



Public Service Commission of Wisconsin

Joseph P. Mettner, Chairman
John H. Farrow, Commissioner

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August 4, 1998

The Honorable John D. Dingell
U.S. House of Representatives
Committee on Commerce
2125 Rayburn House Office Building
Washington, DC 20515-6115

Dear Representative Dingell:

This is in response to your letter of July 15, 1998, in which you asked several questions regarding recent electric price and supply problems in the Midwest. The attachment to this letter contains the Public Service Commission of Wisconsin responses to the questions. I am also enclosing a copy of 1997 Wisconsin Act 204, which Governor Thompson signed on April 28, 1998. The Act was published on May 11, 1998. This new law is the most recent effort in Wisconsin to restructure the electric industry.

Thank you for your interest in this very important matter. If I or my staff can be of any further assistance to you, please do not hesitate to contact us.

Sincerely,


Joseph P. Mettner
Chairman

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Attachments

- 1. Please outline your understanding of the course of events leading to supply curtailments and price surges in electricity markets during the week of June 22, including any gaps in your understanding of relevant factors.**

It is my understanding that a constrained transmission system, an inadequate supply of electricity caused by the unavailability of several nuclear units in the region, storm damage, and hot, humid weather were the primary events that caused shortages and price surges during that week. An increasingly competitive wholesale market requires the transmission system that was originally designed to serve relatively limited regional transfers of power to be used for significantly greater transfers of power. Wholesale market changes and resultant use of the transmission system have combined to demonstrate the need to enhance and expand the region's constrained transmission infrastructure. With several nuclear units in the region down for safety and maintenance reasons, some utilities found it difficult to meet customers' demand for electricity alone. In addition, storms caused damage to some transmission lines creating further difficulties in gaining access to electricity supply outside of a utility's service territory. When hot weather hit the region, limitations on owned generation supply and access to others' generation became acute, creating a situation where utilities desperately sought electricity from a market with too few available resources.

- 2. Are you considering initiating, or have you already begun an inquiry into these events? If so, please describe the purposes, scope, and timetable for completion of any such proceeding.**

Wisconsin is currently in the midst of improving the infrastructure of the state's electric system. That effort includes an aggressive schedule to add generation and assess weaknesses in the region's transmission system as it affects our state. This and other reliability related measures are the Commission's highest priority. A preliminary review of the events you refer to indicates that Wisconsin ratepayers and utilities were not nearly as affected by the price surges as occurred in other states. The Commission has, however, had discussions with certain parties about the events and will take formal action if that appears to be necessary.

- 3. Are you seeking or participating in any such proceeding undertaken by another organization?**

At this point the Commission is not. The Commission is continuing to engage in discussions with other participants in the electric industry on reliability matters in order to continually improve our understanding of the region's electric system and the events that you describe.

4. **Do you consider the price spikes and supply shortages in the Midwest during June to be a one-time event, or might they recur? Are you concerned about the remainder of the summer, and what are the factors affecting near-term market stability? If you think a recurrence of market turbulence is possible, do you believe changes in market structure or regulation may be needed?**

I believe the price spikes and supply shortages could recur in the region. In fact, since the week of June 22 significant spikes have occurred which is not surprising given that the same generation and transmission problems still exist. Until these problems are mitigated, delivery of electricity in the region will be vulnerable to persistent, widespread hot weather. This is certainly a concern to regulators, consumers, and utilities in the state. Price spikes of the magnitude that have occurred threaten the financial integrity of the utilities and the bills that customers pay, especially if the frequency and duration of spikes are high and prolonged.

Changes in the electric industry are necessary. An effective, competitive generation market must be a high priority. Many utilities are reluctant to add power plants given the uncertainties in the industry and the structure must allow for unregulated entities to easily enter the market. In Wisconsin, recent legislation was designed to encourage the construction of merchant power plants by changing certain existing rules and streamlining the regulatory process. The transmission system must also be strengthened and effectively run by an independent entity either as an Independent System Operator or as the result of divestiture. This entity must be strong and independent from generators both in fact and appearance. State and federal regulators must be certain not to fail in this endeavor. It is also useful to explore innovative pricing mechanisms for customers so that they can effectively deal with price changes and alter their electricity usage in ways that benefit both the customer and system reliability. In short, a balance of regulatory efforts, use of markets, and customer input are all ingredients to resolving reliability problems as they now exist.

5. **Are you aware of any complaints alleging market manipulation or conflicts of interest involving regulated utilities or other market participants?**

I am aware of many allegations that have been reported in the press. At this point, I am not aware of allegations of improper actions by Wisconsin utilities or other market participants in the state.

6. **What if any direct or indirect effects on consumers resulted, or may yet result, from the price and supply disruptions in the Midwest in late June? Are residential consumers more or less vulnerable than industrial consumers in terms of price increases and reliability of supply?**

Any effects on consumers should be closely analyzed and remedial action, to the full extent possible, should be taken. Although the particular circumstances of individual customers must be considered, many industrial customers are probably more vulnerable to price and supply matters than residential customers. Many industrial customers are on tariffs that allow their supply to be interrupted or curtailed and the prices they pay may change under

certain market conditions. Residential customers would be among the last to lose their electricity and the prices they pay for electricity are relatively stable.

7. What, if any, effects did this market volatility have on public power entities and their consumers?

I believe the recent events caused many parties to reassess the Midwest electricity market both in terms of opportunities and vulnerability. The events reinforce the importance that regional matters can affect individual states and even customers. They also mean that restructuring must be done carefully with the end-user clearly in mind. Consumers, particularly large ones, must be fully aware of their tariff conditions and other provisions that may be available to them and be certain that they have an effective communication link with their utilities and regulators.

On a positive note, the recent events demonstrated to many electricity customers the importance of electricity to their businesses and in their daily lives. This, coupled with an increased awareness of the strengths and weaknesses of the electric system, should result in their active participation in the restructuring of the electric power industry. Greater involvement by the customer can only serve to aid the process.

8. Do you foresee any lessons to be drawn from this experience for state and federal legislators deliberating the merits of electric restructuring legislation? How would more widespread retail competition affect market stability in the future, and how would residential consumers be affected? Are markets ready to make a smooth transition to full retail competition now, and should Congress pass legislation to compel states to adopt competition?

The key issue is to be certain that the proper infrastructure is in place for each stage of restructuring. Without this, competitive markets are less likely to work and consumers will be vulnerable. In this regard, my response to the last part of question #4 applies. Legislators should be certain that regulators have the proper tools to assure that the transmission system can be effectively and independently operated. This will encourage independent power producers to appear in the region and provide electric supply. Without addressing the infrastructure issue, wholesale competition will not flourish and retail competition would be especially ineffective with residential customers extremely vulnerable to price and supply problems.

In Wisconsin, we do not feel the infrastructure issue has been resolved, although the foundation for accomplishing this is in place. Legislation has been passed that encourages the development of merchant power plants and regulators have been given the authority to see that the transmission system is enhanced to support the changed power markets and operated independently. As this process evolves, I believe we can begin to explore ways to allow customers greater choice without disadvantaging other customers. It may not be necessary for Congress to require states to adopt retail competition, especially at a date certain. Federal regulators should aggressively pursue the implementation of independent

regional transmission systems and the states could then be given the opportunity to design a retail competition package that fits the needs of its customers. Ultimately it should be the customers who have the last say as to how electric service in their state should be provided. This said, I believe it is imperative that regulators should not operate in a vacuum. They must consider the activities and the possibilities within their region when developing electric restructuring policy that works best for the consumer in their states.