

INITIAL DECISION RELEASE NO. 283
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11616

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

In the Matter of :
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AMERICAN ELECTRIC POWER : INITIAL DECISION
COMPANY, INC. : May 3, 2005
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APPEARANCES: PARTIES

J.A. Bouknight Jr., David B. Raskin, and Kevin F. Duffy for American Electric Power Company, Inc.

Paul F. Roye, David B. Smith Jr., Catherine A. Fisher, M. Cathey Baker, Catherine P. Black, Andrew P. Mosier Jr., Ronald E. Alper, and Arthur S. Lowry for the Division of Investment Management, Securities and Exchange Commission

Randolph L. Elliott and William W. Benz for National Rural Electric Cooperative Association and American Public Power Association

LIMITED PARTICIPANTS

Grace Soderberg for National Association of Regulatory Utility Commissioners

Lynn N. Hargis for Public Citizen, Inc.

BEFORE: Robert G. Mahony, Administrative Law Judge

This proceeding is on remand from the United States Court of Appeals for the District of Columbia Circuit's decision in National Rural Electric Cooperative Association v. SEC, 276 F.3d 609 (D.C. Cir. 2002). The court of appeals vacated the Securities and Exchange Commission's (Commission or SEC) approval of a merger (Merger) between two registered public-utility holding companies, American Electric Power Company, Inc. (AEP), of Columbus,

Ohio, and Central and South West Corporation (CSW) of Dallas, Texas. See American Electric Power Co. and Central and South West Corp., 54 S.E.C. 697 (2000) (Approval Order). The court remanded the matter for further proceedings consistent with its opinion.

I. BACKGROUND

Congress enacted the Public Utility Holding Company Act of 1935 (PUHCA or the Act) to correct grave abuses “found in the use of the holding company device in the nation’s electric and gas utility industries.” North American Co. v. SEC, 327 U.S. 686, 689 (1946) (finding Section 11(b)(1) of the Act constitutional). At that time, public-utility companies were often built “gerrymandered” or scattered across the United States in such ways that bore “no relation to the economy of operation or to effective regulation,” giving rise to the litany of abuses enumerated in Section 1(b) of the Act. Id. at 701; see also American Electric Power Co., 46 S.E.C. 1299, 1305 (1978) (describing the era as a time “of unbridled and unsound expansion of utility holding companies”). With the Act, Congress sought “to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems.” Id. at 704 (quoting Section 1(c) of the Act).

Section 11(b)(1) is the Act’s most controversial provision, sometimes referred to as the Act’s “death sentence provision.” See Joel Seligman, The Transformation of Wall Street 136, 180, 247-64 (3d ed. 2003); Note, Section 11(b) of the Holding Act: Fifteen Years in Retrospect, 59 Yale L.J. 1088, 1088 (1950). The provision requires holding companies “to integrate and coordinate their systems and to divest themselves of security holdings of geographically and economically unrelated properties.” North American, 327 U.S. at 704. At times, this has meant divestment, reorganization, or Commission rejection of a proposed merger. See Cities Service Power & Light Co., 14 S.E.C. 28 (1943). Through enforcement of Section 11(b)(1), Congress “hoped to rejuvenate local utility management and to restore effective state regulation, both of which had been seriously impaired by the existence and practices of nation-wide holding company systems.” North American, 327 U.S. at 704 (citing legislative history).

Relevant to this proceeding is the Commission’s authority to approve proposed acquisitions of securities and utility assets under Section 10 of the Act. Pursuant to Section 10(c)(1), and by reference Section 11(b)(1), the Commission only approves such acquisitions when the proposed system constitutes a “single integrated public-utility system.” For electric utility companies, a proposed system is an “integrated public-utility system” when it meets four separate requirements under Section 2(a)(29)(A):

1. Interconnection requirement: the post-acquisition public-utility system’s assets must be “physically interconnected or capable of physical interconnection”;
2. Coordination requirement: the assets must be capable of economic operation “as a single interconnected and coordinated system”;
3. Single Area or Region requirement: the system must be “confined to a single area or region”; and

4. Localization requirement: the system “must not be so large as to impair . . . the advantages of localized management, efficient operation, and the effectiveness of regulation.”¹

NRECA, 276 F.3d at 611 (citing Electric Energy, Inc., 38 S.E.C. 658, 668 (1958)); see also Envtl. Action, Inc. v. SEC, 895 F.2d 1255, 1263 (D.C. Cir. 1990).

On March 5, 1999, the Commission issued notice that it had received a joint application-declaration (Application) from AEP and CSW seeking approval under the Act of a proposed acquisition. 69 SEC Docket 913. The Application proposed, in relevant part, that AEP acquire, by means of a merger, all the issued and outstanding common stock of CSW. Interested parties were granted leave to request a hearing or file comments for the Commission to consider in its approval process.

On June 14, 2000, after receiving eight sets of comments or requests for hearing of which six were withdrawn, the Commission approved the Merger without a hearing. AEP, 54 S.E.C. at 697. The Merger resulted in a combined AEP/CSW system with a generating capacity of 37,000 megawatts (MW) that serves five million customers in portions of eleven states. NRECA, 276 F.3d at 612. National Rural Electric Cooperative Association (NRECA) and American Public Power Association (APPA),² who filed comments and requested a hearing during the application stage, filed a petition for review of the Commission’s Approval Order with the United States Court of Appeals for the District of Columbia Circuit.

The matter was argued on October 4, 2001, and the court of appeals issued its decision on January 18, 2002, vacating and remanding it for further proceedings. The court concluded that the Approval Order failed to meet two requirements for a “single integrated public-utility system” under the Act. First, the Commission “failed to explain its conclusions regarding the interconnection requirement.” Id. at 610. In particular, the court required an explanation for the Commission’s acceptance of a unidirectional contract path to meet the interconnection

¹ An “integrated public-utility system” is fully defined in Section 2(a)(29)(A) for electric utility companies as:

a system consisting of one or more units of generating plants and/or transmission lines and/or distributing 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 art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation.

² NRECA is an association of approximately 1,000 rural electric cooperatives; APPA is an organization of approximately 2,000 municipal and other state and local government-owned utilities. Both NRECA and APPA have members located in areas served by the combined AEP/CSW system. AEP, 54 S.E.C. at 703-04 n.12.

requirement of Section 2(a)(29)(A) of the Act. The court further stated that the Commission failed to follow its own prior reasoning, or provide some rationale, for its departure from precedent on integrating distant utilities that rely on contract rights or on a third party to interconnect two systems. Id. at 616.

On the second requirement, the court found that the Commission “failed to justify its findings that the proposed acquisition will satisfy the Act’s single-area-or-region requirement.” Id. at 610. Here, the court found improper the “flexible” manner in which the Commission applied this requirement in its Approval Order, ruling that it effectively “read the requirement out of the Act.” Id. at 618. The court further stated: “The 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.” Id. at 618-19; see also Appendix A (attached herein).

On August 30, 2004, in response to the court’s decision, the Commission issued a Notice and Order for a Hearing (Notice) pursuant to Section 19 of the Act, naming AEP and the Division of Investment Management (Division) as parties. American Electric Power Co., 83 SEC Docket 2450. The Notice ordered a hearing before an administrative law judge for “further supplementation of the record . . . to address the issues identified in the court’s opinion” and to determine: (1) “whether AEP and CSW systems are interconnected, through a unidirectional contract path or otherwise” and (2) “whether the resulting combined system operates in a single area or region,” so as to satisfy the requirements of Sections 10(c)(1) and 11(b)(1) of the Act. Id. The Commission also directed the administrative law judge, in conducting such determinations, to make relevant findings regarding the two electric systems and “the geographic area covered by [the] systems.”³ Id.

On September 17, 2004, NRECA and APPA (collectively, NRECA/APPA) were admitted as parties pursuant to Rule 210(b) of the Commission’s Rules of Practice. Public Citizen, Inc. (Public Citizen), and the National Association of Regulatory Utility Commissioners (NARUC) were subsequently admitted as non-party, limited participants pursuant to Rule 210(c) of the Commission’s Rules of Practice.⁴ (Prehearing Orders of Oct. 22 and Dec. 13, 2004; Commission Order Denying Intervention as a Party and Granting Right of Cross-Examination, dated Jan. 7, 2005.)

