

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD



Arnold Schwarzenegger, Governor

May 1, 2007

VIA E-MAIL FOR ELECTRONIC FILING

The Honorable Kimberly D. Bose, Secretary
Federal Energy Regulatory Commission
Dockets Room, Room 1A, East
888 First Street, N.E.
Washington, D.C. 20426

**Re: Comments of the California Electricity Oversight Board
The Nevada Hydro Company, Inc.
Docket No. ER06-278-000, et seq.**

Dear Ms. Bose:

The California Electricity Oversight Board hereby e-files its Comments in Docket No. ER06-278-000, et seq.

Thank you for your attention to this matter.

Sincerely,

/s/ Jeffrey A. Diamond

Jeffrey A. Diamond
Senior Staff Counsel
California Electricity Oversight Board

cc: Official Service List of Docket No. ER06-278-000

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

The Nevada Hydro Company, Inc.	)	Docket No. ER06-278-000
	)	Docket No. ER06-278-001
	)	Docket No. ER06-278-002
	)	Docket No. ER06-278-003
<hr/>	)	Docket No. ER06-278-004

**COMMENTS OF THE
CALIFORNIA ELECTRICITY OVERSIGHT BOARD**

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.214, of the Federal Energy Regulatory Commission (Commission) the California Electricity Oversight Board (CEOB) hereby submits the following comments in the above-captioned proceeding.

I. CORRESPONDENCE AND COMMUNICATION

The principal office of the CEOB is located at 770 L Street, Suite 1250, Sacramento, California, 95814. All service of pleadings, orders, correspondence, and communications regarding this Docket should be made on the following persons:

Erik Saltmarsh, Chief Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
Tel: 916-322-8601
Fax: 916-322-8591
ErikSaltmarsh-Service@eob.ca.gov

Jeffrey A. Diamond, Senior Staff Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
Tel: 916-322-8601
Fax: 916-322-8591
jdiamond@eob.ca.gov

II. BACKGROUND

The CEOB is the California state agency having statutory responsibility for the oversight of the California Independent System Operator Corporation (CAISO), the

electricity and ancillary services markets administered by the CAISO, the reliability of the California electric grid, and the investigation of California's energy markets to ensure the protection of California's citizens and consumers.

Pursuant to the Commission's November 17, 2006 Order on Rate Request (November 17, Order) granting the CEOB's motion to intervene,¹ and the Commission's January 11, 2007 Notice extending time to comment to and including May 1, 2007, the CEOB respectfully submits the following comments.

III. COMMENTS

The Nevada Hydro Company, Inc. ("TNHC") proposes a pump storage facility that would be the most efficient in the region to recapture pumped energy for use at critical times. The CEOB is very supportive of such technologies and believes that this type of technology can be a valuable component of a generation portfolio. The following comments reflect the CEOB's evaluation of this particular project as currently proposed as a rate based transmission element and is not indicative, generally, of advanced transmission technologies.

The CEOB believes that the Lake Elsinore Advance Pump Storage ("LEAPS") combined with the Talega-Escondido/Valley-Serrano interconnection project ("TE/VS") (collectively, "LEAPS project"), as currently proposed by TNHC, raises three distinct policy concerns: (1) whether the TNHC Project can produce adequate economic benefits substantially in excess of its costs for California ratepayers; (2) whether the cost of the LEAPS project should be included in the CAISO's Transmission Access Charge (TAC);

¹ *The Nevada Hydro Company, Inc.*, Order on Rate Request, 117 FERC ¶ 61,204 (2006).

and (3) whether it is in the public interest that the CAISO should have operational control over the LEAPS unit.²

A. The Cost of LEAPS Will Outweigh the Benefits Accruing to California Ratepayers.

The CEOB has concluded that the cost of the LEAPS project, as currently proposed as a rate based transmission element, will outweigh the benefits accruing to California ratepayers. As discussed more fully below, the CEOB believes that the expected revenue arising from the sale of energy and ancillary services will not be sufficient to cover the project's costs. In theoretical terms, the LEAPS proposal will operate as an imperfect price hedge for California ratepayers. Moreover, the CEOB expects any economic benefit arising from the imperfect price hedge to dissipate over time as California implements its comprehensive energy and environmental policies. Each of these topics is discussed below.

