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May 24, 2012

TRANSMITTED VIA E-MAIL

CPUC Energy Division
Attention: Tariff Unit, 4th Floor
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: PG&E Advice Letter 4034-E
SCE Advice Letter 2730-E
SDG&E Advice Letter 2362-E

Dear Program Manager:

On May 4, 2012, the three major Investor-Owned Utilities (IOUs) filed the above-cited Advice Letters requesting Commission approval of separate contracts each IOU signed with Calpine Energy Services, L.P. (Calpine) for the Resource Adequacy (RA) capacity provided by Calpine's Sutter Energy Center (Sutter).

TURN opposes these contracts and urges the Commission to reject the Advice Letters. TURN also urges the Commission to fight any subsequent attempts the California Independent System Operator (CAISO) might make at the Federal Energy Regulatory Commission (FERC) to expand its own contracting authority and provide Calpine similar contracts.

I. EACH CONTRACT IS "HIGH COST / BAD FIT"

The Advice Letters make abundantly clear that the contracts the IOUs were forced to negotiate would turn the Commission's "least cost /best fit" criterion on its head -- the contracts are instead examples of "high cost / bad fit" resource procurement that should be avoided. The "high cost" of the Sutter contracts was publicly noted by the Independent Evaluator, which said that the three IOU contracts were "above market".[1] The significant gap between the three contracts' prices and market value is evident when comparing the prices the IOUs would pay for Sutter[2] to historic RA prices reported by the Energy Division in its annual RA reports.[3]

The "bad fit" of the Sutter contracts is evident in SDG&E's request for a waiver of existing RA rules that limit its ability to count capacity in Northern California.[4] Further, TURN believes that the contracts will result in one or more IOUs buying some RA capacity that will be surplus to its needs.

PG&E argues that the contract is "just and reasonable" because "it is consistent with the framework under which the utilities were ordered to enter into negotiations with Calpine".[5] PG&E also contends that "the overall cost of the contracts signed by PG&E, SCE and SDG&E is less than the cost cap set in the Resolution".[6] SCE and SDG&E make similar arguments.[7]

The IOUs' contracts may be consistent with the resolution and be priced under the resolution's cost cap. As discussed herein, however, the effects of this contract do not meet a broader standard of being just and reasonable. One thing is clear – TURN and other parties correctly predicted that a Commission action forcing the IOUs to enter into contracts with Calpine would result in uneconomic deals that are "high cost" and a "bad fit".

II. THE SUTTER CONTRACTS PUNISH LOWER-COST GENERATORS AND HARM MARKETS

Even if the Sutter contracts actually meet any IOU RA needs, the contracts will visit other harms on the state's power sector. For example, some generators that are willing and able to compete for the IOUs' business will find their potential sales and revenues reduced by the presence of Sutter RA capacity in IOU portfolios. Commission approval of the contracts would thus harm the type of efficient, competitive generators the state should instead be encouraging. The contracts would also do broader harm to competitive power markets and reduce

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[1] See page 8 of the public version of the Independent Evaluator's Report for each IOU.
[2] See the confidential version of the IE's Report for PG&E (p. 22) and SDG&E (p. 19) and Confidential Attachment G to SCE's Advice Letter. These data are also available in the contract attached to each Advice Letter.
[3] For example, in its 2011 report, Energy Division reported the median "system RA" market price in 2010 was $1.97/kW-yr (p. 24). This report is available at http://www.cpuc.ca.gov/PUC/energy/Procurement/RA/.
[4] SDG&E Advice Letter, pp. 7-8.
[5] PG&E Advice Letter, p. 4.
[6] Id.
[7] SCE Advice Letter, p. 3. SDG&E Advice Letter, p. 3.

the potential value they might bring to the state's electricity customers. Furthermore, this outcome will only embolden other generators to come forward and ask the Commission to require the IOUs to offer them above-market contracts.

