

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's Own Motion Into the Operations and Practices of Calpine Power America-CA, LLC; Notice of Opportunity for Hearing; and Order to Show Cause Why the Commission Should Not Impose Fines and Sanctions For Calpine's 2007 Violation of System and Local Resource Adequacy Requirements.

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PUBLIC UTILITIES COMMISSION
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SAN FRANCISCO
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ORDER INSTITUTING INVESTIGATION
NOTICE OF OPPORTUNITY FOR HEARING
AND ORDER TO SHOW CAUSE WHY THE COMMISSION SHOULD NOT
IMPOSE APPROPRIATE FINES AND SANCTIONS

I. INTRODUCTION

In Decisions (D.) 05-10-042 and 06-06-064, the Commission established rules requiring all load-serving entities (LSEs) in the service territories of California's three largest investor-owned electric utilities to procure sufficient generation capacity, including reserves, to ensure that all retail customers within their service areas have reliable electric service. D.05-10-042 required LSEs to demonstrate that they had acquired sufficient generation capacity to serve forecasted retail customer load plus a reserve margin without accounting for local transmission constraints. D.06-06-064 required LSEs to demonstrate that they had acquired sufficient generation capacity within certain areas of their load with transmission constraints.

These decisions were part of a series of Decisions the Commission issued over a period of two and half years, beginning in 2004, to implement a resource adequacy (RA) program that would secure cost-effective investments in electric generation capacity for California. In each of these Decisions, the Commission considered and vetted the

concerns of all affected LSEs and other interested parties to ensure that the resource adequacy program it established would sustain the reliability of electric service for the long-term.

On October 31, 2007, Calpine Power America-CA, LLC (Calpine) submitted a Year-Ahead System Resource Adequacy Requirement Compliance filing and a Local Resource Adequacy Requirement Compliance filing, both of which reflected deficiencies in violation of the Commission-established Resource Adequacy Requirements (RAR). Calpine's System RAR filing included a contract that was scheduled to expire, thereby overstating its available resources. This erroneous filing resulted in a System RA deficiency totaling 70.37 megawatt-months between the months of July, August, and September for 2008. Calpine's Local RAR filing used wrong demand response allocations in a manner that resulted in 10.76 MW-months of Local RA deficiencies for 2008.

The Commission found, in D.05-10-042 and D.06-06-064, that an LSE's failure to make the necessary RAR showings in its compliance filings jeopardizes the reliability of the grid and may burden the California Independent System Operator (CAISO) with the potential obligation to make the requisite procurement as a backstop if it needs such capacity in the period of the deficiency. The Commission relies on accurate resource procurement and reporting to manage the many uncertainties that pose threats to the reliability of the grid. The Commission has determined that LSEs should be held accountable in procuring and reporting accurate resource adequacy compliance filings.

Therefore, the Commission initiates this proceeding in order to consider whether the evidence set forth in the Consumer Protection and Safety Division (CPSD) Investigation Report of Calpine Power America-CA, LLC shows that Calpine violated Commission rules and directives. The Commission hereby orders Calpine to appear and show cause why the Commission should not find that Calpine violated Commission rules pursuant to Public Utilities Code section 380 by allowing system and local RAR deficiencies, and whether the Commission should impose appropriate fines and sanctions.

II. BACKGROUND

Against the backdrop of California's energy crisis, the Commission established comprehensive RAR rules that require LSEs to demonstrate both (1) aggregate and system resource adequacy (acquisition of sufficient generation capacity to serve forecasted retail customer load, including a reserve margin), and (2) local resource adequacy (acquisition of sufficient generation capacity within defined, transmission-constrained areas)¹ in their service areas.

A. Resource Adequacy Requirement Compliance Filings

These comprehensive rules require the LSEs to make several filings before the Commission, to demonstrate that they are in compliance with the RAR directives.

Among the compliance filings required on October 31, 2007 were:

- "Preliminary Local RAR Compliance Filing": an Advice Letter filing² with Energy Division using an approved template that demonstrates the LSE's capacity contracts for 2007 with units included on the 2007 Local Area Resource Data List maintained by the CAISO for proposed 2007 RAR contracts.
- "Year-Ahead System Resource Adequacy Compliance Filing": an annual Advice Letter filing with Energy Division using an approved template that demonstrates qualifying capacity contracts in sufficient megawatt quantities to satisfy the 90% forward commitment obligation for loads plus reserve requirements for each of the five summer months, May-September, of the following year.
- "Year-Ahead Local Resource Adequacy Compliance Filing": an annual Advice Letter filing with Energy Division using an approved template that demonstrates qualifying capacity contracts in sufficient megawatt quantities to satisfy 100% of the local procurement obligation for each month of the next calendar year (January through December).

