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October 2, 2007

Mr. Doug Simpson
Market Operations Specialist,
Market Development
Alberta Electric System Operator
2500, 330-5th Ave SW
Calgary, AB
T2P 0L4

Re: TransAlta's Comments On The AESO's Congestion Management Plan

Dear Mr. Simpson:

Thank you for the opportunity to provide comments on the AESO's Recommendation Paper on a Congestion Management Plan (CMP), dated August 30, 2007. TransAlta offers the following comments:

The CMP Should Incent The AESO To Get The Transmission Lines Built On Time

It is the responsibility of the AESO to ensure transmission is developed in a timely manner. TransAlta is very concerned that the planning and implementation of transmission development in the province has failed to the extent that such a congestion management plan is necessary. Such a plan should never be a substitute for adequate transmission lines being built on time. As stated in the Transmission Development Policy (TDP) of December 22, 2003 "Transmission planning must be proactive in nature and must therefore lead load growth and generation development. Both population and economic growth are expected to continue in the province and transmission assets should be developed in a manner, which is prudently in advance of projected needs." The Transmission Development Policy outlined a vision for the development of future transmission in the province. It stated that "Transmission is the backbone of the electric industry." "Transmission policy must contribute to a stable investment climate in order to maintain investor confidence and support continued capital investment in generation and transmission in Alberta. Alberta's transmission system is already congested because growth in electricity demand and investment in new generation facilities have not been matched by investment in transmission facilities." Almost four years later there have still been no major transmission projects completed. The much needed North/South line will likely now be delayed far past its original planned in service date of 2009.

Concerns With The Proposed CMP

1. Transmission Costs Are Not Generator Costs

Placing transmission costs on generators is contrary to the principle that loads are to pay for transmission costs, a principle embodied in the Transmission Regulation section 47(a)(i) which states that “the just and reasonable costs of the transmission system are wholly charged to DFO’s, customers who are industrial systems and persons who have made an arrangement under section 101(2) of the Act, and exporters, to the extent required by the ISO tariff”. Congestion is a transmission cost.

As stated in the TDP, transmission policy must contribute to a stable investment climate. Generators have made investment decisions with the understanding that transmission would be built well in advance of generation need and that congestion would not be a normal operating condition. Section 15(e) of the Transmission Regulation states the ISO must “. . . plan a transmission system that (i) is sufficiently robust so that 100% of the time, transmission of all anticipated in-merit electric energy referred to in section 17(c) of the Act can occur when all transmission facilities are in service, and (ii) is adequate so that, on an annual basis, at least 95% of the time, transmission of all anticipated in-merit electric energy referred to in section 17(c) of the Act can occur when operating under abnormal operating conditions”. That understanding made for acceptable investment risk and projects have proceeded on that basis. Alberta’s market structure is predicated on a congestion free system that does not rely on locational signals to indicate that one area of the province is better to locate in than another. The proposed CMP would shift this fundamental predicate, as a generator on the wrong side of a congested line can be dispatched down with no compensation, sending a strong locational signal that will discourage generation in resource rich northern Alberta. Fundamental market design changes such as these should not be made lightly, nor through AESO OPPs or rules, as they contribute to an unstable investment climate in Alberta.

2. Proposed CMP Is Discriminatory

Dispatching down northern generators, as outlined in the AESO’s proposed CMP, results in discrimination between generators when none should exist. The Electric Utilities Act (EUA) section 5(b) states: “All persons wishing to exchange electric energy through the power pool may do so on non-discriminatory terms”. EUA section 33 also states “The Independent System Operator must forecast the needs of market participants and develop plans for the transmission system to provide efficient, reliable and non-discriminatory system access service and the timely implementation of required transmission system expansions and enhancements.”

