Clay Faber
Director – Regulatory Affairs
8330 Century Park Court
San Diego, CA 92123-1548

Tel: 858-654-3563
Fax: 858-654-1788
CFaber@semprautilities.com

May 4, 2012

ADVICE LETTER 2354-E
(U 902-E)

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

SUBJECT: COMPLIANCE WITH RESOLUTION E-4471 TO ENTER INTO CONTRACT WITH SUTTER ENERGY CENTER

San Diego Gas & Electric Company ("SDG&E") hereby submits to the California Public Utilities Commission ("Commission") for approval the following changes to its electric tariff sheets as shown in enclosed Attachment A. Approval of this advice letter and the proposed tariff sheets are essential conditions precedent to an agreement negotiated and executed by SDG&E and Calpine Energy Services, LLC. This agreement, under which SDG&E will buy and Calpine Energy Services will sell a resource-adequacy product during the period July 1, 2012, through December 31, 2012, was negotiated and agreed upon in compliance with those certain directions of the Commission provided in Resolution E-4471.

A. PROCEDURAL BACKGROUND

The stated purpose of Resolution E-4471 "is to keep the Sutter plant online in 2012, enabling further analysis of the impacts of current and proposed dynamic transfer tariff changes at the CAISO".[1] To achieve this goal, Resolution E-4471 directed SDG&E, Pacific Gas & Electric ("PG&E"), and Southern California Edison ("SCE") to enter into contract negotiations with Calpine with respect to the Sutter Energy Center ("Calpine Sutter") for a price less than available under the California Independent System Operator's ("California ISO" or "ISO") Capacity Procurement Mechanism ("CPM").[2] The Resolution further requires the utilities to engage an Independent Evaluator to provide third-party oversight of the contracting process[3] and submit a Tier 2 advice letter upon completion of the negotiations.[4] In addition, the Resolution directed Calpine Sutter to provide the Independent Evaluator and the Commission's Energy Division with cash flow models and other financial information.[5]

[1] Resolution E-4471, at p.1.
[2] Resolution E-4471, at p.13 (Ordering Paragraph 1).
[3] Resolution E-4471, at p.13 (Finding 12).
[4] Resolution E-4471, at p.13 (Ordering Paragraph 3). By letter dated April 30, 2012, the date for filing the Tier 2 advice letter was extended to May 4, 2012, by the CPUC's Executive Director.
[5] Resolution E-4471, at p.13 (Ordering Paragraph 2).

B. CONTRACT SUMMARY

The following table provides a summary of the SDG&E-Calpine Sutter resource-adequacy transaction:

Counterparty	Calpine Energy Services, LP
Resource type	Natural Gas Fired
Location	Calpine Sutter Combined Cycle facility, Yuba City, NV
Capacity	10.4% of total capacity
Expected Deliveries	System Resource Adequacy Capacity, no Energy
Delivery Point	CAISO Control Area/ Local Area Resource region in which the Sutter units are electrically interconnected.
Length of Contract	Six (6) Months; July 1, 2012 – December 31, 2012

C. THE STRUCTURE OF THE NEGOTIATIONS

The negotiations between SDG&E and Calpine Sutter took place independently of Calpine Sutter's negotiations with PG&E and SCE. As required by Resolution E-4471, SDG&E engaged an Independent Evaluator to monitor and supervise the negotiations process. The Independent Evaluator actively monitored the negotiations and, as discussed below, prepared a report regarding the negotiations and evaluating the reasonableness of the terms and conditions of the agreement negotiated by SDG&E and Calpine Sutter. The utilities requested and received advice from the Commission's executive leadership that independent negotiations and separate agreements would meet the direction of Resolution E-4471 that the three utilities "jointly negotiate" an agreement with Calpine Sutter. Upon this advice, the three utilities accepted Calpine Sutter's proposals for the structure of the negotiations and proceeded to negotiate with Calpine Sutter in the manner proposed by Calpine Sutter. From this point forward, SDG&E did not communicate with the other utilities regarding the status or substance of their negotiations with Calpine Sutter or any other related subject, *e.g.*, the form and content of the compliance filings they would submit to the Commission's Energy Division on April 30, 2012.

D. THE SDG&E - CALPINE SUTTER NEGOTIATIONS

The substance and results of the negotiations conducted between SDG&E and Calpine Sutter are provided in Confidential Attachment B to this Advice Letter. A true and correct copy of the executed SDG&E-Calpine Sutter resource-adequacy confirm is appended to Attachment B. SDG&E believes the contents of Attachment B should be protected from public disclosure and requests that the Commission treat the information provided in Attachment B as confidential. SDG&E attaches the Declaration of Nuo Tang, Senior Energy Administrator in the SDG&E Electric and Fuel Procurement Department, in support of its request to preserve the confidentiality of the information provided in Attachment B.

E. REASONABLENESS OF CONTRACT

SDG&E submits it has complied with the Commission's directions provided in Resolution E-4471 by entering into good faith negotiations with Calpine Sutter. Those negotiations resulted in the execution of a resource-adequacy transaction for SDG&E's load-ratable share of Calpine Sutter's Net Qualifying Capacity for the period July 1, 2012, through December 31, 2012. SDG&E submits that the contract terms and conditions of the agreement may be found to be reasonable on each and every of three independent grounds.

First, as the Commission directed, SDG&E entered into an agreement that will permit Calpine Sutter to remain online and in operation through the end of 2012 at price below the California ISO's CPM tariff rate. This is consistent with the stated purpose of Resolution E-4471 as it will provide the Commission and the California ISO with additional time during and information with which to study the effects a resource interconnected with the ISO service area via a pseudo-tie and providing dynamic transfer capabilities may have on ISO operations under the newly revised ISO tariffs related to such resources.

Second, the terms and conditions in the agreement are reasonable and reflect a reduction in costs on a megawatt-for-megawatt basis to SDG&E ratepayers relative to potential costs associated with a CPM designation.[6] To confirm the reasonableness of the agreement, the Commission's Energy Division and the Independent Evaluator were provided with Calpine Sutter's cash flow models and detailed financial information. (This information was not made available to SDG&E during the negotiations.) SDG&E believes its agreement with Calpine Sutter will mitigate the potential costs of the pending California ISO CPM tariff waiver on its customers and, per the terms of Resolution E-4471, represents a significant cost savings. The Commission may independently verify the significance of the savings by comparing the results of the negotiations against its understanding of Calpine's financial condition and, from that perspective, the likelihood SDG&E could have achieved any greater a level of savings.

Third, by executing its agreement with Calpine Sutter, SDG&E believes it has provided regulators with additional time in which to address the need for systemic changes to the structure of California energy markets. This alone would be valuable to California energy consumers. A number of proposals have been submitted to the Commission regarding the systemic changes that might be considered in the resource-adequacy program and/or long-term procurement planning proceedings and SDG&E submits, with the Calpine Sutter "crisis" temporarily resolved, the Commission should attend to these larger matters with all due and deliberate speed.

F. INDEPENDENT EVALUATOR REPORT

Pursuant to the directions of Resolution E-4471, SDG&E engaged the services of an Independent Evaluator to monitor and supervise the negotiations process. Merrimack Energy Group, Inc., of Portsmouth, New Hampshire, was engaged as the Independent Evaluator to monitor and supervise the negotiations process. Wayne J. Oliver and Ed Selgrade served as the firm's principals for this engagement. Their report, entitled ""*Negotiations of Contracts Between San Diego*

[6] Importantly, the SDG&E-Calpine Sutter agreement is subject to a condition precedent requiring that all three utilities must successfully execute contracts with Calpine Sutter and receive acceptable regulatory approvals for those contracts. Absent this condition, SDG&E would face the potential that SDG&E would be responsible for the share of Calpine Sutter capacity bought and sold under its agreement with Calpine Sutter and, if it were the only utility buying Calpine Sutter capacity directly, the California ISO could still go on to procure the remainder of the available Calpine Sutter capacity pursuant to its CPM tariffs. In that event, SDG&E would be allocated a ratable share of the ISO's CPM procurement costs in addition to the costs of its contract and would thereby bear obligations for a disproportionate and unfair share of costs associated with saving Calpine Sutter from retirement.

Gas and Electric and Calpine Corporation for the Sutter Energy Center In Conjunction with Resolution E-4417: Report of the Independent Evaluator on the Contract Negotiation Process," dated May 4, 2012, regarding the negotiations that took place between SDG&E and Calpine Sutter is attached as Attachment C to this Advice Letter. There are two versions of this report: a public version which omits references to products and prices that were discussed by the parties; and, a confidential and privileged version where the full details of the negotiations are provided.

In its Report, the Independent Evaluator concludes that the negotiations between SDG&E and Calpine Sutter were conducted in good faith and in a manner consistent with the Commission's directions. The Independent Evaluator finds the terms and conditions of the confirm negotiated by SDG&E and Calpine Sutter to be reasonable, and recommends the Commission approve the SDG&E-Calpine Sutter resource-adequacy confirm. SDG&E submits this recommendation, insofar as it is based in part on the reasonableness of the pricing terms negotiated by the parties, provides further evidence that recovery of the costs of the agreement would result in just and reasonableness rates. Importantly, in reaching its conclusions, the Independent Evaluator had access to Calpine Sutter's data regarding 2012 cost of operations as well as direct knowledge of the negotiations conducted by Calpine Sutter and the other two utilities and, unlike SDG&E which did not have access to these data or any knowledge of the Calpine Sutter negotiations with the other utilities, could evaluate the pricing terms in light of Calpine Sutter's revenue requirements. Thus, the Independent Evaluator's recommendation provides a wholly independent and sufficient basis upon which the Commission may find the SDG&E-Calpine Sutter resource-adequacy confirm reasonable.

G. NON-BYPASSABLE CHARGE

Resolution E-4471 directed SDG&E to include tariff sheets in this Advice Letter to recover the cost of the Calpine Sutter agreement through a non-bypassable charge imposed on all benefitting customers.[7]

In A.11-05-023, SDG&E requested the approval of Local Generation Balancing Account (LGBA) and the Local Generation Charge rate component to record and recover the costs and benefits of new generation to be shared by all benefiting customers pursuant to D.06-07-029 which adopted a Cost Allocation Mechanism (CAM). SDG&E intends to recover the costs of the Calpine Sutter contract using these same mechanisms. However, this proceeding is still pending before the Commission.

Specifically, at this time, SDG&E is requesting approval to establish a memorandum account, the Sutter Energy Center Memorandum Account (SECMA), in which it will record the costs of the SDG&E-Calpine Sutter resource-adequacy confirm until the LGBA is approved. SDG&E is requesting authority to transfer the costs recorded in the SECMA to the LGBA upon Commission approval of the LGBA or to a different balancing account, if deemed appropriate by the Commission.

