

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)	
WISCONSIN ELECTRIC POWER COMPANY)	
for approval of a power supply cost recovery plan)	Case No. U-13107
and factors for calendar year 2002.)	
_____)	

At the March 12, 2003 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

PRESENT: Hon. Laura Chappelle, Chairman
Hon. David A. Svanda, Commissioner
Hon. Robert B. Nelson, Commissioner

OPINION AND ORDER

History of Proceedings

On September 28, 2001, Wisconsin Electric Power Company (Wisconsin Electric) filed an application to implement a power supply cost recovery (PSCR) plan for calendar year 2002 pursuant to 1982 PA 304, as amended, MCL 460.6h et seq., (Act 304) and to bill monthly PSCR factors of up to 4.37 mills per kilowatt-hour (kWh).¹

At a prehearing conference on November 5, 2001, Administrative Law Judge George Schankler (ALJ) granted leave to intervene to International Paper Company. At a hearing on November 20, 2001, he granted leave to intervene to the Industrial Power Users Coalition (IPUC),

¹After the November 20, 2001 order in Case No. U-12615, Wisconsin Electric's 2001 PSCR plan, determined that expenses related to ash disposal, fuel handling, dry cask storage of spent nuclear fuel, and sulfur dioxide emissions allowances were not recoverable under the PSCR clause, Wisconsin Electric revised its requested factor in this case to 4.18 mills per kWh. Ex. A-12, at 2.

an unincorporated association that represents the interests of International Paper and Louisiana Pacific Company, both customers of Wisconsin Electric. The Commission Staff (Staff) also participated.

The ALJ conducted an evidentiary hearing on May 7, 2002. Thereafter, Wisconsin Electric, IPUC, and the Staff filed briefs, and Wisconsin Electric and IPUC filed reply briefs. On July 17, 2002, the ALJ issued a Proposal for Decision (PFD). IPUC filed exceptions, and Wisconsin Electric and the Staff filed replies to exceptions.

Purchased Power

Comparing the supply mix in Wisconsin Electric's 2002 PSCR plan with reported actual data for 2000, IPUC noted an increase in the percentage of supply relying on power purchases and a corresponding decrease in the percentage of the utility's own generation resources. IPUC argues that Wisconsin Electric failed to justify the shift in favor of more expensive purchased power and that the added costs resulting from the shift are unreasonable. The ALJ rejected this argument, characterizing IPUC's comparison of 2000 data and the 2002 PSCR plan as superficial. PFD at 10.

In its exceptions, IPUC argues that there is nothing to show that the shift from generated to purchased power was necessary or prudent. Acknowledging that Wisconsin Electric cited planned outages to explain the expected reduction in its own plants' output, IPUC maintains that the utility failed to explain why the outages or their timing were necessary, did not quantify the costs caused by the outages, and failed to meet its burden of proof on the issue.

Wisconsin Electric argues that it met its burden of proving by a preponderance of the evidence that the supplies projected in its plan are reasonable and prudent. It says that its witnesses explained in detail how it developed its forecast and expected supply portfolio, taking into account

the principles of economic dispatch. It says that the cause of the planned outages was a need for maintenance to comply with environmental requirements and that making allowances for the outages was necessary to develop a plan that reflects the efficient, economical operation of its system and the economic dispatch of its system resources.

A PSCR plan, being forward-looking in nature, must rely on a forecast that uses known and expected circumstances to project how the utility can optimally meet its customers' requirements, giving due regard for principles of economic dispatch, reliability, and security of supply. The evidence supporting Wisconsin Electric's 2002 PSCR plan establishes that it is reasonable as a basis for making a forecast and developing a planned supply portfolio.

