BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)

Reply Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. on Capacity Markets White Paper

October 11, 2005

Lisa M. Decker, Esq.
Counsel

Constellation Energy Group, Inc.
111 Market Place, Suite 500
Baltimore, Maryland 21202
Phone: (410) 468-3792
Fax: (410) 468-3499
Email: Lisa.Decker@constellation.com

On behalf of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc

Andrew B. Brown

Ellison Schneider & Harris L.L.P.
2015 H Street
Sacramento, CA 95814
Tel: (916) 447-2166
Fax: (916) 447-3512
Email: abb@eslawfirm.com

Attorneys for Constellation Energy Commodities Group, Inc., and Constellation NewEnergy, Inc.

Table of Contents

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)

Reply Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. on Capacity Markets White Paper

I. Introduction and Summary

On September 23, 2005, the California Public Utilities Commission ("Commission" or "CPUC") received comments from twenty-three separate parties, including Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, "Constellation") in response to the Capacity Market White Paper ("White Paper") issued on August 25, 2005 by the Commission's Energy Division ("Staff"). Constellation's reply comments submitted herein address specific issues raised by various parties in their comments, as follows:

- Several parties, including the Alliance for Retail Energy Markets ("AReM"), Morgan Stanley Capital Group ("MSCG"), and the California Independent System Operator Corporation ("CAISO"), encourage the Staff and Commission to consider an ***energy only market construct*** instead of implementation of an integrated energy/capacity market construct. While energy only market structures are indeed a correct theoretical vision for competitive electricity markets, the success of an energy only market structure in incenting investment in infrastructure depends on the allowance of scarcity pricing and the elimination of *ex ante* mitigation at both system-wide levels in the form of safety net bid caps and within load pockets. In short, it requires that market monitoring activities focus on identification and remediation with respect to actual market power abuse, rather than on the implementation of measures intended to prevent the potential exercise of market power. To date, neither the industry nor its regulators have been successful in clearly differentiating between market power and the scarcity pricing needed to send clear price signals of investment in generation and demand response. Therefore, it is

necessary to implement a robust capacity market design that provides (i) forward planning to identify resource adequacy requirements, (ii) forward price signals to both buyers and sellers about what the spot market price of capacity will be if they choose not to forward contract for capacity, and (iii) mechanisms that define the resources that are permissible to meet the resource adequacy requirement and that define how compliance with the requirement will be demonstrated. At the same time, policymakers should be taking the steps, supported by Constellation and others, to develop transparent spot and forward energy prices needed to incent investment in generation, transmission and demand response, with a capacity market as a bridge to that vision.

- Several parties, including Calpine Corporation ("Calpine") and Pacific Gas and Electric Company ("PG&E"), argue that capacity market design should be a relatively low priority in California market structure reform. Specifically, they would have the Commission focus instead on having the utilities enter into new long term contracts for capacity. Continuation of the hybrid market structure in which the utilities continue to procure infrastructure - either through self-build or through new long term Power Purchase Agreements ("PPAs") when both are predicated on guaranteed cost recovery by the utility – is sure to detrimentally impact the competitive wholesale markets because the self-build and PPA assets do not compete in the energy markets on an even playing field with assets that do not have the same level of regulatory protection. Moreover, both utility self-build and this form of PPA fail to shift the risks of new infrastructure investment to the wholesale marketplace, and instead leave consumers fully exposed to new future stranded costs and the likelihood of new non-bypassable charges that have the potential to considerably inhibit the development of the retail market, which relies on the ability to compete against the utilities' generation rates, including non-bypassable charges.
- Several parties mischaracterize the status of capacity market reform that is occurring in eastern markets. While there is robust debate in these various markets, the Staff and Commission must not accept that such debate is a basis for concluding that the implementation of a capacity market construct in California is not attainable nor

worthwhile.[1] Nothing could be further from the truth. Capacity market reform has been necessary in all the organized markets because price signals that would have otherwise led to the development of needed capacity resources have been compromised by various forms of mitigation measures, including bid caps, RMR contracts, and out of merit dispatch. In short, mitigated markets undervalue capacity and the costs of providing generation over the long term, providing a "free" regulatory hedge that is only free until reliability is compromised. That has been true in the East and is true in California. Consumers and other market participants are naturally resistant to having prices increase. But investors have a variety of options when choosing where to invest their capital. If a market cannot provide a reasonable return for their investment, it is reasonable to expect that investment will not take place. Further, a return to rate regulation, as advocated by some parties, including Coalition of California Utility Employees, will not cause prices to stay at their current levels. It must not be forgotten that rate of return based regulation is what originally led to $20 billion dollars stranded cost collection in California. Moreover, the very fact that resource adequacy requirements are being investigated is indication that the current artificially low price levels are insufficient to support new investment, and it can be surmised that even under rate of return regulation, prices simply must go up in one form or another to ensure resource adequacy. Debate about capacity market reform is a healthy sign that the industry is working to find the best and most efficient solutions. It is not an indication that capacity markets will not work or are unnecessary. Rather such arguments serve only to delay – or outright prevent – the development of competitive markets, and Constellation recommends that the Commission should continue, without further delay, the good work started by the Staff with issuance of its thoughtful and well-founded capacity market recommendations.

