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Subject: LSP South Bay, LLC South Bay Replacmeent Project

Gentlemen:

This letter responds to concerns expressed by California Energy Commission ("CEC") air quality staff in their October 31, 2006 data requests as well in the San Diego County Air Pollution Control District ("SDAPCD" or "District") staff's letter of November 22, 2006, regarding the possibility of simultaneous commercial operation of the existing South Bay Power Plant ("SBPP") and the proposed South Bay Replacement Project ("SBRP"). The CEC staff raised concerns that the California Independent System Operator ("CAISO") reliability must run ("RMR") status of the South Bay Power Plant ("SBPP") does not permit LSP South Bay, LLC ("LS Power") to control whether the SBPP and the new SBRP operate simultaneously or not. As described below, there are multiple independent reasons to conclude that simultaneous commercial operation of the SBPP and the SBRP cannot and will not occur.[1]

To begin with, the SBRP will request and accept a permit condition from the CEC and the SDAPCD prohibiting simultaneous commercial operation with the SBPP following achievement of commercial operation of the SBRP. With such permit conditions in place, the CAISO cannot enforce the RMR contract to operate the SBPP or the SBRP in violation of the

[1] As used in this letter, "simultaneous commercial operation" means the operation of both the SBRP and SBPP at the same time more than 30 days following the commercial operation date of the SBRP. As documented below, such simultaneous commercial operation will not occur.

permit condition. Moreover, even without the permit condition, simultaneous commercial operation of the SBPP and the SBRP is not possible for several reasons, including the following:

- The expected air quality offset limitation for the SBRP will not allow simultaneous commercial operation of the SBPP and the SBRP;
- The electrical interconnection agreement for the SBRP would not permit simultaneous commercial operation;
- The gas interconnection is insufficient to allow simultaneous commercial operation of the SBPP and the SBRP;
- The existing Cooperation Agreement and the proposed Option to Lease between the Unified Port District of San Diego ("Port") and LS Power provide that the SBRP will replace operation of the SBPP as soon as possible; and finally,
- The SBRP must comply with the California Coastal Act, which requires cessation of the once-through cooling used at the SBPP and demolition of the SBPP.

For these and other reasons, as elaborated upon below, the SBRP and the SBPP cannot operate simultaneously once the SBRP achieves commercial operation.

I. The RMR Contract cannot Compel the SBPP and/or the SBRP to Operate in Violation of Permit Conditions

Although the CAISO can generally determine when RMR generation facilities operate, the RMR contract does not permit the CAISO to require operations in violation of contractual or permit conditions. Section 4.6 of the *pro forma* RMR contract explicitly and unambiguously prevents the CAISO from doing so:

4.6 Limitations on ISO's Right to Dispatch

ISO's Dispatch Notice may not request Owner to, and Owner shall not be obligated to:

(i) Provide service from a Unit at less than the Minimum Load for the Unit;
(ii) Provide service from a Unit for less than the Minimum Run Time;
(iii) Start-up a Unit after less than the Minimum Off Time;
(iv) Start-up a Unit unless the time between the delivery of the Dispatch Notice requesting such Start-up and the commencement of the applicable Requested Operation Period equals at least the Start-up Lead Time for the Unit and the Dispatch Notice provides sufficient time to satisfy the Ramping Constraint of the Unit;
(v) Provide service from a Unit in excess of its Unit Availability Limit;
(vi) Provide service from a Unit when to do so would violate environmental limitations applicable to the Unit as set forth in Section 3 of Schedule A;
(vii) Start-up or provide service from a Unit in violation of any applicable law, regulation, license or permit; or
(viii) Start-up or provide service from a Unit to the extent that doing so would cause a breach of an Existing Contractual Limitation; or
(ix) Deliver Energy or Ancillary Services to the extent such Delivery would cause a breach of a contract for capacity made available through an

> Upgrade or a Capital Item or Repair for which ISO is not obligated to make a Surcharge Payment or pay ISO's Repair Share. (Emphasis added).

