Comments of Calpine Corporation
Standard Capacity Product
December 18, 2008

Calpine appreciates the opportunity to submit comments in response to the December 4, 2008 Updated Straw Proposal and the participant workshop on December 11, 2008.

Overview of Comments:

Calpine supports the revised and corrected direction of the Updated Straw Proposal. We specifically support a ubiquitous and commonly-applied performance standard with in-period financial penalties for non-performance.

Along with many other market participants, Calpine views this SCP process as a very high priority. While we support the direction in which the CAISO is headed, Calpine acknowledges that there is much work still to be done to finalize a workable and reasonable set of performance obligations and incentive mechanisms. We believe diligence will be required on the part of all participants – and most particularly on the part of the CASIO -- but we prefer to allow whatever time it takes to get the product "right." We do not believe that an arbitrary completion date is in the best interest of the market.

The rest of this document suggests principles and guidelines that the CAISO may find useful in further refinement of the proposal.

In the long run, SCP should be the primary, if not sole, compliance product.

In the participant meeting there was much discussion over the need for SCP exemptions and grandfathering. Indeed, below, Calpine supports those requests, where reasonable. However, we also support the increasing, and possibly exclusive use of SCP as the vehicle which the CAISO uses to validate RA compliance.

Non-performance penalties should be objectively relaxed in some cases.

Pre-existing (so called "grandfathered") contracts are likely to contain provisions for availability and non-performance. In those cases the CASIO should recognize, and honor those conditions by exempting them from incremental tariff-based, non-performance penalties.

The exemption could be based on a requirement that each of the contractual counterparties confirm that the pre-existing contract contains certain objective standards in the areas of offer obligations, availability targets and/or performance incentives.

Certain classes of contracts should receive automatic exemptions from non-performance penalties. Most specifically, Calpine believes that QF contracts that have a unilateral right to generate and "must take" status cannot be incrementally charged for non-performance.

Calpine would support the creation of a sunset date for the creation of newly exempted contracts. Certainly, that date should be no later than the date of approval of non-performance tariff modifications.

SCP obligations should be identical.

The CAISO Updated Straw Proposal contains an offer obligation for both Energy and Ancillary Services, for units that are qualified to provide A/S. Calpine continues to believe that the mandatory provision of A/S, without compensatory differentiation, is unfair.

Performance evaluations must reference a common standard.

Calpine supports the development of a common, fleet-wide availability standard. This common standard will allow the differentiation of "good" and valuable capacity from that which is not. The common standard appropriately rejects the ill-founded principle that a unit should only be held to its historic performance.

Performance targets must be based on reliability standards and known in advance.

Performance targets should be driven by objective, reliability-based principles that are known in advance.

The performance targets should be sufficient robust as to adequately represent the reliability value added by individual units. Performance over a large set of representative hours is preferred by Calpine, as in the Joint Parties proposal. Narrow metrics should be rejected as inadequately representing the nature of the obligations of an SCP unit.

For example, in the participant meeting two troubling metrics were discussed – one that would target a very narrow set of peak hours, and one that would target hours subject to scarcity. First, these very narrow metrics are not knowable in advance and could yield binary (zero or full) compensation outcomes. Second, these narrow metrics fail to recognize the reliability contributions offered by a resource over a much longer horizon.

Take the example of a summer in which a unit has perfect availability, but is forced off in late September. One surprisingly warm day in September, if triggering scarcity, could wipe out all of the reliability value the unit provided during the summer months.

Calpine does not, at this point offer a proposal other than that suggested in the Joint Parties proposal. However if the CASIO is inclined to limit the targeted hours, we suggest that the following be included:

1. On-peak summer hours
2. Significant summer ramping hours
3. Hours in which the Loss of Load Probability is high

<u>Non-performance penalties should immediately reward appropriate behavior</u>.

Based on our view of the CAISO Updated Straw Proposal, Calpine could support a self-funding financial mechanism that would reward performance that is better than fleet-wide average and discipline performance below the fleet-wide average. Those who pay into the penalty fund would be the source of rewards (if any) for those who perform better than average. The mechanism should be designed with the principle that all dollars remain within the generation pool.

Calpine believes that this kind of mechanism creates proper incentives. First, it provides strong encouragement for the availability of highly reliable capacity. Second, places the initial offer of SCP-RA capacity where it belongs – with the party that will be subjected to the costs and risks of non-performance – the generator.

Calpine believes that the fund should clear monthly, based on a trailing evaluation of performance. A monthly clearing provides the clearest link between performance and consequence, and likely provides the most immediate incentives for performance correction.

A monthly clearing also allows for monthly weighting of the mechanisms. In this way performance during identified periods (e.g. August) could be valued higher than during other periods (as with TCPM.)

Calpine envisions a graduated penalty and incentive mechanism. That is, the further performance is from the fleet average the higher the consequences. Data analysis – including the distribution of historic data – should inform the specific construction of the mechanism, and Calpine would suggest that the CAISO immediately begin assembling and analyzing that data.

Charges should be formulaic and payments should be tiered. Specifically, the charges for non-performance should be based on a graduated proportion of the ICPM backstop rate. Payments should be based on a symmetrical, graduated rate, but subject to four conditions.

1. First, the rewards should be scaled down proportionally if penalties are insufficient in a given month to fund all rewards.
2. Second, if penalties exceed rewards, the excess balance should be held by the CASIO for future months.
3. If at the end of a calendar year, there is a balance in the pool account, it should be re-distributed to any scaled-down reward payments
4. Finally, if after re-distribution, a balance remains, it should be distributed to LSEs in proportion to their incurrence of backstop (ICPM) capacity procurement.

Calpine supports unit substitution

Calpine believes that pre-arranged unit substitution is a reasonable component of the performance obligation. The substitute unit would have to have similar characteristics – including locational attributes and key constraint effectiveness. We encourage the CAISO to develop appropriate technical guidelines.

Thanks for the opportunity to comment.