- Other parties, including CAISO and The Utility Reform Network ("TURN") would have the Staff and Commission go slow on capacity market reform and perform additional extensive evaluations of various capacity market designs. Competitive markets in California do not have the luxury of a go-slow approach. The need for reforms that will serve as the foundation to encourage maintenance of existing capacity resources and

[1] In fact, New York is the organized market with the longest history of capacity market reform and its use of the demand curve is showing very promising signs of success in terms of supporting the investments necessary to secure needed capacity resources.

investment in new capacity resources is both immediate and urgent. Absent reforms to enhance and encourage the development of competitive markets, California will surely be beset by regulatory intervention and be set on a course back to rate regulated investments that will come at a high price to consumers and will end any vision of the benefits that competitive wholesale and retail markets can bring to all energy consumers in California. The Staff and the Commission must strongly reject delay, and the Staff should present formally to the Commission its recommendations, and request that the Commission convene immediately a series of workshops to finalize the important implementation details raised in the White Paper and various comments.

As Constellation stated in its initial comments, the Staff has provided a solid foundation upon which the Commission can proceed to direct the implementation of sound capacity market design that will not only help to ensure that there are sufficient and efficient capacity resources to meet California's energy needs, but will also ensure that benefits of truly competitive markets are achieved.

II. Constellation Reply Comments

A. Implementation of an Energy Only Market Construct Requires the Elimination of All Forms of Ex Ante Mitigation, Is Politically Infeasible, and Must Not Be Allowed to Derail Development of Sound Capacity Market Reform in California.

Both the CAISO and AReM included papers by industry experts with their comments that present the theoretical underpinnings of an energy only market construct.[2] In that regard, those papers correctly point out that if energy and ancillary services market prices were permitted to rise and fall, without regulatory intervention, in direct response to supply and demand, the resulting price signals may well provide the necessary incentives for consumers to enter into business transactions to manage price volatility according to their individual risk

[2] See, AReM Comments' prepared paper by Lynne Kiesling, *An Analysis of Electricity Capacity Markets in California*. See also, CAISO's five attachments: Attachment 1 - "ICAP Systems in the Northeast: Trends and Lessons," by Scott M. Harvey; Attachment 2 - "ICAP Reform Proposals in New England and PJM," by John D. Chandley; Attachment 3 – "On an 'Energy Only' Electricity Market Design for Resource Adequacy," by William W. Hogan; Attachment 4 – Discussion Paper on Resource Adequacy for the Midwest ISO Energy Markets; and Attachment 5 – "An Energy-Only Resource Adequacy Mechanism," by Eric S. Schubert.

tolerance preferences. In so doing, a business environment would develop that supported increased levels of demand response as a way to manage price volatility, and that would provide the incentives necessary for the maintenance of existing and construction of new resources when and where necessary. These papers also appropriately point out that an energy only market is predicated upon a presumption that consumers will determine for themselves the level of electricity supply reliability that they want without regulatory intervention. The absence of regulatory price intervention is thus the key to success of an energy only construct. Unfortunately, these papers do not provide sufficient clarity as to what conditions must be satisfied to ensure the development of competitive markets when regulators and market participants are simply not prepared to eliminate *ex ante* mitigation or allow for scarcity pricing such that price signals can work.

For instance, Ms. Kiesling's *"An Analysis of Electricity Capacity Markets in California,"* states that Australia has elevated its safety net bid cap to AUD$10,000 per MWh in its energy only market design. While that level of energy bid cap may exist in Australia, California's bid cap currently sits at $250/MWh, with an even lower trigger of $91.87/MWh used for the automated mitigation procedures applicable to units subject to the Must Offer Obligation. Mr. Harvey's comprehensive review, *"ICAP Systems in the Northeast, Trends and Lessons,"* while clearly making the case that unfettered energy prices would create the type of demand response necessary to control price spikes, and that energy prices mitigated at the levels present in the northeast will not provide adequate price signals for reliability, nevertheless remains critical of Northeast capacity markets designs, without providing recommendations on specific remedies. Dr. Hogan's *"On an "Energy Only" Electricity Market Design for Resource Adequacy,"* articulates the need for market structures to replace the "missing money" that price caps and

other regulatory interventions take out of the market, but that is nevertheless needed to support investment in generation when and where it is needed. Dr. Hogan presents specific ways that operating reserve requirements and scarcity pricing mechanism can serve to replace the missing money rather than implementation of formal capacity market design. The mechanisms, intended to improve energy and ancillary price signals, should be energy market reforms that California continuously moves toward. However, the organized markets in the East have clearly demonstrated that implementation of scarcity pricing in constrained locations and raising bid price caps so that demand response can provide a more natural and market based control on price volatility, are difficult to design and implement.