³ As a procedural matter, NRECA/APPA and Public Citizen both contend that the court’s *vacatur* nullified the Approval Order and any new approval order requires a *de novo* review that addresses all requirements of the statute. This Initial Decision is limited to the issues stated in the Notice.

⁴ Public Citizen is a nonprofit research, lobbying, and litigation organization that advocates consumer protection and government and corporate accountability, with members from states served by the combined AEP/CSW system. AEP, 54 S.E.C. at 704 n. 17. NARUC is a nonprofit organization that represents the collective interests of public utility regulatory commissions from all the fifty states and the District of Columbia. (Prehearing Order of Dec. 13, 2004.)

A public hearing was held on January 10, 2005, in Washington, D.C. AEP submitted fourteen exhibits that included direct testimony from three expert witnesses; Public Citizen submitted seven exhibits that included direct testimony from two experts. The Division, NRECA/APPA, and NARUC did not submit exhibits and did not offer any expert testimony. AEP's experts were Paul B. Johnson (Johnson), J. Craig Baker (Baker), and David Harrison Jr., Ph.D. (Harrison).⁵ (AEP Exs. 1, 2, 5.) Public Citizen's two experts were John A. Casazza (Casazza) and Lynn N. Hargis (Hargis).⁶ (Public Citizen Exs. 1-2, 4.)

After the hearing, NARUC filed a letter, received February 9, 2005, withdrawing from the proceeding. The parties and Public Citizen filed proposed findings and conclusions and supporting briefs by February 14, 2005, and replies thereto by February 28, 2005. On March 7, 2005, the parties and Public Citizen presented oral argument as to their respective positions.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

As the proponent of an order authorizing an acquisition under PUHCA, AEP bears the burden of proof on the two issues in this remand proceeding. See 5 U.S.C. § 556(d). A “preponderance of the evidence” standard has been applied in accordance with Steadman v. SEC, 450 U.S. 91, 97-104 (1981) (interpreting 5 U.S.C. § 556(d)). All arguments, proposed findings and conclusions proffered by the parties were considered and only those consistent with this decision were accepted.⁷

⁵ Johnson, manager of the East Transmission Planning for American Electric Power Service Corporation (AEP Service), has a bachelor's degree in engineering and a master's degree in management from Purdue University, and has served as an AEP Service engineer since 1981. (AEP Ex. 2 at 2-3.) Baker, Senior Vice President of Regulatory Services for AEP Service, has a bachelor's degree in business administration from Walsh College and a master's degree in business administration in finance from Akron University. (AEP Ex. 5 at 2-3.) Harrison, Senior Vice President of National Economic Research Associates, Inc., has a bachelor's degree from Harvard College, a master's degree from the London School of Economics, and a Ph.D. in economics from Harvard University. Harrison is a former member of the Faculty Steering Committee of the Energy and Environmental Policy Center at Harvard, and a senior staff economist on the President's Council of Economic Advisors. Currently, he directs projects in regional economic assessments, energy policy, environmental policy, and transportation. (AEP Ex. 1 at 2-3.)

⁶ Casazza, President of American Education Institute, graduated from Cooper Union School of Engineering and from Cornell University, where he received a bachelor's degree in electrical engineering. Casazza has expertise in the operations of public utility systems and their rate and service regulation under state and federal agencies. (PC Ex. 1 at 1-3.) Hargis, counsel for Public Citizen, has a bachelor's degree from Southern Methodist University and a Juris Doctor degree from University of California at Berkeley. In her law practice, Hargis advises on regulatory matters regarding the Federal Energy Regulatory Commission (FERC), Public Utilities Regulatory Policies Act of 1978, and PUHCA. (H. Tr. 40; PC Ex. 2 at 1-2.)

⁷ Citations to the January 10, 2005, hearing transcript are noted as “(H.Tr. __.)” Citations to AEP's exhibits are noted as “(AEP. Ex. __ at __.)” and citations to Public Citizen's exhibits are

A. Interconnection Requirement

The court of appeals found that AEP, which services customers in parts of Indiana, Kentucky, Michigan, Ohio, Tennessee, Virginia, and West Virginia, and CSW, which services customers in parts of Arkansas, Louisiana, Oklahoma, and Texas, are “neither contiguous nor physically interconnected – indeed, at their closest points, they are separated by hundreds of miles.” NRECA, 276 F.3d at 611-12. In seeking approval of the Merger, AEP and CSW proposed to interconnect their systems by way of a “250 MW, unidirectional transmission service contract” (Contract Path) with Ameren Corporation (Ameren). Id. at 612. AEP/CSW, at the time, expected “fewer opportunities to transfer energy economically from west to east than from east to west, but when and if such opportunities arise, New AEP proposes to make use of its rights under pre-existing transmission service agreements.” Id. at 612 (internal quotations omitted). The Contract Path continued for four years (1999-2003) and was renewable. Id. at 612, 614.

The court held that the Commission “failed to explain its conclusions regarding the interconnection requirement” for the proposed combination of these two systems. Id. at 610. Although the court did not agree with NRECA/APPA that the 250 MW Contract Path was “too small [or] too tentative” to meet the interconnection requirement, the court was “puzzled by the Commission’s acceptance of a unidirectional contract path to meet this requirement.”⁸ Id. at 615. In its reasoning, the court determined that “interconnection” on its face connotes a mutual connection requiring “two-way transfers of power.” Id. (quoting Webster’s Third New Int’l Dictionary 1177 (1993)). The court went on to state that “PUHCA itself requires the interconnected system be one which under normal conditions may be economically operated as a single interconnected and coordinated whole.” Id. Finding only a unidirectional flow, the court concluded that, absent some explanation from the Commission, it could not “understand how a system restricted to unidirectional flow of power from one half to the other can be operated in such a manner.”⁹ Id.

noted as “(PC Ex. __ at __).” Citations to the Division’s, AEP’s, NRECA/APPA’s, and Public Citizen’s briefs are noted as “(Div. Brief at __),” “(AEP Brief at __),” “(NRECA/APPA Brief at __),” and “(PC Brief at __).” Citations to the parties’ reply briefs are noted as “(Div. Reply at __),” “(AEP Reply at __),” “(NRECA/APPA Reply at __),” and “(PC Reply at __).” Citations to the transcript of the oral argument are noted as “(OA Tr. __).”

⁸ “Although we recognize that 250 megawatts represents a small percentage of New AEP’s total generating capacity, [NRECA/APPA] point[s] to no statutory language, legislative history, or case law requiring that physically separated zones of a power system be interconnected by lines capable of transmitting any specific percentage of the power generated in each zone.” NRECA, 276 F.3d at 614.

⁹ Moreover, the court noted that the Commission failed to follow its own prior reasoning regarding integration of distant utilities. NRECA, 276 F.3d at 615. The court found that where the Commission has accepted transmission contracts for integration in the past, the contracts involved were for transmission of “large amounts of power in both directions between relatively closely situated utility assets” and “where the merging companies are members of ‘tight power

1. AEP's Position and Evidence on Remand

On remand, AEP contends that the Contract Path used to interconnect the AEP and CSW systems is not unidirectional. AEP states that it “has acquired firm transmission service from east to west between the former AEP and CSW systems under [Federal Energy Regulatory Commission’s (FERC)] standard open access tariff,” which also permits “AEP to ‘redirect’ such service on a firm or non-firm basis without additional charge in order to move power in a different direction.” (AEP Brief at 3.) AEP contends that its experience since the Merger has confirmed that the contract transmission rights it acquired are adequate to interconnect the combined systems as power has flowed in both directions. Moreover, AEP argues that the availability of non-firm transmission services to augment the Contract Path is further support that the interconnection requirement has been met. (AEP Brief at 13.)

