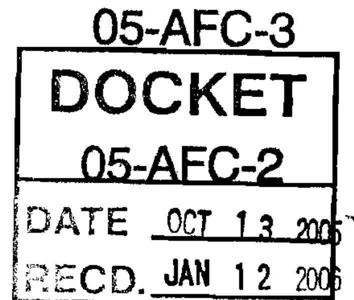
From: "Jenifer Morris" <jenifer@njr.net>
To: "Eric Knight" <Eknight@energy.state.ca.us>, "Robert Worl" <rworl@energy.state.ca.us>
Date: 1/12/2006 8:40:07 AM
Subject: 05-AFC-02 and 05-AFC-03 -- Data Adequacy -- Sun Valley and Walnut Creek Projects



Bob,

This is to follow up on our call regarding offset status for offset acquisition for the projects during the Data Adequacy phase.

Edison Mission Energy (EME) completed extensive due diligence prior to initiating preparation and filing of the Walnut Creek and Sun Valley Energy Projects. These efforts included meetings with senior staff at EPA Region 9 and South Coast Air Quality Management District to understand the policy issues regarding offsets in the South Coast Air Basin. In addition, we prepared a market study and met with and retained various consultants to understand their perspective and the commercial issues.

As discussed in the AFC, EME is closely following Rulemaking for the Priority Reserve Amendment for PM10 and CO offsets. CO offsets may not be required if the Basin is redesignated as attainment. Please see the comments submitted by Latham and Watkins on behalf of EME to South Coast that are attached.

For VOC ERCs, Edison Mission Energy has retained a consultant who has initiated calls to various holders of banked credits for VOCx. We will revise the confidential filing to highlight that initial discussions,

If you or staff have any addition questions, please call my cell phone. We will do our best to provide the information that we have to assist staff as they consider their data adequacy recommendations for these projects for the January 18th Business Meeting. EME is eager to get started on the 12-month AFC process so that operation by 2008 is feasible.

Thanks,

Jenifer Morris

Jenifer Morris
NJ Resources, LLC
7240 Heil Avenue
Huntington Beach, CA 92647

714-841-7522 Office
714-614-5620 Cell

CC: "Scott Galati" <sgalati@gb-llp.com>, "Dereck Benham" <dbenham@EdisonMission.Com>, "Tom McCabe" <tmccabe@edisonmission.com>, "Larry Kostrzewa" <lkostrzewa@EdisonMission.Com>, "Doug Davy" <Doug.Davy@CH2M.com>

Michael J. Carroll
Direct Dial: 714.755.8105

650 Town Center Drive, 20th Floor
Costa Mesa, California 92626-1925
Tel: (714) 540-1235 Fax: (714) 755-8290
www.lw.com

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October 13, 2005

File No. 039716-0001

Mr. Henry Pourzand
South Coast Air Quality Management District
Planning, Rule Development & Area Sources
21865 Copley Drive
Diamond Bar, CA 91765

Re: Comments on PAR 1309.1

Dear Mr. Pourzand:

On behalf of Edison Mission Energy, we submit the following comments on Proposed Amended Rule 1309.1 – Priority Reserve ("PAR 1309.1").

Conceptually, EME supports the proposed amendments to PAR 1309.1. We concur with District Staff that there is a critical shortage of generating capacity in the District, and that new generating facilities are needed in the South Coast Air Basin (Basin) to address the shortfall. In addition, we agree that obtaining emissions offsets for new generating facilities in the Basin has become an area of critical need. The majority of new electrical generating facilities cannot be certified, permitted and constructed without emission offsets, making this issue one of overwhelming importance. Therefore, we fully support the proposal to allow certain qualified generating facilities access to the Priority Reserve for the purpose of obtaining required emission offsets.

We offer the following comments regarding specific aspects of PAR 1309.1:

1. We understand that the U.S. Environmental Protection Agency is considering approving the District's request for redesignation of the Basin as attainment for carbon monoxide ("CO"). However, the timing and the certainty of the outcome of the approval process is uncertain. The District should include provisions for the transfer of CO into the Priority Reserve account for use by qualified facilities in the event that redesignation of the District as attainment for CO does not occur within the projected timeframe. The availability of CO offsets in the Priority Reserve could be made contingent on redesignation not occurring in time.

2. In establishing the amount of the mitigation fee, District Staff apparently plans to evaluate recent "market" transactions involving emission reduction credits ("ERCs") for

guidance. In conducting this evaluation, the District must take into consideration the fact that a liquid market for PM-10 ERCs does not currently exist. Recent transactions have been isolated, and generally for small quantities of ERCs. Benching the mitigation fee to prices paid in these transactions would lead to setting an inappropriately high mitigation fee.

3. Due to the limitations imposed on the transfer of ERCs obtained from the District's Priority Reserve, applicable mitigation fees should either be refundable or made payable at the end of the permitting process. Generating facilities will be unlikely to risk the investment of significant funds, totaling in some cases millions of dollars, unless the District provides some means to recover the investments if the projects are not permitted. We suggest that District Staff coordinate with the California Energy Commission on the timing issues related to payment of mitigation fees.

4. We agree that applicants for the Priority Reserve should be required to perform diligence to determine the availability of ERCs from the open market. However, the required "due diligence effort" of PAR 1309.1(a)(4)(C) must be better defined and must terminate at some reasonable point. Energy generating facilities should not be obligated to continue searching for available ERCs once an initial demonstration of unavailability in the market has been made.

5. Under PAR 1309.1(a)(4)(D), the requirement that facilities be fully operational at the rated capacity "within 3 years following issuance of a Permit to Construct or initial California Energy Commission certification, whichever is later" is overly aggressive. The typical CEC deadline for commencement of construction is 5 years from certification in recognition of the fact that these projects have long lead times. We urge District Staff to extend the timeline under PAR 1309.1(a)(4)(D) to be consistent with CEC requirements, or to eliminate this provision altogether.

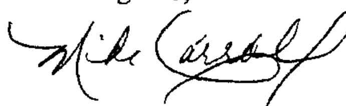
6. District Rule 1306(b), which contains the methodology for calculating emission increases for purposes of offsets, needs to be modified for peaking generating plants. The current methodology utilizes a worst-case-month scenario. Operation of peaking units will vary dramatically from month to month. Using a worst-case-month scenario dramatically overestimates the need for annual emission offsets, and places unreasonable demands on both the market and the Priority Reserve for offsets.

7. Pursuant to PAR 1309.1 (a)(5)(F), allocations from the Priority Reserve cannot be banked or transferred. PAR 1309.1 should contain a mechanism for returning offsets to the Priority Reserve in the event that source tests reveal that actual emissions are lower than were anticipated at the time the permit was issued. Otherwise, offsets may become unused and inaccessible to generating facilities which are in need of such offsets.

8. Generating facilities should not be required to contract with the state for the sale of power to qualify for access to the Priority Reserve. See PAR 1309.1(a)(4)(E). The state of California may not offer such contracts in the future, making the requirement both unnecessary and impractical to satisfy.

In closing, we appreciate the District's recognition of the need to address the offset requirement issue for new generating facilities in the Basin, and the District's efforts in proposing amendments to Rule 1309.1. We fully support the effort, and are committed to working with the staff to address the concerns raised above.

Warm regards,



Michael J. Carroll
of LATHAM & WATKINS LLP

cc: Tom McCabe
Jennifer Morris