

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



May 25, 2012

Advice Letter 4034-E/4034-E-A

Brian K. Cherry  
Vice President, Regulation and Rates  
77 Beale St., Mail Code B10C  
P.O. Box 770000  
San Francisco, CA 94177  
Email: [PGETariffs@pge.com](mailto:PGETariffs@pge.com)

**Subject:** Approval of PG&E AL 4034-E and 4034-E-A requesting approval of a power purchase agreement between PG&E and Calpine Energy Services in compliance with Commission Resolution E-4471

Dear Mr. Cherry:

Energy Division approves Advice Letter 4034-E/4034-E-A (Advice Letter), with an effective date of May 25, 2012. Energy Division finds the Advice Letter is in compliance with Commission Resolution E-4471.

**Background:**

On March 22<sup>nd</sup>, 2012 the Commission issued Resolution E-4471 ordering Pacific Gas and Electric ("PG&E") to negotiate a power purchase agreement with Calpine Energy Services L.P. ("Calpine") for the Sutter power plant for a price less than that available under the Capacity Procurement Mechanism (CPM). The California Independent System Operator ("CAISO") had filed with the Federal Energy Regulatory Commission ("FERC") in order to create a contracting mechanism to provide Sutter with a backstop contract that would provide additional revenue to keep it operating. CAISO released a report as part of the backstop contracting process (referred to as Capacity Procurement Mechanism) that demonstrated the potential reliability risks that might occur in future years upon retirement of Sutter.

On May 4<sup>th</sup>, 2012 PG&E filed Advice Letter 4034-E in compliance with Commission Resolution E-4471. The Advice Letter included as an appendix the procurement contract for Resource Adequacy (RA) from the Sutter plant (contract or RA Agreement) for which PG&E is seeking approval. PG&E also requests approval of a subaccount to the New System Generation Balancing Account. On May 7, 2012 PG&E filed a supplemental AL 4034-E-A in which PG&E attached the confidential Independent Evaluator Report.

**Protests:**

DRA filed a protest on May 23<sup>rd</sup> disputing whether this contract and the pricing terms were just and reasonable. DRA discussed the contract price relative to market prices PG&E otherwise pays for resource adequacy (RA) capacity and used this comparison to dispute PG&E's assertion that PG&E followed the dictates of Resolution E-4471. Energy Division dismisses the protest, since Resolution E-4471 set the standard against which PG&E was required to demonstrate reasonableness, i.e. the

contract is less than PG&E's proportionate share of the CPM price of \$17.4 million. PG&E demonstrated that they complied with the requirements of the resolution.

Alliance for Retail Energy Markets, Direct Access Coalition, Energy Users Forum, and Marin Energy Authority filed a joint protest (AREM et al. protest) on May 24<sup>th</sup> arguing that the approval of this Advice Letter would create costs for direct access customers without the accompanying allocation of RA capacity credit, meaning that customers on direct access or customers of community choice aggregators would pay for RA capacity that they would not receive the benefits of. Protestants requested that the Commission order the utilities to allocate RA capacity credit to all benefitting customers as a means of giving them the benefits to go along with the costs of the Sutter contract. Energy Division does not believe this protest merits rejection of the Advice Letter since we plan to implement this request, as specified below. While the AREM et al. protest would have Energy Division implement their request at a later date, we believe we can comply immediately and avoid any further delays.

TURN protested the Advice Letter on May 24<sup>th</sup> on the basis that the mechanics of how Calpine and the utilities negotiated was not leading to best value for ratepayers. In addition, TURN proposed a means to return over market revenues to ratepayers in the form of agreements for future years. These concerns are outside the scope of the Advice Letter, as TURN's suggested process and any future year agreements are not criteria Energy Division was ordered to use in reviewing the Advice Letter. TURN's protest attempts to relitigate Resolution E-4471.

CUE filed a protest on May 24<sup>th</sup> and states that Calpine is bluffing about Sutter's retirement. CUE proposes a detailed mechanism to repay above market 2012 payments for Sutter from future profits from the Sutter plant. As with TURN's protest, CUE's suggestion is outside the scope of the Advice Letter and is an attempt to relitigate Resolution E-4471.

PG&E responded to the protests on May 25, 2012. PG&E argued that DRA, TURN, and CUE filed protests that are outside the scope of the Advice Letter. PG&E argued that the AREM et al. protest can be accommodated if the Energy Division provides the capacity allocations. PG&E states, "Thus, all parties are on equal footing with regards to their RA procurement efforts in light of the Resolution and as long as an allocation of RA is made by the Energy Division for inclusion in an RA filing, all customers should bear the costs of the RA Agreement." (p. 5)

#### **Discussion:**

Energy Division does not find any of the four protests meet the grounds for protest established in General Order 96-B (Section 7.4.2). In particular "a protest may not rely on policy objections to an advice letter where the relief requested in the advice letter follows rules or directions established by statute or Commission order applicable to the utility". (Ibid.) With the exception of the AREM et al. protest which the Energy Division addresses via separate action, each of the other protests requests a relitigation of Resolution E-4471 and each requests the Energy Division not apply the approval standard clearly communicated via the Resolution.

In light of the above, PG&E's Advice Letter is in compliance with Commission Resolution E-4471, and we find that PG&E has shown that the Sutter contract is just and reasonable and the costs fully recoverable in rates. PG&E's contract is less than the price that would otherwise have been charged for Sutter at the CPM price. PG&E's Advice Letter requested the following findings: PG&E's entry into the RA agreement with Calpine for Sutter is reasonable, the payments made by PG&E are just and reasonable and fully recoverable in rates, the RA Agreement is not subject to further reasonableness reviews other than a review of PG&E's administration of the RA Agreement; and PG&E's portion of the total IOU compensation to Calpine is not more than its proportional load share.

**Allocation of RA capacity credit:**

As adopted in D.07-09-044 and D.09-06-028, the Energy Division allocates capacity credit to load serving entities (LSEs) for the contracts whose costs are paid for via a non-bypassable charge to all benefitting customers. For purposes of PG&E's Sutter contract, Energy Division will allocate capacity for July and August 2012 (capacity for those months was already allocated April 12th and May 16th respectively), for use in the RA filings due on June 1 and July 2. Via revised letter dated today, Energy Division will send revised capacity allocations to each LSE for these filing months to reflect the Sutter contract. Energy Division will continue to allocate capacity for this contract along the normal schedule for the remaining months of the contract term.

Sincerely,

*Molly Storkel for Ed Randolph*

Edward F. Randolph, Director  
Energy Division

Cc via email:

President Michael R. Peevey  
Commissioner Mark J. Ferron  
Commissioner Catherine J.K. Sandoval  
Commissioner Mike Florio  
Commissioner Timothy Alan Simon  
Frank Lindh, General Counsel  
Chief ALJ Karen Clopton  
Service List for R.10-05-006  
Service List for R.11-10-023  
Service List for R.12-03-014

Protestors:

CUE, via email, [mdjoseph@adamsbroadwell.com](mailto:mdjoseph@adamsbroadwell.com)  
TURN, via email, [matthew@turn.org](mailto:matthew@turn.org)  
AReM et al., via email, [sue.mara@rtoadvisors.com](mailto:sue.mara@rtoadvisors.com)  
DRA, via email, [Claire.eustace@cpuc.ca.gov](mailto:Claire.eustace@cpuc.ca.gov); [cynthia.walker@cpuc.ca.gov](mailto:cynthia.walker@cpuc.ca.gov)



**Brian K. Cherry**  
Vice President  
Regulation and Rates

*Mailing Address*  
Mail Code B10C  
Pacific Gas and Electric Company  
P.O. Box 770000  
San Francisco, CA 94177

Fax: 415.973.6520

May 7, 2012

**Advice 4034-E-A**

(Pacific Gas and Electric Company ID U39 E)

Public Utilities Commission of the State of California

**Subject: Supplemental Filing for Approval of Resource Adequacy Agreement  
Between Calpine Energy Services, L.P. and Pacific Gas and Electric  
Company Pursuant to Resolution E-4471**

**Purpose:**

Pacific Gas and Electric Company (“PG&E”) submits to the California Public Utilities Commission (“Commission”) a supplemental filing to PG&E’s Advice Letter 4034-E, dated May 4, 2012 (“Advice Letter”).<sup>1</sup> The Advice Letter submitted to the Commission for approval of an agreement between Calpine Energy Services, L.P. (“CES”) and PG&E for Resource Adequacy (“RA”) product (“RA Agreement”). The Advice Letter is currently pending at the Commission.