According to Baker, AEP East (old AEP system) and AEP West (old CSW system) are interconnected under the Act “by using transmission service contracts to move electric power and energy across a system operated by Ameren [], pursuant to an Open Access Transmission Tariff (OATT) . . . and the rights under the OATT are sufficient to allow the system to be operated as a single interconnected and coordinated whole.”¹⁰ (AEP Ex. 5 at 9.)

For east-to-west transmission, AEP relies on firm transmission service over the 250 MW Contract Path to connect the hundreds of miles between AEP East and AEP West. (AEP Ex. 11 at 2.) The Contract Path was originally with Ameren OATT, but has been converted to the Midwest Independent System Operator (MISO), one of the two Regional Transmission Organizations (RTOs) that has been formed on both sides of the Contract Path. (H. Tr. 95; AEP Ex. 5 at 18.) Geographically, the Contract Path runs from the westernmost point of the old AEP system in Southwest Indiana across the Ameren line in Illinois to a transmission line located in approximately St. Louis, Missouri, called the MoKanOK line (for Missouri-Kansas-Oklahoma),

pools.” *Id.* at 616 (collecting cases). This issue is better addressed below in the “single area or region” section as the court’s language suggests: “Although a long transmission line may be sufficient to interconnect two distant utilities, the length of the line – that is, the distance between the connected utilities – may violate PUHCA’s region requirement.” *Id.*

¹⁰ On February 1, 2005, NRECA/APPAA filed a motion to strike AEP Exhibit 10 and related portions of Baker’s testimony for AEP’s failure to show that Baker has personal knowledge of the information contained therein. AEP filed its opposition on February 10 representing that, among other reasons, the exhibit was offered for “illustrative purposes, as an example of both [Baker’s] and AEP expert Johnson’s explanation[s].” (AEP Opposition to Motion to Strike at 4-5.) Based on AEP’s representation, I deny NRECA/APPAA’s motion to strike Baker’s testimony. AEP Exhibit 10 will remain included in the hearing record only for illustrative purposes of the experts’ testimony. As such, Exhibit 10 will not be considered as evidence. See generally Peabody Coal Co. v. Director, Office of Workers’ Comp. Programs, 165 F.3d 1126, 1129 (7th Cir. 1999). All other objections not previously ruled upon are hereby denied. 17 C.F.R. §§ 201.111, .320, .321.

which AEP currently jointly owns and has entitlements to use.¹¹ (H. Tr. 61, 95-96; AEP Ex. 11 at 2.) The MoKanOk line then travels through Missouri and Kansas to the easternmost part of the old CSW system, located in approximately Tulsa, Oklahoma, linking the two systems. (AEP Ex. 11 at 2; Appendix B) Baker notes that the RTOs alongside the Contract Path now provide a much broader contract path than under the Ameren OATT, because AEP may now utilize wire-to-wire connections between utilities other than Ameren. (H. Tr. 95; AEP Ex. 5 at 19.) The Contract Path, originally a four-year contract expiring May 31, 2003, has since been renewed twice and, absent renewal, expires in June 2005. (H. Tr. 102; AEP Ex. 5 at 19.)

For west to east, instead of firm transmission service, AEP relies on its rights under applicable FERC OATT rules to redirect the Contract Path in the opposite direction “at any time at no additional charge.” (AEP Ex. 5 at 10-11, 13.) Baker acknowledges that, at the time of the Merger, AEP could have reserved long-term firm transmission service running from west to east, as it has from east to west on the Contract Path, but AEP made a business decision that the cost of such an endeavor would be “an unnecessary and imprudent expenditure of money.”¹² (AEP Ex. 5 at 15-16.) Baker represents that the cost of such firm reservation from west to east would currently be around \$9 million, triple the cost at the time of the Merger. (H. Tr. 116; AEP Ex. 5 at 16.)

To redirect the flow on the Contract Path, Baker cites to FERC Order No. 888 (Order No. 888), which “requires all electric utilities that own or control transmission facilities to offer transmission service over such facilities, as available, to all eligible parties, such as other utilities, power marketers, independent power producers and retail customers, in states where customers are allowed to choose their power suppliers.”¹³ (AEP Ex. 5 at 11.) Since Order No.

¹¹ After the hearing, however, AEP advised that Associated Electric Cooperative, a member of NRECA, recently notified AEP that it would like to terminate the MoKanOK contract with AEP. AEP represents that it intends to explore its options, but if the contract is terminated, “the length of the Contract Path between AEP east and AEP west would increase to approximately 400 miles.” (AEP Brief at 19 n.14.)

¹² The cross-examination of Johnson establishes that AEP has no plan to build a transmission line between AEP East and AEP West because the capacity between the two sides of the company already exists. (H. Tr. 59-60.) Johnson also acknowledges that AEP cannot backup the largest unit in the old CSW system, such as in Texas, with electrical capacity from the AEP East. If the capacity were needed, AEP could purchase it on the open market pursuant to the rules of FERC. (H. Tr. 83-84.)

¹³ Order No. 888’s preamble states: “The legal and policy cornerstone of these rules is to remedy undue discrimination in access to the monopoly owned transmission wires that control whether and to whom electricity can be transported in interstate commerce. A second critical aspect of the rules is to address recovery of the transition costs of moving from a monopoly-regulated regime to one in which all sellers can compete on a fair basis and in which electricity is more competitively priced.” Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, Order No. 888, 61 Fed. Reg. 21540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 at ¶ 31,634-35 (1996).

888, an electric utility has a federally guaranteed right to use the other utility's transmission system so long as capacity is available. (AEP Ex. 5 at 11-12.) Order No. 888 requires "each transmitting utility to adopt a pro-forma OATT spelling out in detail uniform terms and conditions for transmission service."¹⁴ An OATT transmission provider also must now "offer both firm and non-firm point-to-point transmission service." According to Baker, one of the effects of Order No. 888 was that it "greatly facilitated the use of transmission contract rights, in lieu of ownership of transmission facilities, in achieving electric system interconnection and integration." (AEP Ex. 5 at 11-12.) Under the OATT, AEP chooses to redirect the flow of the power only when it is economically viable and the capacity is available.¹⁵ (AEP Ex. 5 at 16-17.)

In addition, Baker explains that AEP may also purchase, for either direction, non-firm transmission service from Ameren whenever necessary:

The sale of non-firm service allows the transmission provider to protect reliability both in the long term, because non-firm service can be sold knowing that it can be recalled to protect reliability, and in the short term, to sell unexpectedly available capacity. In this respect, the sale of transmission service is not unlike many businesses such as airlines and hotels that charge a premium to lock in availability when it is needed, then discount to fill up empty seats or rooms on a short-term basis.

(AEP Ex. 5 at 11-14.) Baker asserts that the unavailability of non-firm service will not be a problem because daily service will be available "even in future months where no available monthly capacity is projected." (AEP Ex. 5 at 17.) He explains that projections for these shorter increment months are "continually updated as the service time approaches, and as unused reservations are released." (AEP Ex. 17-18.) If Ameren becomes unavailable or uneconomical, Baker states that alternative contract paths could be pursued with other electric providers. (AEP Ex. 5 at 20; AEP Ex. 8.) AEP Exhibit 8 shows, in flow-chart form, that AEP East could deliver energy to AEP West without using the Contract Path by way of transmission service paths of alternative third parties – e.g., AEP East (PJM) to TVA to Entergy and to AEP West (SPP). (AEP Ex. 5 at 20; AEP Ex. 8.)

Baker concludes that AEP's Contract Path is not, in fact, unidirectional based on operations over the last four years. (AEP Ex. 5 at 10.) AEP Exhibit 6 sets forth the amount of energy transfers flowing across the Contract Path from east to west and from west to east on a monthly basis during the years 2000 to 2004. It shows that AEP has moved power in both

¹⁴ "Every public utility that owns, controls or operates facilities used for the transmission of electric energy in interstate commerce must have on file with [FERC] a tariff of general applicability for transmission services, including ancillary services, over such facilities. Such tariff must be the open access pro forma tariff contained in Order No. 888 . . . or such other open access tariff as may be approved by [FERC] consistent with Order No. 888." 18 C.F.R. § 35.28(c)(1) (Non-discriminatory open access transmission tariff).

