

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Delta Energy Center, LLC)	Docket No. ER06-261-000
)	
Los Esteros Critical Energy Facility, LLC)	Docket No. ER06-268-000
)	
Delta Energy Center, LLC)	Docket No. ER03-510-000
)	(Not Consolidated)

**MOTION FOR LEAVE TO ANSWER AND ANSWER
OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION,
PACIFIC GAS AND ELECTRIC COMPANY,
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, AND
CALIFORNIA ELECTRICITY OVERSIGHT BOARD**

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”) 18 C.F.R. §§ 385.212 and 385.213 (2005), the California Independent System Operator Corporation (“CAISO”), Pacific Gas and Electric Company (“PG&E”), the California Public Utilities Commission (“CPUC”), and the California Electricity Oversight Board (collectively, the “California Parties”) hereby request leave to submit a limited reply to Delta Energy Center, LLC’s (“Delta”) and Los Esteros Critical Energy Facility, LLC’s (“LECEF”) January 9, 2006 unauthorized Answer to the California Parties’ Joint Protest. 1/

1/ Answer to Supplemental Protest and Motion to Reject, Answer to Joint Protest and Motion to Consolidate, and Request for Necessary Leave to Answer, Docket Nos. ER06-261-000, ER06-268-000 and ER03-510-000 (filed Jan. 9, 2006) (hereinafter “Answer”). Delta’s and LECEF’s January 9, 2006 filing was a two part Answer: (i) a permitted Answer to PG&E’s and CPUC’s separate Motion to Reject and (ii) an unauthorized Answer to the California Parties’ Joint Protest.

Delta and LECEF submitted, as attachments to their Answer, their July 5, 2005 Local Area Reliability Service (“LARS”) proposal letters in response to PG&E’s and the CPUC’s Motion to Reject. ^{2/} The California Parties previously were unable to include with or discuss the proposals in their Joint Protest because they are confidential under the provisions of the CAISO Tariff, although the California Parties expressly noted the importance of the proposals to the analysis of the issues before the Commission. ^{3/} Delta and LECEF made their LARS proposals public with their Answer. ^{4/} The California Parties now seek in this submission only to address the relevance of the proposals to the request for a five-month suspension of rates and the relevance of the recent Calpine Bankruptcy Court proceedings to the escrow request, neither of which could be adequately addressed in the Joint Protest.

I. STATEMENT OF ISSUES

1. The Commission should accept and consider the California Parties’ limited response because good cause exists to permit the response. Specifically, with the inclusion of the proposal letters into the public record there are additional facts that the California Parties were previously unable to include in their analysis in the Joint Protest and such information will serve to clarify the record. 18 C.F.R. § 385.213(a)(2); 18 C.F.R. § 385.101(e); ISO New England, Inc. v. New England Power Pool, 106 FERC ¶ 61,280 (2004); Entergy Services, Inc., 105 FERC ¶ 61,318 (2003).

2. The Commission should reject Delta’s and LECEF’s mischaracterization of the Commission’s test for ordering the maximum suspension of proposed rates, and should order the maximum, five-month suspension of Delta’s and LECEF’s proposed rate increases as the proposed increases are excessive by more than the 10 percent threshold established in West Texas Utilities Company, 18 FERC ¶ 61,189 (1982) (“West Texas”).

^{2/} See Answer at p. 3, n. 6. The LARS process is described in the Joint Protest at pp. 7-9.

^{3/} See Joint Protest at p. 10, n. 18.

^{4/} See Answer, Attachments 1 and 2.

3. Delta's and LECEF's status as debtor in bankruptcy does not negate the need for an amount equal to their refund liability to be held in an escrow account effective as of the date the five-month suspension expires. 11 U.S.C. § 1129(a)(9); Devon Power LLC, 102 FERC ¶ 61,314 (2003).

II. MOTION FOR LEAVE TO FILE LIMITED RESPONSE

The Commission should permit the California Parties to file this limited response because the California Parties were not able to address Delta's and LECEF's previously confidential proposals in their Joint Protest. The Commission's procedural rules generally do not provide for answers to protests, answers, or similar filings unless otherwise allowed by the decisional authority. ^{5/} However, the Commission may, for good cause, permit such an answer. ^{6/} Good cause exists to permit the California Parties to respond to the Answer to the Joint Protest, because the California Parties' limited response provides clarifying information with respect to the previously confidential, but now disclosed LARS proposals made by Delta and LECEF and corrects the mischaracterizations in the Answer of both the West Texas maximum suspension policy and the effect of Delta and LECEF being debtors in bankruptcy on the need for a refund escrow account. This limited response will therefore materially aid in the efficient disposition of these proceedings. ^{7/} The California Parties thus, respectfully request leave to submit this limited response.

