BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Integrate and Refine Procurement Policies and Consider Long-Term Procurement Plans.	R. 10-05-006 (Filed May 6, 2010)

COMMENTS OF CALPINE CORPORATION ON PROPOSED DECISION

Jeffrey P. Gray
Vidhya Prabhakaran
Davis Wright Tremaine LLP
Suite 800
505 Montgomery Street
San Francisco, CA 94111-6533
Tel. (415) 276-6500
Fax. (415) 276-6599
Email: jeffgray@dwt.com
vidhyaprabhakaran@dwt.com

Attorneys for Calpine Corporation

March 12, 2012

SUBJECT INDEX OF RECOMMENDED CHANGES[1]

I. SYSTEM TRACK I ISSUES

- All references to the need for resources after 2020 should be deleted from the Proposed Decision ("PD").
- The PD should be revised to reflect the current uncertainty regarding the need for new resources.
- The PD should be revised to accurately reflect the record regarding the need to retain existing generation.
- The PD should be modified to acknowledge that the risk of economic retirements is real.
- The PD should be revised to avoid any suggestion that backstop procurement mechanisms or "mothballing" can or should be the primary means for addressing economic retirements.
- The PD should be revised to adopt Calpine's proposal or some similar action to ensure existing resources have access to sufficient revenue streams to prevent economic shutdown.

II. RULES TRACK III ISSUES

- The PD should be revised to clarify that, for purposes of calculating the limits on the investor-owned utilities ("IOUs") procurement of greenhouse gas ("GHG") compliance instruments, the IOUs' anticipated compliance obligations should include not only compliance obligations associated with their own generating assets, but the compliance obligations of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs; and
- The PD should be revised to direct the IOUs to procure compliance instruments on behalf of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs.

[1] *See also* Appendix A for proposed revisions to Findings of Fact, Conclusions of Law, and Ordering Paragraphs.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Integrate and Refine Procurement Policies and Consider Long-Term Procurement Plans.	R. 10-05-006 (Filed May 6, 2010)

COMMENTS OF CALPINE CORPORATION ON PROPOSED DECISION

Pursuant to Rule 14.3 of the California Public Utilities Commission ("Commission") Rules of Practice and Procedure, Calpine Corporation ("Calpine") submits these comments on the proposed decision ("PD") addressing System Track I and Rules Track III issues.

I. COMMENTS ON SYSTEM TRACK I ISSUES

As discussed in more detail below, the PD includes several, significant errors that require modification by the Commission. Among these errors, the PD:

- Mischaracterizes key portions of the record regarding the "need" for resources;
- Ignores clear and uncontroverted evidence that existing generation is at risk of economic retirement; and
- Fails to grasp significant structural flaws affecting capacity and energy markets.

In this proceeding, Calpine proposes that the Commission adopt an interim procurement requirement to ensure the continued availability of uncontracted existing resources[2] during the planning period at issue. The modeling performed to date assumes that uncontracted existing resources will remain available to help satisfy reliability requirements through 2020. Current market conditions, however, provide no such assurance that these existing resources will remain available over the planning period.

The Calpine proposal provides a simple and straightforward approach to better ensure the continued availability of uncontracted existing resources at a cost that is low relative to the cost of replacement resources in the future. Absent adoption of the Calpine proposal or some similar action by either the Commission or the California Independent System Operator ("CAISO") to ensure existing resources have access to sufficient revenue streams to recover going-forward

[2] "Uncontracted existing resources" refers to existing resources that are not under contracts to, or owned by, load serving entities during the planning period.

costs, the Commission risks the economic retirement of existing resources and increased costs to ratepayers associated with the procurement of replacement resources.

A. The PD Mischaracterizes Key Portions of the Record Regarding Resource "Need"

In concluding that the Settlement Agreement should be approved, the PD would find that "[t]he record clearly supports a conclusion that no new generation is needed by 2020, and the record does not clearly support a conclusion that new generation is needed even after 2020."[3] This finding goes well beyond provisions in the Settlement Agreement, is not supported by the record, and fails to distinguish the potential need for *new* resources from the actual need for *existing* resources to remain available.

