

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Integrate and Refine  
Procurement Policies and Consider Long-Term  
Procurement Plans.

R. 12-03-014  
(Filed March 22, 2012)

**COMMENTS OF CALPINE CORPORATION  
ON TRACK III RULES ISSUES**

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April 26, 2013

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Pursuant to the March 21, 2013 *Administrative Law Judge’s Ruling Seeking Comment on Track III Rules Issues* (“March 21 Ruling”),<sup>1</sup> Calpine Corporation (“Calpine”) submits the following comments regarding Track 3 Procurement Rules.

**I. OVERVIEW**

As discussed below, there are two fundamental flaws in existing rules that govern the procurement practices of the investor-owned utilities (“IOUs”):

1. Existing resources are not afforded the same contracting opportunities as new resources.
2. There are limited forward contracting opportunities for existing resources.

The California Public Utilities Commission (“Commission”) has previously acknowledged the need to address the above issues<sup>2</sup> but, to date, has failed to take any definitive action to correct these defects.<sup>3</sup>

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<sup>1</sup> See *March 21 Ruling*. On March 28, 2013, ALJ Gamson granted the request of the Division of Ratepayer Advocates to extend the comment dates for Track III Rules issues from April 12 to April 26, 2013.

<sup>2</sup> See e.g., Decision 10-06-018, mimeo at 32-33 (“A multi-year forward commitment has the potential to provide important reliability benefits. It would provide advance knowledge of impending reliability problems, years ahead of delivery, allowing planners to address those problems in a timely, cost effective manner. Additionally, a multi-year forward commitment would be expected to stimulate merchant generator investment, supporting our policy not to rely solely on Commission-directed forward procurement by IOUs to provide the investment needed for new generation. Further, as the CAISO points out, a multi-year forward commitment would promote competition between new and existing resources as well as competition between transmission upgrades and generation supply additions. Such competition could yield more cost-effective outcomes.”)

<sup>3</sup> See e.g., Decision 10-06-018, mimeo at 68 (“While a multi-year forward procurement obligation could improve upon the current program in certain respects, we are not ready to implement such a feature at this time. Thus, we

Current procurement rules have created market conditions that do not provide existing resources that are not under long-term contracts with reasonable opportunities to obtain sufficient and stable revenue streams to recover going-forward costs (including major maintenance costs). Consequently, they provide minimal or no return on, and of, the capital invested in existing resources that are not under long-term contracts. In addition, current procurement rules provide little or no incentive to improve the performance of existing resources through additional capital investment.<sup>4</sup> These market conditions are the result of procurement rules that unreasonably restrict the contracting opportunities available to existing resources.

IOU resource solicitations typically do not consider existing resources as potential alternatives for new resources – even if the existing resource can satisfy the IOU’s identified “need.” For instance, existing resources are generally precluded from participating in the long-term resource solicitations of the IOUs. As a result, existing resources without contracts or whose power purchase agreements (“PPAs”) will soon expire must rely on short-term markets, such as the California Independent System Operator (“CAISO”) energy and ancillary services (“AS”) markets, year- and month-ahead markets for resource adequacy (“RA”) capacity, and intermediate-term solicitations administered by the IOUs pursuant to their bundled procurement authority.

In stark contrast, new resources are supported by long-term PPAs or regulated rates in the case of utility-owned generation (“UOG”). The compensation available to new resources through long-term solicitations dwarfs the compensation available to existing resources, with new resources receiving “five to ten times the price” of existing resources<sup>5</sup> and, unlike the

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direct Energy Division and other appropriate Commission staff to study the potential of a forward procurement obligation and report its findings to the Commission.”)

<sup>4</sup> See April 5, 2013 Comments of Calpine Corporation (R.11-10-023) describing potential upgrades to improve the performance of existing resources.

<sup>5</sup> See The Brattle Group, *Resource Adequacy in California, Options for Improving Efficiency and*

revenue from the short-term markets, long-term PPAs generally provide for a return on, and of, capital.

