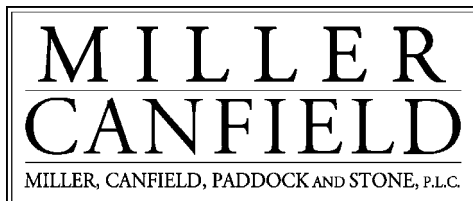


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May 26, 2006

Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way, Suite 7
Lansing, MI 48911

Re: Wisconsin Electric Power Company
2006 PSCR Plan and Factors
MPSC Case No. U-14707

Dear Ms. Kunkle:

Enclosed for electronic filing in the above-captioned matter please find the Initial Brief of Wisconsin Electric Power Company. Also enclosed is a Proof of Service. If you should have any questions, please advise.

Very truly yours,

MILLER, CANFIELD, PADDOCK AND STONE, P.L.C.

Ronald W.
Bloomberg

Ronald W. Bloomberg

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
WISCONSIN ELECTRIC POWER COMPANY)
d/b/a We Energies, for approval of power supply)
cost recovery plan and authorization of monthly)
supply cost recovery factors for the calendar year)
2006. _____)

Case U-14707
[e-file]

PROOF OF SERVICE

STATE OF MICHIGAN)
)ss
COUNTY OF INGHAM)

Lisa A. Becker, being first duly sworn, deposes and says that on May 26, 2006, she served a true copy of ***Initial Brief of Wisconsin Electric Power Company*** upon the following parties by depositing the same in a United States postal depository enclosed in an envelope bearing postage fully prepaid, plainly addressed. The parties were also served by electronic mail.

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Lisa A. Becker

Subscribed and sworn before me
on this 26th day of May, 2006.

Edith Loomis
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Edith D. Loomis
State of Michigan, County of Ingham
My Commission Expires: December 5, 2006

* * * *

Case No. U-14707

May 26, 2006

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I. INTRODUCTION

Wisconsin Electric Power Company ("WEPCO" or the "Company") seeks approval pursuant to Section 6j of 1982 PA 304 ("Act 304"), MCL 460.6j, of its 2006 power supply cost recovery ("PSCR") plan, factors and forecast. The preponderance of record evidence supports approval of the plan, factors and forecast as filed by WEPCO.

II. HISTORY OF PROCEEDINGS

On September 30, 2005, WEPCO filed with the Michigan Public Service Commission ("Commission") its Application, together with the supporting testimony and exhibits of Thomas P. Lorden and Paul D. Schumacher, seeking approval of its PSCR plan and factors for the 12-month period ending December 2006 and five-year forecast.

On November 15, 2005, a prehearing conference was held. Administrative Law Judge ("ALJ") Daniel E. Nickerson, Jr. presided. WEPCO and the Commission Staff ("Staff") participated in the hearing. The petition to intervene of Louisiana Pacific Corporation ("LP") was granted and a schedule was set.

On November 16, 2005, Tilden Mining Company, L.C. ("Tilden") filed a Delayed Petition To Intervene. On December 2, 2005, WEPCO filed a response not objecting to Tilden's intervention provided Tilden is limited to addressing PSCR issues material to these proceedings and its intervention.

On March 6, 2006, the direct testimony and exhibits of Nicholas Phillips, Jr., on behalf of LP and Tilden were filed. The MPSC Staff ("Staff") did not file direct testimony. On April 3, 2006, WEPCO filed the rebuttal testimony and exhibits of Mr. Lorden and Mr. Schumacher. Prior to the hearing, LP served two subpoenas on WEPCO employees.

On April 4, 2006, an evidentiary hearing was held. At the commencement of the hearing, Exhibits LP-1 through LP-24 and Exhibits A-16 and A-17 were admitted by stipulation. (3 Tr 42-43) Also, the prefiled direct and rebuttal testimony of Mr. Lorden and Mr. Schumacher were bound into the record and their Exhibits A-1 through A-15 were admitted into evidence. Mr. Lorden and Mr. Schumacher were cross-examined by counsel for LP/Tilden and Staff. Following the cross-examination of Mr. Lorden, Exhibits LP-26 through LP-37 were admitted into evidence. (3 Tr 129) Following the cross-examination of Mr. Schumacher, Exhibits LP-40 thorough LP-43 were admitted. (3 Tr 172) Following the close of the Company's case, LP/Tilden withdrew the prefiled testimony of Mr. Phillips and agreed not to seek to call other Company witnesses. (3 Tr 176) The record was then closed. The record consists of 178 pages of transcript and 57 exhibits.

Initial briefs are scheduled to be filed on May 26, 2006. WEPCO is filing this brief in compliance with the established schedule.

