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BEFORE THE  
PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Wisconsin Electric Power Company;	)	
Wisconsin Energy Corporation; and W.E. Power, LLC;	)	
for a Certificate of Public Convenience and Necessity	)	Docket No. 05-CE-130
for Construction of Three Large Electric Generation	)	
Facilities, the Elm Road Generating Station, and	)	
Associated High Voltage Transmission Interconnection	)	
Facilities to be Located in Milwaukee and Racine Counties	)	
	)	
Application for Approval of Affiliated Interest	)	
Agreements Between Wisconsin Electric Power Company	)	Docket No. 05-AE-118
and Elm Road Generating Station (amended filing)	)	MULTIPLE UTILITIES
	)	
	)	

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**DIRECT TESTIMONY OF MARY L. WOLTER and ANDREW J. HESSELBACH**

**ON BEHALF OF APPLICANTS**

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18 **Q. Please state your name, business address, and title.**

19 A. My name is Mary L. Wolter. My business address is 231 West Michigan Street,  
20 Milwaukee, Wisconsin 53203. I am a Financial Consultant for Wisconsin Electric Power  
21 Company (“WE”, “Wisconsin Electric”).

22 **Q. Please describe your educational and business experience.**

23 A. I received a Bachelor of Business Administration degree, majoring in both accounting and  
24 finance from the University of Wisconsin - Milwaukee in May, 1984. In June, 1984, I  
25 accepted an internal auditor position with Wisconsin Gas, a WICOR company. I held  
26 several positions with Wisconsin Gas, the most recent being Manager-Rates. In April, 1995  
27 I was recruited to assist in forming the company’s unregulated affiliate, WICOR Energy,  
28 where I assumed the role of Risk Manager. After Wisconsin Energy Corporation’s

1 acquisition of WICOR and the combination of WICOR Energy with Kaztex Energy  
2 Management in April, 2001, I assumed my current position with WE. I am a Certified  
3 Public Accountant, a Certified Management Accountant, and a Certified Internal Auditor.

4 **Q. What are your responsibilities as a Financial Consultant?**

5 A. My responsibilities generally include long-term financial forecasts, project analysis, and  
6 special studies. Since I joined WE I have been assigned primarily to the Power the Future  
7 project, assisting in the development of the leases and affiliated interest agreements. I  
8 testified previously before this Commission regarding the affiliated interest agreements  
9 developed in connection with the Port Washington Generating Station (“PWGS”) CPCN  
10 (Docket Nos. 05-CE-117 and 05-AE-109) in addition to numerous other proceedings on  
11 behalf of Wisconsin Gas Company and WICOR Energy.

12 **Q. Please state your name, business address and title.**

13 A. My name is Andrew J. Hesselbach. My business address is 301 W. Wisconsin Avenue,  
14 Milwaukee, Wisconsin 53203. Effective April 15, 2002, I was appointed Manager-  
15 Business Planning and Contracts for W.E. Power, LLC (“We Power”), the Wisconsin  
16 Energy Corporation (“WEC”) subsidiary that will design, build and own all or a majority  
17 portion of the new power plants that are part of WEC's *Power the Future* (“PTF”) plan.

18 **Q. Please describe your educational and business experience.**

19 A. I graduated from the University of Wisconsin – Madison in 1990 with a Bachelor of  
20 Science in Industrial Engineering. After two years with Northern Illinois Gas Company, I  
21 accepted a position with Wisconsin Natural Gas Company in 1992. In 1994 I received my  
22 Wisconsin certification as a Registered Professional Engineer and in 1996 earned a Master  
23 of Business Administration degree from Marquette University with an emphasis in finance.

1 For the past ten years my work experience has included the development of  
2 Blackhawk Energy Services, a joint venture non-utility energy marketing subsidiary of  
3 Wisconsin Energy Corporation, Project Manager within the Energy Marketing Department,  
4 Manager for natural gas transportation services, and Manager – Customer Relations for  
5 WE. As noted earlier, I am currently Manager – Business Planning and Contracts for We  
6 Power LLC.