1. Insufficient Net Revenue

The expected net revenue arising from the sale of energy and ancillary services will not be sufficient to cover the costs of LEAPS. That fact now appears to be uncontroverted by any party to this proceeding. During the April 19, 2007, public CAISO Board of Governors meeting, Governor Tim Gage asked whether the LEAPS plant was viable strictly as a merchant generator. TNHC responded that the LEAPS project was not viable strictly as a merchant plant.³ An analysis performed by the CEOB

² The CEOB's comments are premised upon the currently proposed LEAPS-TE/VIS combined project. While there have been discussions about a "new" project involving only the TE/VIS portion of the LEAPS project, that scenario is not before the Commission at this time. The CEOB believes that a TE/VIS ("wires only") project has the potential to bring significant benefits to California, and if proposed formally the project should be analyzed carefully but expeditiously.

³ Profitability of the LEAPS project is dependent on the difference between off-peak wholesale electricity prices and peak wholesale electricity prices, since the source of energy for the uptake pumps is electricity.

regarding the price spread between peak and off-peak wholesale prices for energy and ancillary services supports that general conclusion.⁴ The record in this proceeding contains no solid data to the contrary. The CEOB respectfully submits that California's ratepayers should not be required to pay for a generation plant that is not viable as a merchant generator and is only proposed to provide generation services.

TNHC's current proposal raises other policy issues, too. If LEAPS project is adopted, as proposed, the Commission, in effect, would take on the function of purchasing AS on behalf of California ratepayers. Since the net cost to consumers for AS would be set by energy arbitrage revenue, as discussed below, the consequence is to take a futures position on the price spread.

2. Price Arbitrage by the LEAPS Unit

The proposed method by which LEAPS would serve the ratepayers of California is through classic price arbitrage. The LEAPS project proposes to use low-cost off-peak energy to pump water that is used later as a "fuel" source to generate high-price peak energy for sale to the market. Under that carefully drawn scenario, LEAPS becomes a price hedge for California ratepayers if, and only if, there exists a significant spread between peak and off-peak energy prices during the life of the project. Plainly, the economic benefit to ratepayers will disappear as the spread between peak and off-peak

⁴ The current proposal allows the CAISO to call on the LEAPS unit for AS as needed. Similarly, it is impossible to know how often the unit will be selling energy into the market. Thus, the CEOB's analysis necessarily assumes that the LEAPS units will be run the same number of hours over each month. Under this constraint, for example, the average ten minute prices realized in the CAISO Real-Time Imbalance Market in July 2006 (the only month since the 2000-2001 electricity crisis period that California has seen a 1 in 50 temperature outcome) were as follows: Average On-Peak price: \$55.12/MWh; Average Off-Peak price: \$39.70/MWh; Average Difference: \$15.42/MWh. Contributing to profitability woes is the fact that LEAPS unit would have to pump water uphill during 4 peak hours each day in order to reach maximum capacity (see Nevada Hydro Company, Inc. Transmittal Letter to FERC, December 18, 2006, Docket ER06-278-005, Page 3, Section III.A, Paragraph 1).

energy prices shrinks. That fact is crucial to this project. The CEOB contends that the price spread will shrink over time and thus there will remain fewer and fewer opportunities for ratepayers to recover their stranded costs in the LEAPS project. There is no historical or other basis to assume that this price spread will be significant enough during the life of the LEAPS project. Moreover, the effectuation of California's energy policy goals will speed up the shrinking of that price spread, to the detriment of those paying for the LEAPS project.

3. California's Energy Policy Will Undermine LEAPS Price Hedging

The State of California has adopted a policy of maximizing peak savings.⁵ To attain this goal California is investing, proposing, and demanding a myriad of methods to reduce peak demand. Demand Response is one method, among others, for achieving this goal. One type of Demand Response is to "time-shift" energy usage from peak hours to off-peak hours thereby flattening the price curve associated with electricity wholesale rates through the day interval.⁶ The flattening of the price curve results in peak energy prices becoming more closely aligned with the off-peak price.