The purpose of this filing is to provide the Commission with the Independent Evaluator (“IE”) report that was unavailable at the time of filing on May 4, 2012.

PG&E is attaching the confidential and public IE reports as Confidential Appendix C and Public Appendix D, respectively.

**Confidential Attachments:**

In support of this advice filing, PG&E provides the following confidential supporting documentation:

- Confidential Appendix C - Confidential Independent Evaluator Report

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<sup>1</sup> Supplements to Advice Letters are authorized by General Order 96-B, section 7.5.1.

**Public Appendix:**

- Appendix D – Public Independent Evaluator Report

**Protests:**

PG&E requests that the protest period for Advice Letter 4034-E not be extended. Therefore, anyone wishing to protest this filing may do so by sending a letter by **May 14, 2012**, which is ten (**10**) days from the date of filing of Advice Letter 4034-E. Pursuant to General Order 96-B, Section 1.3, PG&E originally requested that the protest period for Advice Letter 4034-E be shortened to 10 days, and that anyone wishing to protest this filing may do so by letter sent via U.S. mail, by facsimile or electronically any of which must be received no later than May 14, 2012. Any protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. Protests should be mailed to:

CPUC Energy Division  
Attention: Tariff Unit, 4<sup>th</sup> Floor  
505 Van Ness Avenue  
San Francisco, CA, 94102

Facsimile: (415) 703-2200  
E-mail: EDTariffUnit@cpuc.ca.gov

Copies of the protests also should be mailed to the attention of the Director, Energy Division, Room 4004, at the address shown above.

The protest should also be sent via U.S. mail (and by facsimile and electronically, if possible) to PG&E at the address shown below on the same date it is mailed or delivered to the Commission:

Pacific Gas and Electric Company  
Attention: Brian Cherry  
Vice President, Regulation and Rates  
77 Beale Street, Mail Code B10C  
P.O. Box 770000  
San Francisco, California 94177

Facsimile: (415) 973-6520  
E-mail: PGETariffs@pge.com

**Effective Date:**

PG&E requests that this supplemental advice filing be approved on or before **May 25, 2012**, and concurrent with Advice 4034-E. PG&E submits this request as a Tier 2 advice letter.

**Notice:**

In accordance with General Order 96-B, Section IV, a copy of this Advice Letter excluding the confidential appendices is being sent electronically and via U.S. mail to parties shown on the attached list and the service lists for R.12-03-014, R.11-10-023 and R.10-05-006. Non-market participants who are members of PG&E's Procurement Review Group and have signed appropriate Non-Disclosure Certificates will also receive the Advice Letter and accompanying confidential attachments by overnight mail. Address changes to the GO 96-B service list and electronic approvals should be directed to e-mail PGETariffs@pge.com. For changes to any other service list, please contact the Commission's Process Office at (415) 703-2021 or at Process\_Office@cpuc.ca.gov. Advice letter filings can also be accessed electronically at: <http://www.pge.com/tariffs>.



Vice President – Regulation and Rates

cc: President Michael R. Peevey  
Commissioner Mark J. Ferron  
Commissioner Catherine J.K. Sandoval  
Commissioner Mike Florio  
Commissioner Timothy Alan Simon  
Frank Lindh, General Counsel  
Chief ALJ Karen Clopton  
Edward Randolph, Director, Energy Division  
Energy Division Tariff Unit, Energy Division  
Service List for R.10-05-006  
Service List for R.11-10-023  
Service List for R.12-03-014

**Limited Access to Confidential Material:**

The portions of this Advice Letter marked Confidential Protected Material are submitted under the confidentiality protection of Section 583 and 454.5(g) of the Public Utilities Code and General Order 66-C. This material is protected from public disclosure because it consists of, among other items, price information of the RA Agreement, which is

protected pursuant to D.06-06-066 and D.08-04-023. A separate Declaration seeking confidential treatment regarding the confidential information is filed concurrently herewith.

Attachments:

Confidential Appendix C: Independent Evaluator Report (Confidential Version)

Public Appendix D: Independent Evaluator Report (Redacted Version)

CPUC Summary Sheet for Advice 4034-E - Corrected

# CALIFORNIA PUBLIC UTILITIES COMMISSION

## ADVICE LETTER FILING SUMMARY ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No. **Pacific Gas and Electric Company (ID U39 E)**

Utility type:

ELC       GAS  
 PLC       HEAT       WATER

Contact Person: Meredith Allen and Kimberly Chang

Phone #: (415) 973-2368 and (415) 972-5472

E-mail: meae@pge.com and kwcc@pge.com

EXPLANATION OF UTILITY TYPE

ELC = Electric      GAS = Gas  
PLC = Pipeline      HEAT = Heat      WATER = Water

(Date Filed/ Received Stamp by CPUC)

Advice Letter (AL) #: **4034-E-A**

Tier: **2**

Subject of AL: **Supplemental Filing for Approval of Resource Adequacy Agreement Between Calpine Energy Services, L.P. and Pacific Gas and Electric Company Pursuant to Resolution E-4471.**

Keywords (choose from CPUC listing): Contracts, Portfolio

AL filing type:  Monthly  Quarterly  Annual  One-Time  Other \_\_\_\_\_

If AL filed in compliance with a Commission order, indicate relevant Decision/Resolution #: Resolution E-4471

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL: No

Summarize differences between the AL and the prior withdrawn or rejected AL: \_\_\_\_\_

Is AL requesting confidential treatment? If so, what information is the utility seeking confidential treatment for: Yes. See the attached matrix that identifies all of the confidential information.

Confidential information will be made available to those who have executed a nondisclosure agreement:  Yes  No All members of PG&E's Procurement Review Group who have signed nondisclosure agreements will receive the confidential information.

Name(s) and contact information of the person(s) who will provide the nondisclosure agreement and access to the confidential information: Terrance M. Robertson (415) 973-6993

Resolution Required?  Yes  No

Requested effective date: **May 25, 2012 (Concurrent with 4034-E)**

No. of tariff sheets: N/A

Estimated system annual revenue effect (%): N/A

Estimated system average rate effect (%): N/A

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected: N/A

Service affected and changes proposed: N/A

Pending advice letters that revise the same tariff sheets: N/A

Protests, dispositions, and all other correspondence regarding this AL are due no later than 20 days after the date of this filing, unless otherwise authorized by the Commission, and shall be sent to:

**CPUC, Energy Division  
Tariff Files, Room 4005  
DMS Branch  
505 Van Ness Ave.,  
San Francisco, CA 94102  
E-mail: EDTariffUnit@cpuc.ca.gov**

**Pacific Gas and Electric Company  
Attn: Brian Cherry  
Vice President, Regulation and Rates  
77 Beale Street, Mail Code B10C  
P.O. Box 770000  
San Francisco, CA 94177  
E-mail: PGETariffs@pge.com**

**DECLARATION OF TERRANCE M. ROBERTSON  
SEEKING CONFIDENTIAL TREATMENT  
FOR CERTAIN DATA AND INFORMATION CONTAINED IN PG&E'S  
ADVICE LETTER 4034-E-A  
(PACIFIC GAS AND ELECTRIC COMPANY - U 39 E)**

I, Terrance M. Robertson declare:

1. I am presently employed by Pacific Gas and Electric Company ("PG&E") and have been an employee since 1989. I am a Principal in the Portfolio Management group in the Energy Procurement department within Pacific Gas and Electric Company (PG&E). I am responsible for intermediate-term portfolio planning and procurement. In carrying out these responsibilities, I have acquired knowledge of procurement process and, based on my experience in procuring energy and capacity for PG&E's bundled customers, I am familiar with the types of contract data and information considered confidential and proprietary, which are the subject of the filing.

2. Based on my knowledge and experience, and in accordance with Decision ("D.") 08-04-023 and the August 22, 2006 the "Administrative Law Judge's Ruling Clarifying Interim Procedures for Complying with Decision 06-06-066," I make this declaration seeking confidential treatment of Appendix C to PG&E's Advice Letter (AL) 4034-E-A. By this Advice Letter, PG&E is seeking this Commission's approval of an agreement that PG&E has executed with Calpine Energy Services.

