:19-21 (Mar. 8, 1999) (Direct Testimony of William Hieronymus).

[63] *Id.* at 3:21-23.

[64] *Id.* at 5:1-3.

[65] *Id.* at 12:2-13.

would not alter the fundamental economics of the wholesale market that result in AEP selling chiefly east of the Mississippi and CSW selling chiefly in the SPP and ERCOT.[66] Thus, in 1997—the latest period for which AEP has submitted any evidence in the record—more than 96 percent of AEP's non-firm wholesale sales were to utilities east of the Mississippi, and 99 percent of CSW's sales were to utilities west of the Mississippi.[67]

None of AEP's witnesses identified any common cultural, geographic, geologic, or socioeconomic characteristics that could justify a conclusion that the area served by the merged company constitutes a single area or region.

SUMMARY OF ARGUMENT

The Commission should not approve AEP's acquisition of CSW. Given the clear purpose of PUHCA to dismantle and prevent the re-assembly of large, multi-jurisdictional public utility holding companies, the Commission's presumption should be against mergers of already-large holding companies. Allowing AEP to acquire the distant CSW companies would signal the end of meaningful enforcement of the Act and herald the re-formation of the vast holding companies that Congress determined were likely to lead to the abuse of economic power to the detriment of consumers, investors and the public.

These abuses by AEP have already become apparent. Last month AEP agreed to pay over $80 million dollars in civil and criminal penalties to other federal law-enforcement and regulatory bodies to settle charges that its subsidiaries had attempted to evade effective regulation and, through fraudulent actions acknowledged by AEP, had tried to manipulate natural gas-markets to their advantage.

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[66] *Id.* at 12:4-18.

[67] *Id.* at 12:18-21.

Because the court of appeals vacated the Commission's earlier order approving AEP's acquisition of CSW, AEP must seek that approval anew, and as before it bears the burden of proof to justify the acquisition. If the Commission concludes—as it should—that AEP has not met its burden of proof, then the Commission can and should order AEP to divest the CSW assets.

AEP has not met its burden of proving that AEP and CSW would be a "single integrated public-utility system" under PUHCA. First, AEP has not shown that the merged company is "physically interconnected or capable of physical interconnection" such that its assets "under normal conditions may be economically operated as a single interconnected and coordinated system." The court of appeals expressed doubt that two large utility systems can operate as an "interconnected" system with only a unidirectional contract right to transfer power from one system to the other. Although AEP's witness accuses the court of a mistaken factual premise, the evidence shows that that the court's description of AEP's legal rights was correct—and that even those limited rights will soon expire with no successor contractual arrangements in place. Simply put, AEP has a one-way contract right but claims that it has not needed and will not need anything more to meet its modest business goals. That assertion is an insufficient response to the court's concerns and does not provide evidence to support a Commission finding that AEP and CSW would be physically interconnected or capable of physical interconnection.

In this regard, the court also held that the Commission had departed without explanation from its precedent holding that contract rights may not be used to interconnect two distant utilities. The evidence does not provide any reason for the Commission to depart from this precedent. Indeed, AEP and CSW are so physically distant from one another that AEP must use at least two transmission-service contracts in order to transfer power from AEP to CSW.

Finally, AEP does not show that AEP and CSW would be a system "confined in its operations to a single area or region … not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operations, and the effectiveness of regulation . . . ." AEP points to decades-old technological changes that have permitted electric utilities to span larger geographical distances and claims that FERC regulatory policies are intended to foster larger wholesale electric markets. But AEP utterly fails to identify the "single area or region" in which AEP and CSW operate. Its efforts to cobble together this region prove too much, as they reduce to a claim that the entirety of the country east of the Rocky Mountains is that region. If that were the law, then PUHCA would permit virtually any two utilities in the eastern United States to merge and claim they operate in a single region. By any measure, PUHCA was intended to prevent that result.

ARGUMENT

I. AEP bears the burden of proof to show why it should not be ordered to divest CSW.

Congress enacted PUHCA to protect utility customers, investors, and the public against the undue aggregation of economic power of large, multi-jurisdictional public utility holding companies.[68] Accordingly, the statutory presumption is against mergers of already-large holding companies. Until it was vacated by the court of appeals, the Commission's earlier order allowing AEP to acquire CSW and form, by many measures, the largest holding company in the country had set a dangerous precedent and signaled the effective end of meaningful enforcement

[68] *See, e.g., Am. Elec. Power Co.*, 1978 WL 19453 at *6 (S.E.C. July 21, 1978) ("The statute was enacted against a background of unbridled and unsound expansion of utility holding companies controlling utilities scattered from coast to coast . . . . Holding companies were piled on top of holding companies resulting in highly leveraged structures of extraordinary complexity."); *see also Am. Elec. Power Co.*, 1973 SEC LEXIS 3484 at *28 (S.E.C. July 18, 1973) ("It is quite evident from the legislative history of the Act that Congress was concerned with the manner in which electric and gas utility systems had developed and sought not only to eliminate the abuses found to exist but more importantly to create an environment through a statutory design which would in the future, regulate and control such systems so as to forestall recurrence of the attendant evils.").

of the Act. Approval of the acquisition—especially now, after the virtual collapse of the merchant electric generation sector that was supposed to provide competition to incumbent utility monopolists like AEP and CSW—would signal to the industry that the Commission is prepared to rubber-stamp mergers of any size, regardless of the Act's clear purposes of limiting the size of holding companies, simplifying their structures, and maintaining their effective regulation to protect consumers, investors, and the public.

This proposed acquisition would foster the very harms the Act was intended to prevent. It would (and indeed, its initial approval did) herald the re-formation of the vast holding companies that the Act was designed to dismantle and prevent from recurring. "The Act is prophylactic in nature and designed to prevent potential holding company abuses in those contexts where Congress determined they were most likely to occur."[69]

These abuses by AEP have already come to light. Last month, after the hearing in this matter concluded, AEP agreed to pay over $80 million dollars in civil and criminal penalties to the FERC, the U.S. Commodity Futures Trading Commission (CFTC), the U.S. Department of Justice (DOJ), and the U.S. Attorney for the Southern District of Ohio to settle charges that its subsidiaries had attempted to evade effective regulation and manipulate natural gas markets to their advantage—wrongdoing that AEP specifically has acknowledged.[70]

On January 26, 2005, the U.S. District Court for the Southern District of Ohio entered a Final Judgment and Consent Order that required AEP and its subsidiary AEP Energy Services, Inc., (AEPES) to pay a $30 million civil monetary penalty in settlement of charges brought by the CFTC that AEPES falsely reported natural gas trades and attempted to manipulate natural gas

[69] *In re Enron Corp.*, Release No. 35-27782 (S.E.C. Dec. 29, 2003).

[70] The presiding judge can take official notice of these facts, including AEP's acknowledgements of wrongdoing, under Rule 323 of the Commission's Rules of Practice.

prices during the period from at least November 2000 through October 2002. Under the Final Judgment and Consent Order, AEPES acknowledged and accepted responsibility for submitting knowing inaccurate data, including incorrect volumes and/or prices, fictitious trades or incomplete reports of actual trades, relating to one or more of the 38 delivery points or hubs for which AEPES provided information during this period. AEPES specifically acknowledged that many of the spreadsheets submitted for its Gulf Natural Gas Trading Desk contained false data favoring the company's financial positions and that the two other trading desks covering the Northeast and Mid-Continent regions submitted knowingly inaccurate data for at least one delivery point.[71]

Also on January 26, 2005, the DOJ and the U.S. Attorney for the Southern District of Ohio announced that AEP and AEPES had entered into a deferred prosecution agreement with them to avoid federal criminal charges. This agreement required AEP and AEPES to pay an additional $30 million criminal penalty to resolve an investigation into AEPES' false reporting of natural gas trades. Under this agreement, AEPES accepted and acknowledged responsibility for the actions of its employees. The DOJ agreed not to file criminal charges stemming from its investigation for a 15-month period; if AEP does not comply with the agreement during that 15-month period, the DOJ will charge AEPES with delivering knowingly inaccurate reports concerning the commodities market for natural gas based on conduct outlined in an agreed-upon statement of facts.[72]

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[71] *U.S. Commodity Futures Trading Comm. v. Am. Elec. Power Co.*, No. 2:03-cv-891 (S.D. Ohio Jan. 26, 2005) (Final Judgment and Consent Order) (included in Attachment A hereto).

[72] U.S. Department of Justice, Press Release, "American Electric Power, Inc., To Pay $30 Million Penalty To Resolve Criminal Investigation" (Jan. 26, 2005) (included in Attachment A hereto).

Finally, on January 26, 2005, AEP, AEPES, and American Electric Power Service Corporation entered into a stipulation and agreed to pay a $21 million civil penalty to the FERC to resolve alleged violations relating to preferences that natural gas pipelines owned by AEP provided to an affiliated marketer AEPES with respect to gas transportation and operation of storage facilities.[73]

AEP's witness Mr. Baker claims that AEP transfers electric energy from AEP East to AEP West largely to displace electric energy that AEP West would otherwise generate (or purchase) from gas-fired generating units, so that higher prices for natural gas support greater transfers of power from AEP East to AEP West and lower gas prices make such transfers less likely or less profitable.[74] He also testified that AEP's transfers of power from AEP East to AEP West also affect the price of electric energy in the west.[75] Since AEP was regularly attempting to manipulate natural gas prices in the Midwest and Gulf trading areas, the data that AEP has presented of post-acquisition energy transfers between AEP and CSW[76] is of dubious probative value. How would these energy transfers have changed if AEP's gas traders had not been fraudulently manipulating gas prices during the period of the investigation (2000-2002)? Did AEP's pre-acquisition production-costs models take account of its ability to manipulate gas prices? Electricity prices? If AEP ceased its efforts at market manipulation after 2002—the above settlements do not cover later periods—did that cessation contribute to the larger west-to-east energy transfers in 2003 and 2004 shown in AEP's Exhibit 6 and undermine AEP's business

[73] *Amer. Elec. Power Co.*, Docket No. IN02-10-001 (FERC Jan. 26, 2005) (Order Approving Stipulation and Consent Agreement and Requiring Payment of Civil Penalty) (included in Attachment A hereto). AEP did not admit or deny violations of FERC regulations.

[74] AEP Exh. 5, p. 15, lines 7-10 (Baker).

[75] AEP Exh. 5, p. 32, lines 12-14 (Baker).

[76] AEP Exh. 6 & 7.

strategy of relying on a unidirectional contract path for east-to-west transfers? AEP has not answered these questions; it asks the Commission to continue to rely on suspect numbers derived from markets it has acknowledged it was attempting to manipulate.

AEP's larger dilemma is that it still lacks the necessary legal approval under PUHCA to acquire CSW. Doubting whether the Commission would ever be able to approve this acquisition, the court of appeals vacated and remanded the Commission's earlier approval order instead of simply remanding the case for further clarification without *vacatur*. A court remands without vacating the agency's order when the court is "unsure and [wants] . . . clarification of [the agency's] position and the rationale therefor."[77] That course is generally appropriate when "there is at least a serious possibility that the [agency] will be able to substantiate its decision" and when vacating the agency's order would be "disruptive."[78] By vacating the Commission's order, the court of appeals apparently did not find a serious likelihood that the Commission would be able to substantiate its earlier decision permitting AEP to acquire CSW or that it would be too disruptive to deprive AEP of the necessary legal approval for the acquisition in the interim.

By vacating the Commission's earlier order, the court of appeals rendered that order a legal nullity. Thus, pending Commission action on remand, AEP has no legal approval from this Commission under the Act of its acquisition of CSW, and AEP is before the Commission seeking that legal approval once again.

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[77] *Checkosky v. SEC*, 23 F.3d 452, 465 (D.C. Cir. 1994) (Silberman, J. concurring). When "deciding whether to vacate an agency's decision pending further explanation," the District of Columbia Circuit considers "the seriousness of the order's deficiencies . . . and the disruptive consequences of an interim change that may itself be changed." *A.L. Pharma, Inc. v. Shalala*, 62 F.3d 1484, 1492 (D.C. Cir. 1995) (internal quotations omitted).

[78] *Allied-Signal, Inc. v. United States Nuclear Reg. Comm'n*, 988 F.2d 146, 151 (D.C. Cir. 1993).

As the proponent of a Commission order approving its acquisition of CSW, AEP bears the burden of proof.[79] There can be no presumption favoring the proposed acquisition as a *fait accompli*. AEP made a deliberate decision in choosing to consummate the merger with CSW although judicial review was pending; it should not now be relieved of the risk it undertook voluntarily. Moreover, the Commission's period of inaction did not shift any of the evidentiary burden away from AEP.

If AEP does not satisfy its burden of proof under the Act to justify its proposed acquisition of CSW, the Commission should not approve the acquisition and should require the divestiture of the CSW companies—just as the Commission represented to the court of appeals that it would do if the merged company did not comply with the Act's requirements.[80]

AEP recognized this point in its 1999 merger application to the Commission in this case, arguing that the Commission could approve its acquisition of CSW while at the same time deferring to the FERC, DOJ, and the Federal Trade Commission (FTC)—all of which had pending investigations of the proposed merger's anticompetitive effects—because the Commission "retains ongoing authority under Section 20(a) of the 1935 Act [15 U.S.C. § 79t(a)] to rescind or further condition its approval of a transaction."[81] Thus, even if the court of appeals had not vacated the Commission's earlier order, the Commission would have had the legal authority to order AEP to divest CSW. Since the court did vacate the Commission's earlier order, it is clear beyond cavil that the Commission may now order such divestiture. Indeed,

[79] 5 U.S.C. § 556(d) (2000).

[80] 276 F.3d at 615-16.

[81] Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item 3.A.1.b(ii)).

unless AEP meets its burden of proof, divestiture would appear to be the only way to comply with the Act.

II. AEP does not satisfy PUHCA's interconnection requirement.

AEP has not submitted evidence to provide a legally sufficient basis for the Commission to find that the utility assets of AEP and CSW are or ever will be "physically interconnected or capable of physical interconnection" so that "under normal conditions [they] may be economically operated as a single interconnected and coordinated system."[82] On this point, the evidentiary record now contains, if anything, less evidence to support a finding in AEP's favor than it did when the court vacated and remanded the Commission's earlier order.

AEP has submitted testimony asserting that the court was mistaken in concluding that AEP was relying on a "unidirectional" contract path—yet neither AEP nor the Commission saw fit to seek rehearing or further review of the court of appeals' decision to correct this supposed mistake. In fact, AEP's new testimony shows that the court's characterization of the facts was correct in January 2002 and remains correct three years later; AEP's real argument that it does not want anything but a unidirectional contractual right to transfer energy from AEP to the former CSW system—as if AEP's business strategy could drive the interpretation of the Act.

Indeed, AEP's testimony reveals that it has no contractual right to continue even these unidirectional energy transfers after June 2005, when its existing contract with Ameren expires. And while AEP's 1999 application to the Commission held out the goal that all of AEP's non-ERCOT utility assets would be put in a single RTO or at worst *contiguous* RTOs, AEP now claims that it satisfies the Act's interconnection requirements with a supposed "system" spread

[82] 15 U.S.C. § 79b(a)(29)(A).

over *non-contiguous* RTOs—and without any legal contract for transmission service in place. With the bar set that low, however, the statute's interconnection requirement all but disappears.

Under the Commission's precedent—and even reasonable extensions of that precedent—AEP's soon-to-expire, unidirectional contract right to transmission service does not satisfy the interconnection requirement of the Act.

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

1. AEP has only a unidirectional right to transmission service over intervening utilities—and only until June 2005.

While the Commission instituted the proceedings on remand to provide AEP with another opportunity to prove that the combined AEP and CSW systems meet the interconnection requirement of the Act, AEP has failed to adduce any such evidence. Its main response to the court's questions on how AEP's 250-MW contract path satisfies the Act's interconnection requirement is to claim that the court got it wrong—that AEP does not have only a unidirectional contract path. In fact, AEP's testimony does not reveal any error on the court's part and only confirms the inadequacy of AEP's evidentiary showing under Commission precedent.

Evaluating AEP's claim of judicial error is made difficult because of the meager evidence AEP has chosen to present. Although the 250-MW Ameren contract path is the central issue, AEP has not introduced as an exhibit its actual contract with Ameren. Neither has it introduced in evidence Ameren's open-access transmission tariff (OATT) under which, it says, Ameren provides the transmission service. Instead, the Commission is left to parse the testimony of AEP's witness, Mr. Baker, who characterizes the Ameren contract and FERC's *pro forma* OATT without quoting any of the relevant contractual or tariff language.

Mr. Baker says that AEP has a contract with Ameren for "firm" transmission service. Under this contract, AEP has "reserved a contract path of 250 MW" for transfers from east to west.[83] This reservation expires in June 2005, and AEP does not have a successor contract in place after that date.[84] Moreover, AEP has not reserved any firm transmission service for transfers from west to east over Ameren's transmission system.[85]

Mr. Baker speculates that the "fact that AEP has only reserved *firm* transmission service from east to west led the court mistakenly to believe that AEP has only a unidirectional contract path across Ameren and that the flow of power under AEP's contract is restricted to a unidirectional flow of power."[86] Mr. Baker asserts, however, "AEP's contract rights can be, and are, used to move power in both directions."[87]

Again, evaluating this claim is made more difficult because AEP did not provide the Ameren contract; for that reason alone the Commission ought to find against the company. But delving beyond the surface of Mr. Baker's characterizations, the Commission can find that AEP has only a unidirectional contractual *right* to move 250-MW of power from east to west, and this right expires in June 2005. AEP has reserved firm point-to-point transmission service under Ameren's OATT. That service is available to AEP on a firm basis—i.e., uninterruptible under normal conditions, on equal priority with Ameren's "native load" customers—only over the contract path over which AEP has reserved service.[88] AEP has no unfettered contractual *right* to

[83] AEP Exh. 5, p. 10, lines 20-22 (Baker).

