

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Wisconsin Public Service Corporation

Docket No. ER05-164-000

ORDER ACCEPTING AND SUSPENDING RATE SCHEDULES AND
ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued December 21, 2004)

1. In this order we accept for filing a power purchase agreement between Wisconsin Public Service Corporation (WPSC) and its affiliate Upper Peninsula Power Company (UPPCo), suspend it for a nominal period, to become effective January 1, 2005, subject to refund and establish hearing and settlement judge procedures. This order benefits customers by ensuring the justness and reasonableness of this power purchase agreement between affiliated companies and by protecting non-affiliated customers against undue discrimination.

I. Background

2. This case involves a power purchase agreement between WPSC and its affiliate UPPCo.¹ Currently, UPPCo purchases 65 megawatts of power from WPSC under the terms of a 2002 power purchase agreement (PPA 1) which expires on December 31, 2007. WPSC and UPPCo have renegotiated their agreement and now seek permission to terminate PPA 1 early and to replace it with a second power purchase agreement (PPA 2) that would take effect on January 1, 2005 and continue at least until December 31, 2014.²

¹ Both companies are subsidiaries of Wisconsin Public Service Resources Corporation.

² PPA 2 does not have a fixed termination date. Instead, there is a 10-year fixed term, after which the agreement renews automatically until a party gives three years written notice of termination.

3. WPSC states that UPPCo's service area is in the Upper Peninsula of Michigan and lies in a constrained portion of the interstate transmission network known as the Wisconsin-Upper Michigan System (WUMS).³ Since 1999, UPPCo has on three occasions issued a request for proposals for 65 megawatts of firm power, which have not resulted in any responsive bids, other than WPSC. WPSC indicates that due to the unique transmission constraints present in the WUMS area, it is unlikely that another request for proposals would yield a different result.

4. After the failure of UPPCo's 1999 request for proposals, it entered into PPA 1 with WPSC.⁴ Under PPA 1, UPPCo receives 65 megawatts of capacity from WPSC. Because of greater than expected price volatility in the cost of natural gas, the price UPPCo is paying for energy under PPA 1 is greater than either UPPCo or WPSC anticipated.⁵ Hence, the parties seek to replace PPA 1 with PPA 2.

5. WPSC states that most of the terms of PPA 2 are similar to those found in PPA 1, but that a few differences exist. Under PPA 2, UPPCo is permitted to unilaterally adjust its power requirements annually so long as it takes at least 40 megawatts and not more than 65 megawatts of power.

6. The other major difference is that under the proposed PPA 2 UPPCo's rates are based on an Average Rate Provision (ARP) rather than the costs of a specific generating unit. The ARP is the average price WPSC charges, under its market based rate authority,⁶ to all non-affiliated wholesale long-term power purchasers in the

³ The transmission constraint problems present in WUMS have been well documented. *See, e.g., Wisconsin Electric Power Co.*, 79 FERC ¶ 61,157 (1997) (rejecting a proposed merger in WUMS and discussing market concentration issues); *Midwest Independent Transmission System Operator*, 108 FERC ¶ 61,163 at P 73, 90-94, 296-98, *order on reh'g*, 109 FERC ¶ 61,157 (2004) (discussing transmission constraints in WUMS and how to accommodate them).

⁴ PPA 1 was set for hearing by the Commission in *Wisconsin Public Service Corp.*, 101 FERC ¶ 61,402 (2002), and the parties reached a settlement which was approved in *Wisconsin Public Service Corp.*, 104 FERC ¶ 61,192 (2003).

⁵ WPSC states that UPPCo's capacity charges under PPA 1 are relatively low, but the energy charge is tied to the cost of power production at Pulliam-31. As the price of natural gas has increased over the past several years, so has the total price UPPCo is paying for its power.

⁶ The Commission most recently granted WPSC market based rate authority in *Wisconsin Public Service Corp.*, 81 FERC ¶ 61,072 (1997). WPSC states that it filed its three-year market-based rate authority update in September of 2004.

Eastern Wisconsin region of WUMS.⁷ By using the ARP as a proxy, WPSC contends that the rates under PPA 2 will accurately reflect the current market price for power in the Wisconsin portion of WUMS and should satisfy any affiliate abuse concerns the Commission may have. According to WPSC, PPA 2 will result in a 10-15 percent decrease in UPPCo's power costs during calendar year 2005.⁸ In exchange for this lower rate, UPPCo agrees to purchase the power at this rate for at least 10 years beyond what was contemplated in PPA 1.

II. Notices and Interventions

7. Notice of WPSC's filing was published in the *Federal Register*, 69 Fed. Reg. 67,337 (2004), with protests or interventions due on or before November 22, 2004. Algoma Group WPS Wholesale Customers⁹ jointly with Great Lakes Utilities (collectively Algoma) and Upper Peninsula Transmission Dependent Utilities¹⁰ (Upper Peninsula TDUs) filed motions to intervene and protest. Wisconsin Public Power Inc. (WPPI) filed a motion to intervene and also submitted comments. UPPCo filed a motion to intervene. WPSC filed an answer to the protests.