IPUC's criticism of the plan for relying too much on purchased power fails to undermine it as a reasonable planning tool. Making a simple comparison between a PSCR plan and reported data two years earlier provides little insight into the utility's planning decisions. Power supply costs and customer demand and energy requirements can vary from year to year for any number of reasons, including weather, customer usage, the economy, and other circumstances that may or may not be foreseeable. In this respect, the Commission agrees with the ALJ that the comparison used as the basis for IPUC's criticism of the plan is superficial and provides an insubstantial basis for evaluating its reasonableness. Moreover, the degree of divergence between the 2000 data and the projected 2002 plan is relatively modest, at least for forecasting purposes: Generated energy decreases from 29.6 gigawatt-hours (GWh) in 2000 to 28.0 GWh in the 2002 plan (from 89.5% to 85.6% of total generated and purchased power) and energy from power purchases increases from 3.5 GWh in 2000 to 4.7 GWh in the 2002 plan. Compare Ex. I-20 with Ex. I-21.

IPUC argued that the projected average cost of purchased power in Wisconsin Electric's plan, at 4.95¢ per kWh, Ex. I-21, l. 26, is excessive when compared to prevailing market prices and to

the average price that Wisconsin Electric receives from making wholesale sales. IPUC proposed to remove excessive costs of purchased power, as measured by those benchmarks. The ALJ rejected this approach, finding that neither the average price of wholesale sales nor spot market prices provided an appropriate basis for comparison with the capacity cost of long-term purchased power. He again characterized IPUC's comparisons as superficial. PFD at 11-12.

In its exceptions, IPUC argues that Wisconsin Electric has not advanced a persuasive justification for recovering the excessive costs of its purchased power arrangements and that the Commission should adopt its proposed disallowance of the excessive portion. As a benchmark for determining excessive costs, IPUC suggests using a long-term forward price of 3¢ per kWh, as reported in Megawatt Daily at the beginning of 2002 for spot market deliveries into Commonwealth Edison's adjacent system in northern Illinois. IPUC alternatively suggests a benchmark based on the average price of Wisconsin Electric's planned wholesale sales, which is 4¢ per kWh.

As another alternative, IPUC suggests that the Commission could continue an adjustment that it adopted in the November 21, 2001 order in Case No. U-12615, Wisconsin Electric's 2001 PSCR plan case. The adjustment sets the cost of the purchased power equal to \$60.78 per megawatt-hour (MWh) (or 6.078¢ per kWh), which is the average cost that Wisconsin Electric had projected that it would incur in Case No. U-11837 for a 1998 test year under its contract with LS Power Whitewater LP (LSP).² In this case, IPUC suggests that the Commission could use \$51.65 per MWh as the basis for the adjustment, because that was the cost that Wisconsin Electric actually incurred under the contract in 1998. Although IPUC maintains that MCL 460.6j(13)(b) continues

²The Staff's rationale for proposing the adjustment in Case No. U-12615 was to reflect the LSP contract price used to make rate computations in Case No. U-11837. The April 12, 1999 order in Case No. U-11837 approved base rates for Wisconsin Electric.

to bar the PSCR recovery of capacity charges in unapproved contracts, it also argues that the adjustment can be justified on the somewhat different basis that it eliminates the cost of excessively priced purchased power.

Wisconsin Electric contends that costs it incurs pursuant to long-term contracts must be evaluated in light of the circumstances prevailing when it signed the contracts, so that later market prices or other costs reflecting other temporal circumstances are not apposite. It argues that the Megawatt Daily spot-market index is not a valid basis for comparison because it is a short-term price for non-firm energy and does not reflect any charges that the utility must incur to meet longer-term capacity requirements. Moreover, it says, IPUC does not account for the transmission charges or other constraints that would affect Wisconsin Electric's access to energy available in Commonwealth Edison's area.

Wisconsin Electric further argues that IPUC's comparison between the average cost of the utility's power purchases and the average revenues from its wholesale sales is similarly mistaken. Wisconsin Electric explains that it signs contracts to procure long-term firm capacity that meets specific needs of its system load (e.g., reliable power to meet demand during peak periods). In contrast, it says, it makes wholesale sales on an opportunistic basis, i.e., when the short-term costs of producing the energy are less than the available price, and they are mostly non-firm energy-only sales.

