

119 FERC ¶ 61,064
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

American Electric Power Service Corporation

Docket No. EL06-102-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued April 19, 2007)

1. On August 28, 2006, American Electric Power Service Corporation (AEP), on behalf of certain operating companies of the AEP system¹ and CSW Power Marketing, Inc. (PMI), filed a petition for declaratory order requesting the Commission to affirm that its proposed business organization complies with the codes of conduct contained in the AEP operating companies' and PMI's market-based rate tariffs. The proposal involves two AEP marketing and trading organizations. The first such organization operates on behalf of the AEP operating companies predominantly in the Eastern Interconnection. For purposes of this order, we will refer to this marketing and trading organization as AEP Eastern.² The second marketing and trading organization, AEP Energy Partners, operates mainly in the Electric Reliability Council of Texas (ERCOT). AEP requests that the Commission affirm that these two entities, AEP Eastern and AEP Energy Partners, may, consistent with the market-based rate codes of conduct, share a senior executive officer who AEP represents is not involved in the daily functions of

¹ Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Ohio Power Company, AEP Texas Central Company, AEP Texas North Company, Public Service Company of Oklahoma and Southwestern Electric Power Company.

² AEP states that AEP Eastern "is responsible for marketing surplus power and energy from regulated (rate-based) generating assets on the AEP system, buying capacity and energy, and engaging in related physical and financial trading activities, all on behalf of the operating utility companies in the AEP system that are parties to the System Integration Agreement and the East and West Pool Agreements." AEP August 28, 2006 Petition for Declaratory Order at 4.

directing, organizing and executing the business decisions of either organization. AEP submitted a supplement to its petition on December 8, 2006. The Commission grants the petition subject to the conditions discussed below.

I. BACKGROUND

2. AEP states that, in accordance with Texas electric industry restructuring law, the two AEP operating companies in ERCOT, AEP Texas North Company (TNC) and AEP Texas Central Company (TCC) are required to separate the generation, retail service and wires functions of the formerly vertically-integrated utilities. AEP states that TCC has disposed of, or is in the process of disposing of, all of its generation, and TNC has mothballed or retired all but one of its generating plants. AEP states that TNC jointly owns one remaining operating generation plant (Oklaunion)³ that AEP must separate from TNC's wires functions to comply with Texas law. To accomplish this separation, TNC entered into a 20-year power sales agreement with an affiliate, PMI. PMI's successor, AEP Energy Partners, will be responsible for marketing and trading TNC's share of the plant's output (54.6 percent of the 690MW output) in the ERCOT control area.

3. AEP states that AEP Energy Partners will be primarily engaged in marketing and trading activities in the ERCOT market. AEP represents that AEP Eastern is responsible for marketing the output of Commission-jurisdictional generating assets on the AEP system. AEP states that it intends that the vast majority of AEP Eastern's marketing activities will remain outside of ERCOT. Nonetheless, AEP states that it does not want to preclude either AEP Eastern or AEP Energy Partners from taking advantage of transaction opportunities that may arise in either market.

II. AEP'S PROPOSAL

4. AEP proposes to maintain physical and functional separation of AEP Eastern and AEP Energy Partners in accordance with the market-based rate tariffs' codes of conduct. AEP represents that this would include separate buildings, no sharing of marketing and trading employees, no sharing of "structuring" personnel responsible for analyzing and pricing transactions, and no sharing of market information. However, AEP explains that AEP Eastern and AEP Energy Partners will share support personnel and certain back

³ Oklaunion is jointly-owned by two AEP operating companies (TNC and the Public Service Company of Oklahoma) and two non-affiliated parties – the City of Brownsville, Texas Board of Public Utilities and the Oklahoma Municipal Power Authority.

office functions, which AEP asserts is consistent with prior Commission orders. According to AEP, these two entities will share accounting, legal, credit, tax and finance services from one AEP organization. One organization will also be responsible for interfacing with the applicable RTOs in each region on billing and administrative matters.

5. AEP proposes, however, that AEP Eastern and AEP Energy Partners share a senior executive officer, the Senior Vice President of Commercial Operations, who AEP represents is not involved in the daily functions of directing, organizing and executing the business decisions of either organization. AEP explains that the proposed shared senior executive is one of 11 members of the AEP executive council that sets corporate policy for AEP. Thus, AEP explains, this executive would not be involved in determining which transactions to pursue, nor in negotiating and approving transactions and trades. AEP adds that he also will not attend staff meetings of either AEP Eastern or AEP Energy Partners.

6. AEP states that the proposed shared senior executive's responsibilities include managing each entity's energy marketing and trading activities in a manner that optimizes the individual gross margin produced by each business unit. His duties also include setting corporate policy for all marketing and trading activities, and he "may set negotiating parameters in advance of the commencement of negotiation of individual agreements for each of the regulated [AEP Eastern] and deregulated [AEP Energy Partners] businesses."⁴ He will also exercise corporate oversight and management for AEP. AEP further states that while the proposed shared senior executive will have access to market information, he will be prohibited from acting as a conduit for sharing that information between AEP Eastern and AEP Energy Partners.⁵

7. AEP adds that the proposed shared senior executive would be responsible for approving "major transactions" (those with a term of four or more years and/or a net present value greater than \$5 million),⁶ and would be informed by the AEP Eastern and AEP Energy Partners officers of the progress in the negotiations for such transactions on a "report out basis." AEP initially represented that less than one percent of their

⁴ AEP December 8, 2006 Supplemental Response at 6; *see also* AEP August 28, 2006 Petition for Declaratory Order at 6.

