Gulf Power Company
500 Bayfront Parkway
Post Office Box 1151
Pensacola, FL 32520-0781
Telephone 904 444-6231

FILE COPY

Susan D. Cranmer
Assistant Secretary and
Assistant Treasurer

the southern electric system

September 12, 1996

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee FL 32399-0870

960000

Dear Ms. Bayo:

RE: The Southern Company - Amendment No. 2 to Form U-1 Relating to Various Electricity and Energy Commodity Brokering and Marketing Transactions (SEC File No. 70-8823)

Enclosed for official filing are fifteen copies of Amendment No. 2 to Form U-1 relating to various electricity and energy commodity brokering and marketing transactions as filed with the Securities and Exchange Commission (SEC File No. 70-8823) on August 21, 1996. This filing is required by Rule 53(a)(4) of the General Rules and Regulations under the Public Utility Holding Company Act of 1935, as amended, 15 U.S.C. §§ 79a et seq. (the "Act").

Please mark the enclosed extra copy of this letter with the date and time the material was accepted in your office for filing and return same to the undersigned.

Sincerely,

Susan D. Cranmer

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Enclosures

cc: Florida Public Service Commission
Cindy Miller, Esq.
Gulf Power Company
G. E. Holland, Esq.

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File No. 70-8823

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 2
to
FORM U-1

APPLICATION OR DECLARATION

under

The Public Utility Holding Company Act of 1935

SEI HOLDINGS, INC.
900 Ashwood Parkway
Suite 500
Atlanta, Georgia 30338

(Name of company or companies filing this statement and addresses of principal executive offices)

THE SOUTHERN COMPANY

(Name of top registered holding company parent of each applicant or declarant)

Thomas G. Boren, President
SEI Holdings, Inc.
900 Ashwood Parkway
Suite 500
Atlanta, Georgia 30338

(Name and address of agent for service)

The Commission is requested to mail signed copies of all orders, notices and communications to:

W.L. Westbrook
Financial Vice-President
The Southern Company
270 Peachtree Street, N.W.
Atlanta, Georgia 30303

Thomas G. Boren, President
SEI Holdings, Inc.
900 Ashwood Parkway
Suite 500
Atlanta, Georgia 30338

John D. McLanahan, Esq.
Troutman Sanders LLP
600 Peachtree Street, N.E.
Suite 5200
Atlanta, Georgia 30308-2216

The Application-Declaration heretofore filed in this proceeding, as amended by Amendment No. 1, is now further amended and restated in its entirety to read as follows:

Item 1. Description of Proposed Transactions.

1.1 Background. SEI Holdings, Inc. ("Holdings") is a wholly-owned non-utility subsidiary of The Southern Company ("Southern"), a registered holding company under the Public Utility Holding Company Act of 1935, as amended (the "Act"). Holdings, directly and through various subsidiaries, is primarily engaged in the business of developing, owning, managing and rendering services to independent power projects and foreign utility systems, including "qualifying facilities," as defined under the Public Utility Regulatory Policies Act of 1978, as amended; "exempt wholesale generators" and "foreign utility companies," as defined under Sections 32 and 33 of the Act, respectively; and other power projects which constitute a part of Southern's integrated electric utility system. Reference is made to File No. 70-8733, and to the order of the Commission dated February 2, 1996 (Holding Co. Act Rel. No. 26468) (the "February 1996 Order") approving the application-declaration of Southern, Holdings, and certain other direct and indirect subsidiaries of Southern, for a more complete description of Holdings, its operations, and its current authority.

Under the terms of the February 1996 Order, Holdings is authorized, subject to certain limitations, to acquire, directly or indirectly through one or more subsidiaries (referred to as "Intermediate Subsidiaries"), in one or more transactions from time to time through December 31, 2000, the securities of or

other interests in any one or more specified categories of energy-related facilities or businesses (referred to as "Energy-Related Companies"), including, among others, any company that derives substantially all of its revenues from brokering and marketing of electric energy, provided that the buyer or seller, or both the buyer and seller, are located within the area covered by the Southeastern Electric Reliability Council ("SERC"). Southern's operating electric utility subsidiaries, Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, and Savannah Electric and Power Company (collectively, the "Operating Companies"), are members of SERC.[1]

Holdings now seeks a modification in the terms of the February 1996 Order solely as it relates to the authority of Holdings to engage through one or more Energy-Related Companies in the business of marketing and brokering. Specifically, Holdings proposes herein that the Commission (i) modify the February 1996 Order to permit Holdings, through one or more subsidiary Energy-Related Companies (hereafter referred to as "Marketing Subsidiaries"), to broker or market other forms of energy commodities, in addition to electricity, including natural gas, oil and coal, and to provide incidental related services to customers; and (ii) eliminate the restriction imposed under the February 1996 Order on the geographic region in which such marketing and brokering activities may be conducted, subject to

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[1] In addition to Georgia, Alabama, Mississippi and Florida, the electric utility members of SERC provide retail and wholesale electric service in all or parts of North and South Carolina, Virginia, Tennessee and Kentucky.

certain qualifications and limitations as regards retail sales of electricity and natural gas. Holdings is not herein requesting any other modifications to the terms of the February 1996 Order.

