

 **WELLHEAD ELECTRIC COMPANY, INC.**

650 BERGUT DRIVE, SUITE C  
SACRAMENTO, CALIFORNIA 95811-0100  
(916) 447-5171 • FAX (916) 447-7602

June 27, 2012

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

Subject: Comments of Wellhead on the May 9, 2012 Notice of Amendments to Cap-and-trade Regulation

Dear Clerk:

Wellhead Electric Company, Inc. (“Wellhead”) submits these comments in response to the May 9, 2012 *Notice of Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments by Linked Jurisdictions* (“Notice”). Wellhead’s comments address the deletion of the Beneficial Holding Relationship provision (Section 95834) and the need for CARB to continue to evaluate and prepare for resolution of the issues faced by a very limited class of generators with pre-AB 32 contracts that have no available mechanism for recovery of AB 32 compliance costs (“Pre-AB 32 Contract Issue”). The Pre-AB32 Contract Issue is not yet resolved and both CARB and the CPUC should be prepared to help address the situation. Wellhead suggests two regulatory amendments that will provide the CPUC and the CARB flexibility needed to address the matter should bilateral negotiations be unsuccessful. First, the CPUC should have the flexibility to not only create rules for revenue allocation, but also be able to adjust the disposition of allowances to utilities within its jurisdiction under a very limited set of circumstances. Second, CARB should enable the CARB Executive Director to adjust allowance allocations when an allocation to a utility fails to comport with Board intent and policy.

*1. The Pre-AB 32 Contract Issue Is Not Resolved.*

The Pre-AB 32 Contract Issue remains an important concern that has not yet been resolved. A generator with a Pre-AB 32 Contract will bear the costs of the cap-and-trade program, and will be the only generation in the utility’s portfolio with carbon costs that the utility and its customers do not see even though the utility receives free allowances assuming a GHG cost is incurred. That condition is clearly contrary to the Statement of Reasons that was adopted by the Board in October 2011.<sup>1</sup> In the case of tolling arrangements where the utility controls dispatch, the utility will also have an incentive to run this limited group of generators more often than would be appropriate with proper consideration of GHG costs, which is also contrary to the intent of the cap-and-trade program. While CARB and the California Public Utilities Commission (“CPUC”) have encouraged a negotiated solution, the issue has yet to be resolved at the CPUC. The Commission considered the issue in D.12-04-046, directing the utilities to renegotiate Pre-AB 32 Contracts with no available mechanism for cost recovery. The Commission, provided the utilities 60 days before it would begin considering the issue in R.11-

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<sup>1</sup>CARB was clear in the October 2011 Final Statement of Reasons that the regulations are not intended to confer free allowances when no associated GHG costs are incurred. CARB states that: “... it is not our intent to provide allowances to entities for carbon costs that they do not, in some manner incur.”

<http://www.arb.ca.gov/regact/2010/capandtrade10/fsor.pdf>

03-012, the CPUC's rulemaking on the Investor Owned Utilities' ("IOUs") use of cap-and-trade allowance revenue. The 60 day period lapsed on Monday, June 18<sup>th</sup>, and to date, there has been no resolution Wellhead is aware of.

*2. Deletion of the Beneficial Holding Relationship Does Not Remove an LSE's Ability to Purchase Allowances for a Generator, If the Utility So Chooses.*

When Wellhead reviewed the changes to Section 95834 in Staff's March 30, 2012 "Discussion Draft", Wellhead was initially concerned that Staff proposed to remove a potential avenue for addressing the Pre-AB 32 Contract Issue. However, Wellhead appreciates staff's clarification during the April 9<sup>th</sup> workshop that staff's intent was to achieve administrative simplicity by removing an unnecessary requirement to have an allowance transfer relationship approved by CARB. Wellhead requests that CARB confirm these statements in the Final Statement of Reasons for this rulemaking, so that stakeholders have clarity that transfers of allowances between a load serving entity ("LSE") and a generator for output and GHG emissions attributable to the generator could still take place in the context of the existing allowance transfer rules.

It is also important to note that the beneficial holding relationship would have exempted allowances purchased pursuant to a beneficial holding relationship from the LSE's holding limits. Now, it is our understanding that LSEs and other entities purchasing allowances on another regulated entity's behalf must comply with the holding limit requirements in Section 95914. With the added administrative simplicity intended by the new structure, this is a good outcome provided, as it appears, that an LSE has the flexibility to purchase allowances on behalf of a contract supplier without violating the holdings limits. Wellhead believes that this issue should also be clarified in the Final Statement of Reasons.

Of greatest importance, though, is that the modified regulatory language for the cap-and-trade regulation would provide an avenue for utilities to address the Pre-AB 32 Contract Issue only *if they adjust and amend the contract*. CARB should provide both the CPUC and itself with an appropriate framework to resolve the issue themselves should the renegotiations not be completed before the first allowance auction in November 2012.

