PROPOSED SUPPLEMENT TO THE CLEAN AIR INTERSTATE RULE PUBLIC HEARINGS

3 JUNE 2004

BEFORE: Sam Napolitano, U.S. EPA
Joe Paisie, U.S. EPA
Sarah Dunham, U.S. EPA
Howard Hoffman, Esq., U.S. EPA

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P R O C E E D I N G S

MR. NAPOLITANO: Good morning. We are going to go ahead and start the hearing now. Lead off by thanking you for coming to EPA's hearing on the recently proposed limitations for SO_2 and NO_x in the supplemental notice for the Clean Air Interstate Rule.

My name is Sam Napolitano. I will be chairing today's meeting. We'll listen to what you have to say to us about the rule, and I'd like to initially introduce other members of the panel.

To the far right of me is Joe Paisie, who is with the Office of Air Quality Planning and Standards, who works extensively on fine particle attainment issues, regional haze, and other NAAQS-related issues.

We have Sarah Dunham, who's with the Office of Atmospheric Programs of the Air Office, who works a great deal on designing the cap-and-trade programs. And it is her group that has designed the model state program language that this proposal focuses on.

And there's also, to my immediate right, Howard Hoffman, who's with our Office of General Counsel, who's the lead attorney for the Clean Air Interstate Rule and a host of other rules, as well, for the Air Office.

I recognize that many of you have come a great

distance, and we appreciate you making the time to participate. Before we move into the comment period, I'd like to briefly describe today's rule and talk a little bit about the ground rules here, which are limited but nonetheless just are designed to keep the day moving.

The Clean Air Interstate Rule, or CAIR, as we call it, is a proposal to reduce interstate transfer of fine particles and ozone. The rule is designed to reduce and cap emissions of sulfur dioxide and nitrogen oxides in the eastern part of the United States.

The states have two options of participating in this program. One is to join cap-and-trade system, which is detailed in the SNPR that we're going to talk about, that will run, be administered, if you will, by EPA. And the other is to make those reductions through an independent set of controls that they verify for us will be sufficient to do the job of providing the SO_2 and NO_x reductions required in the state levels.

The Clean Air Interstate Rule basically will reduce power plant SO_2 emissions by approximately 3.6 million tons annually by 2010 and it will reduce ultimately, when it hits the cap levels in the eastern part of the United States, SO_2 annually by about 5.5 million tons. For NO_x, the emission reductions

will be also quite substantial, measuring about 1.5 million tons of reduction annually by 2010 and 1.8 million tons by 2015 when the cap actually is lowered.

By substantially reducing SO_2 and NO_x emissions across a multistate region, the Clean Air Interstate Rule will help many states and cities across the country meet the national health-based air quality standards that we have in place for ozone and fine particles. Because SO_2 and NO_x contribute to the formation of fine particles in ground-level ozone, these pollutants are really associated with a lot of illnesses and in some cases, premature death.

Reducing emissions from these pollutants will significantly address the health issues concerned with the agency and the public at large, in addition to improving visibility and protecting sensitive ecosystems from problems such as acid rain.

The supplemental proposal that is the subject of today's hearing provides important details and regulatory text for CAIR. It does not change the required reductions and time lines proposed by the rule back in January. EPA is in the process of reviewing the extensive public comments that we received at the end of March on that proposal and plans to respond to those comments as well as the ones that we get after

this hearing on the supplemental notice in the final rule making that we are going to complete this fall.

The supplemental notice includes model cap-and-trade programs for power plants that states may adopt to achieve required emission reductions. Cap-and-trade programs, like the Clean Air Act's Acid Rain Program are recognized not only for ensuring significant emission reductions and lowering costs, but also providing incentives for early reductions and developing innovative strategies.

Use of the cap-and-trade mechanism in the achievement of the requirements of CAIR will ensure complete accountability and transparency, as well as the savings and streamlined implementations, which are the objectives of this rule.

The notice also includes details on proposed integration of the original proposal with existing Clean Air Act requirements. In particular, for the Regional Haze Program, EPA is proposing that the emissions reductions under this rule, if achieved by power plants under the model cap-and-trade program, would satisfy source-specific best available retrofit technology, BART, requirements for the power sector.

Now let's turn to the comment portion of today's hearing to talk about a few ground rules and

1 what we'll be doing from this hearing. We will be
2 preparing a written transcript, which will be available
3 as part of the official record. We are also accepting
4 written comment on the proposed rule for 45 days after
5 its publication in the Federal Register. That's
6 expected to be this week or early next. We have a --
7 excuse me -- we have a handout available at the
8 registration table with detailed information for
9 submitting written comments to us.
10 Now I would like to outline a couple of the
11 ground rules. I will call the scheduled speaker to the
12 microphone. At that point, I wish that you would
13 submit -- or, excuse me, state your name, your
14 affiliation, and where you are from. It will also help
15 the court reporter here if you will also spell your
16 name.
17 In order to be fair to everyone that's come to
18 the hearing, we are asking you to limit your testimony
19 to five minutes each. After you finish your testimony,
20 a panel member will ask clarifying questions, if there
21 are any. And we will be transcribing today's hearing,
22 and each speaker's oral testimony will become part of
23 the official record of this rule making. Please be
24 sure to give a copy of any written comments that you've
25 brought to the registration table.