Pursuant to OP No. 5 of Resolution E-4471, SDG&E includes tariff sheets that will authorize SDG&E to record the costs of the SDG&E-Calpine Sutter resource-adequacy confirm in the Sutter Energy Center Memorandum Account (SECMA) in Attachment A.

[7] Resolution E-4471 at p.13 (Ordering Paragraph 5).

H. NECESSARY REGULATORY FINDINGS, CONCLUSIONS AND ORDERS

The SDG&E-Calpine Sutter resource-adequacy confirm is conditioned on the receipt of timely and acceptable regulatory approval, provided further that such approval bears no unacceptable material modifications to the terms of the agreement or impairing the rights of either parties contemplated under the agreement. In issuing these approvals, SDG&E respectfully requests the Energy Division and Commission should enter each and every of the following findings, conclusions and orders:

Necessary Findings of Fact

- Pursuant to the terms of Resolution E-4471 issued by the Commission March 29, 2012, SDG&E and Calpine Sutter entered into good faith negotiations for SDG&E to buy and Calpine Sutter to sell a capacity-oriented product for the purpose of keeping Calpine Sutter online in 2012.

- The negotiations conducted by SDG&E and Calpine Sutter resulted in the execution by both parties of a resource-adequacy confirm on or about May 4, 2012. The confirm, attached to SDG&E Advice Letter 2354-E, complies with the Commission's direction in Resolution E-4471.

- The terms and conditions of the resource-adequacy confirm executed by SDG&E and Calpine Sutter will result in a cost to SDG&E ratepayers that is less than would result from comparable costs that might otherwise be paid under the California ISO's CPM tariff rate.

- To the extent the SDG&E-Calpine Sutter resource-adequacy confirm contributes to the ability of Calpine Sutter to remain in operation, this agreement will permit the Commission and the California ISO to gather further information regarding the effect units offering dynamic-transfer capability and delivering energy via a pseudo-tie interconnection will have on ISO system operations vis-à-vis recently revised ISO tariffs related to such units.

- The Independent Evaluator, retained under the direction of the Commission, attended and participated in the negotiations between SDG&E and Calpine Sutter.

- The Independent Evaluator concluded that the negotiations were conducted in good faith by both parties, and recommends that the Commission approve the SDG&E-Calpine Sutter resource-adequacy confirm as being reasonable.

- The conclusions and recommendations of the Independent Evaluator are based, in part, on its review of Calpine Sutter's data regarding the unit's 2012 costs of operation and its direct knowledge of the negotiations conducted between Calpine Sutter and the other two utilities, information that was not available to SDG&E during its negotiations with Calpine Sutter.

- **[If the Commission does not adopt the findings related to the Path 26 Counting Constraint set forth in the separate section below:]** Notwithstanding that SDG&E may be unable to include some or all of the capacity provided under the SDG&E-Calpine Sutter resource-adequacy confirm in its system resource-adequacy demonstrations filed with the Commission and the California ISO, the confirm provides substantial benefits to SDG&E, SDG&E customers and the public interest by allowing SDG&E to avoid the costs of any CPM designation which Calpine Sutter might otherwise receive and, further, by permitting the Commission and the California ISO to gather further information regarding the effect units offering dynamic-transfer capability and delivering energy via a pseudo-tie interconnection will have on ISO system operations vis-à-vis recently revised ISO tariffs related to such units.

- The Sutter Energy Center Memorandum Account proposed by SDG&E for the recording of costs related to the SDG&E-Calpine Sutter resource-adequacy confirm complies with the terms of Commission Resolution E-4471.

Necessary Conclusions of Law

- Because the costs to SDG&E's ratepayers under the SDG&E-Calpine Sutter resource-adequacy confirm will be lower than would otherwise be the case were Calpine Sutter to receive CPM payments from the ISO as a unit at risk of retirement, with an allocable share of those costs assigned to SDG&E's ratepayers, the SDG&E-Calpine Sutter resource-adequacy confirm will result in rates that are just and reasonable and should be approved.

- Because the SDG&E-Calpine Sutter resource-adequacy confirm will contribute to the Commission's and the California ISO's ability to gather further information regarding the effect units with dynamic-transfer capability and delivering energy via a pseudo-tie interconnection will have on ISO system operations vis-à-vis recently revised ISO tariffs related to such units, the SDG&E-Calpine Sutter agreement is in the public interest and should be approved.

- The conclusions and recommendations of the Independent Evaluator provide an independent and sufficient basis upon which the Commission may find the SDG&E-Calpine Sutter resource-adequacy confirm to be reasonable as to its terms and conditions.

- The Sutter Energy Center Memorandum Account proposed by SDG&E for the recording of costs related to the SDG&E-Calpine Sutter resource-adequacy confirm complies with the terms of Resolution E-4471 and should be approved so as to allow SDG&E to record the costs of the SDG&E-Calpine Sutter confirm until appropriate cost recovery mechanisms are implemented.

Necessary Orders

- SDG&E Advice Letter 2354-E is approved.

- SDG&E is authorized to enter into the resource-adequacy confirm between SDG&E and Calpine Sutter dated May 4, 2012, and to perform pursuant to each of the terms and conditions included in that agreement.

- The Sutter Energy Center Memorandum Account proposed by SDG&E for the recording of costs related to the SDG&E-Calpine Sutter resource-adequacy confirm complies with the terms of Resolution E-4471 and should be approved so as to allow SDG&E to record the costs of the SDG&E-Calpine Sutter confirm until appropriate cost recovery mechanisms are implemented.

SDG&E further requests that the Commission grant SDG&E a waiver of the "Path 26 Counting Constraint". The Path 26 Counting Constraint, adopted by the Commission in its prior orders related to the resource-adequacy program, could limit SDG&E's ability to include Calpine Sutter capacity in its 2012 system resource-adequacy demonstrations. A waiver of this rule would allow SDG&E and its customers to enjoy the greatest benefit from the confirm, and therefore is in the public interest. If the Commission grants the waiver, it should adopt the following findings, conclusions and orders:

Additional Findings

- Calpine Sutter is located in the generation zone north of Path 26.

- Pursuant to various orders of the Commission regarding the resource-adequacy program, SDG&E is subject to certain limitations on its ability to include resource-adequacy resources located north of Path 26 in its system resource-adequacy demonstrations filed with the Commission and the California ISO.

- In order for SDG&E to count the resource-adequacy capacity to be provided by Calpine Sutter pursuant to the SDG&E-Calpine Sutter resource-adequacy confirm, the limitations on SDG&E's ability to include resource-adequacy resources located north of Path 26 in its system resource-adequacy demonstrations filed with the Commission and the California ISO would need to be waived.

- In the absence of a waiver of the limitations on SDG&E's ability to include resource-adequacy resources located north of Path 26 in its system resource-adequacy demonstrations filed with the Commission and the California ISO, the value of the SDG&E-Calpine Sutter waiver to SDG&E's ratepayers would be diluted.

Additional Conclusions of Law

- In the absence of a waiver of the limitations on SDG&E's ability to include resource-adequacy resources located north of Path 26 in its system resource-adequacy demonstrations filed with the Commission and the California ISO, the value of the SDG&E-Calpine Sutter transaction to SDG&E's ratepayers would be diluted.

- It is in the public interest for the Commission to waive, for the resource-adequacy capacity provided by Calpine Sutter to SDG&E under the terms of the SDG&E-Calpine Sutter resource-adequacy confirm, the limitations on SDG&E's ability to include resource-adequacy resources located north of Path 26 in its system resource-adequacy demonstrations filed with the Commission and the California ISO.

Additional Order

- SDG&E is authorized to include the resource-adequacy capacity provided by Calpine Sutter to SDG&E under the terms of the SDG&E-Calpine Sutter resource-adequacy confirm in its 2012 system resource-adequacy demonstrations filed with the Commission and the California ISO without regard to the limitations on SDG&E's ability to include system resource-adequacy resources located north of Path 26 as adopted in prior Commission orders.

I. EFFECTIVE DATE

Pursuant to Resolution E-4471, this Advice Letter filing should be treated as a Tier 2 advice letter, subject to Energy Division disposition[8]. SDG&E respectfully requests this Advice Letter be approved no later than May 25, 2012, which is the date agreed upon by the parties to the agreement as the "outside date" by which time final approvals of this advice letter must be received. This date is important to both parties to the agreement. From SDG&E's perspective, SDG&E is required to file its month-ahead resource-adequacy compliance demonstration for the month beginning July 1, 2012, no later than May 31, 2012. Approval of the agreement by May 31st, then, is necessary in order for SDG&E to include the resource-adequacy capacity procured through the attached agreement in SDG&E's upcoming resource-adequacy demonstration. (In addition, SDG&E is also requesting that the Commission waive the resource-adequacy program convention commonly referenced as "the Path 26 Counting Constraint" and described in this advice letter so as to permit SDG&E to include the full extent of the resource-adequacy capacity being procured from Calpine in its resource-adequacy demonstrations for the term of the agreement.)

J. PROTEST

Anyone may protest this Advice Letter to the Commission. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. **SDG&E requests a shortened protest period, in order for the Energy Division to have time to consider any such protests in its decision whether to approve the Advice Letter by May 25, 2012. SDG&E requests that protests be due no later than May 18, 2012, fourteen days from the date this Advice Letter was filed. SDG&E also proposes a shortened protest reply period, such that replies would be due on May 22, 2012, four days from the last day for protest. The protest must be made in writing and must be received by May 18, 2012, fourteen days from the date filed.** There is no restriction on who may file a protest. The address for mailing or delivering a protest to the Commission is:

[8] Resolution E-4471, at p.13 (Ordering Paragraph 3).

CPUC Energy Division
Attention: Tariff Unit
505 Van Ness Avenue
San Francisco, CA 94102

Copies of the protest should also be sent via e-mail to EDTariffUnit@cpuc.ca.gov. A copy of the protest should also be sent via both e-mail and facsimile to the address shown below on the same date it is mailed or delivered to the Commission.

Attn: Megan Caulson
Regulatory Tariff Manager
8330 Century Park Court, Room 32C
San Diego, CA 92123-1548
Facsimile No. (858) 654-1879
E-Mail: mcaulson@semprautilities.com

K. NOTICE

A copy of this filing has been served on the utilities and interested parties shown on the attached list including parties in R.12-03-014 and R.11-10-023 by either providing them a copy electronically or by mailing them a copy hereof, properly stamped and addressed.

Address changes should be directed to SDG&E Tariffs by facsimile at (858) 654-1879 or by e-mail at SDG&ETariffs@semprautilities.com.

