June 27, 2012

California Air Resources Board

1001 I Street

Sacramento, CA 95814

Dear Board Members:

La Paloma Generating Company (La Paloma) appreciates the opportunity to comment on proposed changes to the cap-and-trade regulation. La Paloma owns and operates a highly efficient 1,020 MW natural gas, combined cycle generating facility in McKittrick, CA. La Paloma continues to support the development and implementation of a well functioning cap and trade program. Unfortunately, the major issue that will create an undue financial burden on La Paloma is not being directly addressed in the proposed amendments. Though the Final Regulation Order establishing a Greenhouse Gas Cap-and-Trade Program for California, Cal. Code Regs. Tit. 17, § 95801 *et seq.* (2011) called for the Executive Officer to identify and propose any necessary solutions as to entities that are unable to recover the costs of the program due to pre-AB 32 wholesale electric power sales contracts, such a remedy has not been reached for La Paloma as of this time.

Though the Board is not required to consider comments not directly relating to the additional documents, La Paloma hopes that the Board will see fit to address this important issue. La Paloma wants to take this opportunity to add to the public record a plea for assistance from the California Air Resources Board. The proposed solution of contract renegotiation has been attempted both with and without the help of the ARB and has failed in all cases. The long-term contract counterparty is Morgan Stanley Capital Group Inc. (Morgan Stanley). Morgan Stanley has indicated that it has entered into wholesale resale contracts of its own relying upon its portfolio of long-term purchase contracts, including the La Paloma contract. We would note, and appreciate, that ARB representatives have participated in certain of these discussions with Morgan Stanley in an effort to further the mandate to provide assistance to entities such as La Paloma. Nonetheless, Morgan Stanley has refused to renegotiate, stating that it would be unfair for it to absorb the costs of these emission allowances, which it cannot economically or feasibly pass through to its counterparties. Accordingly, resolution through bilateral negotiations has been attempted and, despite best efforts, has failed for La Paloma. We are aware, however, that this proposed solution has been effective for generators that hold long-term contracts with the state’s independent owned utilities (IOUs). The IOUs are the beneficiary of the carbon allowances via the auction process, and no doubt have been encouraged by the regulating authorities to negotiate the amendments intended by the Final Regulation Order.

The California cap and trade program as currently structured does not provide the same relief to sellers maintaining long-term contracts as was provided in other proposed federal and regional legislation, presumably to avoid discriminatory and burdensome outcomes. For example, two of the federal Cap-and-Trade proposals, Waxman-Markey (H.R. 2454) and Kerry-Boxer (S. 1733) and the memorandum of understanding between several States in the Northeast known as the Regional Greenhouse Gas Initiative ("RGGI"), all provided allowances to certain facilities subject to long-term contracts that did not allow the recovery of the costs of purchasing allowances at auction. The CARB cap-and-trade program does not provide similar allowances. As such, the solution proposed by CARB for generators to negotiate with their counterparties is flawed since the counterparties cannot be caused to negotiate, as is the case with La Paloma.

La Paloma does not believe this unduly discriminatory outcome resulting from the difference in the nature of the counterparty (IOUs vs. wholesale marketing companies) was either intended or would survive legal challenge. Nor is it desirable to impose such a burden on an efficient and clean natural gas-fired generator such as La Paloma. Indeed, the CARB Board directed that solutions should be proposed for entities in the situation now faced by La Paloma when needed. Only with an effective solution does the program avoid discriminatory, inefficient, undesirable and legally suspect outcomes.

Again, La Paloma appreciates the opportunity to add our concerns to the public record, and we hope that the Board will take our situation under consideration. Please feel free to contact Carla Banks at (713) 898-0530 for additional information or to discuss this matter further.

Sincerely,



Carla Banks