1.2 Recent Developments in the Electric and Gas Industries.

The electric utility industry has experienced dramatic changes over the past 15 years, with an accelera' ing trend towards deregulation in the name of enhanced competition, lower cost and better service. Today, traditional utilities must compete for new load (as well as to retain existing load) with a variety of legislatively or administratively created entities not known until recently, including "qualifying facilities," "exempt wholesale generators" and independent power marketers and brokers. In addition, recent energy policy initiatives at the federal level are clearly designed to promote competition in wholesale markets by requiring that the local electric utility provide transmission access to competing buyers and sellers.[2]

The States are also actively considering a variety of measures designed to promote competition among electricity suppliers at the retail level. According to a survey conducted

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[2] *See "Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities,"* Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, IV FERC Stats. & Regs. ¶ 32,514, 60 Fed. Reg. 17,662 (April 7, 1995), adopted April 24, 1996 as Order 888, FERC Stats. & Regs. ¶ 31,036 (1996); and sections 721 and 722 of the Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992).

by the Edison Electric Institute ("EEI")[3], 47 States and the District of Columbia have initiated legislative or administrative processes for the purpose of addressing retail wheeling, industry restructuring, retail competition or alternative regulation. Since the beginning of 1995, bills addressing these matters have been introduced in 33 State legislatures, and the utility commissions in 37 States and the District of Columbia have initiated, completed, or participated in generic, company specific or informal proceedings on various proposals to promote retail competition.[4] Also, pilot programs for retail wheeling have been approved in Idaho, Illinois, Massachusetts, Michigan, New Hampshire, New York, Pennsylvania and Washington.[5]

Although Rhode Island is the only State that has yet passed legislation establishing retail access for all electric

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[3] *See "Retail Wheeling & Restructuring Report," Vol. 3, No. 1* (Edison Electric Institute, June 1996). EEI is an industry trade organization whose membership consists of investor-owned electric utilities.

[4] *Id.* at pages 2 - 3. A more recent survey on retail competition measures by the States conducted by Regulatory Research Associates, Inc., an independent research organization, generally confirms the data presented in the EEI survey. *See "Regulatory Focus" - "Electric Industry Restructuring Update"* (Regulatory Research Associates, Inc., July 12, 1996).

[5] Under the New Hampshire pilot program, for example, certain large customers may gain access through their local utility to alternative suppliers. Utilities in Massachusetts and Rhode Island have agreed to a timetable that would phase in retail competition in those states beginning as soon as January 1, 1998. *See "No Doubt About It: Massachusetts Utilities See No Choice But Choice,"* The Energy Daily (King Publishing Group, February 20, 1996); *"Smallest State Takes Big Step Toward Competition,"* The Energy Daily (King Publishing Group, February 8, 1996).

customers,[6] it is evident that a significant number of other States are fairly far along in their consideration of substantive restructuring measures which, once implemented, would enable non-traditional power suppliers, including power marketers, to compete with local franchised utilities for sales to retail electric customers, similar to the kind of competition among long-distance carriers that has evolved in the telephone industry.

Retail and wholesale competition in the natural gas industry has evolved more quickly. Today, most aspects of natural gas production have been deregulated, and the transportation and storage functions of the interstate pipelines have been "unbundled" from the merchant (gas sales) function, essentially transforming interstate pipelines into common carriers under the open-access provisions of the Federal Energy Regulatory Commission's ("FERC's") Order No. 636.[7] As a result, local gas distribution companies (LDCs) and most large industrial customers today have the ability to contract directly with gas producers or

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[6] *See Electric Utility Week* (McGraw-Hill, August 12, 1996), p. 8.

[7] *See "Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,"* Order No. 636, III FERC Stats. & Regs., Regulations Preambles ¶ 30,939, 57 Fed. Reg. 13,267 (April 16, 1992). FERC initiated efforts to promote competition in 1985 when it issued Order 436, which offered certain incentives to interstate pipelines to provide open access, non-discriminatory, transportation to end-use customers, thereby enabling such customers to contract for gas supplies directly with producers and gas marketers. *See "Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,"* Order No. 436, FERC Stats. & Regs., Regulations Preambles ¶ 30,665, 50 Fed. Reg. 42,408 (October 18, 1985).

other suppliers (*i.e.*, independent gas marketers) for necessary supplies.

Most States have also implemented measures designed to encourage LDCs to provide transportation separately from sales of natural gas, as a result of which industrial and large commercial gas customers now generally have the ability to make direct purchases of gas from producers and gas marketers. According to U.S. Department of Energy sources, by 1995, approximately 78% of all gas sales to industrial customers were made by sellers other than LDCs, and 26% of gas sales to commercial customers were delivered, but not sold, by LDCs.[8] It is evident, therefore, that significant steps have already been taken to deregulate end-use gas sales, at least to certain categories of customers (industrial and large commercial customers).

Further, due to the increasing importance of natural gas as a fuel for electric generation, many of the larger natural gas producers and pipeline concerns, including Enron Corporation (Enron Power Marketing, Inc.), Amoco Corp. (Amoco Power Marketing Corporation), Panhandle Eastern Corporation (Associated Power Services, Inc.) and NorAm Energy Corporation -- formerly ArkLa, Inc. (NorAm Energy Services, Inc.), have organized and are very actively engaged in the business of power marketing on a national scale.[9] These developments underscore that the electricity and

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[8] *See U.S. Department of Energy - Energy Information Administration Natural Gas Monthly*, Table 24 (February 1996).

[9] In this regard, it is significant to note that the Act, as it has apparently been construed by the Division of Investment Management, imposes no limitation whatsoever on the ability of

natural gas industries are no longer separate and distinct and immune from competition with each other. Indeed, the energy industry is becoming increasingly integrated and competitive at all levels, with the growing recognition that different forms of energy, particularly electricity and natural gas, are interchangeable. To be competitive in this emerging market, energy suppliers must be able to offer large customers energy options, the benefits and savings associated with the ability to aggregate supplies, fuel switching capabilities, and single