CLAY FABER
Director - Regulatory Affairs

(cc list enclosed)

CALIFORNIA PUBLIC UTILITIES COMMISSION

ADVICE LETTER FILING SUMMARY
ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No. **SAN DIEGO GAS & ELECTRIC (U 902)**

Utility type:
☒ ELC ☐ GAS
☐ PLC ☐ HEAT ☐ WATER

Contact Person: Joff Morales
Phone #: (858) 650-4098
E-mail: jmorales@semprautilities.com

EXPLANATION OF UTILITY TYPE
ELC = Electric GAS = Gas
PLC = Pipeline HEAT = Heat WATER = Water

(Date Filed/ Received Stamp by CPUC)

Advice Letter (AL) #: 2354-E

Subject of AL: Compliance with Resolution E-4471 to enter into Contract with Sutter Energy Center

Keywords (choose from CPUC listing): Procurement, Power Purchase Agreement

AL filing type: ☐ Monthly ☐ Quarterly ☐ Annual ☐ One-Time ☒ Other

If AL filed in compliance with a Commission order, indicate relevant Decision/Resolution #:

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL: None

Summarize differences between the AL and the prior withdrawn or rejected AL[1]: N/A

Does AL request confidential treatment? If so, provide explanation: Yes See attached

Resolution Required? ☐ Yes ☒ No

Tier Designation: ☐ 1 ☒ 2 ☐ 3

Requested effective date: 5/4/2012

No. of tariff sheets: 3

Estimated system annual revenue effect: (%): N/A

Estimated system average rate effect (%): N/A

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected: Table Contents, SECMA

Service affected and changes proposed[1]: None

Pending advice letters that revise the same tariff sheets: None

Protests and all other correspondence regarding this AL are due no later than 20 days after the date of this filing, unless otherwise authorized by the Commission, and shall be sent to:

CPUC, Energy Division
Attention: Tariff Unit
505 Van Ness Ave.,
San Francisco, CA 94102
EDTariffUnit@cpuc.ca.gov

San Diego Gas & Electric
Attention: Megan Caulson
8330 Century Park Ct, Room 32C
San Diego, CA 92123
mcaulson@semprautilities.com

[1] Discuss in AL if more space is needed.

General Order No. 96-B
ADVICE LETTER FILING MAILING LIST

cc: (w/enclosures)

Public Utilities Commission
DRA
Y. Schmidt
W. Scott
Energy Division
P. Clanon
S. Gallagher
H. Gatchalian
D. Lafrenz
M. Salinas
CA. Energy Commission
F. DeLeon
R. Tavares
Alcantar & Kahl LLP
K. Harteloo
American Energy Institute
C. King
APS Energy Services
J. Schenk
BP Energy Company
J. Zaiontz
Barkovich & Yap, Inc.
B. Barkovich
Bartle Wells Associates
R. Schmidt
Braun & Blaising, P.C.
S. Blaising
California Energy Markets
S. O'Donnell
C. Sweet
California Farm Bureau Federation
K. Mills
California Wind Energy
N. Rader
CCSE
S. Freedman
J. Porter
Children's Hospital & Health Center
T. Jacoby
City of Chula Vista
M. Meacham
E. Hull
City of Poway
R. Willcox
City of San Diego
J. Cervantes
G. Lonergan
M. Valerio
Commerce Energy Group
V. Gan
Constellation New Energy
W. Chen
CP Kelco
A. Friedl
Davis Wright Tremaine, LLP
E. O'Neill
J. Pau
Dept. of General Services
H. Nanjo
M. Clark
Douglass & Liddell
D. Douglass
D. Liddell
G. Klatt
Duke Energy North America
M. Gillette
Dynegy, Inc.
J. Paul
Ellison Schneider & Harris LLP
E. Janssen
Energy Policy Initiatives Center (USD)
S. Anders
Energy Price Solutions
A. Scott
Energy Strategies, Inc.
K. Campbell
M. Scanlan
Goodin, MacBride, Squeri, Ritchie & Day
B. Cragg
J. Heather Patrick
J. Squeri
Goodrich Aerostructures Group
M. Harrington
Hanna and Morton LLP
N. Pedersen
Itsa-North America
L. Belew
J.B.S. Energy
J. Nahigian
Luce, Forward, Hamilton & Scripps LLP
J. Leslie
Manatt, Phelps & Phillips LLP
D. Huard
R. Keen
Matthew V. Brady & Associates
M. Brady
Modesto Irrigation District
C. Mayer
Morrison & Foerster LLP
P. Hanschen
MRW & Associates
D. Richardson
OnGrid Solar
Andy Black
Pacific Gas & Electric Co.
J. Clark
M. Huffman
S. Lawrie
E. Lucha
Pacific Utility Audit, Inc.
E. Kelly
R. W. Beck, Inc.
C. Elder
School Project for Utility Rate Reduction
M. Rochman
Shute, Mihaly & Weinberger LLP
O. Armi
Solar Turbines
F. Chiang
Sutherland Asbill & Brennan LLP
K. McCrea
Southern California Edison Co.
M. Alexander
K. Cini
K. Gansecki
H. Romero
TransCanada
R. Hunter
D. White
TURN
M. Florio
M. Hawiger
UCAN
M. Shames
U.S. Dept. of the Navy
K. Davoodi
N. Furuta
L. DeLacruz
Utility Specialists, Southwest, Inc.
D. Koser
Western Manufactured Housing Communities Association
S. Dey
White & Case LLP
L. Cottle
Interested Parties
R.12-03-014
R.11-10-023

ATTACHMENT A
ADVICE LETTER 2354-E

Cal. P.U.C. Sheet No.	Title of Sheet	Canceling Cal. P.U.C. Sheet No.
Original 22847-E	PRELIMINARY STATEMENT, III. MEMORANDUM ACCOUNTS, SUTTER ENERGY CENTER MEMORANDUM ACCOUNT (SECMA), Sheet 1	
Revised 22849-E	TABLE OF CONTENTS, Sheet 1	Revised 22831-E
Revised 22850-E	TABLE OF CONTENTS, Sheet 3	Revised 22823-E

PRELIMINARY STATEMENT

III. MEMORANDUM ACCOUNTS
SUTTER ENERGY CENTER MEMORANDUM ACCOUNT (SECMA)

1. Purpose

Pursuant to Resolution E-4471, the purpose of the SECMA is to record the cost of entering into a contract with Calpine Corporation for the Sutter Energy Center (Sutter). The SECMA is an interest bearing memorandum account that is recorded on the Utility's financial statements.

2. Applicability

The SECMA shall apply to the Utility's benefiting customers[1] unless otherwise specified by the Commission.

3. Rates

The SECMA does not have a rate component.

4. Accounting Procedure

The Utility shall maintain the SECMA by making entries at the end of each month as follows:

a. A debit entry equal to costs associated with the Sutter Energy Center Contract, including:

   a. Capacity costs

b. A debit or credit entry equal to the interest shall be calculated on the average of the balance at the beginning of the month and the balance after entries in 4.a above, at a rate equal to one-twelfth of the interest rate on three-month Commercial Paper for the previous month, as reported in the Federal Reserve Statistical Release, H.15, or its successor publication.

c. An entry to transfer the balance in the SECMA after performing procedures 4.a. through 4.b. to the appropriate balancing account as approved by the Commission

5. Disposition

The SECMA balance shall be transferred to a Local Generating Balancing Account (LGBA) upon approval by the Commission, or to another balancing account as otherwise directed. Once the final costs are transferred, the SECMA will be closed.

[1] "Benefiting customers" are defined in D.06-07-029 as all Bundled Service Customers, Direct Access Customers, Community Choice Aggregation Customers, and customers who are located or locate within the distribution territory of an investor-owned utility but take service from a local publicly-owned utility subsequent to the date that the new generation goes into service.

TABLE OF CONTENTS

The following sheets contain all the effective rates and rules affecting rates, service and information relating thereto, in effect on the date indicated herein.

(Continued)

TABLE OF CONTENTS

(Continued)

San Diego Gas & Electric Advice Letter 2354-E
May 4, 2012

DECLARATION OF NUO TANG REGARDING CONFIDENTIALITY OF CERTAIN DATA

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DECLARATION OF NUO TANG REGARDING CONFIDENTIALITY OF CERTAIN DATA

I, Nuo Tang, do declare as follows:

1. I am a Senior Energy Administrator for San Diego Gas & Electric Company ("SDG&E"). I have reviewed Advice Letter 2354-E, requesting approval of a resource-adequacy contract with Sutter Energy Center (with attached confidential and public appendices), dated May 4, 2012 ("Advice Letter"). I am personally familiar with the facts and representations in this Declaration and, if called upon to testify, I could and would testify to the following based upon my personal knowledge and/or belief.

2. I hereby provide this Declaration in accordance with D.06-06-066, as modified by D.07-05-032, and D.08-04-023, to demonstrate that the confidential information ("Protected Information") provided in the Advice Letter submitted concurrently herewith, falls within the scope of data protected pursuant to the IOU Matrix attached to D.06-06-066 (the "IOU Matrix").

3. I address below each of the following five features of Ordering Paragraph 2 in D.06-06-066:

- That the material constitutes a particular type of data listed in the Matrix,
- The category or categories in the Matrix to which the data corresponds,
- That it is complying with the limitations on confidentiality specified in the Matrix for that type of data,
- That the information is not already public, and

- That the data cannot be aggregated, redacted, summarized, masked or otherwise protected in a way that allows partial disclosure.[1/]

4. SDG&E's Protected Information: As directed by the Commission, SDG&E demonstrates in table form below that the instant confidentiality request satisfies the requirements of D.06-06-066:[2/]

Data at issue	D.06-06-066 Matrix Requirements	How moving party meets requirements
1. ***Sutter Advice Letter Attachment B***	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided is non-public bid information from the negotiations. The data provided also includes Bilateral contract terms and conditions
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VIII.B and VII. B respectively.
2. ***Independent Evaluator Report Section IV- Description of Contract Negotiation Process (pg 12)***	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided is non-public bid information from the negotiations.
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VIII.A.

1/ D.06-06-066, as amended by D.07-05-032, *mimeo*, p. 81, Ordering Paragraph 2.

2/ *See, Administrative Law Judge's Ruling on San Diego Gas & Electric Company's Motions to File Data Under Seal,* issued April 30 in R.06-05-027, p. 7, Ordering Paragraph 3 ("In all future filings, SDG&E shall include with any request for confidentiality a table that lists the five D.06-06-066 Matrix requirements, and explains how each item of data meets the matrix").