III. DISCUSSION

A. WEPCO's 2006 PSCR Plan Satisfies the Requirements of Act 304 and Should be Approved.

Subsection 6j(3) of Act 304, MCL 460.6j(3), sets forth the requirements for a PSCR plan. Specifically, subsection 6j(3) specifies that the PSCR plan is to describe expected sources of power supply and changes in the cost of power anticipated over the 12-month PSCR period and to request specific PSCR factors. The plan must also describe all major contracts and power supply arrangements entered into by the utility. This description must include the price of fuel, the duration of the contract arrangement and an explanation or description of any other term or provision as required by the

Commission. Further, the plan must include the utility's evaluation of the reasonableness and prudence of its decisions with regard to its PSCR plan, and an explanation of the actions taken by the utility to minimize the cost of fuel to the utility.

Subsection 6j(6) of Act 304 establishes a basis for evaluating the reasonableness and prudence of a PSCR plan. Specifically, subsection 6j(6) requires the Commission in reviewing decisions underlying a PSCR plan to consider the: (i) availability and sources of supply, including interruptible service, (ii) cost associated with generation and purchases, and (iii) efforts made to minimize the cost of fuel.¹ Additionally, the Commission is required to consider and advise of any items that may be reasonably disallowed under subsection 6j(13) of Act 304.

Consistent with the filing requirements and the review standards established in subsections 6j(3) and (6) of Act 304, the record evidence in this proceeding demonstrates that the decisions underlying WEPCO's 2006 PSCR plan are reasonable and prudent and should be approved.

B. Forecast of 2006 Power Supply Requirements

Mr. Lorden testified that the Company's forecasts for customer requirements were developed pursuant to a variety of methods. (3 Tr 51-53) These forecasts include meeting the reserve requirements of the Mid-America Interconnected Network ("MAIN") and the Public Service Commission of Wisconsin ("PSCW"). (3 Tr 56, 149) Mr. Lorden testified that these forecasts were reasonable. (3 Tr 55) For the 2006 PSCR plan period, the forecasted Net System Requirements are 32,758,257 MWh. (Exhibit A-1).

¹Subsection 6j(6) also references the ability of the utility to reduce or eliminate out-of-state sales. However, because WEPCO is a multi-state utility, this requirement is inapplicable.

C. Sources of Power Supply

1. MISO Day 2 Market

The Company is a market participant of the Midwest Independent System Operator (“MISO”).² MISO is a regional transmission organization approved by the Federal Energy Regulatory Commission (“FERC”). MISO transactions are subject to and regulated by MISO tariffs on file with FERC. On April 1, 2005, the MISO Day -2 market commenced operation. The instant case covers the first full year in which the MISO Day-2 market is in effect. As discussed below, the MISO Day-2 market affects the Company’s power supply plan in various ways, such as: (i) how the Company’s power supply resources are dispatched; (ii) the revenues the Company receives from MISO for the energy the Company generates and supplies; (iii) how energy is provided to serve customers; (iv) the costs the Company is charged for energy provided to its customers; and, accordingly, (v) how PSCR costs are determined.

For example, under the MISO Day-2 market, the Company no longer simply generates, transmits and distributes energy directly to its customers. Rather, the Company is required to offer into the MISO Day-2 market all available energy generated or obtained through purchase power agreements by the Company. (See 3 Tr 164, Exhibits LP-4 and LP-12) If the “offer” is accepted, MISO will dispatch the generation and the energy is sold to MISO. Similarly, the Company enters a “bid” with MISO for

² MCL 460.10w(1) provides:

Each investor-owned electric utility in this state shall, at the utility's option, either join a FERC approved multistate regional transmission system organization or other FERC approved multistate independent transmission organization or divest its interest in its transmission facilities to an independent transmission owner.

energy used to provide service to the Company's customers. If such "bid" is accepted, the Company purchases from MISO the energy to serve its load.

In the MISO Day-2 market, MISO controls the dispatch of all the Company's energy resources. Like the Company had done in the past (3 Tr 50-51), MISO selects the resources to utilize on an economic dispatch basis. Mr. Schumacher testified:

In accordance with MISO market rules, the Company offers virtually all of its generation into the MISO day-ahead energy market and bids its load into the same market. MISO performs security-constrained economic dispatch of all the generators across the MISO footprint based on the generator offers it receives to meet the projected customer load. As such, MISO will dispatch gas-fired facilities only after dispatch of lower-cost generators. In this way, the cost to serve the customers across the entire MISO footprint is minimized. Accordingly, Wisconsin Electric seeks to keep its power supply costs to a minimum through effective operation within the MISO energy market. (3 Tr 164)