7 **Q. What have your responsibilities been with regard to the *Power the Future* initiative?**

8 A. I have been involved in two distinct aspects of *Power the Future*. As part of my duties as  
9 the Manager - Customer Relations for WE and now as Manager-Business Planning and  
10 Contracts for We Power I have participated in communicating with business customer  
11 groups regarding PTF. With respect to this testimony, I have worked to coordinate the  
12 development and completion of numerous contractual arrangements between WE / We  
13 Power / WEC and our investor and utility partners. I testified with Ms. Wolter before this  
14 Commission regarding the affiliated interest agreements developed in connection with the  
15 Port Washington Generating Station CPCN (Docket Nos. 05-CE-117 and 05-AE-109).

16 **Q. What is your purpose for testifying in this proceeding?**

17 A. We will explain how the affiliated interest agreements related to the construction of the Elm  
18 Road Generating Station (“ERGS”) were developed and will explain the reasoning behind  
19 the major terms and provisions that differ from those already approved in the PWGS  
20 CPCN.

## 21 **DEVELOPMENT OF THE AFFILIATED INTEREST AGREEMENTS**

22 **Q. What are the affiliated interest agreements that have been presented to the**  
23 **Commission for review and approval in this proceeding?**

1 A. There are three basic agreements presented for approval with each of the Elm Road units: a  
2 facility lease, a ground lease, and a ground sublease.

3 **Q. Please explain how these leases were developed.**

4 A. The ERGS leases were modeled upon the affiliated interest agreements filed in compliance  
5 with the Final Port Washington CPCN order and approved by the Commission in Docket  
6 No. 05-AE-109. Changes were necessitated primarily for three reasons: (1) ownership of  
7 the ERGS facility may include other parties besides We Power, (2) this facility involves  
8 coal-based technology instead of natural gas-based technology, and (3) new common  
9 facilities are being constructed that will benefit Wisconsin Electric's existing Oak Creek  
10 Power Plant as well as the new generating facilities.

11 **Q. Who was involved in the development of these documents?**

12 A. These leases were developed through numerous negotiations between We Power and We  
13 Energies personnel and their respective outside legal counsel with input from the Customer  
14 Groups and representatives of the other potential owners of the facilities, namely MGE  
15 Power and Wisconsin Public Power, Inc. (WPPI).

16 **Q. Can you explain how the ownership structure of the ERGS facilities differs from that  
17 of the PWGS facilities?**

18 A. A diagram reflecting the Applicants' ownership interests in the ERGS facilities is included  
19 as Exhibit \_\_\_\_ (AH-1). The boxes that are darker in color illustrate the ownership  
20 structure that was approved for the PWGS facilities. Under that structure, We Power owns  
21 a 100% interest in a limited liability company ("LLC") which, in turn, owns the new  
22 generation units and leases them to Wisconsin Electric. The boxes that are lighter in color

1 are additions to that structure that reflect the potential ownership interests of MGE Power  
2 and WPPI in each of the units as well as the addition of a third unit at this site.

3 **Q. What are ERGS SC and ERGS IGCC?**

4 A. "ERGS SC" is an LLC, wholly owned by We Power, that will build and own a majority  
5 interest in each of the 2 supercritical ("SC") pulverized coal units at the Elm Road site.

6 "ERGS IGCC" is also an LLC that is wholly owned by We Power. It will build and own a  
7 majority interest in the integrated gasification combined cycle ("IGCC") unit at the Elm  
8 Road site. Each of these limited liability companies will lease their ownership interests in  
9 the new facilities to the utility, Wisconsin Electric.

10 **Q. Why were separate ERGS LLCs created?**

11 A. Separate companies were established primarily because of the differences in technology  
12 used in the units, but also because of the differences in the lease agreements which will be  
13 highlighted later in our testimony.

14 **Q. Do you know with certainty at this time the percentage ownership that ERGS SC and**  
15 **ERGS IGCC (each commonly referred to as an "ERGS LLC") will have in the units?**

16 A. An ERGS LLC will own 100% of the units unless and until other parties elect to take an  
17 ownership interest in one or more units. MGE Power and WPPI have an option to do so  
18 after a CPCN has been approved. In no event will ERGS LLC own less than 83% of each  
19 of the units.