Wisconsin Electric says that the adjustment of the contract capacity charges in Case No. U-12615 relates to the issue of obtaining prior approval of the contracts pursuant to MCL 460.6j(13)(b) and that this issue will be resolved by the expected decision on its application for approval of the contracts and their capacity charges in Case No. U-13266.

The Commission is persuaded that the comparisons used by IPUC to evaluate the average cost of purchased power are inappropriate. With respect to the comparison with the average revenues from wholesale sales, the Commission addressed a similar issue in the September 16, 2002 order in Case No. U-12725, at 25, as follows:

International Paper's proposed disallowance is not adequate to make a prima facie showing of imprudence or other impropriety with respect to Wisconsin Electric's wholesale transactions. As Wisconsin Electric's witness testified, it is well known that wholesale transactions relating to the purchase and sale of power can be negotiated at different times and under different circumstances, cover different contract terms (e.g., spot market transactions, month- or year-long contracts, summer only months), relate to different hours of the day (peak or off-peak), require varying types of firm or non-firm commitments, have different price structures for capacity and energy, and fulfill different needs within each transacting utility's load profile. Comparing two averages, expressed in dollars per megawatt-hour, says nothing meaningful by itself about the underlying transactions.

It is thus inappropriate to compare the average cost of planned power purchases with the average revenues expected from various types of wholesale sales transactions, including opportunity sales.

The comparison drawn by IPUC from the Megawatt Daily index is even less appropriate. A spot market price reflects ongoing market volatility and makes no provision for the costs of securing a fixed commitment of long-term capacity. Because much of Wisconsin Electric's purchased power costs reflect the charges it pays for capacity, there is no meaningful basis for comparing those costs with energy-only spot market prices, even before factoring in the cost of obtaining transmission access from Commonwealth Edison's area.

Contrary to IPUC's argument, the Commission did not decide whether certain of Wisconsin Electric's power purchase agreements contained excessive costs when it adjusted the contracts' capacity charges in Case No. U-12615. Moreover, the Commission is issuing an order approving the contracts today in Case No. U-13266. Thus, it is not necessary or appropriate in this case to retain the capacity charge adjustment adopted in Case No. U-12615.

IPUC argues that, regardless of the outcome in Case No. U-13266, MCL 460.6j(13)(b) bars recovery of the contract capacity charges because issuance of an order in Case No. U-13266 would be too late to qualify as “prior” approval for purposes of the 2002 plan year. The statute requires the Commission, in adjudicating a PSCR reconciliation case, to “[d]isallow any capacity charges associated with power purchased for periods in excess of 6 months unless the utility has obtained the prior approval of the commission.” IPUC contends that, at a minimum, the grant of approval cannot apply retroactively, i.e., it cannot cover capacity charges incurred during that part of the plan year that has already lapsed. It construes the statute to refer to a time “‘prior’ to the imposition of the relevant [PSCR] charges,” which it says gives effect to the statutory purpose of protecting customers from paying the charges. IPUC’s exceptions at 10-11.

Wisconsin Electric construes “prior,” as used in MCL 460.6j(13)(b), to refer to any date preceding an order adjudicating a PSCR reconciliation case. It says that the Commission relied on this construction of the statute in Case No. U-12615 when it indicated that Wisconsin Electric should make an effort to obtain approval of the contracts prior to the 2001 PSCR reconciliation case.

As explained in today’s order in Case No. U-13266, the Commission rejects IPUC’s interpretation of the statute to bar PSCR recovery of capacity costs incurred during the 2002 PSCR plan year. There is no textual basis in the statute for inferring that the word “prior” refers to the beginning of the plan year or any other preceding point in time. The order in Case No. U-13266 confers the approval required to avoid the cost recovery bar in MCL 460.6j(13)(b).

