

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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Order Instituting Rulemaking to Consider
Refinements and Further Development of the
Commission's Resource Adequacy
Requirements Program.

R.05-12-013
(Filed December 15, 2005)

**COMMENTS OF
DYNEGY MORRO BAY, LLC, DYNEGY MOSS LANDING, LLC,
DYNEGY OAKLAND, LLC, and DYNEGY SOUTH BAY, LLC
ON DECISION ON PHASE 2 – TRACK 2 ISSUES: ADOPTION OF A PREFERRED
POLICY FOR RESOURCE ADEQUACY**

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December 2, 2009

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In accordance with Rule 14.3 of the Commission’s Rules of Practice and Procedure and the November 3, 2009 Notice to Parties of Record in Rulemaking 05-12-013, and in accordance with Administrative Law Judge Mark Wetzell’s November 19, 2009 ruling extending the time for comments and replies, Dynegy Morro Bay, LLC, Dynegy Moss Landing, LLC, Dynegy Oakland, LLC, and Dynegy South Bay, LLC (collectively, “Dynegy”) hereby submits these comments on the Proposed Decision of Administrative Law Judge Mark Wetzell (“PD”) in the above-captioned proceeding.

SUMMARY

Dynegy agrees with the following PD conclusions:

- The current RA program is not meeting the long-term objective of facilitating development of new generating capacity.¹
- Price discrimination, even if achieved in the near term, cannot be sustained over the long term without making market prices less, rather than more, transparent.²

¹ PD at 40.

² PD at 41.

- Greater transparency and symmetry of information is needed to promote investment decisions, mitigate market (both buyer and seller) power, and reduce transaction costs.³
- Energy-only models are not viable.⁴

Dynegy disagrees with the following inconsistent and contradictory findings of the PD, which:

- Tout the need for the RA program to support state policy goals, but fails to do so in a manner that applies to all LSEs on a non-discriminatory basis.
- Imply that a centralized market will impede or supplant bilateral contracting.
- Adopt a multi-year forward mechanism without adopting market mechanisms that will allow market participants to manage the risk of long-forward investment.
- Assume that a “bulletin board” system can provide the kind of price transparency and information symmetry needed to support investment in generating capacity.
- Find that the current RA program does not support the hybrid market, and has led to reliance on utility-owned generation and long-term contracts, but does not recognize that these outcomes are a byproduct of the hybrid market rather than the RA program design.

In sum, the PD finds California’s RA program to be lacking, but takes no meaningful action to fix it. Instead, the PD simply directs the implementation of a multi-year forward requirement without providing adequate tools to manage the risks of such requirements – a misdirected remedy that is almost certain to perpetuate, rather than correct, the unsatisfactory

³ *Id.*

⁴ The PD rejects energy-only models because they do not meet the Public Utilities Code Section 380 requirement that LSEs maintain physical generation capacity sufficient to meet peak demand plus planning reserve requirements. PD at 14-15. However, energy-only models could, in theory, ensure sufficient generating capacity to meet those requirements if prices were allowed to rise to levels that would provide fixed cost recovery of low capacity factor resources. Given the political distaste for such price spikes, Dynegy agrees with the PD’s conclusion that energy-only models are not viable, but not because they would not provide for sufficient physical capacity.

results yielded by the current program. The PD simplistically offers an undefined bulletin board as the solution to the price opacity provided by the current market, but does not recognize that mere price transparency – assuming that the bulletin board will provide it – will not correct the underlying problems that have all but dried up merchant investment. Dynegy urges the Commission to reconsider this PD, re-examine the problems of the current RA and procurement programs, and develop and approve a new decision that will truly further the state’s goals.

COMMENTS

The PD proposes to largely retain the existing RA program structure because implementing a centralized capacity market would cede too much jurisdiction to the Federal Energy Regulatory Commission (FERC), and the bilateral approach is the preferred way to procure resources that meet California’s policy goals (e.g., increased reliance on renewable resources). Justifying a *status quo* that has, by the PD’s own admission, failed to meet the goals set for it, is misguided and myopic. Furthermore, it ignores the reality of centralized markets.