20 **FACILITY LEASE**

21 **Q. Could you please describe the purpose of the facility lease?**

22 A. The facility lease is an agreement between an ERGS LLC, which would build and own an  
23 interest in new generating facilities, and Wisconsin Electric, which leases the new

1 generating facilities and uses them to produce electricity for its customers. The facility  
2 lease conveys from the Lessor (ERGS LLC) to the Lessee (Wisconsin Electric) the Lessor's  
3 interest in a completed generating facility, which the lessee has the right to operate and use  
4 for the term of the lease.

5 **Q. How many facility leases will there be according to the proposed ERGS ownership**  
6 **structure?**

7 A. Each unit will have a separate facility lease between the ERGS LLC and Wisconsin  
8 Electric, so there will be at least three separate facility leases under this proposal, one for  
9 each generating unit.

10 **Q. Are the proposed ERGS leases significantly different from the leases the Commission**  
11 **approved in the Port Washington CPCN proceeding?**

12 A. No, they are largely identical. For the benefit of those parties that are not familiar with the  
13 Port Washington lease we have summarized in Exhibit \_\_\_\_ (AH-2) the key terms that  
14 remain in common between the Port Washington and ERGS leases. The most prevalent  
15 changes are purely clerical name conforming changes and are not material to the terms of  
16 the leases. For example, "Elm Road" had to be substituted wherever "Port Washington"  
17 had been used, and "coal" had to be substituted for "gas" when referencing the technology.

18 **Q. What explains the important differences between the ERGS leases and the leases**  
19 **approved by the Commission in Phase I for the Port Washington Generating Station?**

20 A. Changes are made to recognize that there may be more than one owner of the generating  
21 unit. For instance, the new concepts "Ownership Interest" and "Lessor's Percentage" are  
22 used to reflect the fact that the lease only applies to the portion of a unit that an ERGS LLC  
23 actually has an ownership interest in, not necessarily the entire unit. Additionally, changes

1 were necessary to accommodate the differences related to the construction and operating  
2 characteristics of coal-based generating technology (Port Washington is natural gas-based  
3 technology), and in order to coordinate and allocate new common facilities utilized by both  
4 the new ERGS units and the existing units at the site.

5 The important differences between the Port Washington lease and the proposed  
6 ERGS Unit 1 leases are explained in more detail in Exhibit \_\_\_\_ (AH-3). Copies of the  
7 ERGS leases themselves are attached as Exhibit \_\_\_\_\_ (AH-4), Exhibit \_\_\_\_ (AH-5), and  
8 Exhibit \_\_\_\_\_ (AH-6).

9 **Q. The most significant changes appear to be related to the “new common facilities”.**

10 **What are these “new common facilities” and why do they require special**  
11 **consideration in the facility leases?**

12 A. “New common facilities” are the structures built and put into service at the time the first  
13 ERGS unit is put into service that are used by and useful to two or more of the units at the  
14 Elm Road site. Portions of the new common facilities benefit the existing Oak Creek Power  
15 Plant units as well as the new units (such as the coal handling systems, water intake  
16 systems, and the training and visitors center), others just benefit the two new supercritical  
17 pulverized coal units (such as the limestone and gypsum handling equipment). Without  
18 special lease terms regarding payment for and ownership of the new common facilities, the  
19 costs of these facilities could be inequitably borne by the owners of the first new ERGS  
20 unit, even if those Unit 1 owners do not participate in the construction and ownership of  
21 succeeding units.

22 **Q. Who will be paying for the portion of the new common facilities that are used by and**  
23 **useful to the existing Oak Creek Power Plant?**

1 A. Wisconsin Electric owns the existing Oak Creek Power Plant facilities, and therefore would  
2 benefit from that portion of the new common facilities that are used by the existing plant.  
3 Accordingly, Wisconsin Electric is assigned the costs attributable to that portion of the new  
4 common facilities. This is accomplished by including these costs in the facility lease  
5 agreements.

6 **Q. According to the facility lease terms, rent payment adjustments are made to the Unit 1**  
7 **lease when new units 2 and 3 are completed and placed into service. Can you explain**  
8 **the purpose of and basis for the rent adjustments?**

9 A. The intent of these "common facilities adjustment events" is to "rebalance" ownership  
10 interests so that all of the new units bear an appropriate share of the total new common  
11 facilities costs. Without "rebalancing", the owners and lessees of Unit 1 would bear most  
12 of the cost of new common facilities since most of the new common facilities are  
13 constructed at the same time Unit 1 is constructed. The ownership interests which may be  
14 held by ERGS, MGE Power, and WPPI in Units 2 and 3 may be different than the interests  
15 they hold in Unit 1 and it would be inequitable for the Unit 1 owners to bear the costs of  
16 facilities used by the Unit 2 and 3 owners.