Data at issue	D.06-06-066 Matrix Requirements	How moving party meets requirements
3. ***Independent Evaluator Report Exhibit 1 and Exhibit 2 (pg 13 – 18)***	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided is non-public bid information from the negotiations and SDG&E's quantitative analysis of the bid information
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VIII.A and VIII. B
4. ***Independent Evaluator Report Section V - Contract Summary and Review (pg 18 – 19)***	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided also includes bilateral contract terms and conditions of contract with non-affiliated third parties
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VII.B and VIII. B
5. ***Independent Evaluator Report Section VI – Recommendation For Contract Approval (pg 19 – 21)***	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided is non-public bid information from the negotiations. The data provided also includes bilateral contract terms and conditions
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VIII.B and VII. B respectively.
6. ***Independent Evaluator Report Section VII – Conclusions (pg. 22)***	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided is non-public bid information from the negotiations.
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VIII.A.

Data at issue	D.06-06-066 Matrix Requirements	How moving party meets requirements
7. *Calpine Sutter RA Confirm*	Demonstrate that the material submitted constitutes a particular type of data listed in the IOU Matrix	The data provided also includes bilateral contract terms and conditions
	Identify the Matrix category or categories to which the data corresponds	This information is protected under IOU Matrix category VII.B.

5. As an alternative basis for requesting confidential treatment, SDG&E submits that the resource-adequacy confirm enclosed in the Advice Letter is material, market sensitive, electric procurement-related information protected under §§ 454.5(g) and 583, as well as trade secret information protected under Govt. Code §§ 6254(k) and 6254.15 by providing market participants with detailed information regarding prices, terms and conditions offered to and by SDG&E for competitively offered and purchased products. Disclosure of this information would place SDG&E at an unfair business disadvantage, thus triggering the protection of G.O. 66-C.[1]/

6. Public Utilities Code § 454.5(g) provides:

> The commission shall adopt appropriate procedures to ensure the confidentiality of any market sensitive information submitted in an electrical corporation's proposed procurement plan or resulting from or related to its approved procurement plan, including, but not limited to, proposed or executed power purchase agreements, data request responses, or consultant reports, or any combination, provided that the [Division] of Ratepayer Advocates and other consumer groups that are nonmarket participants shall be provided access to this information under confidentiality procedures authorized by the commission.

[1]/ This argument is offered in the alternative, not as a supplement to the claim that the data is protected under the IOU Matrix. California law supports the offering of arguments in the alternative. *See, Brandolino v. Lindsay*, 269 Cal. App. 2d 319, 324 (1969) (concluding that a plaintiff may plead inconsistent, mutually exclusive remedies, such as breach of contract and specific performance, in the same complaint); *Tanforan v. Tanforan*, 173 Cal. 270, 274 (1916) ("Since . . . inconsistent causes of action may be pleaded, it is not proper for the judge to force upon the plaintiff an election between those causes which he has a right to plead.")

7. General Order 66-C protects "[r]eports, records and information requested or required by the Commission which, if revealed, would place the regulated company at an unfair business disadvantage."

8. Under the Public Records Act, Govt. Code § 6254(k), records subject to the privileges established in the Evidence Code are not required to be disclosed.[3/] Evidence Code § 1060 and Government Code §6254.15 provide a privilege and protection for trade secrets, which Civil Code § 3426.1 defines, in pertinent part, as information that derives independent economic value from not being generally known to the public or to other persons who could obtain value from its disclosure.

9. Public Utilities Code § 583 establishes a right to confidential treatment of information otherwise protected by law.[4/]

10. If disclosed, the Protected Information could provide parties, with whom SDG&E is currently negotiating, insight into SDG&E's procurement needs, which would unfairly undermine SDG&E's negotiation position and could ultimately result in increased cost to ratepayers. In addition, if developers mistakenly perceive that SDG&E is not committed to assisting their projects, disclosure of the Protected Information could act as a disincentive to developers. Accordingly, pursuant to P.U. Code § 583, SDG&E seeks confidential treatment of this data, which falls within the scope of P.U. Code § 454.5(g), Evidence Code § 1060, Government Code §6254.15 and General Order 66-C.

11. Developers' Protected Information: The Protected Information also constitutes confidential trade secret information of the developer listed therein. SDG&E

3/ *See also* Govt. Code § 6254.7(d).
4/ *See*, D.06-06-066, *mimeo*, pp. 26-28.

is required pursuant to the terms of its resource-adequacy contract to protect non-public information. Some of the Protected Information in the resource-adequacy contract (including confidential appendices), and my supporting declaration relates directly to commercial aspects of the respective transaction. Disclosure of this extremely sensitive information could harm the owners' ability to negotiate necessary contracts and/or could invite interference from competitors.

12. In accordance with its obligations under its resource-adequacy contract and pursuant to the relevant statutory provisions described herein, SDG&E hereby requests that the Protected Information be protected from public disclosure for one year following expiration of the contract.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed this 4th day of May, 2012, at San Diego, California.

Nuo Tang
Senior Energy Administrator
Electric and Fuel Procurement
San Diego Gas & Electric

San Diego Gas & Electric Advice Letter 2354-E
May 4, 2012

Public Version of the IE Report

Negotiation of Contract Between San Diego Gas and Electric and Calpine Corporation for the Sutter Energy Center

In Conjunction with Resolution E-4417

Report of the Independent Evaluator On the Contract Negotiation Process

Public Redacted Version

May 4, 2012

Prepared by
Merrimack Energy Group, Inc.

Table of Contents

I. Introduction

Overview

On March 22, 2012 the Public Utilities Commission of the State of California (" CPUC" or "Commission") issued a Resolution ("Resolution E-4471") which orders Pacific Gas & Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and San Diego Gas & Electric Company ("SDG& E") (jointly referred to as "IOUs") to enter negotiations with the Calpine Corporation ("Calpine") with regard to a contract with the Sutter Energy Center ("Sutter") for a price less than that available under the Capacity Procurement Mechanism ("CPM") for plants designated at risk of retirement .[1] The inability of the Sutter plant to earn market revenues sufficient to cover "going forward' costs and the actions to obtain permission to shut down and/or to obtain relief under the California Independent Operato r ("CAISO") CPM program are reviewed in some detail in the Resolution.[2] In short, t he purpose of this Resolution is to try to keep the Sutter plant online in 2012 by ordering that the subject negotiation occur. The Resolution does not require that contracts be executed , but if they are , and if they are approval, they would provide sufficient revenues to cause Calpine to keep the Sutter plant in operation . The Resolution indicates that this will enable further analysis of the impacts of current and proposed dynamic transfer tariff changes at CAISO.

In the Resolution, the CPUC identified the following conclusions and directives with regard to negotiations between the IOU's and Calpine:

1. The IOU's should jointly negotiate a limited term contract with Calpine;
2. The contract should be executed in a manner that minimizes cost to ratepayers;
3. It is expected that in the contract the costs should be significantly below what would be paid if the Sutter plant were subject to the Capacity Procurement Mechanism ;
4. A not to exceed cost of $2.95 million per month, up to a n absolute maximum total CPM cost of $17.4 million is established based on the CAISO's filing at the FERC;

---

[1] The Sutter Energy Center is located in Yuba City, California. Sutter is a 572 MW nameplate capacity gas-fired combined cycle power plant with a Net Qualifying Capacity of 525 MW. The plant came on line in May, 2001. The plant is compris ed of two gas turbines, each with a dependable capacity of 185 MW and one steam turbine with a net dependable capacity of 191 MW. As noted in Resolution E -4471, the plant is air cooled rather than once through water cooled and is not located in a local cap acity area. The Sutter plant is not directly connected to the CAISO but is one of a small number of resources using a pseudo -tie to connect to the CAISO grid. The pseudo -tie allows the Sutter plant to provide resources more flexibly than via traditional im port rules, using the CAISO's dynamic transfer tariff. The Federal Energy Regulatory Commission ("FERC") acceptance with modifications of the CAISO pseudo -tie agreement allowed the CAISO to dispatch the Sutter plant, and allows Calpine to receive revenues from CAISO markets. The Sutter plant also has flexible ramping capability that allows discrete portions of its capacity to be dispatched as needed to satisfy demand.

[2] The Sutter plant does not meet all conditions for designation as a plant at risk of reti rement under the CAISO Tariff. As a result, CAISO, as explained in the Resolution, has a pending petition before the Federal Energy Regulatory Commission ("FERC"), action on which may not come in a timely fashion or in the form requested.

5. The IOUs shall complete negotiations (or not complete negotiations) and file an Advice Letter within 30 days from the effective date of the resolution;
6. It is prudent for the IOUs to engage an Independent Evaluator as part of the contract oversight process . The Independent Evaluator shall include their report when the joint Tier 2 advice letter is filed;
7. As part of these negotiations, Calpine shall provide cash flow models and other detailed financial information to the Energy Division and the Independent Evaluator.[3]

The Resolution also identified as an objective to keep the Sutter plant online i n 2012 and to enable further analysis of current and proposed "dynamic transfer" tariff changes at the CAISO. Resolution E -4471 concluded that there is need for more information on the strengths, weaknesses and capabilities of connecting to the grid throug h a pseudo -tie using the CAISO's dynamic transfer tariff and therefore , there is need for the continued operation of the Sutter plant.

On March 30, 2012 , the Commission confirmed that it will actively supervise the negotiations between Calpine and IOU's a nd clarified that the effective date of the Resolution for purposes of triggering the 30-day period in which to complete negotiations and submit a Tier 2 advice letter is the date of publication, March 29, 2012. Commission supervision of the contract will occur via the retention of an Independent Evaluator engaged by the IOU's for purposes of monitoring the negotiations on behalf of the Commission. As required by the Resolution, the IE will submit a report after the conclusion of the negotiations which shall be included along with a Tier 2 Advice Letter . Finally, the Commission will review the materials submitted by the IE along with the joint Tier 2 advice letter and make a determination.

Pursuant to these requirements, the IOU's engaged Merrimack Energy Group, Inc. to serve as the IE. [4]

Proposed Plant Shutdown and CAISO Report

On November 22, 2011, Calpine filed a GO 167 notice with the Commission stating that it was planning on retiring the Sutter plant in 2012 due to a lack of resource adequacy (RA) contract s. On the same day, Calpine submitted a request to the CAISO and all required supporting documentation, for designation of the Sutter plant as CPM capacity for 2012. The Calpine request stated that absent such a CPM designation, the Sutter plant will be retired in 2012 and will not be available for commercial operations in 2013 and later years. To date, the Sutter plant has not operated in calendar year 2012.