In projecting how, and the extent to which, Company resources would be dispatched during the 2006 PSCR Plan period, the Company took into account the role MISO fulfills. (3 Tr 55) Mr. Schumacher described the Company's use of a September 2005 PROMOD model output, subject to various adjustments for some MISO costs actually incurred through August 2005, for constructing the projection of the Company's 2006 PSCR plan and costs. (3 Tr 164)

Although under the MISO Day-2 Market the Company purchases all the energy to serve its customers' load requirements from MISO, the Company prepared its 2006 PSCR Plan and calculated its PSCR factors in a manner consistent with the methodology used in prior PSCR proceedings. Thus, rather than presenting all power supply as purchases from MISO, the PSCR plan retains the traditional presentation of projections of fuel costs for generating resources and payments for non-MISO power purchases. The Company accounts for the impact of MISO by: (i) presenting MISO

energy transactions and MISO energy market costs on an hourly 'net' purchase and sales basis; and (ii) identifying other MISO costs. See Exhibit A-3. This manner of presentation identifies and provides for recovery of all PSCR costs. It also facilitates a comparison of PSCR costs under the MISO Day-2 Market with the Company's PSCR costs in its base rates, and the PSCR Factors set in prior (pre-MISO Day-2) years.

2. Expected Sources of Company Generation

As shown on Exhibits A-4, WEPCO projects generating in 2006 approximately 30,639,602 MWh of energy with its generating facilities. More specifically, WEPCO anticipates for the 2006 plan period, that its coal-fired plants will generate 66.3% of the energy produced internally. Approximately 6.2% of energy generated internally will be produced by the Company's gas/oil fueled combustion turbines, and 1.2% by its hydro-generation. WEPCO's nuclear power plant will produce 26.3% of the Company's generated energy. (See Exhibit A-4, p 2) Mr. Lorden testified that as part of the Company's "Power The Future" plan, the first unit of the Port Washington Generating Station, totaling 545 MW, was placed in service in 2005. (3 Tr 59) Mr. Lorden also identified planned generating units outages of more than 90 days in 2006. (3 Tr 59)

3. Fuel Procurement

a. Fossil Fuel

Mr. Lorden testified that the Company has a flexible and pragmatic approach to the procurement of coal. (3 Tr 67) Mr. Lorden stated that WEPCO has ten coal contracts, nine of which are classified as either long-term (more than 5 years in length) or intermediate-term (one to five years in length), and one spot market agreement. (3 Tr 69) WEPCO uses long-term contracts to encourage coal producers to dedicate

reserves to meet the total contract tonnage, provide assurance of operation and provide the coal suppliers with the ability to obtain favorable financing for their operations. (3 Tr 68-69) Mr. Lorden testified that the Company's long-term contracts provide a stable, reliable supply of quality coal at anticipated cost levels (3 Tr 68), and that because such contracts provide an assured volume from one origin for a definite period, WEPCO experiences lower transportation costs. (3 Tr 68) With respect to intermediate-term contracts, Mr. Lorden testified that WEPCO uses these to construct a portfolio that will more closely track "market" pricing. (3 Tr 69) Mr. Lorden described in detail the Company's systematic procedures in bidding and negotiating long-term and intermediate-term coal contracts. (3 Tr 70-72)

Mr. Lorden testified "that natural gas and oil will account for approximately 6 percent of the energy generated (in MWh) by the Company, and approximately 28 percent of the Company's owned and leased generating capacity (in MW)." (3 Tr 75) Mr. Lorden testified that the Company purchases gas for the Alliant Energy Neenah, Calpine Zion and Ameren Elgin plants under tolling arrangements. Mr. Lorden stated that the Company acquires natural gas through the combination of spot purchases and seasonal term/base load purchases, and that this is the most economical purchase plan for natural gas because of the variable and unpredictable amount of incremental load for which WEPCO uses natural gas. (3 Tr 75) Mr. Lorden testified that the costs and benefits of the Company's approved fuel price risk management hedging tools were included in the Company's PSCR plan. (3 Tr 77) Mr. Lorden also stated that the Company acquires oil for generation through spot purchases and bulk purchases stored

in local terminals. (3 Tr 75) Mr. Lorden testified that the Company's fossil fuel purchasing practices were reasonable and prudent. (3 Tr 77)

