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September 7, 2004

Mr. Matt Trask
CALIFORNIA ENERGY COMMISSION
1516 Ninth Street
Sacramento, CA 95814

RE: Docket 03-IEP-01: Post-Workshop Comments of Duke Energy North America on the Draft Staff White Paper Resource, Reliability and Environmental Concerns of Aging Power Plant Operations and Retirements.

Dear Mr. Trask:

Duke Energy North America ("DENA") thanks the California Energy Commission ("Commission") for the opportunity to provide these post workshop comments on the issues arising from the August 13, 2004 revised Draft Staff White Paper, *Resource, Reliability and Environmental Concerns of Aging Power Plant Operations and Retirements* ("Draft White Paper") and the associated August 26 workshop. These comments follow-up on our written August 23, 2004 pre-workshop comments as well as the presentation and discussion made during the workshop.

I. General Comments.

As mentioned during the workshop, DENA will soon face a number of major threshold decisions regarding its existing powerplants and the need to potentially retire significant capacity due to ongoing economic pressures. Simply put, the current poor wholesale market structure in California, coupled with the lack of bilateral contracts for existing capacity, provides an extremely strong market signal that existing capacity is not needed to serve California loads. However, as the Commission's work in the Aging Power Plan Study ("APPS") effort shows, much of this capacity is in fact needed to assure reliability over a range of system conditions.

While some progress can be seen in relation to the development of a Resource Adequacy Requirement ("RAR"), the additional time required to finalize implementation details does not bode well for existing capacity not already under contract.[1] Likewise, the CAISO's market redesign efforts continue to languish and implementation of these reforms is not imminent. Entities like DENA simply cannot remain optimistic that needed changes will occur within the timeframe necessary to maintain the availability of existing resources.

Moreover, as pointed out in our prior comments, in some instances it is not realistic to believe that existing capacity can be "mothballed" indefinitely and brought back into service on a short time table, particularly where there is no explicit revenue support for the substantial costs associated with maintaining the mothballed assets. The suggestion that mothballing is a viable option is overstated where there are no supporting revenues, and thus creates a false sense of security. Absent revenues to at least support maintenance of the mothballed assets, the economics will likely drive the decision toward full retirement before the transition to a new market structure that recognizes the need for these assets will be completed.

The immediate circumstances of California's "transitional" market is precisely why DENA has stressed the need for immediate transitional capacity arrangements—like the Short Term Reliability Contract concept—to maintain the availability of existing resources. Transitional measures are needed until such time as a functioning capacity market structure evolves to support a fully developed and implemented RAR mechanism that drives standardized utility procurement actions. The inherent time lag between rule finalization and completion of implementation details essentially means that the new mechanisms will not be operational before reaching the critical retirement dates identified in the Draft White Paper. Absent some form of immediate transitional actions to maintain this existing capacity, the Commission should expect earlier retirements than are currently reflected in the Draft White Paper. This risk should be explicitly identified in the report.

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[1] A proposed decision on initial RAR issues was recently released by the CPUC, but that draft recognizes that a subsequent phase will be required to develop the implementation details. DENA believes that some form of stop-gap arrangements are necessary to maintain resource availability during the transition to a market structure that supports capacity commitments.

As mentioned in DENA's earlier comments, the Commission should look at all existing capacity that is potentially at risk for retirement. The exclusion of existing peaker resources, like DENA's Oakland unit, is an error that should be corrected in order to provide a complete picture. This is important not only given the expanding use of peaking capacity by the utilities in the procurement plans, but because peakers—by definition—provide reliability "insurance" through their capacity. The Draft White Paper would be more complete by including aged peaking projects in the pool of resources potentially at risk for retirement.

Similarly, the Commission should reconsider the degree of "protection" that is presumed to exist for those existing resources that may currently be subject to a CAISO RMR. As noted in prior comments to the Commission, the RMR contracts do not have a particular duration, but instead can be terminated by CAISO upon limited notice. In the context of existing facilities, were CAISO to remove the RMR status for a particular unit, recovery of certain common costs is undermined. The loss of this contract thus would create heightened cost under-recovery impacts for those former RMR units that may in turn trigger earlier retirements. Accordingly, the Commission should explicitly recognize the potential for accelerated retirements either from the direct loss of the RMR for a particular unit, or from the loss of RMR at an associated unit within the power plant. Stating that a plant is not at risk of retirement because it currently holds an RMR contract may be an oversimplification that gives false comfort.

Other potential cost impacts could push older resources toward retirement. DENA's earlier comments have mentioned two additional areas: The first example would be the potential imposition of Selective Catalytic Reduction ("SCR") where air quality retrofitting is not currently required, such as at DENA's Morro Bay facility. Thus the Draft White Paper should explicitly recognize that should a SCR retrofit requirement come into play for currently exempt project, this regulatory change could push that existing capacity toward retirement. The second example of a cost driver for retirements is competitive disadvantage associated with PG&E's gas transportation rate where a number of existing projects not directly connected to the PG&E backbone carry additional fuel transportation costs not incurred by the direct-connect generators. Thus there is a competitive disadvantage for those existing facilities irrespective of the relatively efficiency of the generators, which constitutes a price signal favoring complete retirement of the site (i.e., repowering / modernization would face a similar competitive disadvantage).