1. The PD’s Focus on Avoiding FERC Jurisdiction Is Misguided

The PD observes that the D.C. Circuit Court of Appeals affirmed FERC’s jurisdiction to review Installed Capacity Requirements in the New England bulk power system⁵ - an outcome the PD seeks to avoid. Whether rejecting a centralized capacity market would ever permanently forestall FERC exercising jurisdiction over programs that affect the reliability of the bulk power system in California and the West is far from certain. While California’s RTO (the CAISO) operates as a single-state RTO, California does not operate as an isolated electrical island in the Western Interconnection. The CAISO operates the largest interconnected balancing authority (by demand) in the Western Interconnection, with a peak demand equal to approximately one-

⁵ PD at 66.

third of the Western Interconnection peak demand. The 500 kV AC backbone transmission system that moves power from the Pacific Northwest to the desert Southwest runs through California and connects to California load-serving centers. And as the Commission is well aware, California relies heavily on imported power to serve its demand. Seeking to permanently avoid FERC jurisdiction over an RA program that affects the reliability of California's bulk power system, and, by extension, the reliability of the Western Interconnection, is not only insular, but also self-centered. Moreover, given that the CAISO has already implemented RA requirements that apply to all CAISO market participants, not just the Commission-jurisdictional Investor Owned Utilities, it would not be difficult to develop a scenario in which FERC could and would exercise its jurisdiction over California RA matters should conditions warrant such intervention. Rejecting a centralized capacity market because of fears of ceding jurisdiction over aspects of the RA program to FERC ignore the realities of California's role in and its dependence on the Western Interconnection.

The PD's concern that a centralized capacity market will spur only development of generic capacity that fails to meet the state's policy goal is misplaced. A centralized capacity market cannot and will not operate in a vacuum, but must operate within California's state policy goals, most notably, the goal to meet a 33% Renewable Portfolio Standard (RPS) target. Load Serving Entities, including the IOUs, must procure resources that will enable them to meet that goal, regardless of any other requirements imposed by the RA program. It is reasonable and logical to expect that LSEs will procure capacity that will meet RA requirements and meet the 33% RPS target. Absent any strategic goal to build rate-base through utility self-build projects, LSEs should not procure capacity that meets RA requirements but is inconsistent with RPS requirements.

As Commission Staff has recognized, the Commission’s jurisdiction does not extend to all California market participants.⁶ The PD’s concern with ensuring that the RA program promotes reliability, equitable cost allocation and coordination with *state* (not just Commission) policies for the electric sector seems at best wishful thinking and at worst disingenuous if the Commission intends to leave in place a program that only applies to 80% of the state’s demand.

As the PD further noted:

If one were to claim that the RA program is meeting its reliability objective based on the assumption that the LTPP process is part of the RA program, then it would have to be acknowledged that the program is inconsistent with Section 380(e)’s directives to implement and enforce RA requirements in a nondiscriminatory manner and to subject each LSE to the same RA requirements.⁷

Citing the requirements of Section 380 of the Public Utilities Code, the PD rejected PG&E and staff proposals that would apply certain requirements to some but not all LSEs.⁸ In that light, the PD’s proposal to retain the current parochial, bilateral RA structure that applies only to the IOUs is incomprehensible.

In sum, the decision to reject a centralized market because it may cede jurisdiction to FERC fails to account for California’s place within the Western Interconnection and does not apply requirements to all LSEs in a non-discriminatory manner.

2. Adopting Multi-Year Forward Requirements Without Adopting Supporting Market Mechanisms Will Not Sustain Merchant Development

The PD adopts multi-year requirements in the apparent hope that doing so will reduce reliance “...on IOU procurement (including utility-owned generation and long-term contracts).”⁹ However, implementing multi-year requirements without also implementing market mechanisms to enable market participants to manage the risks of developing and operating RA resources in a

⁶ PD at 58-59.

⁷ PD at 32-33.

⁸ PD at 62-63.

⁹ PD at 39-40.

multi-year forward structure will increase, instead of reduce, reliance on utility-owned generation and long-term contracts.

Without doubt, specialized resources will have to be developed to meet California's ambitious RPS goals while preserving reliability. The Commission's goals should be to (1) identify, with the CAISO's help, the operational and reliability needs that will inevitably result from increased reliance on intermittent renewable resources; (2) create market mechanisms for developers to manage the risks of developing those kinds of resources, and (3) allow market participants to respond to those needs by developing the required resources. Any other approach will almost certainly drive up costs or preserve utility self-build as the only viable option to meet California's "unique reliability needs." California's needs for the kinds of generation required to meet an aggressive renewable portfolio standard are not unique; every region increasing their reliance on renewable resources will face the same needs. If California does not design an RA program that truly encourages merchant development, merchant development will abandon California for "greener" pastures. California will then fully depend on utility development - the kind of development the PD purports to want to avoid - to meet its policy goals.