In further support of their advocacy for energy only markets, Ms. Kiesling and the CAISO also point out that other markets in the Midwest and Texas are considering the implementation of energy only market constructs. However, a closer examination reveals these markets are not yet near the operating stage. The whitepaper prepared by the Public Utility Commission of Texas ("PUCT") Staff, and included by the CAISO with its comments, bespeaks strong regulatory support for an energy only market construct and the desire to avoid the implementation of any specific form of capacity market design. However, the formal proposal put forth by the PUCT Staff to implement this vision falls far short of the energy only market construct. Attachment 1 to these reply comments is the strawman proposal put forth by the PUCT Staff to implement an energy only market. It includes a construct whereby the Electric Reliability Council of Texas is expected to enter into capacity contracts and socialize the costs of those contracts whenever its evaluations of the capacity resource base is found to be less than optimal. Furthermore, the proposal calls for energy bid caps in Texas to be raised only to a potential maximum of $5,000/MWh, far below the AUD$10,000/MWh *[approx. $7,500US]*

adopted in the relatively successful energy only Australian markets, and in Texas, the proposed $5,000/MWh bid cap level is only reached after three years. Finally, the proposal also calls for regulators to monitor the revenues earned by generators and to reduce the bid cap to $500/MWh when the revenues exceed a certain threshold. Thus, the Texas proposal is fairly far removed from a true energy only market, as is explained in more detail in the comments that Constellation submitted in response to the strawman proposal, included here as Attachment 2 to these Reply Comments.

The Midwest Independent Transmission System Operator, Inc. ("MISO"), likewise, while investigating the feasibility of an energy only market structure, has made no final decision to proceed in that direction. In fact, the Organization of Midwest ISO States ("OMS"), composed of regulators in the MISO states, have issued a series of questions to MISO shown in Attachment 3 to these Reply Comments, "*Questions from the Organization of Midwest States to MISO on its Discussion Paper on Resource Adequacy for the Midwest ISO Energy Markets,"* that raise serious questions about the extent of mitigation "relaxation" that MISO would need to implement for its energy only proposal to be successful.[3]

In theory, energy only markets remain the ideal market structure. Development of market design policy should, without question, be formulated in ways that cause markets to progress toward that ideal. Implementation of the type of capacity market structure recommended by the Energy Division Staff would provide for just that by allowing for a bridge to improved energy market scarcity pricing and elimination of price caps. A downward sloping demand curve would create a set of short term ***price signals*** that work in concert with the short term energy and ancillary prices signals provided by an LMP based energy market, and would offer a revenue safety net for resources that permits ongoing energy market reforms with respect

[3] See, e.g., pages 6 and 7 of Attachment 3.

to scarcity pricing and raising of bid caps. As scarcity pricing mechanisms are implemented, bid caps are raised to higher levels, and demand response capability increases, energy market prices will provide more and more of the overall market based revenues, and the amount required from the capacity market, will by definition and design, decline as the demand curve pricing is periodically reviewed. The capacity market construct will, when and if energy market reforms are implemented, become simply irrelevant, having served its necessary function as the bridge to competitive energy only markets.

Thus, the Commission must balance the theoretical vision of energy only markets with more practical and realistic market design. In that regard, Constellation directs the Staff and Commission attention to Attachments 4 and 5. Attachment 4 is a paper prepared by Mr. Larry Ruff for five companies and filed in the Federal Energy Regulatory Commission's ("FERC") Standard Market Design Rulemaking.[4] In this paper, Mr. Ruff demonstrates that need for capacity markets when scarcity pricing that would occur in uncapped energy market is suppressed. Attachment 5 is the is the original white paper prepared by Tom Paynter and Mark Reeder of the New York Public Service Commission ("NYPSC") that initiated the implementation of the demand curve in New York, which provides the framework upon which the demand curve structure supported by Staff is founded.

MSCG also expressed a strong distaste for capacity markets, and advocates a market structure that relies on energy price signals only to stimulate investment. As part of its recommendations for an energy-only construct, MSCG recommends that the Commission impose upon the California IOUs the competitive procurement practices employed in New Jersey, Maryland, and the District of Columbia. MSCG suggests that such forward contracting will, in an energy only market environment, ensure appropriate hedges to protect consumers.

[4] Filed on November 15, 2002 in FERC Docket No. RM 01-12-000.

Constellation believes that the MSCG comments miss the mark by ignoring the reality that unmitigated energy markets are unlikely to be achievable for the foreseeable future and therefore the need remains for capacity market implementation, as discussed above. However, Constellation wholeheartedly agrees with MSCG that the type of competitive procurement practices they advocate would (i) protect consumers from new stranded costs, (ii) enhance the competitive viability of wholesale markets, and (iii) provide the framework necessary for the development of competitive retail markets. Indeed, Constellation suggested that same type of competitive procurement in California in testimony that it submitted in Rulemaking 04-04-003 on August 6, 2004. In the mechanism referred to by MSCG, the utilities continue to serve all the retail load that does not elect an alternative supplier, but they do secure the energy, capacity and ancillary services to meet its load obligations from the wholesale markets through competitive bidding. Utility retail customers are provided with fixed prices of various durations that are determined based on input from all stakeholders and customer preferences. Because the utility procurements transfer the price risk and the resource adequacy risks to the winning wholesale suppliers, these processes are generally described as providing "full requirements service" from the wholesale supplier to the utilities.