Transmission Charges

Wisconsin Electric proposed to recover incremental transmission expense of \$19.3 million (before making provision for line losses) through its PSCR factor. The incremental transmission

expense represents the difference between transmission costs it projected for 2002 and those it estimated for 2001. Transmission charges payable to the American Transmission Company LLC (ATC), which owns the transmission facilities located in Wisconsin Electric's service territory, account for most of the transmission costs (\$83.2 million³ out of total transmission costs of \$91.8 million in 2002). The other transmission costs are assessments owed by Wisconsin Electric as a member of the Mid America Interconnected Network, Inc., and the Midwest ISO.

The ALJ recommended that the Commission adopt Wisconsin Electric's proposal to recover the transmission costs as part of its PSCR costs. PFD at 16-18. In its exceptions, IPUC opposes PSCR recovery of transmission charges.

The September 16, 2002 order in Case No. U-12725, which approved Wisconsin Electric's base rates, also addressed and rejected IPUC's objections to the recovery of transmission charges through Wisconsin Electric's PSCR clause. In that order at 14-17, the Commission classified the transmission charges payable to ATC as PSCR costs that would be recovered in Act 304 proceedings.

However, the record developed by Wisconsin Electric in this case does not fully anticipate the treatment accorded to those costs in Case No. U-12725, so that Wisconsin Electric's proposal to recover incremental transmission expense for all of the 2002 plan year is not entirely consistent with the order. The order authorizes only the prospective recovery of transmission charges through the PSCR clause, as follows:

For purposes of classifying the transmission component of rates as part of the PSCR base, the Commission adopts the Staff's proposal to increase the base by \$1.826 per [MWh]. The change in PSCR base, as well as the provisions in this order approving a change in the PSCR treatment of transmission charges, shall become effective at the same time as the rate increase authorized by this order (i.e.,

³This amount includes the pass-through of \$478,000 for a share of ATC's assessment from the Federal Energy Regulatory Commission.

the day after the order is issued) and shall not be afforded retroactive effect in 2001 and 2002 PSCR plan and reconciliation proceedings for periods prior to the effective date of this order.

Case No. U-12725 order at 17. To conform to the rate order, the 2002 PSCR plan must be modified to permit recovery of the transmission charges identified on page 2 of Exhibit A-17,⁴ but only to the extent that the charges are attributable to periods when the rate order in Case No. U-12725 was in effect (commencing September 17, 2002, the day following its issuance). The order authorized prospective recovery only of the transmission charges and foreclosed PSCR recovery attributable to prior periods, given that the rate order in effect prior to Case No. U-12725⁵ made provision for the recovery of transmission expense in the base rates that Wisconsin Electric had then been collecting.

The computation of the PSCR factor of 5.17 mills per kWh in this order incorporates only the rate case's prospective PSCR determinations.⁶ (The factor computation appears in Exhibit A attached to this order.) For the part of the 2002 plan year that precedes Case No. U-12725, Wisconsin Electric was permitted to self-implement a factor under Act 304, and any inconsistencies between the assumptions it used and those approved in this order will be resolved in the reconciliation case.

⁴The last line on page 2 of Exhibit A-17 identifies the relevant amount of transmission charges for all of 2002 as \$91,844,100.

⁵Order dated April 12, 1999, Case No. U-11837.

⁶The September 16, 2002 order in Case No. U-12725 also recomputed the PSCR base. The factor computed in this case for periods after September 16 uses the PSCR base of \$0.01379 per kWh approved in Case No. U-12725. As usual in reconciling a PSCR plan year that straddles the effective date of a base rate case, the 2002 reconciliation will delineate between periods occurring before and after the effective date of the rate case. The determinations in Case No. U-12725 that affect the recovery of PSCR costs (specifically, the new PSCR base and the authorization to recover transmission charges) apply prospectively beginning September 17, 2002.