The problem for LEAPS in this case is two-fold. The LEAPS project actually facilitates the goal of flattening the price curve.⁷ Thus, the price hedge of the LEAPS unit will shrink as the price spread shrinks. With less spread in the energy prices, LEAPS not only loses the price hedge, but it will be unable to generate sufficient revenue to reimburse ratepayers for their large and risky investment in the LEAPS project. The

⁵ See California Energy Commission Integrated Energy Policy Report 2005, page 69.

⁶ The California Public Utilities Commission is presently crystallizing Demand Response through docket R.07-01-041 (January 25, 2007).

⁷ All other things being equal, when the LEAPS unit buys power during off-peak hours it adds to the demand which puts upward pressure on market prices. When the unit sells power during peak hours it adds to the supply and puts downward pressure on prices.

CEOB respectfully submits that ratepayer exposure to that type of risk is not acceptable, especially since California's ratepayers are still paying off the cost of the Summer 2000-2001 energy crisis.

Another policy issue raised by TNHC's current proposal involves California's Greenhouse Gas ("GHG") initiative. TNHC has not clearly explained its operation in the context of California's new regulatory landscape. The LEAPS unit will have a carbon cost "component" because it will rely upon off-peak power produced by carbon emitting generation. There is a probability that the LEAPS unit will have to purchase emission credits in order for its power to be deliverable to California consumers. Thus, it is unclear what effect the GHG initiative will have on the ability of the LEAPS unit to provide its power to the California ratepayers who paid for and are supposed to benefit from the project.

B. The Cost of LEAPS Should Not Be Included in the CAISO's TAC.

The CEOB is opposed to the inclusion into the CAISO's TAC of any construction, operation, or maintenance costs of the LEAPS unit, as a currently proposed rate based transmission element.

First, under § 1223 of the EPAct of 2005 the Commission is directed to "encourage, as appropriate, the deployment of advanced transmission technologies." Notwithstanding the foregoing, Congress did not equate pumped storage with a transmission line, nor did it command the Commission to rate base all advanced transmission technologies. While the Commission may have the authority to rate base advanced transmission technology when appropriate, the TNHC has not established that the LEAPS unit, as currently proposed, acts sufficiently like transmission to justify inclusion in the TAC.

Second, adding generation units to TAC could indirectly and unintentionally restructure California's electricity market. This problem may arise when the approved rate of return (ROR) for the generation part of the project is included in the TAC and is much higher on a risk-adjusted basis than the expected ROR for merchant generation. Entities that otherwise may consider constructing new merchant generation may instead select generation projects which are eligible for recovery through the TAC, shifting their risk to ratepayers while receiving the guaranteed ROR. Shifting the focus of investment from the type of merchant generation that should be built to the type that can be built with no risk to investors is a market distortion that California can live without.

If the relative ROR favors the TAC-included projects over time, then the California electricity market would no longer consist of an independent and market-neutral transmission system operator and a set of generators competing in energy markets. Instead, the CAISO would become a super utility and generators would compete for the residual electricity demand not satisfied by the CAISO. This problem would be made worse if the CAISO operates the generation units. Moreover, the problem would not disappear even if the CAISO contracts with a third-party scheduling coordinator to bid and operate the unit because the ROR is already built into the TAC.

Finally, it is not appropriate to include a cost-based, fixed revenue requirement for a generator in the TAC when the benefits associated with that revenue requirement are supposed to be determined by the competitive market. Indeed, once a generator's cost-based, fixed revenue requirement is rolled into the TAC, it will be impossible for the market to allocate the benefits using the FERC-approved cost-causation basis.

C. The CAISO Should Not Have Operational Control of LEAPS.

The CEOB is opposed to the CAISO's operational control of the LEAPS unit, as currently proposed as a rate based transmission element, for several reasons.

First, there is nothing about the structural nature of the LEAPS project that necessitates the CAISO operating the project in the first place. If operated by an entity separate from the CAISO, the project would be able to have its resources bid into energy and ancillary services (AS) markets like any other profit maximizing generator.