Full Requirements Competitive Procurements require that the winning suppliers in the procurement processes hedge their load serving obligations in the wholesale markets. Specifically, the full requirements obligations taken on by the winning wholesale suppliers in the New Jersey, Maryland, and District of Columbia processes transfer from the utilities to the winning bidders all the responsibilities and price risks associated with providing energy, capacity, and ancillary services as those requirements are defined in the PJM market rules. Thus, the prices that are achieved in the Full Requirements Competitive Procurements are a reflection

of the prices for those energy, capacity, and ancillary services in the wholesale markets. When wholesale market prices are artificially depressed through mitigation, and those flaws are not corrected through mechanisms such as well designed capacity markets, the competitive procurement processes are not the vehicle that will correct those flaws. Rather, the flaws must be corrected at the more basic wholesale market level, and that is exactly what PJM Interconnection, L.L.C. ("PJM") is proposing through its Reliability Pricing Model ("RPM") capacity market reform. The wholesale market reforms at the PJM wholesale level will translate immediately to the competitive procurement processes as wholesale suppliers reflect the impact of those reforms in their bids to serve the utility load.

Why then, if the competitive procurement practices advocated by MSCG are not sufficient to support energy only market structure alone, are they so important? There are several reasons. The first is that Full Requirements Competitive Procurement practices, as described above, transfer price risk away from utilities and thus away from any direct pass through of those risks to consumers. In short, the risks of serving the utility load are transferred to competitive wholesale suppliers who can manage those risks in the wholesale markets, thereby alleviating any need for utility self-build of generation and the accompanying stranded cost risk.

Second, by creating regular and recurring opportunities to bid on load serving transactions at the wholesale level, wholesale suppliers will invest in maintenance of existing generation and in new capacity resources when such investment is viewed as improving their competitiveness in the Full Requirement Competitive Procurement processes, and thus the stability of the regular competitive cycle provides an important nexus between resource adequacy/capacity markets and the Full Requirement Competitive Procurement processes: When the wholesale markets provide pricing stability and assurance that investments will not be

undermined by regulatory intervention (i.e., when the wholesale market is perceived as providing ***long term*** viability to investment decisions), wholesale suppliers will manage the required investment without the need for utility backed contracts that seek to socialize the costs or transfer risks to consumers. These stable wholesale structures are themselves enhanced when the wholesale suppliers making those investments see that the marketplace, via the Full Requirement Competitive Procurement processes, provides ample transactional opportunities to realize the value of those investments. Specifically, stable wholesale market design and the stable price signals that it creates, along with Full Requirement Competitive Procurement practices, provide a powerful "one-two punch" that brings the full benefits of wholesale market competition to consumers.

The third reason that Full Requirements Competitive Procurement processes are so important is that, in transferring infrastructure development risk to the wholesale market, they eliminate the formation of new non-bypassable charges, thus paving the way for robust retail competition. Retail competition, in turn, by increasing the number of buyers of wholesale services beyond just the utilities, further enhances the viability of wholesale competitive markets.

B. Delay of Capacity Market Reform In Favor of Mandating New Utility Financed Self-Build or Long Term PPA Contracts Will Only Serve to Undermine the Development of Competitive Wholesale Markets.

Calpine's and PG&E's comments that capacity market reform is much less important than getting the IOUs to enter into new long term contracts for the development of infrastructure is misguided and, if adopted, may serve to compromise the development of competitive wholesale markets. Specifically, the type of long term PPAs that Calpine and PG&E call for are replicas of Mountainview and other Commission approved contracts and utility procurement practices that have created the hybrid market structure in California, a structure in which merchant generation is expected to co-exist and compete effectively alongside a large fleet of

utility owned generation and contractual assets that enjoy guaranteed cost recovery, including a return to the utilities. The Mountainview type of long term PPA contract is only slightly different than utility owned generation. While they may transfer construction price risk to the developer and may provide some performance incentives for the operator once constructed, all of the market risk, including fuel price risk, is borne by neither the buyer nor the seller in those contracts, rather ongoing risks remain squarely on the backs and shoulders of consumers, and the utility retains its full ability to collect a return on the PPA investment. As a result, a class of generators is created that carry the positive and negative risks associated with the competitive market and a class of generators that do not see any such risk. This hybrid structure cannot lead to successful wholesale competitive markets because assets that do not have guaranteed cost recovery and rely instead on competitive markets to earn a reasonable rate of return cannot compete effectively with the assets that do have a virtually certain rate of return and do not rely on competitive markets to earn a return. Thus, implementation of measures that would propagate this flawed structure must be avoided. Instead of the hybrid structure, Constellation directs the Staff and Commission's attention to the Full Requirements Competitive Procurement process described in the preceding section of these reply comments.

Embedded in the Calpine and PG&E recommendations is an implicit premise that long term contracts alone could or would be successful in providing the necessary incentives for infrastructure investment. Constellation urges the Staff and the Commission to resist that premise and to recognize, as was stated in the section above, that the long term contract needed in the California markets is not a long term contract between Calpine and PG&E that leaves all market risks with consumers (and in effect perpetuates the very expensive practices of rate regulation), but rather the long term certainty that comes about when the underlying market

structure is stable and provides the opportunity for a reasonable and sustainable revenue stream. Regulatory stability will provide the necessary underpinning for long term investment because a stable market structure that provides for accurate and robust price signals will assure investors that their investment will not be undermined or devalued by regulatory instability. In effect, a stable wholesale market structure ***is*** the "long term contract" that developers and generation owners need to proceed with infrastructure investment. Once a stable market structure is in place, bilateral contracting reflecting the value of assets can be developed that meet the specific needs of buyers and sellers in ways that do not impose new stranded costs on consumers.