In the interest of making the best use of everyone's time, we ask that you respect the time-keeping system, which consists of a green, yellow, and red light. When you begin speaking, the green light will come on. The yellow light will signal that you have two minutes left to speak. We ask that you conclude your remarks when the red light comes on.

If you would like to testify but have not registered to do so yet, please sign up at the registration table. It is our intention to allow everyone an opportunity to comment. We ask for your patience as we proceed throughout the day.

Again, thank you very much for joining us in participating in this hearing. So now let's get started.

The first speaker is Conrad Schneider. Would you please come up?

MR. SCHNEIDER: Good morning. My name is Conrad Schneider, S-c-h-n-e-i-d-e-r. I'm the advocacy director of the Clean Air Task Force. And I'm from Brunswick, Maine, however, our organization is based in Boston. We're an environmental nonprofit advocacy organization. And I'm pleased to have this opportunity to be able to address the panel for the record today on the CAIR rule. And I have a short PowerPoint

presentation that I can go through and I'll be happy to answer any questions you might have about it.

First of all, you know, in a vacuum, we're pleased that EPA is moving forward with a rule that would cut emissions of sulfur dioxide and nitrogen oxides in the applicable region. There is no question about that. The concern that I'll raise today really relates to the comments that we already filed and will file in this period about whether the proposal meets the legal standard under the law necessary for a rule of this type. Significant contribution; you're also under a requirement to examine for, from the perspective of executive orders, the costs and benefits of the rule and so forth. So my comments are really given in that light and that spirit.

So our overarching comment is that, before I get into the substance, though, the process. I'll just note we haven't had a lot of time to be able to process the new information that's come out in your technical information or even some of the specific substance of the proposal. So I'm not going to be able to address all of those today. You know, this rule is not yet published, as you noted, and you guys dropped a lot of information onto the Web just earlier this week, so just note that, please.

1 Our concern is that, not withstanding the
2 proposal that's finalized, there are many areas within
3 the relevant region that will not meet the $PM_{2.5}$ or
4 eight-hour ozone standards. In order to do so, we
5 really need steep, steeper than you proposed, cuts in
6 those two pollutants, and I'm going to get into that in
7 a second. And those reductions really need to happen
8 under the law by 2010, we feel, in order to allow the
9 states to meet their timely attainment objectives.
10 And in addition, I would add since you added to
11 this discussion, that meeting the requirements in terms
12 of visibility will also require much greater reductions
13 even than you've proposed here ultimately.
14 I'm just going to talk a little bit about
15 nonattainment, and we've done some IPM and REMSAD runs
16 and matched them to yours. This is the base in 2010.
17 All of my comments can be referenced to 2010 because
18 that's the attainment date. Next slide. And your
19 proposal does something to alleviate that problem, but
20 in our comments, we propose an alternative which in
21 2010 would reduce that number to 13 counties in
22 nonattainment and by 2015, the date that you're
23 comparing in your technical documents, actually reduce
24 it down to five. So we feel that there can be more
25 done beneficially and cost-effectively and more needs

to be done under the definition of significant contribution under the rule.

So in summary, our view is that your proposed reductions are too little and too late, and we have proposed this alternative which, put in sort of lay terms, in essence mirrors for the region EPA's 2001 Straw proposal, which reinstated a 2 million ton sulfur cap that works out to 1.4 in the region. And the details of the NO_x, the caps that we proposed are in our comments. Next.

And under Executive Order 12866, you're required to look at and try to maximize, look at different alternatives and then try to maximize one of those alternatives will be the net benefits. And I'll just use as one example our alternative we proposed in our comments.

Here we've gone through the typical process using the same methodology that you do to estimate cost using IPM, using net benefits, using REMSAD-based modeling, and BenMAP end function modeling to figure out what the costs and benefits are. As you can see in the red, the net benefits of our alternative are much greater than the benefits of your proposal in 2010.

Now -- if you'll go back one slide -- and we're also through that process actually able to quantify the

number of lives saved from those dates under each of the proposals. Typical analysis that you do for RIAs shows that there is much greater power in terms of not just the legal test but in terms of policy and saving lives under a tighter proposal in those dates.

Okay. Switching ground for a second to this new idea, which is that the CAIR might be able to supplant the specific BART requirements, we believe is a legal matter. These things are separate and independent from each other. We don't believe by regulation you can alter it from the course that Congress set to develop a full visibility program under 169A of the act.

We know and you know that states will need substantial additional reductions from all available sources in order to meet the ultimate goal of regaining natural vistas in our national parks. And we don't believe it's appropriate to exempt power plants from the BART source categories. We really believe we need the CAIR strengthened and moved up in time and a BART rule, strong BART rule, to achieve that.

And my colleague, Bruce Hill, from the Clean Air Task Force, will address, I'm not sure, this group or another group tomorrow on the details of this. But I'll just leave you with one thought that if you are

trying to qualify the CAIR as better than BART, we would submit that it's not appropriate to include non-BART sources in that showing. We believe that violates both the act and the principle that BART reductions meet in addition to other programs.

So what I'm going to do is right now is to show you views of Acadia National Park. These were -- are modeled images that were made from the wind haze modeler that NPS uses to evaluate the air quality. And this is a representation of the 80th percentile day in Acadia National Park. This is supposed to be the view of Blue Hill from the top of Cadillac Mountain.