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companies outside of registered holding company systems to organize national power marketing subsidiaries to sell electricity at wholesale or retail anywhere in the United States. Specifically, the Division of Investment Management has concurred in a series of no-action letters that a company organized to engage in electricity marketing is not an "electric utility company" within the meaning of Section 2(a)(3) of the Act if it does not own or operate physical "facilities" for the generation, transmission, or distribution of electric energy. Hence, the acquisition of the securities of such a marketing subsidiary by a company that is not in a registered holding company system is not subject to the Commission's jurisdiction under Section 9(a) of the Act, and the acquiring company does not become a statutory "holding company" or "affiliate" of a public utility company as a result thereof. *See Enron Power Marketing, Inc.*, SEC No-Action Letter dated January 5, 1994 (Ref. No. 94-1-OPUR); *CRSS Power Marketing, Inc.*, SEC No-Action Letter dated March 31, 1994 (Ref. No. 94-4-OPUR); *Electric Clearinghouse, Inc.*, SEC No-Action Letter dated April 13, 1994 (Ref. No. 94-5-OPUR); *Inter-Coast Power Marketing Co.*, SEC No-Action Letter dated December 6, 1994 (Ref. No. 95-15-OPUR); and *AIG Trading Corporation*, SEC No-Action Letter dated January 20, 1995 (Ref. No. 95-1-OPUR). In each of these no-action letters, the company emphasized that, since a power marketer would remain subject to regulation by FERC under the Federal Power Act, no regulatory "gap" would result if the entity were treated for purposes of the Act as a non-utility. In the *Electric Clearinghouse* no-action letter request, the company also stressed the pro-competitive nature of power marketers, arguing that any determination to treat a marketer as an "electric utility company" under Section 2(a)(3) of the Act would have a "chilling effect on the development of a competitive electric power industry as the regulation to which power marketers would then be subjected to [sic] under the Act would serve as a significant deterrent to entry."

source procurement services covering all of the customer's energy needs. Moreover, today's energy markets are national in scope, as the ability to both purchase and deliver electricity and gas is subject to fewer and fewer physical and regulatory barriers.

In 1994, the Commission itself took note of these developments in its "Request for Comments on Modernization of the Regulation of Public-Utility Holding Companies" (Holding Co. Act Rel. No. 26153, dated November 2, 1994), which culminated in June 1995 with the presentation by the Division of Investment Management of a series of proposals and recommendations designed generally to reduce regulatory burdens on registered holding company systems in order to enable them to compete more effectively with other utilities and alternative energy suppliers in the increasingly competitive energy markets (the "*Report on Regulation of Public-Utility Holding Companies*").

More recently, in *Consolidated Natural Gas Company, et al.*, Holding Co. Act Rel. No. 26512 (April 30, 1996) ("*Consolidated Natural Gas*"), the Commission authorized a registered gas utility holding company to acquire an interest in a venture that will supply, sell, purchase, market, broker or otherwise trade electricity or fuel, and provide electricity or fuel management services, and carry on activities, or perform services related to the foregoing. In its order, the Commission again took note of the "increasing integration of energy markets" and observed that "the restructuring of the electric industry now underway will dramatically affect all United States energy markets as a result of the growing interdependence of natural gas transmission and

electric generation, and the interchangeability of different forms of energy, particularly gas and electricity."[10] Further, although the Commission reserved jurisdiction over Consolidated's proposal to market electricity and gas to retail customers, it took note of the rapid developments in retail electric competition due to State initiatives and of the positioning by both traditional utilities and other suppliers to compete in retail electric markets as they open.[11]

1.3 Relationship to Other Authorizations. Southern Company Services, Inc. ("SCS"), a subsidiary service company of Southern, as agent for the Operating Companies, has been authorized by FERC to sell electricity at wholesale to unaffiliated entities at market-based rates.[12] Holdings also currently owns, indirectly, all of the stock of Southern Energy Marketing, Inc. ("Southern Energy"), an "exempt wholesale generator" within the meaning of Section 32 of the Act,[13] which has also been authorized by FERC to sell electricity at wholesale at market-based rates.[14] As a consequence, there may be occasions when Holdings (through Southern Energy or a Marketing Subsidiary) will compete with SCS and the Operating Companies for wholesale customers. However,

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[10] *Consolidated Natural Gas* at pp. 11 - 12.

[11] *Id.*, note 12.

[12] *See Southern Company Services, Inc.*, 75 FERC ¶ 61,130 (April 30, 1996).

[13] *See Southern Energy Marketing, Inc.*, 71 FERC ¶ 61,376 (1995).

[14] *See Southern Company Services, Inc., et al.*, 72 FERC ¶ 61,324 (1995), *order on reh'g*, 74 FERC ¶ 61,141 (1996).

such competition is the inevitable consequence of limitations that are embodied in certain "Codes of Conduct" that were filed with FERC as a part of the separate market-rate applications of SCS and of Southern Energy.[15] In general, the Codes of Conduct, which apply to all of Southern's subsidiaries, prohibit SCS and the Operating Companies from disclosing to any other subsidiary of Southern non-public information known to them concerning the identity of any actual or potential wholesale customer, or the terms under which the Operating Companies have sold or offered to sell power to any such customers. In order to compete effectively in all wholesale markets, therefore, Southern is committed to developing a marketing capability on each side of this FERC-imposed information barrier.

Although Southern Energy may market electricity on a national scale, as an "exempt wholesale generator" it may not make domestic retail sales, and is restricted under current FERC interpretations of Section 32 in the amount of fuel marketing and brokering activities that it may engage in or related services that it may offer to potential customers.[16] Thus, subject to

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[15] The Codes of Conduct were originally filed with FERC as a part of Southern Energy's market-rate application. Southern Energy proposed two Codes of Conduct, one applicable to SCS and the Operating Companies and the other applicable to Southern Energy and to all other subsidiaries of Southern other than SCS and the Operating Companies. The Codes of Conduct have been revised several times, most recently as a part of a compliance filing to the market-rate order issued April 30, 1996 to SCS and the Operating Companies. *See Southern Company Services, Inc., supra* n. 12.

[16] An "exempt wholesale generator" is defined in Section 32(a) as any person determined by FERC "to be engaged directly, or indirectly through one or more affiliates . . ., and

receipt of an order in this proceeding, Holdings may elect to decertify Southern Energy as an "exempt wholesale generator" (in which case Southern Energy would be treated as a Marketing Subsidiary of Holdings subject to all of the terms and conditions of the February 1996 Order, as modified by the Commission's order in this proceeding) and/or organize one or more new Marketing Subsidiaries to engage in the broader range of wholesale and retail energy marketing activities, and other activities related thereto, as described below.

