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Re: 2009 IEPR-OTC

To Whom It May Concern:

SCE would like to thank the California Energy Commission (“CEC”) and the California Public Utilities Commission (“CPUC”) for this opportunity to provide comments on the July 28, 2009 workshop which focused on The Inter-Agency Analysis of Generation and Transmission Options for Eliminating Reliance upon Once-Through Cooling Power Plants. SCE thanks the CEC, the CPUC and the California Independent System Operator (“CAISO”) (collectively the “Joint Agencies”) for their leadership role in helping to develop the draft Once-through Cooling (OTC) policy (collectively, the “Draft Policy”) issued by the State Water Resources Control Board (“Water Board”) on June 30, 2009.

SCE supports the Water Board’s overall goal of protecting marine life. SCE, however, disagrees with the Draft Policy’s compliance requirement establishing closed cycle cooling as the “best technology available.” A cost-benefit analysis of the statewide Draft Policy should be conducted by the Water Board to determine the appropriate standard of performance. Such cost benefit analysis is likely to show that the costs of closed cycle cooling are significantly greater than the benefits produced. In such a case, SCE would recommend that the Water Board specify other practical and cost-beneficial steps to protect marine organisms instead of closed-cycle cooling or its equivalent.

SCE is fully prepared to work with the Joint Agencies to facilitate a smooth implementation of the Water Board’s final OTC policy, while ensuring reliable and safe operation of the State’s electrical power supply. As the Joint Agencies have acknowledged, addressing a phase-out of OTC technology will be a very challenging, and potentially costly, endeavor. SCE’s comments below are intended to highlight various significant issues and challenges in implementing the Draft Policy that the Joint Agencies and stakeholders must account for as the Water Board finalizes its OTC policy.

The Cost and Corresponding Rate Impact Of Replacing OTC Plants Is Likely To Be Significant

The Joint Agency proposal to implement the Draft Policy envisions replacing more than 30% of the State's generating capacity in a relatively short time, via some combination of repowered technologies onsite, new generation located in other areas, and/or upgrades to the transmission system. In addition, California has adopted, or is in the process of adopting, other policies which will place significant costs on electricity customers, including but not limited to:

- new renewable generation and supporting infrastructure to deliver and integrate renewable energy;
- new transmission;
- programs and policies to promote distributed solar PV;
- new policies to promote combined heat and power projects;
- aging distribution system replacement as well as significant upgrades necessary to accommodate higher levels of electrification (e.g., plug-in hybrids) and distributed solar PV; and
- smart grid infrastructure including advanced meters.

The Joint Agencies need to carefully evaluate the total cost, necessary up-front capital expenditures, and the combined rate impact of all these initiatives to form a realistic view of how much procurement and investment cost recovery is sustainable in an accelerated time frame.

In addition to these additional policies which place significant costs on electricity consumers, the current aggressive timeline for OTC replacement itself could increase the cost of OTC replacement. Under the aggressive timeline set forth in the Draft Policy, the three IOUs and LADWP will be competing for OTC replacement and other infrastructure projects, thus potentially creating a seller's market for the IPP developers and equipment manufacturers. Given the difficulty in acquiring viable project development sites and in acquiring requisite air emissions offsets, a few developers who might be successful in overcoming these obstacles will have tremendous leverage and considerable market power. Equipment manufacturers may also have difficulty supplying the necessary equipment to meet the schedule outlined in the Draft Policy.

In addition, the IOUs currently rely heavily on cheaper, shorter duration contracts to serve their load. If these contracts will instead be replaced with more expensive, longer duration contracts, the resulting increased debt imputation and capital lease accounting treatment could severely impact the IOUs' balance sheets, leading to potential changes in credit ratings. Thus, careful analysis is also warranted of the impact of these replacement contracts on the IOUs' balance sheets.

SCE urges the Joint Agencies to be mindful of all of these factors when seeking to implement any OTC policy.

Flexible Timelines Are Needed To Conduct Studies And Feasibly Implement The Retirement Of OTC Fossil Plants Without Undesirable Reliability And Rate Impacts

Implementing the replacement of more than 30% of California's generating capacity along with other significant modifications to California's electrical system should be preceded by careful planning and analysis. An integrated study including both Publicly Owned Utilities and IOUs has not been completed; thus, the feasibility of shutting down California's OTC generation is unknown at this time. Although the Joint Agency Staff Paper includes enhanced Local Capacity Requirements evaluations that focus on local load pockets receiving power from smaller renewable generators, those studies do not evaluate stability and the inertia needed to maintain system reliability. An integrated study of impacts to stability and inertia encompassing all affected utilities must be completed to have a more complete understanding of the impacts of retiring OTC plants.

In addition to such planning, there is a likelihood of significant delay in the implementation schedule due to challenges related to licensing, permitting, procurement and construction. For example, SCE currently has 1750 MW of contracts for new generation resources that cannot obtain air emissions permits. Thus, it is very likely that the South Coast Air Quality Management District's air pollution credits issue must be resolved before a comprehensive OTC replacement plan can be implemented for southern California.

Furthermore, siting any new greenfield generation or new transmission in the region is likely to run into extraordinary opposition, resulting in long lead times and unpredictable outcomes. Similarly, there are numerous issues associated with siting and permitting a transmission line, which typically take 6-11 years to resolve.

