

## California ISO Report on Basis and Need for CPM Designation for Sutter Energy Center

Submitted by	Company	Date Submitted
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Thank you for this opportunity to comment on the proposals contained in the California Independent System Operator’s (CAISO’s) “Report on Basis and Need for CPM Designation for Sutter Energy Center” issued December 6, 2011. Southern California Edison (SCE) understands the CAISO’s desire to maintain existing flexible capacity as the system incorporates increasingly large amounts of intermittent renewable resources mandated by the California legislature and regulators. In this regard, SCE supports the effort by the CAISO to anticipate the resource requirement of the electrical grid over an extended period of time and to develop a long-term framework to address such need.

SCE supports the CAISO’s proposal to undertake a stakeholder process intended to develop a long term capacity procurement mechanism that will enable the CAISO to procure the resources needed over the longer term to ensure the reliability of the electrical grid. However, SCE has serious concerns with the CAISO’s proposal to prevent Calpine’s Sutter Energy Center (SEC) facility from retiring by way of making a Capacity Procurement Mechanism (CPM) award after seeking an exception to the current FERC-approved tariff. In sum, the analysis relied on to determine the unit’s need is questionable, and even if need can be satisfactorily demonstrated, CPM is the wrong tool in this situation, as a result the payment is excessive and still provides no guarantee the unit will be available to the CAISO in 2017. Moreover, since the flexibility need is driven materially by renewable integration, costs should not be allocated exclusively to load. These comments provide additional detail of our concerns.

**Background:** CAISO has presented a “needs analysis” using the CPUC’s Long Term Planning Proceeding (LTPP) high load case and the CPUC’s standard planning assumptions. These assume (among other things) over 8,000MW of once-through-cooling (OTC) plants in the LA Basin retire by 2017 and are not replaced. Based on this analysis, CAISO concludes that the capacity provided by the Sutter plant will be needed starting in 2017/18. Moreover, they assume the plant will not be able to restart at that time if it retires next year as Calpine has stated it would absent a contract. The CAISO proposes to grant a CPM designation to the Sutter plant in 2012 and will seek a waiver from FERC of the restrictions preventing this designation. Specifically, the current tariff only allows such CPM payments for capacity at risk of retirement needed in the next resource adequacy compliance year. Early next year, after resolving the Sutter issue, CAISO proposes to undertake a stakeholder process to develop a mechanism to address longer-term system needs. They expect these rules to be in place before the end of 2012 and, presumably, to eliminate the need for an additional CPM designation for the Sutter plant beyond 2012.

**CAISO's Need Analysis is Deficient.** SCE has concerns with the analysis that CAISO has used to make a needs determination. In part, CAISO is only relying on the high-load scenario of the LTPP analysis, whereas other scenarios do not reflect similar need. The analysis assumes that the load in 2017/18 is the same as the load in 2020. SCE observes that there is considerable uncertainty regarding the timing of need for flexible capacity, how impacted OTC units will achieve compliance with State Water Resources Control Board regulations, and the degree to which future flexible capacity needs will be met with resources also needed for local capacity requirements. Because there is so much uncertainty around the analysis presented in the LTPP proceeding, most parties entered a Settlement Agreement that concluded the analysis was inconclusive and that further work was needed by the CAISO. At this time, this further work has not been completed.

**CPM is the wrong solution to this issue, and in turn the price paid would be too high.** CPM was designed as an "RA contract replacement", and as such, the CAISO purchases daily must-offer participation from CPM units. But here, the CAISO has no such "must offer" need for 2012. Rather, as long as the unit is available in 2017, the CAISO should find it perfectly acceptable if the unit mothballs and does not participate in the markets until then. This could include a full termination of the pseudo tie and the associated cost of transmission. The CPM mechanism simply does not apply to this situation where daily market participation is unnecessary.