b. Nuclear Fuel

Mr. Lorden testified concerning procurement of nuclear fuel and related fuel cycle services. Mr. Lorden described in considerable detail the Company's nuclear fuel procurement, conversion, enrichment and fabrication practices, contracts and arrangements. (3 Tr 78-79, Exhibit A-10) He stated that WEPCO purchases uranium from Energy Resources of Australia pursuant to a long-term agreement. (3 Tr 80-81) WEPCO also purchases, through Nuclear Management Corporation ("NMC"), uranium under contracts with UG U.S.A. and Areva. Through NMC, the Company obtains some conversion services for the 2006 PSCR period pursuant to contracts with ConverDyn, UG U.S.A., and Areva, with the remainder purchased on the spot market. (3 Tr 81) As for enrichment services, Mr. Lorden testified that the Company contracted with the United States Enrichment Corporation, but that such contract expires during 2006. (3 Tr 82) The Company, through NMC, has contracted with Urenco for the remainder of its 2006 enrichment services. (3 Tr 82) Fuel fabrication services are obtained through an agreement with Westinghouse Electric Corporation. (3 Tr 82) Mr. Lorden described actions the Company has taken with regards to the disposal of Spent Nuclear Fuel ("SNF"). (3 Tr 87-88)

4. Purchased Power

WEPCO has purchase power agreements for approximately 1,473,000 MWh of energy from suppliers other than MISO. This energy is offered into the MISO Day-2 energy market. The Company's net purchases from MISO are approximately 1,369,139

MWh (Exhibit A-5). Mr. Schumacher described Company procedures and practices used to secure contracts and obtain purchased power at the least cost. Mr. Schumacher stated that in connection with longer-term purchases, the Company uses a formal competitive bidding process. For mid-term purchases (12 to 24 months in duration) the Company may use an informal competitive bidding process. (3 Tr 148-149) Mr. Schumacher described in detail the procedures used, and factors considered, by the Company in procuring reliable and economic long-term arrangements for purchased power. (3 Tr 150-152)

“There are many factors considered [by WEPCO]. First the amount of lead time available before the power is needed may dictate whether or not sufficient time exists to consider newly constructing generating capacity versus existing units. Second, the location of the supply resource is critical to assuring the power can be delivered on a firm basis to the Company’s control area, under the MISO Open Access Transmission Tariff, given the current constraints on transmission in the Upper Midwest. The evaluated cost of purchase power over the term of the agreement, both the fixed capacity payments and variable energy payments, are critical factors in selecting power supply contracts. Other factors include the credit worthiness of the supplier; diversity of power supply options; expected reliability of supply, bonus/penalty provisions for performance; nomination, scheduling or dispatch rights; and need to achieve certain portfolio standards such as renewable energy requirements; etc.” (3 Tr 150)

Mr. Schumacher described the long-term energy agreements the Company has entered into since its 2005 PSCR filing. (3 Tr 151-153) These agreements do not include any capacity charges in effect for longer than six months. (3 Tr 151) Mr. Schumacher testified that the entry into these purchase power agreements was reasonable and prudent. (3 Tr 153-154)

5. Other Power Supply Items

Mr. Lorden also described other sources of supply, including customer-owned generation and renewable energy, such as wind, hydro, landfill gas generation, etc. Mr. Lorden stated that the energy produced by these other sources amounts to approximately one-tenth of 1% of the Company's system requirements. (3 Tr 60) He testified that the Company is planning to increase the amount of renewable energy in its generation portfolio. (3 Tr 61) Mr. Lorden further testified that WEPCO has interruptible and curtailable services available. (3 Tr 63-65) PSCR costs include transmission charges (3 Tr 91, 167), SO₂ and NO_x reduction costs (3 Tr 92, Exhibit A-7). The PSCR costs do not include any costs for fuel handling and ash disposal or for the dry cask storage of spent nuclear fuel. (3 Tr 59)

Mr. Lorden stated that the Company's decisions to provide power supply in the manner set forth in its 2006 PSCR plan are reasonable and prudent. (3 Tr 67)

6. Major Contracts and Power Supply Arrangements

Act 304 requires a PSCR plan to describe all major contracts and power supply arrangements entered into by the utility. Exhibits A-8 through A-10 meet this requirement by providing, among other things, a description of the price of fuel and the duration of the contract arrangements. The testimony and exhibits of Mr. Schumacher, described the Company's purchase power contracts. (3 Tr 151-153, Exhibits A-13 and A-14)

D. Power Supply Costs

Mr. Lorden testified that for 2006, the Company estimates a total system power supply cost of \$951,219,864. As shown on Exhibit A-11, of the total system power supply cost, \$513,529,864 is attributable to fuel for generation and \$306,207,237 is attributable to purchased power. There is a \$51,007,727 credit for external Opportunity Sales. The balance of power supply costs is for Transmission Service and NOx reduction costs.