*3. The CPUC Should Have Greater Flexibility In Addressing The Pre-AB 32 Contract Issue.*

While Wellhead still hopes that there will be a negotiated solution, and will continue to engage PG&E towards that end, there is an unmistakable and significant probability that negotiations will not be successful prior to the initial allowance auction later this year<sup>2</sup>, and in that case, CARB and the CPUC should be prepared to act expeditiously on their own if necessary. The CPUC is currently evaluating how it will expand the scope of the R.11-03-012 proceeding to address the pre-AB32 contract issue<sup>3</sup>. While the use of utility revenue from the sale of free allowances to compensate generators with Pre-AB 32 contracts may be a possible

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<sup>2</sup>This is in part because regulatory approval of the changes can take three to six months.

<sup>3</sup> The scope of this proceeding has been focused on the use of revenues CPUC jurisdictional utilities receive from the sale of free allowances and has to date specifically excluded consideration of the pre-AB32 issue. In fact the issue was moved out of this proceeding but the CPUC is now planning to bring it back in as noted in a June 20<sup>th</sup> letter from Executive Director Paul Clanon.

solution, the timing for implementing this type of solution is unclear. For these reasons, Wellhead believes that it would be prudent for CARB to provide the CPUC with greater flexibility to address the issue. In particular, the CPUC should have the discretion to control the disposition of a small pool of allowances needed to meet the requirements of a Pre-AB 32 contract for which the utility does not incur any costs. As proposed in the regulatory language below, if a utility has failed to comply with the direction the CPUC and CARB have provided regarding renegotiation of a Pre-AB 32 contract with no means of GHG cost recovery, then the CPUC should have the ability to require the utility to transfer allowances to the generator.

Wellhead's proposed regulatory Amendments (noted in bold and underlined) are:

**Section 95892 Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.**

(a) Allocation to Individual Electrical Distribution Utilities. The allowances allocated to each electrical distribution utility from each budget year shall be the electrical distribution utility sector allocation calculated pursuant to section 95870(d) for the budget year multiplied by the percentage allocation factors specified in Table 9-3. **Without limiting the effect of Section 95892(c)(3),** any allowance allocated to electrical distribution utilities must be used exclusively for the benefit of retail ratepayers of each such electrical distribution utility, consistent with the goals of AB 32, and may not be used for the benefit of entities or persons other than such ratepayers.

(c) Monetization Requirement.

(1) In 2012 an electrical distribution utility must offer one sixth of the allowances placed in its limited use holding account in 2012 for sale at each of the two auctions scheduled for 2012.

(2) Within each calendar year after 2012, an electrical distribution utility must offer for sale at auction all allowances in a limited use holding account that were issued:

(A) From budget years that correspond to the current calendar year; and

(B) From budget years prior to the current calendar year.

**(3) The CPUC may direct a utility to withhold allowances from consignment to the auctions if the CPUC determines that the utility has not or will not incur the costs of GHG compliance for which the allowances are attributable. The CPUC shall have discretion to control the disposition of these allowances and direct the utility to transfer the allowances to another entity as deemed necessary by the CPUC to comport with the CARB policy that free allowances to be aligned with actual costs of GHG compliance incurred.**

*4. In Addition, CARB Should Provide the Executive Director With Flexibility To Adjust Allowance Allocations When An Electrical Distribution Utility Does Not Actually Bear The Costs That An Allowance Allocation Was Based On.*

Wellhead also believes that CARB should also be prepared to directly resolve the Pre-AB 32 Contract Issue. CARB should include additional amendments to the cap-and-trade regulation to provide the Executive Director with the flexibility to address this issue through administrative adjustments to allowance allocations if the Pre-AB 32 Contract Issue is not resolved prior to the

initial allowance auction or free allowance allocation. In summary, Wellhead's proposed revisions would position the Executive Director to adjust a utility's allowance allocation if it determines that a generator with a Pre-AB 32 Contract is bearing costs for which the utility would otherwise receive free allowances attributable to that generation.

Wellhead's proposed regulatory Amendments (noted in bold and underlined) are:

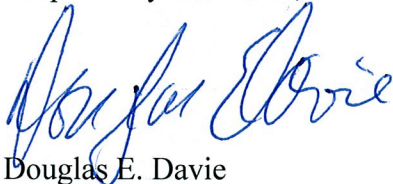
**Section 95892 Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.**

- (f) **In the event that the Executive Director determines that an electrical distribution utility receives allowances attributable to a contract for the sale of electricity at wholesale, which:**
- i. does not provide for payment of, or refer to, GHG costs for energy dispatched and purchased by the electrical distribution utility, either directly in the contract or through a CPUC authorized pricing basis that includes GHG costs;**
  - ii. was full executed before the final approval of AB 32 (September 27, 2006); and**
  - iii. has not been amended to address GHG costs with such changes approved by the appropriate regulatory authority on or before September 1, 2012,**

**then the Executive Director will reduce the allocation of free allowances to that electrical distribution utility to reflect the GHG emissions associated with the utility's purchases under such contract and the Executive Director shall freely allocate those allowances to the generator for the limited purpose of addressing the generator's costs of cap-and-trade compliance; provided, that such allowances may not be sold or traded, they may only be used for compliance with these regulations by the recipient. The Executive Director shall have the discretion to adjust future allocations under this provision based on the generator's actual verified emissions for a particular compliance period.**

Wellhead appreciates the opportunity to provide these comments and would be pleased to answer any questions the Board may have.

Respectfully submitted,



Douglas E. Davie  
Vice President

cc: Douglas K. Kerner, Attorney, Ellison Schneider & Harris LLP