And if you would go to the next slide, you can see what the benefit of the CAIR rule would be for that view. Let's just toggle back and forth, just in case you missed it. It's hard to see that there's actually any benefit. This is actually the 1.2 deciview improvement that would be anticipated by your rule. It, there is actually a perceptible difference if you look on the laptop. It's not really coming through here.

Let's go to the next slide. You can see that that is the regional haze target view, which is 1 deciview above, you know, less visibility than natural. So that's how far we really have to come and

how far short the CAIR is from the ultimate goal. Bruce, tomorrow, will get into the issue of how it relates to BART, how it relates to glide path, how it relates to all the different issues. But, you know, we have this much ground to make up in terms of restoring visibility and pristine conditions.

We feel it's inappropriate to, at this point, start throwing out programs. We know all the programs work together. And, of course, the CAIR can't deliver guaranteed reductions in specific places. For example, I'll use an example from your modeling, the TVA system. Your, for sulfur, your IAQR target is about 70 percent reduction in sulfur dioxide. Your modeling shows that the TVA system reduces their SO_2 emissions by 40 percent. So for Great Smoky, which is an impacted area from the TVA system, they're not going to achieve the reductions that would be expected if you had, you know, pro rata special distribution of the benefits. So that's just one example of where if you're in the underserved particular area relative to even your own target is much less than BART.

I'll just add that there are several issues that have popped up in just the last week. I'm not going to go into detail. These are detailed in my written comments. I won't spend my last couple seconds

on going through. There are a number of different issues, including especially flow control, if you're talking about supplanting the NO_x SIP Call, the issue of how you calculate the allowances, and even I guess there's new information or a new proposal about definitions, and we have concerns that we will arcticulate about all those things. I'll be happy to take any questions from the panel.

MR. NAPOLITANO: Thank you. Will we be able to get a copy of this presentation for reference?

MR. SCHNEIDER: I can either leave it electronically today or I can submit it, you know, when we submit our comments to the record.

MR. PAISIE: If you can get it to me by e-mail.

MR. SCHNEIDER: Great.

MR. NAPOLITANO: Thank you, Conrad, very much.

MR. SCHNEIDER: Yeah. The benefits were calculated using the benefits methodology that you-all used in Clear Skies and you slightly changed that methodology when you went to the IAQR. And we will be submitting a formal record, recalculated numbers that match exactly that methodology. But for now, we've just replaced them, and all of the benefits will be a little bit less using the new methodology, by about 11 percent less.

MR. NAPOLITANO: In case you just joined us, we're trying to get you ten minutes, here, on the clock. The next speaker that we have is John Kinsman from the Edison Electric Institute, please. Excuse us, John. Okay. We're good to go. Thank you.

MR. KINSMAN: My name is John Kinsman. I'm director of air quality programs at Edison Electric Institute, which is the association of United States shareholder-owned electric companies which generated almost 70 percent of electricity in the United States in 2001. EEI members have a crucial interest in the proposed Clean Air Interstate Rule, CAIR rule, which will require hundreds of facilities to install new emission control equipment over the next decade or so at a cumulative cost of tens of billions of dollars.

EEI is generally supportive of the policy objective underlying EPA's proposed rules and the proposed rule's goal of making a substantial contribution towards attainment of the new national ambient air quality standards for eight-hour ozone and fine particles and the approach, the kind of cap-and-trade program that has proven so successful since passage of the Clean Air Act Amendments of 1990.

EPA's proposal would achieve the largest air pollution reductions of any kind not specifically

1 mandated by Congress. However, regarding the purported
2 health effects of sulfate and nitrate fine particles,
3 focusing only on specific $PM_{2.5}$ constituents at issue in
4 this rule making, sulfates and nitrates, calls into
5 question whether the health benefits that the agency
6 has projected will actually be produced, as discussed
7 in great detail in EEI's March 30 comments on EPA's
8 January 30 notice of proposed rule making.
9 EEI supports efficient actions to further
10 reduce emissions. EEI has discussed multi-emission
11 programs in earnest with EPA and environmental groups
12 and Congress since the mid-1990s and realizes the need
13 to further reduce emissions of SO_2, NO_x, and mercury.
14 But we need to build on substantial progress made to
15 date.
16 Electric generators in the United States,
17 including EEI members, already have achieved massive
18 reductions in their SO_2 and NO_x emissions under
19 existing Clean Air Act programs. For example, electric
20 generating units, EGUs, have dramatically reduced SO_2
21 emissions through the Acid Rain Program by almost
22 40 percent, and those reductions will grow.
23 Coal-based EGUs also have substantially reduced
24 NO_x emissions through widespread installation and use
25 of combustion controls to meet the Title IV NO_x

requirements. In addition, many EGUs in the eastern half of the U.S. have cut their NO_x emissions even further in response to the NO_x State Implementation Plan, or SIP Call, rule that went into effect in several northeastern states in 2003 and went into effect throughout the eastern U.S. earlier this week. All in all, NO_x emissions have been cut 40 percent and will go even lower with a NO_x SIP Call.

Regarding the NO_x SIP Call, just as the 2004 summer ozone season gets underway, a large portion of the eastern coal-based electric generating unit fleet is installing state-of-the-art pollution control technology called selective catalytic reduction, or SCR, to cut NO_x emissions by nearly one million tons.