1. MISO Net Transaction and Other Costs

As described in Section III.C.1., above, MISO credits the Company for energy sold to MISO at the Locational Marginal Price ("LMP") for the generation node involved, and charges the Company for energy delivered to the Company at the LMP for the commercial pricing node involved. The MISO LMP consists of three components: (i) Marginal Energy Component; (ii) Marginal Congestion Component; and (iii) Marginal Loss Component. (Exhibit LP-10) For purposes of presenting its 2006 PSCR Plan and calculating its proposed PSCR Factors, the Company "nets" out, on an hourly basis, the MISO charges incurred and MISO credits received for service during that hour. The Company then shows the resulting "net" amounts in calculating the recoverable MISO costs for such hour.

The MISO Market Purchases, MISO Market Sales and Net MISO Transactions figures (\$/MWh) shown on Exhibit A-3, page 3 and Exhibit A-15 are based upon the Marginal Energy Cost Component and the Marginal Congestion Component of the LMP. (3 Tr 135) During each hour, the Marginal Energy Cost Charge is uniform across each

load zone. The Company has three (3) MISO load zones (*i.e.*, WEC.N, WEC.S and WEC.ESE).

Mr. Schumacher described the costs resulting from the Marginal Congestion Component of the MISO LMP. (3 Tr 155-156) Mr. Schumacher also described MISO's allocation of using Financial Transmission Rights ("FTRs") to help load serving market participants hedge congestion costs. FTR revenues are included in the line entitled "Less MISO FTR – Revenue" on Exhibits A-3 and A-15. All FTR revenue/credits received by the Company are included in the PSCR Plan.

The costs resulting from the Marginal Loss Component of the LMP are included in the line entitled "MISO-Losses" on Exhibit A-15. Mr. Schumacher described the Marginal Loss Component, stating:

MISO calculates marginal transmission losses based on an analysis of transmission system loss contributions to each CP node, and projects the cost of marginal transmission costs on daily settlement statements. In an effort to provide a transition from the historic use of average transmission system losses to the new energy market and the corresponding use of marginal losses, MISO calculates a re-distribution and indicates that amount on the daily settlement statements. (3 Tr 157)

Mr. Lorden testified:

Only the incremental cost of marginal losses is included in the power supply cost plan, as shown on Exhibit A-3 (TPL-3), page 4 under MISO Energy Market Costs. The incremental cost of marginal losses is projected to be \$7,850,045 which is the remainder of the projected cost of MISO – Losses of \$46,832,347 less the projected cost of MISO – Loss Distribution (average losses) of \$38,982,302. (3 Tr 97)

From the amount of the Marginal Loss Component of the LMP, the Company deducts the amount of the "MISO Loss Distribution." The MISO Loss-Distribution represents "average transmission losses." The amount included in the PSCR costs is only the incremental congestion costs above average system losses. The difference between

these amounts is set forth in the line entitled "Net Losses" on Exhibit A-15. This amount is the net amount the Company pays to MISO. It is a power supply cost, just like any other amount paid to MISO.

The Company also incurs "MISO – Administrative Costs as shown on Exhibit A-15.

2. MISO Revenue Sufficiency Charges and Credits

In addition to the cost resulting from Net MISO Energy Transactions, the Company also incurs charges and receives credits related to MISO Revenue Sufficiency Make Whole Payments. Revenue Sufficiency Make Whole Payments are payments made to generators for Reliability Assessment Commitment ("RAC") operations, when the MISO dispatches a generator and the LMP paid to the generator does not fully cover the generator's costs. Mr. Schumacher testified:

MISO may dispatch various units, usually gas-fired peaking units, out of economic merit order for system reliability purposes. MISO will pay the generator its costs to operate to make the generator whole for costs that are not met by the LMP revenues received. (3 Tr 158-159)

MISO dispatches the majority of generators in economic order, with additional generators dispatched as part of the MISO Reliability Assessment Commitment ("RAC") process to maintain reliable operation of the transmission system. These RAC-committed generators often have operating costs higher than the MISO hourly LMP levels. Accordingly, MISO provides a "make-whole" revenue sufficiency payment to these generators to cover their costs to operate. (3 Tr 165)

Revenue Sufficiency Make Whole Payment charged by MISO to the Company are included in Exhibit A-15 under the heading "MISO Total Uplift Costs." Such costs reflect the amount the Company projects to be charged by MISO in 2006 based upon the Company's projected load weighted share of all the Day-Ahead make whole payments made by MISO to all generators in the Day-Ahead market. (Exhibit LP-43) In 2005, the

Company paid MISO approximately \$13,900,000 in Revenue Sufficiency Make Whole Payments. (Exhibit LP-43)

The Company's 2006 PSCR plan does not include any Revenue Sufficiency Make Whole Payment credits because the model used to prepare the 2006 PSCR Plan was based upon the economic dispatch of the Company's resources and, therefore, did not include RAC operation of the Company's resources. Mr. Schumacher testified:

The Company used the security constrained economic dispatch model "PROMOD" to project some of its 2006 PSCR costs. This model does not project unit commitment and operation as set forth by MISO under the RAC process. Accordingly, the costs of RAC operations were not included in the 2006 PSCR plan and factors. (3 Tr 165)

Accordingly, the PSCR Plan does not include any generation, any cost of fuel, any LMP payments or any Revenue Sufficiency Make Whole Payment credits related to the RAC operation of Company resources in the calculation of PSCR costs or factors.

