

Comments of Calpine Corporation On the CAISO's GMC Straw Proposal

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Submitted by	Company	Date Submitted
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General Comments

The CAISO has proposed to substantially change both the cost allocation and the rate design for collection of its nearly \$200 million operating cost. The current rate design for GMC includes 17 charge types which makes the transactional cost difficult to interpret. In addition, the existing rate structure creates incentives for market behavior that the CAISO apparently finds unattractive.

The new proposal greatly simplifies the rate design by lobbying most costs into one of two “buckets” and creates a third category for congestion hedges. Calpine supports the CAISO’s effort to create simplifications and more transparency. However, the CAISO proposes to allocate GMC costs equally between supply and demand so one-half of the total costs of CAISO operations would be paid by supply¹.

For the reasons identified below, Calpine does not support incremental allocations of GMC costs to generation and imports. If the CAISO is not inclined to charge all GMC costs directly to load, where they will ultimately reside in any case, Calpine offers alternatives.

Calpine does not support charging indirectly that which could be charged directly

The CAISO proposes to “variablize” its fixed cost of operation and design rates to charge 98 percent of its costs to loads, exports, generation and imports. The billing determinants are generally Mwhts or MWs per hour² (for instance, for ancillary services.) The average cost, when allocated this way will be roughly \$0.40 per Mwh for every Mw of supply and every Mw of consumption.

¹ This is, by definition correct, but the CAISO has produced bill estimates that reflect the fact that a significant amount of supply is under the operational control of the state’s 3 largest IOUs.

² The CAISO breaks out two buckets, one for “awards” and one for “flows”, but for simplicity, we lump them together.

However, costs allocated to supply will not (for the most part³) remain with supply, as generation/import bids theoretically rise to cover the *expected value* of the actual GMC exposure. Thereby, the entire GMC cost will be allocated to loads – directly by the CAISO, and indirectly by generators and importers raising their supply bids.

For a variety of reasons, suppliers will not know precisely what their GMC exposure will be. The simplicity of the new design does improve transparency and forecasting GMC exposure will be more accurate with this proposal than without it. Nonetheless, a supplier will not know *a priori* whether it will receive awards or what awards it will receive and what energy will flow and therefore, what GMC exposure it might have. In addition, since a single generator can provide multiple products, even if it could know with certainty the optimized IFM and RT outcomes, it is not feasible to differentiate each hourly bid of capacity by the specific allocation of expected GMC exposures.

Rather than bidding the minimum-possible GMC, suppliers are more likely to bid the *expected value* – which could include a probabilistic view of the costs of awards, flows, ISTs, bid-segment fees and even possibly export fees⁴. This expected value would reflect the risk that GMC costs could be higher than the minimum possible exposure. So ultimately, loads could bear a risk-adjusted level of GMC costs that exceed the direct costs of CAISO operation.

Charging the costs of GMC directly to loads and exports rather than indirectly to suppliers eliminates the payment of reasonable, but risk-adjusted supply bid costs.

The “Flow Through” theory is compelling, but not proven.

Parties have suggested that if all supply bids include the same GMC uplift, that dispatch order and infra-marginal revenue expectations for uncontracted assets should be unaffected. While some distortions will clearly occur⁵, Calpine believes that if these assumptions are proven out, that generator and import revenue expectations would be unchanged.

However, Calpine is predominantly an infra-marginal supplier. It does not control the resources that are generally on the margin and those who might control marginal resources will have a different *expected value* of risk and cost exposures that may influence their bid levels. Revenue compression for infra-marginal generation is a certain possibility if marginal generators (or those bidding marginal generation) face lower risk expectations.

³ An unfortunate exception to this rule could be existing fixed-price contracts. We discuss them later.

⁴ This expected value should also be in allowable in the Default Energy Bids which are used in LMPM.

⁵ For instance, the average cost of non-spin for the month of November was less than the proposed GMC charges. The cost of non-spin would more than double with this change.

Calpine agrees that the CAISO should “Seek To Do No Harm.”