As a result of this new ozone-reduction regulation issued and enforced by EPA, power sector NO_x emissions will fall to less than one-fifth of the nation's total NO_x emissions. The industry is responsible for less than 1 percent of U.S. volatile organic compound emissions, the other emission of importance to ozone formation.

The power industry will spend almost $10 billion to install the new pollution controls, and hundreds of millions each year to run them. The bottom line is that the electric power industry has made major

strides in cutting emissions already, and we will do much more. Future emissions from power plants will be reduced dramatically under the proposed EPA regulation that we are discussing at this hearing or perhaps through new legislation by Congress. Either way, emissions will be reduced by another two-thirds from current levels over the next decade or so. Emission rates per ton of coal used will be reduced by 90 percent from their peaks.

Responding to Conrad's statement that the TVA will have only reduced their emissions 40 percent under the rule, that's ignoring substantial reductions that were already underway, already undertaken and achieved under the Acid Rain Program.

We also maintain that Clear Skies is the best approach. Legislative strategies for improving air quality can deliver benefits with more certainty than the proposed rules. Clear Skies targets and timetables would be established immediately, and costly and time-consuming litigation would be significantly reduced or eliminated. Clear Skies would eliminate state-to-state differences in implementation, which could seriously constrain compliance options. As a congressional mandate, Clear Skies would clarify and simplify the Clean Air Act for affected power

generators while the proposed rules are simply another layer on top of the existing regulatory labyrinth.

We agree with EPA Administrator Leavitt who stated last December that, We continue to believe that the Clear Skies Act is the best approach to reducing power plant emissions.

As far as comments on the Clean Air Interstate Rule, while the EEI is supportive of the underlying policy objectives, we have several concerns, including the timing, lack of certainty, and the potential lack of flexibility.

Regarding the time, many EEI members are concerned that power generators may not have enough time to install all the control technologies that would be needed to meet the rule's emission reduction mandates, especially for reduction requirements imminent in the next half decade. 0n pages 30 to 32 of the supplemental proposal, EPA discusses the implementation schedule for the CAIR, and on page 32, requests comments on all aspects of the issues concerning the timing of the proposed CAIR compliance dates in relation to the National Ambient Air Quality Standard attainment dates.

EEI believes, based on the real world considerations discussed in our March 30 comments, that

the industry will be hard-pressed to meet the 2010 deadlines and that the suggestion by some commenters on the January proposal to accelerate the date for CAIR emission reductions to before January 1, 2010, should be rejected.

Regarding regulatory certainty, because EPA is proposing the CAIR under its existing rule making authorities, the agency has a lesser ability to affect other sections of the Clean Air Act. EEI is generally supportive of EPA's approach regarding how CAIR would, number one, satisfy best available retrofit technology, BART, requirements; and number two, effectively replace requirements under the NO_x SIP Call.

In addition, EPA should do all that it can to ensure utilities subject to the rule that compliance with the CAIR will, one, satisfy the 2018 reasonable further progress goal under the Regional Haze rule; number two, preclude affected sources and states from being targeted by redundant Section 126 petitions and EGU source-specific control requirements; and number three, reinforce the fact that pollution control projects undertaken to comply with the CAIR are not subject to NSR permitting requirements.

Specifically related to BART, in the supplemental proposal on page 101, EPA states, Today,

EPA proposes that BART-eligible EGUs in any state affected by CAIR may be exempted from BART for controls for SO_2 and NO_x if that state complies with CAIR requirements through adoption of the CAIR cap-and-trade program for SO_2 and NO_x. EPA has demonstrated that the proposed CAIR cap-and-trade program is better than BART for BART-eligible EGUs within the proposed CAIR region. EEI supports this finding.

Regarding the NO_x SIP Call, EEI supports EPA's proposal to allow states to write rules under which compliance with the annual caps will satisfy compliance with the ozone season caps under the NO_x SIP Call. The alternative, that is, having both ozone season caps and annual caps with which to comply without corresponding environmental and regulatory benefits, would only add to the burdens of compliance.

And regarding regulatory flexibility and emissions trading, in the supplemental proposal on pages 136 to 138, EPA discusses the tremendous benefits of emissions trading for the regulated community and the environment. EEI has, for more than 15 years, strongly supported emissions trading and continues to note the overwhelming success of the acid rain SO_2 program and the utter lack of any hot spots being created by emissions trading programs. EEI commends

the agency for implementing the CAIR through a cap-and-trade program.

Some specific emissions trading issues will now be discussed, first, early action credits for NO_x. In the supplemental proposal on page 99, EPA solicits comments on whether NO_x emission reduction credits should be included in the CAIR, and if so, how a NO_x ERC program should be structured. EPA proposes four possible approaches that may be utilized.

EEI had recommended in its March 30 comments that EPA should propose in their upcoming supplemental notice on CAIR emission trading programs a wide range of flexible alternatives that would allow for early reduction credits for NO_x. Accordingly, EEI appreciates the agency's consideration of alternatives and will attempt to comment further in writing during the comment period.

On the issue of emissions banking, EEI supports the EPA's proposal not to require restrictions on the ability to use banked allowances, pages 190 to 192 of the supplemental proposal. EEI concurs with EPA's conclusions that flow control is a very complicated procedure to explain, understand, and implement.