The exclusion of the effects of RAC operations, including the exclusion of Revenue Sufficiency Make Whole credits which might be received by the Company, does not adversely affect, or increase, the PSCR Factor. As explained in Exhibit LP-43:

These costs occur when the MISO dispatches a generator and the LMP paid to the generator does not fully cover its costs. As such, revenue sufficiency make whole payments fully compensate the Company for costs to operate generating units dispatched by MISO when the LMP is not sufficient to fully compensate the generators. The net cost effect of RAC operations of the Company generating units is that operating costs are offset by LMP revenue from unit operations and make whole revenues. There is no "gain." Because the effect on power supply costs for the Company from RAC operations is zero, WEPCo did not include the generation or costs related to RAC operations nor the revenues the Company would receive from those operations in the PSCR Costs for purposes of setting its PSCR Factors. (Exhibit LP-43. emphasis added)

Since neither the generation nor the costs related to RAC operations are included in the plan, there is no basis to offset any projected 2006 Revenue Sufficiency Make Whole Payment credits against projected PSCR costs.

The net effect of the Company's treatment of RAC operations is the same as if the generation, cost thereof, revenues from MISO LMP, and revenue sufficiency payments were included in the PSCR plan and factors. Mr. Schumacher stated:

Since costs related to RAC operations are not included in the PSCR plan costs or Factors, revenues or credits related to RAC operations should also not be included in the PSCR Plan and Factors. To include such credits, without including the corresponding costs, would under-recover costs incurred. (3 Tr 165-166)

To include any projected MISO revenue sufficiency make whole revenues in the calculation of the PSCR factor when the underlying generation and costs related to RAC operations are not included would underrecover PSCR costs.

3. Minimizing Costs

Mr. Lorden's testimony detailed a number of efforts by WEPCO to minimize fuel costs. In particular, Mr. Lorden stated that the Company consistently evaluates its fossil fuel costs:

- "A. Does the Company use systematic procedures for periodic market investigations of fossil fuel costs and availability, particularly prior to renewal or re-negotiation of contracts?
- Q. Yes, the Company relies on extensive direct contacts with coal companies throughout the country, transportation companies' coal departments, data collected from current periodicals, trade journals, purchased research reports from coal market consultants, over-the-counter coal trades and options posed by coal traders, and other coal consuming companies for these market investigations. (3 Tr 70)

Mr. Lorden also testified that in addition to negotiating the most advantageous coal contracts possible, any price changes requested by a supplier must comply with the terms of the contract and must be substantiated with required supporting documentation. (3 Tr 72) In order to validate a price change, the Company will visit the mine, conduct audits and/or hire an outside consultant to evaluate the supplier's data. (3 Tr 72) WEPCO also negotiates terms which allow the Company to monitor the quality of coal on a consistent basis and to assess penalties or reject deliveries for inferior coal. Mr. Lorden testified that:

Each coal purchase agreement contains a provision that guarantees the heat value. Older contracts also contain an ash content guarantee. More recent contracts require the heat and ash content guarantee along with a maximum allowable SO₂ content. Coal that is received having other than the guaranteed qualities may have a premium or penalty assessment where applicable under the terms of a contract for heat, sulfur and/or ash content, as well as provisions for rejection of coal that does not meet the minimum heat content guarantee or exceeds the maximum ash or sulfur guarantees. (3 Tr 72)

Moreover, WEPCO consistently reviews coal transportation rates. (3 Tr 73) As discussed, the Company's coal procurement plan has focused on the use of long-term and intermediate-term contracts to obtain the necessary amounts of high quality coal at the lowest possible prices. (3 Tr 70-71) Additionally, as discussed supra, the Company continually evaluates the market as regarding coal costs and availability, actively analyzes the quality of coal deliveries, and enforces contract penalty provisions that protect the Company and its customers from costs incurred due to substandard coal.