Even with its confidence that stable wholesale market structures will provide the incentives necessary for capacity resources when and where necessary, Constellation is nevertheless aware of two important facts that must be addressed. The first is that there appears to be the need for immediate development of resources to ensure reliable operations. The second is that market participant/investor confidence in the stability of the market structures takes some time to develop. Therefore, special attention must be given to address how an immediate, urgent need for additional capacity resources will be dealt with. In this regard, Constellation recommends the following guidelines:

- The immediate, urgent needs must be clearly defined and independently verified as to the number and location of MW that are necessary to address the requirement.
- The full range of potential solutions to meet the requirement must be identified and independently verified.
- The adopted solutions must fairly allocate the costs to the customers that benefit from them.
- The adopted solutions must fairly treat existing and new capacity.

- The adopted solutions must not create new non-bypassable charges at the retail level that will last longer than the amount of time it will take for capacity market design mechanisms to be implemented.
- The adopted solutions must support the continued development of competitive wholesale and retail markets.

In short, immediate resource requirements must be addressed through targeted, short term actions that will not undermine the success of the capacity market structure. Imposition of new long-term non-bypassable charges on consumers will only serve to reinforce and further institutionalize the equivalent of rate based generation resources as the only means by which necessary infrastructure is achieved in California, thwarting the development of competitive wholesale markets.

C. Characterizations of Capacity Market Reform Experiences in the Eastern Markets as Evidence that those Models are Unworkable for California are Incomplete and Misguided.

As noted in the introductory comments, several parties characterize the eastern capacity markets generally as unsuccessful in stimulating investment.[5] With respect to PJM and ISO-NE, those comments are entirely premature, as their capacity market reforms are still under development. New York's, on the other hand, having been in place now for over three years, has, according to reports filed by the New York Independent System Operator, Inc. ("NYISO") and by the NYISO's Independent Market Monitor, performed as expected in bringing stability to the market place and ensuring sufficient capacity resources even in the state's more constrained locations. More importantly, the NY model has not led to overpayments to generators, as demonstrated by the fact that the oversupplied regions of New York (outside of New York City

[5] See, e.g., comments of AReM, MSCG and CUE.

and Long Island) are clearing at very low capacity prices, a signal that investment in those regions is currently not needed, as is indeed the case.

PJM conducted a long and thorough process to secure stakeholder input on capacity market reform; having secured that input, PJM proceeded to present to the FERC its RPM proposal for capacity market reform. Unanimous support for each and every detail of the RPM was never a realistic expectation within the PJM stakeholder process, just as it is not a realistic expectation here in California. Just as in PJM, there will almost certainly be disagreements on the final implementation mechanisms; it is the responsibility of regulatory agencies, both at the Commission and FERC, to resolve these disagreements so that markets move forward consistent with established policies. Furthermore, it is important to note that the one market that has implemented the type of capacity market reform recommended by Staff – New York - is relatively free of controversy in its continued use of the demand curve approach. While there were significant levels of controversy and debate when the demand curve was introduced and implemented, the NYPSC, working closely with the NYISO and its market participants, moved forward. The New York model not only has been in place for three years, but has successfully gone through the first triennial review of the demand curve pricing signals required by the NYISO tariff. With respect to whether the New York demand curve approach is working to support resource adequacy, both the NYISO in its 2004 compliance filing with FERC (Attachment 6) and Dr. David Patton (the Independent Market Monitor) in his 2004 State of the Market Report (Attachment 7) have attested to its success:

> The NYISO anticipated that the ICAP Demand Curves would result in price stability, an increase in the amount of capacity committed to Bilateral Transactions, and incentives to build new generation. In fact, the NYISO has observed an increase in capacity committed to the NYCA and an improvement in price signals.

> Given the comparatively longer lead time required to site, develop, and complete the construction of a new generation project, it is difficult for the NYISO to demonstrate to the Commission any specific conclusions regarding the effects of the ICAP Demand Curves on development of new generation in the eighteen-month period since their implementation. Although the pace of new generation investment in New York has diminished somewhat, this result is more attributable to the current excess position in the ICAP markets and the lower market prices that accompany any supply situation in excess of demand.
>
> It has always been the NYISO's expectation that the relative pace of new generation investment would reflect the degree of excess capacity present in the market at any given time. Because they place a value on, and provide some revenue for, capacity in excess of minimum reliability requirements, the NYISO continues to believe that the ICAP Demand Curves will provide price signals that encourage the addition of new generation in future increments that maintain system reliability. In the meantime, the present condition of excess capacity and the market clearing prices that result from such conditions correctly reflects a competitive ICAP market outcome. While it would be premature to reach specific conclusions after just eighteen months of experience with the ICAP Demand Curves, the NYISO is encouraged by its observation of market behaviors and outcomes that were anticipated for the Demand Curves. With the impending initial periodic adjustment of the ICAP Demand Curve parameters, which will be submitted to the Commission for its approval in the near future, the NYISO anticipates that it should experience even more significant gains towards the objectives of the Demand Curves in the ICAP markets over the next three years.[6]

and

> One of the reasons for implementation of a capacity demand curve was to minimize the uncertainty surrounding the capacity market. The convergence and stabilization of UCAP prices is an expected and positive development. The economic signals sent by the capacity market will not have the desired effect in guiding new investment if the signals are subject to substantial uncertainty over