⁵ AEP August 28, 2006 Petition for Declaratory Order at 11.

⁶ AEP states that transactions of greater than ten years duration require the signature of the Chief Executive Officer of AEP.

marketing activities exceeded these thresholds.⁷ In the supplement to its petition, AEP acknowledges that, although there are a small number of “major transactions,” those transactions represented approximately 38 percent of the total value of all AEP’s transactions in 2005, and over 80 percent in 2006. AEP contends that the small number of major transactions shows that “such transactions ... clearly would not be defined as ‘day to day operations.’”⁸

8. AEP also represents that none of the major transactions were in the SPP region, and only three were in ERCOT.⁹ The remaining “major transactions” were in the AEP PJM market area, where AEP claims any cross-over is extremely unlikely between AEP Energy Partners and the AEP operating companies on whose behalf AEP Eastern is operating. AEP submits that it would be “highly unusual” for AEP Energy Partners and AEP Eastern to have transactions in the other’s market that would exceed the “major transaction” thresholds.¹⁰ Thus, AEP concludes that it would be rare for AEP Eastern and AEP Energy Partners to be involved in the same transactions above the thresholds.

9. In the supplement to its petition, AEP proposes to change the responsibility of the shared senior executive so that he would be removed from the approval process for any major transaction involving a proposal by either business to sell into the other’s market; instead, such transactions will require approval by the Chief Executive Officer of AEP.

10. AEP represents that the two most senior officers in AEP Eastern and AEP Energy Partners with day-to-day involvement in the marketing and trading activities are not shared and are fully subject to the market-based rate code of conduct. These two officers

⁷ For example, in 2005 there were only five “major” transactions of the more than 120,000 AEP transactions; in 2006, only ten of the more than 140,000 AEP transactions fell into the “major” category.

⁸ AEP December 8, 2006 Supplemental Response at 9. AEP contends that the “value” of the major transactions is misleading and notes that some of these major transactions arose out of retail auctions, which are not negotiated transactions and that it “was an administrative matter for the[se] contract[s] to require” the shared senior executive’s signature, “rather than a matter of day to day management of the auction process.” *Id.* at 10.

⁹ We note that AEP does not indicate what it means by express concerns related to AEP Energy Partners’ business.

¹⁰ AEP August 28, 2006 Petition for Declaratory Order at 6.

would be separately responsible for overseeing the “position and margin analysis” and “structuring” functions of their respective entities but would report to the proposed shared senior executive. AEP explains that, at the end of each day, each “position and margin analysis” function is responsible for reporting each business unit’s position and profit and loss for the purposes of managing commercial risks. It states that the “structuring” function is responsible for the pricing of requirements and non-standard marketing offerings.

11. AEP also states that it has a market risk oversight (MRO) function, independent of the management chain of either marketing entity or the shared senior executive. AEP states that the MRO function is responsible for monitoring and reporting risks consistent with established limits and guidelines in the AEP Commercial Operations Market Risk Policy. MRO personnel will report through AEP’s financial service organization, ultimately to the Chief Financial Officer. AEP represents that employees in the MRO function are being trained to ensure that they will not act as conduits for the prohibited transfer of market information between AEP Eastern and AEP Energy Partners.

12. AEP claims that it needs at least one senior executive to have overall responsibility for its commercial operations, and that this senior executive must possess sufficient expertise in marketing and trading to effectively manage these activities. AEP concludes that its proposal to share this senior executive officer is both necessary and appropriate to provide the oversight needed to satisfy its fiduciary responsibilities to shareholders.

III. NOTICE OF FILINGS AND RESPONSIVE PLEADINGS

13. Notice of AEP’s petition was published in the *Federal Register*, 71 Fed. Reg. 54,034 (2006), with interventions and protests due on or before September 27, 2006. The WPS Resources Corporation filed a timely motion to intervene and comments. The WPS Resources Corporation generally supports AEP’s petition and submits that the Commission’s interpretations and determinations concerning its code of conduct requirements in this proceeding will provide the electric industry with much-needed guidance concerning shared officer issues under the market-based rate code of conduct.

14. Notice of AEP’s December 8 supplemental filing was published in the *Federal Register*, 71 Fed. Reg. 76,308 (2006), with interventions and protests due on or before December 26, 2006. None was filed.

IV. DISCUSSION

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the timely, unopposed motion to intervene serves to make the WPS Resources Corporation a party to this proceeding.

B. Commission Determination

16. As discussed below, based upon the representations made by AEP in its filings, the Commission hereby affirms that AEP Eastern and AEP Energy Partners may, consistent with the market-based rate code of conduct, share the senior executive as proposed, subject to the conditions set forth herein.