This revenue differential is exacerbated by the fact that procurement practices that exclude existing resources from participating in long-term resource solicitations have led to an over-supply of capacity, which, in turn, has served to further depress compensation available to existing resources. By effecting dramatically different levels of compensation for what is essentially the same wholesale product (e.g., capacity), the disparate treatment between new and existing resources leads to excessive reliance on expensive new resources and under-investment in and/or the premature retirement of existing resources.<sup>6</sup>

In addition to eliminating the disparate treatment between new and existing resources, greater access to multi-year contracting opportunities for existing resources must be created. The exact timing and magnitude of future reliability requirements, as well as future market rules, remain uncertain. Nevertheless, while the Commission continues to evaluate these issues, the limited compensation available from current energy, AS, and RA markets provides few incentives to maintain (and potentially upgrade) existing resources. In light of the uncertainty about prospective market conditions and the poor current market conditions, additional intermediate-term procurement is needed to better ensure the continued availability of existing resources to satisfy future reliability requirements.

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*Effectiveness* (“*Brattle Group Whitepaper*”) (October 2012) at 15. The *Brattle Group Whitepaper* was attached as Appendix A to the Comments of Calpine Corporation on Track 3 Procurement Rules (filed November 2, 2012).

<sup>6</sup> See *Brattle Group Whitepaper* at 18.

## II. RESPONSE TO ALJ QUESTIONS<sup>7</sup>

The following comments address the specific questions in the *March 21 Ruling* given Calpine's general concerns regarding discrimination between new and existing resources and the lack of forward procurement opportunities for existing resources.

### 1. Maximum and minimum limits on IOU forward purchasing of energy, capacity, fuel, and hedges

- a. Should the Commission modify the Assembly Bill (AB) 57 bundled procurement guidelines to indicate minimum and maximum limits for which the three IOUs must procure for future years? If so, should these minimum and maximum limits address energy, system resource adequacy (RA), local RA, and/or flexibility?

Calpine believes that all load serving entities ("LSEs"), not just the IOUs, should be subject to mandatory multi-year forward procurement requirements for system, local, and flexible capacity similar to the requirements that exist in forward centralized capacity markets. Requiring only the IOUs to contract forward would impose an inequitable burden on the IOUs relative to other LSEs. In addition, forward procurement requirements that are applicable only to the IOUs may not result in sufficient intermediate-term procurement because they would exclude capacity procurement by Energy Service Providers ("ESPs") and Community Choice Aggregators ("CCAs") whose customers account for a material portion of overall load in the state. Further, multi-year terms (or a market design in which capacity prices are sufficiently predictable multiple years in the future) are necessary to support investment in major maintenance and/or upgrades to facilities by facilitating the amortization of such investment over multiple years.

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<sup>7</sup> The questions are numbered to correspond with the question numbering convention used in the *March 21 Ruling*. Questions for which Calpine is not providing a response have not been reproduced in these comments. Calpine, however, reserves the right to respond to such questions in its reply to comments and/or at other appropriate points during the proceeding.

In the PJM control area, 100% of projected need is secured on a three-year forward basis (with limited carve-outs for additional demand-side resources to be procured closer to the delivery year). Alternatives to PJM's approach could include procuring capacity with a mix of one- and multi-year terms. For example, if procurement were undertaken annually for terms of one and five years and the five-year term component accounted for 75% of procurement, then each year, 15% of incremental procurement would be for five-year terms (i.e., in combination with 5-year contracts signed in the previous four years, the total amount of capacity under 5-year contracts would be 75%).<sup>8</sup>

There are at least three potential approaches for creating forward procurement requirements applicable to all LSEs

Centralized Capacity Market. In a centralized capacity market, an LSE in the CAISO balancing authority area would be required to either secure sufficient capacity on a forward basis or have the CAISO procure capacity on its behalf. There are numerous benefits associated with such a centralized capacity market,<sup>9</sup> including leveling the competitive playing field among all capacity resources by assuring that all suppliers are providing exactly the same product at the same time (e.g., a one-year capacity commitment on a 3-year forward basis); increasing the scope of cost allocation to potentially include the allocation of reliability costs to non-Commission jurisdictional entities, such as municipal utilities and exporters; helping to limit credit and collateral requirements for non-IOU LSEs; increasing the efficiency of capacity procurement, especially as capacity procurement requirements are differentiated with respect to operating characteristics; and creating a clearing price market that could be more easily monitored and mitigated, and that would yield more transparent and rational pricing for capacity.