[6] See Attachment 6 to these Reply Comments, *NYISO Second Annual Compliance Report on Implementation of the ICAP Demand Curve and Withholding Behavior Under the ICAP Demand Curve, Submitted by the NYISO in Docket #03-647-00 on December 1, 2004.*

the longer-run, causing investors to discount the capacity market signals.[7]

D. Delay of Capacity Market Reform to Provide for More Study and Evaluation of Capacity Market Structures Fails to Recognize the Urgent Need for Capacity Market Implementation. The Important Work Initiated With the White Paper Must Be Completed As Soon As Possible.

The Commission Staff has produced a thoughtful and comprehensive review of the importance of implementation a capacity market in California and the key elements of well-designed capacity markets, and has made specific recommendations for implementation. The focus now should be on addressing the implementation details of the short term capacity market design that the Staff has recommended so that the important work that has begun with the issuance of the White Paper can be concluded as expeditiously as possible. The focus, however, should not, and must not, be on putting capacity market design on hold in favor of further evaluation and analysis, as some parties, including the CAISO and TURN, have suggested. The CAISO, of all parties, knows the urgency with which resource adequacy must be addressed in this state. TURN, as well, knows that reliable service to the consumers it represents will be compromised by inaction on this important issue. The Commission, by supporting the capacity market development recommended in the White Paper, should declare the debate over on whether or not there should be capacity market reform in California, and proceed to implementation of reforms as soon as possible.

III. Conclusion

Constellation again applauds the Energy Division Staff in its work on the Capacity Market Whitepaper. As described in detail above, Constellation urges the Commission to stay on track and move quickly toward the adoption of a capacity market structure like that used by

[7] See Attachment 7 to these Reply Comments, *2004 State of the Market Report by Potomac Economics, Ltd, Independent Market Advisor to the New York ISO, dated July 2005.*

the NYISO. While an energy only market design provides inspiration for the proper direction of a theoretically optimal market design, there are a host of practical limitations that make it infeasible to pursue in its pure form. If, however, the capacity market construct is ultimately successful over time, the types of price signals associated with the energy only structure will become dominant. In the meantime, the Commission must avoid calls to delay development of the formal capacity market and move forward with the most effective approach for resource adequacy. Actions taken now in furtherance of the capacity market will help get new resource additions in place and elevate system reliability. Furthermore, if the Commission wishes to get the optimal long-run market design in place, it will pursue the Full Requirements Competitive Procurement approach discussed above.

October 11, 2005

Respectfully submitted,

Lisa M. Decker, Esq.
Counsel

Constellation Energy Group, Inc.
111 Market Place, Suite 500
Baltimore, Maryland 21202
Phone: (410) 468-3792
Fax: (410) 468-3499
Email: Lisa.Decker@constellation.com

On behalf of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc.

Andrew B. Brown

Ellison Schneider & Harris L.L.P.
2015 H Street
Sacramento, CA 95814
Tel: (916) 447-2166
Fax: (916) 447-3512
Email: abb@eslawfirm.com

Attorneys for Constellation Energy Commodities Group, Inc., and Constellation NewEnergy, Inc.

CERTIFICATE OF SERVICE

I, Eric Janssen, am over the age of 18 years and employed in the City and County of Sacramento. My business address is 2015 H Street, Sacramento.

On October 11, 2005, I served the within document, *Reply Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. on Capacity Markets White Paper***,** in R.04-04-003, with electronic and mail service as prescribed in R.04-04-003 and the August 25, 2005 ALJ Ruling, and personal service on the Assigned Commissioner and Assigned Administrative Law Judge, at San Francisco, California.

Executed on October 11, 2005, at Sacramento, California.