Regarding opt-in for non-EGUs, on pages 159 to 166 of the supplemental proposal, EPA discusses

individual unit opt-in for sources otherwise not subject to the proposed CAIR. EPA presents an example opt-in approach that could be included in the final CAIR model rules.

At this time, EEI does not offer any specific comments on the example for a potential opt-in approach. But we note that EPA does note in the supplemental proposal that, quote, if a state chooses to achieve emissions reductions from non-EGUs, then the state's EGUs may not participate in the EPA-administered cap-and-trade program. If the EPA in the final CAIR model rule allows for opt-ins, the EEI believes that the agency should make more clear that such opt-ins would not disqualify the state's EGUs from participating in the EPA-administered cap-and-trade program.

And with regard to allowance auctions, on pages 145 to 146 of the supplemental proposal, EPA discusses the concept of auctions of allowing -- emissions allowances. Noting that EPA has softened its discussion of this issue from its January proposal, EEI nevertheless notes its continued opposition to allowance auctions, as discussed at length in EEI's March 30 comments.

In conclusion, any new regulations must begin

to integrate and streamline the NO_x SIP Call, NSR, Section 126, BART, and Regional Haze programs. Further, if the current proposals, including the mercury proposal, are to achieve the desired emission reductions at reasonable cost to the American consumer, it is necessary to provide flexible timeframes to feasibly allow construction activities at hundreds of units, requiring a capital investment of tens of billions of dollars.

EEI appreciates the opportunity to provide comments on the proposal.

MR. NAPOLITANO: Thank you, John. Any questions? Thank you very much. Our next speaker is Michael Bradley from the Clean Energy Group. Michael, we're just going to run with a running clock, here.

MR. BRADLEY: Okay. Do I need to spell my name? It's B-r-a-d-l-e-y.

MR. HOFFMAN: Do you happen to have any extra copies?

MR. BRADLEY: I left three copies with the, at the desk. I do have additional copies, if you want them.

MR. NAPOLITANO: Mike, you have to about 42 minutes. We're going to just let the clock run.

MR. BRADLEY: I'm not worried about it. Good morning. My name is Michael Bradley. I'm the executive director of the Clean Energy Group. Clean Energy Group is a coalition of electric generating and electric distribution/transmission companies that share a commitment to responsible environmental protection and stewardship. Members include Calpine Corporation, Conectiv Energy, Consolidated Edison, Entergy Corporation, Exelon Corporation, KeySpan Corporation, National Energy & Gas Transmission, Northeast Utilities, Public Service Enterprise Group, and Sempra Energy.

With electric generating plants in operation or under development in all regions of the country, the Clean Energy Group member companies have a diverse generation mix of more than 120,000 megawatts that includes substantial coal-, oil-, and gas-fired generation as well as nuclear, hydroelectric, and renewable assets.

Since 1997, Clean Energy Group has been actively engaged in the developments of the federal, regional, and state air quality initiatives related to electric, the electric generating sectors, such as NO_x SIP Call, New Source Review reform, the mercury and nickel MACT rule, and multipollutant legislation. As

such, our membership has a keen interest in EPA's proposed Clean Air Interstate Rule.

The Clean Energy Group provided EPA oral and written comments on the originally proposed rule. This, that appeared in the Federal Register back in January of this year. I'm not going to iterate all of the issues that we got into there, but I'm going to add some following comments that are more germane to the supplement.

The Clean Energy Group continues to advocate enactment of multipollutant legislation for the electric generating sector that comprehensively reduces emissions from fossil fuel fire-powered power plants in an integrated manner that includes a flexible but environmentally protective replacement for the New Source Review program. Specifically, the group supports the Clean Air Planning Act of 2003, Senate Bill 843. CEG believes that a legislative approach will provide maximum certainty in the future for investments in new electric generating capacity as well as for pollution control expenditures.

Additionally, in the context of national multipollutant legislation, such as the Clean Air Planning Act, the Clean Energy Group believes that even stricter NO_x and SO_2 caps along with an earlier

implementation time frame could be justified from an air quality standpoint than what is proposed in CAIR.

However, CEG recognizes that there's no guarantee that Congress will move forward in enacting such legislation. On this basis, we applaud the administration for its efforts to promulgate new regulations requiring additional SO_2 and NO_x emission reductions from electric generating units that contribute to downwind nonattainment of the eight-hour ozone standard and the $PM_{2.5}$ standard. The Clean Energy Group believes that the proposed CAIR, when fully implemented, will go a long way towards improving air quality in the eastern half of the United States while at the same time reducing investment uncertainty in the electric generating sector.

With respect to the supplemental proposed -- proposal recently released by EPA, however, CEG is disappointed in the fact that the agency decided to eliminate the discussion of an optional approach to the proposed heat input-based approach for establishing state NO_x budgets under CAIR based on the generation output approach that appeared in the May 11 draft of the proposed supplemental rule that was sent to the Office of Management and Budget for review. Attached to my written testimony is a copy of the May 11 draft

version of Section II of the preamble of the proposed supplemental rule, entitled, State-by-State Emission Reduction Requirements and EGU Budgets, which the Clean Energy Group requests be entered into the record along with my testimony.

