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Mr. Jeff Hatch-Miller, Chairman  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, Arizona 85007-2996

Ms. Kristin K. Mayes, Commissioner  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, Arizona 85007-2996

**Re: Devers-Palo Verde No. 2 Transmission Line  
Docket No. L-00000A-06-0295-00130**

Dear Chairman Hatch-Miller and Commissioner Mayes:

Southern California Edison (SCE) received your letters dated May 10, 2006, requesting information about the proposed Devers-Palo Verde No. 2 (DPV2) transmission line. This letter responds to those letters. SCE will present further detail and backup materials at the Line Siting Committee's evidentiary hearings.

The DPV2 project has been the subject of extensive studies for several years by regional planning groups. These groups, which include the Western Electricity Coordinating Council (WECC), Southwest Transmission Expansion Plan (STEP), the Southwest Area Transmission (SWAT), the Palo Verde Engineering and Operating Committee, and the Western Arizona Transmission Study (WATS) organizations, have evaluated and approved various studies supporting the proposed line. DPV2 is just one of many transmission projects under consideration for the Western Interconnection that will strengthen the reliability of the transmission system, improve the grid's ability to transport the output from new and existing generation resources by removing transmission constraints, and thereby help meet the growing demand for electricity demand in the West.

California is not relying solely on out-of-state resources to meet its generation needs. It is also building generation facilities in California – 13,000 MW of new generation have been constructed since 2001. Another 8,400 MW of new generation have been approved but not yet constructed. An additional 8,000 MW have been announced or are undergoing regulatory review. The California Legislature has also undertaken an aggressive goal for California investor-owned utilities to meet 20% of their energy needs with renewable resources by 2017. SCE is committed to meet the RPS requirement by 2010 or as soon as otherwise feasible.

## ***Consumer Costs of Proposed DPV2***

### **A. SCE's Report to the CAISO (Appendix G in SCE's California Application)**

It is important that we make a clarifying point regarding SCE's report to the California Independent System Operator Corporation (CAISO). DPV2 will not cost Arizona consumers \$231 million between 2009 and 2014. As explained below, the "Consumer Surplus" figure does not reflect the actual costs to Arizona consumers. In fact, as the evidence at the hearing will demonstrate, even the DPV2 costs noted in footnote 3 in Commissioner Mayes' letter to Arizona are offset by many benefits. DPV2 is expected to provide a substantial overall economic benefit to Arizona consumers, as discussed below and will be discussed in the evidentiary hearings.

A few points regarding SCE's report to the CAISO. First, in evaluating SCE's report to the CAISO, it is important to note that the analysis is based on a market simulation model that is a commonly-used tool in the electric power industry to forecast market prices and production costs. The model dispatches generation based on least-cost economics, subject to transmission constraints, and determines regional market prices based on the marginal cost of generation in each area.

Second, the Arizona cost impact from the report to the CAISO is expressed in the "Net Impact" number. This net impact represents the change in production costs to Arizona due to DPV2. The model calculates the change in utility production costs using three measurements: (1) the change in power costs paid by Arizona utilities if all power was purchased at market prices (the "Consumer Surplus"); (2) the profits that would be received by these same utilities for their own generation ("URG Producer Surplus"); and, (3) the "transmission congestion revenue" that would be received by these same utilities if they operated in a market with congestion pricing. In actuality, Arizona utilities do not purchase all of their power at market prices and they neither sell generation from their own plants to their own retail customers at market prices nor do they earn congestion revenues. However, netting these three components reflects customer impacts because if utilities earned such profits and congestion revenues, they would be passed on to customers in the form of lower rates. The resulting "Net Impact" is the costs imposed on the Arizona utilities and their customers due to DPV2, and includes the cost of buying power from independent generators at slightly higher market prices. For instance, in 2009 this net impact is about \$12 million. This net impact represents the change in production and purchase costs to Arizona utilities due to DPV2.

Third, even this net impact of DPV2 as estimated by the model is more than offset by the benefits Arizona receives from DPV2, which are summarized below and details of which will be also provided during evidentiary hearings.