As identified in the CAI SO Report, Section 43.1.2 of the CAISO Tariff authorizes the CAISO to designate Eligible Capacity to provide CPM Capacity services in order to

[3] In the Finding associated with the Resolution the Commission stated that "use of "open book" financial information provides an additional layer of oversight for the Commission in assessing a contract."
[4] Merrimack Energy Group, Inc. is the only IE that is included in the IE pool for all three utilities (i.e., Pacific Gas & Electric, San Diego Gas & Electric and Southern California Edison).

address six listed types of circumstances. One of the CPM categories consists of the procurement of capacity at risk of retirement within the current Resource Adequacy (RA) Compliance Year that will be needed for reliability by the end of the calendar year following the current RA Compliance Year. Section 43.2.6 of the CAISO Tariff states that the CAISO may issue a CPM designation for such capacity at risk of retirement in the event that all of the following requirements apply:

1. The resource was not contracted as RA Capacity nor listed as RA Capacity in any Load Serving Entity's (LSE) annual RA Plan during the current RA Compliance Year;

2. The CAISO did not identify any deficiency, individual or collective, in an LSE's annual RA Plan for the current RA Compliance Year that resulted in a CPM designation for the resource in the current RA Compliance Year;

3. CAISO technical assessments project that the resource will be needed for reliability purposes, either for its locational or operational characteristics, by the end of the calendar year following the current RA compliance Year;

4. No new generation is projected by the CAISO to be in operation by the start of the subsequent RA Compliance Year that will meet the identified reliability need; and

5. The resource owner submits to the CAISO and the Department of Market Monitoring (DMM), at least 180 days prior to terminating the resource's Participating Generator Agreement (PGA) or removing the resource from PGA Schedule 1, a request for a CPM designation under Section 43.2.6 and the affidavit of an executive officer of the company who has the legal authority to bind such entity, with the supporting financial information and documentation discussed in the Business Practice Manual (BPM) for Reliability Requirements, that attests that it will be uneconomic for the resource to remain in service in the current RA Compliance Year and that the decision to retire is definite unless CPM procurement occurs.

On December 6, 2011, the California ISO issued its report on Calpine's request entitled "California ISO Report on Basis and Need for CPM Designation for Sutter Energy Center." The Report addresses the basis and need for the CAISO to designate the Sutter Energy Center as capacity at risk of retirement, pursuant to the provisions of the CAISO Tariff regarding the CPM.

The CAISO's review confirmed that the Sutter plant was not contracted as RA Capacity nor listed as RA Capacity in any LSE's annual Resource Adequacy Plan during the current RA Compliance Year, i.e., during 2012.

The CAISO conducted analysis, including technical assessments, which projects that the Sutter plant will be needed for reliability purposes, specifically for its operational characteristics, in the 2017/2018 time frame. The CAISO determined through its study

that there is no additional new capacity with needed flexibility projected to come online in time to meet the ident ified need. The retirement of existing capacity with the required flexible characteristics would pose a significant risk to reliability.

On December 6, 2011, the CAISO r eported that it intended to make a filing with FERC requesting a waiver of existing t ariff provisions that currently limit the procurement of capacity at risk of retirement to cases in which capacity is needed in the next resource adequacy compliance year, a condition which the Sutter plant does not meet . The waiver if granted will enable the CAISO to procure the Sutter capacity for 2012 based on the CAISO's determination of need by the end of 2017.

Calpine's CAISO Filings

As noted, on November 22, 2012, Calpine Corporation submitted a request for CPM designation of the Sutter Energy Center under CAISO Tariff Section 43.2.6., including an Affidavit of Alexandre Makler in support of Calpine's request. The Affidavit stated that Calpine's economic analysis showed that, under a range of assumptions for projected market revenues in 2012 (assumi ng either flat prices from 2011 to 2012, or increased 2012 prices, reflective of some forward price curves), Sutter would sustain cash flow losses and be unable to recover its going forward costs in 2012 and subsequent years. Sutter would also not obtain a return of or on invested capital during 2012 and subsequent years. The analyses that Calpine conducted indicate an unacceptable level of risk that Sutter would not recover its going forward costs or meet its cash and investment requirements in 2012 and subsequent years. Calpine considered not only its risk of failure to recover Sutter's going forward costs under reasonable scenarios, but also the uncertainties and risks that it might incur other non -compensable costs during 2012 and later years.

On January 24, 2012, Calpine submitted a supplemental Affidavit of Alexandre Makler to CAISO in connection with CAISO's planned filing with FERC. This supplemental Affidavit addresses Calpine's economic analysis and decision-making in more detail. The Affidavit stated:

> "Neither the Tariff nor the Commission's ("FERC") March 17, 2011 Order prescribes evaluative criteria that a company must use in determining whether it is economic or uneconomic to continue operation of a resource seeking designation as CPM cap acity at risk of retirement. Calpine used its business judgement in conducting relevant analyses and in weighing those analyses and other factors and considerations in making its determinations that it will be uneconomic for Sutter to remain in service in 2012 and that Sutter will be retired in 2012, absent CPM designation as capacity at risk of retirement (or comparable bilateral capacity procurement). Calpine's exercise of its business judgment was not based on any single economic analysis or calculation. Calpine conducted analyses, under reasonable scenarios, that indicated an acceptable level of risk that Sutter would not recover its going forward costs or meet its cash and investment requirements in 2012 and subsequent years. In addition to its assessment of the risk of failure of

recovering its going forward costs and the risk of not meeting cash and investment requirements, Calpine considered the uncertainties and risks that contingencies might occur that would cause the company to incur other non-compensable costs during 2012 and later years. These risks include items such as the risk of a major equipment failure, the substantial risks of deferring maintenance, and the need for additional capital investment in order to meet environmental requirements or to maintain operational characteristics. These contingencies were not explicitly accounted for in the "models" and quantitative analyses used in assessing the risk of failure of recovering the company's going forward costs and the risk of not meeting its cash and investment requirements. Calpine's assessment of these contingency-related uncertainties and risks was informed by the company's business experience and its objectives in allocating limited and discretionary funds among investment alternatives. In short, Calpine's business judgment as to whether it would be economic to operate Sutter in 2012 is not based exclusively on a single analysis showing substantial and sustained losses such as that attached to the Request. Nonetheless, the analyses that Calpine conducted showed, respectively, that Sutter would sustain cash flow losses and would not recover its going forward costs in 2012 and subsequent years, and that Sutter would not obtain a return of or on invested capital during 2012 and subsequent years."

Regulatory Requirements for the Independent Evaluator

The requirements for participation by an Independent Evaluator (IE) in utility solicitations are outlined in decisions D.04-12-048 (Findings of Fact 94-95, Ordering Paragraph 28), D.06-05-039 (Finding of Fact 20, Conclusion of Law 3, Ordering Paragraph 8) of the California Public Utilities Commission (Commission or CPUC) and D.09-06-050.

In Decision 04-12-048 (December 16, 2004), the CPUC required the use of an IE by investor-owned utilities (IOUs) in resource solicitations where there are affiliate, IOU-built or turnkey bidders. The CPUC generally endorsed the guidelines issued by the Federal Energy Regulatory Commission (FERC) for independent evaluation where an affiliate of the purchaser is a bidder in a competitive solicitation, but stated that the role of the IE would not be to make binding decisions on behalf of the utilities or administer the entire process. [5] Instead, the IE would be consulted by the IOU, along with the Procurement Review Group ("PRG") on the design, administration, and evaluation aspects of the Request for Proposals ("RFP"). The Decision identifies the technical expertise and experience of the IE with regard to industry contracts, quantitative evaluation methodologies, power market derivatives, and other aspects of power project development. From a process standpoint, the IOU could contract directly with the IE, in consultation with its PRG, but the IE would coordinate with the Energy Division.

[5] Decision 04-12-048 at 129-37. The FERC guidelines are set forth in Ameren Energy Generating Company, 108 FERC ¶ 61,081 (June 29, 2004).

In Decision 06-05-039 (May 25, 2006), the Commission required each IOU to employ an Independent Evaluator regarding all RFOs issued pursuant to the RPS, regardless of whether there are any utility -owned or affiliate -owned projects under consideration. In addition, the Commission directed the IE for each RFO to provide separate reports (a preliminary report with the shortlist and final reports with IOU advice letters to approve contracts) on the entire bid, solicitation, evaluation and s election process, with the reports submitted to the utility, PRG and Commission and made available to the public (subject to confidential treatment of protected information). The IE would also make periodic presentations regarding its findings to the utili ty and the utility's PRG consistent with preserving the independence of the IE by ensuring free and unfettered communications between the IE and the CPUC's Energy Division, and an open, fair and transparent process that the PRG could confirm.

In D. 09 -06-050 issued on June 18, 2009 in Rulemaking 08 -08-009, Order Instituting Rulemaking to Continue Implementation and Administration of California Renewable Portfolio Standard Program, [6] the CPUC required that bilateral contracts should be reviewed according to the same processes and standards as contracts that come through a solicitation. This includes review by the utility's Procurement Review Group and its IE, including a report filed by the IE.

In D.10-07-042 issued on July 29, 2010, the Commission reaffirm ed the role of the IE and required the Energy Division to revise the IE Template to ensure that the IEs focus on their core responsibility of evaluating whether an IOU conducted a well-designed, fair, and transparent RFO for the purpose of obtaining the lo west market price for ratepayers, taking into account many factors (e.g. project viability, transmission access, etc.).

This report is filed consistent with the above requirements and is generally consistent with the requirements outlined in the CPUC's Short Form IE Report Template.[7]

Issues Addressed in this Report

This report addresses Merrimack Energy's assessment and conclusions regarding the following issues. To maintain consistency with the CPUC Independent Evaluator Report Template requirements for IE reports, this report will address the relevant issues associated with IE template requirements to the extent the requirements are consistent with this assignment.[8]

1. Describe in detail the role of the IE throughout the solicitation and negotiation process;

[6] Decision Establishing Price Benchmarks and Contract Review Processes for Short-Term and Bilateral Procurement Contracts for Compliance With the California Renewable Portfolio Standard.
[7] Based on the unique nature of this project and since the process did not involve a solicitation or the results compared to solicitation results, the report does not address all sections and questions contained in the IE Template.
[8] Since many of the requirements of the IE Template address a solicitation process, the requirements associated specifically with a solicitation process will not be included in the report.

2. Assess the proforma cost information for Sutter provided by Calpine as a basis for assessing the estimated going forward costs;

3. Describe project specific negotiations. Highlight any areas of concern including unique terms and conditions;

4. Was the contract negotiations process undertaken in a fair and consistent manner and consistent with the requirements outlined in the Resolution?

5. Based on your analysis of the contract negotiation process, the objectives of the Resolution and the overall market, do the contracts merit Commission approval?