In its comments back in January -- on the January rule -- I guess that was in March -- EPA -- Clean Energy Group strongly recommended that the state NO_x in the CAIR be based on each state's pro rata share of generation output and that EPA promote the concept of output-based allowance allocations to the affected sources in its model rule.

There is increasing recognition by policymakers that output-based regulation is an important method of rewarding and encouraging efficiency. In fact, EPA considered recommending output-based allocations late in the development of the NO_x SIP Call rule. A judgment was made at that time that it was too late in the process to change horse to an output-based approach, but EPA made the commitment to apply an output-based approach in the second round of the Section 126 trading rule, which was published in the Federal Register on January 18, 2000.

In 1999, EPA convened an Updating Output Emission Limitation Workgroup to work through the

perceived challenges in implementing an output-based emission trading program, such as monitoring data availability and the treatment of combined heat and power systems. Based on the input received from this workgroup, EPA published a guidance document for states participating in the NO_x Budget Trading Program under the NO_x SIP Call entitled, Developing and Updating Output-Based NO_x Allowance Allocations. That was published in May 2000.

Several states, including New Hampshire, Massachusetts, Connecticut, and New Jersey adopted and are using output-based allocation allowances in their NO_x SIP Call programs. These programs are proving to be effective and relatively straightforward to administer. Considering the clear policy benefits associated with output-based allocation approaches, CEG respectfully requests that EPA prepare and issue another supplemental rule proposal that discusses the pros and cons of an optional output-based approach to determination of state budgets. We strongly believe that an opportunity for public review and comment on this important issue should be provided.

CEG will address additional issues and provide a much more comprehensive set of comments on the supplemental rule in its written comments later on this

year once the rule is published and the time frame is known. Thank you.

MR. NAPOLITANO: Thank you, Michael. Does anybody have any questions? Thank you very much. The next speaker, would you please come to the podium, Mr. Ray Butts from Florida Power & Light Company, please.

MR. BUTTS: Good morning. My name is Ray Butts. That's B-u-t-t-s. I'm the manager of strategic & regulatory planning in the environmental services department of Florida Power & Light Company. Florida Power & Light Company is the regulated utility of FPL Group and is the largest investor-owned utility in the state of Florida, serving approximately seven million people with a generating capacity of over 19,000 megawatts. FPL Group also includes our wholesale electric generating company, FPL Energy, with an additional 11,000 megawatts of electric generation operating in 24 states.

Regarding our comments on the Clean Air Interstate Rule, let me first note that FPL Group supports the earlier comments made by Mr. Bradley on behalf of the Clean Energy Group. We, too, believe that a comprehensive multipollutant legislation that integrates the various rules of the Clean Air Act and

reforms New Source Review is the most appropriate and efficient mechanism for achieving pollution reduction and providing economic certainty for the future of the electric generating sector.

Short of passing a multipollutant legislation, FPL agrees that EPA's CAIR proposal will achieve significant reductions of SO_2 and NO_x emissions. However, we believe that EPA's supplemental rule proposal has a serious shortcoming in that it continues to promote a heat input-based method of allocating emissions allowances to state budgets. Our experience under the Clean Air Act amendments of 1990 indicate that the heat input allocation method provides a disproportionate allocation of allowances to inefficient generating units, resulting in fewer allowances in the budgets of states that have cleaner, more efficient generating units.

FPL believes that an output-based emissions allowance allocation system would achieve a more balanced and equitable distribution of allowances throughout the electric generating sector. An output-based allowance allocation system levels the playing field for all electric generation and is fuel neutral; it recognizes and encourages efficient electric generating units; provides the opportunity to

1 develop a more robust market-based trading program; and
2 allows the allowance allocation to nonemitting
3 generation, such as nuclear, hydro, and renewable
4 energy sources.
5 These nonemitting energy sources are part of
6 the solution for reducing pollutant emissions and
7 should be rewarded for their contribution to clean
8 energy and thus, should be included in the allowance
9 allocation. As Michael stated, clearly, EPA has
10 previously recognized the value of utilizing an
11 output-based allowance trading system. In the
12 development of the final rule in Section 126 petition
13 clearly stated that the agency has committed to
14 adopting an output-based allocation system for the
15 updated allocations in the Section 126 control remedy.
16 Subsequently, EPA published a guidance document for
17 states participating in the NO_x budget trading process
18 to assist these states in developing their own
19 output-based NO_x allowance allocations.
20 In today's rule making for the Clean Air
21 Interstate Rule, the docket includes the May 11 review
22 version that was sent to OMB of the supplemental notice
23 for proposed rule making that includes a discussion of
24 using output-based methods for allocating allowances.
25 This output-based allocation discussion was not found

in the published version of the final supplemental notice. FPL asks that EPA publish an additional supplemental notice proposal that includes the discussion of output-based allocation methods and solicits further public review and comment of this option.

FPL believes that the allowance allocation method may have significant impact on the NO_x budgets for several states and should be fully vetted before the final rule is developed. We will provide you written comments. Thank you.

MR. NAPOLITANO: Thank you. Questions for? Thank you very much. The next speaker is Mr. Chris Recchia of the Ozone Transport Commission.