As an initial matter, neither the Settlement Agreement nor the record addresses the need for resources "after 2020." Accordingly, all references to the need for resources after 2020 should be deleted from the PD. With respect to the need for new resources "by 2020," the PD mischaracterizes key provisions in the Settlement Agreement. Specifically, the Settlement Agreement provides that "[t]he resource planning analyses presented in this proceeding *do not conclusively demonstrate* whether or not there is need to add capacity for renewable integration purposes through the year 2020."[4] Thus, in contrast to the PD, the Settling Parties do not believe that "clear evidence" exists that there is no need for new resources.

Furthermore, while the PD correctly notes that four of the scenarios modeled in this proceeding show no need for new resources by 2020,[5] the PD essentially disregards the fact that other modeled scenarios demonstrate a need for up to 8,200 MW of new resources.[6] It is precisely because the Settling Parties do not believe that the evidence supports a finding that no new resources are needed by 2020 that they agreed that further analysis is needed before a reliable determination can be made on the need for new resources.[7]

This uncertainty is also a reason why the Commission should take action to preserve existing resources assumed to be available in the current modeling. Preserving existing resources provides a hedge against the uncertainty associated with future reliability requirements,

---

[3] PD at 10-11.

[4] Settlement Agreement at 5 (emphasis added); *see also* PD at 7.

[5] PD at 7.

[6] CAISO/Rothleder, Exh. 2400 at 43-44; Joint IOU Supporting Testimony, Exh. 106 at 3-3 (Table 3-1).

[7] Settlement Agreement at 4-5; *see also* PD at 7.

including the need for new resources. As a result, the PD should be revised to reflect the current uncertainty regarding the need for new resources.

Further, although uncertainty exists with respect to the need for new resources by 2020, the record demonstrates there is a need for *existing* resources to remain available to satisfy reliability requirements during the planning period. Specifically, sensitivity studies show that if existing resources assumed to be available in the modeling shut down, substantial amounts of new replacement resources will be necessary to satisfy reliability requirements, with a potential cost to ratepayers in the billions of dollars. This is true even under a scenario that does not otherwise show a need for *new* resources:

Scenario	Existing Uncontracted Resources Assumed Retired[8]	"Need" for Replacement Resources	Cost of Replacement Resources[9]
Trajectory High Load[10]	3,200 MW	2,600 MW[11]	$3.12 – 5.52 billion
Trajectory[12]	3,200 MW	1,400 MW	$1.68 - 2.97 billion

No evidence was presented disputing the results of these sensitivity studies. Accordingly, the PD should be revised to accurately reflect the record regarding the need to retain existing generation.

[8] The resources used in the sensitivity studies were selected because some of the units do not currently have contracts and none of the units have contracts that extend beyond 2013 (*i.e.*, they will be exposed to short-term markets in the near future). The units were also selected because they are generally similar to other units (both Calpine and non-Calpine) that were built in the past 10 years and are not under long-term contracts. *See* Calpine/Barmack, Exh. 601 at 5.

[9] The range in the cost of replacement capacity was calculated using publicly available estimates of the cost of new capacity from the California Energy Commission and other public sources. *See* Calpine/Barmack, Exh. 601 at 13.

[10] The renewable integration modeling results for the "Trajectory High Load" scenario show a need for 4,600 MW of new resources to satisfy reliability and renewable integration needs. CAISO/Rothleder, Exh. 2400 at 43.

[11] The amount of replacement resources is less than 1-for-1 because on the day of the simulation in which the greatest amounts of new generic resources are needed to serve load and satisfy flexibility requirements, 600 MW of the resources that were modeled as retired in the sensitivity analysis are forced out. Because the 600 MW are forced out, removing them as part of the sensitivity analysis does not increase need. *See* Calpine/Barmack, Exh. 601 at 12, note 18.

[12] The renewable integration modeling results for the "Trajectory" scenario do not show a need for *new* resources to satisfy reliability and renewable integration needs. Calpine/Barmack, Exh. 601 at 5.

B. The PD Ignores Clear and Uncontroverted Evidence that Existing Generation Is at Risk of Economic Shutdown

Essentially, the PD would reject Calpine's proposal because it does not believe "that any combined cycle plants, owned by Calpine or anyone else, are facing a real risk of economic shutdown."[13] This conclusion is not supported by the record and is specifically contradicted by a draft Resolution currently pending before the Commission. Additionally, the PD would find that current mechanisms available to the Commission and the CAISO exist to mitigate the risk of economic shutdowns and that it is unclear, if such shutdowns occur, that they would result in generation becoming permanently unavailable (*i.e.*, the PD assumes existing generation can be "mothballed.")[14] These findings are similarly not supported by the facts and demonstrate a fundamental failure in procurement policy.

