Northern California Power Agency Comments on the CAISO Proposal for New Transmission Facilities for Renewable Generators

July 14, 2006

Northern California Power Agency ("NCPA") would like to thank the CAISO for the opportunity to provide comments on the CAISO proposal for new transmission facilities for renewable generations that was discussed during the July 7, 2006, CAISO stakeholder meeting.

NCPA Supports Development of Renewable Resources

NCPA strongly supports the concept of renewable resource development. A significant portion of NCPA's power portfolio is comprised of renewable resources, including geothermal, wind, landfill gas fired, and hydro electric generation, in addition to the solar and green power programs of individual members.[1] NCPA's members have been very proactive in the area of renewable generation, have adopted aggressive renewable portfolio standards, and continue to pursue new opportunities. These comments presented on the proposal for new transmission facilities for renewable generators should not be considered or interpreted as a lack of support for the development of a means to enhance the ability to access renewable resources. Nor are these comments made, as has been suggested, because NCPA members do not have requirements to pursue state renewable goals under California law, and therefore are resistant to cost allocation for such; to the contrary, NCPA members are subject to goals for renewable development that are highly similar to those applied to CPUC-jurisdictional entities. Rather then, these comments are specifically focused on NCPA's concerns with concepts discussed in the whitepaper developed by the CAISO.

[1]For Example: http://www.cpau.com/docs/factsheets/pcl/pcl.html
http://www.alamedapt.com/electricity/green.html
http://www.siliconvalleypower.com/res/?sub=green,
http://www.rosevilleelectric.org/newsInformation/powerContentLabel/powerContentLabelAnnual.html

The Proposal Raises Policy Questions on the Proper Role of the ISO

An overall general concern that NCPA has, is that this proposal puts the CAISO in the role of integrated resource planning, and NCPA questions whether this is an appropriate role for an independent grid operator. This is not to say that integrated resource planning is not needed in the State, but that such a role should remain with the utilities and their regulators under state and/or local jurisdiction. Therefore, the following comments should be taken in the context that NCPA believes that the proposed generation planning role should not lie with the CAISO.

The CAISO Proposal is Too Vague to Evaluate Costs and Benefits

NCPA understands that the intent of the CAISO proposal is to introduce the general idea of developing a mechanism that can be used for the construction of new transmission lines in geographic regions identified as likely to support significant quantities of renewable resources in order to develop a declaratory order that may be filed at FERC. NCPA has concerns about the lack of detail contained within the proposal considering the CAISO's expedited timeline, and the CAISO's intent to present these concepts to the CAISO Board of Governors as early as August 3, 2006. A policy such as the one proposed will have long term impacts on all Load Serving Entities ("LSEs") within and beyond the CAISO control area, could impose significant costs on the market, and should be fully vetted prior to implementation. NCPA would like the concept to be expanded on through the stakeholder process, to develop a methodology for quantitative evaluation of the potential costs and benefits associated with such a project. It is difficult at this point in time to assess the impact of the proposed transmission project without more thorough evaluation of the details involved. NCPA has specific concerns about how the CAISO will determine the need for such facilities, and how the potentially significant cost of such facilities will be allocated to the market.

The Current Proposal Deviates from the Principle of Cost Causation

The CAISO proposal for cost recovery treatment recommends a rolled-in rate treatment of unrecovered cost through the CAISO's Transmission Access Charge ("TAC"). The proposal

indicates that the up-front investment cost of the facilities will initially be covered by the Participating Transmission Owner and rolled into the CAISO's TAC, which is paid by all users of the CAISO Controlled Grid, including exports. The proposal also states that the generation developers that utilize the facilities will reimburse the Participating Transmission Owner their share of the renewable generator supply transmission line in installments. The CAISO claims that this methodology would allow renewable generator supply transmission lines (referred to as "trunk lines") to be built in advance of Generator Interconnection requests, but will ultimately be paid by the generation developers. The whitepaper proposes that this approach is consistent with the principles underlying rolled-in treatment by providing 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.

This is a perfect example of where the lack of specific details makes it difficult for NCPA to support such a proposal. NCPA strongly believes in the principle of cost causation, and does not agree that the proposed facilities would necessarily result in equal (or very limited) benefits to all the participants that would bear the cost. As stated by the CAISO, this proposal is for a third category of transmission investment. The proposed trunk lines are not categorized as network facilities and will not necessarily result in improved grid reliability or lower overall grid costs by reducing losses and congestion. Indeed, given the location and intermittent nature of the resources likely to be connected, the proposed facilities could result in a decrease of reliability and increase in grid costs. Therefore, the proposal is not consistent with the principles underlying rolled-in treatment by providing grid benefits to all participants in the CAISO markets.

While increasing generation capacity in general could lower wholesale generation costs (and overlooking the issue of whether generation planning is an appropriate role for the CAISO), the CAISO's presumption that all participants will benefit from their proposal to provide "a more diverse portfolio and economic means of meeting the State's RPS" is based on a misleading notion, namely that: 1) All LSEs are in the same situation in failing to meet their RPS goals (municipal utilities are, on average, meeting their RPS goals, many are exceeding their goals, and some have already achieved renewable portfolios that exceed anything contemplated by the

State's RPS goals); and 2) That all resources are equal regardless of their location. This ignores the CAISO's other proposed market mechanisms that will explicitly price congestion, and impose requirements on LSEs to contract for resources that are deliverable to their load and meet local reliability requirements.