Rate Design of PSCR Factor

IPUC objects to the Commission's historical practice of imposing and reconciling the monthly PSCR factor as a uniform charge or credit applied to all customers' energy usage. It says that rate classes characterized by higher load factors or higher voltages have lower loss factors and therefore cause fewer costs to be incurred per unit of energy consumed than rate classes with lower load factors or voltages. It contends that a uniform factor ignores this causal relationship by averaging capacity costs across all classes without regard to their relative contribution to system costs.

The Commission finds that IPUC's exception is without merit. In the first place, IPUC is not proposing to modify Wisconsin Electric's PSCR plan for 2002, but to change the ongoing procedures used to implement the PSCR clause. Although IPUC is not specific as to details, evaluating the cost effects of serving different rate classes would require a cost-of-service study. This type of analysis might be appropriate in a base rate case, but not in an annual PSCR proceeding. The Commission so held in the September 14, 1990 order in Case No. U-8866-R, Consumers Energy Company's (Consumers) 1988 PSCR reconciliation case.

Moreover, the Commission rejected a similar argument on its merits in the May 7, 1991 order adjudicating Consumers' electric base rates in Case No. U-9346, at 121-22, aff'd ABATE v Public Service Comm, 205 Mich App 383; 522 NW2d 140 (1994). The order noted that the PSCR base accounts for the bulk of PSCR costs and that those costs are allocated by class and recovered through base rates designed to reflect the cost of service. The order further held that any benefit of making demand-based allocations of the cost increment or difference reflected in monthly PSCR factors would be outweighed by the complexity it would add to the process.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1982 PA 304, as amended, MCL 460.6h et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. Wisconsin Electric's 2002 PSCR plan, as amended in this order, and a PSCR factor up to 5.17 mills per kWh, as computed in Exhibit A attached to this order, are reasonable and prudent, and should be approved.

THEREFORE, IT IS ORDERED that:

A. Wisconsin Electric Power Company's 2002 power supply cost recovery plan is approved as amended in this order.

B. The authorized power supply cost recovery factor effective for Wisconsin Electric Power Company's 2002 plan year after September 16, 2002 is 5.17 mills per kilowatt-hour, relative to a power supply cost recovery base of \$0.01379 per kilowatt-hour recovered through the base rates approved in the September 16, 2002 order in Case No. U-12725.

C. Within 30 days of the date of this order, Wisconsin Electric Power Company shall file tariff sheets reflecting the power supply cost recovery base and factors approved by this order.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ Laura Chappelle
Chairman

(S E A L)

/s/ David A. Svanda
Commissioner

/s/ Robert B. Nelson
Commissioner

By its action of March 12, 2003.

/s/ Dorothy Wideman
Its Executive Secretary

CALCULATION OF THE 2002 PSCR FACTOR RESULTING FROM U-12725
 Costs and Net System Requirements from U-13107 Exhibit A-12

	<u>September</u>	<u>October</u>	<u>November</u>	<u>December</u>	<u>TOTAL</u>
Revised Power Supply Costs	\$19,187,765	\$44,339,767	\$36,550,115	\$49,088,899	\$149,166,546
less 2002 Incremental Transmission Costs	-\$749,778	-\$1,606,667	-\$1,606,667	-\$1,606,667	-\$5,569,779
plus 2002 Transmission Costs	\$3,571,711	\$7,653,667	\$7,653,667	\$7,653,667	\$26,532,712
	\$22,009,698	\$50,386,767	\$42,597,115	\$55,135,899	\$170,129,479
Net System Requirements (MWH)	1,217,608	2,631,300	2,511,566	2,755,023	9,115,497
 AVERAGE COST PER KWH					\$0.01866
less PSCR Base from U-12725					\$0.01379
Difference					\$0.00487
times Loss Multiplier					1.06
PSCR FACTOR					\$0.00517