Second, there is no benefit accruing to ratepayers by having the CAISO involved in any manner regarding operational control of the LEAPS unit, whether through a firewall, auction to third parties, or contracts with third parties. Moreover, there will likely be a conflict of interest when the CAISO selects which AS generators will run verses those that do not in markets that the CAISO operates, especially when the selection is not based solely on bids or operational contingencies. These actions would set a precedent for the CAISO to act as market participant, thereby clouding the CAISO's impartiality as well as the competitive nature of the California energy market. The CAISO must remain a neutral grid operator.

Third, to maximize the benefits to ratepayers of the LEAPS project, the CAISO would have to operate LEAPS (and the grid reasonably adjacent to it) with a clear bias towards the project, despite other resources that might be available, including lower-cost alternatives. This could have the unwanted effect of preventing cheaper, more cost-effective resources from being built due to the fact that the market environment would be seen as uncompetitive.

Finally, CAISO operational control of the LEAPS unit would conflict with California's resource adequacy (RA) policy. RA, including ancillary services, is now

contracted by utilities on a forward basis. It has not been established by TNHC how the AS provided by the LEAPS unit would be apportioned to the utilities or how the utilities would account for such AS in their filings with the CPUC. TNHC's proposal could have the unintended effect of motivating utilities to under-procure AS so that they can partake of the "free" AS provided by the LEAPS unit.

IV. CONCLUSION

The CEOB respectfully requests the Commission give due deliberation to these comments.

May 1, 2007

Respectfully submitted,

/s/ Jeffrey A. Diamond

Erik N. Saltmarsh, Chief Counsel
Jeffrey A. Diamond, Senior Staff Counsel
Kris G. Chisholm, Staff Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
916-322-8601
Attorneys for the California Electricity Oversight

Board

CERTIFICATE OF SERVICE

I hereby certify that on this day I served by U.S. Mail or by electronic service the foregoing document upon each person or party designated on the official service list for this proceeding as compiled by the Secretary of the Commission.

Dated at Sacramento, California, this 1st day of May 2007.

/s/ Melissa Turben

Melissa Turben
Legal Secretary
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
916-322-8601

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD



Arnold Schwarzenegger, Governor

May 1, 2007

VIA E-MAIL FOR ELECTRONIC FILING

The Honorable Kimberly D. Bose, Secretary
Federal Energy Regulatory Commission
Dockets Room, Room 1A, East
888 First Street, N.E.
Washington, D.C. 20426

**Re: Comments of the California Electricity Oversight Board
The Nevada Hydro Company, Inc.
Docket No. ER06-278-000, et seq.**

Dear Ms. Bose:

The California Electricity Oversight Board hereby e-files its Comments in Docket No. ER06-278-000, et seq.

Thank you for your attention to this matter.

Sincerely,

/s/ Jeffrey A. Diamond

Jeffrey A. Diamond
Senior Staff Counsel
California Electricity Oversight Board

cc: Official Service List of Docket No. ER06-278-000

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

The Nevada Hydro Company, Inc.	)	Docket No. ER06-278-000
	)	Docket No. ER06-278-001
	)	Docket No. ER06-278-002
	)	Docket No. ER06-278-003
<hr/>	)	Docket No. ER06-278-004

**COMMENTS OF THE
CALIFORNIA ELECTRICITY OVERSIGHT BOARD**

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.214, of the Federal Energy Regulatory Commission (Commission) the California Electricity Oversight Board (CEOB) hereby submits the following comments in the above-captioned proceeding.

I. CORRESPONDENCE AND COMMUNICATION

The principal office of the CEOB is located at 770 L Street, Suite 1250, Sacramento, California, 95814. All service of pleadings, orders, correspondence, and communications regarding this Docket should be made on the following persons:

Erik Saltmarsh, Chief Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
Tel: 916-322-8601
Fax: 916-322-8591
ErikSaltmarsh-Service@eob.ca.gov

Jeffrey A. Diamond, Senior Staff Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
Tel: 916-322-8601
Fax: 916-322-8591
jdiamond@eob.ca.gov

II. BACKGROUND

The CEOB is the California state agency having statutory responsibility for the oversight of the California Independent System Operator Corporation (CAISO), the

electricity and ancillary services markets administered by the CAISO, the reliability of the California electric grid, and the investigation of California's energy markets to ensure the protection of California's citizens and consumers.