MR. RECCHIA: Hi. Good morning. I'm Chris Recchia. I'm the executive director of the Ozone Transport Commission. Thanks for the opportunity to be here to comment on the supplemental proposal. OTC, as you know, was created by Congress under the Clean Air Act Amendments of 1990 to coordinate ground-level ozone reduction strategies in the Northeast and Mid-Atlantic region of the U.S. and to advise EPA, as we're doing today, on air transport issues. OTC represents 12 states and the District of Columbia.

We agree that it's well past time for a

comprehensive regional approach to addressing emissions from the power sector. And the IAQR/CAIR or whatever it's going to be called in the final rule making is the most significant advance to addressing interstate transport of pollutants to date, and we are very grateful to EPA for taking the initiative to do this.

We do, however, have significant overarching concerns, many of which have been expressed in the earlier testimony and in writing, but I would like to kind of reiterate some of them today and talk about some of the provisions of the supplemental rule.

Unfortunately, I can't start this conversation without talking a little bit about process and, you know, we do want to contribute productively to this and we are putting, if you will, as us farmers in Vermont would say, all our eggs in this basket. The IAQR, CAIR, is very, very important and is the mechanism by which we see that we can finally address transport from upwind sources.

While we think you might be meeting your legal obligation by the timing and the format of these releases, we don't feel like we're getting a real good opportunity to get reaction from you on the earlier drafts and comments before we see a supplemental. The comments originally were based on the preamble, not on

rule language. Now we're getting some rule language but not incorporating comments. And it appears that comments really won't be incorporated until we see a final rule, and we're not sure whether that's going to be good or bad. So, you know, I also, unless we missed it, to our knowledge, this is not yet published in the Federal Register. Okay. I didn't miss it. So, you know, I do assume that it's going to be the same as this, what you guys released, but it just seems odd that we're doing this in this fashion.

So, you know, we have worked closely with you to define emission reductions. We supported our original comment with detailed analyses needed from this sector as part of the overall attainment strategy. We need responses to those and hope that you will seriously consider the previous comments and the comments we're making today in revisions to the rule.

We're emphasizing the fact that the OTC is trying to implement across this region what other states are affected by the CAIR rule the same successful work we've done with cap-and-trade in the region. To date, we've reduced our NO_x emissions in the region by about 70 percent compared to about 10 percent for the rest of the country. We want to emphasize that we don't expect any single rule making

to bring the entire region into attainment. We do, however, expect that a multipollutant program seeking reductions for power plants will adequately address that sector to give that sector some security and certainty but also to make sure that they are significantly contributing to our overall attainment strategy.

Yet in 2010, our attainment deadline for most of the ozone transport region, we'll have approximately 106 counties not meeting the eight-hour ozone standard, 47 of which are going to be beyond the marginal nonattainment. The IAQR, like the Clear Skies Act before it, would improve this only by about three counties.

In January, the OTC formally adopted a multipollutant position, rule-specific targets and time frames to give us hope of achieving attainment by gaining reasonable controls in this sector. I don't want to take the time to discuss the position in detail. You've got it; you've heard about it before. But in summary, the NO_x and SO_x emissions would be capped at 1.87 million tons and 3 million tons respectively by 2008, and 1.28 million tons and 2 million tons by 2012.

We've done integrated planning modeling, IPM

modeling, using EPA's assumptions, modifying some of those. That information is in the record. We hope you'll consider and evaluate that. We've talked about meeting these reductions sooner, the fact that our attainment deadlines are sooner than the 2015 that is proposed.

So specific details of this proposal, I think, you know, we have a couple of major concerns. One is regarding the application of significant contribution as part of a highly cost-effective test; we don't feel that's an appropriate application of the provision of the Clean Air Act. We think you should simply use Section 110(a)(2)(d) as a SIP Call provision, that significant contribution be considered proactively during SIP submittal. We know that this would require a little more analysis up front, but we think it would create a process that finally demonstrates that all areas that significantly contribute to transport are addressing that transport -- I'm sorry, significantly contribute to nonattainment downwind are addressing that transport.

We don't think the link to highly cost-effective makes sense, but also we don't think the application is highly cost-effective, addresses the full scope of what the cost-effectiveness of the

reductions are or are needed in this process. We think that you need to consider the relative contribution for cost of a particular attainment strategy, as well, and if in the region, it costs significantly more to, if you will, deal with the other sectors now, because we've already dealt with power plants. We're dealing with them in our sector. If we have to do these all through local controls, first of all, our modeling shows it's impossible and secondly, if we were to do it, it would get increasingly cost ineffective. It would be much more expensive to do additional controls if you still have power plants still in the transport team region, the Midwest or West, that are, can still do the cost-effective controls that we've already done that needs to be done first. And there is no way in the highly cost-effective provision you have here to accommodate that.

Regarding the proposed retirement ratio, we do feel that a discount penalty on top of retirement ratio is appropriate and consistent with the NO_x SIP Call, for example. However, we don't think they go to the heart of the issue concerning the SO_2 allowance bank, which by our estimate by 2010 is going to have about 13 million tons in there. Unless we, unless we deal with it, SO_2 bank, we're not going to encourage early

installation and control technology, and we're going to delay meaningful reduction until the second phase, till we're through the second phase of the program and not get them for a typical length of time.