III. RESPONSE

^{5/} 18 C.F.R. § 385.213(a)(2).

^{6/} 18 C.F.R. § 385.101(e).

^{7/} ISO New England, Inc. v. New England Power Pool, 106 FERC ¶ 61,280 at P 19 (2004) ("We will accept the answers to protests and answers to answers noted above, given the complex nature of this proceeding and because these answers aided in clarifying certain issues"); Entergy Services, Inc., 105 FERC ¶ 61,318 at P15 (2003) (finding good cause to accept answers, including an answer to an answer, because the answers provided the Commission "information that assisted [in the] decision-making process").

A. The Standard Set in West Texas Demands the Imposition of the Maximum Five-Month Suspension of Delta’s and LECEF’s Proposed Rates

Delta and LECEF mischaracterize the standard for ordering a maximum suspension as set forth in West Texas, [8/](#) stating that the Commission must make the ultimate determination that the proposed rates are “in fact” substantially excessive before the Commission may suspend proposed rates. [9/](#) If accepted, Delta and LECEF’s suggested rewrite of the West Texas policy would create an absurd result, requiring the Commission to make a factual determination regarding the proposed rates before holding a hearing and developing a record. The correct West Texas standard provides that the Commission will impose a five-month suspension where its preliminary investigation indicates that the proposed rates may be unjust and unreasonable and may be substantially excessive. [10/](#) This well-established standard is more than satisfied in these proceedings.

As they acknowledge in their Answer, in July 2005, Delta and LECEF voluntarily submitted proposals to the CAISO for reliability-must-run (“RMR”) service for the 2006 Contract Year. Those proposals were described by Delta and LECEF as the rates at which the two unit owners were “willing to provide” RMR service, presumably using their prior RMR operating experience (three years for Delta and two for LECEF) to develop the proposals. The

[8/](#) West Texas Utility Company, 18 FERC ¶ 61,189 (1982).

[9/](#) Answer at p. 24.

[10/](#) RockGen Energy, LLC, 100 FERC ¶ 61,261 at P 40 (2002) (citing West Texas) (imposing a five-month suspension upon determining that RockGen’s proposed rate for Emergency Redispatch Service may be substantially excessive).

LARS proposal for Delta was the same as its 2005 rate. ^{11/} LECEF proposed, in its July 2005 proposal letter, a higher rate than its 2005 rate, \$7 million rather than the \$1.1 million rate in place for 2005. LECEF explained in its proposal the reason for the rate increase – the termination of its power sale contract with the California Department of Water Resources (“CDWR”) under which LECEF previously recovered a portion of its fixed costs.

The CAISO used the proposal rates in making its choices of RMR units for 2006, working under the entirely reasonable assumption that the rates reflected what Delta and LECEF believed to be the cost of providing RMR dispatch. The rates Delta and LECEF have now filed with the Commission for the same rate year, however, are *several multiples* of the proposals Delta and LECEF submitted in the LARS process. They are the epitome of filed rates that may be unjust and unreasonable and may be substantially excessive.

Specifically, Delta has submitted a rate comprised of an Annual Fixed Revenue Requirement (“AFRR”) of \$103.8 million and a self-selected Fixed Option Payment Factor (“FOPF”) of 0.50. If Delta continues to operate under Condition 1, that would result in a 252 percent RMR rate increase. ^{12/} If instead, Delta exercises its option to operate under Condition 2 and thus withdraw the facility from the market, as Delta intimates in its Answer it may, ^{13/} the rate increase would be approximately 600 percent.

^{11/} The 2005 rate for Delta has been accepted by the Commission and is subject to refund pending the outcome of FERC Settlement Procedures.

^{12/} Pursuant to Article 3.1 of the CAISO RMR Agreement, an RMR Unit operating under Condition 1 may also participate in market transactions and retain the resulting revenues. Accordingly, it is reimbursed under the RMR Agreement for only a portion of its fixed costs. Under Condition 2, an RMR Unit bids into the market only when it receives a dispatch notice from the CAISO and retains no revenues from market transactions. Thus, all of its just and reasonable fixed costs are reimbursed under the RMR Agreement, i.e., it has an FOPF of 1.

^{13/} Answer at p. 25.