## **B. Arizona Consumer Benefits**

Before we talk about benefits, there is an important point about project costs. The construction and operating costs of the DPV2 line itself will be paid for by California consumers. Arizona consumers will benefit from the construction of DPV2 in several ways. The DPV2 line will provide a reliability benefit, including improved protection during extreme contingencies. For example, a SCE extreme contingency study shows that DPV2 would significantly reduce the amount of load that would need to be dropped to mitigate the loss of the Palo Verde hub. During such extreme contingencies, DPV2 could provide a transmission path for power to flow to Arizona from California or the Pacific Northwest. As major outages in the Western Interconnection during the last 10 years have shown, such emergencies unfortunately do occur from time to time.

Arizona will also benefit from local economic development associated with DPV2, including increased employment and tax revenue during construction and increased tax revenue throughout the life of the project. Among other benefits, DPV2 will also provide greater fuel and load diversity and improve generation investment incentives. The project may complement and support other proposed transmission projects, such as the TransWest Express, which would import to Arizona low-cost energy and renewable power from Wyoming and adjacent states. DPV2 will improve the utilization rates of generating resources in Arizona and neighboring states, thus increasing efficiency of the electrical grid and its interconnected resources. Furthermore, DPV2 will help support and improve liquidity of the PV Hub, which offers the benefits of reduced transaction costs and improved price transparency, risk management, and procurement opportunities for Arizona utilities.

### ***Impact on Arizona's Power Supplies***

As noted in letters from various Arizona utilities to the Commission, Arizona will need to increase its power supplies in the not too distant future. The DPV2 line will not have any material impact on this need. The production cost model that SCE used to study the cost-effectiveness of the proposed line estimates that the power flowing across the line will come from a variety of generation resources in the Desert Southwest, with only a smaller portion coming from resources in Arizona. The proposed DPV2 is a 1200 MW line, with an expected average flow of 900 MW. However, on average only 230 MW of this 900 MW will come from increased Arizona generation, and the majority of that will be utilized during Arizona's off peak hours. During peak hours, DPV2 will only increase Arizona generation by approximately 50-100 MW. This amount comprises less than ½ of 1% of Arizona's power supply during summer peak hours. Therefore, DPV2 will have minimal effect on the availability of Palo Verde generation to serve the peak loads of Arizona's utilities. Arizona has already approved several thousand megawatts of power generating facilities that have not yet been built.

If even a portion of these approved, but not yet built, facilities is added to current supply, the effect of DPV2 on the availability of Arizona generation is even more *de minimus*.

DPV2 does not materially alter Arizona's resource needs. Based on the letters sent from Arizona utilities, it appears that they will need new power supplies in the 2011 to 2012 time period with or without DPV2. Furthermore, by making it more attractive for generation to locate in Arizona due to the presence of available transmission, the DPV2 line will have a positive impact on Arizona's generation supply.

### ***Reliability/Power Supplies Directed from California into Arizona***

The line can carry power to Arizona from California and other parts of the Western grid and can do so during emergency conditions, such as during major generation or transmission outages in the Palo Verde area. In addition to providing access to California generation during emergency conditions, the DPV2 line will also provide Arizona utilities with access to two important resources: new generation near Blythe and the substantial planned additions of California renewable resources.

### ***Environmental Impacts to Arizona Resulting from DPV2***

SCE needs to clarify another point. SCE has not conducted any studies on the environmental impacts of the construction of additional generation in AZ that will be spurred by the construction of DPV2, because DPV2 will not require that new generation be built in Arizona. Rather, DPV2 will help encourage utilization of existing facilities and investment in new generation and support transmission that Arizona utilities acknowledge they will need. SCE understands that the ACC has already approved additional generating capacity that has not been built in part because of transmission congestion. DPV2 will help alleviate that congestion and therefore may facilitate the development of generation already approved by the ACC.

SCE has, however, conducted extensive studies concerning the environmental impact of the construction and operation of DPV2. SCE's application provides extensive documentation to support a finding that this project is environmentally compatible. The recently issued Draft EIS/EIR by the Bureau of Land Management and the California Public Utilities Commission supports this view.

### ***Estimated Tax Benefits from DPV2***

SCE is still continuing to refine its analysis of tax benefits, and will provide this information at the hearings. However, based on the current results, the combined tax and construction benefits – without considering the other benefits discussed above (see Section B, p. 3, *supra*) – exceed the net lifecycle costs as reflected in the study SCE did for the CAISO.

If you have any questions, please feel free to contact us.

Sincerely,

  
Alan J. Fohrer  
Chief Executive Officer

  
John R. Fielder  
President

cc: ACC Commissioner Marc Spitzer  
ACC Commissioner William Mundell  
ACC Commissioner Mike Gleason  
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