8. Upper Peninsula TDUs and WPPI argue that the WUMS is a highly concentrated, constrained market and note that the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) Independent Market Monitor (IMM) has classified this area as a Narrow Constrained Area. In this vein, Upper Peninsula TDUs take issue with WPSC's contention that the proposed sale is made at a verifiably competitive rate.¹¹

⁷ WPSC notes that, even though the ARP is based on market based rate contracts, WPSC is prohibited from directly negotiating a contract with an affiliated company such as UPPCo under the Commission's market-based rate policies.

⁸ WPSC's filing does not address potential cost savings beyond the calendar year 2005 timeframe.

⁹ Algoma Group is a group of municipally-owned electric utilities and electric cooperatives purchasing power from WPSC. For purposes of this filing, the Algoma Group includes the Wisconsin cities of Manitowoc and Marshfield, as well as Alger Delta Electric Cooperative.

¹⁰ The Upper Peninsula TDUs include the Village of L'Anse Electric Utility, Baraga Municipal Water & Light Plant, City of Escanaba, City of Gladstone, Negaunee Electric Department and Ontonagon County Rural Electrification Association.

¹¹ Upper Peninsula TDUs Protest at 7-10, 15; WPPI Comment at 3-4. A "Narrow Constrained Area" is defined under the Midwest ISO's Transmission and Energy Markets Tariff § 63.4.1(b) as "an electrical area identified by the IMM that is defined by one or more Binding Transmission Constraints that are expected to be binding for at least five hundred (500) hours per year during a given twelve month period and within which one or more suppliers are pivotal."

9. Upper Peninsula TDUs provide anecdotal information of unsuccessful requests for proposals in this area. They note that, when two of their members, Alger Delta and Ontonagon, sought bids from 25 potential suppliers in 1999, they received no responses.¹² Ontonagon then attempted to obtain one megawatt of capacity from WPPI, but was informed that Wisconsin Electric Power Company (WEPCO) had reserved all of the available transmission capacity between Wisconsin and the Upper Peninsula for its marketing affiliate. Ultimately, Ontonagon negotiated a deal with WEPCO at rates comparable to those offered by WPPI.¹³

10. Upper Peninsula TDUs state that WPSC's request for approval of a market-based rate sale to an affiliate is outside the framework of the market-based rate authority that WPSC has obtained from the Commission (*i.e.*, not pursuant to WPSC's market-based rates tariff) and that WPSC's claim of a significant rate reduction for UPPCo is limited and speculative given that WPSC only asserts that for a single calendar year, out of at least a ten-year term, UPPCo's charges will be reduced from the PPA 1 level by approximately 10-15 percent.¹⁴

11. Upper Peninsula TDUs request that, if the Commission accepts PPA 2, that it impose several additional conditions, including that UPPCo's energy costs be capped at cost-based levels and that WPSC and UPPCo be required to make power available to Upper Peninsula TDUs on rates, terms, and conditions no less favorable than those at which WPSC makes power available to UPPCo. Upper Peninsula TDUs suggest that the rates charged under PPA 1 be used as the cost-based ceiling until December 31, 2005 (when PPA 1 would have expired). After December 31, 2005, Upper Peninsula TDUs suggest that WPSC be required to file a cost-based rate ceiling for Commission review.

12. Upper Peninsula TDUs explain that they are concerned that, as their members' long term power purchase agreements expire, these members will find that WPSC and UPPCo have monopolized all the available transmission capacity into WUMS, leaving none for other utilities to meet the TDU members' native load needs.¹⁵

13. Algoma requests that the Commission set the matter for investigation and hearing. Algoma notes that, in addition to affiliate abuse concerns, PPA 2 raises basic issues for WPSC's other wholesale customers, including concerns that the sale: 1) may shift costs to other wholesale customers' service under WPSC's W-2A tariff; and 2) appears to confer upon UPPCo impermissible advantages vis-à-vis WPSC's other non-affiliate customers receiving service under market based rates.

¹² Upper Peninsula TDUs Protest at 5.

¹³ Upper Peninsula TDUs protest at 15.

¹⁴ Upper Peninsula TDUs protest at 6, 7 and 11.

¹⁵ Upper Peninsula TDUs protest at 5, 6 and 16.

14. Algoma also raises concerns that, in contrast to PPA 1, which required the agreement of both parties to change UPPCo's 65 megawatts capacity reservation, PPA-2 grants UPPCo the unilateral right to adjust demand nominations annually within a bandwidth of 40 megawatts to 65 megawatts. Hence, if UPPCo were to take only 40 megawatts of power in a given year, up to 25 megawatts of firm capacity would be removed from the denominator of the Algoma settlement formula rate, representing a potential cost shift of 0.8 percent for Algoma customers.¹⁶ This result, says Algoma, would be unfair to WPSC's non-affiliated wholesale customers taking service under the W-2A tariff.