¹ Resolution E-4017, p. 2.

² LSEs are no longer required to file Advice Letters for RA compliance showings after the 2008 Compliance Year. D.08-01-025 adopted a new reporting template and electronic submission procedure proposed by the Energy Division to replace Advice Letters for the compliance showings. (D.08-01-025, pp. 16-19.)

- “Month-Ahead System Resource Adequacy Compliance Filings”: (1) a monthly Advice Letter filing with Energy Division using an approved template which demonstrates: (a) acquisition of 100% of the qualifying system capacity obligation (adjusted forecast plus reserve margin) for a “compliance month” from the qualifying capacity providers maintained by the CAISO and the amount of capacity from each provider; and (b) the sale of any qualifying capacity previously identified in a resource adequacy compliance filing for system resource adequacy requirements, and that the capacity remains fully available to the CAISO, and (2) a monthly load forecast submitted to the CEC demonstrating adjustments to the Preliminary Load Forecast for positive and negative load growth due to load migration.

(Resolution E-4017, pp. 2-3.)

B. System Resource Adequacy Requirement

The System RAR requires LSEs to demonstrate that they have acquired sufficient capacity to serve their retail customer load and a 15-17% reserve margin beginning in June 2006. The supply contracts that count for RAR purposes must identify specific resources that provide the qualifying capacity rather than contracts with unspecified resources that provide for liquidated damages (LD) in the event of a breach. The Commission also established penalties for non-compliance with System RAR, stating that such penalties were necessary for the program to achieve its objectives of providing reliable, cost-effective electricity and fostering an environment more conducive to investment in generation infrastructure. The penalties were set as a multiple of the cost of the capacity an LSE failed to procure.

C. Local Resource Adequacy Requirement

Local RAR requires LSEs to demonstrate that they had acquired 100% of their Commission-determined “year-ahead” local procurement obligation for the following calendar year. To meet local requirements, LSEs had to make the specific

generation capacity procurement within load pockets³ where the demand is needed.

LSEs are subject to penalties when they fail to make the required compliance filings. The cost for new capacity was set at \$40 per kW-year and a penalty of 100% of the cost was determined to be a reasonable fine.

D. Public Utilities Code Section 380

In January 2006 the Legislature enacted Public Utilities Code section 380⁴, essentially codifying the Commission's activities under the RAR proceedings and authorizing the Commission to determine the most equitable means for achieving the RAR program goals⁵. In D.06-06-064, the Commission determined that a penalty regime is the most equitable means for achieving the RAR goals.

It is clear that penalties over and above backstop procurement costs are necessary to deter non-compliance with the Local RAR program. If LSEs were free to rely on CAISO backstop procurement and simply pay the CAISO for that procurement (through the Scheduling Coordinator), and nothing more, the Local RAR program could be rendered ineffectual to the extent that LSEs elect such a course of action. This is fully consistent with our earlier determination that a penalty regime is needed for System RAR. (D.06-06-064, p. 66.)

The Commission previously reached the same conclusion in D.05-10-042.

[A] regulatory program that imposes significant procurement obligations upon LSEs cannot be expected to succeed unless those LSEs have reason to believe there are consequences for non-compliance that outweigh the costs of compliance. (D.05-10-042, p. 93.)

The Commission is empowered to see that the provisions of statutes affecting public utilities, such as Section 380, "are enforced and obeyed, and that

³ D.06-06-064 defined load pockets as areas within an LSE's service area which have physical transmission constraints such that the transfer capability of the transmission serving the area is less than the load demand within the area. Thus additional generation capacity within the load pocket is needed to satisfy the load demand.

⁴ Unless otherwise stated, all citations henceforth are to the California Public Utilities Code.

⁵ California Public Util. Code, §380(h).

violations thereof are promptly prosecuted and penalties therefore ..., recovered and collected”⁶. The Commission’s enforcement power extends, not only to the Commission’s own proceedings but, to the commencement of actions before the Courts of the State and includes authority to seek mandamus and injunctions in order to ensure that its regulatory directives and policies are respected and followed⁷. Electric service providers (ESPs) are subject to Commission enforcement authority pursuant to the same statutes as if they were public utilities⁸, and Community Choice Aggregators (CCAs) are subject to Commission enforcement actions pursuant to section 2111.

Consistent with the foregoing provisions of law, the Commission’s Energy Division staff established a citation program to fulfill the objectives of the resource adequacy program and Public Utilities Code section 380. The citation program imposes penalties for non-compliance as determined in D.06-06-064 and these penalties are consistent with other citation programs approved by the Commission⁹.

