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SEC Judge Jolts Electric-Power Industry

Ruling Against AEP's 2000 Merger
With Texas Firm Dusts Off
Depression-Era Utility Law

By REBECCA SMITH

Staff Reporter of THE WALL STREET JOURNAL

May 9, 2005; Page B2

A Securities and Exchange Commission hearing judge's recent decision challenging the legality of a \$6.6 billion utility merger has sent a shudder through the U.S. electric-power industry, which is worried that a largely ignored Depression-era law limiting big utility mergers is back from the dead.

On May 3, an administrative law judge at the SEC issued a decision concluding that the acquisition by Ohio's [American Electric Power Co.](#) of Central & South West Corp. of Texas -- which created the U.S.'s most sweeping utility company in June 2000 -- violated a key provision of a 1935 law. Specifically, Administrative Law Judge Robert G. Mahony found that the merged company didn't constitute an integrated-utility system operating in a "single area or region," as the U.S.'s Public Utility Holding Company Act requires. Instead, he concluded that the utility, stretching from Virginia to Michigan to Texas and spanning 11 states, operates over at least four distinct regions. It is unclear what the SEC's remedy might be, but it is likely that hearings on the merger will be held.

The decision amounts to a sharp rebuke of the SEC's enforcement of the act in recent years. Rather than hew to the interpretation that once limited mergers and acquisitions to closely situated utilities, the commission has applied a looser standard in recent deals, largely making the act moot.

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Dow Jones, Reuters

[American Electric Power Co. Inc. \(AEP\)](#)

PRICE	35.05
CHANGE	-0.24
U.S. dollars	4:00 p.m.

[Exelon Corp. \(EXC\)](#)

PRICE	47.00
CHANGE	-0.80
U.S. dollars	4:00 p.m.

[Public Service Enterprise Group Inc. \(PEG\)](#)

PRICE	55.55
CHANGE	-0.85
U.S. dollars	4:02 p.m.

* At Market Close

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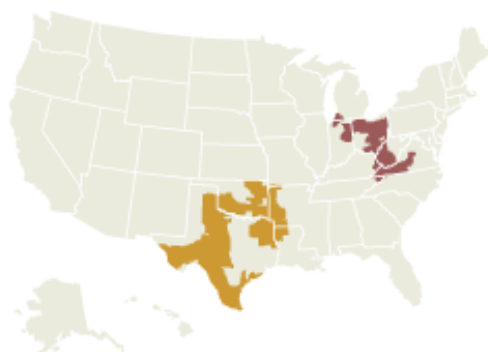
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Separation of Power

A judge has cited a 1935 law potentially threatening mergers like the one between AEP and Central & South West that cover multiple regions.

PRE-MERGER: ■ Central & South West Corp.
■ AEP



Source: American Electric Power Co.

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compelled to enforce the act according to its original meaning, experts said, this could have a chilling effect on big utility mergers -- perhaps even subjecting deals like the proposed combination of Illinois-based [Exelon Corp.](#) with [Public Service Enterprise Group Inc.](#) of New Jersey to closer scrutiny. That transaction would create a utility larger than AEP, by some measures.

Exelon Executive Vice President Elizabeth A. Moler, a former chairwoman of the Federal Energy Regulatory Commission, said she is confident the Exelon-PSEG merger can satisfy the regional rule, because all its units would sell power through PJM Interconnection LLC, a regional market maker. The act, she added, "is an anachronism" that should

be abolished.

It is unclear whether the current case involving AEP will lead to greater enforcement or will put more weight behind efforts in Congress to repeal the act. A provision of the omnibus energy bill that passed the House and is before the Senate would repeal the act. Also, the Government Accountability Office is examining the SEC's enforcement of the act.

AEP Chief Executive Michael Morris said he was puzzled by the SEC decision, coming five years after the acquisition was consummated on an earlier SEC approval. "Do I think PUHCA is back from the dead?" he asked. "That could be."

Mr. Morris said his company will challenge the decision at the SEC, arguing that the combined entity has been operated in an integrated, cohesive way long enough to demonstrate that old-fashioned definitions of "regions" don't mean much anymore. Mr. Morris said that at the very worst, the commission might order AEP to break some pieces into different companies.

The AEP case was lodged in the U.S. Court of Appeals for the District of Columbia by the National Rural Electric Cooperative Association, joined by the American Public Power Association, in 2000. The court, in January 2002, found that the SEC had interpreted the "single area or region" requirement "so flexibly as to read it out of the Act" and questioned whether the two companies, separated by some distance, satisfied a requirement that utilities be electrically interconnected. The court vacated the SEC's approval of the transaction and sent the matter back to the agency.

The Public Utility Holding Company Act remains one of the most important pieces of utility legislation ever passed by Congress. It was created shortly after the 1929 stock-market crash exposed the financial chicanery and self dealing that had become rampant in the electric-power industry, which at the time was controlled by a handful of gigantic power trusts. The 1935 act broke up the trusts and restricted future mergers. For years, those provisions pretty much confined mergers to nearby utilities.

But changes in the electric-power industry, such as greater integration of transmission systems and the formation of multistate markets, led many industry experts and regulators to conclude by the 1990s that the act no longer was needed. The SEC took that position after 1995 by accepting utility arguments, in most cases, that mergers didn't violate the law.

Sue Kelly, general counsel for the American Public Power Association, said that notwithstanding one's opinion of the act or its relevance, "the SEC is on the hot seat" because it must now either reject its earlier

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position or ignore two recent legal decisions.

AEP may have its work cut out for it. A big chunk of AEP's transmission system is functionally separate from the rest, lying in an electrical island called the Electric Reliability Council of Texas. Elsewhere, its utilities participate in other regional markets in the eastern grid, including the Southwest Power Pool and PJM Interconnection.

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