¹⁵ Baker notes: "A request to redirect service on a firm basis is treated as a new request, which means it must be reevaluated to see if capacity is available." (AEP Ex. 5 at 13.)

directions: 98% flowing from east to west and the remaining 2% from west to east. (AEP Ex. 5 at 16; AEP Ex. 6; Appendix C.) Over the period, the east-to-west transfers averaged 198,779 MW hours per month and the west-to-east transfers averaged 3,619 MW hours per month. (AEP Ex. 6.) AEP Exhibit 7 measures the AEP transactions across the Contract Path and shows a similar disparity between east-and-west and west-and-east transactions over this period. (AEP Ex. 7; Appendix D.)

2. Positions of the Division, NRECA/APPa, and Public Citizen

The Division agrees with AEP that the combined AEP/CSW system meets the interconnection requirement. The Division's position is that interconnection "is fundamentally about whether transmission capacity exists that will permit a holding company system to transmit power or cause power to be transmitted between various parts of its system." (Div. Brief at 18.) In view of operations since the Merger, the Division asserts that the evidence demonstrates "significant quantities of power [being] transmitted in multiple directions between various parts of the system in a way that makes the combined operation work in a coordinated way" and thus meeting the Act's interconnection requirement. (Div. Brief at 20.) Citing Commission precedent Unitil Corp., 50 S.E.C. 961 (1992), Cities, 14 S.E.C. 28, and Engineers Public Service Co., 12 S.E.C. 41 (1942), the Division argues that the combined AEP system is interconnected in three respects: (1) physically interconnected by the Contract Path; (2) physically interconnected by transmission service contracts based on the OATTs required under Order No. 888; and (3) "capable of physical interconnection" as the system has the potential to interconnect the east and west portions of the system by other means. (Div. Brief at 19-30.)

NRECA/APPa, on the other hand, contends that the combined AEP/CSW system fails to meet the interconnection requirement because AEP continues to only have a unidirectional right to transmission service over intervening utilities, and AEP and CSW are distant utilities such that they cannot be interconnected under Commission precedent. (NRECA/APPa Brief at 13-14.) Further, NRECA/APPa argues that the evidentiary record on remand now contains even less support, than the record before the court of appeals, to find that the two systems are interconnected: "AEP and CSW are so physically distant from one another that AEP must rely on at least two transmission-service contracts" (Contract Path and MoKanOK) to transfer power from one end of the system to the other. (NRECA/APPa Brief at 13.) Also, AEP's testimony now shows that AEP has no contractual right to continue even unidirectional energy transfers after June 2005 or sooner, given the pending expiration of the Contract Path and the notice of termination regarding the MoKanOK line. (NRECA/APPa Brief at 25-26; NRECA/APPa Reply at 6.) Accordingly, NRECA/APPa concludes that AEP has not met its burden of proof and to hold otherwise would make "the statute's interconnection requirement all but disappear." (NRECA/APPa Brief at 21.)

Public Citizen similarly contends that AEP's position, which relies on the Contract Path and non-firm transmission service to meet the interconnection requirement, is fundamentally flawed. For Public Citizen, AEP has failed to prove that its two widely distant groups of utility assets are "interconnected" so that "under normal conditions" they can be economically "interconnected and operated" as a single utility system. (PC Brief at 15.) Public Citizen argues that, at most, "AEP has shown that there are sporadic transfers of relatively small amounts of

electric energy from West to East, using ‘rented’ contract path transmission service” and that AEP “has had ‘tiny’ and ‘occasional transfers’ of megawatt hours from East to West using ‘as available’ transmission service.” (PC Brief at 15.) Public Citizen also emphasizes that the combined AEP/CSW system fails to meet the basic requirements of an “integrated” utility system because it cannot ensure backup for outages of its own generation. (PC Brief at 15.)

Witness Casazza disagrees with much of Baker’s testimony, especially his reliance on RTOs for broader transmission services and on non-firm transmission availability. Casazza opines that the advent of RTOs has not resulted in greater efficiencies, but higher costs. (PC Ex. 1 at 4-5.) He maintains that the problems in operation have increased because of the large increase in the number of participants and the increased complexity of transactions, making for much greater difficulty. He does not believe that RTOs and Independent System Operators (ISOs) have resulted in the ability of a single integrated utility system to operate economically over large distances. (PC Ex. 7-8.)

Casazza asserts that operating a single integrated utility system over large distances, such as from Ohio to Texas, will have serious consequences for all intervening and surrounding systems in terms of costs and reliability. (PC Ex. 1 at 8.) In contrast to Baker, Casazza states that non-firm transmission will not have the necessary capacity when needed because the open market is largely undependable. (PC Ex. 1 at 9.) This is because other surrounding electric utility systems will also require transmission capacity to meet their individual systems’ needs, and that past experience has shown increasing transmission constraints due to limited transmission capacity. (PC Ex. 1 at 9.) In addition, he notes that “the large number of transmission facilities intervening between the two AEP systems increases the probability that constraints will occur somewhere, limiting AEP’s ability to operate as an integrated system. This is the result of the nature of the transmission systems and the requirements of reliability standards,” which he believes have not changed with the advent of RTOs. (PC Ex. 1 at 9.)

3. Analysis

Section 2(a)(29)(A) of the Act requires an integrated public utility to be “physically interconnected or capable of physical interconnection.” The court of appeals found the Approval Order’s ruling on the interconnection requirement wanting because it believed the Contract Path was unidirectional and only transferred electric power from east to west. The court, defining interconnection as a “connection between two or more: *mutual* connection,” held that the definition requires a two-way transfer of electric power. NRECA, 276 F.3d at 615 (emphasis in original). Absent an explanation from the Commission, the court was unable to discern how a unidirectional contract path met the interconnection requirement.

To provide the required explanation, AEP introduced evidence showing that the Contract Path meets this requirement because it has always been bi-directional. Baker testified that, under Order No. 888, AEP has the right to redirect the Contract Path “at any time at no additional charge.” Baker explained that AEP made a business decision not to reserve long-term firm transmission capability from west to east because the cost of such an endeavor would be “an unnecessary and imprudent expenditure of money.” (AEP EX. 5 at 15-16.) This evidence, which I credit, establishes that ninety-eight percent of the electric power transfers along the

Contract Path is from east to west, and two percent of the flow is from west to east. (AEP Ex. 5 at 10-11.)

Although the west-to-east electric power flow is clearly a miniscule amount in relation to the east-to-west flow, the Act does not require any particular amount to establish the bi-directional nature of the Contract Path. In fact, the court stated in regard to the capacity of the Contract Path: “Although we recognize that 250MW represents a small percentage on New AEP’s total generating capacity, [NRECA/APPa] point[s] to no statutory language, legislative history, or case law requiring that physically separated zones of a power system be interconnected by lines capable of transmitting any specific percentage of the power generated in each zone.” NRECA, 276 F.3d at 614.

NRECA/APPa and Public Citizen contend that if the Contract Path is not renewed in June 2005 and AEP has only non-firm service to transfer energy, there will be no guarantee that the service will be available when it is needed. While this is a legitimate concern, the Contract Path is currently in place and energy is flowing bi-directionally. As backup, AEP may also purchase non-firm transmission services from Ameren whenever necessary or arrange alternative contract paths with other electric providers to meet the requirement of a bi-directional electric power flow for establishing interconnection. Nonetheless, as the court previously noted, and the Division points out, in the event of a change in circumstances, the Commission is authorized pursuant to Section 11 of the Act to order AEP “to divest one of the systems if the company fails to devise a satisfactory method of integrating its utilities after the contract . . . expires.” Id. at 614-15.

Based on the evidence presented by AEP, I credit Baker’s testimony and AEP Exhibits 6 and 7 that demonstrate that energy has been consistently transferred in both directions since the approval of the Merger. I conclude, therefore, that the interconnection requirement of Section 2(a)(29)(A) has been met.