The most prevalent example of where this policy would be used to grant unequal benefits is the Tehachipi wind area facilities. The Tehachipi wind area facilities are located in Southern California, and are presumably deliverable to non-load pocket load in Southern California. NCPA's customers are located in and serve load in Northern California. It is highly questionable that NCPA's members would be able to utilize the wind resources located in Tehachipi to serve their load in the north but would, under the current proposal, still be required to pay a portion of the cost of the facilities. This issue becomes even more of a concern as we move into MRTU, which is based on a locational marginal pricing ("LMP") design that is meant to provide location specific incentives. Allocating the cost of these facilities based on a peanut butter spread type methodology does not conform to the principles of cost causation and would negate the intended locational pricing benefits purported by the proponents of LMP.

To add to this concern, a number of NCPA's members are located in load constrained areas, and may be required to acquire a significant amount of resources within a geographic specific area. This is counter to the conceptual benefit identified by the CAISO that these facilities will enable all market participant greater access to renewable generation resources. Entities that are marooned in load constrained areas most likely will not be able to access this generation, while bearing a share of the cost. The CAISO should recognize that connecting generation to the grid is only one half of the solution, and that under the CAISO's own proposed resource adequacy requirements the energy has to then be deliverable to the load.

One of the discussion questions posed by the CAISO inquired about what is an equitable cost allocation mechanism. NCPA believes that the cost mechanism used to distribute the cost of these type of facilities should be based on cost causation principles, and that the cost of these facilities should be allocated to those LSEs that directly benefit from the access made available as a result of these facilities, and that they have had the opportunity to actively participate in the

economic evaluation of the facilities. In the absence of cost causation principles, the economic evaluation of the trunk lines should be conducted within the framework of the entire market design, and the incremental costs that will be imposed on load-pocket load (or other load that is unable or does not need to take delivery of the generation) should be included in the analysis and decision process.

The Proposal Could Disadvantage Other Renewable and Thermal Resources

The proposal could disadvantage other developed and undeveloped renewable resources that have realized the cost of developing generation inter-tie facilities. The proposal specifies that this policy would only be applicable to large projects with individual renewable resources that are significantly smaller than the efficient transfer capability of the transmission facility. Renewable projects located in areas with limited renewable possibilities will still be required to cover the full cost of constructing inter-tie facilities and reflect those costs in the energy produced. Renewable resources that eventually develop and connect to the CAISO controlled facilities may not be exposed to the same level of cost on a forward going basis, considering a potential significant share of the cost may have been covered by the market. This reduced cost would be reflected in the energy cost of these facilities, and could provide these facilities with a competitive advantage over those facilities forced to cover the full cost of connecting to the CAISO grid.

The proposal does not specify that these facilities would be limited to renewable generation. To the extent that non-renewable generation is allowed to interconnect to these facilities, they may also enjoy the competitive advantage of reduced interconnection cost. The CAISO specified that it did not intend to limit these facilities solely to renewable resources. In theory, this may result in multiple gas fired facilities interconnecting to these market subsidized facilities and gain a competitive advantage. This issue is also contradictive to the locational specific incentive provided under LMP design.

The Proposal Needs to Address How These Facilities Will be Financed

The proposal lacks specific detail on how these facilities will be financed. The proposal indicates that these facilities will ultimately be paid for by generation developers when generation developers step forward to attach generation resources to the line. The proposal states that once the generator has interconnected to the facility, it would be responsible for its proportionate share of the cost of the facility. The proposal does not specify whether the generator will only be responsible for forward going costs, or will the generator inevitably be responsible for their full cost of the project by repaying the initial cost of the project born by the market.

The potential exists that the expected generation may not materialize over time, and the cost of the facilities will continue to be paid by transmission users without any benefit of increased access to renewable generation. A specific threshold of committed investment, in the form of contractual commitments, should be establish prior to investing in these types of facilities to ensure that sufficient renewable projects will be developed to cover the cost of the facilities. The CAISO Proposal (at page 10) does offer an eligibility criterion: "Load Serving Entities entering into signed forward contracts with associated renewable resources in the area. Such a prerequisite might include a minimum number of developers in the area with contracts established that would demonstrate a critical mass that would support development of the transmission." However, requiring (presumably long-term) forward contracts raises an interesting perspective: LSEs should be able to contract for these renewable resources based on long-term firm transmission rights, and without such long-term firm transmission rights, LSEs would be discouraged from making these commitments.

Long-term transmission rights could provide an alternative to the financing dilemma. If provided the opportunity to secure long-term transmission rights that will ensure that the contracting LSE can rely on the deliverability of the resource to the LSE's load and provide credit toward local reliability requirements for the length of the contract, then LSEs, including NCPA members, would be far more likely to consider contracting with these remote resources and thereby, voluntarily finance the trunk lines.

Conclusion

NCPA believes that generation planning is an inappropriate role for the CAISO, and integrated resource planning should remain the domain of the load serving utilities and their regulators. There are mechanisms, such as long-term transmission rights, that the CAISO could pursue to facilitate the voluntary activities of the utilities to meet their RPS goals and fund such projects contemplated in the CAISO's whitepaper. However, if the CAISO is going to pursue this role, then projects should be evaluated in the context of the full market design and should either follow the principles of cost causation or, if peanut-buttered, consider the incremental costs to all transmission users.