17. The applicable market-based rate codes of conduct require the employees of the AEP operating companies to operate separately from the employees of any marketing affiliates “to the maximum extent practical.”¹¹ AEP argues that this does not require separation of AEP Eastern and AEP Energy Partners to the maximum extent *possible* but rather to the maximum extent *practical*, which it asserts its proposed business organization does.

18. While the proposed shared senior executive will have access to market information from both AEP Eastern and AEP Energy Partners, AEP acknowledges that this executive will be subject to a “no conduit” rule to prevent the sharing of such information between the two groups. AEP contends that such activity is permissible under the Commission’s standards of conduct rules.¹² AEP asserts that since the purpose of these two rules is the same – physical and functional separation of two business functions so that they operate independently of one another and do not share non-public

¹¹ AEP Operating Companies, FERC Electric Tariff, Second Substitute Volume No. 5, Original Sheet No. 5.

¹² AEP August 28, 2006 Petition for Declaratory Order at 7 *citing Standards of Conduct for Transmission Providers*, Order No. 2004, 68 Fed. Reg. 69,134 (Dec. 11, 2003), FERC Stats. & Regs. ¶ 31,155 at PP 149-50 (2003), *order on reh’g*, Order No. 2004-A, 69 Fed. Reg. 23,562 (Apr. 29, 2004), FERC Stats. & Regs. ¶ 31,161 at P 139 (2004), *order on reh’g*, Order No. 2004-B, 69 Fed. Reg. 48,371 (Aug. 10, 2004), FERC Stats. & Regs. ¶ 31,166 B (2004); *order on reh’g*, Order No. 2004-C, 70 Fed. Reg. 284 (Jan. 4, 2005), FERC Stats. & Regs. ¶ 31,172 (2005), *order on reh’g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005).

market information – the Commission should apply the same rules that apply under the standards of conduct to shared senior executives under the code of conduct. AEP contends that this should follow from the fact that the need for senior executive oversight is also the same under both rules – to fulfill a fiduciary obligation to shareholders and properly carry out executive activities and decision-making.

19. AEP pledges that the proposed shared senior executive will not be involved in the daily functions of directing, organizing and executing the business decisions of either AEP Eastern or AEP Energy Partners. AEP further represents that this executive will not coordinate the operations of the two entities to increase returns for AEP Energy Partners at the expense of AEP Eastern, nor hold joint meetings of these two organizations where market information is shared.¹³

20. Based upon the representations made by AEP in its filings, the Commission affirms that the proposed business organization complies with the applicable codes of conduct, subject to the conditions set forth herein. This includes AEP's representation that AEP Eastern and AEP Energy Partners will be operated in all respects as separate business units and that the shared senior executive will not help either business unit optimize its results at the expense of the other.¹⁴ In particular, we conclude that the proposed shared executive, the Senior Vice President for Commercial Operations, functioning as described in AEP's filings, is sufficiently removed from the day to day operations of AEP Eastern and AEP Energy Partners that he may be shared between these two organizations, consistent with the market-based rate codes of conduct.

21. However, since AEP concedes that the proposed shared senior executive will have access to market information from both AEP Eastern and AEP Energy Partners, our grant of AEP's petition is conditioned upon the shared senior executive not being a conduit for sharing marketing information between these two entities. Accordingly, this senior executive is prohibited from sharing marketing information obtained from one of these entities with the other entity. Further, if this senior executive holds meetings that include employees from both entities, no market information may be discussed or shared unless it is simultaneously disclosed to the public. Market information includes, but is not limited to, information regarding power or transmission business, present or future, positive or

¹³ See AEP August 28, 2006 Petition for Declaratory Order at 10 and AEP December 8, 2006 Supplemental Response at 5.

¹⁴ AEP December 8, 2006 Supplemental Response at 5.

negative, concrete or potential, and information related to sales or purchases that may or may not be made.¹⁵

22. Moreover, our grant of the petition is conditioned on AEP's implementing the proposal in the supplement to its petition that, if a transaction meets the criteria requiring approval by the senior executive and involves a proposal by either AEP Eastern or AEP Energy Partners to sell into the other's market, the senior executive will be removed from the approval process and any such transaction will require the approval of the Chief Executive Officer of AEP.

23. We emphasize that this order only addresses the shared senior executive's responsibilities and functions as described in AEP's filings. AEP should not assume that other activities and functions by this shared executive, where the code of conduct may be implicated, would be permissible absent express Commission approval.

The Commission orders:

AEP's petition for declaratory order that AEP's Senior Vice President of Commercial Operations may be a shared executive is granted as discussed in the body of this order, subject to the conditions set forth.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

¹⁵ *UtiliCorp United, Inc.*, 75 FERC ¶ 61,168 at 61,557 (1996). The sharing of market information and separation of employees are subjects of the pending market-based rate rulemaking proceeding. See *Notice of Proposed Rulemaking, Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Docket No. RM04-7-000, 71 Fed. Reg. 33102 (June 7, 2006), FERC Stats. & Regs. ¶ 32,602 (2006). To the extent that the Final Rule addresses either of these issues, any changes adopted by the Commission will be applied prospectively.