B. “Single Area or Region” Requirement

Section 2(a)(29)(A) of the Act requires, in pertinent part, that an integrated public-utility system “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.*” (emphasis added.) The court of appeals held that the Approval Order’s ruling on the “single area or region” requirement could not “withstand even the most deferential review, both because the Commission failed to make any evidentiary findings on the issue and because it erroneously concluded that a proposed acquisition that satisfies PUHCA’s other requirements also meets the statute’s region requirement.” NRECA, 276 F.3d at 617.

The court, in particular, faulted the Commission’s use of a flexible approach to the region requirement.¹⁶ Under this approach, the Commission analyzed the region requirement more on

¹⁶ The Approval Order stated

advancements in technology rather than on its traditional considerations such as the geographic, socioeconomic, and geologic traits of the particular area or region.¹⁷ The court found that the Commission in applying its flexible approach neglected to treat this requirement as a separate requirement. Instead of discussing “the noncontiguous and seemingly dissimilar regions” served by the combined AEP/CSW, “the Approval Order ultimately determined [] that New AEP satisfied the region requirement not because of any identified similarities between areas currently served by the CSW, but instead because New AEP satisfied all *other* PUHCA requirements.” Id. at 618 (emphasis in original). The court concluded:

This 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.” The Commission applies the requirement [in the Approval Order] as if it did not include the word ‘single’ but instead read:

The Act does not define the terms “area” and “region.” The terms, by their nature, are susceptible of flexible interpretation, which permits us to respond to the current state of the industry and to give the terms practical meaning and effect.

We have found that the single area or region test should be applied flexibly when doing so does not undercut the policies of [PUHCA] “against scatteration – the ownership of widely dispersed utility properties which did not lend themselves to efficient operation and effective state regulation.” We have not required that combining systems be contiguous for the requirement to be met. . . .

[T]he New AEP System will be interconnected and susceptible of economic and coordinated operation and no adverse finding is required on anticompetitive grounds under section 10(b)(1). We find below that the size of the New AEP System will not impair efficient operation, localized management or effective regulation and that the Merger will result in economies and efficiencies under section 10(c)(2). In view of these considerations, we find that the New AEP System will operate in a “single area or region.”

54 S.E.C. at 739-41 (footnotes omitted).

¹⁷ The court found that prior Commission precedent analyzed the geographic and socioeconomic characteristics of the areas covered by the proposed system: In Middle West Corp., 15 S.E.C. 309, 336 (1944), the Commission held that “the geographic characteristics of the territory encompassed by this sector or properties [were] fairly homogeneous.” NRECA, 276 F.3d at 617. In American Natural Gas Co., 43 S.E.C. 203, 206 (1966), the Commission “listed several factors that could be relevant to a finding that different service areas are located in ‘a common economic and geographic region,’ including ‘industrial, marketing and general business activity, transportation facilities, and gas utility requirements.’” NRECA, 276 F.3d at 617. In contrast, the Approval Order stated that “[i]n view of the changes in the electric industry, many of these factors have far less relevance than they did sixty-five years ago.” AEP, 54 S.E.C. at 741-42 (noting the “application of section 2(a)(29)(A) has evolved with the changes in the industry”).

‘confined to an area *or areas* not so large as to impair . . . Technological improvements may well justify ever-expanding electric utilities, but [PUHCA] confines such utilities to a “single” area or region.

Id. at 618 (emphasis in original).

By abandoning its traditional considerations, the Commission, in the court’s view, effectively interpreted “the phrase ‘single area or region’ so flexibly as to read it out of the Act.” Id. at 618. Based on the statute’s plain language, however, the court held that “only Congress” can decide that recent technological advances have made the region requirement so “outdated” as to eliminate it as a requirement. Id. The court concluded that nothing in the record before it could support the Approval Order’s basis “for concluding the 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.” Id. at 618-19.

1. AEP’s Position and Evidence on Remand

AEP argues that the combined system meets the “single area or region” requirement in four respects: (a) all of the combined system, except for a portion in Texas, is located within the North American Electric System’s Eastern Interconnection, which itself operates as a single, independent electrical machine; (b) all of the combined system, except for a portion in Texas, operates within the footprint of three coordinated RTOs that, pursuant to FERC rules and joint operating agreements, are required to operate in a unified fashion; (c) the combined system and the first-tier utilities directly interconnected thereto are in a single region that are bound together and function as an economic unit; and (d) an analysis of trade flows in several industries shows that the central portion of the United States, where the combined system lies, comprises a single economic region. (AEP Brief at 4-6.)

a. The Eastern Interconnection

Johnson describes the North American Electric System as covering the forty-eight contiguous United States, the seven adjacent Canadian provinces, and part of Baja Norte, Mexico. (AEP Ex. 2 at 5.) To serve the electric demand, there is in excess of 990,000 megawatts of electric generating capacity, 893,000 MW of which is within the forty-eight states. (AEP Ex. 2 at 5.) Johnson states that the North American Electric System is composed of three Interconnections: the Eastern, Western, and Electric Reliability Council of Texas (ERCOT) Interconnections. (AEP Ex. 2 at 6; AEP Ex. 3.) The Eastern Interconnection covers the North American continent east of the Rocky Mountains, excluding ERCOT, and is the largest of the three. (AEP Ex. 2 at 6; AEP Ex. 3.) The Western Interconnection covers all or portions of twelve western states and the two western Canadian provinces. The ERCOT Interconnection covers most of the state of Texas and is the smallest of the three. (AEP Ex. 2 at 6-7; AEP Ex. 3.)

According to Johnson, the Eastern Interconnection currently “covers diverse weather, load densities and generation resources” and is made up of transmission facilities, “owned and operated by numerous entities including investor-owned utilities, federally (or provincially)

chartered utilities and state and municipal electric companies and electric cooperatives.” (AEP Ex. 2 at 14.) Since the Interconnection’s inception in 1962, Johnson states that transmission coordination has evolved such that four RTOs now cover two-thirds of the Eastern Interconnection to provide “independent operational oversight of the electric facilities, reliability assurances, and facilitation of a competitive generation electric market.” (AEP Ex. 2 at 15.) According to Johnson, one benefit of this increased coordination has been that inexpensive generation resources in one part of the Interconnection may be shifted to another part of the Interconnection achieving “generation dispatch economies.” (AEP Ex. 2 at 17-18.) Adjoining areas of the Interconnection may also supply an area, short on generation resources or experiencing an outage, with the necessary resources. (AEP Ex. 2 at 17-18.) Based on increased coordination and facilitated by technological advances and evolving FERC rules, Johnson concludes that the contemporary Eastern Interconnection can best be described as operating electrically as a large, “single machine.” (H. Tr. 67; AEP Ex. 2 at 4, 14, 23-24.)

With Johnson’s testimony as a basis, Baker espouses a “common sense approach” to the single-area-or-region requirement and concludes that the combined AEP/CSW system operates in a single area or region. (H. Tr. 118; AEP Ex. 5 at 21.) He states that the trend over time has been to increase the scope of interaction and trade among the nation’s electric utilities. (AEP Ex. 2 at 21.) Baker construes the entire Eastern Interconnection, of which all AEP’s non-ERCOT operations are part, to be in a single area or region under the Act. (H. Tr. 118; AEP Ex. 5 at 21.) Although he acknowledges, as does Johnson, that the combined AEP system does not operate exclusively within the Eastern Interconnection – because AEP’s Texas Central Company (TCC) and most of AEP’s Texas North Company (TNC) are in ERCOT – he states that neither TCC nor TNC can be operated as an independent system without a loss of substantial economies. (H. Tr. 62; AEP Ex. 5 at 21-22.) He projects a loss of approximately \$50 million per year if TCC and TNC were no longer part of the combined AEP/CSW system. (AEP Ex. 5 at 22.)