1.4 Description of Proposed Activities. Holdings proposes to engage, through one or more Marketing Subsidiaries, in all forms of brokering and marketing transactions involving electricity and other types of energy commodities, including, without limitation, oil, natural gas and coal, and in providing incidental related services to customers, such as fuel management, storage and procurement services. Holdings proposes that Marketing Subsidiaries may engage in such activities without regard to the location or identity of customers or source of revenues, *provided, however,* that (i) unless additional approvals are obtained from FERC, Marketing Subsidiaries will not sell electricity to the Operating Companies, and (ii) Marketing

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exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale." (Emphasis added). FERC has interpreted Section 32 to prohibit an "exempt wholesale generator," such as Southern Energy, from engaging in fuel delivery and transmission transactions except to the extent necessary to effectuate its own sales of power. *See CNG Power Services Corporation,* 69 FERC ¶ 61,002 (1994); *CNG Power Services Corporation,* 71 FERC ¶ 61,026 (1995); and *CNG Power Services Corporation,* 71 FERC ¶ 61,378 (1995).

Subsidiaries will not make any sales of electricity or natural gas to retail customers in any State unless authorized or permitted to make such sales under the laws of that State. In addition, Holdings requests that the Commission reserve jurisdiction over any sales by Marketing Subsidiaries of natural gas or electricity to customers outside the United States pending completion of the record in this proceeding.[17]

It is also proposed that Marketing Subsidiaries may, from time to time through December 31, 2000, invest up to $300 million at any one time outstanding to acquire or construct physical assets that are incidental and reasonably necessary in the day-to-day conduct of marketing operations, such as oil and gas storage facilities, gas or coal reserves, or a pipeline spur that is needed in order to make deliveries of fuel to an industrial customer; *provided, however,* that, without the further order of the Commission, no Marketing Subsidiary will acquire any facilities if, as a result thereof, it would be or become an "electric utility company," as defined in Section 2(a)(3) of the Act, or a "gas utility company," as defined in Section 2(a)(4).

Brokering Activities. Brokering generally involves bringing two parties (typically a buyer and seller) together for a fee or commission which one of the parties has agreed to pay. As the

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[17] It is not intended that such proposed reservation of jurisdiction would in any way limit or restrict Holdings' ability to make retail sales of electricity or gas outside the United States through "exempt wholesale generators" or "foreign utility companies," as defined in Sections 32 and 33 of the Act, respectively, subject to satisfying the specific requirements of those sections.

Marketing Subsidiary would neither buy nor sell power or energy in a brokering transaction, there would be no price exposure or significant financial risk. In addition, brokering, as such, is not regulated as the sale of power under the Federal Power Act or any state regulatory scheme. The Commission has, on several occasions, approved proposals involving electricity and gas brokering activities as an acquisition of an interest in a non-utility business that is incidental and ancillary to the principal business of a registered holding company system.[18]

Marketing Activities. Marketing transactions may take a variety of different forms. In general, however, these transactions involve contracts under which the performance of the parties is expressed in terms of the obligation to make or take physical delivery of electricity, gas or other energy commodities, as well as the purchase and sale of commodity-based derivative contracts, such as options, swaps and exchange-traded

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[18] *See Entergy Corp.*, Holding Co. Act Rel. No. 25848 (July 8, 1993) (authorizing sale of consulting services to non-affiliates, including expertise relating to brokering of power resources); and *UNITIL Corp.*, Holding Co. Act Rel. No. 25816 (May 24, 1993) (authorizing organization of a new subsidiary to serve as a power brokering agent). Other "consulting services" orders issued over the years have not imposed any geographic limitations. *See e.g., The Southern Company*, Holding Co. Act Rel. No. 22132 (July 17, 1981); *American Electric Power Company, Inc.*, Holding Co. Act Rel No. 22468 (April 28, 1982); and *Middle South Utilities*, Holding Co. Act Rel. No. 22818 (January 11, 1983). Hence, the geographic limitation contained in the February 1996 Order, insofar as it applies to brokering, is at odds with established Commission precedent.

futures contracts, under which physical delivery may or may not in fact occur.[19]

Generally, what distinguishes a marketer from a broker is that a marketer, unlike a broker, usually takes title to the commodity (in this case, electricity, gas, oil, etc.) and bears the risks associated with market price fluctuations of the commodity (market risk) and the ability to enforce performance by the other party to the contract (counter-party credit risk). As described in greater detail below, a critical aspect of successful marketing involves the use of various risk mitigation measures to balance overall portfolio position in order to limit the financial impact of any loss that may be sustained on any particular commodity transaction due to adverse market price movements or counterparty defaults. Such measures may include entering into off-setting physical delivery contracts (i.e., off-setting purchases and sales of electricity, gas, etc.), the purchase and sale of derivative instruments, such as options and futures contracts, for purposes of hedging a physical position, and an appropriate mix of long and short-term contracts.

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[19] The purchase and sale of commodity-based derivatives in a commodity business (generally, options, futures contracts and swaps) may be for the purpose of hedging (or off-setting) an existing position under a contract calling for physical delivery of a commodity, or as a substitute for a position to be taken at a later time in a physical market, for example, to lock in the price of a block of electricity or gas that will be needed in the future in order to supply new customers. For an electricity/gas marketer, the purchase and sale of energy-based derivatives may be a less risky means to take a position in a commodity than other alternatives, such as building expensive power plants or purchasing and holding large inventories of a commodity.

Although it is not Holdings' purpose here to describe with particularity the form of each marketing transaction in which a Marketing Subsidiary may engage, the following describes some of the more typical arrangements that are contemplated:

(a) Electricity and/or Fuel Arbitrage Transactions. Marketing may involve a simple fuel-for-electricity exchange in which a Marketing Subsidiary may commit to purchase fuel from an electricity producer and, in turn, supply electricity at an agreed price. A Marketing Subsidiary in this case would seek to participate in the evolving integrated energy market by identifying and capturing the electric and/or fuel arbitrage profits that are inherent in the wholesale electric and natural gas business.

