

**Comments of CalPeak Power LLC on CAISO's
*Commitment Cost Enhancements Second Revised Proposal, dated July 15, 2014***

CalPeak Power LLC ("CalPeak") appreciates this opportunity to provide comments on the CAISO's *Commitment Cost Enhancements Second Revised Proposal* ("Second Revised Proposal"), dated July 15, 2014, and respond to questions posed by the CAISO in the response to the comments by CalPeak on the *Commitment Cost Enhancements Revised Proposal* which were filed July 1, 2014 ("Initial Comments").

CalPeak's subsidiaries, CalPeak Power – Border LLC, CalPeak Power – Enterprise LLC, CalPeak Power – Panoche LLC, and CalPeak Power – Vaca Dixon LLC, operate four substantially identical peaker plants. Two of them, CalPeak Power Border Unit 1 ("Border") and CalPeak Power Enterprise Unit 1 ("Enterprise"), are located in SDG&E's electric and gas service territories. The other two, CalPeak Power Panoche Unit 1 ("Panoche") and CalPeak Power Vaca Dixon Unit 1 ("Vaca Dixon" and collectively with Border, Enterprise and Panoche, the "CalPeak Units"), are in PG&E's electric and gas service territories. All four utilize Pratt & Whitney, Model FT8-2 (DLN), Twin-Pac gas turbine engines, in which each unit is comprised of two combustion turbines that, singly or together, turn a single generator. In a 2-in-1 configuration, *i.e.*, with both CTs operating at each unit, the PMin in this configuration for each power plant is 44 MW and the PMax values range between 48 and 52 MW, depending on the unit.

The CalPeak Units have heat rates, in the range of 10,588-12,370, again depending on the configuration as a multi-stage generator (MSG) unit. As a result they are seldom called upon to run by the CAISO. Because CalPeak's subsidiaries only operate peakers which run seldomly and unpredictably, the natural gas used to run their power plants is purchased on the spot market.¹

CalPeak encourages CAISO to quickly adopt an interim approach that can be realistically implemented in time for the winter of 2014-15. With that in mind, CalPeak suggests several improvements to the current proposal.

I. The CAISO Should Act Quickly on Interim Tariff Changes for the Winter of 2014-15

The CAISO began this process in order to make changes to the commitment cost provisions of its tariff which cause under recovery in the event of natural gas price spikes. While in principle CalPeak supports the CAISO's efforts to make changes to the commitment cost provision to reflect the actual cost of natural gas, as CalPeak explained in its Initial Comments and further explains below, the Second Revised Proposal will not accomplish its intended goal since it will not provide adequate compensation for units such as the CalPeak Units.

CalPeak recognizes that it is very difficult for the CAISO to write better rules now since there are several other CAISO and CPUC proceedings pending that will affect how the cost commitment rules should be written. CAISO has indicated that it: (1) intends to propose new language relating to operational flow orders; (2) will conduct a new stakeholder proceeding to make changes to its bidding rules; and (3) is conducting a stakeholder proceeding relating to

¹ Unlike many other generators in California, CalPeak also has no affiliates that operate natural gas-fired power plants in California or purchase significant quantities of natural gas, so it is not in a position to share natural gas supplies with its affiliates.

when it will set administrative prices. Meanwhile, the CPUC has received an application from SoCalGas and SDG&E to change provisions of their tariffs relating to operational flow orders. Time is of the essence, however, particularly for generators like CalPeak's subsidiaries with generating facilities in Southern California where increased use of natural gas due to the retirement of SONGs make the threat of natural gas price spikes during the winter of 2014-15 very real.

In light of the need to make more progress in related proceedings, CalPeak believes that the CAISO should refocus the stakeholder proceeding to make only interim tariff changes that will take effect in time for the winter of 2014-15. CalPeak believes that there are only two key changes to the Second Revised Proposal which would make it acceptable as an interim approach: (1) change the bid cap from the proposed 125% of the proxy cost calculation to 150% of the proxy cost (this will leave in-place the current bid cap that is used in the registered cost calculation); and (2) in the event of a natural gas price spike that requires re-running the day-ahead market, provide for setting an administrative price which includes all costs generators incur for securing natural gas supplies. If the CAISO decides to limit availability of the relief proposed in clause 2 of the preceding sentence, it should be at a minimum offered to all resources with high heat rates (and which therefore run infrequently) and not just to units whose operation is limited by permits, which is an arbitrary limitation.