Under cross examination, Baker acknowledges that his position – that the entire Eastern Interconnection makes up a single area or region – would permit combinations of public-utility companies covering large areas of the North American continent. (H. Tr. 118-22.) For example, if the combined AEP/CSW system and Entergy, which operates in parts of Mississippi, Louisiana, Arkansas, and Texas, were to merge, Baker would consider the merged entity to be in a single area under the Act. (H. Tr. 118-19.) Similarly, if the combined AEP/CSW system and the Southern Company, which operates in parts of Mississippi, Georgia, Alabama, and Florida, were to merge, Baker would consider the merged entity to be in a single area. (H. Tr. 119.) Baker would also consider a merger between the combined AEP/CSW system and Exelon Corp., with utilities in Philadelphia, Pennsylvania, and Chicago, Illinois, to be within a single area or region under the Act. (H. Tr. 120.) However, he would not consider a merger between the combined AEP/CSW system and XCEL Energy Inc., which operates in Colorado, to be part of a single area or region because the merged entity would extend into parts of the Western Interconnection. (H. Tr. 121.)

For AEP, then, the combined AEP/CSW system meets the single-area-or-region requirement because the entire Eastern Interconnection can be defined as a single area or region and all of AEP’s non-ERCOT operations are entirely within the Eastern Interconnection. In addition, AEP contends, the ERCOT portions were previously found to be integrated with the

non-ERCOT portions of the old CSW system in Central and South West Corp., 47 S.E.C. 754 (1982). (H. Tr. 49; AEP Brief at 28.) However, even if the ERCOT portion of CSW were not integrated with the rest of the system, AEP further argues that it “would be permitted to retain this part of the system pursuant to Section 11(b)(1)(A)(B)(C) of the Act because the ERCOT portion of the Combined System cannot be operated as an independent system without the loss of substantial economies.” (AEP Brief at 28.)

b. Impact of RTOs

Baker asserts that, under evolving standards, the area defined by the boundaries of the three FERC-approved RTOs in the Eastern Interconnection comprises a single area or region from an electricity market and operations perspective. (AEP Ex. 5 at 21, 31-32.) These RTOs are the MISO, the Pennsylvania-New Jersey-Maryland Interconnection (PJM), and Southwest Power Pool (SPP). (AEP Ex. 5 at 29-30.) Baker states that FERC has mandated that all RTOs operate unified electricity markets within their geographic area. (AEP Ex. 5 at 27.) FERC also has ordered PJM, MISO, and SPP to enter into joint operating agreements to eliminate barriers to trade between the three RTOs, and to eliminate additive or “pancaked” transmission pricing. (H. Tr. 143; AEP Ex. 5 at 19, 28, 30, 35.) The joint operating agreement between PJM and MISO has been signed and filed at FERC, while one between MISO and SPP is under development. (AEP Ex. 5 at 30-31.)

According to Baker, FERC’s pro-competition policies involving OATTs, the development of RTOs, and the standard market design have promoted geographic expansion of the areas in which electric utilities do business. (AEP Ex. 5 at 25.) In Order No. 2000, FERC concluded that RTOs “were necessary to address operational and reliability issues facing the industry, and to eliminate what the FERC perceived as residual discrimination in transmission services.” (AEP Ex. 5 at 27.) In Order 2000, as Baker explains, “FERC took steps to strongly encourage RTO development stating that it was the FERC’s objective for all transmission-owning entities in the nation to place their transmission facilities under the control of appropriate RTOs.” (AEP Ex. 5 at 27.) Baker states that Order No. 2000 has encouraged large RTOs to form, or be planned, over large parts of the United States. (AEP Ex. 5 at 27.) Additionally, Baker notes that FERC’s Notice of Proposed Rulemaking on Standard Marketing Design proposes coordination among RTOs through joint operating agreements, with the objective of creating seamless electricity markets over vast distances. (AEP Ex. 5 at 28-29.)

As currently configured, AEP East is incorporated into the PJM RTO and AEP West’s non-ERCOT companies belong to the SPP RTO. (AEP Ex. 5 at 29; AEP Ex. 9.) A third RTO, MISO, lies between the SPP and PJM RTOs. (AEP Ex. 5 at 29-30.) The Texas-based facilities belong to ERCOT. (AEP Ex. 9.) Baker explains that FERC has moved to eliminate any seams between the PJM and MISO RTOs, with the objective that transactions can be consummated across the PJM and MISO footprints just as if the two constitute a single RTO. (AEP Ex. 5 at 30.) Based on the existence of these coordinated RTOs and development of FERC policy, Baker concludes that the combined AEP system is part of a single area or region under the Act. (AEP Ex. 5 at 31-32.)

c. First-Tier Utilities

To further support its position, AEP argues that the Commission in Entergy Corp., 51 S.E.C. 869 (1993), has already established a definition of a “region” for purposes of its review of the competitive impacts of mergers under a separate section of the Act, Section 10(b)(1). (AEP Brief at 33-35.) In approving Entergy’s proposed acquisition of Gulf States Utilities, which were contiguous and interconnected electric utilities at the time, the Commission determined that the merging utilities and all directly interconnected neighbors (“first-tier utilities”) comprised a “single market area” in which the merged company competes to supply electric power under Section 10(b)(1). (AEP Brief at 33; 51 S.E.C. at 877, 883.) AEP argues that, “in light of the centrality of competition to the operation of the electric industry at this time, it is appropriate to use this market area definition [under Section 10(b)(1)], as FERC uses the same market area in its review of competitive impacts, in establishing the ‘single area or region’ requirement for purposes of Section 11(b)(1).” (AEP Brief at 6.) AEP states that it previously used this “first-tier utility” method to define the relevant region in its Application, which the Commission found satisfactory, and such a finding was not challenged on appeal. (AEP Brief at 34.)

AEP asserts that although Section 10(b)(1) is only relevant to an assessment of competitive conditions under the Act, the same definition should be used now in determining whether utilities operate in a single area or region under Section 10(c)(1), and by reference Section 11(b)(1). AEP relies on Exhibit 11, entitled “AEP and First-Tier Interconnected Network,” which purportedly shows that the area covered by the combined AEP system is a “single seamless area, devoid of any attributes of gerrymandering or ‘scatteration.’” (AEP Ex. 11; AEP Brief at 35.) AEP Exhibit 11 also purportedly shows that the interconnected network “has a well-developed transmission system that interweaves and binds together this region and supports its function as an economic unit.” (AEP Ex. 11; AEP Brief at 35.)

The territory covered by the first-tier utilities in Exhibit 11 encompasses a much larger territory than that covered by the combined AEP system. (AEP Ex. 11; 276 F.3d at 619.) The first-tier-utility coverage includes territories as far west as eastern New Mexico, and runs east across Texas into Oklahoma, Kansas, Arkansas, Louisiana, Mississippi, Alabama, Missouri, Tennessee, Kentucky, Illinois, Indiana, Michigan, Ohio, Georgia, South Carolina, North Carolina, Virginia, West Virginia, into parts of Maryland and scatters into Pennsylvania, bordering on the state of New York. (AEP Ex. 11; Appendix E.)

d. Operating as a “Functional” Region

AEP offers Harrison’s testimony to support a finding that the combined AEP/CSW system operates within a single area or region from the standpoint of trading in important commodities and the transportation infrastructure for such trade. (AEP Ex. 1.) Harrison’s focus was on whether the combined AEP service territory consisted of a *functional region*, which he defines as an area exhibiting “more interaction [e.g., economic interdependence] with one another than outside areas based on some criteria.” (AEP Ex. 1 at 4.) Harrison primarily examined the transportation infrastructure and trade flows for several manufacturing industries within the service territories of the combined AEP/CSW system. He then compared these

findings with the transportation infrastructure and trade flows between this specific region and other economic regions.¹⁸

For natural gas, Harrison states that the transportation routes show “that the biggest capacity is for pipelines that extend from the Gulf Coast production region to major markets in the Midwest and the Northeast.” (AEP Ex. 1 at 9.) For roadway travel, Harrison finds that “several major arteries clearly connect AEP East and AEP West states” as major highways facilitate economic linkages, connecting Dallas, Houston, and New Orleans with Chicago, Cincinnati, and Indianapolis. (AEP Ex. 1 at 25.) For waterways, he finds the commodity flows “indicate a broad region through the middle of the United States running from the Great Lakes in the North to the outfall of the Mississippi River and the Gulf Intracoastal Waterway in the South.” (AEP Ex. 1 at 31.) In regard to railways, he states that his findings show “substantial commodity flows among the Northeast, Midwest, and South” and that “rail lines also provide some connections with the West, although only a few major rail arteries cross the Rocky Mountains.” (AEP Ex. 1 at 34.) In analyzing the U.S. Census Regions, Harrison states that his “results indicate that the Midwest and South regions (which consist of three and eight AEP states, respectively) are the most closely connected of the four Census regions . . . suggest[ing] that these two Census regions are in a broad economic region, encompassing much of the center of the country.” (AEP Ex. 1 at 40.)