Pursuant to the Commission's November 17, 2006 Order on Rate Request (November 17, Order) granting the CEOB's motion to intervene,¹ and the Commission's January 11, 2007 Notice extending time to comment to and including May 1, 2007, the CEOB respectfully submits the following comments.

III. COMMENTS

The Nevada Hydro Company, Inc. ("TNHC") proposes a pump storage facility that would be the most efficient in the region to recapture pumped energy for use at critical times. The CEOB is very supportive of such technologies and believes that this type of technology can be a valuable component of a generation portfolio. The following comments reflect the CEOB's evaluation of this particular project as currently proposed as a rate based transmission element and is not indicative, generally, of advanced transmission technologies.

The CEOB believes that the Lake Elsinore Advance Pump Storage ("LEAPS") combined with the Talega-Escondido/Valley-Serrano interconnection project ("TE/VS") (collectively, "LEAPS project"), as currently proposed by TNHC, raises three distinct policy concerns: (1) whether the TNHC Project can produce adequate economic benefits substantially in excess of its costs for California ratepayers; (2) whether the cost of the LEAPS project should be included in the CAISO's Transmission Access Charge (TAC);

¹ *The Nevada Hydro Company, Inc.*, Order on Rate Request, 117 FERC ¶ 61,204 (2006).

and (3) whether it is in the public interest that the CAISO should have operational control over the LEAPS unit.²

A. The Cost of LEAPS Will Outweigh the Benefits Accruing to California Ratepayers.

The CEOB has concluded that the cost of the LEAPS project, as currently proposed as a rate based transmission element, will outweigh the benefits accruing to California ratepayers. As discussed more fully below, the CEOB believes that the expected revenue arising from the sale of energy and ancillary services will not be sufficient to cover the project's costs. In theoretical terms, the LEAPS proposal will operate as an imperfect price hedge for California ratepayers. Moreover, the CEOB expects any economic benefit arising from the imperfect price hedge to dissipate over time as California implements its comprehensive energy and environmental policies. Each of these topics is discussed below.

1. Insufficient Net Revenue

The expected net revenue arising from the sale of energy and ancillary services will not be sufficient to cover the costs of LEAPS. That fact now appears to be uncontroverted by any party to this proceeding. During the April 19, 2007, public CAISO Board of Governors meeting, Governor Tim Gage asked whether the LEAPS plant was viable strictly as a merchant generator. TNHC responded that the LEAPS project was not viable strictly as a merchant plant.³ An analysis performed by the CEOB

² The CEOB's comments are premised upon the currently proposed LEAPS-TE/VIS combined project. While there have been discussions about a "new" project involving only the TE/VIS portion of the LEAPS project, that scenario is not before the Commission at this time. The CEOB believes that a TE/VIS ("wires only") project has the potential to bring significant benefits to California, and if proposed formally the project should be analyzed carefully but expeditiously.

³ Profitability of the LEAPS project is dependent on the difference between off-peak wholesale electricity prices and peak wholesale electricity prices, since the source of energy for the uptake pumps is electricity.

regarding the price spread between peak and off-peak wholesale prices for energy and ancillary services supports that general conclusion.⁴ The record in this proceeding contains no solid data to the contrary. The CEOB respectfully submits that California's ratepayers should not be required to pay for a generation plant that is not viable as a merchant generator and is only proposed to provide generation services.

TNHC's current proposal raises other policy issues, too. If LEAPS project is adopted, as proposed, the Commission, in effect, would take on the function of purchasing AS on behalf of California ratepayers. Since the net cost to consumers for AS would be set by energy arbitrage revenue, as discussed below, the consequence is to take a futures position on the price spread.