The PD also acknowledges that moving to multi-year forward requirements will re-surface two contentious and important RA program issues – the treatment of imports and resource counting rules.¹⁰ PG&E's suggestion that it would be appropriate to use historic import levels¹¹ neatly underscores the discrimination present in the current RA program, namely, that resources meeting RA requirements within California must be physical, while import resources need not be. Assuming that reliable resources outside California will be available for California's exclusive use in the future because they have been there in the past is an

¹⁰ PD at 78-79.

¹¹ PD at 78.

unconvincing assumption on which to hang the reliability of electric supply in the nation's most populous state. Adopting multi-year requirements warrants the full re-examination of the RA program's fundamental assumptions about how import resources are used to meet RA requirements.

Further, it is presumptuous that California will be able to accurately predict the dependable capacity value of intermittent resources five years in advance, given that these capacity values depend on historical levels, that it has only recently changed its counting rules for intermittent resources, and given the expectations that the amount of renewable resources will dramatically increase over the coming years. As the PD suggests, adopting a multi-year forward requirement mandates re-examining the counting rules for intermittent resources. If California continues to use historical output to annually set the Net Qualifying Capacity values for such resources in a five-year forward RA paradigm, the capacity values assigned to such resources will change five times between the first instance the resource is used to meet projected RA requirements and when it actually produces energy to serve demand. Both buyers and sellers need a liquid tool for managing the kinds of uncertainties, like fluctuating capacity values, associated with multi-year forward requirements – a tool such as a centralized capacity market.

3. While Price Discrimination Should Be Addressed, Risk Discrimination Is The Real Issue

The PD discusses price discrimination between new and existing resources at length. The PD notes the potential appeal of price discrimination (citing the Bilateral Trading Group's assertion that price discrimination would save ratepayers \$1 billion a year).¹² The PD also acknowledges that any purported savings from price discrimination depend on a lack of price

¹² PD at 22, 37.

transparency,¹³ that price discrimination would be at odds with an objective to promote investment needed for reliability, and that sustaining price discrimination over time would be unlikely.¹⁴

It appears that the PD appropriately concludes that price discrimination does not promote the goals of the RA program or promote merchant investment. However, the PD fails to grasp that it is not price discrimination, but risk discrimination, that underlies the failure of the current paradigm.

Make no mistake, Dynegy supports greater price transparency in the RA program, and concurs with the position that price discrimination cannot and should not be sustained. Dynegy, however, is skeptical that simply directing the development of a bulletin board will ultimately provide symmetric and transparent information, and, further, that such information will, of its own accord, eliminate price discrimination. The details of such an information platform have not been worked out, and the details will matter. Merely providing a place to post bids and offers will neither significantly reduce transaction costs nor ensure information symmetry. And if the bulletin board takes on additional functions, such as credit and clearing functions, the question as to why, having gone this far, the Commission did not adopt a centralized market, must be asked again.

Further, price transparency alone will not solve the more fundamental problems of the current RA program. Action of a greater scope is needed. While the PD makes no attempt to address California's hybrid market structure, it takes some convoluted, contradictory paths to struggle to accomplish the goals of the RA program within the tangled incentives created by the current hybrid market structure. Eliminating price discrimination and improving price

¹³ PD at 38.

¹⁴ PD at 37.

transparency are laudable goals, but they will, by themselves, do nothing to shift investment from the IOUs to the merchant sector absent fundamental changes in the current paradigm. A transparent forward price means relatively little if a merchant faces all of the risk of developing and operating a long-life asset while an IOU with guaranteed rate-based cost recovery faces none of the same risk. Symmetry of information does not eliminate asymmetry of risk, and will do little to accomplish reduced reliance on IOU generation development. Any and all modifications to the RA program seem destined to fail to achieve the objective of reducing reliance on IOU self-build procurement unless risk asymmetry is addressed.

4. A Centralized Capacity Market Does Not Discourage Bilateral Contracting

The PD repeatedly asserts that bilateral procurement is essential to meet the state's policy goals.¹⁵ Assuming that to be true, the PD provides no rationale as to why a centralized capacity market would disrupt or prevent bilateral trading from continuing to take place.