SCE suggests that these and other similar challenges warrant a flexible timeline for implementing of the Draft Policy. Otherwise, the draft policy may force the retirement of resources currently critical to operating the electrical system, without a clear pathway to replacing them in time.

SCE's RFO Process Is Robust And Does Not Need to Be Modified

One of the questions asked of panelists at the July 28, 2009 workshop was whether and to what extent changes to the utilities' RFO process are necessary. SCE's new generation RFO process is robust and does not need to be modified. SCE's RFOs are designed to foster competition by allowing a broad mix of product types to compete against one another so that SCE can select the products that best fit its customers' needs at the lowest possible cost. If the procurement objective of the RFO, or the product, or the location of the capacity is too narrowly defined, then the potential for lack of competition greatly increases. SCE does at times incorporate certain product attributes, including the ability to satisfy local resource adequacy requirements, as constraints or valuation adders in the RFO evaluation process. The IOUs must have the flexibility to define RFO parameters that would result in a competitive outcome, and

should avoid being required to conduct solicitations that are targeted to a particular location or product type.

Before an RFO for replacement generation could be conducted, it would be necessary for the Joint Agencies to agree on assumptions as to which OTC generators need to be replaced at what time, and the extent to which transmission alternatives will be implemented to replace this generation as opposed to the addition of replacement (non-OTC) generation. In procuring replacement generation, the lead times for new generation procurement, regulatory approvals, permitting, construction, and transmission interconnection need to be taken into account. Generators have a shorter lead time to decide whether to shut down, repower, or add cooling towers in comparison to transmission interconnection. These lead times must take into account the timing for large generator interconnection pursuant to the CAISO's new Grid Interconnection Process Reform process. Additionally, the risk that the replacement generation may not come on-line, or may not come on-line on time, must be taken into account. As experience has shown, these risks are quite significant, and accordingly, it may be desirable to procure additional generation for risk mitigation, or allow for the OTC generators that are being replaced to continue to operate as necessary for reliability.

Since all the fossil OTC generators interconnected in SCE's service territory are privately owned, any assumptions about the willingness of the owner to comply with OTC requirements, as opposed to retiring their plants, may be wrong. This is particularly problematic in terms of licensing and constructing new transmission. SCE has the burden of proving a reliability need to license new transmission and condemn property, if necessary. Because SCE cannot dictate a retirement or repower decision for the private owners of fossil OTC generation, demonstrating a reliability need for transmission years in advance of an OTC generator's retirement or repower decision timeline will likely prove to be very contentious and difficult.

For these reasons, clear assumptions are needed concerning which OTC generators must be replaced at what time, and the extent to which transmission alternatives will be implemented to replace that generation as opposed to the addition of replacement (non-OTC) generation.

Costs Of OTC Policy Compliance Should Be Borne By All Benefiting Customers

The Joint Agency proposal and the draft policy are not clear about who will share the costs for the OTC replacements if IOUs are the designated agents to implement the Draft Policy.

The cost of OTC replacement should be borne equally by all customers in the electrical system, including IOUs' bundled customers, DA customers, CCA customers, POU customers, municipal departing load customers, and self-generation customers. Ideally, a Centralized Forward Capacity Market should be adopted as the procurement mechanism for OTC replacement which fairly allocates costs very broadly. If the Joint Agencies are nevertheless intent on relying on IOU procurement activity to facilitate OTC replacement, SCE urges the Joint Agencies to give consideration to the design of a cost allocation mechanism that reaches all of these classes of customers, including customers outside the CPUC's jurisdiction.

OTC Policy Cannot Be Implemented Via Current Resource Adequacy Requirements

One of the questions asked of panelists at the July 28, 2009 workshop was how load serving entities plan to meet their Resource Adequacy (“RA”) requirements without OTC capacity. RA in each LSE’s portfolio is currently a short-term requirement (*i.e.*, a one year or less forward demonstration). It does not take into account, nor can it solve, long-term system planning issues such as phase-out of OTC plants.

To satisfy RA or energy requirements, LSEs do not need to sign long-term agreements with suppliers. It should also be noted that SCE’s pre-approved procurement authority granted by the CPUC to fulfill its RA requirements is limited to contracts up to 59 months in duration. Such short-term contracts generally do not drive resource addition decisions such as a long term policy goal to replace OTC capacity. The CPUC has acknowledged this in its LTPP proceedings, and has authorized an interim Cost Allocation Mechanism whereby IOUs offer long-term contracts to build new generation resources as agents for “wires” customers, and the costs and benefits of the new generation resources are broadly allocated.

LSE’s will likely continue to rely on existing plants to fulfill their RA requirements. However, if the Water Board’s Draft Policy specifying compliance dates for each OTC generator is adopted, it should not be necessary for the CPUC to impose restrictions on IOU contracting with OTC generators. An IOU would simply not contract with an OTC generator beyond its compliance date if the OTC generator does not demonstrate that it intends to comply with the Water Board’s OTC policy.

Conclusion

SCE urges the Water Board and Energy Agencies not to view the OTC policy in isolation. Rather, the policymakers must examine this policy in the context of the state’s other energy and environmental goals. Policymakers must also be mindful of costs on the state’s energy consumers, especially in light of the current economic downturn. SCE stands ready to help the Water Board and Energy Agencies to achieve their goal of preserving marine life in a way that preserves reliability, and is environmentally responsible and cost conscious.

Very truly yours,

/s/ Manuel Alvarez

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