



WILDFLOWER
E N E R G Y

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August 2, 2013

Dr. Steve Cliff
Chief, Program Evaluation Branch
California Air Resources Board
1001 I Street
Sacramento, California 95814

Filed Online And Sent Via Email

Subject: Wildflower Comments on July 18, 2013 Discussion Draft of Cap-and-trade Regulatory Amendments

Dear Dr. Cliff:

Wildflower Energy LP ("Wildflower") provides the following comments in response to the July 18, 2013 *Discussion Draft of Cap-and-Trade Regulatory Amendments*. Wildflower submits these comments in conjunction with the attached comment forms where Wildflower provides suggested revisions to the cap-and-trade regulation. Wildflower has a Pre-AB 32 long-term contract with a non-utility power marketer that lasts through the duration of the cap-and-trade program. The contract does not expressly contemplate any greenhouse gas ("GHG") control program or treatment of such program compliance costs, and this new cost burden poses a serious threat to the continued financial viability of Wildflower's newer, clean generation facilities.

Wildflower is concerned that the Staff proposal for transitional assistance to a "legacy contract" will not address the financial risk that affected facilities face due to their inability to pass through GHG costs. Wildflower requests that the ARB revise its proposal to address actual, verified emissions during a compliance period through the duration of the contract. In addition, the ARB should include some mechanism that would encourage a counterparty to renegotiate the contract. A counterparty that purchases electricity through a legacy contract has no incentive to renegotiate the contract. This situation will not change between now and 2015. Unless the ARB integrates a mechanism that would encourage the counterparty to a legacy contract to renegotiate, the ARB should provide assistance through the duration of the legacy contract.



I. *Wildflower's Facilities Operate Under A Pre-AB 32 "Legacy" Contract.*

Wildflower is the owner of Larkspur Energy Facility and Indigo Energy Facility, two natural gas-fired peaker power plants operating in Southern California (hereinafter "Facilities"). Wildflower's Facilities were permitted during the Energy Crisis, and entered into a Pre-AB 32, long-term tolling contract with a third-party power marketer from 2004 through 2021. The tolling contract does not expressly contemplate the cap-and-trade program or other GHG emissions control programs. The fact that the Pre-AB 32 agreement is a tolling contract is significant because the marketer controls the dispatch of the facilities, presumably based on economics of the contract relative to market conditions, which will in turn determine how much GHGs are emitted.

The Pre-AB 32 contract issue presents two primary concerns: the financial viability of the projects and the achievement of the state's GHG goals.

1. First, as the generators subject to ARB regulation (and given the tolling contract is with a marketer, not a CPUC jurisdictional entity), Wildflower has the responsibility for securing and retiring allowances. However, the Facilities have no ability to directly control the regulatory costs associated with the allowances because dispatch is dictated by the marketer under the tolling contract. The exclusion of AB 32 costs artificially makes the Facilities appear less expensive to that marketer under the Pre-AB 32 contract. Since Wildflower does not control dispatch and because the marketer is externalizing the compliance cost burden, Wildflower is concerned that this inequity creates a financial squeeze on the Facilities and jeopardizes their continued financial viability.
2. Second, the Facilities are simple-cycle "peaker" plants intended to support system reliability with their fast start capabilities. Simple cycle plants typically have higher GHG emissions rates than baseload combined cycle plants due to relatively lower fuel efficiencies. While the Facilities are not designed with the intention to operate at high capacity factors (and historically have operated at *low* capacity factors), since the start of 2013, the Facilities are seeing much higher operations levels presumably again because the marketer does not need to internalize or price-in the Facilities' GHG compliance cost burdens.

II. *Section 95894 Should Be Revised To Account For Actual Emissions During The First Triennial Compliance Period.*

The Discussion Draft would add a new Section 95894 to the Cap-and-trade regulation, which would allocate 2015 vintage allowances to "Legacy Contract" holders. The quantity of allowances would be based on the 2012 emissions year. If adopted, the revised Section 95894 would leave Wildflower exposed to a significant portion of its compliance costs in 2013 and 2014. This is because 2015 allowances trade at a lower price than current vintage allowances, and 2015 allowances cannot be used to satisfy a 2013 and 2014 compliance obligation.