Contrary to the PD, the risk of economic shutdowns is not an abstract concept or hypothetical scenario but rather a reality currently at issue before the Commission and the CAISO.[15] Specifically, *as the PD acknowledges*, the economic shutdown of Calpine's Sutter Energy Center ("Sutter") is presently being addressed by the Commission in Draft Resolution E-4471.[16] In Draft Resolution E-4471, the Commission would direct Pacific Gas & Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company (collectively, the "IOUs") to enter into contract negotiations with Calpine that would prevent the shutdown of Sutter.[17] If Draft Resolution E-4471 is not approved or other action is not taken by the Commission or CAISO to ensure Sutter has a sufficient and stable enough revenue stream to recover of going-forward costs (including major maintenance costs), Sutter will be shut down.

Furthermore, while Sutter is the first resource to put the issue of an economic shutdown squarely before the Commission, the market policies which led to Calpine's decision affect all existing non-IOU generation resources without contracts. The record demonstrates that compensation from the markets currently available to uncontracted existing resources has been

---

[13] PD at 15.

[14] PD at 15.

[15] On January 26, 2012, the CAISO filed a Petition for Waiver of Tariff Provisions and Request for Confidential Treatment in FERC Docket No. ER12-897-000 seeking the authority to procure Sutter during 2012 pursuant to the risk of retirement provisions of the CPM. *See* Draft Resolution E-4471 at 11-12 (Findings 5).

[16] PD at 15, note 10. In November 2011, Calpine submitted a notice pursuant to Commission General Order 167 stating that it was planning to retire Sutter in 2012 for economic reasons. *See* Draft Resolution E-4471 at 2.

[17] Draft Resolution E-4471 at 10 (Ordering Paragraph 1).

declining[18] and is expected to drop even further as more renewable resources come on-line.[19] The adverse impacts from declining market revenues are exacerbated by the fact that current procurement policies and practices exclude existing resources from participating in long-term resource solicitations. Thus, it is critical that fundamental changes to procurement policies and practices are made[20] and that backstop mechanisms are not relied upon as a primary measure to prevent economic shutdowns as proposed by the PD.[21]

As a general matter, backstop mechanisms are used to address discreet, short-term reliability needs and are not designed to address broader market issues. In addition, the PD overstates the Commission's ability to use backstop mechanisms to prevent economic shutdowns. Even assuming the Commission has jurisdiction over non-IOU generation resources (which Calpine does not concede), General Order 167 Operating Standard 24 obligates a generating asset owner ("GAO") to maintain "a unit in readiness for service ... *only* to the extent that the regulatory body with relevant ratemaking authority has instituted a mechanism to compensate the GAO for readiness services provided." (Emphasis added). Thus, if a GAO is not compensated for providing readiness service, the Commission has no authority under its General Orders to prevent the GAO from retiring a resource. This is, in fact, why Draft Resolution E-4471 would direct the IOUs to enter into contract negotiations with Calpine for Sutter.[22]

The suggestion in the PD that resources at risk for economic retirement can be "mothballed" is similarly misplaced and not supported by the record. In support of its position, the PD relies exclusively on argument - as opposed to evidence - presented by The Utility Reform Network ("TURN") that it "simply does not make sense" for a generator to permanently retire a resource for economic reasons.[23] During cross examination, however, TURN admitted

---

[18] Calpine Opening Brief at 4-5 (*citing* CAISO Market Issues and Performance Annual Report 2010 at 53); *see also* Calpine/Barmack, Exh. 601 at 6-9.

[19] Calpine Opening Brief at 5-6 (*quoting* CAISO *Integration of Renewable Resources; Operational Requirements and Generation Fleet Capability at 20% RPS* at v (August 31, 2010)).

[20] Even under the most optimistic scenarios, however, the time necessary to develop and implement such solutions does not address the near-term needs of Sutter.

[21] *See* PD at 15.

