BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Integrate and Refine Procurement Policies and Consider Long-Term Procurement Plans.	Rulemaking 10-05-006 (Filed May 6, 2010)

NOTICE OF EX PARTE COMMUNICATION BY WELLHEAD ELECTRIC COMPANY, INC.

Douglas E. Davie, Vice President
Wellhead Electric Company, Inc.
650 Bercut Dr., Suite C
Sacramento, CA 95811
Tel: (916) 447-5171
Fax: (916) 447-7602
E-mail: ddavie@wellhead.com

Douglas K. Kerner
Ellison, Schneider and Harris L.L.P.
2600 Capitol Avenue, Suite 400
Sacramento, CA 95816
Tel: (916) 447-2166
Fax: (916) 447-3512
E-mail: dkk@eslawfirm.com

Attorneys for Wellhead Electric Company, Inc.

December 20, 2011

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WELLHEAD ELECTRIC COMPANY, INC.

Pursuant to Rules 8.2 and 8.4 of the California Public Utilities Commission's Rules of Practice and Procedure, Wellhead Electric Company, Inc. ("Wellhead"), hereby gives notice of the following ex parte communication.

On Monday, December 19, 2011, Doug Davie, Vice President of Wellhead and Douglas K. Kerner, Attorney for Wellhead, met first with Matthew Tisdale, advisor to Commissioner Michael P. Florio, from approximately 1:00 to 1:45 pm, and second with Sara Kamins, advisor to Commissioner Mark J. Ferron, from approximately 2:00 to 2:35 pm. Mr. Davie initiated these meetings and both were held at the California Public Utilities Commission located at 505 Van Ness Avenue, San Francisco, California, 94102. There were two documents presented as written materials at both meetings; 1) August 11, 2011 Comments of Wellhead Electric Company, Inc. on the July 25, 2011 Revisions to the Cap-and-Trade Regulation (hereto, Attachment 1); and 2) GHG Costs and Pre-AB 32 Power Sales Contracts key points summary (hereto, Attachment 2).

In both meetings, discussions focused on power purchase agreements entered into before the passage of AB32 and that do not have a mechanism for recovery of greenhouse gas compliance costs and the need for the Commission to take action to eliminate the problem.

Attached to this Notice are the written materials presented during this meeting and copies

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of this Notice may be obtained by contacting Deric J. Wittenborn at (916) 447-2166 or djw@eslawfirm.com.

December 20, 2011 Respectfully submitted,

By: ______________________

Douglas K. Kerner
Ellison, Schneider & Harris
2600 Capitol Avenue, Suite 400
Sacramento, CA 95816
Tel: (916) 447-2166
Fax: (916) 447-3512
E-mail: dkk@eslawfirm.com

Attorneys for Wellhead Electric Company, Inc.

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Attachment 1

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

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"

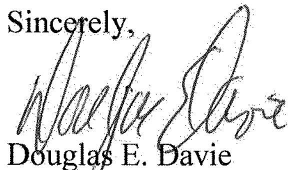
> "(4) In the event there is a long-term contract for the sale of electricity at wholesale to a distribution utility which:
>
> i) does not directly or indirectly provide or refer to GHG costs either explicitly or through a CPUC authorized pricing basis that includes GHG costs;
>
> ii) was fully executed 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.

GHG Costs and Pre-AB32 Power Sales Contracts

- Both CARB and the CPUC have recognized that contracts negotiated and executed before AB32 was effective and which do not have a mechanism for GHG compliance cost recovery from the purchaser need to be addressed. Here's why that's important:

  1. The amount of free allowances allocated to distribution utilities assumes GHG compliance costs from projects under contract are paid by the distribution utility ***-- the recipient of free allowances will have a windfall benefit because they do not incur the costs that were assumed in that allocation of free allowances.***

  2. Generation from a project that does not include GHG will be less expensive than lower GHG emitting projects that include GHG costs ***-- the distribution utility's least cost dispatch decisions will result in higher GHG-emissions.***

  3. Consumers will not see the cost of GHG emissions if the distribution utility does not pay such costs ***-- the intended transparency to encourage consumers to modify their behaviors to reduce GHG emissions will be lost.***

- In adopting cap & trade regulations, CARB acknowledged that such contracts need to be addressed but hopes this will get resolved through negotiations between the parties. The three categories of contracts that are potentially involved are:

  1. Contracts between GHG emitters and an electric distribution utility, such as Fresno Cogen;

  2. Contracts between GHG emitters and an electric wholesale market participant; and

  3. Contracts between GHG emitters and their host under a CHP arrangement (the host may take delivery of thermal and/or electric energy).

- The CPUC has a proceeding to address the first category when the utility is subject to CPUC jurisdiction. The proceeding was initially R.11-03-012, the GHG auction revenue allocation, but any consideration of the issue has been moved to R.10-05-006, the LTPP OIR

- The recent and pending Petition for Modification by SDG&E for the Otay Mesa Energy Center ("OMEC") contract, submitted on November 16, 2011 in R.01-10-024, correctly recognizes the key principles Wellhead is asking the CPUC to address:

  - SDG&E and OMEC have a pre-AB 32 contract that does not have a mechanism for recovery of OMEC's GHG Compliance costs

  - The Petition acknowledges that the IOU has been allocated allowances for the emissions of the contracted party that, unless properly addressed, will undermine the purposes of overall GHG policy.

  - The modifications to the contract make it clear that the Compliance Obligation is properly in SDG&E's hands "consistent with SDG&E's and California Utilities' Current Approach to GHG Costs".

Fresno Cogeneration Partners, LP situation

- SO2PPA was executed in 1986

- Consistent with D.95-12-063 which sought to encourage QF contract restructurings, FCP entered into negotiations with the utility.

- After years of discussion/negotiation, a mutually beneficial amended agreement was executed by FCP on 5/1/2006 and by the utility on 5/22/2006.

- FCP's situation is similar to OMEC with one major exception, our utility counterparty has been unwilling to address the issue voluntarily as SDG&E did.

What does the CPUC need to do?

- The CPUC should affirm that a power sales contract does not have a mechanism for recovery of GHG costs if: 1) it is silent on the issue; AND 2) it is not paid on a CPUC-approved methodology (e.g. avoided cost or CHP Settlement) or on a wholesale electric energy market index.

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- The CPUC should consider "pre-approving" contract modifications that simply implement the administrative practice of using CARB's beneficial holding provisions for pre-AB32 contracts not having a mechanism for recovery of GHG costs.

  - Wellhead/Fresno Cogen asks the CPUC to look closely at its proposal to CARB and consider supporting that simple administrative approach which solves all of the problems with CPUC jurisdictional contracts without the need for contract amendment negotiations and subsequent CPUC reasonableness proceedings and sets a form of solution for the other pre-AB32 contracts (attached).

- If a pre-approved approach is not identified, the CPUC should set a date in early January 2012 for a Pre Hearing Conference on the status of negotiations and to set an expedited schedule for the necessary proceeding. This is necessary to ensure the matter is resolved before the initial auction of GHG allowances later in 2012 (as noted in IEP's September 25th motion for expedited resolution of this issue).