[84] *Id.* at 19, lines 16-21.

[85] *Id.* at 10, line 26, to 11, line 1.

[86] *Id.* at 10, line 26, to 11, line 1 (emphasis original).

[87] *Id.* at 11, lines 1-2.

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

move a single megawatt of power west to east: all it has under its Ameren contract and the applicable OATT is the ability to move power from west to east on a non-firm basis—i.e., if the transmission capacity is available at the time; this is the same right that any non-firm transmission customer has under the OATT of a utility regulated by the FERC.[89]

Mr. Baker asserts, "AEP has the right under applicable FERC rules, to redirect its contract path from west to east at any time at no additional charge."[90] Since AEP did not file the contract and Mr. Baker does not cite the FERC rules, one cannot be sure what he means. But he appears to be referring to the provision of FERC's *pro forma* OATT that allows a firm transmission customer to designate an alternative point of receipt and point of delivery—including changing the direction of point-to-point service—at no additional charge *on a non-firm basis*.[91] Thus, AEP cannot reverse its contract path on a firm—i.e., non-interruptible—basis at will. To obtain *firm* transmission service from Ameren from west to east, AEP must make a new application for transmission service under Ameren's OATT.[92] Until AEP makes that request and Ameren grants it, AEP may only obtain non-firm transmission service west-to-east over Ameren.[93] In short, under its "firm" transmission contract with Ameren and its reservation of "firm" transmission service under Ameren's OATT, *AEP has no contractual rights to firm transmission service from west to east*. AEP's legal right to firm transmission service is unidirectional.

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

[90] AEP Exh. 5, p. 11, lines 23-24 (Baker).

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

[92] FERC *pro forma* OATT, sec. 17, 19, & 22.2 (Appendix B to FERC Order No. 888-A).

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

Other than its contractual right to 250-MW of firm service over its designated east-to-west path over Ameren's system, and its right to change to *non-firm* service in the opposite direction—i.e., over a different path, if and when available—at no additional charge, AEP is left in the same place as any other utility seeking transmission service from Ameren: "for east to west transfers in addition to those using the firm path, and for west to east transfers, AEP can purchase non-firm transmission service from Ameren."[94]

After June 2005, however, AEP has left the Commission almost in the dark. Its entire evidentiary presentation consists of six lines of Mr. Baker's testimony, where he discloses that even though the current Ameren contract expires in June 2005, AEP has yet to reserve transmission capacity after that date.[95] Mr. Baker asserts that "AEP has the right to 'roll over' its long-term reservation," and that it will make a formal request to do so in 2005.[96] This is an apparent reference to section 2.2 of the FERC *pro forma* OATT, which requires a transmission customer seeking to use such rollover rights to match the term and price of any competing offer to use the transmission path.[97] AEP has not shown that it has satisfied these preconditions.

Moreover, AEP's testimony shows that to continue transferring power from AEP to CSW after June 2005, AEP will have to obtain transmission service from two FERC-regulated RTOs—the MISO and SPP.[98] Ameren is a member of MISO, which now provides transmission service and administers requests for transmission service over Ameren's transmission facilities.[99]

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[94] AEP Exh. 5, p. 11, lines 24-25 (Baker). See FERC *pro forma* OATT, sec. 14 & 18.

[95] AEP Exh. 5, p. 19, lines 16-21 (Baker).

[96] *Id.* at 19, lines 18-20.

[97] FERC *pro forma* OATT, sec. 2.2 (Appendix B to FERC Order No. 888-A).

[98] AEP Exh. 5, p. 19, lines 17-18 (Baker).

[99] *Id.* at 19, line 7.

AEP is not a member of MISO, but must contract for service from MISO just as it would from Ameren—although Mr. Baker admitted that the price of reserving the contract path under the MISO OATT would be triple the price of doing so under Ameren's OATT until 2008 and after that would remain double the price from Ameren alone.[100] Thus, the advent of regional transmission service under MISO would make it more expensive to transfer power between AEP East and AEP West. AEP has not, however, submitted any evidence showing that it has requested service from MISO after June 2005—much less that MISO has granted that request.

But MISO cannot deliver power to AEP West, whose utility companies are not members of MISO and are not directly interconnected with MISO. Transmission service from MISO to AEP West may be available under the SPP OATT.[101] Two of the four operating utilities of AEP West—those outside ERCOT—are members of the SPP.[102] Thus, AEP would be required to obtain and pay for transmission service from SPP to transfer energy from AEP East and the MISO transmission system to AEP West's facilities. AEP, however, has not filed any evidence showing that it has requested firm transmission service from the SPP, or that firm service will be available on a long-term basis, or that long-term firm service will be available at an economical price.[103]

AEP's failure to file any evidence to show it has a firm contractual path—in any direction—providing a non-physical but contractual interconnection between AEP and CSW beyond June 2005 precludes the Commission from finding that the utility assets of AEP and CSW are "physically interconnected or capable of physical interconnection." AEP's testimony

[100] AEP Exh. 5, p. 16, lines 2-4 (Baker).

[101] AEP Exh. 5, p. 19, lines 16-18.

[102] *Id.* at 29, line 15.

[103] *Id.* at 19, lines 16-21.

is that it has not even requested firm transmission service after June 2005 to support unidirectional, east-to-west transfers of energy. AEP has no contract path over Ameren, MISO, or SPP after June 2005, period. A promise to request transmission service at a future date does not support a Commission finding that that AEP has "*contractual rights* to use a third-party's transmission lines or [that] physical interconnection is contemplated or . . . possible within the reasonably near future."[104] AEP's failure to provide evidence of any contractual right to interconnection beyond June 2005 has rendered impossible a Commission finding that AEP's acquisition of CSW meets the Act's interconnection requirement.[105] Even if a unidirectional contract path were sufficient under the Act—and it is not, as shown next—AEP has not satisfied its burden of proof to show that it has such a path after June 2005.

2. AEP has not shown how its unidirectional contract path—even if renewed—would meet the interconnection requirements of the Act.

Although AEP has left the future of the interconnection between AEP and CSW after June 2005 indeterminate, assume *arguendo* that AEP will be able to obtain a new contract path over MISO and SPP to provide equivalent service to its existing 250-MW contract path over Ameren and the MOKANOK line. AEP has still failed to show that it would comply with the Act's interconnection requirement.

In describing the existing 250-MW contract path and the interconnection requirement, the court was "puzzled by the Commission's acceptance of a unidirectional contract path to

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[104] *Madison Gas & Elec. Co.*, 168 F.3d 1337, 1340 (D.C. Cir. 1999) (emphasis added) (internal citation omitted); *see also Gen. Pub. Utils. Corp.*, 32 S.E.C. 807, 825, 1951 S.E.C. LEXIS 575 (Dec. 28, 1951) (A promise to "inform" the SEC how it will comply with the statute cannot be reconciled with the need for the interconnection capability to be "foreshadowed by . . . facts shown in the record.").

[105] *Gen. Pub. Utils. Corp.*, 37 S.E.C. 28, 32 (1956) ("Accordingly, since there were no immediate and concrete plans for interconnection, we held that the mere possibility of interconnection at an indefinite future time was not sufficient and that the properties were not then capable of interconnection.").

'interconnect' AEP and CSW."[106] As shown in the last section, the court's characterization of AEP's contractual rights as "unidirectional" is true beyond peradventure: AEP has provided no evidence of anything but a unidirectional contract path—i.e., the "'contractual rights to use a third-party's transmission lines.'"[107]

AEP is not planning to build a physical transmission line connecting AEP and CSW.[108] In lieu of an actual physical interconnection, AEP has not obtained a contractual equivalent of such a physical line—a contract with a third-party utility for firm transmission service in both directions.

Mr. Baker explains at length that AEP does not believe it would be economical to contract for two-way firm transmission service. He argues that the potential availability of non-firm service from west to east, even though not assured, is sufficient for AEP's business purposes.[109] Apparently AEP does not believe that it would economical to contract for even a single megawatt of firm transmission service from west to east.

Be that as it may, AEP's economics arguments beg the question whether AEP and CSW could then be deemed "physically interconnected or capable of physical interconnection." AEP's view is that if its business model does not require a contractual right to use a third-party's transmission lines, then the Act should not require one, either. But this gets things backwards: it is AEP that must comply with the statute, not the statute with AEP. Taken to its logical conclusion, AEP's argument would mean that if gas prices decline, and it becomes uneconomical to have even the 250-MW unidirectional contract path, AEP could dispense with it, rely on the

[106] 276 F.3d at 612.

[107] *Id.* at 615 (quoting *Madison Gas & Elec. Co.*, 168 F.3d at 1340).

[108] Tr. 59:22-24.

[109] AEP Exh. 5, p. 10, line 20, to p. 11, line 11 & p. 16, lines 1-4.

possible availability of non-firm transmission service in both directions, and essentially ignore the statutory interconnection requirement altogether.

Indeed, the court of appeals considered and rejected AEP's business-model explanation for ignoring the statutory requirement.[110] The Commission's earlier order explained the very facts that AEP now brings before the Commission a second time:

> Applicants also expect that, from time to time, there will be opportunity to transfer energy economically from the West Zone to the East Zone. In these circumstances, Applicants will make use of their rights to nominate secondary points of receipt and delivery under their transmission service agreements with Western Resources and Ameren.[111]

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

> Petitioners also argue that the 250 MW interconnection is inadequate because it provides only east-to-west power transfers. However, as discussed above, the need for interconnection was primarily in that direction. Although firm transmission service from west to east was considered by Applicants, they ultimately determined that there would be adequate transmission capacity on a non-firm basis to accommodate economic transfers from CSW to AEP, and therefore firm transmission would not be required.[112]

The court considered but rejected that argument.[113] In describing the contract path and finding that it constituted a unidirectional path, the court found that:

> [t]his 'contract path' will enable New AEP's western zone (the current CSW system) to make use of some surplus generating capacity . . . in the eastern zone (the current AEP system). . . . AEP and CSW apparently expect that there will be fewer 'opportunities to transfer energy economically' from west to east than from east to west, but when and if

[110] 276 F.3d at 612 (citing *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *61 n.79, *65-66).

[111] *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *65-66.

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

[113] 276 F.3d at 612, 615.

> such opportunities arise, New AEP proposes to make use of its rights under pre-existing transmission service agreements.[114]

The court therefore found that a contract path that only provided for transmission service on a firm basis in one direction (with the availability of non-firm transmission options) constituted "a system restricted to unidirectional flow of power from one half to the other . . . ."[115]

This conclusion underscores the court's understanding that, while transmission services are generally offered on both a firm and non-firm basis, there are significant differences between the two. Firm transmission service is an assured contractual right to transmission service, equal in priority to the transmission provider's use of its facilities to provide service to its "native load" customers, and thus can be curtailed only in emergency circumstances.[116] "In contrast, non-firm transmission service is more economical than firm service, but is subject to curtailment or interruption, often with little or no notice by transmitting utilities."[117] Non-firm transmission service is available only from excess transmission capacity that is not needed to provide firm transmission service or service to the transmission provider's "native load" customers.[118] Short-term non-firm service—the kind that AEP indicates it uses for west-to-east transfers—can be displaced

[114] 276 F.3d at 612 (citing *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *61 n.79, *65-66).

[115] 276 F.3d at 615.

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

[117] Energy Information Administration, *Transmission Pricing*, Transmission Pricing Issues, *at* http://www.eia.doe.gov/cneaf/solar.renewables/rea_issues/html/pricing.html (last visited Feb. 1, 2005). See FERC *pro forma* OATT, sec. 14.7 (Appendix B to Order No. 888-A).

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

by longer-term non-firm service.[119] The transmission provider has no obligation to plan or build transmission facilities to provide non-firm transmission service.[120]

AEP concedes these limitations and admits that non-firm service from west to east is not always available over the 250 MW contract path. Mr. Baker testified that for a two-year period beginning January 1, 2005, monthly non-firm service would not be available for five of the twenty-four months reviewed.[121] Whereas the Act requires that the assets at issue be "physically interconnected or capable of physical interconnection," during these five months there is no evidence that AEP would be able to obtain contractual rights that would make it capable of moving energy in both directions between AEP East and AEP West. Thus, AEP has no present contractual rights to service in any of those twenty-four months, and it has provided no evidence that it would be even able to obtain such contractual rights during five of the months. Thus, it has provided no showing that the utility assets of AEP East and AEP West would even be "capable of physical interconnection" during those months. If that contractual path is not available, AEP has not committed to obtaining service over alternative paths; it has not investigated them because they are likely to be too costly.[122]

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

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

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

[122] AEP Exh. 5, p. 20, lines 1-9.

In short, AEP has not complied with Commission precedent by demonstrating that it has contractual rights or by committing to make alternative arrangements to ensure that the Act's interconnection requirements could be satisfied at all times.[123] Thus, AEP has not shown that AEP East and West will be "capable of physical connection and of supplying power to one another as needed."[124]

The fact that FERC has approved PJM, MISO, and the SPP as RTOs does not change the legal analysis. AEP cannot show that its East and West Zones could be interconnected by means of transmission service from a *common* power pool or RTO, because the utilities in the East and West Zones are members of three different such regional organizations (PJM, SPP, and ERCOT).

Moreover, AEP's East and West Zones are not even in contiguous RTOs, since PJM and SPP are separated by the MISO. AEP has no firm contractual arrangements in place after June 2005 over MISO and SPP to replace the Ameren and MOKANOK arrangements in place today—much less bi-directional contract rights that make AEP capable of moving power between the zones as needed.

AEP's present arguments are a far cry from the position it advanced at the outset of this case, when the transmission Valhalla it described for the Commission was the possible membership of the entire AEP system (outside ERCOT, of course) in a single RTO or at least in contiguous RTOs (described using the then-current term "ISO" for "independent system operator"):

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[123] *Madison Gas & Elec. Co.*, 168 F.3d 1337, 1341 (D.C. Cir. 1999) (the applicant "has committed to take measures to ensure that the interconnection requirements of section 2(a)(29) of the Act are satisfied" if planned FERC approval for the construction of interconnection tie-lines does not occur).

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

> Applicants' goal ultimately is to further enhance the interconnection of the Combined System through participation in a regional ISO (subject to the need of the CSW-ERCOT companies to continue participation in the ERCOT ISO). Assuming that the Combined Company belongs to a single ISO, the ISO will have the capability to use the other members' transmission lines to transmit power within the Combined System. The effect is the same even if the Combined Company belongs to separate but contiguous ISOs, provided the ISOs are not permitted to erect economic barriers between them.[125]

AEP has voluntarily chosen another path, by keeping both its East Zone companies and its West Zone non-ERCOT companies out of the MISO. Thus, even if membership in contiguous RTOs without "economic barriers" between them was a possible means of meeting the interconnection requirement—a point that NRECA and APPA do not concede—that possibility is now out of the picture and thus the Commission need not decide that question in this case.

In the end, AEP asks for the Commission to find that the merged company would meet the interconnection requirement because intervening multiple RTOs may have non-firm transmission capacity available if AEP should require it. But AEP has no transmission contracts, has not requested transmission service from the relevant RTOs, and has not shown that the service would be available if AEP were to ask for it. On the present record, these facts do not support a finding that the utility assets of AEP and CSW are "physically interconnected or capable of physical interconnection" so that "under normal conditions [they] may be economically operated as a single interconnected and coordinated system."[126] Under AEP's view of the statute, utility assets only need to be "capable of interconnection" on a sporadic and unknown basis. If that is all that is

[125] Form U-1, Amend. No. 2, at __ (Mar. 8, 1999) (Item 3.B.1.a (i)).

[126] 15 U.S.C. § 79b(a)(29)(A).

required, however, then nearly any two utilities in the United States could meet the interconnection requirement, and this critical provision of the Act becomes a dead letter.

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

The court of appeals held that AEP and CSW are "distant utilities."[127] In this vein, the court noted, "AEP and CSW's systems are neither contiguous nor physically interconnected—indeed, at their closest point, they are separated by hundreds of miles."[128] Because Commission precedent had held without exception that contract rights alone cannot be used to integrate distant utilities,[129] the court agreed with NRECA and APPA that in its earlier order in this case "the Commission failed to follow its own prior reasoning regarding the interconnection of distant utilities."[130] The court held that the Commission's clear previous policy "obligate[d] the Commission to provide some rationale for its current contrary view,"[131] but a "satisfactory explanation for [its] change in course" that was "not evident" in the Commission's earlier order in this case.[132]

The hearing in this case has provided no factual basis for the Commission's unexplained swerve in policy. As recently as 1998, the Commission reiterated its determination that electric

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[127] 276 F.3d at 615.

[128] 276 F.3d at 612.

[129] *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.").

[130] 276 F.3d at 615.

[131] *Id.*

[132] *Id.* at 617.

properties may not be interconnected by means of contractual rights where the utilities are separated by significant distances.[133] The Commission's commitment to this principle is clearly and repeatedly expressed in its prior decisions.[134] The facts in this case do not support a departure from that policy. Not only are AEP and CSW hundreds of miles apart, but the 250-MW one-way contract path allows AEP to transfer a miniscule amount of power relative to the size of the loads of the utilities in AEP's West Zone. By comparison, the court noted, "the few cases in which the Commission has accepted transmission contracts as evidence of interconnection, unlike this case, have involved contracts for transmission of large amounts of power in both directions between relatively closely situated utility assets."[135] While AEP may in the future have to use contracts with two RTO to secure a one-way contract path between AEP and CSW, nothing in AEP witness Mr. Baker's testimony suggests in any way that the advent of RTO transmission service will bring AEP and CSW economically closer; to the contrary, his testimony was that the price of the Ameren contract path would triple until 2008, after which it would settle back to double the pre-RTO price. The MISO OATT, if anything, makes AEP and CSW even more "distant" from one another.