For example, suppose a municipal electric system ("MuniPower") has entered into a long-term, fixed-price, gas contract to purchase gas which it uses to generate electricity. Because MuniPower has a source of fixed-price gas, it essentially produces fixed-price power. If events (e.g., an unusual cold spell) were to drive up gas demand and hence spot gas prices, MuniPower would have an opportunity to sell its gas supply on the spot market at a profit, but would be prevented from doing so since its gas supply is essentially dedicated to producing its electricity requirements. In such a case, a Marketing Subsidiary could enable MuniPower to realize a profit on the sale of its gas, but without any interruption in the supply of electricity to MuniPower's customers. Specifically, a Marketing Subsidiary could contract with third party power producers for an

alternative supply of lower-cost electricity to meet MuniPower's needs in exchange for the right to MuniPower's gas supply, which the Marketing Subsidiary would then resell on the spot market at a profit. In this example, MuniPower would benefit from the lower cost source of electricity and/or through a sharing of the profit realized by the Marketing Subsidiary in remarketing MuniPower's gas supply.

(b) Dispatch Control of Energy Assets. Another example is a transaction in which an owner of generation and related energy assets wants to "outsource" dispatch control (but not physical operation) of its generating facilities in return for fixed price electricity. To illustrate, suppose a generation cooperative ("Coop") has a mix of generation assets which it uses to supply its member cooperatives' power needs. The Coop fuel generation mix includes gas, oil and coal, which Coop purchases on the spot market. As long as Coop purchases its fuel on the spot market, its electricity cost will fluctuate with the spot market for fuel. Coop could reduce or eliminate such price volatility by entering into a contract with a third party who agrees to take over the fuel procurement and dispatch responsibilities of all of Coop's generation assets in exchange for Coop's agreement to purchase power under a long-term fixed price contract.

In this situation, a Marketing Subsidiary could offer Coop what is essentially a "fixed-for-floating swap." The Marketing Subsidiary would expect to realize a profit on the transaction through its ability to achieve overall savings on fuel cost and by controlling the dispatch of Coop's generating units in order

to assure that the units with the lowest fuel cost at any time are dispatched first.[20] The Marketing Subsidiary could supply Coop with power from either Coop's own generation assets, or from more economic facilities, depending on the current market for power. Further, the Marketing Subsidiary may have the opportunity to maximize the value of any excess Coop generating capacity by marketing such capacity to a much greater number of potential purchasers than Coop on its own would be able to do. The net result for Coop is a lower cost of power which it can pass on to its member cooperatives.

(c) Sale of Options on Capacity or Energy. In another type of transaction that is becoming increasingly common in the electric utility industry, many utilities, as well as power marketers, instead of asking for bids for firm power to meet future energy needs, have begun asking for options on capacity or energy. This allows utilities to avoid additional capital spending in an uncertain market environment, and allows them to quickly assess the cost of meeting future energy needs.

To illustrate, suppose that a utility has completed its resource planning which indicates the need for a certain amount of additional capacity several years in the future. Instead of requesting bids for fixed-price energy or capacity, the utility may prefer to request bids for options on that energy or capacity. A Marketing Subsidiary, in this situation, could sell

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[20] This type of "fixed-for-floating swap" transaction was recently offered by Oglethorpe Power Corp., the largest electric cooperative in the United States. *See Power Markets Week* (McGraw-Hill, February 12, 1996), pp. 1-3.

such an option for a premium paid up front. However, if the purchasing utility operates in a market where spot electricity prices are driven by the cost of gas-fired generation, and the Marketing Subsidiary's position under the option contract sold to the utility is covered by rights to gas-fired generation which the Marketing Subsidiary has acquired or owns, the Marketing Subsidiary would be exposed under the option contract to the risk of any increase in the price for natural gas. A Marketing Subsidiary could hedge this risk by purchasing an option in the natural gas futures market.

(d) National Energy Supplier. The fourth example involves making retail sales to a large energy consumer with facilities in many different locations who wishes to "outsource" all of its energy needs at all locations in order to achieve overall savings, by, among other means, obtaining volume discounts that a single source supplier could offer, and by eliminating the high cost of administering separate procurement programs at each location. To illustrate, suppose that a national department store chain has stores in all fifty States and wishes to engage an "energy partner" to advise it on its current energy purchases. A Marketing Subsidiary could address this customer's needs in several ways. Initially, it could begin advising the customer on fuel procurement practices in order to identify lower cost supplies, and undertake to represent the customer in negotiations with its various electric utility, gas utility and fuel suppliers. Ultimately, and subject to necessary changes in State

laws, the Marketing Subsidiary may itself wish to become the electricity supplier at each of the customer's stores.

1.5 Use of Risk Mitigation Measures. Holdings represents that, in the ordinary course of business of any Marketing Subsidiary, it will take appropriate measures to mitigate the market and counterparty credit risks associated with the portfolio of electricity and fuel purchase or sales contracts of these subsidiaries. As previously indicated, such measures may include matching long-term firm or variable price electricity sales contracts with long-term firm or variable price fuel purchase contracts. A Marketing Subsidiary may also hedge fuel price risk through the purchase of fuel or fuel reserves or options on fuel reserves.

In addition, a Marketing Subsidiary may purchase or sell commodity-based derivative instruments, such as electricity or gas futures contracts and options on electricity or gas futures, such as are traded on the New York Mercantile Exchange, and gas and oil price swap agreements in order to hedge positions under existing contracts for physical delivery.[21]

Holdings may also hedge price risk exposure under a purchase or sale contract by taking an opposite position to that purchase or sale. Similarly, in a portfolio of purchase and sales contracts, risk could also be limited through an appropriate mix

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[21] In this regard, it should be noted that one of the attractive features of using exchange-traded commodities futures contracts (such as exist for electricity, gas and oil), in addition to their liquidity, is that they tend to virtually eliminate counterparty credit risk due to the fact that the exchange itself acts as the counterparty.

of long-term and short-term contracts, and diversification of the mix of customers and suppliers regionally and across industry lines. Finally, Holdings will endeavor to limit risk exposure through contract provisions (i.e., liquidated damages) that would place a ceiling on the amount of damages payable when performance failure occurs and/or exclude consequential damages.