17 **Q. Can you explain how such a rent payment adjustment is determined?**

18 A. We have provided a simplified example of the adjustment process in Exhibit \_\_\_\_ (AH-7).

19 When Unit 1 is constructed, new common facilities costs are tracked separately and  
20 depreciated separately by ERGS SC. When Unit 2 is constructed, it is assumed that Units 1  
21 and 2 will share all of the new common facilities between them.

22 When Unit 2 goes into service, therefore, one-half of the total new common  
23 facilities constructed with Unit 1 would be allocated to and shared by the Unit 2 owners. If

1 ERGS LLC owned 84% of Unit 1 and 84% of Unit 2 they would simply shift half of their  
2 share of the new common facilities to Unit 2 and recover the costs through the Unit 2 lease.  
3 Upon expiration of each respective lease, Wisconsin Electric would have an equitable share  
4 of new common facilities included in each lease in order to make an economic decision  
5 regarding renewal, purchase, or termination of the facilities.

6 **Q. Will additional new common facilities be constructed as part of the construction of**  
7 **Units 2 and 3?**

8 A. No. Components of Units 2 and 3 that might have been classified as new common facilities  
9 in Unit 1 (such as site preparation or transmission upgrades) will not be separately  
10 identified as new common facilities when built for Units 2 and 3. Perhaps an example  
11 using site preparation costs might help explain why this is reasonable.

12 Site preparation costs incurred when Unit 1 is constructed would conceivably  
13 benefit Units 2 and 3. However, when Unit 2 is actually under construction the costs of site  
14 preparation for Unit 2 cannot reasonably be allocated back to Unit 1 because Unit 1 does  
15 not benefit from the Unit 2 site preparation. Because it is unlikely that Unit 2 could justify  
16 allocation of site preparation costs to Unit 3, and because the costs are probably immaterial,  
17 we have also not made any assumptions that Unit 2 would share incremental new common  
18 facilities costs with Unit 3.

19 **Q. Schedule 7.4 of the facility lease makes reference to “Components” when describing**  
20 **the new common facilities adjustment event calculation. What is meant by that term?**

21 A. The new common facilities are divided into four different types, or components: (1) those  
22 related to the circulating water system, (2) those related to fuel delivery and handling, (3)  
23 those common only to the supercritical pulverized coal Units 1 and 2, and (4) site-wide

1 common systems. The costs of constructing each component are allocated and later  
2 “rebalanced”, if necessary, among the units based upon a different allocation metric. The  
3 circulating water system costs will be allocated among the existing and new units based  
4 upon gallons per minute of water design requirements, and fuel delivery systems costs will  
5 be allocated among the existing and new units based upon tons of coal per hour design  
6 requirements. The Unit 1 and 2 common costs will be allocated only to those two units and  
7 will be divided based upon total design megawatts of the units and, likewise, the site-wide  
8 common costs will be allocated among all of the units at the site based upon design  
9 megawatts.

10 **Q. On what cost basis will the new common facilities be reallocated among the units?**

11 A. The reallocation will be done at the net book value of the assets as determined by the ERGS  
12 LLC.

13 **Q. Are rent payment adjustments made when the existing Oak Creek Power Plant units  
14 are retired?**

15 A. No, they are not. As already indicated, Wisconsin Electric, via the Unit 1 facility lease,  
16 pays for that portion of the new common facilities used by and useful to Wisconsin  
17 Electric’s existing Oak Creek units. At the end of the Unit 1 lease term, Wisconsin Electric  
18 has the option to own the new common facilities allocated to the existing units. When those  
19 facilities are no longer needed by those retired units, they can then be utilized by Wisconsin  
20 Electric in repowering the existing units or for future new units at the Oak Creek site.  
21 Making transfers of ownership of those new common facilities to other minority owners  
22 through the “rebalancing” process would require Wisconsin Electric to negotiate with those

1 other owners for future use of the facilities when they ultimately need to make decisions  
2 regarding the use of the existing Oak Creek site.