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

[134] *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.").

[135] 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.

III. The merged company is not confined to a single area or region.

Section 11(b)(1) of the Act requires that each holding company system must operate as part of "a single integrated public-utility system."[136] Section 2(a)(29)(A) of the Act requires that each integrated public-utility system must be "confined in its operations to a single area or region."[137] In the instant case, the merged company would stretch nearly from Canada to Mexico, beginning from Virginia west through Ohio, north to Michigan, then (after skipping hundreds of miles) south through Texas right to the very banks of the Rio Grande. There is simply no factual basis upon which the Commission can conclude that this entire area, covering some 197,400 square miles,[138] is confined to a single region. Certainly AEP itself, despite its efforts to torture the meaning of the word "region," and to substitute exhortations about "changing circumstances" and "technological change" for actual statutory analysis, failed in its direct prefiled testimony to identify the single area or region that might encompass Canton, Ohio and Brownsville, Texas. AEP's failure in this regard is not surprising, for, as the record makes plain, there is no such region, unless the entire Eastern United States, from the Atlantic Ocean to the Rocky Mountains, is defined as a single region.

In its initial decision in this case, the Commission, although finding that the merger met the "region" requirement, likewise failed to identify the region that it believed encompassed the entire merged company. Instead, relying upon a 1995 report by its own staff,[139] the Commission essentially read the requirement out of the Act by first describing what it viewed as the overarching goal of the Act – "preventing 'the growth and extension of holding companies [that]

[136] 15 U.S.C. § 79k(b)(1).

[137] 15 U.S.C. § 79b(a)(29)(A).

[138] 2000 SEC LEXIS 1227 at 90.

[139] *Id*. at 83-84.

bears no relation to economy of management and operation,'"[140] and then finding that since this merger (in the Commission's view) does bear some relation to economy of management and operation, and (again in the Commission's view) does not violate any of the other requirements of Section 2(a)(29)(A), the "region" requirement was therefore met.

The court of appeals, however, reversed. In its opinion, the Court made clear that, in order to win approval of its merger with CSW, AEP must demonstrate, independent of the other requirements of section 2(a)(29)(A) of the Act, that the merged company will be "confined in its operations to a single area or region." The Court similarly agreed that the Commission's failure to make any evidentiary findings on the issue of region requirement constituted reversible error.[141] The Court then went on, citing to prior decisions by the Commission, to identify the types of considerations that must be analyzed in determining whether a proposed merger will be confined to a single area or region: "[P]rior Commission decisions addressing the region requirement have analyzed such factors as the geography and socioeconomic characteristics of the areas covered by the system."[142] In particular, the Court cited *Middle West Corp*.,[143] wherein the Commission found the region requirement to be met where "[t]he area is more or less typical throughout, relying largely on oil and other minerals, agriculture, and relatively light industry for its subsistence,"[144] and *American Natural Gas Co*., wherein the Commission looked to whether the merging service territories were similar in terms of "industrial, marketing and general

[140] 2000 SEC LEXIS 1227 at 84.

[141] 276 F.3d at 617.

[142] *Id*.

[143] 15 SEC 309 (1944).

[144] *Id*. at 336.

business activity, transportation facilities, and gas utility requirements."[145] Finally, the Court was clear that the Commission could not cite to changes in the industry over the years as effectively overriding the requirement that merger applicants carry their burden of demonstrating that their operations would be confined to a single area or region: "[t]echnological improvements may well justify ever-expanding electric utilities, but PUHCA confines such utilities to a 'single' area or region."[146]

The evidence produced by AEP on remand fails to make the showing required by the court of appeals. Instead, AEP once again relies heavily on general references to technological and regulatory changes that have made possible ever-expanding utilities. Where AEP has attempted to offer evidence to support its claim that the merged company is confined to a single area or region, it has been forced to define "region" so broadly that the entire United States east of the Rockies would be considered one region. Moreover, the testimony of its two witnesses on the "region" requirement, Mr. Baker and Dr. Harrison, is internally inconsistent. In any event, no decision of this Commission, no decision by any court of appeals, and nothing in the legislative history of the Act support AEP's overly expansive reading of the "region" requirement.[147]

AEP Exhibit No. 1 is the prepared direct testimony of Dr. David Harrison, Jr. Dr. Harrison begins by declaring that "[t]here is no one definition or criteria [sic] for what

[145] 43 SEC 203, 206 (1944).

[146] 276 F.3d at 618.

[147] Indeed, AEP's approach to the region requirement is directly contrary to this Commission's teaching that "[t]he statute and its legislative history make it clear that, consistently with geographic conditions (in the broad sense of that term) as much compactness should be achieved in outlining the spheres of holding company influence as physical facts permit." *Cities Serv. Power & Light Co*., 14 SEC 28, 59 (1943).

constitutes a 'region;' the concept of region is heavily dependent upon the context."[148] In the instant case, of course, the context is a proposed merger of two electric utility holding companies. Despite this fact, and despite his own testimony as to the importance of "context," Dr. Harrison then proceeds to undertake an analysis that, by his own admission, includes no analysis of electricity infrastructure, no analysis of electricity trading, and no analysis of electricity markets.[149] Rather, to judge whether a single region exists in the context of a proposed electric utility merger, Dr. Harrison analyzes, among other things, employment in the lumber, tobacco, and publishing industries.[150]

To be fair, Dr. Harrison does also analyze some factors more closely related to the electricity industry. In particular, he examines the infrastructure for transportation in North America of natural gas,[151] a fuel widely used for the production of electricity. Neither his analytical framework nor his conclusions, however, warrant a finding by this Commission that AEP East and AEP West are confined to a single area or region.

Dr. Harrison's analytical framework stands in direct contradiction to this Commission's precedent. Where this Commission, as the court of appeals cited approvingly, has looked in cases like *Middle West Corp.* at whether "[t]he area is more or less typical throughout,"[152] Dr. Harrison purports to find that AEP East and AEP West constitute a single area or region precisely because of their differences. For example, he notes that "[f]or the most part, AEP West

[148] AEP Exh. 1, p. 3, lines 26-27.

[149] Tr. 35-36.

[150] AEP Exh. 1, p. 5.

[151] *Id*. at 8-14.

[152] 276 F.3d at 617.

states are net suppliers of natural gas and AEP East states are net receivers of natural gas…."[153] Next, Dr. Harrison notes that, as one might expect, there is a relatively strong correlation between natural gas prices in Texas, where a great deal of natural gas is produced, and natural gas prices in the Northeast and Midwest, where much of the Texas-produced gas is consumed.[154]

From this unexceptional observation, however, Dr. Harrison goes on to conclude that "[t]he information on natural gas suggests the existence of a broad functional region linking major natural gas production and consumption areas. The region encompasses the major gulf coast production areas and the Midwest and East consumption areas."[155]

Thus, where the Commission and the Courts have looked to the extent to which areas alleged to be within a single region are similar, Dr. Harrison opines that AEP East and AEP West are in a single region because they are dissimilar. AEP West is a major oil and gas producing region; the Northeast and Midwest, including the AEP East states, are not major oil and gas producing areas, but consume oil and gas to meet the demand engendered by their colder climates and manufacturing base. The AEP East and AEP West states, in other words, are different in geography, natural resources, climate, and economy. Under the analytical framework traditionally used by this Commission, and cited by the court of appeals,[156] Dr. Harrison's testimony thus leads to the conclusion that the AEP East and AEP West states are in fact in different regions.

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[153] AEP Exh. 1, p. 10.

[154] *Id.* at 12.

[155] *Id*. This analysis has been undercut, however, by AEP's recent acknowledgement that its gas traders attempted to manipulate gas prices in the Gulf, Midwest, and Northeast markets.

[156] For instance, the Court noted disapprovingly that the Commission "[n]ever mention[ed] whether the territories served by AEP and CSW have common geographic or geologic traits …." 276 F.3d at 617.

It is true, of course, that areas with geographic, geologic, and economic differences may nevertheless be determined to be within a single area or region. Dr. Harrison himself cites the example of Old Town Alexandria and the rural Shenandoah Valley.[157] In such a case, however, it is not the fact that Old Town Alexandria and the rural Shenandoah Valley are different that leads to the conclusion that they are in a single region. Old Town and the Shenandoah Valley are considered to be in a single region because of geographic proximity.

By contrast, Canton, Ohio, and Brownsville, Texas, are geographically separated by a significant distance.[158] When one adds to that Dr. Harrison's analysis showing that they lie in areas that are very different economically and geologically as well, it is impossible to conclude that Canton and Brownsville are part of a single area or region.

Dr. Harrison's analysis of functional regions, although perhaps useful for purposes of general economic analysis, sheds no light upon the meaning of the "region" requirement of section 2(a)(29)(A). "Functional regions are characterized by economic interdependence. This economic interdependence includes movements of goods and services and other measures of transactions within the region. Economic interdependence is also reflected in the degree to which prices are correlated."[159] In contrast to the analysis referred to by the court of appeals, Dr. Harrison thus defines functional regions entirely by trading patterns, independent of geographic proximity or geological or cultural similarities.[160] Dr. Harrison thus opined that the merged

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[157] AEP Exh. 1, p. 42.

[158] As NRECA and APPA argued earlier in this case, "the AEP and CSW headquarters are approximately 1,000 miles apart and the boundaries of the service territories are even more distant." 2000 SEC LEXIS 1227 at *91.

[159] AEP Exh. 1, p. 4.

[160] Thus, as Dr. Harrison forthrightly conceded, the entire world constitutes a single functional region with regard to trading in oil. *Id*. at 20. This simply points out that functional regions are not helpful in determining compliance with the "region" requirement within the meaning of the Act.

company is within a single area or region without addressing the significant distance between the AEP East states and AEP West states, and without any analysis whatsoever of the cultural characteristics of the respective areas. Nor did he analyze their geological characteristics, except to note that the AEP West states, but not the AEP East states, have significant deposits of oil and natural gas. Again, this observation actually supports the conclusion that AEP East and AEP West are in fact in separate regions.

Ultimately, of course, Dr. Harrison was forced to concede that one can find the merged AEP to be confined to a single area or region only if one defines the entire Eastern United States as a single region:

> Q. So, it's a broad region consisting – encompasses the major Gulf Coast production areas, and the Midwest and East consumptions? And that's basically the entire Eastern United States?
>
> A. That's correct.[161]

In addition to his own analysis, Dr. Harrison's testimony also included several examples of efforts by federal agencies to divide the United States into regions. Although the examples chosen by Dr. Harrison generally involved dividing the country into several large regions, rather than many small ones, the merged AEP invariably spilled over into multiple regions. For example, in his discussion of oil transportation patterns, Dr. Harrison notes that the division of the United States into five Petroleum Administration for Defense Districts ("PADDs").[162] The merged AEP is included in no fewer than three of these five districts – PADD 1 (East Coast), PADD 2 (Midwest), and PADD 3 (Gulf Coast). The United States Census Bureau divides the country into even larger districts – only four for the entire United States. The merged AEP is

[161] Tr. at 33.

[162] AEP Exh. 1, p. 17.

split between two.[163] Indeed, it appears that, other than Dr. Harrison himself, the only person who believes that the merged AEP is confined to a single area or region is AEP's other witness on the question, Mr. Baker.

Like that of Dr. Harrison, the testimony of AEP witness Mr. Baker attempts to support the notion that the entire Eastern United States is a single area or region.[164] Rather than discussing trade patterns in other industries, however, Mr. Baker argues in effect that, due to technological advances[165] and federal regulatory policies, the entire electrical Eastern Interconnection[166] can be considered to be a single area or region.[167] As was true of Dr. Harrison, Mr. Baker offers both an analytical framework and a conclusion that cannot be reconciled with the Commission's precedent, the court of appeals' remand, or the language and purpose of the Act.

Mr. Baker's analytical framework is faulty because it repeats the error addressed by the court of appeals, by conflating the "region" requirement with the "interconnection" and "coordination" requirements. For instance, in identifying the factors that lead to his conclusion that the combined company is within a single area or region, Mr. Baker states:

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[163] *Id*. at 40. The Census Bureau further divides the country into nine sub-regions, four of which include part of AEP's service territory. *Id*.

[164] "From an electrical standpoint, the Eastern Interconnection can accurately be described as a 'single area.'" AEP Exh. 5, p. 21.

[165] The technological advances since passage of the Act in 1935 are actually described in the testimony of AEP witness Paul B. Johnson (AEP Exhibit No. 2), but it is Mr. Baker who argues that these developments support a finding that the merged company is confined to a single area or region. (AEP Exh. 5, pp. 20-21).

[166] The Eastern Interconnection is the largest of the three Interconnections that make up the North American Electric System. The Eastern Interconnection includes "virtually the North American continent east of the Rocky Mountains excluding the area of the ERCOT Interconnection," which is confined to part of the state of Texas. Within the Eastern Interconnection, each electric utility is interconnected "and operat[ed] in synchronism with one another at 60 Hertz (cycles per second)." AEP Exh. 2, pp. 6-7.

[167] Of course, even if the Eastern Interconnect were determined to be a "single area or region," that would not solve AEP's problem, as the merged company does not operate entirely in the Eastern Interconnect. Two of the AEP West utility subsidiaries are located in ERCOT. AEP Exh. 5, p. 21.

> The clear trend over time has been continually to increase the scope of interaction and trade among the nation's electric utilities. The fundamental drivers for this phenomenon have been the economic and reliability advantages of increased interconnection and coordination as discussed above. These factors, in turn drove technological innovation and increase physical interconnection among electric utilities. At the same time, federal government policy has continually promoted increased interconnection and coordination.[168]

NRECA and APPA agree that technological and policy developments since 1935 have both promoted and enabled increased interconnection and coordination—although, as explained elsewhere in this brief, AEP East and AEP West are not "physically interconnected or capable of physical interconnection" within the meaning of section 2(a)(29)(A). However, as the court of appeals made clear, such technological advances do not effect changes in regional boundaries: "Technological improvements may well justify ever-expanding electric utilities, but PUHCA confines such utilities to a 'single' area or region."[169] Yet AEP, through the testimony of Mr. Baker, is once again asking the Commission to find that the "region" requirement has been met because it can show increased coordination and interconnection among utilities in the Eastern United States.

Mr. Baker's overly optimistic description of the effects of regulatory policy, especially on the part of the FERC, in breaking down barriers to electricity trading and interconnection in the Eastern Interconnection, likewise cannot be found to have changed regional boundaries in the radical manner AEP urges. This portion of Mr. Baker's testimony begins with a summary of developments in federal electricity policy since the passage of the Act in 1935. The summary makes it clear that change has been a constant theme over this entire period. Mr. Baker himself cites the Federal Power Commission's 1964 "National Power Survey," the Northeast blackout of

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[168] *Id*.

[169] 276 F.3d at 618.

1965, the development thereafter of the National Electric Reliability Council and its constituent regional reliability councils,[170] the 1978 enactment into law of the Public Utility Regulatory Policies Act, and the 1992 passage of the Energy Policy Act.[171] Indeed, while AEP urges the Commission to abandon seventy years of precedent and find that the Eastern Interconnection is a single area or region, AEP witness Johnson admits that the existence of the Eastern Interconnection, so called because each utility therein is at least indirectly interconnected with all the others, dates back to 1962.[172] Thus, the policy initiatives the FERC has undertaken during the last decade are best viewed as evolutionary steps in keeping with trends that have been ongoing for the better part of the last century.

Moreover, those initiatives themselves, while significant, have not been as entirely successful as AEP portrays. As an example, Mr. Baker describes FERC Order No. 888, issued in 1996, as having had a "profound effect on the electric utility industry."[173] In fact, FERC itself is in the process of considering revisions to Order No. 888, due to concerns that transmission-owning utilities continue to have opportunities to exercise transmission market power and engage in unduly discriminatory practices.[174] Thus, notwithstanding the fact that Order No. 888 was a significant development in the regulation of the electric utility industry, there is no basis for concluding that it (and subsequent developments) have eliminated all or substantially all

[170] The combined AEP system was spread across three separate regional reliability councils: ERCOT, SPP, and the East Central Area Reliability Coordination Agreement ("ECAR").

[171] AEP Exh. 5, pp. 23-24.

[172] AEP Exh. 2, p. 13.

[173] AEP Exh. 5, p. 25.

[174] *See* FERC gearing up to revamp open-access rules in concert with new market testing, Inside FERC (Dec. 13, 2004) (Attachment B hereto).

barriers to the free and unimpeded flow of electricity in the Eastern Interconnection, let alone between the Eastern Interconnection and the AEP West companies in ERCOT.

The next development discussed by Mr. Baker is FERC Order No. 2000,[175] in which FERC encouraged the development of RTOs. AEP's testimony in this regard, not surprisingly, glosses over the fact that the very name *Regional* Transmission Organization strongly indicates that FERC views each RTO as a separate region for purposes of operating, planning and expansion of the transmission system.[176] In any event, Mr. Baker does not appear to consider RTO membership to be a prerequisite for inclusion in the single area or region that he believes includes the entirety of the post-merger AEP, since he includes in that region both the ERCOT portion of AEP[177] and FERC-regulated "public utilities" that are not members of RTOs, such as Entergy and the Southern Company.[178] Moreover, FERC has not mandated RTO membership for the public utilities it regulates, but has left such membership to the voluntary choice of each such utility. Accordingly, this Commission cannot rely on AEP's member utilities' memberships in multiple, non-contiguous RTOs to find that the merged company complies with the region requirement.