3. Attached to this declaration is a matrix identifying the data and information for which PG&E is seeking confidential treatment. The matrix specifies that the material PG&E is seeking to protect constitutes information that should be protected under Decision 06-06-066 and General Order 66-C. The matrix also specifies why confidential protection is justified. Finally, the matrix specifies that: (1) that PG&E is complying with the limitations specified in the IOU

Matrix for that type of data or information (where applicable); (2) that the information is not already public; and (3) that the data cannot be aggregated, redacted, summarized or otherwise protected in a way that allows partial disclosure. By this reference, I am incorporating into this declaration all of the text in the attached matrix that is pertinent to this filing.

I declare under penalty of perjury, under the laws of the State of California that, to the best of my knowledge, the foregoing is true and correct. Executed on May 7, 2012, at San Francisco, California.



Terrance M. Robertson

**PACIFIC GAS AND ELECTRIC COMPANY'S (U 39 E)  
Advice Letter 4034-E-A  
May 7, 2012**

**IDENTIFICATION OF CONFIDENTIAL INFORMATION**

Redaction Reference	1) The material submitted constitutes a particular type of data listed in the Matrix, appended as Appendix 1 to D.06-06-066 (Y/N)	2) Which category or categories in the Matrix the data correspond to:	3) That it is complying with the limitations on confidentiality specified in the Matrix for that type of data (Y/N)	4) That the information is not already public (Y/N)	5) The data cannot be aggregated, redacted, summarized, masked or otherwise protected in a way that allows partial disclosure (Y/N)	PG&E's Justification for Confidential Treatment	Length of Time
Appendix C	Y	Item VII B) Contracts and power purchase agreements between utilities and non-affiliated third parties.  <b>General Order 66-C.</b>	Y	Y	Y	<p>This Appendix discusses, analyzes and evaluates confidential terms of the Agreement and the negotiation process. Disclosure of this information would provide valuable market sensitive information to competitors. Release of this information would be damaging to negotiations with other counterparties and should remain confidential.</p> <p>Furthermore, the counterparty to the Agreement has an expectation that the terms will remain confidential. I am informed and believe that General Order 66-C also provides a basis for confidential treatment. General Order 66-C includes in its category of records not open to public inspection "Information obtained in confidence from other than a business regulated by this Commission where the disclosure would be against the public interest." (Paragraph 2.8). It is in the public interest to treat such information as confidential because if such information were made public, it could have a damaging effect on current and future negotiations with other counterparties.</p>	<p>For information covered under Item VII B), remain confidential for three years.</p> <p><b>For information covered under General Order 66-C, remain confidential indefinitely.</b></p>

**Redacted Appendix D**  
**Independent Evaluator Report**

Redacted (Public Version)

***Negotiations of Contracts Pacific Gas and Electric and  
Calpine Corporation for the Sutter Energy Center  
In Conjunction with Resolution E-4417***

***Report of the  
Independent Evaluator  
On the Contract Negotiation Process  
Public Non-Confidential Version***

***May 4, 2012***

***Prepared by  
Merrimack Energy Group, Inc.***



## Table of Contents

I. Introduction .....	1
II. Description of the Role of the IE.....	7
III. Economic Analysis Reported to the Energy Division .....	8
IV. Description of the Contract Negotiation Process.. .....	10
V. Contract Summary and Review.....	20
VI. Recommendation for Contract Approval .....	23
VII. Conclusions .....	23

## I. Introduction

### Overview

On March 22, 2012 the Public Utilities Commission of the State of California (“CPUC” or “Commission”) issued a Resolution (“Resolution E-4471”) which orders Pacific Gas & Electric Company (“PG&E”), Southern California Edison Company (“SCE”), and San Diego Gas & Electric Company (“SDG&E”) (jointly referred to as “IOUs”) to enter negotiations with the Calpine Corporation (“Calpine”) with regard to a contract with the Sutter Energy Center (“Sutter”) for a price less than that available under the Capacity Procurement Mechanism (“CPM”) for plants designated at risk of retirement.<sup>1</sup> The inability of the Sutter plant to earn market revenues sufficient to cover “going forward” costs and the actions to obtain permission to shut down and/or to obtain relief under the California Independent Operator (“CAISO”) CPM program are reviewed in some detail in the Resolution.<sup>2</sup> In short, the purpose of this Resolution is to try to keep the Sutter plant online in 2012 by ordering that the subject negotiation occur. The Resolution does not require that contracts be executed, but if they are, and if they are approval, they would provide sufficient revenues to cause Calpine to keep the Sutter plant in operation. The Resolution indicates that this will enable further analysis of the impacts of current and proposed dynamic transfer tariff changes at CAISO.

In the Resolution, the CPUC identified the following conclusions and directives with regard to negotiations between the IOU’s and Calpine:

1. The IOU’s should jointly negotiate a limited term contract with Calpine;
2. The contract should be executed in a manner that minimizes cost to ratepayers;
3. It is expected that in the contract the costs should be significantly below what would be paid if the Sutter plant were subject to the Capacity Procurement Mechanism ;
4. A not to exceed cost of \$2.95 million per month, up to an absolute maximum total CPM cost of \$17.4 million is established based on the CAISO’s filing at the FERC;

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<sup>1</sup> The Sutter Energy Center is located in Yuba City, California. Sutter is a 572 MW nameplate capacity gas-fired combined cycle power plant with a Net Qualifying Capacity of 525 MW. The plant came on line in May, 2001. The plant is comprised of two gas turbines, each with a dependable capacity of 185 MW and one steam turbine with a net dependable capacity of 191 MW. As noted in Resolution E-4471, the plant is air cooled rather than once through water cooled and is not located in a local capacity area. The Sutter plant is not directly connected to the CAISO but is one of a small number of resources using a pseudo-tie to connect to the CAISO grid. The pseudo-tie allows the Sutter plant to provide resources more flexibly than via traditional import rules, using the CAISO’s dynamic transfer tariff. The Federal Energy Regulatory Commission (“FERC”) acceptance with modifications of the CAISO pseudo-tie agreement allowed the CAISO to dispatch the Sutter plant, and allows Calpine to receive revenues from CAISO markets. The Sutter plant also has flexible ramping capability that allows discrete portions of its capacity to be dispatched as needed to satisfy demand.

<sup>2</sup> The Sutter plant does not meet all conditions for designation as a plant at risk of retirement under the CAISO Tariff. As a result, CAISO, as explained in the Resolution, has a pending petition before the Federal Energy Regulatory Commission (“FERC”), action on which may not come in a timely fashion or in the form requested.

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5. The IOUs shall complete negotiations (or not complete negotiations) and file an Advice Letter within 30 days from the effective date of the resolution;
6. It is prudent for the IOUs to engage an Independent Evaluator as part of the contract oversight process. The Independent Evaluator shall include their report when the joint Tier 2 advice letter is filed;
7. As part of these negotiations, Calpine shall provide cash flow models and other detailed financial information to the Energy Division and the Independent Evaluator.<sup>3</sup>

The Resolution also identified as an objective to keep the Sutter plant online in 2012 and to enable further analysis of current and proposed “dynamic transfer” tariff changes at the CAISO. Resolution E-4471 concluded that there is need for more information on the strengths, weaknesses and capabilities of connecting to the grid through a pseudo-tie using the CAISO’s dynamic transfer tariff and therefore, there is need for the continued operation of the Sutter plant.

On March 30, 2012, the Commission confirmed that it will actively supervise the negotiations between Calpine and IOU’s and clarified that the effective date of the Resolution for purposes of triggering the 30-day period in which to complete negotiations and submit a Tier 2 advice letter is the date of publication, March 29, 2012. Commission supervision of the contract will occur via the retention of an Independent Evaluator engaged by the IOU’s for purposes of monitoring the negotiations on behalf of the Commission. As required by the Resolution, the IE will submit a report after the conclusion of the negotiations which shall be included along with a Tier 2 Advice Letter. Finally, the Commission will review the materials submitted by the IE along with the joint Tier 2 advice letter and make a determination.