Ultimately, a successful energy commodity marketer must be able to manage a "book" of contracts involving purchases, sales and trades of electricity and other energy commodities. The marketer will seek to hedge the risk associated with these contracts through a combination of physical assets, balanced physical purchases and sales, purchases and sales on futures markets, or other derivative risk management tools. A successful marketer will need a strong physical presence (assets), as well as the capability to participate in the growing financial market for energy-related products. In this connection, the value added by the marketer, from the perspective of its customer, is the superior ability of the marketer to aggregate risks so as to manage them as efficiently as possible. In order to do this, the marketer needs to have the ability to participate in all the energy markets, both physically and financially.

1.6 Other Matters. As indicated above, the aggregate amount of investment made by Southern in order to finance Holdings' investment in any Marketing Subsidiary will be subject to all of the limitations applicable to investments in Energy-Related Companies, as set forth in the February 1996 Order. Similarly, Holdings anticipates that guarantees of performance by

any Marketing Subsidiary may be required from time to time, and will count the amount of any such guarantees against the overall limitations set forth in the February 1996 Order.

Holdings, on its own behalf and on behalf of Southern, undertakes that it will not seek recovery through higher rates to the Operating Companies' customers in order to compensate Southern and Holdings for any possible losses that they may sustain on investments in Marketing Subsidiaries or for any inadequate returns on such investments.

All Marketing activities, including the fuel-for-energy (arbitrage) and energy commodity brokering and marketing activities described above, will be carried on by personnel employed by Southern Electric International, Inc. ("Southern Electric"), a wholly-owned subsidiary of Southern, who are already experienced in the day-to-day power marketing activities of Southern Energy and fuel procurement activities of Holdings' associate independent power projects. Any services that Southern Electric may render to a Marketing Subsidiary will be rendered at cost in accordance with Rules 90 and 91 and the Commission's order dated December 31, 1994 (Holding Co. Act Rel. No. 26212).

Item 2. Fees, Commissions and Expenses.

The fees, commissions and expenses paid or to be paid in connection with the proposed transaction are estimated not to exceed $29,000, inclusive of the Commission's $2,000 filing fee.

Item 3. Applicable Statutory Provisions.

Sections 9(a) and 10 of the Act and Rules 23 and 54 thereunder are applicable to the proposed transactions and activities described herein, certain aspects of which have been approved as a part of the February 1996 Order. Holdings states that the proposed transactions satisfy all of the applicable standards of Section 10 and of Section 11(b), to which Section 10(c) refers.

Section 10 Analysis: For purposes of Sections 9(a)(1) and 10 of the Act, Holdings' proposal to engage in the activities described in this Application-Declaration constitutes an acquisition of securities and of an interest in a non-utility business.[22] In order to approve the Application-Declaration, the Commission must find that the applicable standards of Section 10(b) are satisfied. Further, the Commission may not approve the proposal if it finds, pursuant to Section 10(c)(1) of the Act, that the acquisition "is detrimental to the carrying out of the provisions of section 11" of the Act.

The Commission has previously approved pursuant to the standards of Sections 10 and 11(b) proposals by registered holding companies to engage in a variety of marketing and brokering activities. Further, the Commission has included "the brokering and marketing of energy commodities, including but not limited to electricity or natural gas" among the permitted activities of "energy-related companies" in which a registered

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[22] *See Consolidated Natural Gas*, page 8.

holding company may conditionally invest under proposed Rule 58, predicated upon earlier case-by-case determinations that such activities satisfy the standards of Sections 10 and 11(b) of the Act.[23]

In *Consolidated Natural Gas*, the Commission for the first time approved a proposal by a registered gas utility holding company to acquire an interest in the business of a power marketer. Subsequently, in *UNITIL Corporation, et al.*, Holding Co. Act Rel. No. 26527 (May 31, 1996) *("UNITIL")*, the Commission authorized an affiliate of an electric utility holding company to broker and market gas and other fuels, as well as electricity, holding that the applicant's proposal was consistent with the precedent established in *Consolidated Natural Gas*.

To be successful, a power marketer must be able to acquire, hold, trade and sell interests in fuel in arbitrage transactions, to hedge market price risk under power contracts, and to be able to provide customers with complete energy options, such as fuel switching and sole source procurement services. Moreover, as recognized in both the *Report on Regulation of Public-Utility Holding Companies* and, more recently, in the *Consolidated Natural*

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[23] *See Notice of Proposed Rulemaking*, Holding Co. Act Rel. No. 26313 (June 20, 1995) (*"Exemption of Acquisition By Registered Public-Utility Holding Companies of Securities of Nonutility Companies Engaged in Certain Energy-Related and Gas-Related Businesses"*), 59 SEC Docket at 1490. Proposed Rule 58 would conditionally exempt pursuant to Section 9(c)(3) of the Act certain acquisitions of securities of non-utility companies from the pre-approval requirements of Section 10. If adopted, acquisitions permitted under proposed Rule 58 would be considered to be "appropriate in the ordinary course of business" within the meaning of Section 9(c)(3). *Id.* at 1494.

Gas and *UNITIL* cases, the energy industry today has become increasingly integrated and competitive at all levels. Electric and gas companies are rapidly being integrated into a market that trades on Btu (British thermal unit) values rather than discrete quantities of electricity or gas.

In its orders on power marketing issued prior to *Consolidated Natural Gas*, the Commission typically imposed geographic limits on where marketing activities could be conducted. In the February 1996 Order, for instance, Holdings' authority to engage in electricity brokering and marketing activities was limited to the area defined by the States served by the electric utility members of SERC, of which the Operating Companies are a part. However, in *Consolidated Natural Gas*, after considering the national scope of the evolving energy markets and the initiatives of other regulatory bodies in promoting wholesale electric competition on a national scale, the Commission determined not to impose any geographic or revenues restrictions on the applicant with respect to wholesale marketing activities.[24] Likewise, no geographic limitation was imposed on wholesale power marketing activities of the applicant in *UNITIL*.