[22] *See* Draft Resolution E-4471 at 8 ("The IOUs should jointly negotiate a limited term contract with Calpine. A contract between the IOUs and Calpine's Sutter plant would satisfy the compensation mechanism requirement of [Operating Standard] 24.")

[23] PD at 15.

that it does not know whether an existing resource can be easily or economically brought back on-line after having been shut down for an extended period.[24]

There are a number of regulatory and economic unknowns that would need to be resolved before the temporary shutdown of an existing resource could be reasonably relied upon as a viable option to ensure the future availability of the resource. Thus, contrary to the PD, there is no basis in the record to conclude that "mothballing" an existing resource is a viable option to ensure the future availability of the resource. Accordingly, the PD should be modified to acknowledge that the risk of economic retirements is real and to avoid any suggestion that backstop procurement mechanisms or "mothballing" can or should be the primary means for addressing economic retirements.

C. The PD Fails to Grasp Significant Flaws in the Existing Market Structure

Economic realities are that, if compensation from the markets available to existing resources is insufficient and/or insufficiently stable to ensure recovery of going-forward costs, such resources should be expected to shut down. As acknowledged in the PD, Sutter is currently an example of this economic reality. The PD, however, fails to grasp the significant market issues which have led to potential economic retirements.

As discussed above, current procurement policies and practices that exclude existing resources from participating in long term resource solicitations limit market opportunities for these resources. Moreover, the residual market opportunities that are available to existing resources yield low compensation that is expected to drop even further as a result of excess supply created by increased renewable generation resources and other procurement policies. Against this market backdrop, sensitivity studies show that if existing resources assumed to be available in the current modeling shut down, substantial amounts of new replacement resources will be necessary to satisfy reliability and renewable integration needs. To effectively address this dilemma and ensure resources assumed by the Commission to be available in the future are in fact available when needed, changes to current procurement policies and practices are necessary. These changes include:

[24] Woodruff/TURN, Tr. at 463-64.

- Adopting a multi-year forward resource adequacy procurement obligation - something the Commission has previously acknowledged "could potentially benefit the RA program with respect to the reliability, cost, and equitable allocation objectives;"[25]

- Ending policies and practices that exclude existing generation resources from participating in long-term resource solicitations; and

- Establishing "attribute" based procurement requirements that will provide reliable investment signals to the market and help ensure long-term renewable integration needs are met.

Calpine's procurement proposal is an initial effort to address flaws in the current market and should be adopted by the Commission. Absent adoption of Calpine's procurement proposal or some similar action by the Commission or CAISO to ensure existing resources have access to sufficient revenue streams to ensure recovery of going-forward costs, such resources should be expected to shut down.

II. COMMENTS ON RULES TRACK III ISSUES

With respect to greenhouse gas ("GHG") procurement obligations, the PD does not clearly indicate whether the IOUs' "anticipated compliance obligations" include the compliance obligations of generators dispatched pursuant to contracts with the IOUs. Under existing contracts that address responsibility for a generator's GHG compliance costs, the IOUs have generally assumed the responsibility to reimburse or pay the generator for such costs or, alternatively at the IOU's election, to provide actual GHG compliance instruments to the generator. As discussed in more detail below, Calpine recommends that the PD be revised to:

- Clarify that, for purposes of calculating the limits on the IOUs' procurement of GHG compliance instruments, the IOUs' anticipated compliance obligations should include not only compliance obligations associated with their own generating assets, but the compliance obligations of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs; and

- Direct the IOUs to procure compliance instruments on behalf of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs.

[25] Decision 10-06-018, mimeo at 33.

As California's largest independent power producer, provider of renewable energy, and owner of combined heat and power or cogeneration facilities, Calpine is one of the largest entities in the State subject to the California Air Resources Board ("CARB") Cap-and-Trade Program. However, certain restrictions (which are not applicable to the IOUs) on the ability of non-IOU generators to procure allowances under the Cap-and-Trade Program and other factors associated with contractual dispatch rights, put the IOUs in the best position to procure GHG compliance instruments at the least cost for ratepayers. Accordingly, the Commission should clarify that the IOUs' "anticipated compliance obligations" (for which the IOUs are authorized to procure up to certain percentages during any given year) also include the compliance obligations of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs. The Commission should also proceed cautiously before imposing undue restrictions on the IOUs' procurement of compliance instruments, so as not to eliminate the flexibility provided by CARB for this purpose.