3 **Q. The rent formulas seem very complex. Couldn't they be combined in some fashion to**  
4 **make them easier to understand?**

5 A. We were able to leave the Basic Rent formula related to the construction costs of the units  
6 themselves virtually unchanged from the version filed in the Port Washington lease, but a  
7 separate rent payment had to be developed for the new common facilities in order to  
8 facilitate the rebalancing of ownership interests in the new common facilities and to  
9 properly account for improvements to those facilities.

10 **Q. What happens upon renewal of the lease?**

11 A. All of the new common facilities should be appropriately allocated by the time the first  
12 lease ends (after thirty years). Therefore, the renewal rent is based upon the sum of the  
13 basic unit rent payment plus the new common facilities rent payment.

14 **Q. In the exhibits you reference an "Approved Amount". What do you mean by an**  
15 **"Approved Amount"?**

16 A. The CPCN "**Approved Amount**" for the ERGS units should include the total of both the  
17 costs incurred to construct the new units and the costs incurred to construct the new  
18 common facilities. The owners in the facilities would each pay their respective share of  
19 those costs incurred. In the facility lease between ERGS LLC and Wisconsin Electric, only  
20 that share of total costs paid by ERGS LLC as an owner would be recovered through rent  
21 payments and that amount would be subject to the limits in the lease's "**Approved**  
22 **Amount**" definition.

1 **Q. Is this similar to the definition of “Approved Amount” that was approved by the**  
2 **Commission for use in the Port Washington facility lease?**

3 A. No. The Port Washington facility lease was based on a price fixed in 2001 dollars that was  
4 to be adjusted based upon a GDP index. In the ERGS lease we have not included a GDP  
5 adjustment because the “**Approved Amount**” is proposed to be based not on a fixed price  
6 but on actual costs incurred.

7 **Q. If the “Approved Amount” is based on actual costs incurred in the ERGS lease, how**  
8 **can Wisconsin Electric customers be protected against cost overruns?**

9 A. The “**Approved Amount**” definition in the ERGS facility lease allows only for cost  
10 overruns that are (1) prudently incurred, (2) approved by the PSCW, and (3) limited to 10%  
11 of the initial construction costs permitted pursuant to the CPCN approval. Additional costs  
12 incurred due to Excused Events, Force Majeure, and certain events of loss are also included  
13 in the “**Approved Amount**” to the extent authorized by the PSCW. In the event that actual  
14 costs incurred to build the unit are lower than the costs permitted pursuant to the CPCN  
15 approval, the lease payments will reflect the lower actual costs incurred.

16 **Q. You mentioned previously that the facility leases differ due to the technological**  
17 **differences of the units. Can you elaborate on that?**

18 A. Our last exhibit provides more specifics on the technological differences within the leases.  
19 The IGCC units, for instance, have different testing standards than the SCPC units, and the  
20 cost uncertainty warrants a different definition of an “**Approved Amount**”. In order to  
21 limit the size of the exhibit, Exhibit \_\_\_\_ (AH-8) only contains specific excerpts of the Unit  
22 2 (SCPC) and Unit 3 (SCPC) facility leases that differ materially from the Unit 1 lease  
23 rather than presenting the leases in their entirety.

1 **Q. Are there additional modifications to the lease documents submitted as exhibits with**  
2 **this testimony that were not included in the May 27, 2003 versions provided with the**  
3 **Applicants' other direct testimony?**

4 A. Yes. The term "Aggregate Principal Amount" was previously defined in the body of the  
5 facility lease in Section 13.1 and has been moved to Schedule 1.1, consistent with the  
6 PSCW Order for the Port Washington facility lease.

7 **Q. How does the utility propose to recover from its customers the payments it makes as**  
8 **lessee under the facility lease?**

9 A. Wisconsin Electric proposes that all monthly billings from the ERGS LLCs be deferred,  
10 along with appropriate carrying costs, until its next subsequent rate recovery proceeding.

