

**BEFORE THE  
PUBLIC SERVICE COMMISSION OF WISCONSIN**

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**In Re: Petition of Customers First! Coalition**

**Docket No. \_\_\_\_\_**

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**PETITION FOR RELIEF REGARDING ELECTRIC RELIABILITY**

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The Customers First! Coalition requests the Public Service Commission to commence an investigation and take appropriate action within its statutory authority to adopt the Generation Action Plan set forth in this Petition. The purpose of this Plan is to insure that electric public utilities construct or procure the additional low-cost, reliable electric capacity and energy which their residential, commercial, and industrial customers need.

1. NATURE AND INTERESTS OF PETITIONER

1. The Customers First! Coalition is an alliance of consumer, business, and labor groups, organizations of senior citizens, farmers, and low-income families, environmental organizations, 82 municipal electric utilities, 26 rural electric cooperative, two wholesale suppliers, and one investor-owned utility.

2. The members of CFC include the Municipal Electric Utilities of Wisconsin (MEUW), Wisconsin Public Power Inc. (WPPI), the Wisconsin Federation of Cooperatives (WFC), Dairyland Power Cooperative (DPC), the Citizens' Utility Board (CUB), National Federation of Independent Business - Wisconsin (NFIB-W), the Wisconsin Merchants Federation (WMF), American Association of Retired Persons - Wisconsin (AARP-W), Wisconsin Community Action Program Association (WISCAP), Madison Gas & Electric Company (MGE), Wisconsin Retired Educators' Association (WREA), Wisconsin's Environmental Decade (WED), RENEW Wisconsin, Wisconsin Alliance of Cities, Wisconsin Towns Association, Wisconsin National Farmers Organization, and International Brotherhood of Electric Workers - Local 2304 (IBEW).

3. CFC was formed in 1996. Its purpose is to support prudent, sequential change in Wisconsin's electric industry which

- maintains low-cost, reliable electric service;
- benefits all residential, commercial, and industrial customers;

- protects Wisconsin jobs and advances economic development;
- promotes environmental responsibility.

## 2. OBJECTIVES OF PETITION

This proposal is designed to accomplish the following objectives:

- permit new generation in Wisconsin to be built immediately through existing PSC procedures;
- create economic incentives to encourage incumbents and new entrants voluntarily to construct new generation in Wisconsin within the current regulatory regime, including permitting those utilities which have expressed a desire to build to do so without disturbing the current relationship between existing generation and customers;
- avoid a protracted legislative battle over spinoff of existing plants to unregulated GenCos that likely would result in Wisconsin another year down the road with no progress;
- take action now to avoid California-style deregulation, with its attendant skyrocketing prices, loss of reliability, and economic distress;
- avoid the federalization of generation in Wisconsin and keep such oversight with the PSC to avoid loss of state control;
- recognize that the PSC at the end of the day has the central obligation to assure that generation is built and that the State of Wisconsin is protected, and provide a process by which, if parties do not respond to incentives for voluntary construction, the PSC will have offered reasonable voluntary options prior to requiring construction.

## 3. LEGAL BASIS OF PETITION

This Petition is filed pursuant to the following statutes:

1. **Section 196.02(7) Commission Initiative**, which authorizes the Commission to initiate a proceeding and take action in any matter within its jurisdiction;
2. **Section 196.03(1) Utility Charges and Service**, which requires public utilities to furnish reasonably adequate service and facilities, at just and reasonable rates;
3. **Section 196.28 Summary Investigations**, which allows the Commission to summarily investigate and take action if it believes that electric service is or will be

inadequate or if it believes that an investigation of any matter relating to any public utility should for any reason be made;

4. **Section 196.37(2) Reasonable Service**, which permits the Commission to make any just and reasonable order relating to a service to be furnished in the future, if it finds that any service is or will be inadequate, or that any service which reasonably can be demanded, cannot or will not be obtained;
5. **Section 196.487 Reliability of Electric Service**, which authorizes the Commission, if it determines that a public utility affiliate is not making sufficient investments in its facilities to ensure reliable electric service, to order such utility to make adequate investments.