II. Response to Commissioner Geesman's Inquiries.

During the August 26 Workshop, DENA noted three areas of inquiry from Chairman Geesman: (1) reconciliation of the AB 57 procurement structure with dynamic local reliability issues; (2) the correlation between potential retirements and intrazonal congestion and the ability to forecast those impacts; and (3) whether there is a means to compare a one-year generation contract with transmission upgrade options.

A. Utility Procurement and Local Reliability.

The CPUC's implementation of the AB 57 procurement structure can readily accommodate local reliability concerns. In fact, such an accommodation has been put into place. On July 8, 2004 the CPUC issued its *Interim Opinion Regarding Electric Reliability Issues* (D.04-07-028).[2] That decision modified earlier decisions related to utility short-term procurement authority as well as directives applicable to utility resource dispatch and scheduling. In effect, the new directive calls for the utilities (primarily SCE) to include foreseeable reliability-related impacts in the dispatch and procurement decisions.[3] The utilities have been given greater flexibility for bilateral negotiations. Consistent with the decision, the CAISO and SCE have developed certain protocols to help address the more immediate local reliability concerns.[4]

The CPUC's actions are a clear example of a rapidly implemented "stop-gap" or transitional mechanism. It was specifically put into effect to foster greater reliability pending future market design changes at the CAISO level that will incorporate transmission congestion and other impacts through locational marginal pricing. Moreover, the decision makes clear that to the extent the utilities undertake procurement or scheduling decisions needed to immediately address local reliability concerns, those decisions will be deemed consistent with their short-term

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[2] This decision is available at http://www.cpuc.ca.gov/word_pdf/FINAL_DECISION/38094.pdf.

[3] See, e.g., D.04-07-028, Findings of Fact 11, Conclusion of Law No. 3.

[4] See, M-438 Local Area Reliability Capacity Commitment, Attachment A (M-438A Local Capacity Commitment Areas), and Attachment B (M-438B Capacity Commitment Tables), posted at http://www1.caiso.com/docs/2004/08/24/2004082410305027495.pdf, http://www1.caiso.com/docs/2004/08/24/2004082410020822366.pdf and, http://www1.caiso.com/docs/2004/08/24/2004082410200326012.pdf.

procurement plan authority as developed pursuant to AB 57. Hence, the CPUC has already reconciled the need for utilities to address local concerns with the regulatory structure.

B. The Correlation Between Potential Retirements And Intrazonal Congestion And The Ability To Forecast Those Impacts.

Commissioner Geesman's question concerning the ability to anticipate intrazonal congestion issues in the face of potential retirements goes to the heart of DENA's concerns and advocacy for a transitional capacity arrangement. While DENA has some reason to believe that the utilities have looked into this issue within the context of their integrated long-term procurement planning filings now pending at the CPUC, information about near-term conditions has been given confidential treatment and entities like DENA are not in a position to comment at this time. Additionally, it is our understanding that the CAISO's traditional LARS analysis used for RMR designations is not sufficiently dynamic to capture certain transient events, but instead focuses on larger reliability concerns. CAISO may be the better suited to address dynamic system events associated with potential retirements, and, as mentioned in the Draft White Paper, a study is expected later in the year that may address this concern.

C. Whether There Is A Means To Compare A One-Year Generation Contract With Transmission Upgrade Options.

DENA believes that some of the utilities may have made a similar an analysis within the context of their integrated long-term procurement plan filing when advocating for particularly transmission projects. But as is the case with the prior question, the utilities' near-term analysis is not public, and therefore DENA is not in the position to provide substantive comments. Similarly, within the context of CAISO LARS process for RMR determination, presumably this type of comparison occurs when the utilities present transmission options to remove the need for RMR.

III. Conclusion.

DENA appreciates this opportunity to provide post-workshop comments. The Commission should undertake revisions to the Draft White paper to more clearly state the need for transitional capacity arrangements to maintain the availability of existing resources pending the finalization of regulatory structures like RAR and its implementation into utility

procurement. Clearly it will take some significant time to implement the new procurement requirements and wholesale market structures. Similarly, it can take significant time and litigation to complete permitting of new generation options or bulk transmission lines. Accordingly, the more conservative approach is to ensure that existing projects would not retire when their capacity is needed for reliability, by maintaining their availability through transitional arrangements that provide financial support for existing capacity.[5] By taking immediate steps to assure the continued availability of these resources, concerns about reliability will be addressed as California transitions toward better market structures.

Please contact me should you have any questions concerning these comments.

Respectfully submitted,

September 7, 2004

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[5] Such support could include capacity arrangements to maintain availability year-round, or support for seasonal lay-ups of capacity during the low demand periods.