Mr. Baker's discussion of what he calls FERC's "Standard Market Design" is also overly optimistic. Of the RTOs in the Eastern United States, only PJM is currently operating energy markets. The MISO, which lies between PJM (which encompasses AEP East) and SPP (which

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[175] Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809, FERC Stats. & Regs. ¶ 31,089, *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088, FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd sub nom. Pub. Util. Dist. No. 1 of Snohomish County, Wash.* v. *FERC,* 272 F.3d 607 (D.C. Cir. 2001) ("Order No. 2000").

[176] Mr. Baker does acknowledge that each RTO must demonstrate "adequate 'scope and configuration,' which means, practically speaking, that they must include many utilities and cover a large geographical area." AEP Exh. 5, p. 27.

[177] *Id*. at 32.

[178] Tr. at 118-119.

includes the non-ERCOT portions of AEP West) has just postponed the implementation of its markets, yet again, until April 1, 2005. The orders in which FERC approved the MISO energy markets[179] are on appeal to the United States Court of Appeals for the District of Columbia Circuit, as are the orders granting SPP certification as an RTO.[180] Moreover, unlike PJM and MISO, SPP has not committed to full implementation of what FERC calls "Day 2" markets.[181] (Even if it did, portions of AEP West in ERCOT would still be outside the market.) Similarly, Mr. Baker's description of developments related to the Midwest ISO/SPP Joint Operating Agreement ("JOA")[182] glosses over the fact that, in SPP's December, 2004 filing, SPP "advised[d] the Commission that by executing the enclosed JOA, SPP does not waive its rights to pursue changes to this agreement, as may be authorized on rehearing and/or judicial review of the Commission's JOA Order."[183] In short, Midwest ISO and SPP have not reached a final agreement on the contents of the JOA, and it is uncertain when or if they will reach agreement.

Moreover, the current version of the JOA between Midwest ISO and SPP itself belies the notion that the entire Eastern Interconnection is one large market, as is clear from FERC's order approving that agreement over SPP's objections:

> [B]oth the SPP JOA and the Midwest ISO's proposed draft JOA addressed in the JOA Order[184] pertain to the Midwest ISO's market to SPP's non-market

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[179] *Midwest Independent Transmission System Operator, Inc*, 108 FERC ¶ 61,163 (2004); *order on reh'g*, 109 FERC ¶ 61,157 (2004).

[180] *Southwest Power Pool, Inc*., 106 FERC ¶ 61,110 (2004); *order on reh'g*, 109 FERC ¶ 61,010 (2004).

[181] "We clarify that the February 10 Order does not contemplate any development and implementation of Day 2 markets, beyond the energy imbalance market in development as part of Phase 1 of SPP's plan, without the preparation of cost/benefit analysis." *Southwest Power Pool, Inc.*, 109 FERC ¶ 61,010 at P 59 (2004).

[182] "FERC directed SPP to file by December 1, 2004, a JOA containing mutually agreed provisions for 'non-market to market' operations. The filing was made as scheduled." AEP Exh. 5, p. 31.

[183] SPP filing in FERC Docket No. ER04-1096 (December 2, 2004) at 2.

[184] *Southwest Power Pool, Inc*., 109 FERC ¶ 61,008 (2004).

> conditions. The market portion of the market-to-non market provisions applies not to SPP, but to the Midwest ISO, leaving undetermined the coordination procedures for when SPP operates markets.[185]

Notwithstanding FERC's use of the word "when," SPP has not in fact committed that it will ever institute the type of energy markets, based upon locational marginal pricing, currently operated by PJM and slated for implementation by Midwest ISO on April 1, 2005.[186]

Indeed, even a close examination of Mr. Baker's testimony itself casts doubt upon his eventual conclusion that the entire Eastern Interconnection is one single area.[187] For example, Mr. Baker admits that AEP engages in separate trading within three separate hubs, in different locations throughout the Eastern Interconnection. Specifically, AEP trades in the PJM Hub, the Cinergy Hub, and the Entergy Hub.[188] 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."[189] Thus, notwithstanding Dr. Harrison's testimony that "[f]unctional regions are characterized by economic interdependence," and that economic dependence in turn is "reflected in the degree to which prices are correlated,"[190] AEP's own evidence shows that electricity

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[185] *Southwest Power Pool, Inc*., 110 FERC ¶ 61,031 at P 22 (2005).

[186] *See supra* n.181.

[187] AEP Exh. 5, p. 21. Of course, as AEP witness Mr. Johnson makes clear, the Eastern Interconnection is not limited to the United States, but includes virtually the entire North American Electric System east of the Rocky Mountains, meaning it includes a very substantial portion of Canada as well. Thus, to accept AEP's argument, the Commission would have to find that Brownsville, Texas, is not only in the same region as Canton, Ohio but that both are in the same region as Toronto and Montreal.

[188] *Id*. at 33.

[189] *Id*.

[190] AEP Exh. 1, p. 4.

trading in the Eastern Interconnection takes place at geographically disparate hubs, and that prices at those hubs are sufficiently divergent that AEP finds it profitable to "continually monitor[] the prices and transmission availability between the Hubs and enter[] into economic transactions as they arise in each."[191]

Based on these facts, Mr. Baker's description of the entire Eastern Interconnection as "one big machine,"[192] and of AEP East and AEP West, including those portions located in ERCOT, as residing within a single wholesale electricity market,[193] reflects a large dose of wishful thinking. Indeed, in its initial decision in this case, this Commission itself made very different findings with regard to the relationship between ERCOT and the remaining portions of the AEP service territory:

> All of the members of ERCOT are electrically isolated from PSO, SWEPCO and other utilities operating in whole or in part in states other than Texas. The ERCOT interchange agreements in effect preclude direct or indirect exchange of electric energy with utilities receiving or transmitting electric energy in interstate commerce. When CP&L and WTU joined ERCOT, they ceased to exchange electric energy with PSO and SWEPCO, except for a special arrangement under which the northern division of WTU, adjacent to the Oklahoma border, could operate alternately either with PSO or with ERCOT as long as simultaneous interconnection was avoided.[194]

Mr. Baker's representations regarding the integration of AEP's ERCOT territories into his single wholesale market cannot be reconciled with the Commission's own findings.

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[191] AEP Exh. 5, p. 33.

[192] *Id*. at 21.

[193] *Id*. at 32-33.

[194] 2000 SEC LEXIS 1227 at 13-14. Public Service Company of Oklahoma ("PSO") and Southwestern Electric Power Company ("SWEPCO") are the AEP operating companies within the SPP. Prior to the merger, CSW operated two separate utility companies within ERCOT – Central Power & Light ("CP&L") and West Texas Utilities ("WTU"). Today CP&L and WTU operate as AEP Texas. See http://www.aep.com/about/serviceterritory/default.htm (last visited February 3, 2005).

It is also noteworthy that Mr. Baker's testimony that the entire Eastern United States is one big market (and therefore a single area or region) when analyzed in terms of electricity trading is at odds with Dr. Harrison's definition of how one defines a functional region. According to Dr. Harrison, it is necessary to look at volumes of trading among regions and comparative price correlations to determine whether different areas are part of a single functional region.[195] Mr. Baker, however, concludes that such apparently disparate areas as PJM, Midwest ISO, SPP and ERCOT are part of a single area or region based entirely on a recounting of actions by federal regulators, with no analysis of the extent to which trading in those areas has increased relative (for instance) to trade between those RTOs and utilities that are not within RTOs. Do market participants in SPP, for instance, now engage in more trading with the MISO region than with non-RTO utilities such as Entergy? Is there a greater degree of price correlation between SPP and PJM than between SPP and the Tennessee Valley Authority, which is not an RTO member? According to Dr. Harrison, these are the types of considerations that must be weighed before one can conclude that a single region exists based on market activity.[196] Yet Mr. Baker's analysis fails completely to weigh these factors.

Significantly, neither Mr. Baker nor Dr. Harrison present any data on actual electricity trading or electricity markets that would lead one to conclude, using Dr. Harrison's criteria or any other set of criteria, that AEP and CSW would operate in a single area or region.[197] Indeed,

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[195] AEP Exh. 1, p. 4.

[196] This is not to say that NRECA and APPA accept Dr. Harrison's analysis as a valid means of determining the existence of a single area or region within the meaning of section 2(a)(29)(A) of the Act. Having presented an expert on the question of defining regions by economic trading, however, AEP should not then be permitted to claim, without reference to that witness's criteria, that a region exists based on trading in a particular commodity (electricity).

[197] AEP Exhibit No. 10, a PowerPoint presentation prepared by SPP depicting a power sale commencing in ERCOT and ending in New York, is not such evidence. Mr. Baker professed no knowledge whether this transaction was real or hypothetical. Tr. 117:12 to 118:6. Moreover, AEP has stated that Exhibit No. 10 "was not offered to prove to

the only *evidence* in the record—as opposed to speculation—points to exactly the opposite conclusion. AEP's merger application to this Commission attached the testimony of an economist, Dr. William Hieronymus, which AEP had filed with FERC to secure that agency's approval of the merger. He concluded that historically, the utility subsidiaries of AEP and CSW have not traded with each other, or with utilities that are reached through the transmission system of the other.[198] Historically, the only overlap in the wholesale sales of AEP and CSW was in sales to utilities that lie between them, and in those cases the extent of the overlap was small.[199] AEP historically did not sell any significant amount of power to markets in Oklahoma, Arkansas, Louisiana, or Texas.[200] AEP and CSW did not sell material amounts of energy to common buyers.[201] He concluded that more competitive wholesale markets and reduction in pancaked transmission rates and improved transmission access would not alter the fundamental economics of the wholesale market that result in AEP selling chiefly east of the Mississippi and CSW selling chiefly in the SPP and ERCOT.[202] Thus, in 1997—the latest period for which AEP has submitted any evidence in the record—more than 96 percent of AEP's non-firm wholesale sales were to utilities east of the Mississippi, and 99 percent of CSW's sales were to utilities west of the Mississippi.[203] Dr. Hieronymus concluded that this situation is unlikely ever to change by

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truth of the matter asserted." Opposition of American Electric Power Company, Inc., to Motion To Strike 4 (Feb. 10, 2005). Even if Exhibit No. 10 is not stricken from the record, as NRECA and APPA have requested, see Motion To Strike of the National Rural Electric Cooperative Association and the American Public Power Association (Jan. 31, 2005), it should be accorded no weight.

[198] *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2, Exh. AC-500, p. 3:19-21 (Mar. 8, 1999) (Direct Testimony of William Hieronymus).

[199] *Id.* at 3:21-23.

[200] *Id.* at 5:1-3.

[201] *Id.* at 12:2-13.

[202] *Id.* at 12:4-18.

conducting a sensitivity analysis of his empirical calculations of market shares and market concentration in the AEP and CSW regions, which showed no material changes even if transmission service were priced across the regions *at zero* other than transmission losses.[204]

Even if Mr. Baker's representations of "one big market" are taken at face value, however, they cannot justify a finding that the combined AEP-CSW "system" would be confined to a single area or region without any showing that the various service territories are geographically proximate or similar geographically or geologically. To hold otherwise leads inexorably to the conclusion acknowledged by Mr. Baker, that AEP could merge with all of the largest utilities and holding companies in the Eastern Interconnection – Entergy, Southern Company, *and* Exelon – and still be considered to be within a single region.[205] In short, adopting AEP's interpretation would make the "region" requirement mere surplusage, and render the Act a virtually empty shell in the process.

Mr. Baker also champions, in what is almost an "aside" in the last two pages of his testimony, the theory that, regardless of such considerations as geographic or geological features, or geographical distances, any two utilities must be considered to be within a single area or region if they, and all of the utilities interconnected with them, form a contiguous whole.[206]

It is not surprising that this argument gets short shrift even from its own proponent.[207] Essentially, AEP argues that the mere showing that the merging utilities are separated by no

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[203] *Id.* at. 12:18-21.

[204] *Id.* at 12:21-24.

[205] Tr. at 118-120.

[206] AEP Exh. 5, pp. 36-37.

[207] By providing a "bright line" test for whether multiple utilities are in a single area or region, this argument runs contrary to AEP's mantra, repeated elsewhere by Mr. Baker himself, that "the terms 'area' and 'region' are by their very nature susceptible of flexible interpretation … ." *Id*. at 20.

more than two wheeling transactions, without more, suffices to prove the existence of a single region. As discussed earlier, however, the court of appeals has already instructed this Commission that a finding that the merging utilities are physically interconnected or capable of interconnection is insufficient to justify a finding that the merged company will operate in a single area or region. *A fortiori*, a finding that the merging utilities are within two wheeling transactions of being physically interconnected cannot possibly suffice to demonstrate that the utilities in question are confined to a single area or region. Moreover, FERC, as part of its recent regulatory policy initiatives, has abandoned the use of first-tier utilities to define geographic markets in analyzing whether potential merger partners will have the ability to exercise market power, requiring a more sophisticated "delivered price" analysis.[208]

Nothing in the Act itself, nothing in the precedents of the Commission or any Federal Court, and certainly nothing in the court of appeals' opinion remanding this case to the Commission supports the notion that the entirety of the United States between the Atlantic Ocean and the Rocky Mountains can be considered to be a "single area or region" within the meaning of the Act. Yet there is no smaller region that encompasses the entire merged AEP. Accordingly, the Commission must find that the merged company will not constitute a single integrated public-utility system, and that the merger therefore violates the Act.

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.

[208] *Merger Policy Statement*, III FERC Stats. & Regs., ¶ 31,044 at pp. 30,117, 30,131 (1996).

Respectfully submitted,

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February 14, 2005

PROPOSED FINDINGS OF FACT

1. AEP has a contract with Ameren for firm transmission service, but this contract expires in June 2005. AEP Exh. 5, pp. 10:20-21, 19:16.

2. Ameren provides transmission service to AEP under an open-access transmission tariff (OATT) that is substantially the same as the pro forma OATT promulgated by FERC in Order No. 888, as modified in Order Nos. 888-A, 888-B, and in later FERC orders. AEP Exh. 5, pp. 9:13-15; 10:20 to 14:21; 15:14-16.

3. Under Ameren's OATT and AEP's transmission contract with Ameren, AEP has reserved a contract path for 250 megawatts (MW) of firm point-to-point transmission service from east to west across Ameren's transmission facilities. AEP Exh. 5, pp. 10:21-22; 15:14-16.

4. The eastern terminus of the Ameren contract path is the Breed-Casey interconnection between AEP and Ameren near the Illinois/Indiana border. *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

5. The western terminus of the Ameren contract path is the interconnection between Ameren and the MOKANOK Line in eastern Missouri. *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

6. The MOKANOK line runs from an interconnection with Ameren in eastern Missouri, westward through Missouri, through southeastern Kansas, and into northeastern Oklahoma to an interconnection with Public Service Company of Oklahoma (PSO), a CSW subsidiary, near PSO's Northeastern Generating Station. *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

7. Ameren, PSO, and two other unaffiliated entities jointly own the MOKANOK line, but each of the owners owns and operates a discrete segment of the line. AEP does not own or operate the segments of the MOKANOK line outside Oklahoma. *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

8. By long-term contract with the other owners of the MOKANOK line, AEP has rights to 212 MW of firm transmission service over the entire length of the line. *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

9. In order to increase its firm transmission service rights on the MOKANOK line, PSO entered into an agreement with Western Resources, Inc. (one of the other owners of the line) to provide firm point-to-point transmission service for the transfer of 38 MW of power from Ameren's interconnection with the MOKANOK line to PSO's

interconnection with the MOKANOK line near PSO's Northeastern Generating Station in northeastern Oklahoma. *Am. Elec. Power Co.*, 2000 SEC LEXIS 1227, at *44-45; *Am. Elec. Power Co.*, Form U-1, Amend. No. 2 (Mar. 8, 1999) (Item I.B.3.b).

10. AEP has not reserved a contract path for any firm point-to-point transmission service from west to east under its transmission contract with Ameren or Ameren's OATT. AEP Exh. 5, p. 10:20 to 11:11; 16:1-7.

11. When AEP decided to acquire CSW, it also decided not to reserve a contract path for firm transmission service from west to east over the Ameren system because the cost of reserving such a firm path, in AEP management's opinion, would have been imprudent and unnecessary. AEP Exh. 5, pp. 10:20 to 11:11 & 16:1-4. The cost of such a firm path would have been $3 million per year. AEP Exh. 5, p. 16:2-3.

12. A 250-MW firm point-to-point transmission reservation on the Ameren system would cost about $9 million per year today. AEP Exh. 5, p. 16:4.

13. AEP transfers electric energy from AEP East to AEP West largely to displace electric energy that AEP West would otherwise generate or purchase from gas-fired generating units. AEP Exh. 5, p. 15:7-10.

14. AEP has estimated that over a ten-year period, it will transfer power from AEP West to AEP East only about 4.3 percent of the time. AEP Exh. 5, pp. 15:6-12; 15:16-19.

15. AEP cannot, by redirecting its contract path under its firm transmission contract with Ameren, obtain firm point-to-point transmission service from west to east. In order to obtain firm point-to-point transmission service from west to east over the Ameren system, AEP must make a new request for transmission service from Ameren, which Ameren must evaluate to determine if capacity is available to provide such service. AEP Exh. 5, p. 10:20 to 11:11; 12:5-10.

16. Non-firm point-to-point transmission service is lower in priority than firm point-to-point transmission service and can be curtailed by the transmission provider before higher-priority service. AEP Exh. 5, p. 13:14-15.

17. Ameren is not required to plan its transmission system to provide non-firm point-to-point transmission service for AEP. AEP Exh. 5, p. 13:15-16.

18. There is no evidence that Ameren plans its transmission system to provide non-firm point-to-point transmission service for AEP.

19. Ameren can sell non-firm service to AEP knowing that it can recall the transmission capacity and curtail non-firm service to AEP to protect reliability. AEP Exh. 5, p. 14:15-18.

20. Ameren's FERC-regulated OATT requires it to offer transmission service over its transmission facilities to all eligible customers so long as capacity is available. AEP Exh. 5, p. 11:17-21, 12:2-4.