Pursuant to these requirements, the IOU’s engaged Merrimack Energy Group, Inc. to serve as the IE.<sup>4</sup>

### **Proposed Plant Shutdown and CAISO Report**

On November 22, 2011, Calpine filed a GO 167 notice with the Commission stating that it was planning on retiring the Sutter plant in 2012 due to a lack of resource adequacy (RA) contracts. On the same day, Calpine submitted a request to the CAISO and all required supporting documentation, for designation of the Sutter plant as CPM capacity for 2012. The Calpine request stated that absent such a CPM designation, the Sutter plant will be retired in 2012 and will not be available for commercial operations in 2013 and later years. To date, the Sutter plant has not operated in calendar year 2012.

As identified in the CAISO Report, Section 43.1.2 of the CAISO Tariff authorizes the CAISO to designate Eligible Capacity to provide CPM Capacity services in order to

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<sup>3</sup> In the Finding associated with the Resolution the Commission stated that “use of “open book” financial information provides an additional layer of oversight for the Commission in assessing a contract.”

<sup>4</sup> Merrimack Energy Group, Inc. is the only IE that is included in the IE pool for all three utilities (i.e., Pacific Gas & Electric, San Diego Gas & Electric and Southern California Edison).

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address six listed types of circumstances. One of the CPM categories consists of the procurement of capacity at risk of retirement within the current Resource Adequacy (RA) Compliance Year that will be needed for reliability by the end of the calendar year following the current RA Compliance Year. Section 43.2.6 of the CAISO Tariff states that the CAISO may issue a CPM designation for such capacity at risk of retirement in the event that all of the following requirements apply:

1. The resource was not contracted as RA Capacity nor listed as RA Capacity in any Load Serving Entity's (LSE) annual RA Plan during the current RA Compliance Year;
2. The CAISO did not identify any deficiency, individual or collective, in an LSE's annual RA Plan for the current RA Compliance Year that resulted in a CPM designation for the resource in the current RA Compliance Year;
3. CAISO technical assessments project that the resource will be needed for reliability purposes, either for its locational or operational characteristics, by the end of the calendar year following the current RA compliance Year;
4. No new generation is projected by the CAISO to be in operation by the start of the subsequent RA Compliance Year that will meet the identified reliability need; and
5. The resource owner submits to the CAISO and the Department of Market Monitoring (DMM), at least 180 days prior to terminating the resource's Participating Generator Agreement (PGA) or removing the resource from PGA Schedule 1, a request for a CPM designation under Section 43.2.6 and the affidavit of an executive officer of the company who has the legal authority to bind such entity, with the supporting financial information and documentation discussed in the Business Practice Manual (BPM) for Reliability Requirements, that attests that it will be uneconomic for the resource to remain in service in the current RA Compliance Year and that the decision to retire is definite unless CPM procurement occurs.

On December 6, 2011, the California ISO issued its report on Calpine's request entitled "California ISO Report on Basis and Need for CPM Designation for Sutter Energy Center." The Report addresses the basis and need for the CAISO to designate the Sutter Energy Center as capacity at risk of retirement, pursuant to the provisions of the CAISO Tariff regarding the CPM.

The CAISO's review confirmed that the Sutter plant was not contracted as RA Capacity nor listed as RA Capacity in any LSE's annual Resource Adequacy Plan during the current RA Compliance Year, i.e., during 2012.

The CAISO conducted analysis, including technical assessments, which projects that the Sutter plant will be needed for reliability purposes, specifically for its operational characteristics, in the 2017/2018 time frame. The CAISO determined through its study

that there is no additional new capacity with needed flexibility projected to come online in time to meet the identified need. The retirement of existing capacity with the required flexible characteristics would pose a significant risk to reliability.

On December 6, 2011, the CAISO reported that it intended to make a filing with FERC requesting a waiver of existing tariff provisions that currently limit the procurement of capacity at risk of retirement to cases in which capacity is needed in the next resource adequacy compliance year, a condition which the Sutter plant does not meet. The waiver if granted will enable the CAISO to procure the Sutter capacity for 2012 based on the CAISO's determination of need by the end of 2017.

### **Calpine's CAISO Filings**

As noted, on November 22, 2012, Calpine Corporation submitted a request for CPM designation of the Sutter Energy Center under CAISO Tariff Section 43.2.6., including an Affidavit of Alexandre Makler in support of Calpine's request. The Affidavit stated that Calpine's economic analysis showed that, under a range of assumptions for projected market revenues in 2012 (assuming either flat prices from 2011 to 2012, or increased 2012 prices, reflective of some forward price curves), Sutter would sustain cash flow losses and be unable to recover its going forward costs in 2012 and subsequent years. Sutter would also not obtain a return of or on invested capital during 2012 and subsequent years. The analyses that Calpine conducted indicate an unacceptable level of risk that Sutter would not recover its going forward costs or meet its cash and investment requirements in 2012 and subsequent years. Calpine considered not only its risk of failure to recover Sutter's going forward costs under reasonable scenarios, but also the uncertainties and risks that it might incur other non-compensable costs during 2012 and later years.

On January 24, 2012, Calpine submitted a supplemental Affidavit of Alexandre Makler to CAISO in connection with CAISO's planned filing with FERC. This supplemental Affidavit addresses Calpine's economic analysis and decision-making in more detail. The Affidavit stated:

“Neither the Tariff nor the Commission's (“FERC”) March 17, 2011 Order prescribes evaluative criteria that a company must use in determining whether it is economic or uneconomic to continue operation of a resource seeking designation as CPM capacity at risk of retirement. Calpine used its business judgement in conducting relevant analyses and in weighing those analyses and other factors and considerations in making its determinations that it will be uneconomic for Sutter to remain in service in 2012 and that Sutter will be retired in 2012, absent CPM designation as capacity at risk of retirement (or comparable bilateral capacity procurement). Calpine's exercise of its business judgment was not based on any single economic analysis or calculation. Calpine conducted analyses, under reasonable scenarios, that indicated an acceptable level of risk that Sutter would not recover its going forward costs or meet its cash and investment requirements in 2012 and subsequent years. In addition to its assessment of the risk of failure of

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recovering its going forward costs and the risk of not meeting cash and investment requirements, Calpine considered the uncertainties and risks that contingencies might occur that would cause the company to incur other non-compensable costs during 2012 and later years. These risks include items such as the risk of a major equipment failure, the substantial risks of deferring maintenance, and the need for additional capital investment in order to meet environmental requirements or to maintain operational characteristics. These contingencies were not explicitly accounted for in the “models” and quantitative analyses used in assessing the risk of failure of recovering the company’s going forward costs and the risk of not meeting its cash and investment requirements. Calpine’s assessment of these contingency-related uncertainties and risks was informed by the company’s business experience and its objectives in allocating limited and discretionary funds among investment alternatives. In short, Calpine’s business judgment as to whether it would be economic to operate Sutter in 2012 is not based exclusively on a single analysis showing substantial and sustained losses such as that attached to the Request. Nonetheless, the analyses that Calpine conducted showed, respectively, that Sutter would sustain cash flow losses and would not recover its going forward costs in 2012 and subsequent years, and that Sutter would not obtain a return of or on invested capital during 2012 and subsequent years.”

### **Regulatory Requirements for the Independent Evaluator**

The requirements for participation by an Independent Evaluator (IE) in utility solicitations are outlined in decisions D.04-12-048 (Findings of Fact 94-95, Ordering Paragraph 28), D.06-05-039 (Finding of Fact 20, Conclusion of Law 3, Ordering Paragraph 8) of the California Public Utilities Commission (Commission or CPUC) and D.09-06-050.

In Decision 04-12-048 (December 16, 2004), the CPUC required the use of an IE by investor-owned utilities (IOUs) in resource solicitations where there are affiliate, IOU-built or turnkey bidders. The CPUC generally endorsed the guidelines issued by the Federal Energy Regulatory Commission (FERC) for independent evaluation where an affiliate of the purchaser is a bidder in a competitive solicitation, but stated that the role of the IE would not be to make binding decisions on behalf of the utilities or administer the entire process.<sup>5</sup> Instead, the IE would be consulted by the IOU, along with the Procurement Review Group (“PRG”) on the design, administration, and evaluation aspects of the Request for Proposals (“RFP”). The Decision identifies the technical expertise and experience of the IE with regard to industry contracts, quantitative evaluation methodologies, power market derivatives, and other aspects of power project development. From a process standpoint, the IOU could contract directly with the IE, in consultation with its PRG, but the IE would coordinate with the Energy Division.