III. CPSD Investigation Report

CPSD’s report documents the results of its investigation into Calpine’s breach of the Commission’s RAR program to date. Staff has not yet released its report to the public so that Calpine may seek confidential treatment from the Commission for any portions of the staff’s report it deems confidential. The Commission directs Calpine to identify portions of the report for which Calpine requests confidential treatment and provide justification for continued confidential treatment of such portions in accordance with Commission’s rules and policies. Calpine shall provide its justification by written motion filed within seven days of this Order and staff and interested parties may provide responses within seven days of the written motion. Any party opposing the confidential

⁶ California Public Util. Code, § 2101

⁷ California Public Util. Code, § 2102

⁸ California Public Util. Code, § 394.25

⁹ Resolution E-4017.

treatment that Calpine requests shall provide justifications for making the relevant parts of the report public. This enforcement proceeding shall be open to the public and transparent because it involves issues affecting the public interest.

A. Calpine's Year-Ahead Filings

Calpine is subject to the Commission's RAR program. Pursuant to D.05-10-042 and D.06-06-064, Calpine was required to file Year-Ahead System RAR and Local RAR compliance filings by October 31, 2007, for the 2008 calendar year. The purpose of a Year-Ahead Compliance Filing is to demonstrate that the LSE has acquired sufficient resources to satisfy 90% of its forward commitment obligation for loads plus reserve commitment for each of the five summer months May, June, July, August and September, in the year-ahead¹⁰. Calpine timely submitted these Year-Ahead filings to the Commission. However, the Commission's Energy Division staff found procurement deficiencies in Calpine's compliance filings, in apparent violation of the RAR rules.

Energy Division staff notified Calpine of the deficiencies on December 13, 2007 and Calpine submitted an amended filing on December 21, 2007, showing that it had acquired the necessary additional capacity to cure the deficiencies. Notwithstanding Calpine's belated correction of these deficiencies, Calpine's failure to comply with the year-ahead filings by October 31, 2007 is subject to penalties pursuant to D.05-10-042 and D.06-06-064. As the Commission noted in D.06-06-064, Calpine's non-compliance is serious because it could have led to the CAISO taking costly remedial measures.

We note that time is of the essence with respect to LSE compliance filings. If an LSE fails to make a timely filing demonstrating it has fulfilled its local procurement obligation, the CAISO may determine that it needs to proceed on the assumption that the LSE is deficient and therefore engage a backstop procurement to cover the deficiency, even if the LSE has in fact acquired the capacity needed to cover its obligation. Such backstop procurement could be necessarily costly. Accordingly, the penalty for failure to make a timely compliance filing should,

¹⁰ D.05-10-042, p. 87.

after a grace period not to exceed 10 calendar days, be equal [to] the penalty for a deficiency.

(D.06-06-064, pp. 68-69.)

D.06-06-064 explained the non-compliance penalties for both System and Local RAR Year-Ahead compliance filings as follows:

Having determined that penalties are needed to assure that the Local RAR programs are met, we turn to the elements of a penalty regime. D.05-10-042 adopted the broad policy that for System RAR, a penalty equal to 300% of the cost of new capacity (150% for 2006 only) is an appropriate sanction for an LSE's failure to acquire the capacity needed to meet its System RAR obligation. ... It is our judgment that a penalty equal to 100% of the cost of new capacity is an appropriate penalty for failure of an LSE to meet its local procurement obligation. (D.06-06-064, p. 67.)

The Commission explained that if an LSE's deficiency would lead to a penalty for System RAR and a penalty for a Local RAR simultaneously, then the imposed penalty should be no more than 300% for the period that the two deficiencies overlap. (D.06-06-064, p. 68.)

B. Calpine's System Resource Deficiency

Calpine's October 31, 2007, Year-Ahead Compliance Filing failed to account for a contract expiring in June of 2008 resulting in system-wide deficiencies. Calpine's RA Compliance Filing- Worksheet A. Certification Form dated February 16, 2006 shows contract CPA-2.10.1-8874 expiring on June 30, 2008. Thus, Calpine wrongly included resources from this expired contract in meeting their RAR obligations for the months of July, August, and September 2008, causing a total system deficiency of 70.37 MW-month. Energy Division discovered these deficiencies in December 2007 and promptly notified Calpine.

The penalty for failing to procure adequate capacity is three times the monthly cost of new capacity, which is valued at \$40 per kW-year. Calpine's 70.37

MW-month deficiency would be subject to a penalty of \$703,700 using the prescribed amount for capacity (\$40) and penalty multiplier (300%)¹¹.

