Comments of The Metropolitan Water District of Southern California on CAISO Proposal for a Third Category or Alternative Treatment of New Transmission Facilities for Renewable Generators

July 14, 2006

I. Introduction

The Metropolitan Water District of Southern California (Metropolitan) is pleased to provide these comments in response to the CAISO White Paper on the above topic dated June 28, 2006. The CAISO summarized its proposal as follows: It proposes to submit a petition for declaratory order to FERC, for authority to establish a new transmission category for high voltage, bulk transfer facilities, not eligible to be classified as network upgrades, that are designed to serve multiple renewable generators, where it has been established that the amount of added transmission capacity will be utilized by renewable generators within a reasonable period of time. The CAISO has proposed that, in lieu of requiring the generators to fund the construction cost of such Interconnection Facilities,[1] the CAISO would permit such cost to be included in a Participating Transmission Owner's Transmission Access Charge and rolled into the CAISO TAC, paid by all users of the CAISO Controlled Grid. As generators interconnect to the facilities, responsibility for the cost of construction would be transferred to such generators. When the capacity of the Interconnection Facilities is fully used, the TAC would no longer include the cost of such facilities.

Metropolitan owns and operates approximately 122 MW of eligible renewable generation, and strongly supports efforts to promulgate the development of additional generation from renewable resources in California. Notwithstanding Metropolitan's keen interest in the expansion of renewable resources, Metropolitan is concerned the CAISO proposal may not achieve its intended purpose, and may conflict with other strategic CAISO initiatives. Metropolitan's concerns are explained below.

II. Metropolitan's Specific Concerns

A. <u>FERC Has Already Rejected a Similar Petition by SCE; CAISO Has Failed to Demonstrate Grid-Wide Benefit</u>

As the CAISO White Paper noted, Southern California Edison submitted a petition for a declaratory order to FERC last year for a category of "new high voltage trunk transmission facilities necessary to interconnect large concentrations of potential renewable generation resources located a reasonable

[1] Metropolitan refers to the CAISO's proposed new category of transmission facilities as "Interconnection Facilities" or "Third Category."

distance from the existing grid."[2] FERC rejected SCE's request, concluding the facilities were not a "network upgrade" and therefore ineligible for rolled-in treatment, the facilities appeared to be generation-tie facilities, and FERC precedent has found recovery from all grid users inappropriate. Moreover, the Commission found that SCE had failed to demonstrate that all users of the CAISO Controlled Grid, who would have paid for the facilities had they been eligible for rolled-in treatment, would benefit from their construction. [3]

The CAISO's White Paper attempted to address the "user benefit" issue by asserting that "the upgrades provide benefits to all participants in the CAISO markets in the form of greater access to renewable generation and therefore a more diverse portfolio and economic means of meeting the State's RPS." However, it appears obvious that the CAISO proposal does not establish a "more economic means" of meeting the State's RPS, because it will not *lower* the overall cost of renewable generation. Instead, the CAISO's proposal will simply *spread* whatever the interconnection cost from those customers of the load-serving entity (LSE) that contracts with the interconnecting renewable generator(s) to all users of the CAISO Controlled Grid.

Moreover, the CAISO's conclusion that non-renewable generators would be eligible to interconnect to the facilities on the same terms and conditions as renewable generators may severely limit the ultimate amount of additional access to renewable generation created by the Interconnection Facilities. As the CAISO itself noted in its White Paper, the individual renewable generation resources "would each have capacity that is significantly smaller than the efficient transfer capability of the transmission facilities."[4] Thermal generation resources (excluding peakers), however, often have capacity that substantially occupies the transfer capability of non-network transmission facilities. A thermal generator would have incentive to site its facilities proximate to the Interconnection Facilities proposed by the CAISO, to avoid initial responsibility for the payment of their construction.

In short, Metropolitan believes the CAISO's slim description of benefits is speculative, and unlikely to be experienced. We fail to discern why FERC should see the CAISO's proposal any differently than it did SCE's.

B. Establishing a New Category of Transmission Will Have Unintended Consequences

Metropolitan is apprehensive that implementation of the CAISO proposal will have unintended consequences. First, Metropolitan understands that the CAISO has concluded that thermal generators should be able to interconnect with the proposed facilities because to deny them would likely violate FERC's open

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[2] *Southern California Edison Co.,* 112 FERC ¶ 61,014 (2005) at ¶ 15.

[3] *Id.,* at ¶ 42.