II. Description of the Role of the IE throughout the Solicitation

In compliance with the above requirements, the IOUs retained Merrimack Energy to serve as Independent Evaluator to oversee the contract negoti ation process between the IOUs and Calpine Sutter and to prepare a report on the contract negotiation process relative to the objectives identified in the Resolution. Th e overall objective of the role of the IE is generally to ensure that the solicitation process or in this case, the contract negotiation process , is undertaken in a fair, consistent, unbiased and objective manner and that the best resources are selected and acquired for the best interest of customers consistent with the objectives outlined in the Resolution.

Description of IE Oversight Activities

The IE was involved in a number of activities and completed several specific tasks in performing its oversight role in connection with the contract negotiation process between the IOU's and Calpine Sutter. The activities of the IE during the process are described below:

- The IE reviewed the process undertaken by the IOUs and Calpine to structure a negotiation approach that met the language in the Resolution for joint negotiations but also did not violate anti-trust considerations;

- The IE monitored the negotiation sessions between the IOUs and Calpine Sutter to ensure the process was undertaken in a fair and equitable manner and that the objective of providing benefits to customers through this process would be met;

- The IE monitored discussions between the IOU's to develop guidelines to ensure the negotiation process would be fair and equitable;

- The IE reviewed the financial information provided by Calpine in support of its request for CPM designation to assess whether the going forward cost estimates submitted by Calpine were reasonable.

Specific tasks and activities of the IE will also be addressed as applicable in other sections of this report.

Comment of the IE Regarding the Complexity of the Proceedings

The compressed time frame, the concentrated nature of three parallel negotiations, and the constraints associated with negotiating what are essentially "going forward", above market, cost of service contracts without open access to cost of service data contributed to a very complex and challenging process for all parties involved. In some cases, negotiations continued through the final weekend before the April 30, 2012 deadline. Document preparation and completion stressed resources but remarkably, not the apparent good faith and civility of the personnel involved. The high level of professional performance of the negotiating parties, evident to the IE throughout the process, speaks well of that good faith and the competence, which each party brought to the task of accomplishing the objectives of the Resolution under these difficult conditions.

III. Economic Analysis Reported to the Energy Division of the Commission

Resolution E-4471 established limited use of "open book" data during the negotiations process since detailed financial documents were provided by Calpine pursuant to the Resolution only to the Energy Division and the Independent Evaluator. The Commission ordered that Calpine shall provide cash flow models and other detailed financial information ("Detailed Financials") to the IE and Energy Division to support their estimated costs.

The Resolution stopped short of ordering the sharing of such information with the three IOUs, although it is assumed for the purposes of this report, that the Commission had the authority to order the direct or indirect disclosure of the Detailed Financials with the three IOUs. This latter approach would have effectively turned the negotiation into an "open book" cost of service negotiation. However, the language in the Resolution would have been drafted in a very different fashion if "open book" negotiations had been intended. As a result, the parties proceeded on the basis that the Resolution did not intend an "open book" approach. The negotiating parties proceeded to execute Non-Disclosure Agreements regarding any data disclosed during negotiations. The operating assumption was that neither the Energy Division nor the Independent Evaluator would disclose the Detailed Financials to the three utilities. The Independent Evaluator was asked by Calpine to execute a confidentiality agreement directly with Calpine. After consultation between attorneys for the Independent Evaluator and Calpine and among the members of the Energy Division, their counsel and counsel for the Independent Evaluator, a letter agreement between the Independent Evaluator and the Energy Division was executed creating a confidentiality obligation on the part of the Independent Evaluator to the

Energy Division not to disclosure except to the Energy Division the Detailed Financials received from Calpine.[9]

While confidential information was not used in the Resolution, t he Resolution did established a maximum cost of $2.95 million per month or an estimated $17.4 million based on the CPM Settlement price , as "cap" on expenditures for the remainder of 2012 for sales from the Sutter Plant to the three utilities. The three IOUs were also directed to enter into contract negotiations with Calpine on the Sutter plant for a price less than that available under the CPM.[10]

Before analyzing the combination of public and confidential data available to the IE, it is important to describe the proper perspective that is needed to assess accurately the many seemingly comparable numbers which are being discussed [11]. First, a proper perspective must distinguish between annualized and monthly or six -month numbers. The figures presented in both the public and the confi dential Calpine filings with CAISO and with FERC are annual ized numbers (e.g., an annualized 2012 going forward cost estimate which was reduced by applying estimated net energy revenues) . Many numbers presented in the Resolution are monthly or six-month numbers (e.g., a monthly maximum of $2.95 million and a six -month "cap" of $17.4 million). Secondly, a proper perspective should distinguish between unit-specific, estimated actual costs of the Calpine Sutter plant and the generic costs which are drawn from the CAISO proceedings and the CAISO Tariff provisions for the CPM. For example, the figure of $67.50 kW -year is understood by the IE as the CPM payment under the Tariff which is based on the defined going forward costs of a generic 50 MW simple cycle gen erating unit ***plus*** an adder of 10%. Applied to the Sutter plant with an assumed average annual capacity of 5 25 MWs, this generically-based CPM payment would be approximately $35 million/year.[12]

In the non-confidential portions of its Request to FERC, Calpine presented the overall results of a going forward cost analysis for Sutter in 2012 and subsequent years conducted by Calpine. "Table 1 shows that Sutter's estimated energy margins (energy

---

[9] This approach to the confidentiality obligation of the Independent Evaluator mirrors the Protective Order approach of the FERC and thus, avoids the chilling effect that is possible when the provider of the information and the independent party evaluating the information are in contractual privity.

[10] The Resolution contains the following language, "It is expected that in the contract the costs should be significantly below what would be paid if the Sutter plant were subject to CPM." (Resolution at page 9.) According to the Resolution, the recent CPM Settlement sets a price of $5.63/kW-month or $67.50/kW-year (this settlement updates the Tariff price of $55/kW-month). The monthly cost recovered for 6 months in 2012 at a capacity of 525 MW would equate to $17.7 million which is slightly higher than the $17.4 mill ion cap established by the Resolution.

[11] More than once, the IE observed references to numbers during the negotiations that could easily have confused the counterparties.

[12] Another important difference in perspective is gained by noting that the CAISO CPM provisions allow a qualifying unit to retain its net energy revenues, although such revenues would supplement the recovery of going forward costs achieved through the CPM payment. In this regard, for its own regulatory purposes, the CAISO CPM provisions seem clearly to accomplish some contribution to capital cost recovery. On the other hand, in its confidential filings with CAISO and with FERC, Calpine properly applied its estimated net energy revenues against its annualized going forward costs to produce lower net operating shortfall.

market revenues less fuel costs) for 201 2 and 2013 are substantially lower than Sutter's estimated non-fuel going forward costs (variable and fixed O&M, transmission expense, property taxes, insurance and major maintenance costs). This results in substantial cash flow losses from operation in 2012 and 2013. In particular, Table 1 shows that Sutter will sustain cash flow losses of $19.7 million in 2012." (Supplemental Affidavi t of Alex Makler, at page 5, in Attachment A to the Petition to FERC for Waiver of Tariff Provisions by CAISO, January 25, 2012, in FERC Docket No. ER12 -897-000.) The cash flow losses of $19.7 million therefore include annual going forward costs plus major maintenance after deducting the net revenues from estimated sales of energy into the market.

Detailed Calpine Financials Deleted

IV. Description of Contract Negotiation Process

The IE participated in an initial call with the IOU's and the CPUC on April 2, 2012 to discuss Resolution E -4471 and the timeframe allotted for completing contract negotiations with Calpine for the Sutter plant.

The IOU's initially viewed the Resolution to require the utilities to "jointly negotiate" with Calpine a limited term contract as stated on page 8 of the Resolutio n. In that regard, notwithstanding the state regulatory mandate, the IOU's were concerned about antitrust issues associated with joint contract negotiations . As a result, one of the initial tasks undertaken by the IOU's was to develop a Joint Negotiating Agreement ("JNA") that would establish the parameters for negotiations and attempt to address the anti -trust issues.[13]

It was discussed by the IOU's that an appropriate approach for negotiations would be one modeled on the Hydrogen Energy California LLC (" HECA") negotiation process. It was suggested that the IOU's follow an approach that would be based on designating one utility to be the lead negotiator. The J NA contemplated that the three utilities would among themselves outline the parameters for negotiation and address issues such as cost allocation, information sharing guidelines, etc. ("Utility Contract Parameters"). The Utilities agreed to follow the Co mmission's objectives and to cooperate together through a "Lead Negotiator" to enter into contract negotiat ions with Calpine for the Sutter Energy Center for a price less than that available under the Capacity Procurement Mechanism ("CPM"), which may take the form of one or more contracts.

The important elements of the JNA from the point of view of the three utilities included:

1. PG&E shall be the Utility Party to negotiate ("Lead Negotiator") with Calpine on behalf of the Utility Parties;

[13] The IOU's felt that the HECA negotiations model could also be applicable for this negotiations process.

2. The Parties agre e to use their best efforts to adhere to the timeline , roles and responsibilities set forth in the JNA;
3. The Lead Negotiator may negotiate with Calpine for the Sutter Contracts which include products or services related to the impacts of dynamic transfer ta riff changes at the CAISO;
4. The Utility Parties agree that the Utility Contract Parameters shall require a condition precedent in the Sutter Contracts that Calpine shall withdraw its CPM request with the CAISO in order for the Sutter contracts to become effective;
5. The Utility Contract Parameters shall be confidential to the Utility Parties and shall not be disclosed to Calpine, except that the Lead Negotiator may communicate with Calpine the terms and conditions of the Utility Contract Parameters that are re quired by the Utility Parties to be included in the Sutter Contracts;
6. Lead Negotiator will retain all benefits of any Sutter Contract for a market product with Calpine for Sutter and the Utility Parties will retain all benefits related to the analysis of t he impacts of dynamic transfer changes at the CAISO on Sutter ("Dynamic Transfer Service") which may be further specified in the Utility Contract Parameters;
7. Lead Negotiator is authorized by the other parties to pay to Calpine no more than $2.95 million pe r month in the calendar year 2012 in capacity or other payments or a total of $17.4 million in capacity or other payments through the end of 2012. Negotiator may negotiate to pay less than the authorized amount. Lead Negotiator shall not negotiate on behal f of the other Utility Parties Sutter Contracts with a term that extends beyond December 31, 2012 or that have capacity or other payments in the aggregate in excess of $17.4 million, as required by the Resolution;
8. Lead Negotiator will negotiate with Calpin e until agreement is reached or until it is determined that a mutually acceptable agreement cannot be reached, but no later than April 23, 2012;
9. Lead Negotiator will communicate the current status of the negotiations with the other Utility Parties on a per iodic basis according to the schedule contained in Exhibit A of the JNA;
10. The Utility Parties will agree on how to calculate and allocate the costs for the products or services delivered under the Sutter Contracts, including for the Dynamic Transfer Service , if applicable in a commercially reasonable manner consistent with CAM allocation methodology in the Utility Contract Parameters. Such agreed upon calculation will be reviewed by the Independent Evaluator for reasonableness and the Lead Negotiator will su bstantiate the calculation according to the Utility Deal Parameters and to the IE's satisfaction;
11. Lead Negotiator and Calpine may execute the Sutter Contracts, mutually acceptable to Lead Negotiator and Calpine and according to the Utility Contract Parameters and the JNA;
12. Lead Negotiator will prepare an init ial draft of the required joint Tier 2 Advice Letter(s) for review and comment by Utility Parties explaining accepted or rejected agreements. The Parties agree that a joint Tier 2 Advice Letter will be filed by April 27, 2012 explaining accepted or rejected agreements.