2. Price Arbitrage by the LEAPS Unit

The proposed method by which LEAPS would serve the ratepayers of California is through classic price arbitrage. The LEAPS project proposes to use low-cost off-peak energy to pump water that is used later as a "fuel" source to generate high-price peak energy for sale to the market. Under that carefully drawn scenario, LEAPS becomes a price hedge for California ratepayers if, and only if, there exists a significant spread between peak and off-peak energy prices during the life of the project. Plainly, the economic benefit to ratepayers will disappear as the spread between peak and off-peak

⁴ The current proposal allows the CAISO to call on the LEAPS unit for AS as needed. Similarly, it is impossible to know how often the unit will be selling energy into the market. Thus, the CEOB's analysis necessarily assumes that the LEAPS units will be run the same number of hours over each month. Under this constraint, for example, the average ten minute prices realized in the CAISO Real-Time Imbalance Market in July 2006 (the only month since the 2000-2001 electricity crisis period that California has seen a 1 in 50 temperature outcome) were as follows: Average On-Peak price: \$55.12/MWh; Average Off-Peak price: \$39.70/MWh; Average Difference: \$15.42/MWh. Contributing to profitability woes is the fact that LEAPS unit would have to pump water uphill during 4 peak hours each day in order to reach maximum capacity (see Nevada Hydro Company, Inc. Transmittal Letter to FERC, December 18, 2006, Docket ER06-278-005, Page 3, Section III.A, Paragraph 1).

energy prices shrinks. That fact is crucial to this project. The CEOB contends that the price spread will shrink over time and thus there will remain fewer and fewer opportunities for ratepayers to recover their stranded costs in the LEAPS project. There is no historical or other basis to assume that this price spread will be significant enough during the life of the LEAPS project. Moreover, the effectuation of California's energy policy goals will speed up the shrinking of that price spread, to the detriment of those paying for the LEAPS project.

3. California's Energy Policy Will Undermine LEAPS Price Hedging

The State of California has adopted a policy of maximizing peak savings.⁵ To attain this goal California is investing, proposing, and demanding a myriad of methods to reduce peak demand. Demand Response is one method, among others, for achieving this goal. One type of Demand Response is to "time-shift" energy usage from peak hours to off-peak hours thereby flattening the price curve associated with electricity wholesale rates through the day interval.⁶ The flattening of the price curve results in peak energy prices becoming more closely aligned with the off-peak price.

The problem for LEAPS in this case is two-fold. The LEAPS project actually facilitates the goal of flattening the price curve.⁷ Thus, the price hedge of the LEAPS unit will shrink as the price spread shrinks. With less spread in the energy prices, LEAPS not only loses the price hedge, but it will be unable to generate sufficient revenue to reimburse ratepayers for their large and risky investment in the LEAPS project. The

⁵ See California Energy Commission Integrated Energy Policy Report 2005, page 69.

⁶ The California Public Utilities Commission is presently crystallizing Demand Response through docket R.07-01-041 (January 25, 2007).

⁷ All other things being equal, when the LEAPS unit buys power during off-peak hours it adds to the demand which puts upward pressure on market prices. When the unit sells power during peak hours it adds to the supply and puts downward pressure on prices.

CEOB respectfully submits that ratepayer exposure to that type of risk is not acceptable, especially since California's ratepayers are still paying off the cost of the Summer 2000-2001 energy crisis.

Another policy issue raised by TNHC's current proposal involves California's Greenhouse Gas ("GHG") initiative. TNHC has not clearly explained its operation in the context of California's new regulatory landscape. The LEAPS unit will have a carbon cost "component" because it will rely upon off-peak power produced by carbon emitting generation. There is a probability that the LEAPS unit will have to purchase emission credits in order for its power to be deliverable to California consumers. Thus, it is unclear what effect the GHG initiative will have on the ability of the LEAPS unit to provide its power to the California ratepayers who paid for and are supposed to benefit from the project.

B. The Cost of LEAPS Should Not Be Included in the CAISO's TAC.

The CEOB is opposed to the inclusion into the CAISO's TAC of any construction, operation, or maintenance costs of the LEAPS unit, as a currently proposed rate based transmission element.

First, under § 1223 of the EPAct of 2005 the Commission is directed to "encourage, as appropriate, the deployment of advanced transmission technologies." Notwithstanding the foregoing, Congress did not equate pumped storage with a transmission line, nor did it command the Commission to rate base all advanced transmission technologies. While the Commission may have the authority to rate base advanced transmission technology when appropriate, the TNHC has not established that the LEAPS unit, as currently proposed, acts sufficiently like transmission to justify inclusion in the TAC.