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<sup>5</sup> Decision 04-12-048 at 129-37. The FERC guidelines are set forth in Ameren Energy Generating Company, 108 FERC ¶ 61,081 (June 29, 2004).

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In Decision 06-05-039 (May 25, 2006), the Commission required each IOU to employ an Independent Evaluator regarding all RFOs issued pursuant to the RPS, regardless of whether there are any utility-owned or affiliate-owned projects under consideration. In addition, the Commission directed the IE for each RFO to provide separate reports (a preliminary report with the shortlist and final reports with IOU advice letters to approve contracts) on the entire bid, solicitation, evaluation and selection process, with the reports submitted to the utility, PRG and Commission and made available to the public (subject to confidential treatment of protected information). The IE would also make periodic presentations regarding its findings to the utility and the utility's PRG consistent with preserving the independence of the IE by ensuring free and unfettered communications between the IE and the CPUC's Energy Division, and an open, fair and transparent process that the PRG could confirm.

In D. 09-06-050 issued on June 18, 2009 in Rulemaking 08-08-009, Order Instituting Rulemaking to Continue Implementation and Administration of California Renewable Portfolio Standard Program,<sup>6</sup> the CPUC required that bilateral contracts should be reviewed according to the same processes and standards as contracts that come through a solicitation. This includes review by the utility's Procurement Review Group and its IE, including a report filed by the IE.

In D.10-07-042 issued on July 29, 2010, the Commission reaffirmed the role of the IE and required the Energy Division to revise the IE Template to ensure that the IEs focus on their core responsibility of evaluating whether an IOU conducted a well-designed, fair, and transparent RFO for the purpose of obtaining the lowest market price for ratepayers, taking into account many factors (e.g. project viability, transmission access, etc.).

This report is filed consistent with the above requirements and is generally consistent with the requirements outlined in the CPUC's Short Form IE Report Template.<sup>7</sup>

### **Issues Addressed in this Report**

This report addresses Merrimack Energy's assessment and conclusions regarding the following issues. To maintain consistency with the CPUC Independent Evaluator Report Template requirements for IE reports, this report will address the relevant issues associated with IE template requirements to the extent the requirements are consistent with this assignment.<sup>8</sup>

1. Describe in detail the role of the IE throughout the solicitation and negotiation process;

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<sup>6</sup> Decision Establishing Price Benchmarks and Contract Review Processes for Short-Term and Bilateral Procurement Contracts for Compliance With the California Renewable Portfolio Standard.

<sup>7</sup> Based on the unique nature of this project and since the process did not involve a solicitation or the results compared to solicitation results, the report does not address all sections and questions contained in the IE Template.

<sup>8</sup> Since many of the requirements of the IE Template address a solicitation process, the requirements associated specifically with a solicitation process will not be included in the report.

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2. Assess the proforma cost information for Sutter provided by Calpine as a basis for assessing the estimated going forward costs;
3. Describe project specific negotiations. Highlight any areas of concern including unique terms and conditions;
4. Was the contract negotiations process undertaken in a fair and consistent manner and consistent with the requirements outlined in the Resolution?
5. Based on your analysis of the contract negotiation process, the objectives of the Resolution and the overall market, do the contracts merit Commission approval?

## **II. Description of the Role of the IE throughout the Solicitation**

In compliance with the above requirements, the IOUs retained Merrimack Energy to serve as Independent Evaluator to oversee the contract negotiation process between the IOUs and Calpine Sutter and to prepare a report on the contract negotiation process relative to the objectives identified in the Resolution. The overall objective of the role of the IE is generally to ensure that the solicitation process or in this case, the contract negotiation process, is undertaken in a fair, consistent, unbiased and objective manner and that the best resources are selected and acquired for the best interest of customers consistent with the objectives outlined in the Resolution.

### **Description of IE Oversight Activities**

The IE was involved in a number of activities and completed several specific tasks in performing its oversight role in connection with the contract negotiation process between the IOU's and Calpine Sutter. The activities of the IE during the process are described below:

- The IE reviewed the process undertaken by the IOUs and Calpine to structure a negotiation approach that met the language in the Resolution for joint negotiations but also did not violate anti-trust considerations;
- The IE monitored the negotiation sessions between the IOUs and Calpine Sutter to ensure the process was undertaken in a fair and equitable manner and that the objective of providing benefits to customers through this process would be met;
- The IE monitored discussions between the IOU's to develop guidelines to ensure the negotiation process would be fair and equitable;
- The IE reviewed the financial information provided by Calpine in support of its request for CPM designation to assess whether the going forward cost estimates submitted by Calpine were reasonable.

Specific tasks and activities of the IE will also be addressed as applicable in other sections of this report.

### **Comment of the IE Regarding the Complexity of the Proceedings**

The compressed time frame, the concentrated nature of three parallel negotiations, and the constraints associated with negotiating what are essentially “going forward”, above market, cost of service contracts without open access to cost of service data contributed to a very complex and challenging process for all parties involved. For PG&E, contract negotiation discussions continued through the final weekend before the April 30, 2012 deadline. Document preparation and completion stressed resources but remarkably, not the apparent good faith and civility of the personnel involved. The high level of professional performance of the negotiating parties, evident to the IE throughout the process, speaks well of that good faith and the competence, which each party brought to the task of accomplishing the objectives of the Resolution under these difficult conditions.

### **III. Economic Analysis Reported to the Energy Division of the Commission**

Resolution E-4471 established limited use of “open book” data during the negotiations process since detailed financial documents were provided by Calpine pursuant to the Resolution only to the Energy Division and the Independent Evaluator. The Commission ordered that Calpine shall provide cash flow models and other detailed financial information (“Detailed Financials”) to the IE and Energy Division to support their estimated costs.

The Resolution stopped short of ordering the sharing of such information with the three IOUs, although it is assumed for the purposes of this report, that the Commission had the authority to order the direct or indirect disclosure of the Detailed Financials with the three IOUs. This latter approach would have effectively turned the negotiation into an “open book” cost of service negotiation. However, the language in the Resolution would have been drafted in a very different fashion if “open book” negotiations had been intended. As a result, the parties proceeded on the basis that the Resolution did not intend an “open book” approach. The negotiating parties proceeded to execute Non-Disclosure Agreements regarding any data disclosed during negotiations. The operating assumption was that neither the Energy Division nor the Independent Evaluator would disclose the Detailed Financials to the three utilities. The Independent Evaluator was asked by Calpine to execute a confidentiality agreement directly with Calpine. After consultation between attorneys for the Independent Evaluator and Calpine and among the members of the Energy Division, their counsel and counsel for the Independent Evaluator, a letter agreement between the Independent Evaluator and the Energy Division was executed creating a confidentiality obligation on the part of the Independent Evaluator to the

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Energy Division not to disclosure except to the Energy Division the Detailed Financials received from Calpine.<sup>9</sup>

While confidential information was not used in the Resolution, the Resolution did established a maximum cost of \$2.95 million per month or an estimated \$17.4 million based on the CPM Settlement price, as “cap” on expenditures for the remainder of 2012 for sales from the Sutter Plant to the three utilities. The three IOUs were also directed to enter into contract negotiations with Calpine on the Sutter plant for a price less than that available under the CPM.<sup>10</sup>

Before analyzing the combination of public and confidential data available to the IE, it is important to describe the proper perspective that is needed to assess accurately the many seemingly comparable numbers which are being discussed<sup>11</sup>. First, a proper perspective must distinguish between annualized and monthly or six-month numbers. The figures presented in both the public and the confidential Calpine filings with CAISO and with FERC are annualized numbers (e.g., an annualized 2012 going forward cost estimate of [REDACTED], which was reduced to a projected 2012 loss of [REDACTED] by applying estimated net energy revenues). Many numbers presented in the Resolution are monthly or six-month numbers (e.g., a monthly maximum of \$2.95 million and a six-month “cap” of \$17.4 million). Secondly, a proper perspective should distinguish between unit-specific, estimated actual costs of the Calpine Sutter plant and the generic costs which are drawn from the CAISO proceedings and the CAISO Tariff provisions for the CPM. For example, the figure of \$67.50 kW-year is understood by the IE as the CPM payment under the Tariff which is based on the defined going forward costs of a generic 50 MW simple cycle generating unit *plus* an adder of 10%. Applied to the Sutter plant with an assumed average annual capacity of 525 MWs, this generically-based CPM payment would be approximately \$35 million/year.<sup>12</sup>

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<sup>9</sup> This approach to the confidentiality obligation of the Independent Evaluator mirrors the Protective Order approach of the FERC and thus, avoids the chilling effect that is possible when the provider of the information and the independent party evaluating the information are in contractual privity.