By placing the burden of congestion on northern generators (or generators on one side of any constraint), the result is undue or arbitrary discrimination between northern and southern generators. The impact of this discrimination is particularly unfair where those northern generators constrained to zero MW’s have no additional generation to take advantage of the

higher pool prices set by constrained up generators in the south under the proposed CMP. Generators should not be required to have a portfolio of generators in congested and uncongested zones in order to be held whole. Nor should they be required to gamble that any MW's that are not constrained down are paid enough to compensate them for their MW's which are constrained off.

3. Northern Generators Are Exposed To Price As Well As Volume Risk

The uncertainty of when you will be constrained down will also cause problems with generator financial arrangements such as pool price hedges and the PPAs. Traders will no longer be able to hedge physical price risk with financial products without taking on additional risk. Dispatching down forces hedged generators into a financial short position which they will be forced to cover at the much higher prices set by southern generation. This additional risk of generation ownership would have implications for future investment as well as for the creditworthiness of existing generation.

TransAlta also has very serious concerns around the impact of a constrained down situation on the PPA contracts. Due to the ownership and dispatch structure related to energy from a unit covered by a PPA (target availability energy, excess energy, uprate energy) as well as Change in Law and Force Majeure provisions it is unclear whether one party would in effect be taking a disproportionate share of dispatch down risk and congestion costs.

4. Generator Remedial Action Schemes (GRAS) Should Not Be Used As A Permanent Solution

While TransAlta understands and accepts the need for a GRAS system in the planning horizon, it is important to recognize it is not a substitute for transmission development. GRAS schemes must have a clear set of criteria for which they are armed and should not be used for other purposes.

AESO Bears The Responsibility Of Assessing The Impact Of The CMP

EUA section 17 states that the AESO must " . . . make rules and establish practices respecting the operation of the transmission system and the management of transmission constraints that may occur from time to time." TransAlta accepts that the AESO needs to develop a congestion management plan, however the AESO's recommendation cannot be thoroughly analyzed by participants as there is no information available to model and understand the impacts. Without knowing how often the system is likely to be constrained, what time of day or year the constraints are likely to occur, which generation units are effective in relieving those constraints, and how much competition there will be between effective units when they are dispatched up or down to relieve constraints, we are making a decision in a vacuum.

The EUA section 16 lays out the responsibility of the ISO to act responsibly. "The Independent System Operator must exercise its powers and carry out its duties,

responsibilities and functions in a timely manner that is fair and responsible to provide for the safe, reliability and economic operation of the interconnected electric system and to promote a fair, efficient and openly competitive market for electricity.” It is neither fair nor responsible of the AESO to request comment on a congestion plan that can have very significant financial impacts without providing participants with the information necessary to make informed decisions. Given limited information, TransAlta estimates the potential financial impacts of a “congestion event” on an individual generator could easily be in the millions of dollars per day. For example, consider a generator in the north of the province with 600 MW of merchant capacity in its portfolio. Assume that all 600 MW are constrained down to zero MW’s as per the congestion policy, and that pool price in that hour was \$80/MWh. For one hour on lost production alone, the generator would have lost revenue of just over \$1 million. Assume also that the generator took conservative risk management steps to hedge 50% of those 600 MW’s (300 MW’s) and now had to go into the market to cover its hedges. Due to the proposed CMP the market price was now \$500/MWh so the cost to back the hedges would be approximately \$3.5 million per day. This simple example underscores the need for a thorough review of the financial implications of any congestion management plan, including any impacts to the PPA contracts, to ensure that there is no undo harm to any one party.

As well as the financial impacts of any congestion plan, the AESO also needs to ensure that any operational issues such as voltage support, impact on hydro units, and RAS on the inertia can be managed. This is important not only from an overall system point of view, but also important to generators in that it may impact the determination of effective generators.

TransAlta Preferred CMP Approach

TransAlta believes the proper approach to real time congestion management is to pay dispatch down and dispatch up payments to generators. Both sets of payments should be paid on a “as bid” basis and the payments should be kept out of market and be pool price neutral (ie. pool price should be reconstituted). Both the dispatch up and dispatch down payments should be borne by the load, as they are a transmission cost.