Merrimack Energy participated in a number of the calls held between the utilities to negotiate the JNA during the week of April 2, 2012, and overall felt the approach taken by the IOU's was a reasonable option for meeting the objectives of addressing anti-trust issues and general contract negotiation guidelines.

The IOU's completed a draft of the JNA on or about April 5, 2012 and sent the draft JNA to Calpine for review and comment.

On April 9, a teleconference was held between the IOU's and Calpine to discuss the IOU proposal and solicit Calpine's signature to the JNA. At the meeting Calpine indicated it would not execute the JNA for a variety of reasons. Those reasons included its complexity, its inability to solve all anti-trust concerns of Calpine since the Utility Contract Parameters would be agreed to by the utilities in private combination and without Calpine's knowledge and its indemnification and release provisions which, in Calpine's view, offered anti-trust and fair trade immunity beyond the intention of the Resolution. In place of the JNA, Calpine proposed an alternative process whereby each utility would negotiate separately and confidentially with Calpine based on its own needs. The utilities and Calpine would work through the process to allocate the capacity from the plant and the cost allocation issues. On April 10, 2012, the IOU's, citing the imperative to move forward quickly, agreed to Calpine's suggested approach and contract negotiations then commenced.

To initiate negotiations, Calpine marked-up a version of the [redacted] for each IOU based on recent agreements. Calpine included [redacted] in each agreement based on recent offerings and submitted the agreement to each utility. Discussions about products of interest for each utility and initial negotiation sessions began during the week of April 9, 2012 and extended through April 30, 2012.

The following Exhibit 1 summarizes the initial negotiating positions of the parties in the parallel proceedings. Exhibit 2 provides more detailed information on each day's negotiations.

Exhibit 1: Summary of Initial Positions of the Parties

Company	SDG&E
Calpine Price and Product Offer	[redacted], in order to cover going forward costs only (inclusive of June, 2012 major maintenance expenses claimed to be necessary)
Company Response	[redacted]
Role of Seller Costs	Calpine insists its offers are based on its going forward costs and that it must recover costs or it will close.
Buyer Reaction to Role of Seller Costs	SDG&E complains, if Seller's costs must be covered (in contrast to payments based on value to Buyers which is characteristic of competitive power markets), that they should have access to confidential Calpine costs. If this is a special case where cost-of-service pricing is required to solve a problem, IOUs reason that cost-of-service should actually be applied. Without access to real costs of Seller, they are at risk for overpaying for which they want protection from the PUC and the IE. The implied suggestion is: Resolution should have been done on an "open book" basis.
Role of Buyer Value	SDG&E will acknowledge the need to cover costs to keep Sutter open but is reluctant to address costs without regard to demonstrated benefits which capture value for Buyer's ratepayers.

Exhibit 2: Summary of Issues for Each Negotiation Session and Meeting

PUC, IOU's and IE April 2, 2012
• Paul Clanon and Frank Lindh of CPUC gave initial April 2, 2012 instructions which were general: The Resolution has a cost cap of $17.4 M, but the rate is to be just and reasonable. The lower the rate, the more just and reasonable. • Resolution is clear that "open book" materials go only to PUC and IE but Mr. Clanon said PUC was willing to ask Calpine to make "open book" to IOUs. IOU's were focused on value of power to them and did not insist on "open book". • Mr. Lindh notes that value extends beyond simple RA product since the payments are a hedge against closure and opportunity for learning about dynamic scheduling and pseudo-ties. IOUs regretted that there is no benchmark for intangible values such as these. IE will be expected to give evaluation of the above market component of total cost which functions as insurance against closure. Concept of negotiating: • Calpine gets three things: [redacted] (to be retained and estimated) plus Balance to be negotiated (needed to keep open). It was recognized [redacted] revenues could be calculated after the fact and [redacted] payment. • IOUs want protection against overpayment and asked how the "open book" differential to $17.4 M is "fed into the process". PUC and IE will not tell the IOU's what the differential

is, but if it is too big the filing will be rejected. IE has right to ask IRs of Calpine and Calpine should be told this.

IOUs and PUC April 10, 2012

- Initial conceptual discussions between Calpine and IOUs as a group (April 10, 2012) dealt with whether the product would be a common RA confirm or not; whether Calpine was willing to negotiate different products and different prices or not. Calpine agreed to concept of IOUs telling Calpine what products they wanted and Calpine being responsible to avoid inconsistent obligations. No IOU coordination was foreseen, provided that PUC blessed idea of three separate negotiations.

SDG&E April 16, 2012

- SDG&E is [redacted] as a hurdle for both parties. SDG&E is interested in paying [redacted] going to Calpine.
- Calpine needs [redacted], which when combined with [redacted] covers going forward costs and leaves Calpine in "net zero" position without any going forward loss and without any contribution to capital costs.
- SDG&E tries to describe the desired [redacted] which SDG&E will think more about. Parties understand the [redacted]. Both parties are agreeable to focus on 2012-only deal. The parties discuss the high level language issues in the RA confirm.

SDG&E April 17, 2012

- Calpine presents its statement of need for coverage of its going forward costs. Calpine claims that $17.4 M is the number that came from CAISO after an "open book" review and that this is the amount that Calpine needs [redacted]. Furthermore, the Calpine filings were under pains of perjury and went unquestioned, after review, by the Department of Market Monitoring at the FERC. The [redacted] is said to cover going forward shortfall for period. However, Calpine has changed its focus to only 2012 now and is now offering the same deal but for shorter period based on some "simple math."
- SDG&E acknowledges the reasoning but complains that it [redacted] and must show PUC some need and some benefits. If Calpine can do [redacted] to provide those benefits, SDG&E will consider the pricing provided that the deal can be shown to be "cost effective" to SDG&E.
- Both parties complain that the Resolution does not give adequate guidance: a cap is stated and then the expectation that the amount paid will be substantially below that cap. Calpine complains most that it doesn't know how the rate can be lower. Calpine notes that IOU's should not look for a market price deal when the problem is that the market is not adequately supporting units like Sutter and to solve the problem, an "out-of-market" deal based on covering costs which are not being covered is needed.
- SDG&E looks to justify above market price by getting [redacted] which can deliver upside to ratepayers. SDG&E asks Calpine whether it is neutral about how to deal with [redacted]

Calpine is willing to [redacted] • Calpine needs more time to study product and offer an adder to the [redacted].
SDG&E Emails April 16-20, 2012
• Emails up to April 20, 2012 did not include IE, but April 20th offer and counteroffer contain full email string: [redacted] • Calpine asks for a [redacted] for [redacted], designed to return to Calpine a 10% of $17.4 M share for SDG&E ($1.74 M) [redacted]. • SDG&E counteroffer is for monthly profile of [redacted] (preferred structure is suggested with same overall price). • The Parties seem to have agreement on total payment as of close of business, April 20, 2012.
IE Interim Verbal Report to Energy Division April 20, 2012
• IE reported on its review to date of the Calpine cost disclosure, noting that it had begun a benchmarking and "scrubbing" operation looking at the principal costs such as transmission, fixed O&M, property taxes and insurance.
• IE observed that both Paul Clanon (before negotiations started) and the IOUs (during negotiations) had stressed the importance of knowing actual costs if the objective was to assure that Calpine recovered actual costs when market revenues could not provide sufficient revenues to cover losses on going forward actual costs.
• IE reported that Calpine was using arguments during negotiations based on claimed costs, but IOUs were not able to assess whether claimed costs were accurate or not. IOUs complained that their ratepayers deserved protection from paying over market costs and possibly even paying over actual costs if IOUs did not know what actual costs were. It appeared to IE that negotiations would fail since parties did not have a path forward (Calpine was not willing to show costs and IOUs were not willing to pay amounts over market costs which they could not be sure represented actual costs).
• IE suggested that Calpine be required to open its books to all three IOUs in a technical session aimed at producing contracts based on accurate assessments of expected Calpine costs. IE could monitor the conference and report in the open to all parties on its assessment of the reasonableness of the disclosed Calpine costs.
• Energy Division took the suggestion under advisement.

SDG&E April 24, 2012

- Calpine reports difficulty pricing the [redacted] deal requested by SDG&E since the [redacted] another cost which must be added to the Sutter revenue requirement [redacted]. Since the [redacted] it also complicates Calpine's other system operations and pricing strategies. Calpine will try to get an offer back to SDG&E by close of business. Calpine is still uncertain where it stands with one of the other two IOUs and that complicates its ability to offer more [redacted] at the moment. Calpine is considering a [redacted] product and is also still trying to model and price the [redacted] deal requested. SDG&E requested on getting offers by close of business today.
- Calpine complains that negotiating three live deals at same time is really very hard. When SDG&E asks to move ahead with negotiations and not wait for Calpine to gain "visibility" on what the other IOUs will do, Calpine asks for more time with other IOUs first.
- In order to move forward on something, the parties discuss possible forms to be used and the attorneys make various suggestions on available forms or forms that can be adapted readily for [redacted] requested. SDG&E's Steve Case offers to send some forms for possible use, [redacted]
- Calpine mentions that it has worked its costs below the CPM number and that it is seeking now a total revenue requirement for the rest of 2012 of no more than [redacted], above its retention of the energy market revenues. The average rate comes out to be [redacted].