21. During the years 2001, 2002, 2003, and the first nine months of 2004 (through September), the amount of energy transferred by AEP across the Ameren system from west to east has averaged approximately 4000 MWh or about 2% of the amount of energy transferred by AEP across the Ameren system from east to west. AEP Exh. 5, p. 16:19-21.

22. For the two-year period beginning January 1, 2005, monthly non-firm transmission service for west-to-east transfers of energy across the Ameren system is not available in five of the 24 months. AEP Exh. 5, p. 17:12-13.

23. AEP cannot determine whether daily or hourly non-firm transmission service for west-to-east transfers of energy across the Ameren system will be available for the next two years because the data do not exist. AEP Exh. 5, p. 17:17-18.

24. AEP has not requested firm transmission service east-to-west across the Ameren system for periods after June 2005 to accommodate transfers of energy to CSW. AEP Exh. 5, p. 19:16-21.

25. In a power pool, multiple non-affiliated utilities agree to coordinate the planning and operation of their power supply and delivery facilities. AEP Exh. 5, p. 8:10-11.

26. The Southwest Power Pool (SPP), located in the central southwest portion of the United States, is an example of a power pool. AEP Exh. 5, p. 8:11-12.

27. In a tight power pool, a group of non-affiliated companies agree to have their facilities centrally planned and operated by an agent. AEP Exh. 5, p. 8:14-15

28. The Pennsylvania-New Jersey-Maryland Interconnection (PJM) is an example of a tight power pool. AEP Exh. 5, p. 8:15-17.

29. The FERC has approved the SPP, PJM, and the Midwest Independent System Operator (MISO) as Regional Transmission Organizations (RTOs). AEP Exh. 5, pp. 18:6-8; 28:6-8.

30. An RTO offers transmission service over the combined transmission facilities of a number of utilities that are its transmission-owning members. AEP Exh. 5, p. 18:10-11.

31. Ameren is a member of the MISO. AEP Exh. 5, p. 19:7.

32. After June 2005, transfers of power between AEP East and AEP West over the existing 250-MW contract path will require AEP to obtain transmission service from MISO and SPP. AEP Exh. 5, p. 19:16-18.

33. AEP has not pursued alternative paths for transferring power between AEP East and AEP West, because they are likely to be more expensive than transmission service over MISO and SPP. AEP Exh. 5, p. 20:1-9.

34. Some of the utility assets of the AEP-CSW combined system, which were part of the former CSW system, are located outside the Eastern Interconnection, in the Electric Reliability Council of Texas (ERCOT). AEP Exh. 5, p. 21:22-23.

35. AEP's east zone is in the PJM RTO. AEP Exh. 5, p. 29:14-15.

36. AEP's non-ERCOT west zone companies belong to the SPP RTO. AEP Exh. 5, p. 29:15-16.

37. The PJM and SPP RTOs are not contiguous. They are separated by a third RTO, the MISO. AEP Exh. 5, p. 19:21-23.

38. FERC's Order No. 2000 does not require utilities to form RTOs; FERC left the formation of RTOs to the voluntary choices of utilities. Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809, FERC Stats. & Regs. ¶ 31,089, *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088, FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd sub nom. Pub. Util. Dist. No. 1 of Snohomish County, Wash.* v. *FERC,* 272 F.3d 607 (D.C. Cir. 2001) ("Order No. 2000").

39. SPP and MISO currently do not operate markets for electric energy. AEP Exh. 5, p. 31:5-6.

40. It is uncertain if PJM and MISO will have a combined energy market. AEP Exh. 5, p. 30:9-12.

41. It is uncertain if MISO and SPP will have a combined energy market. AEP Exh. 5, pp. 30:19-23; 31:1-10.

42. AEP's decision to transfer electric energy from AEP East to AEP West rather than purchase the same energy in the west affects the demand and therefore the market-price levels in the west. AEP Exh. 5, p. 32:12-14.

43. AEP trades power in at least three different market hubs in different locations: PJM, Cinergy Hub, and Entergy Hub. AEP Exh. 5, p. 33:1-7.

44. The AEP East zone is in PJM and is adjacent to the Cinergy Hub. AEP Exh. 5, p. 33:8-9.

45. The AEP West zone is adjacent to the Entergy Hub. AEP Exh. 5, p. 33:9-10.

46. The PJM, Cinergy, and Entergy Hubs do not have uniform market prices. AEP Exh. 5, p. 33:12.

47. Transmission constraints result in different market prices for energy between the PJM, Cinergy, and Entergy Hubs. AEP Exh. 5, p. 33:16-17.

48. Historically, the utility subsidiaries of AEP and CSW have not traded with each other, or with utilities that are reached through the transmission system of the other. *Am. Elec.*

Power Co., Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 3:19-21).

49. Historically, the only overlap in the wholesale sales of AEP and CSW is in sales to utilities that lie between them, and in those cases the extent of the overlap is small. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 3:21-23)

50. AEP has not historically sold any significant amount of power to markets in Oklahoma, Arkansas, Louisiana, or Texas. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 5:1-3).

51. Before the merger, AEP and CSW did not sell material amounts of energy to common buyers. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 12:2-13).

52. More competitive wholesale markets and the reduction of pancaked transmission rates and improved transmission access cannot alter the fundamental economics of the wholesale market that result in AEP selling chiefly east of the Mississippi and CSW selling chiefly in the SPP and ERCOT. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 12:4-18).

53. In 1997, the latest period for which there is evidence in the record, more than 96 percent of AEP's non-firm wholesale sales were to utilities east of the Mississippi, and 99 percent of CSW's sales were to utilities west of the Mississippi. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 12:18-21).

54. The expectation that the fundamental economics of the wholesale market result in AEP selling chiefly east of the Mississippi and CSW selling chiefly in SPP and ERCOT are confirmed by the sensitivity analysis performed by the Applicant's witness Dr. Hieronymus, which shows no material changes in this pattern even if transmission were priced across the regions at zero costs other than transmission losses. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 12:21-24).

55. ERCOT utilities engage primarily in operations within Texas. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 15:7-8).

56. To examine the effects of a merger on market power, FERC considers each utility that is directly interconnected to the merging companies to be a separate "destination market." Competing suppliers are defined as those who have capacity or energy that is physically and economically deliverable to the destination market. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 19:1-20).

57. Utilities in the SPP and ERCOT generally have different supply alternatives. ERCOT and the SPP are interconnected only via two direct-current (DC) ties. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 27:16-18).

58. Because of the location of AEP and CSW and the fact that their historic trading partners do not overlap, any analysis that puts them in the same geographic market necessarily assumes a large geographic market. *Am. Elec. Power Co.*, Form U-1, Amend. No. 2, Exh. D-1.2, Vol. 2 (Mar. 8, 1999) (Exh. AC-500, Direct Testimony of William Hieronymus, p. 39:19-24).

59. The area served by the merged company covers 197,400 square miles. *American Elec. Power Co.*, 2000 SEC LEXIS 1227, at *90.

60. Some of the states served by the merged companies are oil and gas producing states and others are predominantly consumers of oil and natural gas. AEP Exh. 1, pp. 10, 17 (Harrison).

61. AEP's expert witness Dr. Harrison was unable to identify the single area or region that it claims encompasses the entire area served by the merged company. AEP Exh. 1, pp. 42.

62. AEP's testimony did not identify any technological developments during the last 30 years that could affect regional boundaries within the United States.

63. AEP's testimony did not identify any common geographic or socioeconomic characteristics that could justify a conclusion that the area served by the merged company constitutes a single area or region.

64. On January 26, 2005, the U.S. District Court for the Southern District of Ohio entered a Final Judgment and Consent Order that required AEP and its subsidiary AEP Energy Services, Inc., (AEPES) to pay a $30 million civil monetary penalty in settlement of charges brought by the U.S. Commodity Futures Trading Commission that AEPES falsely reported natural gas trades and attempted to manipulate natural gas prices during the period from at least November 2000 through October 2002. Under the Final Judgment and Consent Order, AEPES acknowledged and accepted responsibility for submitting knowing inaccurate data, including incorrect volumes and/or prices, fictitious trades or incomplete reports of actual trades, relating to one or more of the 38 delivery points or hubs for which AEPES provided information during this period. AEPES specifically acknowledged that many of the spreadsheets submitted for its Gulf Natural Gas Trading Desk contained false data favoring the company's financial positions and that the two other trading desks covering the Northeast and Mid-Continent regions submitted knowingly inaccurate data for at least one delivery point. *U.S. Commodity Futures Trading Comm. v. Am. Elec. Power Co.*, No. 2:03-cv-891 (S.D. Ohio Jan. 26, 2005) (Final Judgment and Consent Order).

65. On January 26, 2005, the U.S. Department of Justice and the U.S. Attorney for the Southern District of Ohio announced that AEP and AEPES had entered into a deferred prosecution agreement with them to avoid federal criminal charges. This agreement

required AEP and AEPES to pay an additional $30 million criminal penalty to resolve an investigation into AEPES' false reporting of natural gas trades. Under this agreement, AEPES accepted and acknowledged responsibility for the actions of its employees. The Department of Justice agreed not to file criminal charges stemming from its investigation for a 15-month period; if AEP does not comply with the agreement during that 15-month period, the Department of Justice will charge AEPES with delivering knowingly inaccurate reports concerning the commodities market for natural gas based on conduct outlined in an agreed-upon statement of facts. U.S. Department of Justice Press Release, "American Electric Power, Inc., To Pay $30 Million Penalty To Resolve Criminal Investigation" (Jan. 26, 2005).

66. On January 26, 2005, AEP, AEPES, and American Electric Power Service Corporation entered into a stipulation and agreed to pay a $21 million civil penalty to the FERC to resolve alleged violations relating to preferences that natural gas pipelines owned by AEP provided to an affiliated marketer AEPES with respect to gas transportation and operation of storage facilities. AEP did not admit or deny violations of FERC regulations. Amer. Elec. Power Co., Docket No. IN02-10-001 (FERC Jan. 26, 2005) (Order Approving Stipulation and Consent Agreement and Requiring Payment of Civil Penalty).

PROPOSED CONCLUSIONS OF LAW

1. Section 9(a)(1) of the Act makes it unlawful for a registered holding company "to acquire, directly or indirectly, any securities or utility assets or any other interest in any business" absent Commission approval under section 10 of the Act.

2. Section 10(c)(1) of the Act requires that the Commission not approve an acquisition that "would be detrimental to the carrying out of the provisions of section 11."

3. Under section 11(b)(1) of the Act, the utility properties of a registered holding company are limited, with exceptions irrelevant here, to a "single integrated public-utility system."

4. Section 2(a)(29)(A) defines an "integrated public-utility system," as applied to electric utility companies, to mean "a system consisting of one or more units of generating plants and/or transmission lines and/or distribution facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operations, and the effectiveness of regulation . . . ."

5. AEP has the burden of proof to show that after its acquisition of CSW, the utility assets of AEP and CSW would be "physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system."

6. Under the Act, for utility assets to be "physically interconnected or capable of physical interconnection," so that "under normal conditions [they] may be economically operated as a single interconnected and coordinated system," the system's utility assets may be interconnected by one or more physical transmission lines that are (a) operated by one or more of the electric companies in the system; or (b) operated by a tight power pool whose members include system's electric companies; or (c) operated by a third-party utility under a long-term contract granting one or more of the system's electric companies legal rights to firm—i.e., non-interruptible under normal conditions—transmission service over those lines in both directions.

7. The utility assets of AEP and CSW are not interconnected by one or more physical transmission lines operated by any AEP or CSW company.

8. The utility assets of AEP and CSW are not interconnected by one or more physical transmission lines operated by a tight power pool whose members include the AEP and CSW companies.

9. The utility assets of AEP and CSW are not interconnected by one or more physical transmission lines operated by a third-party utility under a long-term contract granting one or more of the AEP or CSW companies legal rights to firm transmission service over those lines in both directions.

10. Under the Act, utility assets cannot be "physically interconnected or capable of physical interconnection," so that "under normal conditions [they] may be economically operated as a single interconnected and coordinated system," by the general availability of transmission service under the transmission tariff of one or more third-party utilities.

11. The general availability of transmission service under the transmission tariff of third-party utilities interconnected with AEP and CSW does not make the utility assets of AEP and CSW "physically interconnected or capable of physical interconnection."

12. Under the Act, a "single integrated public utility system" must be "confined in its operations to a single area or region."

13. AEP has the burden of proof to show that after its acquisition of CSW, AEP and CSW would constitute a system that is "confined in its operations to a single area or region."

14. The entire Eastern United States between the Atlantic Ocean and the Rocky Mountains is too large an area to be considered a single area or region within the meaning of the Act.

15. Increased interconnection and coordination among electric utilities does not alter regional boundaries.

16. Two or more electric utilities, located in separate, non-contiguous FERC-approved Regional Transmission Organizations, are not confined in their operations to a single area or region within the meaning of the Act.

17. Separate areas that are not geographically proximate, and that are not geographically or geologically similar, are therefore not located in a single area or region.

18. The fact that two utilities are separated by two or fewer wheeling transactions does not demonstrate that the two utilities are located in a single area or region.

19. The fact that two distant regions engage in commerce in one or more commodities does not demonstrate that electric utilities serving those distant regions are confined in their operations to a single area or region within the meaning of the Act.

20. The creation of the Eastern Interconnection in 1962 did not create a single area or region within the meaning of the Act.

21. AEP and CSW would not constitute a system "confined in its operations to a single area or region."

ATTACHMENT A

Contents:

U.S. Commodity Futures Trading Commission, Press Release No. 5041-05, "U.S. Commodity Futures Trading Commission Settles Lawsuit With American Electric Power Company And AEP Energy Services, Inc. For False Reporting And Attempted Manipulation In Natural Gas Markets" (Jan. 26, 2005)

U.S. Commodity Futures Trad. Comm. v. Am. Elec. Power Co., No. 2:03-cv-891 (S.D. Ohio Jan. 26, 2005) (Final Judgment and Consent Order)

U.S. Department of Justice, Press Release, "American Electric Power, Inc., To Pay $30 Million Penalty To Resolve Criminal Investigation" (Jan. 26, 2005)

Amer. Elec. Power Co., Docket No. IN02-10-001 (FERC Jan. 26, 2005) (Order Approving Stipulation and Consent Agreement and Requiring Payment of Civil Penalty)

ATTACHMENT B

Contents:

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.

Dated at Washington, D.C., this 14th day of February 2005.

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Release: 5041-05
For Release: January 26, 2005

U.S. COMMODITY FUTURES TRADING COMMISSION SETTLES LAWSUIT WITH AMERICAN ELECTRIC POWER COMPANY AND AEP ENERGY SERVICES, INC. FOR FALSE REPORTING AND ATTEMPTED MANIPULATION IN NATURAL GAS MARKETS

Federal Government Collects $81 Million: Defendants Ordered to Pay $30 Million Civil Monetary Penalty to CFTC; AEP Energy Services, Inc. to Pay an Additional $30 Million to U.S. Department of Justice to Avoid Federal Criminal Prosecution, and $21 Million to the Federal Energy Regulatory Commission

WASHINGTON, D.C. – The U.S. Commodity Futures Trading Commission (CFTC) announced today that it has entered into a Final Judgment and Consent Order (Judgment and Order) with defendants **American Electric Power Company, Inc. (AEP)** and **AEP Energy Services, Inc. (AEPES)**, a subsidiary of AEP. The Judgment and Order entered by the U.S. District Court for the Southern District of Ohio, requires the defendants to pay a $30 million civil monetary penalty in settlement of charges that defendants falsely reported natural gas trades and attempted to manipulate natural gas prices.

Today's Judgment and Order resolves the CFTC's lawsuit against the defendants, brought on September 30, 2003, in the U.S. District Court for the Southern District of Ohio (see CFTC Release 4846-03). The CFTC's complaint charged that from at least November 2000 through October 2002, AEP and AEPES repeatedly and deliberately reported false natural gas trading information, including price and volume information, to certain firms that compile natural gas price indexes. The complaint further alleged that AEP and AEPES knowingly delivered false information to price index compilers in an attempt to skew those indexes for their financial benefit.

AEPES Acknowledges & Accepts Responsibility for Its Wrongdoing

Under the terms of the Judgment and Order, AEPES acknowledges and accepts responsibility for submitting knowingly inaccurate data, including incorrect volumes and/or prices, fictitious trades, or incomplete reports of actual trades, relating to one or more of the 38 delivery points or hubs for which AEPES provided information during the period. AEPES specifically acknowledges that many of the spreadsheets submitted for its Gulf Natural Gas Trading Desk contained one of more instances of false data favoring the company's financial positions and that two other trading desks covering the Northeast and Mid-Continent regions submitted knowingly inaccurate data for at least one delivery point.

The Judgment and Order mandates that AEP and AEPES cooperate fully and expeditiously with the CFTC and its Enforcement Division concerning the reporting of trade prices and/or volumes to energy reporting services and price indexes.

AEPES Pays Additional $30 Million Penalty to Avoid Criminal Prosecution by Federal Prosecutors

In addition to settling charges brought by the CFTC, AEPES entered into a deferred

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Related Document
Order

prosecution Agreement (Agreement) with the U.S. Department of Justice and the U.S. Attorney's Office for the Southern District of Ohio to avoid federal criminal charges. The Agreement requires AEPES to pay an additional $30 million dollar criminal penalty to resolve an investigation into AEPES' false reporting of natural gas trades. The Agreement provides that should AEPES commit any federal crime within a fifteen-month probationary period, federal prosecutors could charge AEPES for any federal crime it commits, including the false reporting and attempted manipulation alleged in the Commission's complaint.

