



# WILDFLOWER ENERGY

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May 21, 2013

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Subject: Wildflower "Legacy" Contract and Comments on May 1, 2013 ARB Workshop

Dear Mr. Cliff and Ms. Orlando:

Wildflower Energy LP ("Wildflower") provides the following comments in response to the May 1, 2013 Workshop regarding *Proposed Adjustments to the Cap-and-trade Program's Treatment of Universities, But-For CHP and Legacy Contracts.* 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 supports Staff's proposal to provide transition assistance to "legacy" contracts. As discussed in detail below, the eligibility criteria for transition assistance should not exclude contracts that have been amended after AB 32 for reasons unrelated to GHG compliance costs. Similarly, transfer of ownership should also not result in a loss of eligibility for assistance. With respect to the three proposed allocation methodologies, the proposal should account for heat rate differences between different technology types. This can be accomplished by allocating allowances based on actual verified emissions or by calculating the electricity efficiency benchmark for simple-cycle "peaker" projects based on the previous two years of emissions data. Wildflower looks forward to continuing to work with Staff to address the Pre-AB 32 legacy contract situation.

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

Wildflower is the owner of Larkspur Energy and Indigo Generation, 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 in the near term.
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. *The Eligibility Criteria For Transitional Assistance To "Legacy Contracts" Should Only Exclude Renegotiations Related To GHG Compliance Costs.***

Staff's May 1, 2013 presentation sets forth the following eligibility criteria: (1) the contract was entered into before AB 32; (2) the contract remains in place and has not been renegotiated; (3) eligibility ceases when the contract expires, is renegotiated or the ownership of the facility is transferred or sold; and (4) the entity claiming transitional assistance must attest that the GHG costs under the legacy contract cannot be passed down.<sup>1</sup> Wildflower is concerned that the third criterion may unduly limit transitional assistance for reasons wholly unrelated to

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<sup>1</sup> See Slide 25 of the Staff Presentation, available at:  
<http://www.arb.ca.gov/cc/capandtrade/meetings/050113/final.pdf>



the recovery of GHG compliance costs. Power Purchase Agreements are commonly amended to address a variety of issues that may have nothing to do with GHG costs (e.g., interconnection, metering, noticing procedures driven by other regulatory changes, etc.). Even when parties are aware of a looming or existing dispute, they may still decide it is prudent to proceed with amendments on matters unrelated to the dispute. For example, suppose the parties discover and both agree that there is an immediate need to amend the contract to reflect a new point of delivery. If the parties are in agreement on the point of delivery and can quickly execute a letter agreement to address the issue and avoid disruptions in service under the contract, then it would be infeasible to delay resolution of this issue based on the presence of a much more contentious and unrelated dispute over GHG compliance costs. Thus, amending a contract after AB 32 became law (January 1, 2007) should not, in and of itself, disqualify a facility (or facilities) from being eligible for transition assistance as a legacy contract. Rather, the ARB should require the parties to attest that there has been no amendment to provide a mechanism to address GHG compliance costs.

In addition, Wildflower shares the concerns expressed by others at the May 1, 2013 workshop regarding the exclusion for transfers of ownership. Transfers of ownership such as new partnerships and sales of stock are an important aspect of corporate finance and governance. Limitations on a corporate parent's ability to engage in these transactions due to the GHG compliance costs concerns of a subsidiary could create a significant burden on the corporate parent. Moreover, the individuals responsible for GHG compliance costs and contract management of a subsidiary project company often have no control or knowledge of a parent corporation's activities. Thus, limitations on transfers of ownership will create a significant burden on both the subsidiary and parent corporation of affected entities. ARB should not include this restriction as part of its eligibility criteria for transition assistance.

### ***III. The Allowance Allocation Formula For Legacy Contracts Should Address The Unique Operational Attributes and Higher Heat Rates Of Peaker Power Plants.***

As peaking facilities, Wildflower's Facilities are very flexible and can provide fast starting (within 10 minutes) energy, capacity and respond to market demands and system upsets. The Facilities play a critical role in helping serve Southern California's reliability needs. This is especially true in light of the difficulties of building new sources in the South Coast Air Basin, the un-availability of once through cooling facilities, and the growing ramping needs attributable to renewable generation additions. The Facilities are designed to provide different types of grid services than most combined cycle plants, and as a result of their fast starting capabilities, they also have higher heat rates. The proposed "electricity efficiency benchmark" in Staff's proposal for Option 1 and 2 (or 0.431 MT/MWh) would not account for the fact that peaker plants are intentionally designed differently than baseload combined-cycle power plants. Typically, peaker power plants operate at a benchmark closer to 0.58 MT/MWh. The term "peaker" is a colloquial



term<sup>2</sup>, and refers to plants that are not designed and intended to be operated at baseload. The Emissions Performance Standard (“EPS”) defines “baseload generation” to mean “electricity generation from a power plant that is designed and intended to provide electricity at an annualized plant capacity factor of at least 60 percent.”<sup>3</sup> The ARB could use this statutory definition to distinguish “peakers” from other electricity-producing only baseload facilities. So long as there is no reporting period during which an affected facility was operated at a 60% or greater capacity factor, then the facility could reasonably be considered a “peaker”. The Staff proposal should then account for this design-based distinction in one of two ways. First, the proposal could include a benchmark (MT/MWh) based on the previous two years of verified emissions for an affected facility. Alternatively, the ARB could simply allocate allowances based on the actual, verified emissions for a particular compliance period.

#### ***IV. In Response To Staff’s Question, Wildflower’s Emissions Could be Captured At The Natural Gas Supplier Level In The Second And Third Compliance Periods.***

On Slide 24 and during the May 1, 2013 Workshop, Staff asked Wildflower whether the emissions associated with the output at Wildflowers’ Facilities could be captured through regulation of the natural gas supplier. 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, this Staff proposal would be an effective means of addressing the GHG cost issues under Pre-AB 32 long term contracts. Moreover, the Staff proposal would avoid some of the problems inherent in the formulas for transitional assistance. In particular, the affected generator would no longer have unmet compliance costs due to the application of a steadily rising cap-decline factor.

#### ***V. Conclusion***

Wildflower supports Staff’s proposal to provide transitional assistance to entities with Pre-AB 32 contracts that do not explicitly account for GHG compliance costs. Eligibility for this assistance should be crafted to avoid penalizing post-AB 32 amendments on issues wholly unrelated to GHG compliance costs. In addition, the eligibility criteria should avoid unintended consequences of interfering with corporate governance and finance through a prohibition on

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<sup>2</sup> The California Energy Commission’s Glossary of Energy Terms defines “peaker” to mean “a nickname for a power generating station that is normally used to produce extra electricity during peak load times.” See *CEC Glossary of Energy Terms*, available at: <http://www.energy.ca.gov/glossary/glossary-p.html>

<sup>3</sup> Cal. Pub. Util. Code Sec. 8340(a)



transfers and sales. Wildflower appreciates Staff's recognition that peakers have different operational attributes and higher heat rates than combined cycles; and as a result, the methodology for transitional assistance should account for these distinctions. Wildflower thanks the ARB for the opportunity to provide these comments and looks forward to working with Staff towards the successful resolution of these issues.

Sincerely,

A handwritten signature in blue ink, appearing to read "Paul Shepard". The signature is fluid and cursive, with a large loop at the end.

Paul Shepard  
Asset Manager, Wildflower Energy, LP