SDG&E April 25, 2012 Email Offers

- As of April 20th, Calpine had made a [redacted] offer for [redacted]. This was recognized as over the 10% load share of SDG&E of the then claimed revenue requirement of $17.4 million. Parties were not in agreement as previously thought on overall cost. As a result, SDG&E made a counteroffer on April 20th and on the 24th, Calpine notes continuing difficulty evaluating a counteroffer to that latest SDG&E [redacted]. On April 25th, Calpine restated that its [redacted] 2012 is still [redacted] and that this number will be used by it to value the call option desired by SDG&E. By close of business, Calpine made a separate [redacted] offer designed to cost SDG&E [redacted]. A separate [redacted] would now be priced at 10% of the expected revenue requirement of [redacted].
- The separate [redacted] from Calpine had the following prominent characteristics: [redacted]

SDG&E April 26, 2012

- SDG&E started the call by reviewing the evaluation it had done of the Calpine price for the [redacted] presented on the prior day. The evaluation would [redacted] and SDG&E thought there was insufficient time to [redacted]. A short effort was made by Calpine to explain how the pricing was based on its [redacted], with something [redacted] to absorb the [redacted]. The parties decided to move on and try to finish the [redacted] negotiations.

• The topic of shaping the [redacted] was discussed since the [redacted] was a bad fit for SDG&E's needs. Calpine resisted and the parties accepted the [redacted].
• [redacted]. SDG&E explained that such a condition was [redacted]. Calpine said that it would accept only a [redacted]. Without that certainty, Calpine may decide to use its [redacted]. Calpine is going to think more about its exposure. [redacted]. SDG&E says that issue is still open for its [redacted].
• The attorneys then negotiated less major issues in the [redacted] to get to closure. They discussed other conditions in the [redacted] that might [redacted] and settled on language that assured that other pre-conditions had been removed before effectiveness. Collapsing filing deadlines for [redacted] were discussed and agreed to. [redacted]
• One major follow-up issue remained: [redacted].
SDG&E April 27, 2012 (first session)
• Calpine compliments SDG&E for changing the structure of the [redacted]. Calpine thinks the path forward is too remote.
• SDG&E argues that this structure moves the decision point forward to the [redacted] when parties will have more visibility on the circumstances. [redacted] SDG&E's Al Pak offers another way to try to get to a better vantage point. That way would be to ask [redacted]
• More discussion follows on whether there is any alternative which is not fatally flawed in meeting Calpine's objective, which, in its terms, is to have certainty that [redacted]

[redacted]" Calpine is generous with its praise for SDG&E's creativity and wishes it could "clone SDG&E and put into other IOUs", which have not been as willing to search for alternatives as SDG&E. Parties agree to talk later in the day.
• Around the close of business, SDG&E sent an email announcing that SDG&E had agreed to accept [redacted] SDG&E filled in the open blanks in the RA form under negotiation and send it to Calpine for possible execution on Monday morning, April 30th. On Saturday, the 28th at 6 pm, a reply was sent by Calpine's counsel [redacted]
Energy Division Extension April 30, 2012 • The Energy Division granted a four day extension in the deadline for filing the Tier 2 Advice Letters in this proceeding. The extension applied to all three utilities, although the extension recognized that the request for extension had been filed only by PG&E.
SDG&E April 30, 2012 • SDG&E accepted the alternative formulation of the condition precedent and the parties planned to execute the agreement. SDG&E executed the agreement and transmitted the execution copy to Calpine, which decided to hold the agreement pending developments in the next days. SDG&E requested that the executed copy be held in escrow.
SDG&E May 3-4, 2012 • The parties during this period reached final agreement on the form of the RA agreement for SDG&E's allocable share of Sutter at a price of [redacted] with a regulatory approval scheme which appears to cause SDG&E and Calpine to share the risk for a final disapproval of the contract after all appeal periods.

V. Contract Summary and Review

This section provides a summary of the contract executed by SDG&E with Calpine.

SDG&E (Negotiating Team -Tang, Nuo; Bartolomucci, Vincent D; Choi, Tony; Pak, Alvin; Keilani, Wendy; and Case, Steven)

On April 30, 2012, SDG&E's and Calpine appeared to ha ve reached agreement for execution of a RA Agreement between the parties. The parties agreed to a monthly price for RA of [redacted] for SDG&E share of load of 10.4%. The total value of the contract is [redacted]. SDG&E's contract negotiation was initially finalized as of such date when both parties accepted changes [redacted] which has been a major sticking point in the negotiations.

[redacted]

The agreement was not signed by both parties on April 30, 2012 after the extension of the negotiating deadline was announced. During the days that followed, t he deal changed in two significant ways. First, the price was [redacted] to [redacted]. Secondly, [redacted].

Furthermore, another last minute material change occurred.
The earlier history of the successful negotiation is summarized below.

From the start of negotiations, SDG&E requested a [redacted] from Calpine that included, [redacted] being offered by Calpine [redacted]. SDG&E wanted [redacted]. Calpine claimed that it needed to retain [redacted]"in order to combine [redacted] in order to cover its costs and be left in a "net zero" position. This claim can be assessed by review of the IE's assessment of the Calpine "open book" financial information for 2012 and 2013 in the confidential report to the Energy Division. Calpine furthermore claimed that the $17.4 million "cap" number in the Resolution is the number which came from CAISO after an "open book" review and that is the amount that Calpine needs after energy revenues.

Both parties agreed to try to negotiate an acceptable pri ce that would include an [redacted] offered by Calpine for [redacted]. Calpine had difficulty creating a product of the type desired since [redacted]. After several days of trying the parties concluded that the [redacted] was too large to close.

The discussions reverted to a [redacted] in an amount equal to the SDG&E load share at a new price reflecting Calpine's efforts to reduce costs below the claimed $17.4 million [redacted]. This price reduction led to a final agreement to use SDG&E load share of 10.4% applied to the [redacted]. As described above, significant changes occurred during the May 3-4, 2012 extension of negotiations: the final price was [redacted] and the formulation of the [redacted]

VI. Recommendation For Contract Approval

Interestingly, at the end, the ability of the parties to reach resolution was not based primarily on the pricing issues. SDG&E and Calpine honed in on the claimed total [redacted]. SDG&E was generally willing to pay its pro rata share.

The major issue that primarily drove the parties toward resolution was an ability to agree [redacted]

[redacted]

Unfortunately, although standard language was present in the applicable contract forms from the start of negotiations, the negotiating parties did not address the standard language until a late stage of negotiations. At that point, the counterparties did focus on [redacted]

In order to accomplish its objectives of receiving funding assurance and putting the Sutter plant into operation by the end of June, Calpine took the position that [redacted] The SDG&E change in position, described above, was largely responsible for causing the initial agreement to appear to be finalized as of the April 30, 2012 deadline.

The April 30, 2012 position taken by SDG&E [redacted] on this issue which can be considered reasonable and prudent. Since the other features, including price, are reasonable, the SDG&E contract would have been recommended for approval in its April 30, 2012 form . With the [redacted] the final agreement merits an even stronger recommendation for approval.

VII. Conclusions

As IE, Merrimack Energy has been actively involved in monitoring the contract negotiation process and reviewing the proforma financial information presented by Calpine. Based on our involvement in the process, the following are our major conclusions regarding the negotiations of Calpine and SDG&E:

- In order to keep the Sutter plant from retiring, Resolution E -4417 ordered PG&E, SCE and SDG&E to enter negotiations with Calpine in an attempt to execute a contract with the Sutter Energy Center for a price understood to be in excess of market prices, but required to be less than the proxy cost of service approach available u nder the CPM. The Resolution created a hybrid setting where "capped" competitive negotiations were to occur which were intended to provide enough coverage of actual costs to keep the plant open but where the negotiating buyers did not have mandatory acces s to examine the plant's estimated budget of going forward costs. This directive to negotiate and other directives regarding the joint nature of the negotiations between the IOU's and Calpine left considerable room and need for interpretation. In this comp lex and challenging setting, SDG&E and Calpine focused on meeting the objectives of the Resolution and negotiated in good faith within their ability to understand the parameters of the Resolution;

- The Resolution relied upon the IE and the Energy Division to review confidential cost data from Calpine in a setting similar to holding a rate case review on a complex technical cost of service issue within a matter of days and without real adjudicatory hearings. This review was designed to give Calpine a prope r incentive to present cost estimates which did not overreach. Calpine appears to have reacted properly and does not appear to have overreached;

- The IOU's originally proposed an approach toward joint negotiations designed to address anti -trust concerns. The original approach was to identify one lead negotiator on behalf of all three IOU's. Calpine objected to this approach since it did not eliminate anti -trust concerns and included a requirement for broad indemnifications and releases from ant i-trust clai ms. Instead, Calpine proposed separate bilateral negotiations with each utility, an approach which also served its interest by providing three chances to negotiate costs of service. While both approaches have merits and problems, the IE found that the bil ateral negotiation approach was time consuming and complex and added uncertainty to the

effectiveness of the process in just covering necessary costs.. By the conclusion, Calpine was not trying to negotiate for different versions of costs and may have regretted its choice of approach;

- The IE believes that for similar processes, with scrutiny over costs and price caps, an "open book" cost of service based arrangement would be more reasonable and equitable. Midway in the process, the IE recommended that a n effort be made to adapt the process to a formal cost of service review;

- The negotiation process revealed a real concern on the part of utilities to drive a balance between getting the best deal for its customers based on market value and providing enough over market cost recovery to keep the Sutter plant on line as the Resolution set as a goal;

- Although Calpine did not provide the financial proforma information to the IE at the initiation of negotiations, Calpine was eventually very forthcoming with information and was very responsive to the requests of the IE for follow -up information and provided detailed explanations associated with information requests of the IE in a timely manner;

- The IE has delivered to the Energy Division a confidential assessmen t of the detailed financial information received from Calpine. Under a confidentiality agreement with the Energy Division, the IE may not disclose the assessment or the detailed financial information to any other party. The Energy Division shall be responsible for the distribution of such confidential materials;

- The utilities expressed several reservations about the long -term status of the Sutter project during negotiations that influenced their position:
    a. Although Calpine would receive revenues through the sale of products from Sutter to keep the plant open in 2012, there is a real possibility that the project may choose to close in 2013. The utilities were concerned about going through the process again in 2013 even if the cost of major maintenance is accounted for;
    b. The utilities were generally concerned about the reasonable level of costs actually required by Calpine and were concerned they could compensate Calpine more than required and determined by the IE and ED to be reasonable;

- The products of interest by SDG&E on which negotiations were originally focused were based on the types of products SDG&E felt had most value given their own portfolio. However, by the end of negotiations the primary product of interest was RA [redacted] The changes were driven primarily by the short time to negotiate and value a deal and the ultimate ease of determining the share of costs for SDG&E based on a consistent product and load share;

- The contract negotiation process was undertaken in a fair and consistent manner and consistent with the requirements outlined in the Resolution;

- Based on the objectives of the Resolution and in light of the overall market conditions and the cost conditions at the Sutter plant, the contract merits Commission approval; and

- The IE further recommends that such approval of the SDG&E contract with Calpine result in cost recovery of the amounts incurred by SDG&E under the agreement.