AEP to Pay a Further Civil Penalty of $21 Million to FERC

Also today, the Office of Market Oversight and Investigations of the Federal Energy Regulatory Commission (FERC) announced that it has entered into a Stipulation and Consent Agreement with AEP, AEPES, and American Electric Power Service Corporation, another subsidiary of AEP, under which AEP will pay a further civil penalty of $21 million to settle claims that former AEP affiliates Jefferson Island Storage and Hub, LLC and Louisiana Intrastate Gas Company violated FERC regulations.

Comment by CFTC Acting Chairman Sharon Brown-Hruska

> "The derivatives markets play a significant role in our economy. Over the last three years, we aggressively pursued a large number of companies and individuals who committed illegal acts that either affected or could have affected natural gas markets. As of today, the Commission has assessed nearly $300 million in penalties against a number of those that we have investigated. Our enforcement actions send a clear signal that market abuses will not be tolerated," said Acting Chairman Sharon Brown-Hruska.

CFTC Enforcement Director Gregory Mocek Comments

Commenting on the settlement, CFTC Director of Enforcement Gregory Mocek stated:

> "The $81 million penalty assessed today reflects the gravity of the defendant's illegal conduct in the natural gas markets. I applaud the extensive efforts of our enforcement staff to expose the company's wrongdoing, as well as their efforts in assisting the Department of Justice and FERC. Over the last three years, corporate compliance departments have changed their controls and the way they report sensitive market information. It is obvious that our diligent enforcement actions in this area have had a positive impact on the veracity of traders."

The Commission would like to thank the Department of Justice and FERC for their ongoing cooperative efforts in pursuing illegal conduct in the energy markets. Additionally, the following CFTC Division of Enforcement staff were responsible for this case: Gregory Compa, Nancy Gogel, Michael McLaughlin, Armand Nakkab, Karin Roth, David W. MacGregor, Lenel Hickson, Jr., Stephen J. Obie, Richard Wagner, and Vincent McGonagle.

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UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

U.S. COMMODITY FUTURES TRADING COMMISSION,

Plaintiff,

vs.

AMERICAN ELECTRIC POWER COMPANY, INC.
and
AEP ENERGY SERVICES, INC.,

Defendants.

No. 2:03-cv-891

Judge Edmund A. Sargus, Jr.

Magistrate Judge Norah McCann King

FINAL JUDGMENT AND CONSENT ORDER

On September 30, 2003, Plaintiff Commodity Futures Trading Commission (the "Commission") filed a two-count Complaint for attempted manipulation and false reporting ("Complaint") against American Electric Power Company, Inc. and AEP Energy Services, Inc. ("Defendants"[1]), alleging, in pertinent part, that Defendants had knowingly delivered false, misleading or knowingly inaccurate information concerning natural gas trades, and did so in an attempt to manipulate the price of natural gas. The Complaint seeks a civil monetary penalty, injunctive and other relief for violations of the Commodity Exchange Act (the "Act"), 7 U.S.C. §§ 1 *et seq.* (2000). Defendants filed an Answer denying certain allegations in the Complaint, including the allegations that Defendants committed violations of the above-referenced statutory provisions.

I.

CONSENT AND AGREEMENT

In order to dispose of all the allegations and issues raised in the Complaint and effect a full and final settlement of any alleged violations of the above-referenced laws without a trial on the merits or any further judicial proceedings, Defendants, without admitting the allegations of the Complaint, and the Commission:

A. Consent to the entry of this Final Judgment and Consent Order (herein referred to as "Judgment" or "Order");

[1] As used herein, "Defendants" does not include any current or former employees of the Defendants.

ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

A. Defendants shall cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement ("Division") in this proceeding, and in any investigation, civil litigation, or administrative matter related to the subject matter of this proceeding or any current or future Commission investigation related thereto. Defendants agree to cooperate fully and expeditiously with the Commission's ongoing efforts to discover documents and information related to reporting trade prices and/or volumes to energy reporting services and price indexes. As part of such cooperation, Defendants agree to:

1. preserve all records relating to the subject matter of this proceeding, including, but not limited to audio files, e-mails, and trading records; and

2. comply fully, promptly, and truthfully with any inquiries or requests for information including but not limited to inquiries or requests:

   a. for authentication of documents;

   b. for any documents within Defendants' possession, custody, or control, including inspection and copying of documents;

   c. to produce any current (as of the time of the request) officer, director, employee, or agent of Defendants, regardless of the person's location and at such location that minimizes Commission travel resources, to provide assistance at any trial, proceeding, or Commission investigation related to the subject matter of this proceeding, including but not limited to, requests for testimony, depositions, and/or interviews, and to encourage them to testify completely and truthfully in any such proceeding, trial, or investigation;

   d. for assistance in locating and contacting any prior (as of the time of the request) officer, director, or employee of Defendants; and

   e. not undertake any act that would limit their ability to fully cooperate with the Commission. Defendants designate D. Michael Miller of the AEP Legal Department to receive all requests for information pursuant to this undertaking. Should Defendants seek to change the designated person to

provided further that, nothing in this Order shall be construed to confer any rights on any third parties or inure to the benefit of any third parties.

ENTRY OF JUDGMENT FORTHWITH. There being no just cause for delay, the Clerk of the Court shall enter this Final Judgment forthwith and without further notice. No further proceedings are required in this action.

DONE AND ORDERED THIS 26th DAY OF January, 2005.

1-26-2005

Edmund A. Sargus, Jr., United States District Judge

APPENDIX

STATEMENT OF FACTS

1. AEP Energy Services, Inc. ("AEPES") is an Ohio corporation headquartered in Columbus, Ohio. It is a separately incorporated, wholly-owned subsidiary of American Electric Power Company, Inc. ("AEP"), which is one of the largest electric utilities in the country, serving approximately 5 million customers.

2. AEPES was created in 1997 to trade and market natural gas and related products and services. AEPES earned substantial profits between 1999 and 2002 from its natural gas trading operations.

3. AEPES divided its natural gas traders into groups, referred to as desks. Four of the desks corresponded with geographic regions of the United States: the West, the Gulf Coast, the Northeast, and the Mid-Continent. AEPES also established other trading desks, including a New York Mercantile Exchange ("NYMEX") desk for trading natural gas futures, options contracts, and other instruments related to the NYMEX, a primary forum for energy trading. The desks traded a variety of physical and financial instruments, including fixed-price physical natural gas, derivatives, swaps, index-based, over-the-counter, and physical contracts. Each desk was staffed by several traders and supervised by a "desk head." A "head of trading," who reported directly to the president of AEPES, oversaw the four regional trading desks.

4. Certain AEPES natural gas traders entered data regarding trades they made into a spreadsheet that in turn was delivered to trade publications that published market price indices for natural gas at various delivery points, or "hubs," based in part on information received from industry participants. Natural gas traders used the published indices to price and settle certain physical and over-the-counter financial derivative natural gas transactions.

Desk, many of the spreadsheets submitted before March 2002 contained knowingly inaccurate data for at least one delivery point. Between November 2000 and July 2002, many of the spreadsheets submitted for the Gulf Desk contained one or more instances of false data favoring the company's financial positions.

9. In September 2002, when media reports exposed false reporting at another energy company, Dynegy, AEPES's management asked all AEPES natural gas traders to certify in writing that they had not engaged in such conduct. When five of the traders assigned to the Gulf Desk were unable to so certify and admitted to falsely reporting, AEPES's management dismissed them for their conduct, reported the conduct to federal regulatory agencies, and issued a press release discussing the dismissals. No other then-current personnel were found by AEPES's management to have engaged in false reporting.

10. There are other matters known to the parties that are not included in this Statement of Facts.

Department of Justice

FOR IMMEDIATE RELEASE
WEDNESDAY, JANUARY 26, 2005
WWW.USDOJ.GOV

CRM
(202) 514-2008
TDD (202) 514-1888

AMERICAN ELECTRIC POWER, INC. TO PAY $30 MILLION PENALTY TO RESOLVE CRIMINAL ALLEGATIONS

WASHINGTON, D.C. – Assistant Attorney General Christopher A. Wray of the Criminal Division and U.S. Attorney Gregory G. Lockhart of the Southern District of Ohio announced today that the Justice Department has entered into an agreement with American Electric Power, Inc., a New York corporation headquartered in Columbus, Ohio, and AEP's wholly-owned subsidiary, AEP Energy Services, Inc. (AEPES), also headquartered in Columbus, resolving an ongoing federal investigation into the submission of knowingly inaccurate reports by AEPES concerning a commodities market.

Under the terms of the agreement, AEPES will pay a $30 million criminal penalty to the Justice Department, in addition to $51 million in payments to the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission under separate agreements.

Under the terms of the deferred prosecution agreement, AEPES has accepted and acknowledged responsibility for the actions of its employees, and is required to fully cooperate with an ongoing Justice Department investigation. Because of the cooperation commitment and the remedial actions taken by the company to date, and in conjunction with the payment of substantial monetary fines, the Department of Justice has agreed to not file criminal charges stemming from the investigation for a 15-month period. If AEPES fails to fully comply with the terms of the agreement during that 15-month period, the Department of Justice will charge AEPES with delivering knowingly inaccurate reports concerning the commodities market for natural gas, based on conduct outlined in an agreed-upon statement of facts.

AEP, one of the nation's largest electric utilities, serving approximately five million customers, agreed by letter to uphold the terms of the government's agreement with its subsidiary.

According to a statement of facts, between November 2000 and July 2002, traders at three of AEPES's four regional natural gas trading desks submitted false, misleading or knowingly inaccurate trade data to industry publications, altering the published index price of natural gas at various trading hubs. Natural gas traders use the published index prices to price and settle certain physical and over-the counter financial derivative natural gas transactions. Upon discovery of the false reporting, AEPES management alerted government authorities, dismissed several traders who admitted falsely reporting data, and restructured the company's reporting system to prevent future submission of false reports.

"When the energy markets are fraudulently manipulated, consumers end up paying the price – especially the bill payers, businesses and governments who rely on utilities like AEP for their energy needs," said Assistant Attorney General Christopher A. Wray. "Today's agreement, involving three close partners on the President's Corporate Fraud Task Force, again demonstrates

this administration's commitment to the full investigation of market manipulation and dishonest financial reporting in the natural gas markets."

"While substantial penalties and changes in internal controls are appropriate responses in this instance, corporate responsibility begins and ends with the actions of individuals," said U.S. Attorney Gregory G. Lockhart. "We expect the company's continued cooperation as we address issues regarding false market information."

In addition to the $30 million criminal payment, AEP and AEPES also entered civil settlements of related investigations today with the CFTC and the FERC. Under the terms of a consent order entered in the matter, AEP and AEPES agreed to pay a civil monetary penalty of $30 million to resolve the allegations of attempted manipulation and false reporting raised in a complaint filed Sept. 30, 2003 by the CFTC. AEP and AEPES simultaneously agreed to a $21 million civil penalty to resolve the FERC's investigation into preferential treatment AEPES received in natural gas storage and transportation through non-public agreements and agreements with affiliated intrastate pipelines.

"This high level of cooperation and collaboration among federal government agencies protects customers by preserving a fair and open competitive marketplace for energy," said FERC Commission Chairman Pat Wood, III.

"Working cooperatively with the Justice Department and FERC allowed us to achieve these comprehensive penalties. Our actions here today send a strong signal that will deter others from wrongdoing and help to restore integrity to these vitally important markets," said CFTC Acting Chairman Sharon Brown-Hruska.

The Justice Department's investigation into the AEPES matter is being conducted by the Fraud Section of the Criminal Division, with substantial assistance from the CFTC and the FERC.

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05-032

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

American Electric Power Company, Inc.	)	Docket No. IN02-10-001
American Electric Power Service Corporation	)	
AEP Energy Services, Inc.	)	

ORDER APPROVING STIPULATION AND CONSENT AGREEMENT AND REQUIRING PAYMENT OF CIVIL PENALTY

(Issued January 26, 2005)

1. The Commission approves the attached Stipulation and Consent Agreement (Agreement) between the Office of Market Oversight and Investigations (OMOI), and American Electric Power Company, Inc. (AEP), and two of its subsidiaries, AEP Energy Services, Inc. (Energy Services) and American Electric Power Service Corporation (Service Corp) (collectively, the AEP Parties). This order is in the public interest because it resolves alleged violations relating to affiliate preferences with a settlement that assesses significant civil penalties and that requires the AEP Parties and their natural gas transportation and storage affiliates to follow a detailed four-year Compliance Plan.

2. The Agreement resolves all issues relating to a non-public, formal investigation in Docket No. IN02-10-000 and an accompanying non-public, preliminary investigation (collectively, Investigations) conducted by OMOI under Part 1b of the Commission's regulations, 18 C.F.R. Part 1b (2004). The Investigations concerned, among other things, compliance with provisions of the Commission's regulations issued pursuant to the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301 *et seq.* (2000). The investigation period for the Investigations was January 1, 1999 through January 25, 2005, the date of execution of the Agreement. The alleged violations relate to preferences that intrastate natural gas pipelines, owned by AEP during most of the investigation period, provided to their affiliated marketer Energy Services with respect to gas transportation and operation of storage facilities. The AEP Parties neither admit nor deny any violations of the Commission's NGPA regulations.

3. The facts stipulated in the Agreement concern storage and transportation services that two intrastate natural gas pipelines provided pursuant to section 311 of the NGPA, 15 U.S.C. § 3371. One such pipeline, Jefferson Island Storage & Hub, LLC (JISH), provided storage service at its storage facility located in Vermilion Parish in southern Louisiana. In April 1999, JISH filed an Operating Statement with the Commission. Under section 284.123(e) of the Commission's regulations, 18 C.F.R. § 284.123(e) (2004), JISH's Operating Statement was to describe how JISH engaged in providing NGPA section 311 services. In July 2001, JISH entered into a separate Asset Management Agreement (AMA) with Energy Services. The AMA, which JISH did not file with the Commission, granted Energy Services the exclusive rights to manage all gas injections into and gas withdrawals from JISH, and allotted Energy Services all uncontracted storage capacity at JISH. Among the matters addressed in the Investigations was Energy Services' use of the authority it received in the AMA and whether, after JISH and Energy Services entered into the AMA, JISH's operations were consistent with its Operating Statement. AEP sold JISH effective October 1, 2004, and Energy Services terminated the AMA effective October 1, 2004.

4. Another matter addressed in the Investigations related to transportation services that Louisiana Intrastate Gas Company (LIG), an AEP-affiliated intrastate gas pipeline during the investigation period until April 2004, gave to Energy Services and LIG Chemical Company (LIG Chemical), another gas marketer then affiliated with AEP. OMOI examined whether LIG, during the period July 2001 through March 2004, accorded transportation of natural gas for LIG Chemical a standing priority over transportation of gas for non-affiliated customers, or permitted LIG Chemical to ship under this same priority natural gas that Energy Services traded on LIG.

5. The Agreement consists of six major components that are summarized below:

A. AEP shall pay a civil penalty pursuant to the NGPA in the principal amount of $21,000,000.

B. The AEP Parties and AEP's natural gas pipeline and storage affiliates (collectively, the AEP Companies) shall be subject to a Compliance Plan, incorporated into the Agreement as an Appendix. The Compliance Plan, which shall remain in effect for four years, recognizes that AEP maintains existing plans for legal and regulatory compliance for operations of AEP Companies. These operations are subject to the statutes administered by the Commission and the Commission's rules, regulations and orders that are addressed in the plans listed in the Compliance Plan (collectively, Commission Requirements). OMOI has reviewed the existing compliance and implementation plans, and at OMOI's

request, AEP has added certain enhancements. In addition, the settlement provides that OMOI will continue to monitor AEP's existing plans of compliance for Commission Requirements to determine the plans' effectiveness. AEP will provide any proposed changes to its existing plans relating to Commission Requirements to OMOI for approval.

C. While in effect, the Compliance Plan also requires AEP to enhance its existing plans by, among other things: (1) developing a written policy for compliance with Commission Requirements, including compliance with NGPA section 311 and its implementing regulations; (2) requiring yearly training in compliance with applicable Commission Requirements for all relevant AEP personnel who act in a non-clerical capacity with respect to an activity subject to a Commission Requirement; and (3) prohibiting any relevant person from acting in a non-clerical capacity with respect to any activity subject to a Commission Requirement for which the person has not received this training.

D. Pursuant to the Compliance Plan, AEP shall designate a Compliance Officer who shall be responsible for implementing the enhancements required by the Compliance Plan, including: (1) acting as liaison with Commission staff for compliance issues of AEP Companies; (2) submitting training materials on Commission Requirements for OMOI approval; and (3) reporting to OMOI on calls to AEP's internal Hotline that allege non-compliance with any Commission requirement.

E. Within one year after a Commission order that approves the Agreement without modification becomes final, AEP shall submit to OMOI a non-public Compliance Report that states in detail the steps AEP has taken to implement the prospective measures set forth in the Compliance Plan. AEP also shall submit to OMOI a Compliance Report for each subsequent 12-month period in which the Compliance Plan is in effect. Commission staff reserves its right to audit and investigate the AEP Parties' compliance with the prospective measures set forth in the Compliance Plan.

F. Should any activity conducted pursuant to the Agreement or the Compliance Plan indicate that AEP or any of its affiliates has engaged in any material violation of any Commission Requirement, AEP shall have a good faith obligation to notify OMOI of such violation with reasonable promptness. AEP is also required to describe in the applicable Compliance Report each such violation and any remedy or sanction for it that AEP implemented after consultation with OMOI.

5. The Agreement does not address or resolve issues pending in any other docketed matter.

The Commission finds:

The Agreement provides an equitable resolution of this matter and is in the public interest.

The Commission orders:

(A) The attached Stipulation and Consent Agreement is approved in its entirety without modification and is incorporated into this order.

(B) The non-public, formal investigation in Docket No. IN02-10-000 and the accompanying non-public, preliminary investigation are terminated with prejudice.