For LECEF, the proposed rate increases above the LARS proposal are equally dramatic. Knowing it was scheduled to lose its contract with CDWR, LECEF advised the CAISO in July that it was willing to provide RMR dispatch in 2006 for \$7 million. With no explanation of new costs or new circumstances that might drive a different conclusion, LECEF is now telling the Commission that it should receive \$44.4 million if it operates under Condition 2, or \$33.3 million if it operates under Condition 1. ^{14/} Those would represent increases of 534 percent and 376 percent respectively above the levels at which in July LECEF said it was willing to provide the same reliability service over the very same period.

Delta and LECEF are required to provide the CAISO and the Commission accurate and factual information in all communications. ^{15/} The CAISO, therefore, reasonably understood the proposal rates to reflect rates at which Delta and LECEF had determined would allow them to recover their fixed costs for providing 2006 RMR dispatch. Delta and LECEF now propose dramatically higher rates without meaningful explanation, but only the irrelevant assertions that the LARS proposals did not establish a binding contract and that each has used the AFRR formula and a FOPF of its own choice.

Under the circumstances, the California Parties seriously question the accuracy and justness and reasonableness of the dramatically higher rates filed with the Commission. In a hearing, Delta and LECEF will have the opportunity to prove whether their filings are indeed consistent with the cost-based formulas of the RMR Agreement. For purposes of deciding

^{14/} The \$33.3 million Condition 1 rate derives from the proposed AFRR of \$44.4 million and a proposed FOPF of 0.75 for LECEF.

^{15/} Delta and LECEF are energy sellers with market-based rate authority subject to Commission's Market Behavior Rules which require sellers to ensure that their communications with independent system operators and the Commission are accurate and factually correct.

whether a five-month suspension of the filed rates is appropriate, however, the only relevant question for the Commission is whether rates that are between 250 and 600 percent above those at which Delta and LECEF volunteered that they were willing to provide RMR service “may be unjust and unreasonable” and “may be substantially excessive.” It would seem that the only possible answer to that question is that the rates may indeed be unjust, unreasonable and substantially excessive.

Furthermore, the proposed FOPFs alone are unjust and unreasonable and may be substantially excessive. [16/](#) Delta proposes a 0.50 FOPF and LECEF proposes a 0.75 FOPF. It is misleading for Delta and LECEF to claim their proposed FOPFs are justified merely because they are “within the range of other FOPFs accepted . . . as part of a 1999 settlement.” [17/](#) As is well established, settlements create no precedent, and even if they did, the settlements Delta and LECEF purport to rely on would have no precedential value here because neither Delta nor LECEF is comparable to the RMR Units that were the subject of the 1999 settlement. The 1999 settling units were old, inefficient units, unlike LECEF and Delta. Units that are comparable in age and efficiency either do not operate under RMR Agreements or do not have FOPFs at all. [18/](#) Further, Delta’s and LECEF’s reference to the “dispositive prescription in Schedule B, Paragraph 8” incorrectly implies that they have the contractual right to file a FOPF or to alter it

[16/](#) A unit’s FOPF is a significant rate driver as described in detail in the Joint Protest at p. 3, n. 4.

[17/](#) Answer at p. 21. Delta and LECEF have offered no justification of their proposed FOPFs in relation to the costs of operating those facilities or the expected market revenues, so the Commission can have no assurance the proposed rates will not produce a substantial windfall for these generators compared with other market participants.

[18/](#) The comparable RMR Units that do operate under RMR Agreements use an alternative form of the RMR Agreement that does not include an FOPF value – an Annual Fixed Reliability Cost (“AFRC”) agreement just like the current rate schedules for Delta and LECEF.

at will. [19/](#) The Schedule B, Paragraph 8 reference specifies that, “Owner shall make a filing...containing the values in Tables B-1 through B-6....” These are the only values in Schedule B of the RMR Agreements that may be revised in a Limited Section 205 filing. All FOPF values are in Table B-0, and as such, revisions or addition of the values, as in the case of Delta and LECEF, are not part of the limited Section 205 filing identified at the end of Schedule B.

Lastly, Delta and LECEF argue that because the Commission has not previously imposed the five-month suspension on rates for the provision of RMR service to the CAISO, the Commission should not do so here. [20/](#) The CAISO has never before requested a five-month suspension of RMR rates because the CAISO has never been confronted with unexplained rate increases approaching the magnitude of those at issue here. Proposed rate increases of this magnitude leave no room to doubt that the proposed rates may be substantially excessive and should be suspended for the full statutory period.