In addition, because the IOUs are best positioned to procure GHG compliance instruments on behalf of generators for whom the IOUs have dispatch rights, the Commission should direct the IOUs to procure compliance instruments whenever a contract provides for recovery of GHG compliance costs. This direction would promote efficiency and stability in the market, and would assure procurement of the least-cost compliance instruments needed to satisfy the generators' compliance obligations, without altering the fundamental economic exchange reflected by existing contracts with respect to the parties' respective obligations for compliance with CARB's Cap-and-Trade Program.

A. The IOUs' Anticipated Compliance Obligations Should Include Not Only Compliance Obligations Associated with their Own Generating Assets, but the Compliance Obligations of Generators Dispatched Pursuant to Contracts that Provide for Recovery of GHG Compliance Costs

The PD would authorize the IOUs to procure GHG compliance instruments within certain percentage "bands," with annual minimum and maximums, based on the individual IOU's "anticipated compliance obligations."[26] The PD, however, does not address the IOUs' procurement of compliance instruments on behalf of generators dispatched by the IOUs pursuant to contracts that provide for recovery of GHG compliance costs.

[26] PD at 54.

CARB provides a special device that allows an IOU to purchase large amounts of allowances on behalf of contracted generating resources, without the allowances counting against the IOU's "holding limits."[27] The holding limit, which applies equally to all affiliated entities, limits the amount of allowances that any set of affiliated entities can hold at any time.[28] However, to address circumstances where an IOU procures allowances on behalf of a contracted generator, CARB permits the IOU to enter into a "beneficial holding relationship," whereby any allowances the IOU purchases on the generator's behalf *count against the generator's holding limit*, so long as the generator confirms the existence of the relationship and the IOU transfers the allowances to the generator within one year.[29]

This aspect of CARB's program confirms that the IOUs are in the best position to correlate dispatch with carbon cost signals and manage the carbon risk for the generating resources under their control (including non-affiliated generation under contract) on a portfolio basis, and provides them with important flexibility to acquire allowances based on their actual dispatch decisions. To ensure the IOUs can fully utilize this flexibility, the PD should be revised to clarify that, for purposes of calculating the quantity of compliance instruments that an IOU can procure, the IOU's "anticipated compliance obligations" should include both its own compliance obligation and the compliance obligation of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs. In addition, the Commission should proceed cautiously before imposing unnecessary restrictions on the IOUs' procurement of compliance instruments and thereby sacrificing the substantial flexibility afforded them by CARB's regulations.

B. The IOUs Should Be Directed to Procure Compliance Instruments on Behalf of Generators Dispatched Pursuant to Contracts that Provide for Recovery of GHG Compliance Costs

To promote efficiency and stability in the GHG allowances market and to ensure the least-cost procurement of compliance instruments, the PD should be revised to direct the IOUs to procure compliance instruments on behalf of generators dispatched by the IOUs pursuant to contracts that provide for recovery of GHG compliance costs. There are three primary reasons why, as a policy matter, it would be prudent for the Commission to direct the IOUs to procure

[27] *See* Cal. Code Reg., Title 17 §§ 95834, 95920(g).

[28] *See* Cal. Code Reg., Title 17 § 95920(a).

[29] *See* Cal. Code Reg., Title 17 §§ 95834, 95920(g).

compliance instruments in circumstances where they might otherwise choose to satisfy their contractual obligations by making a monetary payment to the generator instead (either as reimbursement for the generator's actual compliance costs or based upon some calculation of the generator's GHG emissions and the market price of carbon).

First, IOUs are in a far superior position to procure GHG compliance instruments, both in terms of knowledge of which units they are likely to dispatch to meet demand most efficiently, and in their ability to procure from the auction or secondary markets. Second, absent such a requirement, the IOUs could be incentivized to engage in speculative behavior, which could frustrate price signals and market stability. Finally, providing such direction would resolve existing ambiguities regarding the parties' respective responsibility for procurement of compliance instruments, without altering the fundamental economic exchange intended by the parties with respect to GHG compliance. These ambiguities can largely be attributed to the unsettled nature of CARB's rulemaking efforts at the time when such contracts were negotiated.