<sup>10</sup> The Resolution contains the following language, “It is expected that in the contract the costs should be significantly below what would be paid if the Sutter plant were subject to CPM.” (Resolution at page 9.) According to the Resolution, the recent CPM Settlement sets a price of \$5.63/kW-month or \$67.50/kW-year (this settlement updates the Tariff price of \$55/kW-month) . The monthly cost recovered for 6 months in 2012 at a capacity of 525 MW would equate to \$17.7 million which is slightly higher than the \$17.4 million cap established by the Resolution.

<sup>11</sup> More than once, the IE observed references to numbers during the negotiations that could easily have confused the counterparties.

<sup>12</sup>

[REDACTED]

Another important difference in perspective is gained by noting that the CAISO CPM provisions allow a qualifying unit to retain its net energy revenues, although such revenues would supplement the recovery of going forward costs achieved through the CPM payment. In this regard, for its own regulatory purposes, the CAISO CPM provisions seem clearly to accomplish some contribution to capital cost recovery. On the other hand, in its confidential filings with CAISO and with FERC, Calpine properly applied its estimated net energy revenues against its annualized going forward costs to produce lower net operating shortfall of [REDACTED].

In the non-confidential portions of its Request to FERC, Calpine presented the overall results of a going forward cost analysis for Sutter in 2012 and subsequent years conducted by Calpine. “Table 1 shows that Sutter’s estimated energy margins (energy market revenues less fuel costs) for 2012 and 2013 are substantially lower than Sutter’s estimated non-fuel going forward costs (variable and fixed O&M, transmission expense, property taxes, insurance and major maintenance costs). This results in substantial cash flow losses from operation in 2012 and 2013. In particular, Table 1 shows that Sutter will sustain cash flow losses of \$19.7 million in 2012.” (Supplemental Affidavit of Alex Makler, at page 5, in Attachment A to the Petition to FERC for Waiver of Tariff Provisions by CAISO, January 25, 2012, in FERC Docket No. ER12-897-000.) The cash flow losses of \$19.7 million therefore include annual going forward costs plus major maintenance after deducting the net revenues from estimated sales of energy into the market.

## **Detailed Calpine Financials Deleted**

### **IV. Description of Contract Negotiation Process**

The IE participated in an initial call with the IOU’s and the CPUC on April 2, 2012 to discuss Resolution E-4471 and the timeframe allotted for completing contract negotiations with Calpine for the Sutter plant.

The IOU’s initially viewed the Resolution to require the utilities to “jointly negotiate” with Calpine a limited term contract as stated on page 8 of the Resolution. In that regard, notwithstanding the state regulatory mandate, the IOU’s were concerned about antitrust issues associated with joint contract negotiations. As a result, one of the initial tasks undertaken by the IOU’s was to develop a Joint Negotiating Agreement (“JNA”) that would establish the parameters for negotiations and attempt to address the anti-trust issues.<sup>13</sup>

It was discussed by the IOU’s that an appropriate approach for negotiations would be one modeled on the Hydrogen Energy California LLC (“HECA”) negotiation process. It was suggested that the IOU’s follow an approach that would be based on designating one utility to be the lead negotiator. The JNA contemplated that the three utilities would among themselves outline the parameters for negotiation and address issues such as cost allocation, information sharing guidelines, etc. (“Utility Contract Parameters”). The Utilities agreed to follow the Commission’s objectives and to cooperate together through a “Lead Negotiator” to enter into contract negotiations with Calpine for the Sutter Energy

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<sup>13</sup> The IOU’s felt that the HECA negotiations model could also be applicable for this negotiations process.

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Center for a price less than that available under the Capacity Procurement Mechanism (“CPM”), which may take the form of one or more contracts.

The important elements of the JNA from the point of view of the three utilities included:

1. PG&E shall be the Utility Party to negotiate (“Lead Negotiator”) with Calpine on behalf of the Utility Parties;
2. The Parties agree to use their best efforts to adhere to the timeline, roles and responsibilities set forth in the JNA;
3. The Lead Negotiator may negotiate with Calpine for the Sutter Contracts which include products or services related to the impacts of dynamic transfer tariff changes at the CAISO;
4. The Utility Parties agree that the Utility Contract Parameters shall require a condition precedent in the Sutter Contracts that Calpine shall withdraw its CPM request with the CAISO in order for the Sutter contracts to become effective;
5. The Utility Contract Parameters shall be confidential to the Utility Parties and shall not be disclosed to Calpine, except that the Lead Negotiator may communicate with Calpine the terms and conditions of the Utility Contract Parameters that are required by the Utility Parties to be included in the Sutter Contracts;
6. Lead Negotiator will retain all benefits of any Sutter Contract for a market product with Calpine for Sutter and the Utility Parties will retain all benefits related to the analysis of the impacts of dynamic transfer changes at the CAISO on Sutter (“Dynamic Transfer Service”) which may be further specified in the Utility Contract Parameters;
7. Lead Negotiator is authorized by the other parties to pay to Calpine no more than \$2.95 million per month in the calendar year 2012 in capacity or other payments or a total of \$17.4 million in capacity or other payments through the end of 2012. Negotiator may negotiate to pay less than the authorized amount. Lead Negotiator shall not negotiate on behalf of the other Utility Parties Sutter Contracts with a term that extends beyond December 31, 2012 or that have capacity or other payments in the aggregate in excess of \$17.4 million, as required by the Resolution;
8. Lead Negotiator will negotiate with Calpine until agreement is reached or until it is determined that a mutually acceptable agreement cannot be reached, but no later than April 23, 2012;
9. Lead Negotiator will communicate the current status of the negotiations with the other Utility Parties on a periodic basis according to the schedule contained in Exhibit A of the JNA;
10. The Utility Parties will agree on how to calculate and allocate the costs for the products or services delivered under the Sutter Contracts, including for the Dynamic Transfer Service, if applicable in a commercially reasonable manner consistent with CAM allocation methodology in the Utility Contract Parameters. Such agreed upon calculation will be reviewed by the Independent Evaluator for reasonableness and the Lead Negotiator will substantiate the calculation according to the Utility Deal Parameters and to the IE’s satisfaction;

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11. Lead Negotiator and Calpine may execute the Sutter Contracts, mutually acceptable to Lead Negotiator and Calpine and according to the Utility Contract Parameters and the JNA;
12. Lead Negotiator will prepare an initial draft of the required joint Tier 2 Advice Letter(s) for review and comment by Utility Parties explaining accepted or rejected agreements. The Parties agree that a joint Tier 2 Advice Letter will be filed by April 27, 2012 explaining accepted or rejected agreements.

Merrimack Energy participated in a number of the calls held between the utilities to negotiate the JNA during the week of April 2, 2012, and overall felt the approach taken by the IOU's was a reasonable option for meeting the objectives of addressing anti-trust issues and general contract negotiation guidelines.

The IOU's completed a draft of the JNA on or about April 5, 2012 and sent the draft JNA to Calpine for review and comment.

On April 9, a teleconference was held between the IOU's and Calpine to discuss the IOU proposal and solicit Calpine's signature to the JNA. At the meeting Calpine indicated it would not execute the JNA for a variety of reasons. Those reasons included its complexity, its inability to solve all anti-trust concerns of Calpine since the Utility Contract Parameters would be agreed to by the utilities in private combination and without Calpine's knowledge and its indemnification and release provisions which, in Calpine's view, offered anti-trust and fair trade immunity beyond the intention of the Resolution. In place of the JNA, Calpine proposed an alternative process whereby each utility would negotiate separately and confidentially with Calpine based on its own needs. The utilities and Calpine would work through the process to allocate the capacity from the plant and the cost allocation issues. On April 10, 2012, the IOU's, citing the imperative to move forward quickly, agreed to Calpine's suggested approach and contract negotiations then commenced.