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<sup>8</sup> The precise percentages as well as how UOG and IOU long-term contracts would count towards the long-term capacity procurement requirements could be resolved through workshops.

<sup>9</sup> These benefits are described in Section IV.B.1 of the *Brattle Group Whitepaper*.

Multi-Year Forward Procurement Requirement. The addition of a multi-year forward procurement requirement to the current RA program would address many of the flaws discussed above by, for example, providing more forward revenue certainty to support investment in major plant maintenance and/or upgrades to facilities. However, in the absence of a clearing price market, the addition of a multi-year forward procurement requirement would not offer the same transparency and rationality of pricing as a centralized market. In addition, contracting forward bilaterally for capacity, as opposed to through a CAISO centralized market, would entail significant credit and collateral requirements. These costs are particularly acute for non-IOU LSEs that generally have less stable customer bases.

Either a multi-year forward centralized market or a multi-year forward RA procurement requirement would encourage forward bilateral contracting for multi-year terms. The key difference would be that, as capacity procurement requirements are extended forward, presumably the term and forwardness of bilateral procurement would likely increase in parallel.

Forward Procurement with CAM Treatment. The IOUs could procure capacity on a multi-year forward basis on behalf of all customers and allocate the costs to other LSEs through the current cost allocation mechanism (“CAM”) or a similar mechanism. While the CAM has historically been applied to new resources, Public Utilities Code section 365.1(c)(2)(A) provides that:

... in the event that the [C]ommission authorizes, in the situation of a contract with a third party, or orders, in the situation of utility-owned generation, an electrical corporation to obtain generation resources that the [C]ommission determines are needed to meet system or local area reliability needs for the benefit of all customers in the electrical corporation’s distribution service territory, the net capacity costs of those generation resources are allocated on a fully nonbypassable basis consistent with departing load provisions as determined by the [C]ommission, to all of the following:

- (i) Bundled service customers of the electrical corporation.
- (ii) Customers that purchase electricity through a direct transaction with other providers.
- (iii) Customers of community choice aggregators.<sup>10</sup>

Accordingly, to the extent that multi-year forward contracts with existing resources are deemed “to meet system or local area reliability needs for the benefit of all customers” the costs of such procurement should be recoverable through nonbypassable charges.

- b. How may the Commission best balance issues regarding departing load in any future requirements for procurement?

As discussed above, the allocation and recovery of the costs associated with the forward procurement of capacity would depend on how the forward procurement requirements are implemented. If the requirements apply to all LSEs, as would be the case if they were implemented through a centralized capacity market or a forward bilateral market for RA capacity, then the market itself would allocate costs. In the case of a centralized capacity market, the CAISO would, in effect, purchase capacity to satisfy any need that has not been met through bilateral procurement and allocate the costs of such procurement to LSEs who are “short” in the applicable delivery year.

To the extent an IOU procured bilaterally for load that subsequently departs, the IOU could sell any resulting surplus capacity into the capacity market. Similarly, under a forward bilateral RA market, all LSEs would be subject to uniform procurement requirements. To the extent that a LSE procured more capacity than is necessary to serve its load in a particular delivery year, the LSE could sell the surplus as the delivery year approaches. In the event that IOUs procure capacity on behalf of all load, the recovery of the costs of capacity procured for

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<sup>10</sup> Pub. Util. Code § 365.1(c)(2)(A).

departing load would be fundamentally different (i.e., it would be recovered through nonbypassable charges.