[4]

access, non-discrimination requirement. If true, Metropolitan believes other thermal generators may have an excellent argument for similar treatment for their respective generation tie-lines, whether or not they also serve renewable generation resources. It is unclear why the CAISO should assume that only those thermal generation developers interconnecting at a Third Category facility would have the ability to assert a discrimination claim, if it continues to require other thermal generation resources to front the cost of construction of their generation tie-line. Metropolitan is uneasy the CAISO proposal may open a Pandora's Box, and result in rolling into the TAC the cost of *all* generation tie-lines, not just those intended to benefit renewable generation. If Metropolitan's concern is realized, the cost of the CAISO proposal will have significantly increased.

Second, Metropolitan understood the purpose of the CAISO's market redesign was, among other things, to reveal the true cost of serving load at various nodes throughout the CAISO Controlled Grid. As the CAISO explained Locational Marginal Pricing in its document entitled The Heart of the Market Redesign:[5]

> "Buyers and sellers can make informed decisions about energy pricing based on the ability to produce and deliver power to where it's needed and, over time, help to determine the best locations for new generation . . . The new pricing system simply provides market participants the correct signals, so they can make wise choices at the wholesale level."

Clearly, implementation of the CAISO proposal would affect those price signals, because it would substantially reduce the initial cost of serving load from more remote locations at which renewable generation is anticipated to be located. The influence on the price signals that would have otherwise been established through CAISO implementation of Locational Marginal Pricing will continue until the generation interconnecting to the Third Category of facilities are fully responsible for the cost of such facilities. Establishing the Third Category will dilute market participant ability to make "wise choices" at the wholesale level.

Third, by offering to subsidize the interconnection costs for certain, but not all, renewable generators, the CAISO threatens to distort the price signals that would otherwise exist under LMP, to incent the development of renewable generation proximate to load. Metropolitan questions the dubious benefit of a CAISO proposal that appears intended to benefit a certain segment of the renewable generation segment, to the detriment of all others.

Fourth, the Third Category of facilities could be used by renewable resources located many miles away from CAISO load centers. Indeed, some of the most promising sites for wind generation are in relatively remote locations outside of

[5] See http://www.caiso.com/docs/2005/02/22/2005022208452427527.pdf.

the ISO Control Area, outside of California, and in the Pacific Northwest. If the Interconnection Facilities for such generation is eligible for inclusion as a Third Category, the cost of implementing the CAISO proposal may be very high.

Fifth, the CAISO's Offer of Settlement in FERC Docket No. EL05-46-000 explained it was being offered, at least in part, to assist the CAISO procurement of resources "to meet local reliability above those resources procured through the CPUC's 2006 [Resource Adequacy Requirement]." Clearly, the CAISO has need for more resources proximate to load, otherwise it wouldn't need the reliability backstop mechanism provided in the Offer of Settlement. However, the CAISO proposal would facilitate and minimize the cost of locating additional generation, renewable or otherwise remote from load.

Sixth, the CAISO's proposal lacks many implementation details. Accordingly, it is difficult to contemplate all ramifications of its implementation. Some potential problems, however, readily come to mind. For example, does the Participating Transmission Owner that includes the cost of the Interconnection Facilities in its TAC include the facilities in its return on equity? Who will own the facility, the PTO or the interconnecting generators? Who will be entitled to depreciate the facilities? What are the proposed terms and conditions under which the cost of the facilities will be repaid by the interconnecting generators? Will generators that interconnect after the initial ones be charged a pro rata share of all incurred costs or just going forward costs?

In sum, Metropolitan has identified above many potential problems and conflicts with existing CAISO policy that would ensue if the CAISO proceeds to carry out its proposal. In contrast, the anticipated benefits are few, to the extent they exist at all.

C. The CAISO Should Not Participate in Subsidy Decisions re Renewable Generation

No one can seriously dispute that the CAISO proposal, if approved, would subsidize certain renewable generation developers proposing to site their facility remote from load.[6] In Metropolitan's view, if renewable generation is to be subsidized, it should not take the form of transmission costs. It is far more appropriate for the individual LSE, rather than the transmission grid operator, to decide upon the form of subsidy for renewable generation. The LSE is in a far better position to determine which renewable generation source provides a better fit for its load with regard to cost, fuel diversity, generation profile, location, etc.

[6] It should be obvious that if the resource was proximate to load, the cost of obtaining grid access would be significantly decreased.