To initiate negotiations, Calpine marked-up a version of the RA Confirmation for each IOU based on recent agreements. Calpine included a monthly RA price in each agreement based on recent offerings and submitted the agreement to each utility. Discussions about products of interest for each utility and initial negotiation sessions began during the week of April 9, 2012 and extended through April 29, 2012.

The following Exhibit 1 summarizes the initial negotiating positions of the parties in the parallel proceedings. Exhibit 2 provides more detailed information on each day's negotiations.

**Exhibit 1: Summary of Initial Positions of the Parties**

Company	PG&E
Calpine Price and Product	[REDACTED]

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Offer	[REDACTED]
Company Response	[REDACTED]
Role of Seller Costs	[REDACTED]
Buyer Reaction to Role of Seller Costs	[REDACTED]
Role of Buyer Value	[REDACTED]

**Exhibit 2: Summary of Issues for Each Negotiation Session and Meeting**

<b>PUC, IOU's and IE April 2, 2012</b>	<ul style="list-style-type: none"> <li>• Paul Clanon and Frank Lindh of CPUC gave initial April 2, 2012 instructions which were general: The Resolution has a cost cap of \$17.4 M, but the rate is to be just and reasonable. The lower the rate, the more just and reasonable.</li> <li>• Resolution is clear that “open book” materials go only to PUC and IE but Mr. Clanon said PUC was willing to ask Calpine to make “open book” to IOUs. IOU's were focused on value of power to them and did not insist on “open book”.</li> <li>• Mr. Lindh notes that value extends beyond simple RA product since the payments are a hedge against closure and opportunity for learning about dynamic scheduling and pseudo-ties. IOUs regretted that there is no benchmark for intangible values such as these. IE will be expected to give evaluation of the above market component of total cost which functions as insurance against closure. Concept of negotiating:</li> <li>• [REDACTED]</li> <li>• [REDACTED]</li> </ul>
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[Redacted]

**IOUs and PUC April 10, 2012**

- [Redacted]

**PG&E April 11, 2012**

- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]

[Redacted]

- [Redacted]

**PG&E April 17, 2012**

- [Redacted]

[Redacted]

- [Redacted]

- [Redacted]

**PG&E April 18, 2012**

- [Redacted]

- [Redacted]

[Redacted]

- [Redacted]

**PG&E April 19, 2012**

- [Redacted]

- [Redacted]

- [Redacted]

**PG&E April 20, 2012**

- [Redacted]

[Redacted text block containing multiple paragraphs and bullet points]

**IE Interim Verbal Report to Energy Division April 20, 2012**

- [Redacted bullet point]

**PG&E April 26, 2012**

- [Redacted bullet point]

[Redacted text block containing several paragraphs and bulleted points]

**PG&E April 27, 2012**

[Redacted text block containing several paragraphs and bulleted points]

- [Redacted]

**PG&E April 28, 2012**

- [Redacted]

**PG&E April 29, 2012**

- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]

**PG&E April 29, 2012**

- [Redacted]

**PG&E April 29, 2012**

- [Redacted]

[Redacted text block]

**PG&E April 30, 2012**

- [Redacted list item]
- [Redacted list item]
- [Redacted list item]
- [Redacted list item]

**PG&E May 1, 2012**

- [Redacted list item]
- [Redacted list item]
- [Redacted list item]
- [Redacted list item]

**PG&E May 3-4, 2012**

- [Redacted list item]

**PG&E May 4, 2012**

[Redacted text block]



## V. Contract Summary and Review

This section of the Report provides a brief overview of the contract negotiation process and a summary of the contract executed by PG&E with Calpine for the Sutter plant.

### A. PG&E (Negotiating Team – Roy Kuga, Marino Monardi, Anna Capelle, Terrance Robertson)

PG&E's contract negotiation with Calpine finally concluded on May 4, 2012 with execution of an RA Confirm Agreement for PG&E's prorata share of the Sutter plant capacity.



Based on discussions at the time an extension was granted by the CPUC to move out the date of final resolution on the contracts from April 30, 2012 to May 4, 2012, [REDACTED]



The PG&E negotiation team throughout the contract negotiation process involved high level management and experienced contract execution staff members and attorneys. The level of resources allocated for this project indicated the importance placed on the negotiation process by PG&E.

As illustrated in the summaries of the negotiation sessions between the parties, negotiations were often tense and reflected the different objectives of the parties. [REDACTED]

[REDACTED]

[REDACTED]

Exhibit 3 below provides a summary of the RA Confirm Agreement pricing and total costs as executed by the parties.

[REDACTED]

**Exhibit 3: Summary of PG&E/Calpine RA Confirm Agreement**

Month	Net Qualifying Capacity (MW)	Prorated Percentage of Unit Factor (%)	Contract Quantity	Capacity Price (\$/kW-month)	Total Cost
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Other important provisions in the RA Confirm are provided below. Many of the provisions are typical provisions included in other PG&E RA Confirm Agreements. Highlighted below are several provisions that are pertinent to this Agreement and primarily address regulatory risk.

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1. [REDACTED]
  2. The product is Contingent Firm RA product;
  3. The delivery period shall be from July 1, 2012 through December 31, 2012, inclusive, unless terminated earlier in accordance with the terms of this Agreement;
  4. [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

8.

[REDACTED]

## VI. Recommendation For Contract Approval

[REDACTED] the agreement reached by the parties provides revenues to Calpine that is lower than PG&E's expected share based on the cost cap of \$17.4 million contained in the Resolution as required by Calpine to keep the project in operation.

[REDACTED]

PG&E aggressively negotiated the agreement with Calpine to get the best deal for the ratepayers and shareholders.

[REDACTED]

[REDACTED]

Based on the objectives of the Resolution and the findings of the IE with regard to the reasonableness of Calpine's costs, the IE recommends approval of the RA Confirm between PG&E and Calpine.

## VII. Conclusions

As IE, Merrimack Energy has been actively involved in monitoring the contract negotiation process and reviewing the proforma financial information presented by Calpine. Based on our involvement in the process, the following are our major conclusions:

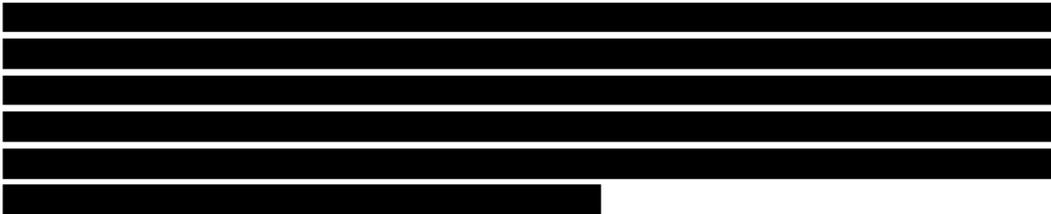
- In order to keep the Sutter plant from retiring, Resolution E-4417 ordered PG&E, SCE and SDG&E to enter negotiations with Calpine in an attempt to execute a contract with the Sutter Energy Center for a price understood to be in excess of market prices, but required to be less than the proxy cost of service approach available under the CPM. The Resolution created a hybrid setting where