With regards to the use of GRAS, TransAlta’s preferred solution is that GRAS schemes should have a sunset clause after which they must be disarmed. The GRAS should only be in place until the planned in service date of the transmission line, not until the “appropriate transmission infrastructure can be provided” as suggested in the proposed CMP. If the line is not in service after the planned in service date, any time the GRAS is activated the generator should be paid dispatch down payments for the duration of the time the unit is offline, which again should be considered as transmission costs, borne by the load.

Benefits Of TransAlta's Preferred CMP Approach

1. Maintains The Integrity Of The Energy Market Price Signal

The TDP stated that "In our market model, it is critical in the relatively few cases where transmission constraints are not removed, real-time congestion arrangements should not alter or distort market prices. Where generators are paid out of merit to alleviate a transmission constraint, the costs of the out of merit payments will be a transmission payment and not a form of uplift in the wholesale energy market price. These costs should be allocated in the same manner as other "wires" costs." The "pay as bid" payments will hold generators who are constrained down whole and at the same time pays them no more than they bid, reflecting the true cost of unconstrained energy. By keeping these payments out of market the integrity of the energy price signal is maintained. TransAlta recognizes that this would represent a change to the current TDP. TransAlta would offer its support to the AESO in engaging the Department of Energy to facilitate this approach.

2. Aligns Incentives To Support Transmission Investment

Paying dispatch down and dispatch up payments also aligns incentives for the AESO and loads to get transmission built. It sends the proper signals regarding the price of congestion, which ultimately helps the AESO ensure the need for new transmission facilities is clearly understood. To the extent the AESO will be scrutinized over transmission costs as part of their rates it provides them additional incentive to get transmission lines built.

3. Economic And Efficient

Pool price neutral payments for dispatch down and dispatch up payments will also result in a more efficient solution for the load than that contemplated by the AESO in its proposed CMP. A simple example illustrates this point. If there is 100 MW of generation that must be constrained down, and that generation bid \$80/MWh then the dispatch down payment to that generator would be \$8000. If the constrained up generator in the south bid in 100 MW at \$500, the cost of the dispatch up payment would be \$50,000. The total congestion cost would be \$58,000. Compare this to the AESO's proposed CMP, where the generator in the south would now set the pool price of \$500/MWh. This new price is applied to all load in the province. If we assume 8000 MW of load, the total cost to the load is $8000 \times (\$500 - \$80/\text{MWh}) = \$3,360,000$. The difference in congestion costs between TransAlta's preferred method and the AESO's proposed CMP = \$3,302,000 for a single hour.

Additional CMP Comments

TransAlta believes its preferred approach set forth above is the optimal solution to congestion management and encourages the AESO to implement this solution immediately. However, TransAlta provides the following additional comments on the

AESO's CMP. We are concerned about the potential for a depressing impact on pool price from a RMO approach, however if there are only a few hours of congestion a year, this may be less offensive. As the number of hours of congestion in Alberta increases, the impact on pool prices will become more marked. Accordingly, TransAlta recommends moving to a pure pro rata approach where the numbers of hours of congestion in a year reaches some maximum level, for example 200 hours. Little incremental work should be needed as the AESO's proposed CMP recognizes that infrastructure and processes will be necessary to allow a pro rata approach where generation is offered at the same price. This would i) minimize the RMO pool price impact of a "race to zero" in the north and ii) enable a more equitable split of the congestion costs among all northern generators. To reiterate, the issues regarding the PPA and financial contracts still must be addressed with regards to any CMP solution which is chosen.

We hope these comments have been useful. TransAlta looks forward to discussing with the AESO their next version of the Congestion Management Plan that addresses the issues raised above. Please feel free to contact me with any questions.

Yours truly,

A handwritten signature in black ink that reads "Sterling Koch". The signature is written in a cursive style with a large, looping flourish at the end of the name.

Sterling Koch
Director and General Counsel
Regulatory & Legal Affairs