More significantly, Wildflower's facilities have been dispatched much more in 2013 than they were in 2012. Wildflower believes that this increased dispatch is attributable to the fact that the entity controlling dispatch under the legacy contract does not bear the costs of cap-and-trade compliance obligation and may be profiting from the legacy contract situation through the collection of a GHG cost adder in the CAISO market. Wildflower's facilities appear relatively cheaper than other resources that face GHG costs. The inability to pass through the GHG compliance costs creates a financial incentive to operate Wildflower's facilities more often because they appear cheaper than they did in 2012.

Thus, the 2012 emissions year is not an appropriate proxy for transitional assistance, and the ARB should instead base the transitional assistance on verified emissions for the 2013 emissions year and provide for a true up to account for 2014 verified emissions. Wildflower has submitted suggested regulatory revisions in the attached comment form that would effectuate this recommendation.

III. *A Counterparty Purchasing Electricity Under A Legacy Contract Has No Incentive To Renegotiate The Legacy Contract Before 2015.*

Proposed Section 95894 would only provide relief through the 2014 emissions year. During the July 18th workshop, stakeholders raised concerns about the short duration of the transitional assistance, and the ARB staff explained that it wishes for parties to continue their efforts to renegotiate the contract. While Wildflower agrees that a negotiated solution is optimal, under the current proposal, counterparties that purchase *electricity* under a legacy contract will not have an incentive to renegotiate. The ARB proposes changes to Section 95921 that would encourage steam host facilities to renegotiate (due to loss of freely allocated allowances), but no such change exists for legacy contracts involving electricity. Wildflower does not expect that anything will change in the next two years in terms of its counterparty's willingness to renegotiate the legacy contract. Meanwhile, Wildflower will continue to incur GHG costs and face significant financial uncertainty due to full GHG cost exposure after 2014. This uncertainty jeopardizes the financial viability of our facilities and will disrupt Wildflower's ability to plan maintenance or invest in any capital improvements to the facilities.

For these reasons, Wildflower requests that the ARB amend Section 95894 to provide for transitional assistance through the duration of the legacy contract. If the ARB does not amend its proposal in this way, then the ARB should consider revisions that would encourage a counterparty that receives electricity from the legacy contract to renegotiate. During the May 1, 2013 Workshop, Staff asked Wildflower whether the emissions associated with the output at Wildflower's Facilities could be captured through regulation of the natural gas supplier. Wildflower explained in its comments on that workshop that its GHG emissions are a function of natural gas usage, and under most tolling arrangements, the fuel supplier is the same entity as the entity receiving the electricity and controlling dispatch. If the point of regulation under a Pre-AB 32 Contract that is also a tolling arrangement is moved to the natural gas supplier, then the dispatch would effectively account for GHG costs. In other words, if the entity controlling the



dispatch faces GHG compliance costs relative to the volume of natural gas delivered for conversion into electricity, then a proper GHG compliance cost price signal could be incorporated into that entity's purchase of electricity and related products. Thus, for certain tolling arrangements where the off-taker provides the fuel, moving the point of compliance would be an effective means of addressing the GHG cost issues under the legacy contract. The proposal would need to be limited to legacy contracts that are also tolling agreements, but this proposal would create a strong incentive for a counterparty under such an agreement to renegotiate. Without this type of an incentive, the counterparty cannot be expected to renegotiate the contract before 2015.

IV. Conclusion

Wildflower appreciates the opportunity to comment on Staff's proposal to provide transitional assistance to entities with Pre-AB 32 contracts that do not explicitly account for GHG compliance costs. Wildflower is concerned that the Staff proposal for transitional assistance to a "legacy contract" will not address the financial risk that affected facilities face due to their inability to pass through GHG costs. Wildflower requests that the ARB revise its proposal to address actual, verified emissions during a compliance period through the duration of the contract. In addition, the ARB should include some mechanism that would encourage a counterparty to renegotiate the contract. A counterparty that purchases electricity through a legacy contract has no incentive to renegotiate the contract. This situation will not change between now and 2015. Unless the ARB integrates a mechanism that would encourage the counterparty to a legacy contract to renegotiate, the ARB should provide assistance through the duration of the legacy contract. Attached, Wildflower has completed the ARB's requested comment form and included suggested regulatory revisions that would effectuate these comments.

Sincerely,

A handwritten signature in black ink, appearing to read 'Paul Shepard', written over a horizontal line.

Paul Shepard
Asset Manager, Wildflower Energy, LP