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[24] Earlier, in its release proposing Rule 58, the Commission had indicated that it did not consider it necessary to limit the extent to which an "energy-related company" may engage in business activities with non-associate companies, citing its decision in *Eastern Utilities Associates, et al.*, Holding Co. Act Rel No. 26232 (February 14, 1995) as precedent for abandoning the imposition of artificial geographic or revenues limitations on certain categories of non-utility business activities of registered holding companies that are closely related to the traditional utility business and would further an important national policy objectives, such as, for example, the promotion of energy conservation and efficiency.

These recent actions clearly establish a precedent for the Commission to remove the geographic restriction imposed in the February 1996 Order on Holdings' marketing and brokering activities. A narrow construction of Sections 10 and 11(b) of the Act that would limit, geographically or in other terms, the ability of Holdings to participate fully and at all levels of this emerging market would serve no legitimate regulatory purpose and, in fact, would frustrate the goal of promoting competition in the increasingly integrated energy markets.

Another reason to eliminate the geographic limitation on Holdings' brokering and marketing activities is to "level the playing field" between Holdings, on the one hand, and, on the other hand, all other companies, including interstate pipeline companies, oil and gas producers, and electric utilities that are not in registered holding company systems. In this regard, as previously indicated, *supra* note 9, the Act is not a deterrent to power or gas marketing activities by companies that are not in registered holding company systems. Thus, in the last two years, we have witnessed a stampede of integrated oil and gas producers, pipelines, investment bank affiliates, commodity trading firms, affiliates of large industrial concerns and exempt electric utility holding companies to establish national power marketing organizations.

Although the Commission did not impose any geographic limitations on the wholesale power marketing activities approved in *Consolidated Natural Gas* and *UNITIL*, it did reserve jurisdiction over sales of gas and electricity by the applicant

to retail customers pending completion of the record. (In *UNITIL*, the Commission approved retail sales in certain States that were identified in the application). In each case, the Commission held that, pending implementation of measures permitting retail wheeling of electricity, it was unable to determine whether the applicable standards of Section 11(b)(1) of the Act would be satisfied.[25] Holdings submits, however, that there is no need for the Commission to reserve jurisdiction over retail sales of electricity or gas by Marketing Subsidiaries in the name of consumer or investor protection or to preserve effective local regulation of these matters, for at least two reasons. First, as described in Item 1.2, above, the vast majority of States have already undertaken studies of, initiated or adopted measures to promote retail competition in both gas and electric markets. Competition between LDCs and non-traditional gas suppliers already exists in most areas, at least with respect to sales to industrial and large commercial customers, and some States are now experimenting with programs to extend customer choice to residential customers as well. While competition and unbundling of the commodity and transmission functions of

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[25] *Consolidated Natural Gas, n.* 25. Under Section 11(b)(1), the Commission shall not permit a registered holding company to retain an interest in a non-utility business unless it finds such interest to be "necessary or appropriate in the public interest or for the protection of investors or consumers . . .." Holdings understands that the Commission's reluctance to authorize retail electricity and gas sales, based on the state of the record that Consolidated had developed, may have been founded upon its sensitivity over the uncertain impact that such an approval might have on the States while they are considering a variety of industry restructuring measures.

traditional electric utilities have not progressed nearly so far, it is clear, as the Commission itself acknowledged in both *Consolidated Natural Gas* and *UNITIL*, that retail electric competition is developing rapidly. To reserve jurisdiction over retail sales of electricity pending consideration of the status of these initiatives on a State-by-State basis will serve no regulatory objective and would merely impose an added burden on Holdings that could impede its ability to react quickly as the States implement retail competition measures.

Second, and far more central to the issue of the impact of the Commission's approval on investors and consumers and on the effectiveness of local regulation, the Commission's order in this proceeding will not have the effect of authorizing or allowing Marketing Subsidiaries to engage in any business activity that would otherwise be unlawful or unauthorized under applicable State law. In this regard, Section 21 of the Act provides in clear terms that "[n]othing in [the Act] shall affect . . . the jurisdiction of any other commission, board, agency, or officer of the United States or any State or political subdivision of any State, over any person . . . insofar as such jurisdiction does not conflict with any provision of [the Act] . . .." There can be little doubt that the States have the power to regulate the sale of electricity and gas to end-use (*i.e.*, retail) customers, whether they choose to exercise such regulatory power in all cases or not. Moreover, the Commission and the courts have long recognized that the Act was not intended to preempt the States in

the exercise of jurisdiction over utilities even where there may exist some degree of overlapping jurisdiction under the Act.[26]

For present purposes, Holdings' representation that it will not make sales of electricity or gas to retail customers unless authorized or allowed under applicable State laws and regulations may be regarded as a restriction or condition imposed on the authority that is requested herein. Such restriction or condition, when incorporated into the terms of the Commission's order, will eliminate any possible question of a conflict between the Commission's order in this proceeding and actions that may or may not be taken by State legislatures or commissions.[27]

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[26] It has been stated that the Act was intended to back-stop and not to replace or supplant the jurisdiction of state regulatory commissions over the operations of electric and gas utilities. *See e.g., Alabama Electric Cooperative, Inc. v. Securities and Exchange Commission,* 353 F.2d 905 (D.C. Cir. 1965). There, the court stated that "[t]he purpose of the Public Utility Holding Company Act, as shown by its legislative history, was to supplement state regulation -- not to supplant it." *Id.* at 907. *See also Municipal Electric Association of Massachusetts v. Securities and Exchange Commission,* 413 F.2d 1052, 1057 (D.C. Cir. 1969); and *American Power & light Co. v. Securities and Exchange Commission,* 158 F.2d 771, 778 (1st Cir. 1946). In *Baltimore Gas and Electric Company, et al. v. Heintz, et al.,* 760 F.2d 1408 (4th Cir. 1985), *cert. denied* 474 U.S. 847 (1985), the court rejected an argument that Sections 9 and 10 of the Act, under which the Commission would have jurisdiction over acquisitions creating new holding companies, was intended preempt State laws that would regulate holding companies differently, in this instance a Maryland law that simply prohibited the formation of holding companies with respect to Maryland utilities. 158 F.2d at 1414 - 1415.