The vast majority of capacity trades that takes place in other centralized markets are bilateral trades. An aggregate supply curve from PJM's recent centralized capacity market auctions illustrates that the vast majority of capacity traded is traded bilaterally, even in a venue with a centralized capacity market. The 2012/2013 supply curve for the Base Residual Auction shown in Figure 1 below shows the price for capacity is \$0/MW beyond 130,000 MW. While there are other reasons for capacity to be offered into this auction at a price of \$0/MW apart from that capacity having traded bilaterally, and while this aggregate supply curve does not differentiate why capacity is offered in at a \$0/MW price, it is reasonable to presume that a substantial portion of this \$0/MW capacity is capacity that has been traded bilaterally.

¹⁵ "We make this determination in light of the overriding importance that we ascribe to maintaining our current scope of jurisdiction over the RA program by keeping the program's focus on LSE-based procurement obligations, as well as our determination that bilateral trading is more conducive to development of the types of capacity resources that are consistent with our policies for the electric sector". PD at 69.

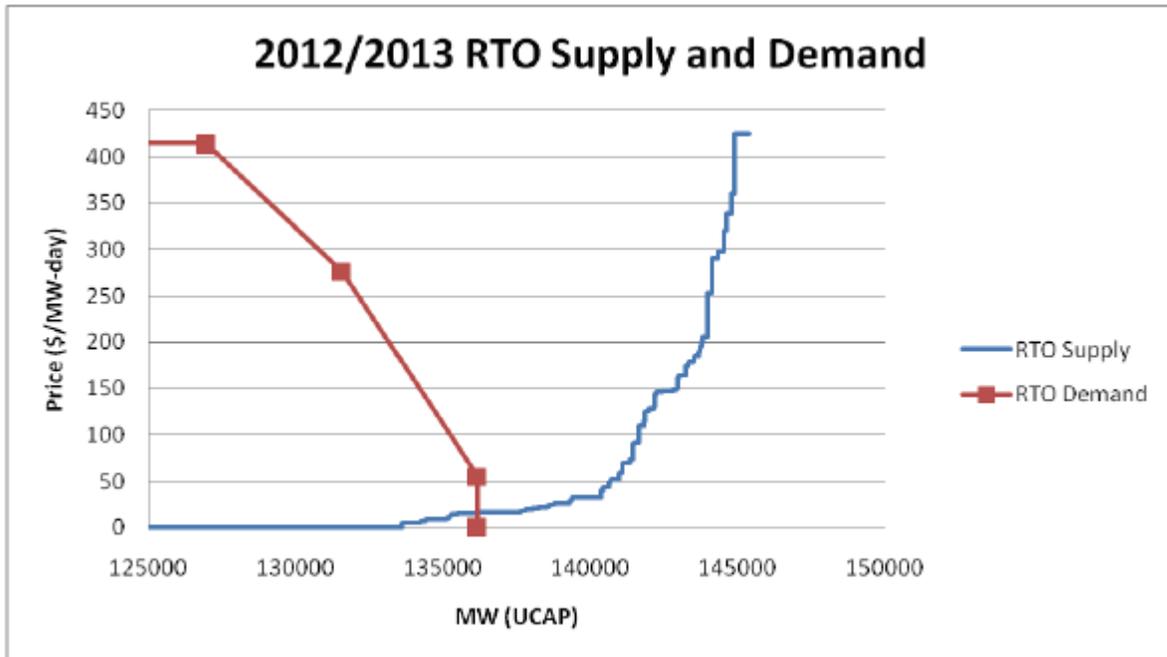


Figure 1 – Supply and Demand Curves for PJM 2012/2013 Base Residual Auction¹⁶

Additionally, data from the New York Independent System Operator (NYISO) centralized ICAP market for 2006 through 2008 also indicates that a centralized market does not preempt or preclude bilateral trading. Figure 2, produced from data available on NYISO’s web site¹⁷, shows that the majority of capacity that counts towards meeting capacity requirements is still traded bilaterally:

¹⁶ Source: PJM Report on 2012/2013 Base Residual Auction Results, available at <http://www.pjm.com/~media/markets-ops/rpm/rpm-auction-info/2012-13-base-residual-auction-report-document-pdf.ashx>.

¹⁷ http://www.nyiso.com/public/webdocs/products/icap/general_info/Installed_Capacity_Auction_Activity_1999-2008.pdf. Per conversations with NYISO staff, the estimated amount of capacity traded bilaterally is obtained for each month by subtracting the strip, monthly and spot quantities from the minimum requirement quantity.

