

 WELLHEAD ELECTRIC COMPANY, INC.

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August 11, 2011

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, California 95814

Subject: Comments of Wellhead Electric Company, Inc. on July 25, 2011 Revisions to the
Cap-and-trade Regulation

Dear Clerk and Board Members:

Wellhead Electric Company, Inc. ("Wellhead") offers the following comments on the California Air Resources Board ("CARB") July 25, 2011 Notice of Availability of Modified Text for the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols ("cap-and-trade").

Wellhead remains very concerned that the proposed cap-and-trade regulations are unfair to, and create problems for, power sales contracts entered into before AB32 was signed into law when such contracts do not have any mechanism available for recovery of GHG costs (hereinafter "Pre-AB32 Contracts"). The failure to address this matter creates multiple problems, and not just for the generator.

Foremost, without addressing this issue, the allocation of allowances to utilities is fundamentally flawed because it gives allowances based on costs that will not be incurred by the utility. Second, not only will the generator be without any ability to recover its costs, but behaviors in contradiction of the state's GHG emission reduction goals are rewarded because the buyer will be economically benefit by running the facility more because it does not incur the GHG costs. Hence, CARB's policy intentions for GHG costs to be directly considered in the economic dispatch of generating resources and for ratepayers to see the carbon price signal of generation purchased by a utility will be undermined.

The need for appropriate treatment of Pre-AB32 contracts has been noted by the CARB, CPUC, CEC, and in other settings dating back to the early work of the Market Advisory Committee. The CPUC and the CEC noted in their opinion on GHG strategies in R. 06-04-009 that Pre-AB 32 Contracts should be addressed: "independent power producers may have contracts with utilities that extend beyond 2012 for which there is no clear provision for recovery of new GHG costs." The Initial Statement of Reasons notes the need for specialized treatment at Footnote 22.

It is therefore disappointing that the proposed regulations do not address the issue, based apparently on the hope by CARB, as indicated in the staff summary, that Pre-AB32 Contracts will be renegotiated. While bilateral negotiations could possibly solve the problems in some instances, relying on renegotiation does not make good public policy as a primary strategy, particularly without clear guidance and a backstop alternative, as we propose below. Under the proposed regulation, Pre-AB32 Contracts will be the only fossil fueled power purchase options

for which the distribution utility does not incur carbon costs, and in the case of tolling agreements where a utility can call on or effectively run the generator without incurring such cost the utility will have an incentive not to renegotiate the Pre-AB32 Contract. Moreover, the result of this built-in utility incentive to run such a generator more than would be the case if it did confront appropriate carbon costs will be increased GHG production, is contrary to AB32's primary policy objective.

Thus, relying on parties to renegotiate contracts is unlikely to resolve the Pre-AB32 Contract concern in addition to being cumbersome and expensive from a transactional perspective. Even if CARB had authority to mandate renegotiation, which we doubt, such an approach would still require CARB to revisit its decision allocating allowances to the electric utilities and/or use allowances allocated to its set-aside at some future date if renegotiations are unsuccessful. CARB should act decisively to avoid the uncertainty, controversy and delay that will result by failing to address the issue at the outset.

Most importantly, not addressing the issue is clearly inconsistent with the allocation of free allowances to distribution utilities. In the allocation methodology, CARB explicitly notes that there will be a cost burden resulting from GHG compliance costs associated with fossil generation being passed from suppliers (whether purchased under contract or produced from utility owned generation) to utility customers. Allowances CARB provides to a distribution utility are intended to result in full compensation for GHG compliance costs that are expected to be passed through to consumers. The determination of how many free allowances a utility receives assumes all of its fossil based generation has a GHG cost. Pre-AB32 Contracts were included in the utilities' S-2 Filings, which are the basis for estimating the utilities' costs associated with the cap-and-trade program. However, Pre-AB32 Contracts will be a source of fossil fueled power for which the utility does not incur GHG compliance costs under the proposed regulations. Hence, unless the regulations require the utility to provide Pre-AB32 Contract suppliers with allowances associated with the power they take under the pre-AB32 Contracts (which would be the most logical, best and simplest solution), the regulations will freely allocate allowances to distribution utilities for GHG costs that will not be incurred by them.

The assumptions in the methodology for allocating allowances to utilities are clear that: 1) GHG costs will be incurred by fossil generators; 2) utility customers should see/incur such GHG costs; and 3) allocations are intended to cover these costs the utility pays to the generator. Yet, as currently written, only the first will occur. This is clearly an inconsistency/error that must be fixed.

Wellhead believes there is a very simple solution within the construct of the proposed regulations that is fully consistent with the proposed regulations and is consistent with the policy objective of making the cost of GHG emissions transparent. The solution 1) takes account of the fact that the free allocation methodology assumes all of the fossil generation in a utility's portfolio will have a GHG cost that is being passed through to its customers and 2) builds on the inclusion of a "beneficial holding relationship" in the proposed regulation. Further, the proposal encourages discussions that could lead to renegotiations before the program starts, improves the incentives for a successful outcome by providing clear guidance as to what CARB expects, and accounts in advance for the chance those discussions are not fruitful.

Accordingly and to that end, Wellhead recommends adding a new subparagraph (4) to section 95834(a) of the proposed regulations reading as follows"

"(4) In the event there is a long-term contract for the sale of electricity at wholesale to a distribution utility which:

- i) does not directly or indirectly provide or refer to GHG costs either explicitly or through a CPUC authorized pricing basis that includes GHG costs;
- ii) was fully executed before the final approval of AB32 (September 27, 2006); and
- iii) has not been renegotiated and approved by the appropriate regulatory authority as of January 1, 2012 to address GHG costs,

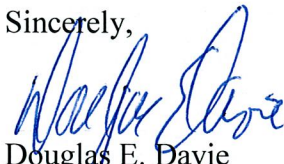
then, a beneficial holding relationship is deemed to exist pursuant to section 95834(a)(1)(A) without further action. The electric distribution utility party to that long-term contract shall purchase and hold allowances for the eventual transfer to the other party to the long-term contract for the sole purpose of supplying that other party with compliance instruments to cover emissions resulting from deliveries under the long term power supply contract.

This addition to the regulations provides clear direction on a backstop approach to addressing the Pres AB32 Contract problem while also eliminating the inconsistency/error in the proposed regulations free allowance allocation methodology. The result will support the clear objectives of AB32 to reduce GHG emissions with regulations/programs that make the full cost of GHG emissions transparent to consumers.

There is a second relatively minor issue that Wellhead understands is already understood by CARB. That is the "beneficial holding relationship" provisions should be available to all long term contracts, not just those executed at an earlier time. This is a useful mechanism and there are recently negotiated/executed contracts that would benefit from its administrative simplicity. The change to the regulations to fix this issue is to simply remove the date limitation in the definition of Long-Term Contract.

Wellhead would be pleased to address any questions CARB has on these matters.

Sincerely,



Douglas E. Davie

Vice President

Wellhead Electric Company, Inc.

cc: Douglas K. Kerner, Esq., Ellison, Schneider & Harris.