_____

Eric Janssen

Service List
R.04-04-003
October 11, 2005

abb@eslawfirm.com
aclark@calpine.com
ajo@cpuc.ca.gov
alan.comnes@dynegy.com
amabed@semprautilities.com
andrew@simpsonpartners.com
annette.gilliam@sce.com
aorchar@smud.org
armi@smwlaw.com
aweller@sel.com
ayk@cpuc.ca.gov
bcragg@gmssr.com
bcragg@gmssr.com
bds@cpuc.ca.gov
berj.parseghian@sce.com
beth.fox@sce.com
bfranklin@eob.ca.gov
bill.chen@constellation.com
bill@jbsenergy.com.
bjones@mjbradley.com
blaising@braunlegal.com
bmcc@mccarthylaw.com
bpowers@powersengineering.com
brbarkovich@earthlink.net
brflynn@flynnrci.com
brian.theaker@williams.com
bsk@cpuc.ca.gov
cab@cpuc.ca.gov
cabaker906@sbcglobal.net
car@cpuc.ca.gov
carlo.zorzoli@enel.it
case.admin@sce.com
cem@newsdata.com
centralfiles@semprautilities.com
ceyap@earthlink.net
chicks@water.ca.gov
chris@emeter.com
chrishilen@dwt.com
chrism@mid.org
ckmitchell1@sbcglobal.net
cleni@energy.state.ca.us
clyde.murley@comcast.net
cmkehrein@ems-ca.com
cmlong@earthlink.net
cpe@cpuc.ca.gov
cpuccases@pge.com
craigtyler@comcast.net
ctoca@utility-savings.com
curtis.kebler@gs.com
daking@sempra.com
Dan.adler@calcef.org
dcarroll@downeybrand.com
ddowers@sfwater.org
dgarber@sempra.com
dgeis@dolphingroup.org
dhuard@manatt.com
diane_fellman@fpl.com
dickerson05@fscgroup.com
djh@cpuc.ca.gov
dkates@sonic.net
dkk@eslawfirm.com
dks@cpuc.ca.gov
dmahmud@mwdh2o.com
dmarcus2@sbcglobal.net
don.winslow@ppmenergy.com
douglass@energyattorney.com
dsandino@water.ca.gov
dsaul@solel.com
dsh@cpuc.ca.gov
dwang@nrdc.org
dwood8@cox.net
dws@r-c-s-inc.com
edchang@flynnrci.com
edwardoneill@dwt.com
ehull@ci.chula-vista.ca.us
eleuze@caiso.com
ell5@pge.com
elvine@lbl.gov
e-recipient@caiso.com
eric@strategyi.com
evk1@pge.com
eyussman@knowledgeinenergy.com
fdeleon@energy.state.ca.us
filings@a-klaw.com
fortlieb@sandiego.gov
frank.cooley@sce.com
freedman@turn.org
garson_knapp@fpl.com
gbaker@sempra.com
gbrowne@smud.org
george.hanson@ci.corona.ca.us
ghinners@reliant.com
gig@cpuc.ca.gov
glw@eslawfirm.com
gmorris@emf.net
greg.blue@dynegy.com
grosenblum@caiso.com
gtholan@caiso.com
gumbrelli@cs.com
gxl2@pge.com
hchoy@isd.co.la.ca.us
hcronin@water.ca.gov
info@tobiaslo.com
irene.stillings@sdenergy.org
j0b5@pge.com
jackp@calpine.com
james.boothe@hklaw.com
janet.combs@sce.com
janreid@coastecon.com
jarmstrong@gmssr.com
jay.bhalla@intergycorp.com
jbradley@svmg.org
jbwilliams@mwe.com
jcervantes@sandiego.gov
jeanne.sole@sfgov.org
jef@cpuc.ca.gov
jeffgray@dwt.com
jennifer.holmes@itron.com
jesus.arredondo@nrgenergy.com
jf2@cpuc.ca.gov
jgalloway@ucsusa.org
jimross@r-c-s-inc.com
jkarp@whitecase.com
jkloberdanz@semprautilities.com
jkloberdanz@semprautilities.com
jleslie@luce.com
jlkm@pge.com
jmcarthur@elkhills.com
JMcMahon@navigantconsulting.com
joe.como@sfgov.org
johnrredding@earthlink.net
joyw@mid.org
jpacheco@water.ca.gov
jskillman@prodigy.net
jsqueri@gmssr.com
jtachera@energy.state.ca.us
jweil@aglet.org
karen@klindh.com
kdg@cpuc.ca.gov
kduggan@capstoneturbine.com
kdw@woodruff-expert-services.com