In the November Straw Proposal, the CAISO describes its “Guiding Policy and Ratemaking Principles” at page 4. In the discussion of the second principle, the CAISO confirms that “a properly designed GMC should seek to do no harm,” and that it “is simply a mechanism to recover ISO revenue requirements in a manner which minimizes market impacts”.

Calpine strongly endorses the concept that GMC should avoid market impacts and believes that allocations of GMC to generation and imports could and will affect market outcomes. In addition to mitigating effects on existing contracts, we offer several alternatives that could minimize the exposure to unnecessary costs or unintended consequences.

Calpine supports accommodations for pre-existing contracts

The “pass-through” theory clearly fails if the added costs of an increased GMC cost cannot be passed through to contractual counterparties. In this case, an allocation of the GMC cost to suppliers simply increases their costs and provides a windfall to loads, as loads avoid costs of operating the CAISO.

In particular, fixed-price, long-term contracts which split the SC responsibility between supply and load will not generally⁶ allow pass-through. Calpine has long-term, fixed-price contracts⁷ for baseload energy where the cost of GMC (if allocated to supply as proposed) would increase by a factor of 10 from an aggregate GMC exposure of about \$250,000 to over \$2.5 million.

Such a dramatic change in the allocation of GMC would not have been anticipated by reasonable negotiators when such a deal was struck. In addition, such a dramatic effect on market outcomes was probably not anticipated by those designing the new GMC structure. However, a theory of “do no harm” would require that such contracts be accommodated for the remaining tenure of the contract.

Calpine is open to reasonable mitigation measures that continue to assess long-term, fixed-price contracts an allocation of GMC as long as it is consistent with historical, and not proposed rates. For instance, Calpine would accept a fixed-cost GMC annual payment (e.g. historical allocations reasonably escalated) or a substantially pro-rated volumetric charge (e.g. one-tenth of the per-mwh charge.)

⁶ Of course, provisions of the underlying contract may allow pass-through.

⁷ Calpine is certainly willing to share these contracts confidentially with the CAISO, as long as such is allowed under the contract.

Calpine proposes alternatives if the CAISO imposes GMC charges on supply

As a first principle, Calpine proposes that *if* the CAISO determines that it must charge supply, that imports and internal generation face precisely the same cost exposure. Differentiated pricing creates the unintended consequence of artificially favoring imports or internal generation.

Calpine understands that the CAISO seeks to apply this same symmetry principle to all resources because “both load and generation will provide similar services”⁸. Certain new technologies might need to be treated differently (e.g. DSM reductions should compete price-wise with incremental generation) but as discussed below, Calpine asserts that load is the major beneficiary of CAISO operational systems and should therefore bear most of the costs. Each of the options below decrease the risk that the CAISO could impose unrecoverable costs on supply or otherwise create harm or unintended market impacts.

Option 1 – Charge Supply only the Market Services Charge.

If the CAISO does impose costs on supply, Calpine supports the comments of SCE⁹ which suggest that generation pay the Market Services charges and not the System Operations charges.

As SCE suggests “the benefits of reliable System Operations are accruing to demand.” Indeed, the CAISO indicates that the “fundamental purpose of system operations is to balance supply and demand.” Additionally, SCE is concerned with price distortions that arise as GMC bid adders are included in IFM results.

Option 2 – Charge Supply, but on a pro-rated basis

As with pre-existing contracts, supply could be charged a pro-rated charge (as a percent of Mwh or price) for both Market Services and System Operations that reflects the possibility that the “pass through” theory may fail.

Option 3 – Charge Supply, with a conditional transition

As an alternative to option 2, the CAISO could prescribe a transition plan in which supply’s pro-rated share of the GMC would increase over, say 4-5 years. This transition period would allow bilateral contracts to expire and be reformed with a clear expectation of future risk. The annual escalation of the discount percentage could be made contingent upon a finding by an independent party that the “pass through” theory is supported.

Thank you.

⁸ Straw Proposal p7

⁹ SCE’s comments on the Discussion Paper, submitted October 21