Petitioner seeks to make the policies and procedures of the Generation Action Plan applicable to the following persons:

Wisconsin Electric Power Company  
231 West Michigan Street  
Milwaukee, Wisconsin 53201

Wisconsin Public Service Corporation  
700 North Adams Street  
Green Bay, Wisconsin 54307

Wisconsin Power & Light Company  
222 West Washington Avenue  
Madison, Wisconsin 53703

Madison Gas & Electric Company  
133 South Blair Street  
Madison, Wisconsin 53703

Because time is of the essence regarding a Generation Action Plan, Petitioner requests that the Commission act upon in this matter as expeditiously as practical, consistent with applicable legal requirements.

#### 4. REASONS FOR PETITION

In support of this Petition, Petitioner states the following:

**A. THERE IS A PRESSING NEED TO BUILD ADDITIONAL GENERATION FACILITIES IN THE EASTERN WISCONSIN UTILITIES (EWU) REGION OF THE STATE.**

1. In his recent speech at Wisconsin's Economic Summit, Governor Thompson stated:

Any plan for a new economy must aggressively address our state's dire energy needs. The greatest threat right now to our current and future economies is our fragile energy supply. We must come together to make sure we are producing and transporting enough energy into our state.

2. The Commission recently issued its first Strategic Energy Assessment pursuant to sec. 196.491(2), Stats. The SEA projects that "peak power requirements, on a statewide basis, are expected to grow at approximately 2 percent per year" (p. xvi). It also notes that, while megawatt hour sales for the state continue to increase at 2 percent per year, "no base load generating units have been placed in service since 1985" (p. xx).

3. Eastern Wisconsin needs a number of new power plants to meet projected load growth. Eastern Wisconsin will need even more additional generating capacity if proposed transmission projects are not built. While a number of proposed plants have been reported in the press, it remains unclear whether sufficient new generation will be built in time to meet projected need.

4. This electric shortage threatens to seriously harm Wisconsin's citizens and businesses and our state's future economic development.

**B. WISCONSIN'S ELECTRIC PUBLIC UTILITIES AND INDEPENDENT POWER PRODUCERS SHOULD BOTH BE ENCOURAGED TO BUILD NEEDED NEW POWER PLANTS.**

1. Wisconsin electric public utilities have an obligation to serve. Under sec. 196.03, Stats., they have a duty to furnish adequate electric service and facilities at just and reasonable rates.

2. They can discharge that duty by applying for authority to construct and constructing additional generation facilities pursuant to sec. 196.49 and 196.491, Stats., and by issuing Requests for Proposals and purchasing electric capacity and energy from independent wholesale merchant plants.

3. Wisconsin electric public utilities have a number of brownfield sites (including Rock River and North Oak Creek) on which new power plants could be expeditiously constructed. Wisconsin electric public utilities also have the experience and expertise required to build additional generation facilities.

4. At the same time, pursuant to sec. 133.01, Stats, competition is the fundamental economic policy of the state, and the Commission should seek to increase the level of wholesale competition in the Wisconsin electric industry.

5. The Commission can promote wholesale competition in the electric industry by adopting policies which encourage the construction of unaffiliated wholesale merchant plants in the state. This will put competitive pressure on the fixed and operating costs of new generation, for the benefit of wholesale and retail customers.

6. The Commission also can promote wholesale competition in the electric industry by encouraging Wisconsin's electric public utilities to purchase needed electricity from independent wholesale merchant plants in the state. Such projects usually need utility anchor tenants in order to be viable. In 1997 Act 204 the legislature required electric public utilities in eastern Wisconsin to procure additional electric capacity from such unaffiliated generators.

7. Procurement of electricity from unaffiliated wholesale merchant plants would also be consistent with the recent report on generation market power by the Commission's consultant, which found a concentration of generation ownership in Wisconsin, and with the legislature's concern about affiliated-interest transactions, as set forth in sec. 196.491(3m)(c)3, 196.52, and 196.795(5), Stats.

### **C. THE COMMISSION SHOULD PROMPTLY DETERMINE HOW THESE NEEDED NEW POWER PLANTS SHALL BE CONSTRUCTED.**

1. The Commission has broad, explicit authority under current law to determine how necessary additional electric service and additional generation facilities shall be provided to customers at just and reasonable rates. See sec. 196.02(7), 196.03(1), 196.28, 196.37, 196.487, 196.49, 196.491(3), Stats.