keith.fuller@itron.com
keith.mccrea@sablaw.com
keithwhite@earthlink.net
kena@calpine.com
kglick@eob.ca.gov
kgriffin@energy.state.ca.us
kjk@kjkammerer.com
kl1@cpuc.ca.gov
klatt@energyattorney.com
KMelville@sempra.com
kmelville@sempra.com
kmills@cfbf.com
kmorton@sempra.com
kms@cpuc.ca.gov
knotsund@uclink.berkeley.edu
kpp@cpuc.ca.gov
l_brown123@hotmail.com
LAdocket@cpuc.ca.gov
laura.genao@sce.com
lcasentini@drintl.com
lcottle@whitecase.com
liddell@energyattorney.com
linda.sherif@calpine.com
lisa.decker@constellation.com
lisa_weinzimer@platts.com
lkaye@ka-pow.com
lmh@eslawfirm.com
lp1@cpuc.ca.gov
lrm@cpuc.ca.gov
lscott@landsenergy.com
lurick@sempra.com
magq@pge.com
map@cpuc.ca.gov
marks@alohasys.com
mary.lynch@constellation.com
matt@bradylawus.com
mclaughlin@braunlegal.com
mcmannes@aol.com
mdbk@pge.com
mdjoseph@adamsbroadwell.com
meb@cpuc.ca.gov
mecsoft@pacbell.net
meg@cpuc.ca.gov
meg@cpuc.ca.gov
mflorio@turn.org
michael.backstrom@sce.com
michael.crumley@elpaso.com
michaeledwardboyd@sbcglobal.net
mjaske@energy.state.ca.us
mjskowronski@inlandenergy.com
mlennon@whitecase.com
mlgillette@duke-energy.com
Mmesseng@energy.state.ca.us
mona.tierney@constellation.com
moxsen@calpine.com
mpa@a-klaw.com
mrh2@pge.com
mrw@mrwassoc.com
mrw@mrwassoc.com
mschmidt@semprautilities.com
mshames@ucan.org
msnow@manatt.com
msw@cpuc.ca.gov
mtrexler@climateservices.com
mts@cpuc.ca.gov
myuffee@mwe.com
mzr@cpuc.ca.gov
nao@cpuc.ca.gov
nes@a-klaw.com
nil@cpuc.ca.gov
npedersen@hanmor.com
nrader@calwea.org
ntoyama@smud.org
pcmcdonnell@earthlink.net
pduvair@energy.state.ca.us
petertbray@yahoo.com
pha@cpuc.ca.gov
philm@scdenergy.com
ppettingill@caiso.com
psd@cpuc.ca.gov
pucservice@manatt.com
puma@davis.com
rae@cpuc.ca.gov
ramonag@ebmud.com
rberliner@manatt.com
rejohnson@att.com
rhoffman@anaheim.net
rhwiser@lbl.gov
rick_noger@praxair.com
rliebert@cfbf.com
rmd@cpuc.ca.gov
rmiller@energy.state.ca.us
roger.pelote@williams.com
rru@sandag.org
rsa@a-klaw.com
rschmidt@bartlewells.com
rsparks@caiso.com
rwalther@pacbell.net
rwethera@energy.state.ca.us
samuel.r.sadler@state.or.us
sarveybob@aol.com
sberlin@mccarthylaw.com
scarter@nrdc.org
scasey@sfwater.org
sed@cpuc.ca.gov
service@spurr.org
sia2@pwrval.com
sjl@cpuc.ca.gov
sscb@pge.com
sschleimer@calpine.com
ssmyers@att.net
sst@cpuc.ca.gov
stevegreenwald@dwt.com
steven@iepa.com
susan.freedman@sdenergy.org
tam@cpuc.ca.gov
tcarlson@reliant.com
tcorr@sempra.com
tcx@cpuc.ca.gov
tdp@cpuc.ca.gov
tglaviano@energy.state.ca.us
tim.hemig@nrgenergy.com
tomb@crossborderenergy.com
toms@i-cpg.com
trf@cpuc.ca.gov
troberts@sempra.com
usdepic@yahoo.com
vhconsult@earthlink.net
vjb@cpuc.ca.gov
vjw3@pge.com
vwood@smud.org
wbooth@booth-law.com
william.tomlinson@elpaso.com
wkeilani@semprautilities.com
WKeilani@semprautilities.com
woodrujb@sce.com
wsm@cpuc.ca.gov
wwesterfield@stoel.com
ygross@sempraglobal.com
ztc@cpuc.ca.gov

ENERGY AMERICA, LLC
ONE STAMFORD PLAZA, 8TH FLOOR
263 TRESSER BLVD.
STAMFORD CT 06901

OCCIDENTAL POWER SERVICES, INC.
5 GREENWAY PLAZA, SUITE 110
HOUSTON TX 77046

BP ENERGY COMPANY
501 WESTLAKE PARK BLVD
HOUSTON TX 77079

APS ENERGY SERVICES COMPANY, INC.
400 E. VAN BUREN STREET, SUITE 750
PHOENIX AZ 85004

NEW WEST ENERGY CORPORATION
MAILING STATION ISB 665
PO BOX 61868
PHOENIX AZ 85082-1868

CONSTELLATION NEWENERGY, INC.
350 SOUTH GRAND AVE., SUITE 2950
LOS ANGELES CA 90071

MICHAEL MAZUR
3 PHASES ELECTRICAL CONSULTING
2100 SEPULVEDA BLVD., SUITE 15
MANHATTAN BEACH CA 90266

QUIET ENERGY
QUIET LLC
3311 VAN ALLEN PL.
TOPANGA CA 90290

AMERICAN UTILITY NETWORK (A.U.N.)
10705 DEER CANYON DRIVE
ALTA LOMA CA 91737

SEMPRA ENERGY SOLUTIONS
101 ASH STREET, HQ09
SAN DIEGO CA 92101

CORAL POWER, LLC.
4445 EASTGATE MALL, SUITE 100
SAN DIEGO CA 92121

PILOT POWER GROUP, INC.
9320 CHESAPEAKE DRIVE, SUITE 112
SAN DIEGO CA 92123

ELECTRICAMERICA
COMMERCE ENERGY, INC.
600 ANTON BLVD., SUITE 2000
COSTA MESA CA 92626

COMMERCE ENERGY, INC.
600 ANTON BOULEVARD, STE 2000
COSTA MESA CA 92626

CITY OF CORONA
DEPARTMENT OF WATER & POWER
730 CORPORATION YARD WAY
CORONA CA 92880

CALPINE POWERAMERICA-CA, LLC
4160 DUBLIN BLVD.
DUBLIN CA 94568