## **2. Impacts of transparency on forward procurement**

- a. Should the Commission require the three major electric IOUs to provide more public transparency into the levels of future procurement for which each has entered into a contract? What confidentiality rules could be changed or removed? In particular how can IOUs provide visibility to the California Independent System Operator (CAISO) regarding their midterm procurement contracts?

Information sharing regarding the IOUs' forward procurement plans is necessary but not sufficient to address the CAISO's intermediate-term reliability concerns. Even if the IOUs are substantially hedged multiple years forward, there are still significant amounts of capacity that will likely be needed but have not been secured by the IOUs, including capacity necessary to meet non-IOU LSEs' share of reliability requirements. In addition, IOU contracting alone does not assure the availability of contracted resources to the CAISO. One function of a capacity market or other formal forward procurement obligation would be for the CAISO to validate forward procurement (i.e., not only receive information about IOU procurement but ensure that the associated resources have tariff and/or regulatory obligations to be available and satisfy performance requirements).

- b. How can bids and offers into request for offers (RFOs) be released publically? What other information could be released?

With a suitable lag in place to address confidentiality concerns, information should be made available so that market participants could replicate the market valuation and other components of the analysis and ranking of offers that the IOUs perform in their solicitations. To do this, the IOUs should make their models available or, to the extent that they rely on commercially available models, document the models they used and provide non-proprietary inputs, as well as all offers.

### 3. Long-term contract solicitation rules

- a. Should the Commission adopt a rule that explicitly indicates that existing power plants may bid upgrades or repowers into new-generation RFOs?

Rather than crafting rules that are tailored to specific vintages of capacity (e.g., new, existing, repowered, upgraded), the Commission should reform long-term procurement rules to eliminate discrimination between different vintages of capacity. Discriminatory procurement policies and practices are inefficient and ultimately raise customer costs. Indeed, as the Brattle Group concluded, absent such non-discriminatory competition, “it will not be possible to meet resource adequacy objectives using the lowest-cost mix of supply resources.”<sup>11</sup>

In addition, long-term procurement should focus on homogeneous products with uniform terms (e.g., generic, local, or flexible capacity for 10-year terms). Structuring long-term procurement in this way will better allow LSEs and suppliers to determine least-cost combinations of new, existing, repowered, and upgraded generation, and potentially other resources, to meet long-term needs.<sup>12</sup> In addition to facilitating competition between different types and vintages of resources, resource solicitations for homogenous products with uniform terms would better ensure least cost/best fit procurement by eliminating the need to compare contracts of different lengths (e.g., comparing UOG resources with an assumed 30-year life to a 10-year PPA) and with disparate value streams (e.g., the energy and ancillary services values of combustion turbines relative to combined cycle facilities).

- (i) How should the existing and upgraded components of the repowers be valued differently in an RFO? How can additions such as energy storage be added to existing facilities and be valued against other types of offers?

The existing and upgraded components of a facility should not be treated differently in long-term solicitations. The goal of every long-term solicitation should be to fulfill well-defined

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<sup>11</sup> *Brattle Group Whitepaper* at 46.

<sup>12</sup> *See* section IV.A of the *Brattle Group Whitepaper*.

needs for capacity, energy, and other products at least cost, regardless of the vintage and/or type of resource.

- (ii) Should contracts for repowering or upgrading of facilities be restricted to the same length of contracts as new facilities? If not, please explain why there would be different contract lengths or different terms, and how these differences would be reflected in the valuation of the bids.

No. As discussed above, to the extent that a resource is able to satisfy the defined need, the resource should be able to participate in the resource solicitation regardless of the vintage and/or type of resource.

- (iv) How should cost allocation issues be addressed?

As discussed above, if suitable forward RA procurement requirements that apply to all LSEs are implemented, then the resulting forward RA market, whether bilateral or centralized, would allocate the cost of forward capacity procurement, regardless of whether the capacity is new, existing, upgraded or repowered. In contrast, to the extent that the IOUs undertake forward procurement on behalf of all customers, not only bundled customers, the cost of such procurement would be recovered through nonbypassable charges.

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Dated: April 26, 2013

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