Mr. Lorden also discussed the Company's process for determining nuclear fuel costs (3 Tr 86-87), and stated that WEPCO's primary objective in negotiating and administering nuclear fuel contracts is to secure an assured supply of a reliable product

or service at a reasonable cost. (3 Tr 85) Mr. Lorden further testified that if circumstances change after execution of a nuclear fuel contract such that benefits are not being, or will not be, realized, the Company "employs all reasonable efforts to negotiate a modification which will restore the original intent of the contract." (3 Tr 85) Further, Mr. Lorden enumerated nine (9) separate actions that the Company has taken to reduce or control the cost of nuclear fuel. (3 Tr 82-85)

With respect to purchased power costs, Mr. Schumacher stated that in selecting suppliers, the purchase cost over the term of the agreement, including both the fixed capacity payments and variable energy payments, is a critical determinant. (3 Tr 150)

4. Revenues from Third Party Sales

The Company includes as an offset to its PSCR costs the net revenues of over \$51 million it projects to receive from "Opportunity Sales," including: (i) non-firm sales into the PJM Market; (ii) sales to Edison Sault under the Joint Operating Agreement; and (iii) firm sales to Edison Sault. The Company, a multi-state utility, also makes sales to other third-parties as follows: (i) retail customers in Wisconsin (approximately 90% of its retail load); (ii) sales to municipalities and other wholesale customers at FERC rates; and (iii) sales pursuant to special contracts approved by MPSC (collectively, "Third-Parties"). Net revenues from these Third-Party "non-opportunity sales" have never been and are not currently credited to PSCR customers. The reasons are clear for the difference in the treatment of revenues from: (i) Opportunity Sales; versus (ii) other sales to Third Parties.

First, the Company's Michigan tariff base rates were most recently set in the MPSC September 16, 2001 Order in Case No. U-12725. The rates set in that case,

including the base cost of power supply included in the base rates, were set based upon a jurisdictional cost-of-service study which separated the cost to service Michigan tariff customers from the cost to serve Third Party customers (e.g., customers served pursuant to rates set by the PSCW, FERC and special contracts approved by the MPSC). (3 Tr 138) Thus, the costs to serve Third-Party customers are not being recovered through rates paid by Michigan tariff customers. (3 Tr 137-138) This is significantly different from the treatment of costs underlying Opportunity Sales. The cost of service study underlying existing rates did not exclude the cost to serve “opportunity sales” from the costs underlying Michigan retail tariff rates.

Because the costs underlying the making of Opportunity Sales were not specifically excluded from Michigan rates, the Company credits the net revenues from Opportunity Sales back to Michigan customers via a credit against PSCR costs. However, since the costs to serve other Third-Parties are specifically separated from costs recovered through Michigan rates, there is no basis upon which to capture or credit to PSCR customers net revenues from such third-party sales.

Crediting net revenues from Third-Party sales to PSCR customers would be confiscatory and unreasonable. All non-power supply costs (e.g., O&M, G&A, depreciation, rate of return, etc.) incurred in connection with such sales are allocated to such Third-Party sales, and must be recovered from such sales (if they are to be recovered at all). The only way non-power supply costs incurred to provide service to such Third-Parties can be recovered is through the net revenues from the sales to such Third-Parties. If the net revenues from such sales are credited to PSCR customers,

such revenues would not be available to cover the cost to serve the Third-Party customers. Such a result is confiscatory, unjust and unreasonable.

Furthermore, the crediting of net revenues from Third-Party sales to PSCR costs would be an enormous windfall to Michigan PSCR customers. Carrying on the logic of crediting the 'net revenues' from all Third Party sales to PSCR customers would, in the case of WEPCO, lead to the result of crediting to PSCR customers (2%-3% of the Company's customers) with all net revenues from the Company's sales to Wisconsin retail customers (90+% of the Company's customers). Clearly such a result is unreasonable.

The differences described above between: (i) Opportunity Sales, from which WEPCO credits net revenues to PSCR Costs; and (ii) other Third-Party sales, are significant and clearly require continuation of the historical treatment of such third-party revenues.

The Company properly credited PSCR customers the anticipated net revenues from Opportunity Sales and did not credit PSCR customers with net revenues from other Third-Party sales.

E. WEPCO's 2006 PSCR Factors are Reasonable and Should be Approved.

In its Application, and as supported by Messrs. Lorden's and Schumacher's testimony and exhibits, WEPCO requests Commission approval of PSCR factors of 16.13 mills per kWh to be effective for the January 2006 through December 2006 billing period. (3 Tr 93) Mr. Lorden testified that these PSCR factors were calculated using the base cost of power supply of \$13.79 per MWh at the generation level, which is the base cost of power supply that was authorized in MPSC Case No. U-12725 and is set

forth in the Company's filed and approved tariffs (Fifth Revised Sheet No. 14). As shown on Exhibit A-11, page 1, the Company's proposed PSCR factors are derived from dividing the total system cost of \$951,219,864 by the net system requirements of 32,785,257 MWh, resulting in an average power supply cost of \$29.01 per MWh at the generation level. From the average power supply cost is then subtracted the PSCR base cost resulting in an average cost of \$15.22 MWh.