1. The IOUs Are in the Best Position to Procure Compliance Instruments

The IOUs are in the best position to efficiently procure GHG compliance instruments on behalf of their respective generation portfolios, including non-affiliated generation under contract for which the IOUs have dispatch rights. In addition, CARB has completely exempted the IOUs from auction purchase limits applicable to non-IOU generators.[30] Thus, absent limitations imposed by the Commission, the IOUs have essentially been granted freedom to purchase as many allowances as they need in any auction.

In contrast, non-IOU generators that are subject to the purchase limit may need to participate in every auction and acquire allowances at the maximum percentage authorized by the Cap-and-Trade Program, just to obtain sufficient compliance instruments to cover their compliance obligations. Undoubtedly, this could influence such generators' bidding strategies and limit their ability to procure the least-cost compliance instruments. For contracts in which the IOUs are responsible for GHG compliance costs, the net result would be higher costs to ratepayers.

Similarly, as described above, the "beneficial holding relationship" allows the IOUs to procure allowances on behalf of contracted generators, without exceeding the general holding

[30] Cal. Code Reg., Title 17 § 95911(c)(4)(B).

limits imposed on other covered entities. While the beneficial holding relationship provides the IOUs with significant flexibility, it potentially limits the flexibility of non-IOU generators. When an IOU procures allowances on behalf of a generator pursuant to such a relationship, those allowances count against the generator's holding limit. However, because the generator will not actually possess any of the allowances for up to a year, it cannot move them to its compliance account and thereby "free-up" its holding limit to allow participation in future auctions and the secondary markets. As a result, at any given time, a large generator with several IOU contracts could have its entire holding limit consumed by allowances procured and held on its behalf by IOUs pursuant to beneficial holding relationships. This, in turn, could greatly impair the least-cost procurement of compliance instruments by the largest non-IOU generators.

2. Mandatory Procurement Would Eliminate Potential Market Distortions Attributable to Speculative Behavior

The PD explains that the primary purpose for procuring compliance instruments is to ensure the IOUs are in compliance with the Cap-and-Trade Program and that the Commission has a duty to ensure that such compliance is achieved in a manner that does not expose ratepayers to unnecessary carbon price risk.[31] Specifically, the PD provides that the IOUs "should not be procuring greenhouse gas compliance instruments for speculation or other financial purposes."[32] To further this policy objective, the Commission should authorize the IOUs to procure compliance instruments on behalf of generators dispatched by the IOUs pursuant to contracts that provide for recovery of GHG compliance costs.

Under existing contracts that address responsibility for the generator's GHG compliance costs, the IOUs have generally assumed the responsibility to reimburse or pay the generator for such costs or, at the IOU's election, to provide actual GHG compliance instruments to the generator instead. In most cases – indeed, for all Calpine's existing contracts with IOUs that address GHG – these provisions were negotiated prior to the final promulgation and effective date of CARB's Cap-and-Trade Program. Thus, the option to make a monetary payment or provide compliance instruments reflected the parties' uncertainty as to how the final regulations would be designed.

---

[31] PD at 52.

[32] PD at 52.

As a consequence, for most contracts executed since the time when Assembly Bill ("AB") 32 was passed (in 2006), but prior to CARB's Cap-and-Trade Program becoming effective, there are significant ambiguities that need to be resolved with respect to which of the parties would bear responsibility for procuring GHG compliance instruments. While Calpine intends to honor its contractual obligations notwithstanding these ambiguities, without certainty that the IOUs will, in fact, procure such instruments on their behalf, large contracted generators will be compelled to participate in the auctions to assure they have secured adequate compliance instruments to meet the projected dispatch of their units. If the IOUs are also procuring allowances for the same contracted generators, this could artificially drive up the auction clearing price, causing negative impacts for all ratepayers and the broader GHG market.

Additionally, the option for IOUs to either provide compliance instruments or make a monetary payment to generators promotes speculative behavior, as the IOUs would be incentivized to buy allowances up front, with the flexibility to either transfer them to contracted generators or sell them on the secondary market, depending on market conditions. While such speculative behavior might appear to benefit ratepayers, it would send artificial price signals to market participants and cause general distortions in the broader market for compliance instruments. Thus, such an option could result in increased costs to ratepayers. The PD's proposed limitations on the IOUs' ability to engage in such speculative behavior[33] would not alleviate the impact of these market distortions.