15. Algoma also objects to the fact that they have been subject to the same market forces that rendered UPPCo's deal uneconomical, and yet it is unclear why UPPCo should be afforded the opportunity to replace its deal with a better one, other than the fact that UPPCo is a WPSC affiliate.¹⁷

III. Discussion

16. Pursuant to Rule 214, of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the timely, unopposed motions to intervene serve to make Algoma, Upper Peninsula TDUs, UPPCo, and WPPI parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept WPSC's answer, and therefore will reject it.

17. Since this is an affiliate transaction, the Commission's affiliate abuse standards as discussed in the *Edgar* case apply.¹⁸ Under the *Edgar* policy, a company bears the burden of demonstrating a lack of affiliate abuse in transactions between affiliated companies.¹⁹ Generally, the easiest way to demonstrate lack of affiliate abuse is to conduct an independently-administered request for proposals bidding process.²⁰

¹⁶ Algoma protest at 4 and 5.

¹⁷ Algoma protest at 8.

¹⁸ See *Boston Edison Co. Re: Edgar Electric Energy Co.*, 55 FERC ¶ 61,382 (1991) (*Edgar*).

¹⁹ See *Edgar*, 55 FERC ¶ 61,382 at 62,167.

²⁰ See, e.g., *Ameren Energy Generating Co.*, 108 FERC ¶ 61,081 (2004); *Allegheny Energy Supply Co.*, 108 FERC ¶ 61,082 (2004). See also *Southern California Edison Co. on behalf of Mountainview Power Co. LLC*, 106 FERC ¶ 61,183 (2004), *reh'g pending*.

However, we agree with WPSC that the unique circumstances in WUMS,²¹ and the failure of prior requests for proposals, means that conducting another request for proposals is not a realistic option for UPPCo at the present time.²² Accordingly, we reject WPSC's proposal that we accept PPA 2 subject to UPPCo's conducting a new request for proposals in early 2005 instead of setting the matter for hearing.

18. Aspects of WPSC's proposed PPA 2 raise issues of material fact that cannot be resolved based on the record before us, and are more appropriately addressed in the hearing and settlement judge procedures ordered below.²³

19. The Commission's preliminary analysis indicates that PPA 2 has not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. Therefore, we will accept PPA 2 for filing, suspend it for a nominal period, to become effective January 1, 2005, as requested, subject to refund, and set it for hearing and settlement judge procedures as further described below.

20. While we are setting these matters for a trial-type evidential hearing, we encourage the parties to make every effort to settle their disputes before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603

²¹ See *supra* note 3.

²² *Allegheny Energy Supply Co.*, 108 FERC ¶ 61,082 at P 18 (2004) (explaining that while a request for proposals is not the only way to demonstrate lack of affiliate abuse, a properly structured request for proposals is an effective method of demonstrating that the "head-to-head" prong of the *Edgar* test has been met).

²³ Among the issues that should be considered at the hearing or before a settlement judge are: 1) whether the ARP is based on a sufficiently large sample of comparable long-term market rate contracts to preclude affiliate abuse given the unique circumstances in WUMS; 2) whether power purchase agreements between WPSC and similarly-situated non-affiliate wholesale customers allow comparable variations in annual power nominations to those proposed in PPA 2; 3) whether a similarly-situated non-affiliate wholesale customer would be permitted to terminate an unfavorable long-term power purchase agreement and replace it with a power purchase agreement with terms and conditions similar to those found in PPA 2; 4) whether PPA 2 is reasonably likely to reduce UPPCo's power costs beyond the calendar year 2005 timeframe; 5) whether an automatic renewal clause is appropriate in a power purchase agreement between affiliates; and 6) whether UPPCo's wholesale power customers are likely to be put at a competitive disadvantage if PPA 2 is accepted given the transmission constraints present in WUMS and the formula-based rates employed by several of UPPCo and WPSC's existing non-affiliated wholesale customers.

of the Commission's Rules of Practice and Procedure.²⁴ If the parties desire, they may, by mutual agreement, request a specific judge as a settlement judge in the proceeding; otherwise the Chief Judge will select a judge for this purpose.²⁵ The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for the commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) WPSC's proposed PPA 2 is hereby accepted for filing and suspended for a nominal period, to become effective January 1, 2005, as requested, subject to refund, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred on the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning the justness and reasonableness of WPSC's proposed PPA 2. However, the hearing will be held in abeyance to provide time for settlement judge procedures, as discussed in Paragraphs (C) and (D) below.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2004), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge in writing or by telephone within five (5) days of the date of this order.

²⁴ 18 C.F.R. § 385.603 (2004).

²⁵ If the parties decide to request a specific judge, they must make their request to the Chief Judge by telephone at 202-502-8500 within five days of the date of this order. The Commission's website contains a listing of Commission judges and a summary of their background and experience (www.ferc.gov - click on Office of Administrative Law Judges).

(D) Within sixty (60) days of the date of this order, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter informing the Commission and the Chief Judge of the parties' progress toward settlement.

(E) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in these proceedings in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss), as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.