2. Regulatory uncertainty arising from the deregulation debate has resulted in clear reluctance on the part of public utilities to invest large sums of capital in needed new power plants. The Commission can resolve this uncertainty by expeditiously adopting clear and specific policies regarding new plant construction by such utilities.

3. Consistent with the requirement of sec. 196.491(3)(d)7 that any such new facilities not have a material adverse impact on wholesale competition, the Commission can adopt policies which encourage construction by a combination of both public utilities and independent wholesale merchant plants.

4. Fuel diversity is essential in the electric industry in order to reduce the risks of overdependence on a single fuel, of fuel-supply shortages, and of fuel-price increases. Virtually all of the new generation added in Wisconsin and the Upper Midwest in the last fifteen years, or currently under construction or permitting, is gas-fired and will rely on interruptible gas. Natural gas prices have risen dramatically, and demand for natural gas will increase substantially as new generation comes on-line. This increased demand may make gas-supply interruptions more likely.

5. Consistent with the requirements of sec. 196.025 and 1.12(4), Stats., which establishes energy priorities, to the extent cost-effective and technically feasible, the Commission should thoroughly

evaluate the benefits and burdens of technologies which do not use natural gas as a primary electric fuel. This evaluation should include clean-coal technology for baseload applications, and renewables technology for other uses. The Commission should determine whether the construction of plants using such technologies and incorporating other environmental commitments would produce net environmental gains.

6. The Commission can promptly make all of these determinations with the scope of its current statutory authority.

**D. SPIN-OFFS OF THE STATE’S POWER PLANTS INTO NON-UTILITY GENCOS ARE NOT LAWFUL, ARE NOT NECESSARY TO GET NEW POWER PLANTS BUILT, AND WOULD CAUSE NUMEROUS PROBLEMS, INCLUDING LOSS OF STATE JURISDICTION.**

1. Two energy holding companies have recently proposed removing their non-nuclear power plants from the rate base, and transferring them to a non-utility affiliate or GenCo.

2. Such proposals are clearly unlawful under current law, and would require major statutory changes. Among the bright-line prohibitions and restrictions which apply to any transfer of power plants owned by public-utility affiliates of an energy holding company to a non-utility affiliate or GenCo are the following:

- **Transfer of Real Property.** Sec. 196.795(5)(k)1 prohibits the transfer of real property which is used to provide utility service to a non-utility GenCo except by public sale or offering to the highest qualified bidder. Both the land and the power plants located on that land are real property subject to this requirement.
- **Transfer of Other Property.** Sec. 196.795(5)(s) provides that the PSC may approve the transfer of other property (including personal property) from a public-utility affiliate to a non-utility affiliate only if 1) the utility is compensated at fair market value, and 2) the utility has minimized such transfers.
- **Use of Utility Employees.** Sec. 196.795(5)(r) provides that the PSC may approve the use of utility employees by a non-utility GenCo only if 1) the utility is compensated at fair market value for such use, 2) the use of such employees does not have any anti-competitive impact on any competitor of the non-utility GenCo, and 3) the utility has minimized such use.
- **Subsidy by Utility Ratepayers.** Sec. 196.795(5)(f) provides that a non-utility GenCo may not be subsidized materially by public-utility ratepayers.
- **Affiliated Wholesale Merchant Plants.** 1997 Act 204 authorized new affiliated wholesale merchant plants which did not serve the needs of retail public-utility ratepayers. See sec. 196.491(1)(w), sec. 196.491(3)(d)2., and sec. 196.491(3m). However, existing utility plants

cannot become affiliated merchant plants, because the statute covers new non-utility capacity only. Also, affiliated merchant plants cannot be used as the means by which the public-utility affiliate meets its own load-growth needs, because then it is not a merchant plant.

**Three-Year Limitation.** 1997 Act 204 also provided that an affiliated wholesale merchant plant may not make a firm sale to its public-utility affiliate for a period of three years or more. Sec. 196.491(3m)(c)3.

3. In addition to these specific provisions, the two GenCo proposals would fundamentally alter the general regulatory compact established by Chapter 196 of the Wisconsin statutes, according to which electric public utilities enjoy an exclusive, indeterminate permit to provide retail electric service in exchange for devoting power plants and other assets to public-utility purposes, and subjecting them to regulation under Chapter 196. The essential term of the regulatory compact is that ratepayers are entitled to reliable service at just and reasonable rates, and utilities are entitled to recover their cost-based revenue requirements and to earn a reasonable return on their investments. The two GenCo proposals would replace this regulatory compact with a wholesale power contract subject to FERC jurisdiction and would transfer the entire difference between the market value and the book value of existing plants (“market to book premium” or “stranded benefits”) to shareholders.