[27] In this regard, the Commission's Rule 24(b) states that: "Every order granting an application or making effective a declaration shall, unless otherwise therein expressly stated, impose upon the applicant or declarant the obligation to comply with any restriction or condition which the application or declaration proposes shall be imposed by the Commission in connection therewith."

Finally, Holdings' proposal provides sufficient protections for Southern system utility customers against the risks that are inherent in any commodity marketing business, which adequately supports the findings that the Commission must make under Section 10(b)(3) of the Act.[28] Any potential detriments to Southern system utility customers will be minimized through the segregation of such activities in separate subsidiaries and Southern's limited investment; the use of risk reduction measures to limit Holdings' overall exposure to both market price and counterparty credit risks, as described in Item 1.4, above; the limitations that, without additional approvals of FERC, Marketing Subsidiaries will not sell electricity to the Operating Companies and that Marketing Subsidiaries are effectively prevented under the Codes of Conduct filed with FERC from appropriating and using non-public price and customer information available to the Operating Companies concerning wholesale electricity opportunities; and the representation that Southern and Holdings will not attempt to seek recovery through higher rates to the Operating Companies' customers to compensate Holdings for possible losses that it may sustain on or inadequate returns from power and energy commodity marketing activities.

Rule 54 Analysis: The proposed transaction is also subject to Rule 54, which provides that, in determining whether to approve an application which does not relate to any "exempt wholesale generator" ("EWG") or "foreign utility company"

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[28] *See Consolidated Natural Gas, n.* 36.

("FUCO"), the Commission shall not consider the effect of the capitalization or earnings of any such EWG or FUCO which is a subsidiary of a registered holding company if the requirements of Rule 53(a), (b) and (c) are satisfied.

Southern currently meets all of the conditions of Rule 53(a). At July 31, 1996, Southern's "aggregate investment," as defined in Rule 53(a)(1), in EWGs and FUCOs was approximately $864,800,000, or about 24.6% of Southern's "consolidated retained earnings," also as defined in Rule 53(a)(1), for the four quarters ended June 30, 1996 ($3,523.2 million). In addition, Southern has complied and will continue to comply with the record-keeping requirements of Rule 53(a)(2), the limitation under Rule 53(a)(3) on the use of Operating Company personnel to render services to EWGs and FUCOs, and the requirements of Rule 53(a)(4) concerning the submission of copies of certain filings under the Act to retail rate regulatory commissions. Accordingly, since the requirements of Rule 53(a) are currently met and none of the circumstances described in Rule 53(b) has occurred, the provisions of Rule 53(c) are currently inapplicable.

Moreover, even if the effect of the capitalization and earnings of EWGs and FUCOs in which Southern has an ownership interest upon the Southern holding company system were considered, there is no basis for the Commission to withhold or deny approval for the proposal made in this Application-Declaration. The action requested in the instant filing (*viz.* approval for certain activities that are very closely related to

the Southern's subsidiary electric utility operations) would not, by itself, or even considered in conjunction with the effect of the capitalization and earnings of Southern's EWGs and FUCOs, have a material adverse effect on the financial integrity of the Southern system, or an adverse impact on Southern's public-utility subsidiaries, their customers, or the ability of State commissions to protect such public-utility customers. On the contrary, Holdings believes that approval of the proposal contained in this Application-Declaration would have a modest beneficial effect on the Southern system, because it will enable Holdings and its associate companies to remain competitive with other energy suppliers and generate an additional source of revenues from activities that are, if anything, even more closely related to Southern's core utility business than the operations of associate EWGs and FUCOs.

Item 4. Regulatory Approval.

The approval of FERC under Section 205 of the Federal Power Act is required as to rates and charges imposed in any domestic wholesale electric power sales contracts or tariffs entered into by a Marketing Subsidiary that are subject to FERC jurisdiction. The status of current FERC approvals affecting Southern Energy and SCS and the Operating Companies is discussed in Item 1.3, above. Retail sales of electricity or gas (to the extent allowed under applicable state law) and, in certain instances, wholesale sales of electricity or gas that are not subject to FERC jurisdiction, may be subject to regulation by the appropriate

State public utilities commission. With these exceptions, no other State or Federal commission (other than this Commission) has jurisdiction over the proposed transactions.

Item 5. Procedure.

Holdings requests that the Commission's order be issued as soon as the rules allow, and that there be no thirty-day waiting period between the issuance of the Commission's order and the date on which it is to become effective. Holdings hereby waives a recommended decision by a hearing officer or other responsible officer of the Commission and hereby consents that the Division of Investment Management may assist in the preparation of the Commission's decision and/or order in the matter unless such Division opposes the matters covered hereby.

Item 6. Exhibits and Financial Statements.

(a) Exhibits.

F - Opinion of Troutman Sanders LLP.

G - Form of Federal Register Notice. (Previously filed).

(b) Financial Statements.

Not applicable.

Item 7. Information as to Environmental Effects.

(a) In light of the nature of the proposed transactions, as described in Item 1 hereof, the Commission's action in this matter will not constitute any major federal action significantly affecting the quality of the human environment.

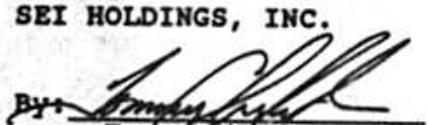
(b) No other federal agency has prepared or is preparing an environmental impact statement with regard to the proposed transactions.

SIGNATURE

Pursuant to the requirements of the Public Utility Holding Company Act of 1935, the undersigned company has duly caused this statement to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 21, 1996

SEI HOLDINGS, INC.

By: 

Tommy Chisholm
Secretary