Accordingly, the CEC staff concern regarding the CAISO RMR authority is misplaced. Any restriction in the permits for the SBRP regarding simultaneous commercial operation or total emissions from the existing and new facilities after commercial operation of SBRP would be fully enforceable notwithstanding the RMR status of either facility.

II. LS Power Will Request and Accept a Permit Condition from the CEC and SDAPCD Prohibiting Simultaneous Commercial Operation of the SBPP and SBRP.

The SBRP requests and will accept a permit condition from the CEC and SDAPCD to ensure that simultaneous commercial operation of the existing SBPP and the new SBRP will not occur. The SBRP proposes the following language, to be included in the CEC conditions of certification and the SDAPCD permit:

> Prior to the Commercial Operation Date (COD) for the South Bay Replacement Project (SBRP), the operator[2] will operate the SBRP equipment simultaneously with the existing South Bay Power Plant (SBPP) boilers only to the extent necessary to carry out required commissioning activities, including acceptance and performance testing. During the commissioning period, the operator will operate the SBRP equipment such that the combined net electrical generation by both SBRP and SBPP units does not exceed 706 MW.
>
> Not later than 30 days after the COD for the SBRP, the operator will not operate the SBRP equipment at the same time that any of the SBPP boilers are operating. Prior to that time, and commencing with the first firing of the first SBRP unit for commissioning purposes, SBRP will operate the SBRP units in such as way so as to ensure that the combined emissions from the SBRP and SBPP units do not exceed the annual emission limits specified in Condition XX (reference to SBRP annual emission limits).

This condition prohibits outright <u>any</u> simultaneous operation 30 days following the commercial operation date of the SBRP. Moreover, the condition further prohibits the SBPP and SBRP from simultaneously operating prior to that time in a manner where the combined emissions of the two plants would surpass the emissions limits of the SBRP alone. Therefore, even if the SBPP and SBRP temporarily operate at the same time during testing and commissioning, combined annual emissions would be less than or equal to those of the SBRP alone.

III. Simultaneous Commercial Operation of the SBRP and SBPP is Impossible even without a Permit Condition

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[2] References herein to "the operator" or "the applicant" refer to LS Power its successor (if any) in either role.

In addition, even without a permit condition like the one proposed above, simultaneous commercial operation of the SBPP and the SBRP is not possible for a number of reasons.

First, the expected air quality offset limitations for the SBRP contemplated by the applicant would not allow simultaneous commercial operation. As discussed above, SBRP has proposed, and will accept, a permit condition restricting operation of the SBRP units to ensure that the maximum combined emissions from the SBPP and the SBRP during commissioning of SBRP will not exceed the annual emission levels shown in Table 8.1-34 of the applicant's Application for Certification ("AFC") for the SBRP alone. This condition is enforceable for the following reasons:

- Emissions of oxides of nitrogen and carbon monoxide are measured through District-required continuous emissions monitors at the SBPP, and will be similarly monitored at the SBRP.
- Emissions of volatile organic compounds, sulfur oxides, and particulate matter are determined through measured fuel consumption and District-approved emission factors at the SBPP, and will be similarly determined at the SBRP.
- The proposed permit condition restricts operation of the SBRP, rather than restricting operation of the SBPP, thus addressing any theoretical concerns that the SBPP might be dispatched by CAISO without regard to these limitations. (As discussed above, the RMR agreement for the SBPP explicitly prohibits the CAISO from dispatching the SBPP in violation of environmental permit conditions.)

Therefore, the SBPP and the SBRP can only operate simultaneously during the commissioning of SBRP and then only to the extent that the combined annual emission levels would be less than or equal to the emission levels of the SBRP only.

Second, LS Power has proposed to interconnect the SBRP with the SDG&E grid as a replacement project only and none of the interconnection studies and agreements contemplate the delivery of energy from both SBRP or SBPP post commercial operation of SBRP LS Power has not sought any right to simultaneous commercial operation of SBPP and SBRP and such condition has not been studied.

Third, because LS Power has always intended that the SBRP truly replace the existing SBPP, it has not requested natural gas interconnection rights that would allow simultaneous commercial operation of both units and does not intend to do so. Moreover, LS Power understands that the existing natural gas infrastructure would not allow deliveries in sufficient quantities to allow such operations.