(C) The Commission's approval of the attached Stipulation and Consent Agreement does not constitute approval of, or precedent regarding, any principle or issue in this matter.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

American Electric Power Company, Inc.	)	Docket No. IN02-10-001
American Electric Power Service Corporation	)	
AEP Energy Services, Inc.	)	

Stipulation and Consent Agreement

I. Introduction

The Office of Market Oversight and Investigations (OMOI), American Electric Power Company, Inc. (AEP), and two of its subsidiaries, AEP Energy Services, Inc. (Energy Services) and American Electric Power Service Corporation (Service Corp), enter into this Stipulation and Consent Agreement (Agreement) to resolve all issues within the scope of the non-public, formal investigation in Docket No. IN02-10-000 and an accompanying non-public, preliminary investigation (collectively, Investigations) conducted by OMOI under Part 1b of the Commission's regulations, 18 C.F.R. Part 1b (2004). The Investigations concerned, among other things, compliance with the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301 et seq. (2000), and provisions of the Commission's regulations and orders. The investigation period for the Investigations was January 1, 1999 through the date of execution of this Agreement.

II. Stipulation

OMOI and AEP, Energy Services and Service Corp (collectively, the AEP Parties) stipulate and agree to the following:

A. AEP is a holding company, headquartered in Columbus, Ohio, whose corporate organization is regulated by the U.S. Securities and Exchange Commission pursuant to the Public Utility Holding Company Act of 1935. During the investigation period, Service Corp provided services such as legal and accounting, to other AEP subsidiaries.

B. During the investigation period, Energy Services engaged in, among other activities, commodity transactions (also known as "physical" or "cash" transactions) and financial transactions relating to natural gas.

C. During most of the period covered by the Investigations, AEP's affiliates included Jefferson Island Storage and Hub, LLC (JISH), Louisiana Intrastate Gas Company (LIG), and LIG Chemical Company (LIG Chemical). AEP sold LIG and LIG Chemical

effective April 1, 2004. AEP sold JISH effective October 1, 2004. AEP, Energy Services, and Service Corp thus no longer own or control the assets that are central to this Agreement, and JISH, LIG, and LIG Chemical are not parties to this Agreement. However, until AEP sold JISH, LIG and LIG Chemical, Energy Services shared a number of corporate officers and directors with these entities.

D. During the period it was an AEP affiliate, JISH was an intrastate natural gas pipeline that operated a natural gas storage facility, comprised of two salt caverns and injection/withdrawal wells, located in Vermilion Parish, Louisiana. JISH's storage facility consisted of two salt dome gas storage caverns with approximately 10 billion cubic feet (Bcf) total storage capacity, which contained both "cushion" gas, necessary to maintain cavern pressures for the operational and structural integrity of the storage facility, and what is referred to as "working capacity" available for storage services.

E. During the period it was an AEP affiliate, JISH performed storage services pursuant to NGPA section 311, 15 U.S.C. § 3371, and Part 284, Subpart C of the Commission's regulations, 18 C.F.R. Part 284, Subpart C. JISH held Commission authority to provide section 311 firm storage services at market-based rates. JISH also provided natural gas transportation services under NGPA section 311 on two pipeline laterals that extend several miles from the storage facility and that interconnect with nine interstate and intrastate gas pipelines.

F. On April 30, 1999, JISH filed with the Commission an Operating Statement in accordance with section 284.123(e) of the Commission's regulations, 18 C.F.R. § 284.123(e) (2004), which requires each intrastate natural gas pipeline offering section 311 services to file with the Commission a statement that describes how the pipeline will engage in these services.

G. On July 1, 2001, JISH executed an Asset Management Agreement (AMA) with Energy Services. The AMA was to terminate on June 30, 2011, although section 4.4 of the AMA provided that either party could terminate it on two business days' notice if AEP were to divest either JISH or Energy Services. The AMA designated Energy Services as JISH's Asset Manager and granted Energy Services exclusive authority to manage all of JISH's injections and withdrawals. The AMA also granted Energy Services the exclusive right to all unsubscribed storage capacity of the facility. Preliminary Statement 4 of the AMA provided that "[s]ubject to the terms and conditions hereof, [JISH] is willing to grant such exclusive rights to Asset Manager, and to operate the Jefferson Storage Facility in accordance with Asset Manager's nominations and other directions."

H. During the period it was an AEP affiliate, JISH did not file either the AMA or an amendment to its Operating Statement with FERC to reflect JISH's actual operations since July 2001.

I. During the period it was an AEP affiliate, LIG was a Louisiana intrastate natural gas pipeline that interconnected with JISH. LIG served sales and transportation markets within the state of Louisiana, and provided transportation services under NGPA section 311 and Part 284, Subpart C of the Commission's regulations. LIG's subsidiary LIG Chemical was LIG's affiliated gas marketing company and a transportation customer of LIG.

III. Applicable Regulations

A. Section 284.123(e) of the Commission's regulations provides, in pertinent part: "[i]f the pipeline changes its operations or rate election under [Subpart C], it must amend the [operating] statement and file such amendments not later than 30 days after commencement of the change in operations or the change in rate election."

B. Section 284.7(b)(1) of the Commission's regulations, 18 C.F.R. § 284.7(b)(1), provides: "An interstate pipeline or intrastate pipeline that offers transportation service on a firm basis under subpart B, C or G must provide such service without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind."

IV. Conclusions of OMOI's Investigation

As a result of the Investigations, OMOI has made conclusions, summarized below, which the AEP Parties neither admit nor deny:

A. After the execution of the AMA, JISH's actual operations were inconsistent with JISH's Operating Statement. Thus, during the period August 1, 2001 through September 30, 2004, JISH violated section 284.123(e). Section 25.1 of JISH's Operating Statement provided that JISH offered its section 311 storage service through storage agreements that listed maximum storage quantities. Under sections 25.5 through 25.8 of the Operating Statement, a storage customer's use of pipeline interconnects with JISH was limited by defined primary and alternate receipt and delivery points as specified in storage agreements. The Operating Statement did not authorize JISH's use of cushion gas for delivery to storage customers. The Operating Statement did not provide for park and loan service, under which JISH would allow a storage customer to withdraw more gas

from storage than it had on account in inventory, or no-notice service, under which a storage customer could withdraw from or inject gas into JISH's storage facility without advance notice. Nor did the Operating Statement grant any storage customer the right to borrow cushion gas from JISH or gas from other storage customers of JISH.

B. During the period from July 1, 2001 through September 30, 2004, Energy Services, as JISH's Asset Manager, received services pursuant to the explicit provisions of the AMA which JISH did not make available to JISH's other storage customers. Under AMA section 2.1, JISH adjusted Energy Services' nominations and schedules for injections and withdrawals "within any day to the extent required to accommodate changes in market demand, the availability of flowing Natural Gas for injection into storage or operational limitations affecting the pipeline facilities interconnected with [JISH]." Pursuant to AMA section 2.1(d), JISH rendered receipts and deliveries in excess of Energy Services' maximum daily injection and withdrawal quantities on a best-efforts basis "when required to allow Asset Manager full utilization of its Maximum Storage Quantity." Pursuant to the AMA, JISH did not limit Energy Services to any specific receipt or delivery points. By providing to Energy Services these services granted by the AMA, during the period July 1, 2001 through September 30, 2004, JISH violated section 284.7(b)(1).

C. During the period from July 1, 2001 through September 30, 2004, Energy Services received services, not explicitly set forth in the AMA, which JISH did not make available to JISH's other storage customers. Such services included Energy Services being allowed to withdraw cushion gas and to use other customers' gas stored at JISH without notice to these customers. By providing Energy Services with these services that were superior to services JISH provided to other storage customers as set forth in the Operating Statement, during the period July 1, 2001 through September 30, 2004, JISH violated section 284.7(b)(1).

D. As JISH's Asset Manager, Energy Services received updated information almost daily from JISH on nominations for injections and withdrawals submitted by other storage customers of JISH. Such information was not available to any other JISH customer and was not publicly available. By granting Energy Services exclusive access to non-public information concerning activities of JISH's other storage customers that was not provided to any other storage customer, during the period July 1, 2001 through September 30, 2004, JISH violated section 284.7(b)(1).

E. LIG had no asset management agreement with Energy Services, but in practice, with respect to gas transportation, Energy Services controlled LIG and LIG Chemical. While Energy Services bought and sold gas on LIG, Energy Services was not listed as a LIG transportation customer. Nevertheless, Energy Services used LIG Chemical to

satisfy its requirements for transportation of gas on LIG. For purposes of gas transportation, LIG treated LIG Chemical as if it were the same entity as LIG. By according NGPA section 311 transportation of natural gas for LIG Chemical a standing priority over transportation of gas for non-affiliated customers, and by permitting LIG Chemical to ship under this same priority natural gas that Energy Services traded on LIG, during the period July 1, 2001 through March 30, 2004, LIG violated section 284.7(b)(1).

V. Agreed-Upon Resolution

For purposes of settling any and all civil and administrative disputes, and in lieu of any other penalty or remedy that the Commission might assess or determine concerning any of the matters in the Investigations, AEP, Energy Services and Service Corp agree that:

A. AEP shall pay a civil penalty in the principal amount of $21,000,000 as follows:

1. Within 30 days of the date on which a Commission order approving this Agreement without modification becomes final (Effective Date), AEP shall pay $21,000,000, either by delivering a certified check made payable to the Federal Energy Regulatory Commission to Federal Energy Regulatory Commission, Lockbox 93938, Chicago, Illinois 60673, or by completing an electronic wire transfer to an appropriate Commission account.

2. Neither AEP nor any of its affiliates shall recover any amount of the civil penalty through any rate for any service subject to the jurisdiction of the Commission.

B. AEP and its affiliates shall comply with the prospective measures that are set forth in the Compliance Plan in Appendix A. The Compliance Plan shall remain in effect for four years from the Effective Date.

C. Within one year after the Effective Date, AEP shall submit to OMOI in Docket No. IN02-10-000 a non-public Compliance Report that states in detail the steps AEP has taken to implement the prospective measures set forth in the Compliance Plan. By the Effective Date's calendar date in each subsequent year, AEP shall submit to OMOI a Compliance Report for the prior 12-month period in which the Compliance Plan was in effect. Commission staff reserves its right to audit and investigate AEP and its affiliates' compliance with the prospective measures set forth in the Compliance Plan.

D. Should any activity conducted pursuant to this Agreement or the Compliance Plan indicate that AEP or any of its affiliates has engaged in any material violation of NGPA section 311 or any rule, regulation, or statutory requirement administered by the Commission, AEP's Chief Compliance Officer shall have a good faith obligation to provide OMOI staff with reasonably prompt notification of such violation after learning of it. AEP shall describe in the applicable Compliance Report each such violation and any remedy or sanction for it that AEP implemented after consultation with OMOI.

E. During the period in which the Compliance Plan is in effect, each entity that is subject to the Compliance Plan shall report to OMOI, upon written request, such information on business activities relating to natural gas or electricity as OMOI deems to be appropriate and as consistent with law and any applicable confidentiality obligations. These reports shall be governed by section 1b.9 and 1b.20 of the Commission's regulations, 18 C.F.R. §§ 1b.9 and 1b.20 (2004).

F. Failure to make a timely civil penalty payment or otherwise comply with any provision of this Part shall violate a final order of the Commission issued pursuant to the NGPA and the Natural Gas Act (NGA), 15 U.S.C. §§ 717 et. seq., and may subject any AEP Party to additional action under the enforcement and penalty provisions of the NGPA, the NGA, or both. Moreover, if payment is not made on time, interest shall accrue under the Commission's regulations at 18 C.F.R. § 154.501(d) (2004) from the date such payment is due.

G. By agreeing to this resolution, neither AEP nor any of its affiliates admit that any of the Conclusions of OMOI's investigation or other matters set forth herein constitute a violation of any statute, regulation, Commission rule, order, or other legal obligation. This Agreement and any Commission order approving this Agreement shall not be deemed or construed as an admission or as evidence of wrongdoing or violation of any statutory, regulatory, or other legal duty of any kind.

VI. Terms

A. OMOI and the AEP Parties agree that they enter into the Agreement voluntarily and that other than the recitations set forth herein, no tender, offer or promise of any kind by any member, employee, officer, director, agent or representative of OMOI or any AEP Party has been made to induce any other party to enter into the Agreement.

B. By this Agreement, OMOI and the AEP Parties evidence their intention to settle only the matters referred to in paragraph VI.C. below that are within the Commission's jurisdiction and statutory authority to settle.

C. On the date the Commission approves this Agreement without modification, this Agreement shall resolve as to AEP and its affiliates, their agents, officers, directors and employees, both past and present (including both LIG and LIG Chemical prior to April 1, 2004 and JISH prior to October 1, 2004), and the Commission shall release and be forever barred from bringing against AEP and its affiliates, their agents, officers, directors, or employees, both past and present, any and all administrative or civil claims or matters asserting any claims, liabilities, causes of action, demands, rights, alleged entitlements, obligations, known or unknown, asserted or not asserted, vested or unvested, without limitation, arising out of, related to, or connected with the matters within the scope of the Investigations. The intent of the parties to this Agreement is that a final Commission order approving the Agreement without modification shall terminate the Investigations with prejudice. This Agreement shall not bar Commission action in the event the Commission determines that any AEP Party has failed to comply with any provision of Part V of this Agreement.

D. Each undersigned representative of a Party affirms that he or she has read the Agreement, that all of the matters set forth in the Agreement are true and correct to the best of his or her knowledge, information and belief, and that he or she understands that the Agreement is entered into in express reliance on those representations.

E. The Agreement binds AEP, Energy Services, Service Corp and any other affiliated entities that are or become subject to the Compliance Plan, and their agents, officers, directors, employees, successors and assigns. The Agreement does not and will not bind or apply to any entity or asset that has been, or in the future is sold, transferred or otherwise alienated such that it no longer is an affiliate of AEP, Energy Services, or Service Corp. For purposes of this Agreement, the term "affiliate" has the meaning given to it in 18 C.F.R. § 358.3 (2004).

F. The Agreement does not affect any other docketed matter before the Commission.

G. In connection with the payment of the civil penalty provided for in section V.A, the AEP Parties agree that the Commission's order approving the Agreement without modification shall be a final and unappealable order assessing a civil penalty under section 504 of the NGPA, 15 U.S.C. § 3414 (2000). With regard to such civil penalty, the AEP Parties waive: a Notice of Proposed Penalty under section 504(b)(6)(E) of the NGPA, 15 U.S.C.A. § 3414(b)(6)(E); hearings pursuant to the applicable provisions of the NGPA; the filing of proposed findings of fact and conclusions of law; an Initial Decision by an Administrative Law judge pursuant to the Commission's Rules of Practice and Procedure; and post-hearing procedures pursuant to the Commission's Rules of Practice and Procedure.

H. The AEP Parties waive judicial review by any court of any Commission order approving the Agreement without modification.

I. Appendix A, referenced in paragraph V. B. of the Agreement and attached hereto, is expressly made part of, and incorporated in, the Agreement.

J. If the Commission does not issue an order approving the Agreement without modification, that becomes final, the Agreement shall be null and void, unless otherwise agreed in writing by OMOI and the AEP Parties.

K. Each of the undersigned warrants that he or she is an authorized representative of the entity designated, is authorized to bind such entity, and accepts the Agreement on the entity's behalf.

Agreed to and accepted:

_____ _____

Robert E. Pease, Date:
Deputy Director,
Enforcement and Investigations
Office of Market Oversight and Investigations

_____ _____

Name: Coulter R. Boyle, III Date:
Title: Senior Vice President,
American Electric Power Company, Inc.

_____ _____

Name: Coulter R. Boyle, III Date:
Title: President
AEP Energy Services, Inc.

_____ _____

Name: Coulter R. Boyle, III Date:
Title: Senior Vice President,
American Electric Power Service Corporation

APPENDIX A

COMPLIANCE PLAN FOR AMERICAN ELECTRIC POWER COMPANY, INC. AND ITS NATURAL GAS MARKETING, PIPELINE AND STORAGE AFFILIATES

This Appendix to the Stipulation and Consent Agreement in Docket No. IN02-10-001 ("Appendix") sets forth enhancements to the existing plans of compliance of American Electric Power Company, Inc. (AEP), AEP Energy Services, Inc. ("Energy Services"), American Electric Power Service Corporation (Service Corp.), and AEP's natural gas pipeline and storage affiliates (hereinafter collectively referred to as "AEP Companies"), that respond to issues arising from a non-public, formal investigation in Docket No. IN02-10-000 and a non-public, preliminary investigation conducted by the Office of Market Oversight and Investigations ("OMOI"). AEP has provided to OMOI its existing plans of compliance and implementation that include legal and regulatory policies, procedures and training for all operations of AEP Companies, including those operations regulated by the Federal Energy Regulatory Commission ("the Commission" and "FERC").

I. Existing Plans of Compliance Measures to be Maintained

A. AEP's existing plans of legal and regulatory compliance and implementation include, but are not limited to, policies, procedures and training with respect to the following:

(1) **Standards of Conduct:** The existing implementation plan provides policies and procedures with respect to the rules adopted in FERC Order Nos. 2004 et al. and the applicability of those rules to the interaction among employees within AEP Companies.

(2) **Energy Trading and Sales:** The existing plan of compliance, incorporated in the Code of Conduct provisions of AEP's Commercial Operations Risk Policy ("CORP"), provides policies and procedures with respect to trading of physical and financial derivative commodity contracts, including, among others, natural gas and electric power contracts, including standards embodied in the Commission's Market Behavior Rules (as established in FERC Orders issued November 17, 2003 in FERC Docket Nos. EL01-118-000, EL01-118-001 and RM03-10-000). The Code of Conduct provisions referred to herein currently are contained in Section 6 of AEP's CORP, as approved by the AEP

Risk Executive Committee January 18, 2005, and only those provisions of the CORP (whether contained in Section 6 or moved elsewhere) are subject to this Compliance Plan.