11 **Q. Can you provide an estimate of the magnitude of the basic rent and new common**  
12 **facilities rent for the first ERGS unit assuming that Wisconsin Electric is the sole**  
13 **owner?**

14 A. The facility leases, in Schedules 7.1 and 14.2, include details of the rent formulas and  
15 examples of the monthly rent payments given various assumptions (project cost,  
16 improvements, rent adjustments for new common facilities, renewal triggering plant  
17 improvements, demolition & removal estimates, monthly management services costs,  
18 community impact mitigation costs, etc.) Using the methodology presented in Annex A to  
19 Schedule 7.1 of the Unit 1 facility lease, a base monthly lease payment of \$16.9 million is  
20 calculated over a 30-year lease term given an "**Approved Amount**" (in 2003 \$) of \$922  
21 million, a 58% equity component of 12.9%, and a 42% debt component of 6%. That \$16.9  
22 million per month rental payment includes all new site common facilities of \$423 million  
23 (in 2003 \$). (After completion of Units 2 and 3 the facility lease rent payments for Unit 1

1 will be reduced by \$1.1 million per month.) To the monthly Unit 1 base lease payments  
2 would be added the management services costs (capped at \$.008 million/month for each  
3 unit), estimated demolition & removal costs (\$.38 million/month) and community impact  
4 mitigation costs (\$.125 million/month) for a total lease payment of \$17.5 million/month.

5 **Q. What is the expected rate impact for Wisconsin Electric's customers after the first**  
6 **new ERGS unit goes into service and the lease payments begin?**

7 A. That is difficult to say with any certainty because there are many different factors that will  
8 affect future revenue requirements, fuel costs, and so on, but some general estimates can be  
9 attempted.

10 Assuming that WEPCO's retail revenue requirement equals \$2 billion, the rate impact  
11 when Unit 1 goes into service at mid-year might be estimated to be 5.1% (new lease payments  
12 of \$16.9 million per month \* 6 months / \$2 billion). For the following year the revenue  
13 requirement would increase to \$2.05 billion (assuming a growth rate of 2.32%). In 2008 the  
14 customers would pay 12 months worth of lease payments instead of six, so the incremental rate  
15 increase would be  $(\$101 \text{ million} / \$2.05 \text{ billion}) = 4.9\%$  compared to the prior year's rates.

16 The impact of the second unit going into service is smaller. This is because the first  
17 unit has borne the cost of the new common facilities for both units thus far. When the  
18 second unit goes into service, again at mid-year, the incremental impact would only be six  
19 months of lease payments (at \$8.2 million/month for Unit 2) compared to a revenue  
20 requirement of \$2.09 billion ( $\$2.05 \text{ billion} * 1.0232$  for growth), or a net increase of 2.4%.

21 Again, these estimated rate increases assume that all other factors remain equal.  
22 That would be an unrealistic expectation. These estimated incremental lease costs are for  
23 the new physical facilities only. The costs for the fuel (i.e., coal) would be included in the  
24 fuel component of rates, so the total impact on customer bills will also depend upon the fuel

1 costs that this new generation is replacing. For instance, if the utility no longer needs to  
2 buy natural-gas-based electric generation from a third party supplier those avoided costs  
3 would have to be net against the total new lease payments and coal costs.

4 **GROUND LEASES AND GROUND SUBLEASES**

5 **Q. Are there any significant differences between the Port Washington ground leases and**  
6 **subleases and those proposed for the Elm Road site?**

7 A. As with the facility leases, the ground leases and subleases are virtually the same except  
8 that accommodations had to be made to reflect multiple owners of the generating facilities  
9 as well as more highly defined easement areas that are appropriate given the ongoing  
10 operation of the existing generating units.

11 **Q. Briefly, how would the ground leases and subleases work given the fact that there**  
12 **could be two or three owners of a facility?**

13 A. Wisconsin Electric will lease the sites only to ERGS LLC during the construction period.  
14 When the facilities have been constructed, control of the sites will be conveyed back to  
15 Wisconsin Electric by means of the subleases. The other owners will not be parties to the  
16 ground leases and subleases. They will instead receive certain contractual easement and  
17 access rights to the facility.

18 **CONCLUSION**

19 **Q. Are any other revisions contemplated to the facility leases, ground leases or ground**  
20 **subleases?**

21 A. No, not by us.

22 **Q. Does this conclude your testimony?**

23 A. Yes, it does.