Second, adding generation units to TAC could indirectly and unintentionally restructure California's electricity market. This problem may arise when the approved rate of return (ROR) for the generation part of the project is included in the TAC and is much higher on a risk-adjusted basis than the expected ROR for merchant generation. Entities that otherwise may consider constructing new merchant generation may instead select generation projects which are eligible for recovery through the TAC, shifting their risk to ratepayers while receiving the guaranteed ROR. Shifting the focus of investment from the type of merchant generation that should be built to the type that can be built with no risk to investors is a market distortion that California can live without.

If the relative ROR favors the TAC-included projects over time, then the California electricity market would no longer consist of an independent and market-neutral transmission system operator and a set of generators competing in energy markets. Instead, the CAISO would become a super utility and generators would compete for the residual electricity demand not satisfied by the CAISO. This problem would be made worse if the CAISO operates the generation units. Moreover, the problem would not disappear even if the CAISO contracts with a third-party scheduling coordinator to bid and operate the unit because the ROR is already built into the TAC.

Finally, it is not appropriate to include a cost-based, fixed revenue requirement for a generator in the TAC when the benefits associated with that revenue requirement are supposed to be determined by the competitive market. Indeed, once a generator's cost-based, fixed revenue requirement is rolled into the TAC, it will be impossible for the market to allocate the benefits using the FERC-approved cost-causation basis.

C. The CAISO Should Not Have Operational Control of LEAPS.

The CEOB is opposed to the CAISO's operational control of the LEAPS unit, as currently proposed as a rate based transmission element, for several reasons.

First, there is nothing about the structural nature of the LEAPS project that necessitates the CAISO operating the project in the first place. If operated by an entity separate from the CAISO, the project would be able to have its resources bid into energy and ancillary services (AS) markets like any other profit maximizing generator.

Second, there is no benefit accruing to ratepayers by having the CAISO involved in any manner regarding operational control of the LEAPS unit, whether through a firewall, auction to third parties, or contracts with third parties. Moreover, there will likely be a conflict of interest when the CAISO selects which AS generators will run verses those that do not in markets that the CAISO operates, especially when the selection is not based solely on bids or operational contingencies. These actions would set a precedent for the CAISO to act as market participant, thereby clouding the CAISO's impartiality as well as the competitive nature of the California energy market. The CAISO must remain a neutral grid operator.

Third, to maximize the benefits to ratepayers of the LEAPS project, the CAISO would have to operate LEAPS (and the grid reasonably adjacent to it) with a clear bias towards the project, despite other resources that might be available, including lower-cost alternatives. This could have the unwanted effect of preventing cheaper, more cost-effective resources from being built due to the fact that the market environment would be seen as uncompetitive.

Finally, CAISO operational control of the LEAPS unit would conflict with California's resource adequacy (RA) policy. RA, including ancillary services, is now

contracted by utilities on a forward basis. It has not been established by TNHC how the AS provided by the LEAPS unit would be apportioned to the utilities or how the utilities would account for such AS in their filings with the CPUC. TNHC's proposal could have the unintended effect of motivating utilities to under-procure AS so that they can partake of the "free" AS provided by the LEAPS unit.

IV. CONCLUSION

The CEOB respectfully requests the Commission give due deliberation to these comments.

May 1, 2007

Respectfully submitted,

/s/ Jeffrey A. Diamond

Erik N. Saltmarsh, Chief Counsel
Jeffrey A. Diamond, Senior Staff Counsel
Kris G. Chisholm, Staff Counsel
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
916-322-8601
Attorneys for the California Electricity Oversight

Board

CERTIFICATE OF SERVICE

I hereby certify that on this day I served by U.S. Mail or by electronic service the foregoing document upon each person or party designated on the official service list for this proceeding as compiled by the Secretary of the Commission.

Dated at Sacramento, California, this 1st day of May 2007.

/s/ Melissa Turben

Melissa Turben
Legal Secretary
California Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
916-322-8601

Submission Contents

Comments by the California Electricity Oversight Board on the Nevada Hydro LEAPS project.
ER06-278_commentcln.pdf..... 1-11

Comments by the California Electricity Oversight Board on the Nevada Hydro LEAPS project.
ER06-278_commentcln.pdf..... 12-22