II. The Second Revised Proposal Should be Improved

- ***The Bid Cap Is Too Low***

As CalPeak explained in its Initial Comments, the CAISO's proposal to remove the Registered Cost option and set a bid cap of 125% of the Proxy Cost will ensure that generators such as CalPeak's subsidiaries will not be adequately compensated. While the prior version of the proposal suggested that at least use-limited resources might get a higher bid cap, the Second Revised Proposal eliminates this possibility. The bid cap should be raised to 150% of the proxy cost. The CAISO recognized last year when it set the Registered Cost cap at 150% of the Proxy Cost that there are generators for which this is necessary for them to recover their costs. Parties have entered into commercial arrangements assuming that they would be subject to this higher cap.

- ***The Proposal for Addressing Price Spikes Does Not Ensure Recovery of Natural Gas Costs***

The CAISO's proposal for addressing natural gas price spikes by running the day-ahead market model again will not provide assurance that generators recover their actual natural gas costs. As CalPeak explained in its Initial Comments, when generators like the CalPeak Units which have low capacity factors and face winter balancing rules are selected to run in the day-ahead market they often have no choice but to immediately purchase gas on the spot market. The Second Revised Proposal does nothing to ensure that generators that are selected to run in the day-ahead market and who are prevented by the CAISO's rules from bidding an energy sale price that compensates them for the risk of natural gas spikes will be able to recover the cost of the gas they purchase. In the event of a natural gas price spike, it would be more equitable and better for a properly functioning electricity market to set an administrative price after the fact which ensures recovery of all natural gas costs incurred.

- ***The Proposal Should Not Assume that CalPeak Can Reduce its Risks by Hedging***

Questions asked by the CAISO appear to assume that CalPeak and its subsidiaries can reduce their own risks by hedging. As CalPeak explained in its Initial Comments, “[h]edging is not feasible for resources such as the CalPeak Units since the units run very infrequently, and it is not possible to accurately predict when the units will be called upon to run. Moreover, physical hedging is precluded by natural gas pipeline company balancing requirements.” Initial Comments at 4. The CAISO responded with questions:

Would the following interpretation be correct: CalPeak believes hedging is not feasible for its resources because it would not be economic to do so?

Can CalPeak explain why physical hedging is “precluded” by natural gas pipeline balancing requirements? What mechanisms, if any, can CalPeak use to hedge (either financially or physically) the cost of buying gas in the intra-day market when the generator is not scheduled to operate day-ahead? For each hedging mechanisms identified, please explain how CalPeak would be able to recover the cost of the hedge.

CAISO, *Commitment Cost Enhancements - Revised Straw Proposal Comments*, at 12.

In short, the CAISO’s interpretation of CalPeak’s initial comments is correct -- given the operating profile of the CalPeak Units, CalPeak believes any hedging strategy would be uneconomic. To further explain: it is not possible for CalPeak’s subsidiaries to hedge economically due to the unpredictability of when and how frequently the CalPeak Units will run. As a result, any hedge provider will charge a significant risk premium, particularly in light of the fact that the CalPeak Units are only called upon when infrequent and unpredictable events happen, such as extreme weather events, transmission outages, and outages of other lower heat rate generators.

The following is instructive of this point. For the past several years, the two CalPeak units in the San Diego area (CalPeak Border Unit 1 and CalPeak Enterprise Unit 1) have had capacity factors of less than 5%. Yet their hours of operation in any given month varied dramatically. While the days on which the units ran in any given month have followed a general seasonal trend, they do not reflect a predictable pattern on particular days or even months, making it extremely difficult for CalPeak or hedge counterparties to make reliable predictions of gas demand at the facilities over any period. As part of this effort, CalPeak would be happy to include further operational data under the terms of an NDA to elucidate this point further. The bottom line is that it is impossible to find a hedging product that would be economic given the low capacity factor of the units.

With respect to physical hedging, it is not possible for CalPeak to hold natural gas in reserve. There are few natural gas storage facilities in Southern California and none south of Los Angeles, making it very difficult to flow the gas to the units. Moreover, the ability of CalPeak’s subsidiaries to contract for delivery of natural gas supplies in advance is limited since under the winter balancing rules there is a substantial risk that CalPeak’s subsidiaries will incur significant penalties for overestimating or underestimating how much gas they will need on a daily basis

since it is difficult to predict when they will be called upon to generate electricity. CAISO's rules provide no means for CalPeak's subsidiaries to recover these costs.

Even if it were possible to financially or physically hedge, the costs of hedging are not part of the proxy price calculation so CalPeak would not be able to recover these costs, particularly if the price cap remains at 125% of the proxy price as the CAISO has proposed.