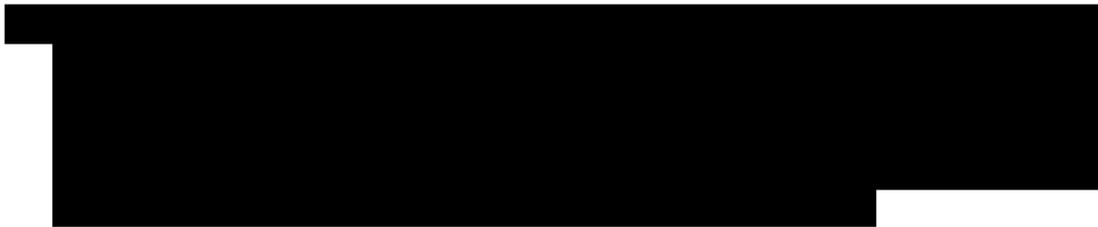
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- “capped” competitive negotiations were to occur which were intended to provide enough coverage of actual costs to keep the plant open but where the negotiating buyers did not have mandatory access to examine the plant’s estimated budget of going forward costs. This directive to negotiate and other directives regarding the joint nature of the negotiations between the IOU’s and Calpine left considerable room and need for interpretation. In this complex and challenging setting, all parties focused on meeting the objectives of the Resolution and negotiated in good faith within their ability to understand the parameters of the Resolution;
- The Resolution relied upon the IE and the Energy Division to review confidential cost data from Calpine in a setting similar to holding a rate case review on a complex technical cost of service issue within a matter of days and without real adjudicatory hearings. This review was designed to give Calpine a proper incentive to present cost estimates which did not overreach. Calpine appears to have reacted properly and does not appear to have overreached;
  - The IOU’s originally proposed an approach toward joint negotiations designed to address anti-trust concerns. The original approach was to identify one lead negotiator on behalf of all three IOU’s. Calpine objected to this approach since it did not eliminate anti-trust concerns and included a requirement for broad indemnifications and releases from anti-trust claims. Instead, Calpine proposed separate bilateral negotiations with each utility, an approach which also served its interest by providing three chances to negotiate costs of service. While both approaches have merits and problems, the IE found that the bilateral negotiation approach was time consuming and complex and added uncertainty to the effectiveness of the process in just covering necessary costs.. By the conclusion, Calpine was not trying to negotiate for different versions of costs and may have regretted its choice of approach;
  - The IE believes that for similar processes with scrutiny over costs and price caps an “open book” cost of service based arrangement would be more reasonable and equitable. Midway in the process, the IE recommended that an effort be made to adapt the process to a formal cost of service review;
  - The negotiation process revealed a real concern on the part of utilities to drive a balance between getting the best deal for its customers based on market value and providing enough over market cost recovery to keep the Sutter plant on line as the Resolution set as a goal;
  - Although Calpine did not provide the financial proforma information to the IE at the initiation of negotiations, Calpine was eventually very forthcoming with information and was very responsive to the requests of the IE for follow-up information and provided detailed explanations associated with information requests of the IE in a timely manner;

**Redacted (Public Version)**

- The IE has delivered to the Energy Division a confidential assessment of the detailed financial information received from Calpine. Under a confidentiality agreement with the Energy Division, the IE may not disclose the assessment or the detailed financial information to any other party. The Energy Division shall be responsible for the distribution of such confidential materials;
- The utilities expressed several reservations about the long-term status of the Sutter project during negotiations that influenced their position:
  - a. Although Calpine would receive revenues through the sale of products from Sutter to keep the plant open in 2012, there is a real possibility that the project may choose to close in 2013. The utilities were concerned about going through the process again in 2013 even if the cost of major maintenance is accounted for;
  - b. The utilities were generally concerned about the reasonable level of costs actually required by Calpine and were concerned they could compensate Calpine more than required and determined by the IE and ED to be reasonable;

- 



- Based on all of its analyses in conjunction with the objectives of the Resolution, the IE recommends approval of the PG&E RA Confirm Agreement with Calpine.

Advice 4034-E-A

Attachment:

**CPUC Summary Sheet**

**For Advice 4034-E - Corrected**

# CALIFORNIA PUBLIC UTILITIES COMMISSION

## ADVICE LETTER FILING SUMMARY ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No. **Pacific Gas and Electric Company (ID U39 E)**

Utility type:

ELC       GAS  
 PLC       HEAT       WATER

Contact Person: Meredith Allen and Kimberly Chang

Phone #: (415) 973-2368 and (415) 972-5472

E-mail: meae@pge.com and kwcc@pge.com

EXPLANATION OF UTILITY TYPE

ELC = Electric      GAS = Gas  
PLC = Pipeline      HEAT = Heat      WATER = Water

(Date Filed/ Received Stamp by CPUC)

Advice Letter (AL) #: **4034-E**

Tier: **2**

Subject of AL: **Approval of Resource Adequacy Agreement Between Calpine Energy Services, L.P. and Pacific Gas and Electric Company Pursuant to Resolution E-4471.**

Keywords (choose from CPUC listing): Contracts, Portfolio

AL filing type:  Monthly  Quarterly  Annual  One-Time  Other \_\_\_\_\_

If AL filed in compliance with a Commission order, indicate relevant Decision/Resolution #: Resolution E-4471

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL: No

Summarize differences between the AL and the prior withdrawn or rejected AL: \_\_\_\_\_

Is AL requesting confidential treatment? If so, what information is the utility seeking confidential treatment for: Yes. See the attached matrix that identifies all of the confidential information.

Confidential information will be made available to those who have executed a nondisclosure agreement:  Yes  No All members of PG&E's Procurement Review Group who have signed nondisclosure agreements will receive the confidential information.

Name(s) and contact information of the person(s) who will provide the nondisclosure agreement and access to the confidential information: Terrance M. Robertson (415) 973-6993

Resolution Required?  Yes  No

Requested effective date: **May 25, 2012**

No. of tariff sheets: 3

Estimated system annual revenue effect (%): N/A

Estimated system average rate effect (%): N/A

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected: Electric Preliminary Statement FS

Service affected and changes proposed: Additional language added to address Sutter RA Contract Net Capacity Costs

Pending advice letters that revise the same tariff sheets: N/A

Protests, dispositions, and all other correspondence regarding this AL are due no later than 20 days after the date of this filing, unless otherwise authorized by the Commission, and shall be sent to:

**CPUC, Energy Division  
Tariff Files, Room 4005  
DMS Branch  
505 Van Ness Ave.,  
San Francisco, CA 94102  
E-mail: EDTariffUnit@cpuc.ca.gov**

**Pacific Gas and Electric Company  
Attn: Brian Cherry  
Vice President, Regulation and Rates  
77 Beale Street, Mail Code B10C  
P.O. Box 770000  
San Francisco, CA 94177  
E-mail: PGETariffs@pge.com**

**PG&E Gas and Electric  
Advice Filing List  
General Order 96-B, Section IV**

AT&T	Dept of General Services	North Coast SolarResources
Alcantar & Kahl LLP	Douglass & Liddell	Northern California Power Association
Ameresco	Downey & Brand	Occidental Energy Marketing, Inc.
Anderson & Poole	Duke Energy	OnGrid Solar
BART	Economic Sciences Corporation	Praxair
Barkovich & Yap, Inc.	Ellison Schneider & Harris LLP	R. W. Beck & Associates
Bartle Wells Associates	Foster Farms	RCS, Inc.
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Brookfield Renewable Power	Green Power Institute	SPURR
CA Bldg Industry Association	Hanna & Morton	San Francisco Public Utilities Commission
CLECA Law Office	Hitachi	Seattle City Light
CSC Energy Services	In House Energy	Sempra Utilities
California Cotton Ginners & Growers Assn	International Power Technology	Sierra Pacific Power Company
California Energy Commission	Intestate Gas Services, Inc.	Silicon Valley Power
California League of Food Processors	Lawrence Berkeley National Lab	Silo Energy LLC
California Public Utilities Commission	Los Angeles Dept of Water & Power	Southern California Edison Company
Calpine	Luce, Forward, Hamilton & Scripps LLP	Spark Energy, L.P.
Cardinal Cogen	MAC Lighting Consulting	Sun Light & Power
Casner, Steve	MBMC, Inc.	Sunrun Inc.
Center for Biological Diversity	MRW & Associates	Sunshine Design
Chris, King	Manatt Phelps Phillips	Sutherland, Asbill & Brennan
City of Palo Alto	Marin Energy Authority	Tabors Caramanis & Associates
City of Palo Alto Utilities	McKenzie & Associates	Tecogen, Inc.
City of San Jose	Merced Irrigation District	Tiger Natural Gas, Inc.
City of Santa Rosa	Modesto Irrigation District	TransCanada
Clean Energy Fuels	Morgan Stanley	Turlock Irrigation District
Coast Economic Consulting	Morrison & Foerster	United Cogen
Commercial Energy	Morrison & Foerster LLP	Utility Cost Management
Consumer Federation of California	NLine Energy, Inc.	Utility Specialists
Crossborder Energy	NRG West	Verizon
Davis Wright Tremaine LLP	NaturEner	Wellhead Electric Company
Day Carter Murphy	Navigant Consulting	Western Manufactured Housing Communities Association (WMA)
Defense Energy Support Center	Norris & Wong Associates	eMeter Corporation
Department of Water Resources	North America Power Partners	