The PD already recognizes that the IOUs should not be procuring compliance instruments for speculation or other financial purposes.[34] For the same reason, the Commission should direct the IOUs to procure compliance instruments on behalf of contracted generators, rather than risk the market distortions that could result from continued uncertainty as to which party will be responsible for procuring compliance instruments for generators dispatched by the IOUs pursuant to contracts that provide for recovery of GHG compliance costs.

3. Mandatory Procurement Does Not Alter the Fundamental Economic Exchange Between the Parties, but Would Resolve Ambiguities in Favor of Least-Cost Procurement of Compliance Instruments

Directing the IOUs to procure compliance instruments on behalf of contracted generators would not change the fundamental economic exchange between the parties. In nearly every one

[33] PD at 53.

[34] PD at 52.

of Calpine's existing contracts that address GHG, the IOU benefits from an efficiency guarantee designed to ensure that it pays no more for GHG compliance costs than if the unit were operated within the efficiency (heat rate) guarantees otherwise provided by the contract. Calpine intends to honor its contractual obligations and this guarantee, which would in no way be diminished by the Commission's direction for the IOUs to procure compliance instruments under such contracts. Such direction would, however, resolve substantial uncertainty that can largely be attributed to the unsettled nature of CARB's regulatory development process while those contracts were under negotiation. It would also better assure that the IOUs are taking into account the real costs for GHG compliance instruments in making dispatch decisions for the generators whose dispatch they ultimately control.

The IOUs enjoy a favorable position with respect to procurement of compliance instruments when compared to non-IOU generators under CARB's Cap-and-Trade Program. Furthermore, having non-IOU generators shoulder the administrative burden associated with such procurement provides no discernible benefit. Therefore, the Commission should direct the IOUs to procure compliance instruments whenever a contract with a generator whose dispatch the IOU controls provides for some means of GHG cost recovery. Doing so would represent a sound policy decision that ensures that the GHG compliance obligation imposed by CARB's Cap-and-Trade Program is satisfied most efficiently and at the least cost to ratepayers.

By: /s/

Jeffrey P. Gray
Vidhya Prabhakaran
Davis Wright Tremaine LLP, Suite 800
505 Montgomery Street
San Francisco, CA 94111-6533
Tel. (415) 276-6500
Email: jeffgray@dwt.com
vidhyaprabhakaran@dwt.com

Dated: March 12, 2012

Attorneys for Calpine Corporation

Appendix A
Proposed Revisions to Proposed Decision

Findings of Fact

- Findings of Fact No. 3 should be revised to state:

  Calpine ~~did not~~ presented evidence ~~on the specific economics of its generation facilities~~ to support its proposal for utility solicitations aimed at existing power plants without contracts.

- Findings of Fact No. 4 should be deleted.
- A new Findings of Fact should be added that states:

  There is current uncertainty regarding the need for new resources by 2020.

- A new Findings of Fact should be added that states:

  The record demonstrates a need to retain existing generation resources.

- A new Findings of Fact should be added that states:

  The risk to existing generation of economic retirements is real.

- A new Findings of Fact should be added that states:

  Backstop procurement mechanisms or "mothballing" cannot and should not be the primary means for addressing economic retirements.

Conclusions of Law

- Conclusions of Law No. 2 should be revised to state:

  Calpine ~~failed to~~ presented adequate evidence to support its proposal for utility solicitations aimed at existing power plants without contracts.

- Conclusions of Law No. 9 should be revised to state:

  To reduce risk to ratepayers, the quantities and sources of greenhouse gas compliance instruments procured by the utilities should ~~be limited~~ not only include compliance obligations associated with their own generating assets, but the compliance obligations of generators dispatched by the utilities pursuant to contracts that provide for recovery of greenhouse gas compliance costs

Ordering Paragraphs

- Ordering Paragraph No. 2 should be revised to state:

  Calpine Corporation's proposal for the utilities to conduct solicitations aimed at existing power plants without contracts is ~~not~~ approved.

- A new Ordering Paragraph should be added that states:

  Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company are directed to procure greenhouse gas compliance instruments on behalf of generators dispatched pursuant to contracts that provide for recovery of GHG compliance costs.