4. As occurred in California, such proposals would remove the state’s major generating assets from state jurisdiction and subject them to federal jurisdiction. This would mean that both the Wisconsin legislature and the Commission would lose much of their authority to insure low-cost, reliable electricity for Wisconsin customers. Such a fundamental loss of regulatory authority at a time of generation scarcity would be a costly mistake. In California this year electric prices have skyrocketed, and reliability has suffered. California has declared its first-ever Stage 3 power emergencies, and rolling blackouts have been averted only by the implementation of extraordinary and costly measures. The two largest California investor-owned utilities are in serious financial difficulty, and the California PUC has had to impose emergency rate increases on retail customers.

5. The statutory changes which would be necessary in order to remove the state’s power plants from state regulation would be very controversial and time-consuming. Given the California experience, it is very uncertain that Wisconsin’s policymakers would adopt such changes. Wisconsin cannot afford a protracted delay with no progress on the issue of generation infrastructure.

6. These proposed spin-offs raise a number of other serious concerns. They would result in a loss of this Commission’s ability to oversee rates and protect retail customers. The Commission also would lose its current authority to approve and condition sales and mergers involving such assets. Costs to retail customers would be federalized, and subject to FERC jurisdiction. Working out the details of the FERC-jurisdictional power-purchase agreement would be very difficult and time-consuming.

7. These GenCo proposals also would make it difficult for the legislature and the Commission to address basic policy issues arising from electric-utility restructuring. For example, it would be very

hard, if not impossible, to deal with generation market power problems (which both the Commission and CFC's study have found to be very severe) in the future, since most generating facilities would be beyond the regulatory authority of the Commission. Also, the state would forfeit its ability to develop an equitable allocation between shareholders and ratepayers of the substantial value or "stranded benefits" of existing power plants (very conservatively estimated at \$3.2 billion over the next seven years by the Commission's study).

8. Wisconsin cannot afford further delay and controversy in solving its energy shortage. The state must find practical generation solutions that are doable in the near term.

#### **E. THE COMMISSION SHOULD ADOPT SPECIFIC NEW MEASURES TO INSURE REGULATORY CERTAINTY FOR NEW UTILITY POWER PLANTS AND POWER PURCHASES.**

##### **Rate-Base Plants with New Regulatory Treatment**

1. The state's public utilities should be encouraged to build new rate-base plants subject to a new form of Commission regulation, derived from the Commission's existing statutory authority, where they demonstrate that this course is prudent in light of alternatives such as purchases from third parties.
2. The rate-recovery mechanisms for such new plant should be defined at the outset by the Commission in an order upon which the utility can rely. The terms of this order would be included in any subsequent CA or CPCN order involving such new plant, and in any relevant rate-case order.
3. These new plants should be treated as stand-alone regulatory assets for ratemaking purposes, as if provided under contract to the distribution arm of the utility by the generation arm of the utility.
4. The Commission, taking into account risk differentials, should determine the key financial terms applicable to such new plants. These may include such terms as return on Construction Work in Progress (CWIP), capital structure, depreciation period, method of recovery of depreciation expense, and return on common equity.
5. Other expense items, such as operations and maintenance and fuel, should be recovered based on their cost.
6. The Commission also could establish performance standards with respect to availability and other issues, with incentives and penalties determined by specific benchmarks.
7. The Commission should evaluate the rate impacts of all such measures on a regular basis, in order to insure that resulting rates remain just and reasonable.

8. The Commission also should consider whether and how it can address up-front stranded cost/stranded benefit issues for the new plant. This should be done in a way which is consistent with its existing statutory authority and which does not prejudice resolution of this issue for existing plants. The utility may propose a specific risk-allocation formula for new plant, which fairly allocates risks and rewards and stranded costs and benefits between ratepayers and shareholders. This allocation will depend upon the other terms and conditions established by the Commission (such as the depreciation period). The Commission may also decide to defer resolution of this issue to a later date.