Fourth, the proposed Option to Lease between LS Power and the Port is for a Project that is licensed by the California Energy Commission that includes "as a condition thereof, the demolition of the Existing South Bay Power Plant." Such condition ensures the SBPP and the SBRP will not engage in simultaneous commercial operations. The Option to Lease plainly contemplates that the SBRP will replace operation of the SBPP as soon as possible. This is also consistent with the Bay Front Master Plan and related local land use plans.

Finally, the project's compliance with the Coastal Act is predicated upon prompt cessation of once-through cooling at the SBPP and demolition of the project. Simultaneous commercial operations would not achieve this important objective.

For all of the above reasons, the project proposed in the AFC is plainly and explicitly intended to promptly replace the SBPP. Simply put, the concern regarding simultaneous commercial operation of the SBRP and the SBPP does not reflect the project proposed by LS Power in the AFC. As such, it is also inconsistent with virtually every aspect of LS Power. related development activity.

IV. Temporary Operation During Commissioning

As requested by CEC staff, the LS Power is analyzing the potential worst-case combined air quality impacts of the SBPP and the SBRP during the SBRP commissioning period. This worst case analysis was based on the following two operating cases for the two plants, even though such operation is both unlikely and physically constrained by both gas supply and transmission constraints: (1) operation of both the SBPP and the SBRP at maximum output for one hour; and (2) operation of the SBRP at maximum output and the SBPP at 65% capacity[3] for twenty-four hours.

In addition to such worst case operation cases being unlikely and physically restrained, such operation would be prohibited by the proposed SBRP permit condition above, which would restrict the combined output from both the existing and new plants to the rated capacity of the existing plant during the commissioning of SBRP. The results of these analyses will be submitted to the District and CEC staff later this month.

V. Conclusion

For many independent reasons, the concern regarding simultaneous commercial operation of the two plants is unwarranted. Fundamentally, the concern reflects a misperception that the authority of the CAISO under the RMR contracts can compel violation of permit conditions, environmental restrictions or contracts. As shown above, the RMR contract contains clear provisions ensuring that the CAISO cannot do so. Moreover, to put this issue to rest once and for all, LS Power is prepared to accept the permit condition prohibiting simultaneous commercial operation set forth above. As just discussed, this condition would be fully enforceable through the RMR contract.

Even without this proposed permit condition, there is ample reason to dismiss the possibility of simultaneous commercial operation. Such operation is inconsistent with the project proposed by LS Power in the AFC. Simultaneous commercial operation is similarly inconsistent with expected air quality restrictions as well as local land use policies and the Coastal Act. Furthermore, simultaneous commercial operation is inconsistent with virtually all of the agreements LS Power has entered into regarding the project, including its gas supply agreements and its Cooperation Agreement with the Port.

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[3] The 65% capacity limitation during 24 hours is set by the maximum allowable temperature in the cooling water discharge channel into South Bay.

Accordingly, LS Power would readily accept a permit condition confirming that the two projects will not operate simultaneously once commissioning of SBRP is complete. Moreover, LS Power will not agree that it is reasonable to assume for any purpose that simultaneous commercial operation will occur as described in the CEC data requests or in the SDAPCD letter. While LS Power will provide an analysis of temporary "worst-case" simultaneous operations during commissioning as described above, for the reasons set forth herein it does not intend to model impacts from a post-commissioning simultaneous commercial operation scenario that cannot legally or practically occur.

I trust this explanation fully addresses this concern. We would be pleased to discuss this matter with you at your convenience should you have any further questions.

Very truly yours,

LSP South Bay, LLC

Kevin R Johnson

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ELECTRONIC PROOF OF SERVICE LIST and ELECTRONIC DISTRIBUTION LIST Revised 10/20/06

SOUTH BAY REPLACEMENT PROJECT
APPLICATION FOR CERTIFICATION
DOCKET NO. 06-AFC-3

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I declare that I transmitted the foregoing document via e-mail, or as indicated by first class postal mail, to the above named on the date indicated thereby. I declare under penalty of perjury that the foregoing is true and correct.

Nona Gray

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