C. Local Area Resource Deficiencies

Calpine's 2008 Year-Ahead Local Compliance Filing included local procurement obligation deficiencies as well. Calpine failed to use the correct number in its demand response calculations creating a deficiency totaling 10.76 MW-month for 2008. The Commission created a penalty equal to 100% of the cost of new capacity for failure to meet local procurement obligations in D.06-06-064. (D.06-06-064, p. 67.) Calpine's penalty for the 10.76MW-month deficiency calculated with the prescribed amount and multiplier is \$35,867.

D. Penalty Assessments

The combined penalties for both System and Local RAR deficiencies total \$739,567. In D.06-06-064 the Commission addressed situations where penalties overlap and clarified that when two penalties overlap for both system and local procurement obligations elements, only the System RAR penalty would apply¹².

Calpine's deficiencies in the System and Local RAR compliance filings overlapped for July, August, and September 2008. Therefore, the Local RAR deficiency penalty would not be added for these three months. The amount of local capacity deficiency during the overlap period is 1.21MW-month, which computes to a penalty of \$4,033. Deducting this amount from the yearly total reduces the Local Area penalty from \$35,867 to \$31,834. Therefore, Calpine's total penalties are \$703,700 for System deficiencies and \$31,834 for Local deficiencies, totaling \$735,534.

A renegotiated liquidated damages (LD) contract is ineligible for RA qualification. D.05-10-042 addressed the grandfathering of LD contracts in phasing out LD contracts. Therefore, Calpine's renegotiation subsequent to D.05-10-042 is not

¹¹ D.05-10-042, Conclusions of Law (COL) 26, and D.06-06-064, COL 25.

¹² D.06-06-064, p. 68.

applicable to this proceeding for purposes of determining Calpine's compliance with the RAR program.

Therefore, **IT IS ORDERED** that:

1. An investigation on the Commission's own motion is instituted into the Operations and Practices of Calpine Power America-CA, LLC to determine whether Calpine violated Commission Resource Adequacy program rules, regulations, or orders in its October 31, 2007 Year-Ahead Compliance Filings. A copy of CPSD's Investigation Report on Calpine's compliance violations will be placed in the docket designated for this proceeding, subject to redactions consistent with the Commission's confidentiality protocols.

2. Calpine is directed to appear at a time and place to be determined by an Administrative Law Judge (ALJ) and show cause why the Commission should not find that Calpine violated RAR rules made pursuant to Public Utilities Code section 380 by allowing system wide and local procurement deficiencies. The Commission's authority to impose penalties is well established in Public Utilities Code section 2107 and 2108.

3. After an ALJ is assigned, a Prehearing Conference pursuant to Rule 7.2 will be convened, and the ALJ will calendar a date, time and location for a hearing on the Order to Show Cause in a subsequent ruling or order. The subsequent ruling will set a schedule for the issuance of prepared testimony and any additional discovery matters. Respondent shall serve prepared testimony responding to the issues stated above and any other allegations presented in this OII/OSC.

4. This ordering paragraph suffices for the "preliminary scoping memo" required by Rule 7.1(c) of the Commission's Rules of Practices and Procedure (Rule). This proceeding is categorized as adjudicatory and will be set for evidentiary hearing. Pursuant to Rule 8.2(b) of the Commission's Rules of Practice and Procedure, in any adjudicatory proceeding, ex-parte communications are not allowed. The issues of this proceeding are framed in the above order.

5. A prehearing conference shall be scheduled for the purpose of setting a schedule for this proceeding, including dates for the exchange of written testimony, determining which witnesses will need to testify, and addressing discovery issues. As to categorization of this proceeding, this order is appealable pursuant to Rule 7.6. Any person filing a response to this Order Instituting Investigation, Notice with Opportunity to be Heard, and Order to Show Cause must state in any response any objections to such orders and notice regarding the need for hearings, issues to be considered, or proposed schedule. However, objections may not address factual allegations that an evidentiary hearing will decide.

6. The Commission directs Calpine to identify portions of the CPSD report for which Calpine requests confidential treatment and provide written justifications within seven days of this Order for continued confidential treatment of such portions in accordance with Commission's rules and policies.

7. The Executive Director of the Commission shall cause a copy of this order and the staff report to be personally served on the Respondent at:

Linda Sherif
CALPINE Power America-CA, LLC
Senior Regulatory Counsel
4160 Dublin Blvd.
Dublin, CA 94568

8. The temporary service list is hereby established for this proceeding to include Calpine, the Director of the Energy Division, and the Director of the CPSD, and shall be used for service of all pleadings until a new service list for this proceeding is established. An initial service list for this proceeding shall be created by the Commission's Process Office and posted on the Commission's Website (www.cpuc.ca.gov) as soon as it is practicable after the first prehearing conference. Any interested party may also obtain the service list by contacting the Process Office at (415) 703-2021.

This order is effective today.

Dated January 29, 2009 at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners