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FEDERAL ENERGY  
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**Market Based Rates for Public Utilities  
Technical Conference on Generation Market  
Power and Affiliate Abuse Issues**

**Technical Conference  
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**Prepared Statement of  
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**ORIGINAL**

**Introduction**

My name is Dennis Eicher. I am President of Power System Engineering, Inc., an engineering and economic consulting firm serving the electric utility industry. While PSE serves clients in all sectors of the industry, we have historically specialized in providing service to small electric utilities, primarily rural electric cooperatives and municipal electric systems; and it is their interests that I am trying to represent today.

Since time is limited, I will focus my remarks on one aspect of the subject of this session, namely whether or not the Commission should continue to be concerned with improper affiliate relationships between utilities. My simple answer, for reasons I will explain later, is a resounding, "Yes!" I intend to further focus my remarks on recent experience in the Upper Peninsula (U.P.) of Michigan where I represent a number of municipal and cooperative clients, generally referred to as the Upper Peninsula Transmission Dependent Utilities (UPTDU). The majority of these small utilities depend entirely on wholesale purchases from others to supply their retail load requirements.

**Description of Electric Power Supply Resources in the U.P.**

Before discussing market power/affiliate abuse issues in the U.P., it is necessary to understand the electrical supply resources and transmission network that are currently used to serve the U.P. The U.P., for all intents and purposes, is divided into two separate and distinct areas. The eastern half of the U.P. is served by Edison Sault Electric Company (ES), Cloverland Electric

Cooperative (Cloverland) and the Village of Newberry (Newberry). It is interconnected with the Lower Peninsula of Michigan (L.P.) via two 138 kV transmission lines across the Straits of Mackinac. Generation in the eastern U.P. consists of roughly 60 MW of hydro-electric capacity and 20 MW of oil-fired diesel engines.

The western side of the U.P. is served by the Upper Peninsula Power Company (UPPCO), Wisconsin Public Service (WPS), and Wisconsin Electric (WE), along with eight municipal electric systems and two rural electric cooperatives. The Western U.P. is connected to Wisconsin via one 345 kV line and two 138 kV lines. Prior to 2000, there was no effective transmission interconnection between the eastern and western sides of the U.P. In 2000, a 138 kV tie between the east and west side was energized. This tie provides approximately 70 MW of transfer capability between the east and west sides of the U.P. However, a significant portion of that capability is often used up by loop flow from Wisconsin to the Lower Peninsula of Michigan.

In the late 1990s, the four investor-owned utilities (IOUs) in the U.P. consolidated their positions through two mergers – WE with ES and WPS with UPPCO. As part of the approval process, Herfindahl-Hirshman Index (HHI) analyses were prepared for each proposed merger. These HHI analyses were alleged to show that market power did not exist in the U.P., or at least that the proposed mergers would not aggravate any market power that already existed.

In my opinion, the results of both those analyses were misleading at best. It seems to me that any rational, unbiased person looking at the power supply situation in the U.P. can not help but come to the conclusion that significant market power does exist. The simple facts are these. Excluding generation owned by the Cities of Marquette and Escanaba, two municipal electric systems whose generating resources are dedicated to supplying their own municipal load, there is approximately 785 MW of total base load capacity (i.e., hydro-electric and/or coal-fired generation) in the U.P. WE owns or controls about 735 MW, or 94 percent of that capacity.

Furthermore, as I have mentioned, there are currently only two transmission paths into the U.P., both highly constrained. WE and/or its affiliate Edison Sault control roughly 80 percent of the transmission capacity into and out of the U.P. WPS controls virtually all of the remaining

capacity. WE also controls the majority of the capacity in the east-west tie. When I look at these facts, I can only conclude that WE, and to a lesser extent WPS, have significant market power in the U.P., regardless of what HHI analyses or any other analyses conclude. In fact, it seems intuitive to me that if such analyses do not conclude that there is market power in the U.P., then it is the analysis that is flawed, either in terms of methodology, assumptions, definition of market area, treatment of long term contracts or something else. The potential for abuse of that market power is aggravated by the fact that two utilities native to the U.P. have merged with two Wisconsin utilities, which raises the possibility of affiliate abuse. Simply put, there is no viable market in the U.P. that can function in light of the market power that these two utilities and their affiliates have.