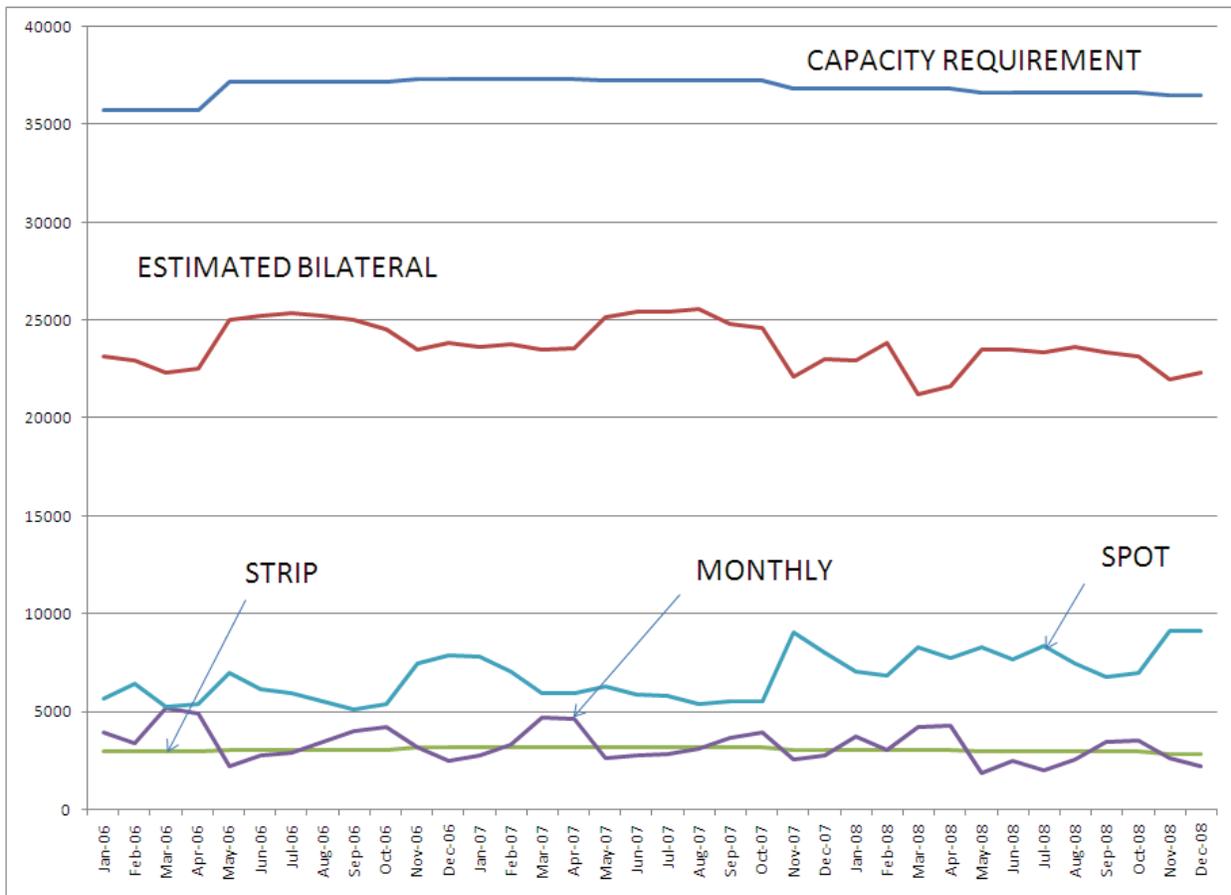


Figure 2 – Data from NYISO ICAP Auctions

Centralized capacity markets do not impede bilateral transactions; it appears, from PJM’s and NYISO’s data, that they facilitate them.

Respectfully submitted,

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December 2, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing COMMENTS OF DYNEGY MORRO BAY, LLC, DYNEGY MOSS LANDING, LLC, DYNEGY OAKLAND, LLC, and DYNEGY SOUTH BAY, LLC ON DECISION ON PHASE 2 – TRACK 2 ISSUES: ADOPTION OF A PREFERRED POLICY FOR RESOURCE ADEQUACY on all parties of record in R.05-12-013 by serving an electronic copy on their email addresses of record and, for those parties without an email address of record, by mailing a properly addressed copy by first-class mail with postage prepaid to each party on the Commission’s official service list as updated on November 30, 2009 for this proceeding.

This Certificate of Service is executed on December 3, 2009, at Houston, Texas.

/s/ Kathy D. Fisher
Kathy D. Fisher