This difference (\$15.22/MWh) between projected 2006 PSCR costs and the cost of power supply included in base rates is then multiplied with the loss factor of 1.06. The purpose of the "loss factor" is to make the calculation of average cost per MWh (\$/MWh) of Power Supply Costs at the generation level equivalent to the average cost per MWh at the sales level. (3 Tr 137) The loss factor of 1.06 was most recently set as part of the Company preceding rate, Case No. U-12725, and is incorporated in the Company's approved and filed Michigan tariffs (Fifth Revised Sheet No. 14). When PSCR costs are calculated on a \$/MWh basis at the generation level, application of that average cost (without adjustment for losses) to a lower projected sales level will result in an underrecovery of PSCR costs. Application of the loss factor is necessary and appropriate so that sales at projected levels will provide for the recovery of power supply costs projected to be incurred to make such sales.

That the PSCR Plan costs to be recovered include a portion of the LMP charged by MISO and designated by MISO as a "Marginal Loss Component" is not a basis for changing the MPSC approved loss factor. First, the Company's calculation of recoverable PSCR costs nets MISO Loss Distribution credits against the loss component portion of the MISO LMP. Mr. Lorden testified:

Only the incremental cost of marginal losses is included in the power supply cost plan, as shown on Exhibit A-3 (TPL-3), page 4 under MISO Energy Market Costs. The incremental cost of marginal losses is projected to be \$7,850,045 which is the remainder of the projected cost of MISO – Losses of \$46,832,347 less the projected cost of MISO – Loss Distribution (average losses) of \$38,982,302. (3 Tr 97)

Thus, the PSCR costs include MISO losses only to the extent those losses exceed MISO average losses. Second, the amounts to be paid by the Company to MISO as the marginal loss component of the LMP are power supply costs incurred by the Company, the same as any other power supply costs paid to MISO for energy. When such costs (like all other PSCR costs) are calculated on an average \$/MWh basis at the generation level, such cost average must be adjusted for line losses in order that application of it to lower sales volumes will recover the full amount of the power supply costs projected to be incurred. This methodology does not result in any 'double recovery' of line losses. Mr. Lorden clearly addressed this point, stating:

Q. ...Is there an overlap between WEPCO's 6% loss factor and the losses included in MISO's LMP?

A. No, it is not the Company's intent to overlap losses. Rather the intent is to ensure that PSCR Plan costs and actual costs are accounted for on the same basis. (3 Tr 97)

Adjusting the average power supply costs of \$15.22/MWh at the generation level by the approved line loss factor of 1.06 results in an average cost above the cost of power supply included in base rates of \$16.13/MWh. The proposed PSCR factors of 16.13 mills per kWh, as based in the 2006 PSCR plan, are reasonable, prudent and calculated in accordance with established Commission precedent.

F. WEPCO's Five-Year Forecast Satisfies the Requirements of Act 304 and Should be Approved.

Subsection 6j(4) of Act 304 requires that a utility file a five-year forecast of the power supply requirements of its customers, its anticipated sources of supply and projections of power supply costs, in light of its existing sources and sources of electrical generation under construction. The forecast must also include a description of all relevant major contracts and power supply arrangements entered into or contemplated by the utility.

Exhibits A-1 and A-2 set forth the power supply requirements of WEPCO's customers for the five year period of 2006-2010. Exhibits A-3 through A-6 and Exhibits A-8 through A-10 set forth the Company's anticipated sources of supply and projections of power supply costs for the five year period of 2006-2010. Exhibits A-8 through A-10 describe all relevant major contracts and power supply arrangements entered into by WEPCO covering the period of 2006-2010.

Therefore, consistent with the filing requirements of subsection 6j(4), the record evidence in this proceeding supports a finding that approval of WEPCO's five-year forecast is appropriate.

IV. CONCLUSION AND RELIEF

The record evidence in this proceeding supports approval of WEPCO's 2006 PSCR plan and factors of 16.13 mills per kWh, and its five-year forecast. WEPCO's application, therefore, should be approved as filed.

Respectfully submitted,

WISCONSIN ELECTRIC POWER COMPANY

Dated: May 26, 2006

By: **Ronald W. Bloomberg**
Digitally signed by Ronald W. Bloomberg
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