III. IOUs COULD NOT NEGOTIATE EFFECTIVELY ON BEHALF OF THEIR CUSTOMERS

The IE reports praise the "good faith" and "competence" of the IOUs and Calpine during negotiations, perhaps implicitly suggesting that all parties' negotiating positions were reasonably balanced.[8] But such happy words cannot hide the fact that the animus for the negotiations skewed the balance of power entirely in Calpine's favor, as is evident in the summaries of the negotiations contained in Section IV of each IE Report.[9] The Commission permitted Calpine to take full advantage of its superior negotiating position, and Calpine used its leverage to prevent the IOUs from acting in the best interests of their customers. The limits on the IOUs' bargaining power resulted in a final contract that is bad for ratepayers and was likely excessive even relative to Calpine's actual need. This result was entirely predictable (and was, in fact, predicted by TURN and other parties).

IV. CALPINE SEEKS THE BENEFITS OF "COST-BASED" CONTRACTS WITHOUT OFFERING ANY OFFSETTING BENEFITS

The IE observed that the negotiations involved "above market, cost of service contracts without open access to cost of service data".[10] TURN observes that the contracts lack other key advantages of traditional "cost of service" regulation. For example, even though Calpine would be receiving above-market contract revenues for the remainder of 2012, there is still no guarantee that the resource will be available in 2013 or later years.[11] Availability of Sutter post-2012 was the entire basis upon which the Commission chose to approve the previous resolution.

Even if Sutter remains in service after 2012, there do not appear to be any provisions in the contracts that would track the net above-market revenues Calpine may earn from the contracts this year so that such revenues might be returned to ratepayers in future years when Calpine's cost of service is below the

[8] For example, see the "Comment of the IE Regarding the Complexity of the Proceedings" at page 8 of the public version of each IE Report.
[9] These sections are partially redacted in the public version of each IOU's IE Report.
[10] See the "Comment of the IE Regarding the Complexity of the Proceedings" at page 8 of the public version of each IE Report.
[11] See public versions of IE Reports for PG&E (p. 25) and SDG&E (p. 22).

market price. Calpine is receiving a subsidy to operate in 2012 with no guarantee of future payback or performance. True cost-of-service contracts would provide such balance -- in exchange for financial support when market conditions are poor, a generator would continue to operate in future years and provide good value when market conditions improve. Calpine makes no such offer in these contracts and is highly unlikely to provide any future discounts if market prices are high.

In addition, parties outside the Energy Division and the IE cannot assess the reasonableness of the contracts in relation to Calpine's costs, as even the confidential versions of the IE reports contain the phrase "Detailed Calpine Financials Deleted".[12] Cost of service regulation does not limit distribution of cost data so severely. Moreover, TURN has never before experienced a situation where important procurement data was withheld from members of the Procurement Review Groups. The withholding of this data is unprecedented and lacks any compelling rationale (other than honoring Calpine's wishes).

The IE offers the following tepid statement in each IE Report -- "[t]his review was designed to give Calpine a proper incentive to present cost estimates which did not overreach. Calpine appears to have reacted properly and does not appear to have overreached". [13] The notion that Calpine had "a proper incentive" to be truthful hardly inspires confidence in the ability of the Energy Division and IEs to perform any due diligence on Calpine's claimed costs.

V. COMMISSION MUST BE PREPARED TO FIGHT EFFORTS BY THE CAISO TO UNILATERALLY ISSUE LONG-TERM CONTRACTS

TURN anticipates that, should the Commission reject the Advice Letters at this point, that the CAISO might revive its efforts before FERC to get tariff authority to issue contracts to generators unilaterally for hypothetical long-term needs. TURN urges the Commission to be prepared to fight for its own ratepayers' interests and jurisdictional prerogatives should the CAISO take such steps.

TURN thus urges the Commission to reject the Advice Letters.

Yours truly,

Matthew Freedman

[12] The same text appears at page 10 of the public and confidential versions of each IE Report.
[13] See the public version of each IE Report at p. 24 (PG&E), p. 25 (SCE) and p. 21 (SDG&E).

The Utility Reform Network

cc: President Michael R. Peevey
Commissioner Mark J. Ferron
Commissioner Catherine J.K. Sandoval
Commissioner Mike Florio
Commissioner Timothy Alan Simon
Frank Lindh, General Counsel
Chief ALJ Karen Clopton
Edward Randolph, Director, Energy Division
Energy Division Tariff Unit, Energy Division
PG&E (Brian Cherry)
SCE (Akbar Jazayeri)
SDG&E (Clay Faber)
Service List for R.10-05-006
Service List for R.11-10-023
Service List for R.12-03-014