(3) **Trade Data Reporting**: As provided in FERC's Order issued July 29, 2003 in Docket No. PA03-1-000, et al., AEP has adopted a clear code of conduct for trade data reporting. All trade data reporting is done by an entity (the risk oversight group) that does not have a financial interest in the published index.

B. During the period in which this Appendix is in effect:

(1) OMOI will review the above plans to evaluate their effectiveness in achieving compliance with statutes administered by the Commission and the Commission's rules, regulations and orders addressed in those plans. For purposes of this Agreement, "Commission Requirements" will mean the statutes administered by the Commission and the Commission's rules, regulations and orders addressed in the above plans, as well as in the enhancements discussed below;

(2) AEP will cooperate in OMOI's review of the above plans;

(3) AEP will provide any proposed changes to the above plans with respect to any Commission Requirement to OMOI staff for OMOI approval, which approval shall not be unreasonably withheld; and

(4) AEP will notify OMOI if it discontinues or substantially reduces the above plans in any area other than one relating to a Commission Requirement.

II. Enhancements to be Added to Existing Plan of Compliance

AEP Companies will implement the following enhancements to its existing plan of compliance, hereinafter referred to herein as "the Compliance Plan Enhancements." The Compliance Plan Enhancements will apply to AEP Companies and to any successor companies owned or controlled by AEP, and the enhancements will remain in effect for four years following the Effective Date). During the four-year term, AEP may request that these enhancements be modified.

A. Compliance Officer

No later than 60 days following the Effective Date, AEP shall designate a

Compliance Officer (hereinafter referred to as the "Compliance Officer"). The Compliance Officer shall be responsible for implementing the terms and conditions of the Compliance Plan Enhancements, which are designed to assure compliance with Commission Requirements, including, but not limited to section 311 of the National Gas Policy Act of 1978, 15 U.S.C. § 3371 ("Section 311"), and the Commission's regulations thereunder. The Compliance Officer and his or her staff, as appropriate, shall be the contact for Commission staff for compliance issues of AEP Companies. In the event the Compliance Officer resigns or is dismissed from his or her position, AEP shall appoint a new Compliance Officer within thirty (30) days and shall provide notice of his or her identity to Commission staff.

B. Training

1. AEP Companies shall provide training designed to assure compliance with applicable Commission Requirements including, but not limited to, Section 311, at least annually to all relevant personnel of AEP who act in a non-clerical capacity with respect to any activity subject to a Commission Requirement. Such training will be mandatory for all such personnel. After 180 days following the Effective Date, no relevant person who acts in a non-clerical capacity and who has not received the annual training required under this Compliance Plan may engage in any activity subject to a Commission Requirement for which that person has not received training.

2. AEP Companies shall have the right to modify the training materials to reflect changes in Commission policy and other relevant developments and to make non-material changes to the presentation of the policy, as long as the materials continue to reasonably comport with the terms of the Compliance Plan Enhancements set forth herein. In addition, AEP Companies may vary the scope of the training materials related to Compliance Plan Enhancements, depending on the specific job function of the personnel trained so long as such variations are appropriate to the given job function. AEP Companies may combine such training with other types of employee training and may provide training and training materials via e-mail or the Intranet with a process to certify participation by persons who receive training.

C. Duties of the Compliance Officer

1. The Compliance Officer shall develop a written policy for AEP Companies for compliance with Commission Requirements including, but not limited to, Section 311. The written policy may incorporate by reference in whole or in part one or more of the above plans of compliance. The written policy shall state, among other things, that AEP shall require yearly training as set forth in Item II. B.1. above. The policy shall also state that appropriate disciplinary measures will be imposed, up to and including termination, for personnel who violate the policy.

2. The Compliance Officer shall submit the written policy for compliance with Commission Requirements to OMOI within 60 days after the Effective Date.

3. No later than 180 days after the Effective Date, as part of the training program described in Item II. B.1. above, the Compliance Officer shall commence a training program for all persons who act in a non-clerical capacity in selling, marketing or providing natural gas transportation or storage services on behalf of any of the AEP Companies subject to the Commission's jurisdiction pursuant to Section 311 or in selling or marketing natural gas or related financial products that may be related to such transportation or storage services. That program shall include, but shall not be limited to:

   (a) an explanation of the scope of the Commission's jurisdiction over the rendering of Section 311 transportation and storage services;

   (b) an explanation of the obligation to provide Section 311 transportation and storage services only under rates, terms and conditions pursuant to, and consistent with, an Operating Statement that has been filed with the Commission pursuant to 18 C.F.R. § 284.123(e);

   (c) an explanation of the obligations pursuant to 18 C.F.R. § 284.126 to file Annual Reports identifying relevant Section 311 transportation transactions and Semi-Annual Storage Reports identifying relevant Section 311 storage transactions;

(d) an explanation of the requirement under 18 C.F.R. §§ 284.7(b) and 284.9(b) to provide interstate transportation and storage services without undue discrimination or preferences of any kind (including a discussion of relevant FERC precedent);

(e) an explanation of the requirements of the Commission's Market Behavior Rule relating to sales of natural gas, 18 C.F.R. § 284.403;

(f) An explanation that, after 180 days following the Effective Date, no person providing services on behalf of any of the AEP Companies who acts in a non-clerical capacity with respect to any activity subject to a Commission Requirement, and who has not received the annual training required under the Compliance Plan Enhancements, shall engage in an activity subject to a Commission Requirement for which that person has not received training;

(g) an explanation of the Hotline described in part III of this Appendix; and

(h) an explanation of any other topic deemed necessary or appropriate by the Compliance Officer to carry out his or her obligations under this Appendix.

4. The Compliance Officer, within 90 days after the Effective Date, shall submit the training materials described in Item II.B.3. above to OMOI for approval.

5. Within 120 days after the Effective Date, the Compliance Officer shall:

(a) compile a list of all persons providing services on behalf of any of the AEP Companies who act in a non-clerical capacity with respect to any activity subject to a Commission Requirement;

(b) notify all such persons of the time and place for the training required by this Appendix; and

(c) provide an electronic or hard copy of the written policies relating to the Compliance Plan Enhancements to each such person

at the time the person is notified of the time and place for the training required by this Appendix.

6. The Compliance Officer shall also:

(a) maintain all documentation of certifications of attendance and materials used in the training required by this Appendix for a period of four years;

(b) notify AEP Companies' HR Department of any person who did not participate in the training required by this Appendix;

(c) no later than the end of each calendar year, determine which personnel required to receive the training provided for by this Appendix have not received the training; and

(d) ensure retention, for a period of four years, of audits, complaints, and compliance training materials to the extent they relate to AEP Companies' Compliance Plan Enhancements provided in this Appendix and any disciplinary actions relating to violations of the same.

III. Hotline

AEP's Hotline for anonymous disclosure of complaints and concerns by any person shall be available for use for reporting by any person any violations of law, rules, regulations, policies or internal procedures relating to Commission Requirements. Within 30 days after the end of each calendar quarter, the Compliance Officer will provide a report to OMOI, describing the content and resolution of any calls to the Hotline that quarter that allege non-compliance with any Commission Requirement including, but not limited to Section 311 or regulations thereunder.

IV. Document Retention

Within 90 days of the Effective Date, AEP shall establish a record retention policy for documents related to Section 311 transactions. All documents shall be kept in either electronic or hard copy and in a manner that, upon receipt of a Commission staff request, permits reasonably prompt access for Commission staff review. Notwithstanding any otherwise-applicable document retention requirement that has a shorter duration, each document

shall be retained until four years following the last day of performance of the related Section 311 transportation or storage transaction.

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Inside FERC

December 13, 2004

FERC gearing up to revamp open-access rules in concert with new market testing

At this point, the answer to concerns about vertical market power and barriers to competitive entry in electric markets is to spruce up order 888, Chairman Pat Wood III said after a technical conference last week. A reworking of open-access transmission regulation could also entail provisions to help wind power better access transmission service, he said.

"It looks like we're certainly going to be making some changes" to the open-access transmission tariff, Wood told *Inside FERC* after the Dec. 7 conference (RM04-7). The remarks came as the commission is revisiting the test for granting market-based rate authority it originally devised in the 1980s within individual cases.

The commission asked about vertical market power and barriers to entry—two of the four prongs of the test—and fielded concerns from panelists about the current state of open access and a need for more transmission. Order 888 should be beefed up because as it stands, it still leaves room for undue discrimination, several panelists told FERC.

It has become "eminently clear" that "you have this huge transmission problem, which exacerbates any market power issues," Commissioner Nora Mead Brownell said in an interview on Thursday. "What I heard is we need to update"

(continued on page 11)

APPA advocates 'mid-course corrections' to fix RTOs, endorses non-RTO options

There is growing discontent within the public power community over the performance of regional transmission organizations, and FERC needs to take stock of its restructuring policies, the American Public Power Assn. said Thursday. In a new paper, APPA said it was "alarmed and dismayed by the level of discontent" and the number of concerns expressed by members operating within RTOs.

"This is not to say that all RTOs are without value and should simply be dismantled," said the paper. But "clearly, corrective actions are needed" to fix the existing RTOs and to encourage non-RTO alternatives in regions where such organizations are unlikely to form.

Releasing the white paper at a Washington press briefing, APPA President and Chief Executive Alan Richardson noted public power's long-time support for the commission's open-access initiatives, but said the current regime is "out of sync with the needs" of municipal systems. In seeking to promote badly needed "mid-course corrections," the group plans to work with other stakeholders, "many of whom share [our] frustrations," Richardson added.

"We think the RTO value proposition is in question," said Jan Schori, who chairs APPA's board and is general manager of the Sacramento Municipal Utility District. The message in the paper is that "when it comes to RTOs, it is time for us

(continued on page 10)

EIA cuts winter, long-term gas price projections

Pointing to "continued high natural gas inventories," the Energy Information Administration last week pulled back sharply on its earlier estimates for winter gas prices. And looking farther out on the horizon, the agency in a second report suggested that a healthy supply situation could push prices below $4.00/Mcf by 2010.

In its December short-term energy outlook, the agency cut 58 cents and 65 cents from its month-ago projections for fourth quarter 2004 and first quarter 2005 Henry Hub spot prices (*IF*, 15 Nov, 9), setting the new marks at $6.39/Mcf and $6.14/Mcf, respectively.

The new report also cuts 15 cents from the 2004 Henry Hub estimate, bringing it to $6.03/Mcf and 32 cents from the 2005 target, which now stands at $6.01/Mcf. Similar reductions were made to the agency's quarterly and annual national average wellhead price estimates.

EIA noted that the average Henry Hub price was $5.15/Mcf in September and

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regulations "on all fronts," including market power screening, the *pro forma* OATT and credit policies, she said.

Order 888 needs "an update" to reflect the physical nature of the grid, Wood said, adding that it was based on a "contract-path model" that conflicts with how the grid works in the current market. "A physical-rights model you can make work, but a contract-path model is at variance with physics," he added.

"But FERC plowed ahead and did that in 1996, and it did a lot of good. But at this stage of the game, we're seeing that it is a frayed edge," particularly for transmission customers taking point-to-point service. An order 888 update could also include changes to accommodate wind generation. "It might be better timing to just do all these together," he said.

Commissioner Joseph Kelliher earlier this fall initiated the idea of picking up where order 888 left off as a way to address lingering or new opportunities for undue discrimination, and colleagues have embraced the plan (*IF*, 18 Oct, 1). Of late, Wood has coupled aims to curb various forms of market power with enhancing open access to transmission inside and outside regional transmission organizations (*IF*, 15 Nov, 1).

For her part, Commissioner Suedeen Kelly has viewed the pending market based rates rulemaking as a forum for finding out what if any changes are needed to open-access rules (*IF*, 29 Nov, 3). Kelly missed the beginning of the technical conference because she was being sworn in for a new term and, for the most part, she and Wood left the questioning of the panel to Brownell, Kelliher and staff.

Brownell credited Kelliher for the "good idea" of re-examining open access. "It's scary," having taken an oath to ensure that rates are just and reasonable, "when you see market power abuse all around you and you don't have the tools to deal with it," she said.

"It's pretty clear that there are changes that need to be made to the OATT to respond to today's market conditions," Brownell added. Revisiting order 888 is not a look backward, she said. Just as with the interim generation market power screens replacing the old hub-and-spoke test, FERC needs to keep current with changing market dynamics.

Asked if the new initiatives replicate, at least in spirit, the failed standard market design proposal, Brownell said, "It isn't SMD by any stretch of the imagination." An SMD rulemaking "would have been another, faster, cleaner way to do it. . . . We're not doing SMD, but in my mind, we have an obligation to deal with market power," she said.

The new aims are about "updating tools," information and transparency and "responding to market conditions as we see them today," Brownell said. Wood noted that Kelliher "wanted to use" the technical conference to further his analysis of order 888 and, according to the chairman, Kelliher "got some of what he needed."

Kelliher reiterated at the meeting how FERC found in order 2000 and the SMD notice of proposed rulemaking that order 888 "does allow opportunity for undue discrimination." Going a step further, he asked: Can order 888 "preclude opportunities for or prevent the exercise of market power? Should it be revised?"

In response, John Hilke, a Federal Trade Commission economist said he understood order 888 to be "transitional." That doesn't mean "it wasn't a useful thing to have in place, but it isn't sufficient," he said.

The OATT is lacking because "it does not provide the incentive to build new transmission," said Ricky Biddle, vice president of planning, rates and dispatching at Arkansas Electric Cooperative. "I don't think open access prevents abuse if the entity wants to do it."

If transmission access is limited, "we ought to have the right" to cost-based power, added Anne Kimber, who spoke on behalf of the Midwest Municipal Transmission Group. FERC should find that the "maintenance of transmission insufficient to support a competitive market is an exercise of transmission market power." It also should deny market-based rates for transmission owners that have not removed congestion that enhances generation market power, Kimber asserted.

Her comments, which largely focused on a need for transmission investment, apparently resonated with Kelliher. If there is inadequate transmission capacity in a market area, "for whatever reason," can the commission grant market-based rate authority? he asked. Even if there is "not malevolence" on the part of a transmission provider, Kelliher continued, "should we consider transmission constraints" barriers to entry?

Hypothetically, if transmission constraints resulted in there only being a single seller in an area, "it seems hard to argue, yes, they should be granted market-based rates," Kelliher added.

Kimber said that munis are "ready, willing and able" to invest in transmission but typically are shut out of the planning process and ultimately grid access. "Today's reliability-based denials may very well be the result of inadequate planning, whether it's intentional or not," she said.

Although she expected the establishment of an RTO to solve the problem, the experience with Midwest Independent Transmission System Operator has been that "the cure is worse than the disease." MISO can be "inflexible" about allowing additional service, she said. "We need long-term rights" for transmission to support long-term power deals, Kimber added.

Speaking for the American Public Power Assn., Susan Kelly, its vice president of policy analysis and general counsel, recommended stepping up access to network service, encouraging joint planning and allowing customers to buy into existing transmission. She also countered the notion that actual service problems don't exist if transmission customers don't file formal complaints.

For one thing, discrimination can be "very subtle and difficult to prove," Kelly said. Customers want to get along with transmission providers, she added, so it is "very difficult to pull the tiger by the tail, especially when you live in the

tiger's cage."

Hilke made a similar point, questioning how it can be discerned if a transmission provider has a real reason for not providing service. It is "almost impossible to prove it, unless someone left a big sign that said, 'we're guilty,' " he asserted.

FERC should focus on market structure, Hilke said. Market power screening is a "sensible and effective technique" for identifying suppliers that can be readily approved and those that need further review. Utilities in areas without RTOs have "the ability and incentive to discriminate," he said.

But there is a difference between something being possible and something actually happening, transmission-owning panelists said. "Just because you see a problem," you cannot "extrapolate" that it is "as widespread or injurious" as assumed, said Steve Wheeler, executive vice president of customer service and regulation for Arizona Public Service.

Also offering a defense of vertically integrated utilities, Paul Bonavia, speaking on behalf of Edison Electric Institute, asserted that "the critical issue at this time is not so much open-access," but transmission investment. The need to develop infrastructure "was the one common thread" among the panelists, added Bonavia, president of commercial enterprises at Xcel Energy.

Orders 888, 889, 2000, 2003 and 2004 are effective in ensuring fair play, he said. Since order 888, there has been a "paucity" of case law alleging discrimination, Bonavia said. There is a "need to get real facts behind significant policy decisions," he warned.

"The commission's open-access policy has been a success" marked by an "absence of any proof" of market power abuse, Bonavia said. He recommended improving the market power screening process.

Brownell didn't buy into the idea that few complaints means there are few problems. "That's just crazy—look at the growing congestion around the country," she said. Brownell also took note of Kimber's recommendation that FERC look "at people's unwillingness to reduce congestion because that could be a form of market power."

Besides calls for joint planning and ownership of transmission as a way to build out the grid, another panelist said transmission providers don't always make the most of what they already have because they use old-fashioned techniques for measuring capacity. "It's not necessarily what transmission owners do that causes market power. It's things that they don't do," said John Stout, senior vice president of Reliant Energy, who represented the Electric Power Supply Assn.

Some line rating assumptions are based on worst-case scenarios of overloading, but such conditions do not exist 24-7 year-round, Stout said. Dynamic line ratings that give real-time calculations of actual capacity have been around for years, but not everyone uses the technology, he said. "Not to use it denies capacity."

FERC plans to examine the other two prongs of the market-based rates test, generation market power and affiliate abuse/reciprocal dealing at a two-day technical conference in late January. *–Katharine Fraser, Rob Thormeyer*