After analyzing several manufacturing industries, Harrison concludes that the combined AEP/CSW system is located within a large, single functional region. (AEP Ex. 1 at 2-3, 42.) When asked on cross examination to clarify, Harrison opines that the continental United States, east of the Rockies, is one “homogeneous” region, that is, a region “demarcated on the basis of internal uniformity.” (H. Tr. 31; AEP Ex. 1 at 4.) (“What’s generally referred to as Midwest, East, and South, yes.”) Harrison also acknowledges that his trade-flow analysis does not include any electricity trade flows or analysis of electricity markets. (H. Tr. 35-36.)

2. The Division’s Position

The Division’s position is that, from the perspective of geography, “there appears to be a simple, common sense answer to the question of whether the AEP system is in a single area or region: There is simply no way that those states are in a single area or region. Hence, it seems ‘obvious’ that the AEP system fails that test.” (Div. Brief at 33.) However, according to the Division, determining whether a system operates in a single area or region is not that simple.

The Division cites the statutory language of Section 2(a)(29)(A) arguing that it “does not refer to a ‘single geographic area or region.’ Nor does it refer to a ‘single demographic area or region.’ It states only a ‘single area or region.’” (Div. Brief at 33.) The Division, therefore,

¹⁸ Included in his analysis on the transportation infrastructure are natural gas and oil pipelines, waterways, road networks, rail networks, and other facilities “that have developed considerably over the past 70 years to lower the cost of both transportation and communications and to facilitate trade within a broader functional region.” (AEP Ex. 1 at 8-37, 42.) His analysis of commodity flows includes “natural gas, oil, and coal, which provide important fuels for electricity generation, as well as many other types of goods.” (AEP Ex. 1 at 37-41.)

concludes that the region requirement cannot be analyzed “merely by pointing to the physical distance between its parts, to the geologic features of the places in which its assets and customers are located, or, more broadly, our common sense and culturally determined notions of what constitutes a distinct region.” (Div. Brief at 34.) To the contrary, the Division contends that a utility system “must be evaluated in terms of the characteristics of the electric market in which it operates as well as in terms of the broader economic markets in which it is situated.” (Div. Brief at 34.)

The Division believes AEP has demonstrated that its combined system, covering portions of eleven states and extending from Virginia to Michigan to Texas, operates in a single area or region. In particular, for the Division, AEP has introduced sufficient evidence that “shows that the combined system operates within a number of unified markets including, most notably, an economically unified market for electricity.” (Div. Brief at 35.) The Division asserts that the Commission has always flexibly applied the region requirement “in the context of changing technology, changing market structures, and the changing nature of the utility business” and that the AEP combined system meets this evolving standard. (Div. Brief at 35 (citing Section 2(a)(29)(A)’s “state of the art” consideration).) In the Division’s view, “the evidence in the record does not require any legal conclusion that the Eastern Interconnection should be the region that satisfies the ‘single area or region’ requirement” only that “AEP operates within a single electricity market that overlaps the footprint of its system.” (Div. Reply at 16-17.)

3. Positions of NRECA/APPa and Public Citizen

NRECA/APPa contends that the combined system is not confined to a single area or region and that the Commission should not approve the acquisition of CSW. (NRECA/APPa Brief at 9, 52.) NRECA/APPa emphasizes that the combined system extends “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.” (NRECA/APPa Brief at 35.) For NRECA/APPa, “there is simply no factual basis on which the Commission can conclude that this entire area, covering some 197,400 square miles, is confined to a single region.” (NRECA/APPa Brief at 35.) NRECA/APPa argues that AEP has failed to identify the single area or region that might encompass Canton, Ohio, and Brownsville, Texas, and concludes that “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.” (NRECA/APPa Brief at 35.) For NRECA/APPa, a finding that the combined AEP system operates in a “single area or region” would depart from Commission precedent. (NRECA/APPa Reply at 23.)

Public Citizen similarly argues that AEP has failed to prove that its two widely distant groups of utility assets are in a single area or region of the country. Public Citizen in particular criticizes the testimony of Harrison:

AEP simply hired a consultant to testify that trade in various products transported by boats, trains, and trucks has increased over the years since 1935 in the United States, including in the parts of the country where AEP’s eleven widely distant groups of utilities are located. AEP’s version of the movie “Planes, Trains and

Automobiles” hardly complies with the court’s direction that evidence must be provided to show that these widely divided states are in a “single” area or region of the country for purposes of complying with the [Act].

(PC Brief at 16.) Emphasizing that the definition of an integrated public-utility company must be viewed as a whole, not “broken apart,” Public Citizen concludes that the combined AEP system does not operate in a “single area or region” under Section 2(a)(29)(A) of the Act. (PC Brief at 27-28.)

4. Analysis

To meet the region requirement under Section 2(a)(29)(A) of the Act, the combined AEP/CSW system must be “confined in its operations to a single area or region, in one or more states.” The court of appeals found that, in making its determination, the Commission traditionally analyzes “such factors as the *geography* and *socioeconomic* characteristics of the areas covered.” NRECA, 276 F.3d at 617 (emphasis added). The court rejected the Commission’s region determination in the Approval Order for “[n]ever mentioning whether the territories served by AEP and CSW have common geographic or geologic traits” and for interpreting “the phrase ‘single area or region’ so flexibly as to read it out of the Act.” Id. at 617-18. For the court, the Commission, in fact, “failed to make any evidentiary findings on the issue.” Id. at 617.

For AEP and the Division, the evidence on remand establishes that the combined AEP/CSW system’s operations, extending from Virginia in the East to Michigan in the North down to Texas in the Southwest, are confined to a “single area or region” under the Act. The Division emphasizes that this requirement cannot be analyzed “merely by pointing to the physical distance . . . to the geologic features . . . or, more broadly, our common sense and culturally determined notions of what constitutes a distinct region.” (Div. Brief at 34.) While acknowledging that “geology, topography, demographics and economics has sometimes played a role,” the Division asserts that “more fundamentally” the Commission relies “on the realities of the underlying market for electricity” as well as on the “broader economic markets” involved. (Div. Brief at 33-34.)

I do not credit the Division’s characterization that the Commission only “sometimes” relies on geography in applying this requirement. A review of past cases, spanning the history of the Act, demonstrates to the contrary. See Cities, 14 S.E.C. at 58-59 (rejecting electric utility system with properties in Wyoming, New Mexico, and Arizona on “geographic considerations alone”); Middle West Corp., 15 S.E.C. 309 at 336 (determining the “geographic characteristics of the territory encompassed by this sector of properties are fairly homogeneous”); American Gas & Electric Co., 21 S.E.C. 575, 576 (1945) (referring to Section 11(b)(1) of the Act as “the geographic integration provisions”); American Natural Gas, 43 S.E.C. at 206 (finding that different service areas are located in “a common economic and geographic region”); Unitil Corp., 50 S.E.C. at 967-968 (finding proposed system in “north central Massachusetts and southern New Hampshire” met region requirement because “the service territories are sufficiently close to be confined ‘to a single region or area’”); Conectiv, Inc., 66 SEC Docket 1812, 1817 & n.32 (Feb. 25, 1998) (finding

“Conectiv electric system will operate in a single area or region in four contiguous states in the Mid-Atlantic region”—Virginia, Maryland, Delaware, and New Jersey).