The proposed CPM designation would provide Calpine with an administratively determined payment at the rate of \$55 per kW-year, or possibly higher<sup>1</sup>. Thus payments could exceed over \$35million per year. This payment would be made outside of any form of competitive markets, and without any basis for concluding this is a necessary or appropriate payment level. For example, this payment is not established with reference to any alternatives including the cost of mothballing the plant or extending the operating life of the 8,000MW of OTC plant assumed to be retired by 2017/18, or even seeking a commitment from a different pseudo-tie participant for 2017.

Moreover, the cost allocation of CPM is in the context of the current RA framework and all costs are charged to load. Here, however, the CAISO requires flexibility, and a material portion of this need is driven by integrating renewable resources. Thus allocating all costs exclusively to load is inappropriate and violates FERC's costs causation/cost allocation principles.

SCE believes that a payment substantially higher than the current market price of RA capacity could disrupt the normal functioning of the bilateral RA capacity market. If the CAISO proceeds with its proposed waiver, they should also seek a waiver of the price contained in the CPM tariff as part of its intended filing with the FERC so that it can set a more appropriate price to pay the Sutter plant. It should also seek cost allocation based on cost causation. To ensure minimum impact on the RA markets, the price should reflect the lowest possible cost-based approach specific to this situation - including an option that considers mothballing and discontinuation of the pseudo-tie in 2012. Moreover, consideration should be made on what the consequences would be to Calpine if, after receiving a payment, Sutter is not available in 2017.

**The mothball option is not evaluated.** Calpine's investment in Sutter is largely a sunk cost and should be ignored in determining the level of payment that would be necessary to retain Sutter capacity, if an interim mechanism is deemed necessary. A mothballing option should provide least-cost, cost-based

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<sup>1</sup> It is unclear how a settlement for the CPM value would impact payments.

payments to allow the Sutter plant to be mothballed in a manner to meet any EPA requirements to retain its air quality permits, but would not require Sutter to provide capacity or a daily “must-offer” to the CAISO. As noted the CAISO should find it perfectly acceptable if the unit mothballs and does not participate in the markets until 2017.

**The CAISO proposal may set a precedent for payments to keep plants operating.** Conditions under which Calpine has sought relief could apply broadly to any other flexible fossil generators that do not have resource adequacy contracts with a load serving entity. Thus the CAISO proposal has significant precedential implications and could lead to material distortions in the RA markets. The price paid to Sutter may provide an incentive to other generators to seek a similar special treatment from the CAISO unless they also gain a similar price for capacity in the RA markets. In addition, the price paid to Calpine under a CPM designation may possibly set a precedent for the longer term capacity procurement mechanism that the CAISO proposes to develop. For these reasons, should the CAISO proceed with its proposal, any payments to Calpine should reflect the lowest possible cost-based alternative specific to this situation.

**Recommendations:** SCE recommends that the CAISO address the following important issues prior to taking any near-term actions with regards to Calpine’s CPM request:

1. Complete the LTPP analysis in accordance with the Settlement Agreement before determining that there is a need for the capacity provided by Sutter. The Settlement Agreement concluded that the analysis undertaken for the LTPP was inconclusive and that further work was needed.
2. Investigate alternatives to making CPM payments to Sutter, such as a payment to Calpine to cover the costs of mothballing the Sutter plant until needed; At a minimum, seek a simultaneous tariff waiver to pay a lowest possible cost-based price, rather than the CPM price, and insure proper cost allocation based on causation.
3. Evaluate alternative options to Sutter’s capacity. This may help to inform the value that retaining Sutter’s capacity provides to retail customers within the CAISO’s balancing area; and
4. Undertake a sensitivity analysis that will give greater understanding of the timing of the need for capacity and may allow for other options

Whether or not the CAISO ultimately decides to pursue a payment for the Sutter plant, the CAISO should proceed with its proposal to open a stakeholder process that will develop a longer term systematic mechanism to ensure it can secure capacity needed for system reliability. This process will provide the CAISO and stakeholders an opportunity to develop a thoroughly vetted procurement mechanism that appropriately minimizes costs and does not undermine conditions in other competitive markets for capacity.