B. Delta’s and LECEF’s Status as Debtors in Bankruptcy Underscores the Need for Potential Refund Amounts to be Held in Escrow

Delta and LECEF oppose the escrowing of potential refunds on the grounds that they have filed for bankruptcy, which they claim affords new protections to ratepayers. [21/](#) However, the mere prospect of being able to ask the Bankruptcy Court for the allowance of a refund as an administrative expense priority claim offers no assured protection for ratepayers.

[19/](#) Answer at p. 24. Delta and LECEF make this same argument at pp. 21-22 of their Answer stating in part: “Owners’ Rate Schedule Revisions implement the express rate formulas authorized under Schedule B, Paragraph 8 of their existing RMR Agreements. . . .”

[20/](#) Answer at p. 25.

[21/](#) Id.

While sections 503(b) and 507(a)(2) of Title 11 of the United States Code (the "Bankruptcy Code") allow for priority in payment of post-petition administrative expenses of debtors, such payments do not have to be made until the effective date of a plan confirmed by a bankruptcy court. ^{22/} The Bankruptcy Code does not set a deadline for a debtor to propose or obtain confirmation of a chapter 11 plan. A debtor can operate for years in chapter 11 before seeking confirmation of a plan. Under the best of circumstances, ratepayers could be left waiting for their refunds for a very long time.

More fundamentally, however, priority in payment has little meaning if there are not sufficient funds available to make the payment. Standing first in line among unsecured creditors does not matter if there is nothing to distribute. There is no assurance that Delta and LECEF will be in a position to pay even their post-petition administrative expenses.

The aggregate financial condition of Calpine and its bankrupt affiliates, including Delta and LECEF, appears perilous. As described by the Debtors in a number of their filings with the Bankruptcy Court:

- Between 2001 and 2004, the Debtors doubled their installed capacity, financed through additional debt,
- The Debtors are at a disadvantage with respect to the cost of energy production in comparison with their competitors,
- The Debtors sold substantially all of their oil and natural gas reserves in July 2005, and
- The Debtors have run at an average baseload capacity factor of 45% over the past year.

^{22/} 11 U.S.C. § 1129(a)(9).

These financial weaknesses are both structural and potentially profound, and the Debtors in their Bankruptcy Court filings have not convincingly described an exit strategy that would guarantee payment of administrative claims such as the refunds that will be at risk if the Commission does not require that they be escrowed.

Indeed, to date, neither Delta nor LECEF has filed any financial information with the Bankruptcy Court, except that each has identified both its assets and liabilities as being more than \$100 million. The 150-plus Calpine-related chapter 11 cases have been administratively consolidated, but not substantively consolidated. It is entirely possible that some of the Debtors, e.g., Calpine affiliates such as Delta or LECEF, may be administratively insolvent and unable to draw on the assets of other Debtors to pay post-petition administrative expenses.

The prospect of administrative insolvencies among the Debtors is very real. The assets of each of the Debtors have been made the subject of court-approved post-petition, debtor-in-possession financing secured by first priority liens and “super-priority” administrative expense claims to the extent that the liens are insufficient to satisfy the post-petition financings. All secured creditors will have to be assured of payment in full before administrative expense claimants can expect any recovery.

In addition, rather than freezing payments to unsecured creditors with pre-bankruptcy claims, the Debtors have obtained Bankruptcy Court permission to pay immediately up to \$20 million in pre-bankruptcy claims owed to vendors who the Debtors consider necessary to their operation under chapter 11. This further reduces the cash available to the Debtors to pay their post-petition administrative expenses.

Lastly, the Debtors have sought and obtained from the Bankruptcy Court approval to pay immediately certain obligations owed with respect to salaries, compensation, employee expenses and benefits, all of which are accorded statutory priorities under Bankruptcy Code

section 507(a)(4)&(5) junior to the priority of the post-petition administrative expenses claim that Delta and LECEF argue will protect ratepayers.

In short, the bankruptcy proceedings fall far short of protecting ratepayers, and the Commission should therefore require an escrow consistent with its ruling in Devon Power LLC. [23/](#)

WHEREFORE, the California Parties respectfully request that the Commission grant this motion for leave to answer, accept this answer, and accept Delta's and LECEF's rate filings subject to refund, suspend the filing for the maximum permissible period pending the outcome of a hearing, and, once the rates take effect at the end of the suspension period, require an amount equal to the refund liability to be held in an escrow account.

[23/](#) 102 FERC ¶ 61,314 (2003).

Dated: January 18, 2006

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 18th day of January, 2006 caused to be served a copy of the forgoing Motion for Leave to Answer and Answer upon all parties listed on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings.

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