### **Practical Examples**

This is not merely theoretical. There are very real practical consequences to this concentration of power supply and transmission capacity and the potential for affiliate abuse in the U.P. Here are a couple of examples:

#### ***Ontonagon County Rural Electrification Association (Ontonagon)***

In the fall of 1999, I assisted Alger Delta Cooperative Electric Association and Ontonagon in issuing a request for proposal (RFP) to seek alternatives to the contract extension prices quoted by UPPCO and WE. RFPs were sent to approximately 25 potential suppliers in the Upper Midwest. No responses were received. Lack of available transmission capacity into the U.P. from Wisconsin and/or the Lower Peninsula of Michigan was undoubtedly a major factor.

As a result, Alger Delta and Ontonagon were forced to extend their contracts with UPPCO for another five years, even though this represented a substantial increase in cost. However, we continued to pursue a replacement of approximately 1 MW (peak) that WE supplied to Ontonagon because of the huge rate increase that would have occurred had Ontonagon accepted the WE proposal. Ultimately, we were able to negotiate a deal with Wisconsin Public Power Inc. (WPPI), a joint action agency of municipal electric systems in Wisconsin. Even though the WPPI proposal would have represented an increase of approximately 22 to

33 percent over the current cost from WE, it was still substantially less than the 65 to 91 percent increase WE had originally proposed.

However, when we attempted to consummate the deal with WPPI, we were informed by WE that all of the available transmission capacity between Wisconsin and the U.P. was reserved by its marketing affiliate; and, thus, WPPI would not be permitted to deliver firm power and energy to Ontonagon. I found this response to be incredible in light of the fact that 1) we were only asking for 1 MW of transmission capacity, and 2) WE was already serving the load in question. Even if WE were to claim that it presently served the Ontonagon load from its U.P. resources, transferring the load from WE to WPPI should have relieved roughly 1 MW of WE's generating resources in the U.P., thereby freeing up an equivalent 1 MW of transmission capacity. In other words, it should not have made any difference to WE whether it deemed the load to be served from its Wisconsin or Upper Peninsula resources. The impact should have been the same.

After seeking assistance from the state legislature, we were ultimately able to strike a deal with WE based on WE's FERC-approved, cost-based wholesale rate rather than its proposed contract rate. While this rate represented an increase of approximately 23 percent over the then current price, roughly the same as the WPPI proposal, it was still substantially lower than what WE had originally proposed.

**Crystal Falls, Michigan (Crystal Falls)**

A similar situation has occurred just recently with respect to the City of Crystal Falls, Michigan. Crystal Falls is supplied partly from a small hydro electric generating which it owns, with the remainder supplied by WE. With the expected expiration of the existing contract with WE, the City sought proposals from both WE and WPS to supply its supplemental requirements, approximately 4 MW on peak. The City chose WPS as its preferred supplier. However, when the City/WPS applied for a transmission path, it was told by Midwest Independent System Operator (MISO) that capacity was not available. Some might argue that this result was not unexpected, since the City was attempting to change its supplier from WE, who would have supplied the load from its U.P. generation resources, to WPS, which would supply the load from its generating resources in Wisconsin. Yet, there

seems to be sufficient transmission capacity and generating resources for WE to supply its affiliate company, ES, and for WPS to supply its affiliate company, UPPCO. Why isn't there sufficient capacity to supply this small amount of load of a non-affiliate?

Furthermore, I would note that WPS and WE have been able to work on a transfer of load responsibility arrangement wherein WE supplies WPS' affiliate UPPCO from U.P. resources, while WPS reciprocates and supplies WE load in Wisconsin from Wisconsin resources. Yet, a similar arrangement has not been offered to Crystal Falls or other UPTDU members.

### **Conclusion**

While there may be many areas of the country where the wholesale power supply market has matured to the point that affiliate abuse is no longer a major issue, there are other parts of the country where this is not true. The Upper Peninsula of Michigan is one such poster child of an area where, due to geography and limited transmission capacity connecting the U.P. to the rest of the world, a truly competitive market does not currently exist, and probably will not exist for many years to come. The fact that this isolated area is dominated by two large Wisconsin utilities and their U.P. affiliates, who together have control of almost all of the generating and transmission resources, means that the potential for affiliate abuse is all too real. The Commission should remain diligent in monitoring the situation to avoid putting the small cooperative and municipals in the U.P. at a further disadvantage. The only realistic alternative I see is for the Commission to enforce an obligation of the dominant utilities to continue to serve *the transmission dependent utilities at cost-based rates.*