



**WILDFLOWER**  
**E N E R G Y**

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June 22, 2012

Mary D. Nichols, Chairperson  
California Air Resources Board  
1001 I Street  
Sacramento, California 95814

Subject: Investment of Cap-and-trade Auction Proceeds to Support Pre-AB32 Contracts

Dear Chairperson Nichols:

Wildflower Energy, LP ("Wildflower") provides these comments on the investment of cap-and-trade auction proceeds and in response to the May 24, 2012 public consultation meeting. Wildflower encourages CARB to utilize a small portion of the auction proceeds to address pre-AB 32 long-term power sales contracts that do not include provisions allowing the project to recover the new greenhouse gas ("GHG") compliance costs within the contract structure and also have no near-term access to markets in which the GHG compliance costs might be recovered ("Pre-AB 32 Projects"). Wildflower owns Pre-AB 32 Projects, which entered into long-term contracts to stabilize the California electric market in 2001 and 2004. These Pre-AB 32 Projects may suffer a potentially devastating penalty for their commitment to long-term contracts and stable pricing. While the "Pre-AB 32 Contract" issue is recognized by both the CPUC and CARB, the issue remains unresolved. As discussed below, a small set-aside of allowance revenue to address this issue would further the purposes of AB 32 by ensuring equity and minimizing the costs of the program.

**Special Circumstance of Projects with Pre-AB 32 Long Term Contracts**

When CARB adopted the draft GHG cap-and-trade regulation, serious issues associated with the treatment of projects with Pre-AB 32 long term contracts. These projects were repeatedly noted by CARB, the California Public Utilities Commission ("CPUC"), and the California Energy Commission ("CEC") both before CARB and in other settings dating back to the early work of the Market Advisory Committee.<sup>1</sup> CARB Resolution 11-32, issued on December 20, 2011, adopting the regulation, provided explicit direction on this topic as follows:

BE IT FURTHER RESOLVED that the Board directs the Executive Officer to monitor progress on bilateral negotiations between counterparties with existing contracts that do not have a mechanism for recovery of carbon costs associated with cap-and-trade for industries

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<sup>1</sup> The CPUC and the CEC noted in their opinion on GHG strategies in R. 06-04-009 that Pre-AB32 Projects 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."* (See Rulemaking 06-04-009 (Filed April 13, 2006), Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies, Section 5.4.1.1)





receiving free allowances pursuant to Section 95891, and identify and propose a possible solution, if necessary. For fixed-price contracts between independent generators and Investor Owned Utilities, the Board further directs the Executive Officer to work with the California Public Utilities Commission (CPUC) to encourage resolution between contract counterparties.

Despite the Board's recognition and direction to staff, the Pre-AB 32 Contract issue remains unresolved for the small group of affected generators.

#### **Pre-AB 32 Contract Issue and Wildflower**

Wildflower is the owner of Larkspur Energy and Indigo Generation, two natural gas-fired power plants operating in Southern California (hereinafter "facilities"). On January 17, 2001, Governor Gray Davis proclaimed a State of Emergency to exist due to the energy shortage in the State of California. Subsequently, on February 8, 2001 and on March 7, 2001, Governor Davis issued Executive Orders D-26-01 and D-28-01, requiring the Energy Commission to invoke the emergency siting procedures in Public Resources Code section 25705 to expedite the licensing of all new renewable and peaking power plants that could be available for service no later than September 30, 2001. In these orders, Governor Davis declared that new generation was needed to avert an immediate threat to public health and safety. Larkspur and Indigo were licensed under this process. Wildflower's facilities also entered into long-term tolling contract with a third-party power marketer through 2021 which does not provide any mechanism for cost recovery of GHG compliance costs. At that time, the State strongly encouraged execution of long-term power purchase agreements for these emergency facilities, in order to avoid some of the spot-market fluctuations that exacerbated the energy crisis.

Over the past decade, the facilities have played an important role not only in meeting intermittent market demands but also in emergency situations such as the recent fires in San Diego. Moreover, Wildflower's long-term contractual agreement reflects a long-term commitment to California for a stable and reliable energy market. Wildflower has never sought to renegotiate the contract for added benefits when market conditions were more favorable. This long-term tolling agreement was entered into long before AB32 was signed into law and currently does not have any mechanism available for recovery of GHG costs. Based on CARB's staff's direction, Wildflower has attempted to renegotiate the contracts to address GHG costs, but the marketer that purchases power under this contract has declined to renegotiate to address these substantial and previously unforeseen GHG costs. Consequently, Wildflower has no ability to recoup the GHG compliance costs starting July 2012, when the first cap-and-trade auction occurs.

Further, Wildflower is unique among Pre-AB32 Projects with a long-term tolling agreement in that the counterparty is with a third-party power marketer rather than a utility. In either case, the electricity ends up serving end-use customers in California. However, this adds a further layer of complexity as the third-party off-taker has full dispatch control over Wildflower's facilities. Wildflower, as the generator, does not have any say in the amount of allowances even needed,





but as it currently stands, Wildflower would have to bear the significant economic burden of complying with the cap-and-trade program.

The significant unrecoverable costs of the cap-and-trade regulation could immediately impact debt coverage ratios and other covenants in financial documents that could result in defaults under such financial documents. Thus, instead of being rewarded for a long-term commitment to California, Wildflower now finds itself in a situation where unrecoverable GHG compliance costs from a pre-AB32 long-term contract could force curtailment or even cease operations.

Moreover, the economic impact of a potential closure of these facilities goes well beyond the direct impact to Wildflower. The operation of each of these facilities is vital to the economic wellbeing of the communities where they are located. In addition to the direct benefit of providing high-paying jobs, the plants also provide second-level benefits by supporting local industrial companies and businesses, and providing significant property taxes that directly support the local communities. The potential closure of these plants will trigger long-lasting harm to communities that are already struggling with some of the highest unemployment levels in Southern California.

#### **Recommendation**

ARB should recommend to the legislature that a small portion of the allowance revenue placed in the Air Pollution Control Fund be set aside for purposes of compensating the limited group of generators with Pre-AB 32 Contracts that have no means of cost recovery.

Such a set-aside would further the purposes of AB 32 by effectuating the legislature's direction in Health and Safety Code Section 38562(b)(1) to "design the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California..." As discussed above, failure to address the Pre-AB 32 Contract issue would be inequitable because it would penalize a small group of generators that entered into long-term contracts during the state's electricity crisis. Further, the cost impacts will jeopardize the financial well-being of the communities where the facilities are located. This result is contrary to the purposes of AB 32 and should be avoided through a small set-aside of allowance revenue sufficient to cover the costs of compliance for Pre-AB 32 Projects.

Wildflower appreciates the opportunity to provide these comments.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Bo Buchynsky'.

Bo Buchynsky  
Senior Vice President, Wildflower Energy, LP