More recently, the Commission has again determined that geography is the most prominent characteristic in applying the region requirement. The case in point is the Commission’s approval of a merger of two public-utility systems in CP&L Energy, Inc., 54 S.E.C. 996 (2000), issued only five months after the Approval Order. Therein, the Commission used strictly geographical terminology to find that “[t]he retail service area of the [combined] CP&L Energy Electric System will be confined to three states, North Carolina, South Carolina, and Florida, in the *Southeastern* United States.” *Id.* at 1022 (emphasis added). The Commission concluded that the combination of CP&L Energy of North Carolina, and Florida Progress Corporation of Florida “will be an integrated public-utility system within the meaning of section 2(a)(29)(A) of the Act.” *Id.* at 1023-24.

When asked to explain the Commission’s reliance on geography and traditional designations of national regions (e.g., “Southeast” in CP&L Energy) so close in time to the date of the Approval Order, the Division stated at oral argument that “[the Commission]’s done so in those cases because it was easy to do so. That was the easiest way in one sentence to get past the issue and move [on] . . . I think you can’t put a term like Midwest or Southwest over the AEP [combined system] and use that as what defines the region.” (OA Tr. 32.)

Accordingly, I find that the traditional considerations by which the Commission applies the region requirement of Section 2(a)(29)(A) to be predominately based on geography, with other factors such as socioeconomics and geology also contributing. To now apply the region requirement based on broad-based economic considerations, effectively ignoring geography, would be contrary to the Commission’s traditional method of analysis. In accordance with the geographic test and the plain language of the statute, the combined system of AEP and CSW is not “confined in its operations to a single area or region” under any of the four scenarios advanced by AEP. Rather than prove that AEP’s operations are confined to a single area or region, under traditional considerations, AEP’s evidence, in fact, exhibits more convincingly that the combined system operates over several regions.

Baker testified that, under FERC policies, RTOs have increased the coordination of energy services over broader areas of the United States. Baker believes that the coordination of three RTOs – MISO, SPP, and PJM – over the areas covered by the non-ERCOT portions of the combined system establishes that the AEP operates in a single area or region. To the contrary, after adding ERCOT to the mix, the evidence suggests more convincingly that the combined system operates over at least four regions, with (1) the MISO RTO serving all or parts of Illinois, Indiana, Kentucky, Ohio, Michigan, Missouri, Iowa, Wisconsin, Minnesota, North Dakota, South Dakota, Montana, and into Manitoba, Canada; (2) the PJM RTO serving all or parts of Illinois, Michigan, Indiana, Kentucky, Ohio, Pennsylvania, West Virginia, Virginia, Maryland, Delaware, and New Jersey; (3) the SPP RTO serving all or parts of Kansas, Arkansas, Oklahoma, Texas, Missouri, Louisiana, and New Mexico; and (4) ERCOT serving the majority of Texas. (AEP Ex. 5 at 30; AEP Ex. 9.)

Similarly, based on analysis of the operations of several manufacturing industries, Harrison testified that the territory covered by the combined system covering eleven states from Texas in the South to Michigan in the North to Virginia in the East actually comprises a large, single functioning region. In fact, Harrison opines that the entire continental United States east of the Rocky Mountains comprises a large, single region. However, Harrison admits that his study does not include any analysis of electricity markets. Further, Harrison's testimony, under the Commission's traditional considerations for applying the region requirement, actually proves more dissimilarities between the territory covered by the old AEP system and former CSW system than any perceived similarities between the two. For instance, Harrison supports his conclusion on the fact that natural gas, crude oil, and other petroleum products produced in the Gulf States are transported consistently northward to supply areas in the Midwest and Northeast United States, because these territories lack either the natural resources or the economies to produce their own. However, it is the very geological or socioeconomic differences of these territories, not the similarities, that created this trade to flow in first place, proving a greater level of heterogeneity than any perceived homogeneity.¹⁹

Also, notably, the U.S. Energy information, upon which Harrison relies for his conclusions regarding oil shipment patterns, breaks the United States down into five distinct regions, or PADDs (Petroleum Administration for Defense Districts). (AEP Ex. 1 at 17-18.) If the combined AEP/CSW system were evaluated by the PADD system, it would fall within three of these regions. Harrison also cites linkage coefficients data between four U.S. Census regions – the Northwest, the Midwest, the South, and the West – to find that the Midwest and the South regions are the most closely connected of the four Census regions. Not only would this combination of already broad regions fail to encompass the entire combined AEP/CSW system, but the statutory language itself calls for confinement of a proposed system to a “single” area or region, not “several” areas or regions. For the reasons stated above, I do not credit Harrison's testimony.

AEP's Eastern Interconnection and first-tier-utility arguments also carry little weight. Both arguments propose to have vast territories of the United States – not traditionally considered part of the same geographical region – fall within a single area or region for purposes of Section 2(a)(29)(A) of the Act. AEP Exhibit 3 shows the Eastern Interconnection as a single area or region covering the entire North American continent east of the Rocky Mountains, excluding the ERCOT area of Texas. For AEP, if a merger combines systems that fall anywhere within this Interconnection, the proposed system meets the “single area or region” requirement. In practice, this could mean that, if a system located in Maine and one in the southeast portion of New Mexico seek to merge, the combined system would be confined to a single area or region under the Act. AEP Exhibit 11, albeit less expansive than the Eastern Interconnection, shows similarly that the first-tier-utility coverage includes territory as far west as eastern New Mexico, as far east as the Atlantic Coast of Virginia, and as far north as the lower peninsula of

¹⁹ In the same vein, Johnson's description of the Eastern Interconnection as covering “diverse weather, load densities and generation resources” (AEP Ex. 2 at 14.) also undermines an argument for homogeneity over this expansive territory.

Michigan.²⁰ Interpreting the idea of a “single area or region” under Section 2(a)(29)(A) in such a fashion, as with all of AEP’s arguments on this requirement, would significantly redefine and expand the traditional notions of this concept.

Although I previously found the bi-directional Contract Path, across Ameren, sufficient in meeting the interconnection requirement, this finding will not support a conclusion that the systems of former AEP and former CSW are “confined in [] operations to a single area or region” for purposes of meeting Section 2(a)(29)(A) of the Act. These two systems are clearly noncontiguous and located in separate, disparate regions of the national map. The 250MW Contract Path, which stretches hundreds of miles, will not place the eleven states in a single area or region. For a system that on its geographic makeup alone, in the Division’s words, “pushes the limits” of the region requirement (OA Tr. 36.), the reliance on the Contract Path as the lone tangible link between these distant utilities renders AEP’s argument on single area or region, in fact, further attenuated.

Based on the totality of evidence presented, I find that AEP has failed to establish that the combined AEP/CSW system is confined in its operations to a single area or region under Section 2(a)(29)(A) of the Act. Therefore, I conclude that the combined AEP/CSW system does not constitute a “single integrated public-utility system” under the Act.

III. CERTIFICATION OF THE RECORD

Pursuant to Rule 351(b) of the Commission’s Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items described in the record index issued by the Secretary of the Commission on February 11, 2005.

IV. ORDER

Based on the findings and conclusions set forth above, I ORDER, pursuant to Section 10 of the Public Utility Holding Company Act of 1935, that the application of American Electric Power Company, Inc., filed on March 5, 1999, seeking approval of its acquisition of Central and South West Corporation, be, and hereby is, DENIED.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission’s Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission’s Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned’s order resolving such motion to correct a manifest error of fact. The Initial

²⁰ Even if I were to adopt AEP’s proposal of using the Section 10(b)(1) “first-tier utility” method in applying the “single area or region” requirement under Section 10(c)(1), which I do not, AEP’s reliance on Entergy Corp. is vitiated by fact that the two utilities therein were, unlike here, contiguously situated. 51 S.E.C. at 883.

Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Robert G. Mahony
Administrative Law Judge