LS Power Generation, LLC comments on the White Paper titled Remove Barriers to Efficient Transmission Investment

Thank you for giving us the opportunity to provide comments on the white paper titled, Remove Barriers to Efficient Transmission Investment issued by the California Independent System Operator (CAISO) on September 21, 2001, outlining the CAISO proposal for establishment of a mechanism for cost recovery for construction a third category of transmission assets that are constructed to provide an access for renewable resources to the CAISO grid. We completely acknowledge and support the state-mandated the Renewable Portfolio Standard (RPS) requirements. However, we believe that the CAISO proposal for providing a cost recovery through Transmission Access Charge (TAC) for construction of high-voltage generation tie-line facilities to connect a region with <u>potential</u> for renewable resources to the CAISO grid has the potential to saddle California rate payers with stranded costs many years into the future. In addition to being highly discriminatory in nature, the proposal has left several unresolved issues that could have a significant impact upon future TAC. The goal of our comments is to outline the inconsistencies in the proposal, express our concerns, and put forth alternatives.

Below is a list of LS Power Generation LLC comments related to the CAISO proposal articulated by the CAISO in the whitepaper issued on September 21, 2006:

1. The paper states that, "the CAISO's proposal is designed to address a market failure that imposes barriers to the efficient development of renewable generation facilities." We would like to indicate that this issue is neither related to market design nor is caused by a market failure, but is rather related to the Large Generator Interconnection Process (LGIP) that was designed by Federal Energy Regulatory (FERC) after hundreds of hours of dialogue, investigations, and deliberation in which the CAISO actively participated. The objective of LGIP was to standardize the generation interconnection process and to remove all ambiguity as it relates to the studies performed and cost responsibilities related to the interconnection cost and the network upgrade costs associated with the interconnection. The LGIP set a standard that all generation resources have to satisfy while connecting to FERC jurisdictional transmission facilities. The CAISO proposal is aimed at carving out an exception for renewable resources which is highly discriminatory in its purist form and is contrary to the principals of the FERC approved LGIP.

   Under the rules established by the FERC LGIP, all generation resources bare the cost of direct assignment facilities (that includes all facilities required to interconnect the plant to the transmission network) associated with interconnecting the facility to the greater transmission grid. The cost for direct assignment is assigned to the interconnecting customer as these facilities do not enhance the transmission network and are only used by the interconnecting customer(s) to deliver the output of their facility to the transmission network. In other words, the cost of these facilities is borne by those who utilize these facilities. Under the CAISO proposal, the cost of the third category of transmission assets would most likely fall upon the shoulders of all market participants and the California ratepayers regardless of whether they derive any financial or reliability benefits from the construction of the third category of transmission assets. Assigning the cost for building transmission facilities to facilitate delivery of energy from renewable regions to the general transmission grid to those individual resources that derive benefit from them is both fair and equitable and will enable us to determine the actual cost of development of renewable resources at a particular region in the state.

Some may argue that everyone in California benefits from development of renewable resources. However, the events of summer 2006 have demonstrated that in addition to renewable resources, the state also needs other sources of generation. The CAISO proposal will continue to be discriminatory so long as the CAISO proposes to subsidize the cost for interconnection of renewable resources to CAISO grid and not advance the same treatment to all other generators proposing to interconnect to the CAISO controlled transmission grid.

2. Another small, yet significant area of inaccuracy in the CAISO document is as follows:

   > *"In contrast, generation interconnections for fossil fuel generation resources tend to be much lower cost, as they are typically 60 kV facilities that are less than five miles in length. Therefore, the percentage of generation to transmission cost of a typical renewable generator is dramatically higher than that of a fossil fuel plant" Page 6, Paragraph 3*

   A review of the interconnection of several lager generation projects in California over the past five years will indicate that most of the large generators have been interconnected to 115 kV, 230 kV and 500 kV transmission networks (in fact, only a small size generator can be connected to the 60 kV and 70 kV systems). Secondly, the cost of direct assignment facilities associated with more than a hand full of these facilities has been quite significant.

3. As a market participant conducting business with the CAISO, the lack of details, especially in relation to the project approval process and the full extent of the financial consequences of this proposal are quite unnerving to us. According to the CAISO proposal:

   > *"The CAISO proposal includes a new third category of transmission asset in which the cost for the unsubscribed portion of these facilities is collected through the Transmission Access Charge (TAC), rather than assigning all of the cost to the initial increment of renewable generation facilities. As more generation is developed in the area, the revenue requirement for the facilities would be transferred from TAC to the generation facilities until the entire cost of the facilities is covered by the generation resources in the area, similar to the cost treatment of generation intertie facilities."*

   The CAISO believes that this approach is a "modest change to the existing policy". We would like to argue that this so called "modest change" could potentially have astronomical impacts upon the future CAISO TAC and that it could saddle the CAISO market participants and the California ratepayers with hundreds of millions of dollars of non-recovered costs.

   The CAISO proposal inaccurately assumes that only the initial cost of the third category of transmission assets will be rolled into TAC and that as new renewable generation develops, the developers will start to reimburse their share of the costs as their respective projects become operational. This assumption is highly speculative, as there is no guarantee that the whole renewable generation potential for any renewable generation region/pocket will ever materialize to a point of fully refunding the cost of the third category of transmission assets. This will leave all of the CAISO market participants and the state's ratepayers holding the bag for transmission facilities that have little or no benefit to the overall transmission system reliability.

During the conference call organized on September 29, 2006, to discuss this whitepaper, the CAISO claimed that the proposed third category of transmission projects would be evaluated within an “enhanced” CAISO grid planning process. As a market participant, we have been patiently waiting for the past several years for this so called “CAISO Enhanced Grid Planning Process” that will comprehensively address the CAISO grid planning issues. The current TEAM methodology is not designed to address these investments. We believe that it is not prudent to move forward with a proposal of this magnitude without adequately addressing the methodology used to evaluate the cost/benefits of these investments.

4. The CAISO proposal has set a threshold that states that the economic impact of any one transmission project would be such so as to not increase the CAISO TAC rates by more than 5% over a 10-year period. We claim that this requirement fails to impose a reasonable cap on the stranded transmission investments in the CAISO controlled grid and hence the TAC rates. This is because the CAISO could end up approving multiple projects where the generation investments fail to materialize and that the cumulative affect of these stranded investments could result in an unreasonable and highly-burdensome impact on all of the California ratepayers. To be realistic, we propose that the CAISO consider setting a minimum threshold on the percentage of initial subscription in the transmission facility (we recommend 60%) with a full commitment of 95-100% subscription with the next 3-4 years. We submit that this sets a manageable burden upon the CAISO stakeholders and the California ratepayers.

5. At several points in the white paper, the CAISO stated that the PTOs, through FERC approved revenue requirements, initially finance the cost of constructing these facilities that would connect the region for renewable generation to the CAISO transmission grid. We recommend that, should this CAISO proposal move forward, the opportunity for constructing and financing the third category of transmission assets should be made available to all market participants and that the PTOs and other participants interested in investing in these transmission projects should be allowed to compete for this investment opportunity.

6. The CAISO has indicating that it will seek a declaratory order with FERC on this issue. However, given the nature of the issue, the magnitude and consequences of the impacts, we would strongly recommend that the CAISO make a full tariff filing at FERC which will provide a specified forum to discuss and resolve this matter.

We look forward to working with the ISO on this issue. If you have any questions, please contact me at (408) 204-7630.