9. The Commission should ensure that this new regulatory treatment does not prevent the state from properly structuring a future competitive market, or from remedying generation market-power problems. Wholesale market-power issues should be addressed by permitting participation by smaller utilities and cooperatives in the new plant. This can be achieved through ownership, through a cost-based, purchase-power agreement, or through other measures. Retail market-power issues should be deferred.

### **Innovative Financing Arrangements for New Plants**

1. The Commission should be flexible in entertaining and approving new financing mechanisms which would facilitate construction of new power plants by public utilities.

2. Such arrangements could include third-party financing vehicles, “synthetic leases,” and/or construction and ownership by an affiliate lessor with a long-term operating lease back to the utility.

3. These would be financing vehicles only. The owner would be a passive entity and not an operating entity. The ownership entity could include as investors unaffiliated third parties (such as banks or other financial institutions) and public utilities (in compliance with the affiliated-interest laws).

4. Wisconsin electric utilities should have complete control over the operation, maintenance, and dispatch of the new plant.

5. Payments to the ownership entity should be equivalent to a rate-based, fixed-cost revenue requirement. The utilities should pay operation and maintenance costs and fuel costs directly.

6. The Commission also could consider approving an arrangement under which utilities get operating-lease accounting benefits and the savings from a lower capital cost due to a more leveraged capital structure are shared between shareholders and ratepayers.

7. The term of the arrangement should be a substantial portion of the life of the plant. Rules for the end of the term also should be addressed.

## **Incentive for Purchases**

1. The Commission could further the state's fundamental economic policy of competition by adopting reasonable measures to encourage Wisconsin electric public utilities to make long-term, firm purchases from independent wholesale merchant plants in the state.
2. Many Wisconsin electric public utilities are net purchasers of power and are increasingly reliant on wholesale purchases from third parties to meet their long-term service obligations to retail customers. Retail customers benefit if utilities buy from third parties when the cost of such purchases is less than the cost of building capacity.
3. The custom and practice in industry is for a wholesaler purchaser which has entered into a long-term firm supply contract to reflect the risks and obligations inherent in such a contract by adding a reasonable increment or margin to the transaction.
4. The Commission should consider approving such an increment or margin when the utility can demonstrate that the power-purchase alternative is beneficial for its customers compared to the construction alternative.
5. The Commission also should determine whether such an increment should be calibrated to induce purchases from wholesale merchant plants which use fuels consistent with the energy priorities set forth in sec. 1.12(4), Stats.
6. Any such increment should be a reasonable adjustment based upon the fixed or capacity portion of the purchase, and not the gross purchase price. The Commission should request utilities and customers to make specific proposals for such an incentive in this docket.
7. In its order in Docket No. 05-EI-112 the Commission found that "it is reasonable to consider the risk to shareholders associated with entering into contracts with IPPs as well as the risks attendant on constructing utility generating plant when determining a utility's allowable rate of return" (Order, p. 32; see also Appendix A, p. 9). One option for such an increment would be to permit utilities to make an adjustment to their rate base which reflected the equity portion of the capacity costs of such power purchases.

## **5. REQUEST FOR RELIEF**

Based upon the above considerations, Petitioner requests the Commission to take the following actions:

1. Open a docket for the purpose of investigating and determining by a date certain the appropriate regulatory actions which will cause the state's electric public utilities to construct and purchase additional reliable, low-cost electric capacity for their customers.

2. Determine that the policies and procedures set forth in this Petition constitute just and reasonable means of encouraging the construction by public utilities of needed new power plants in the state, and the purchase of electricity by such utilities from independent wholesale merchant plants.

3. Direct the state's electric public utilities to file with this Commission, no later than 60 days from the date of the Commission's direction, a specific generation-action plan, consistent with the Commission's Strategic Energy Assessment, which plan may include Applications for Certificates of Authority pursuant to sec. 196.49, Stats, Applications for Certificates of Public Convenience and Necessity pursuant to sec. 196.491(3), Stats., and Requests for Proposals from Wisconsin independent wholesale merchant plants.

4. Declare that, if an electric public utility does not respond adequately to the Commission's direction, the Commission shall exercise its authority pursuant to sec. 196.02(7), 196.03(1), 196.28, 196.37(2), and 196.487(2), Stats., to order such utility to make adequate investments to ensure reliable electric service.

Dated at Madison, Wisconsin, this 11th day of January, 2001.

Respectfully submitted,

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By:

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