We recommended that we use something, a mechanism such as progressive flow control, to eliminate the number of banked allowances that can be used in a given year. Our analysis shows that a 2 to 1 discount ratio and a 10 percent trigger would achieve greater reductions in a more aggressive time frame without causing, by the way, significant increase in retail electrical cost or fuel switching that is of concern to folks.

So finally, regarding the option of incorporating BART into CAIR, we think that we, we strongly feel that SO_2 and NO_x reductions under the cap-and-trade program are a necessary addition to but not a replacement for the retrofit technology. We think that BART should be a benchmark from which reductions are achieved but it shouldn't substitute for that.

So in conclusion, OTC is committed to seeing that the transport issue is addressed. We appreciate the role that this rule can play in that. We think you have a unique opportunity, and we've provided you with

the information to make this, more certainty for the utility industry by making it more meaningful and more substantive reductions. We need them in a quick time frame in order to meet our attainment deadlines. And that's very, that's pretty much it. Thanks for the opportunity to testify again. I appreciate your work. Let me know if there is anything I can answer or help with.

MR. NAPOLITANO: Thank you. Questions for Chris?

MS. DUNHAM: Can you tell me your numbers again?

MR. RECCHIA: I think that I may need to check on that. But they thought it was going to be on the order of about 13 million tons banked.

MS. DUNHAM: By 2010. Is that just --

MR. RECCHIA: Just because -- yeah. Just because they're accumulating, okay. And then if that starts to get used, but it's used very slowly over time, our projections where you don't really start eating into that bank until I want to say about 2014, 2015. And then it takes to, like, 2020 to get the use of that bank. I'll double-check on that number, though. It's in the record already, but I'll check on it to make sure it's right.

MR. NAPOLITANO: Chris, did you give us a written copy?

MR. RECCHIA: I don't have -- I will leave a written copy for you. Maybe not from anything other than myself, but I will do that.

MR. NAPOLITANO: Thank you.

MR. RECCHIA: Thank you very much.

MR. NAPOLITANO: Our next speaker will be Mr. Bernard Melewski from the Adirondack Council.

MR. MELEWSKI: Good morning.

MR. NAPOLITANO: Good morning.

MR. MELEWSKI: I have a couple of read-along copies, if you'd like them.

MR. NAPOLITANO: Please.

MR. MELEWSKI: I apologize for the quality of the read-along copies. I broke my carbon rule of not touching a finished document. So we'll be revising this document. I think again -- the clock's started?

MR. NAPOLITANO: Yes.

MR. MELEWSKI: All right. I'll find nothing objectionable about half the panel leaving before I spoke.

Good morning. My name is Bernard Melewski. I am here today representing the Adirondack Council. The Adirondack Council is a not-for-profit environmental

organization based in the Adirondack Park of New York State. The mission of Adirondack Council is to ensure the ecological integrity and wild character of the Adirondack Park. The Adirondack Park, as many know, is the largest park, state or federal, in the continental United States. The six million acre park includes over one million acres of true wilderness, which were protected as forever wild by the New York State constitution in 1894.

Due to its geography and its geology, the Adirondack Park is being destroyed by acid deposition. Acid rain is damaging the forests, the waters, and the wildlife of the Adirondack Park, including the high-elevation red spruce forests on its mountainsides. The growth and regeneration of the sugar maple trees has been stunted, and more than 500 lakes within the Adirondack Park are too acidic to support their native species of fish. Many more lakes and hundreds of streams suffer from acid shock, the acid bath that comes with the annual snowmelt. The same pollutants that cause acid rain also contribute to summer ozone and particulates that can have devastating effects on human health.

On February 25th of this year, the Adirondack Council testified at public hearings held by EPA in

support of the proposed Clean Air Interstate Rule. As we said then, we believe that the interstate rule will result in substantial public health benefits far in excess of its cost. But we take a special interest in the secondary benefits of the reduction in acid deposition throughout the eastern portion of the nation and in the most sensitive area, the Adirondack Park.

The new cap-and-trade program envisioned in the proposed rule and the target reductions in emissions meet or exceed the recommendations in the report to Congress for the National Acid Deposition Assessment Program in 1998, and EPA's regional cap-and-trade approach for these two pollutants is also consistent with the recommendations of several other subsequent reports, including those by the National Academy of Sciences; Environmental Defense; the Clean Air Network; the Southern Appalachian Mountains Initiative, SAMI; and the Association of New England Governors and Eastern Canadian Premiers.

We want to take this time to reiterate our strong support of nitrogen reductions on a year-round basis. In its 1995 report to Congress on the progress of the acid rain control program, the EPA observed that the contribution of nitrogen emissions to the overall acid deposition problem had been underestimated. In

the Adirondacks, nitrogen builds up in the winter snow pack, and with the spring snowmelt, contributes heavily to the episodic acidification of lakes and streams.

We also believe that the agency's proposals to integrate the proposed rule with the existing Acid Rain Program by increasing the number of sulfur allowances required to be held by electric generating units in order to emit one ton of sulfur dioxide in 2010 and again in 2015 and beyond is a reasonable approach. We urge the agency to resist calls for relaxation of the proposed second phase or the adoption of a wait-and-see approach after 2010.

The agency poses in the supplemental rule the following dilemma for further public comment: That the proposed retirement in 2015 and beyond of sulfur dioxide allowances at a rate of three allowances per ton will result in slightly increased reductions in emissions beyond levels envisioned by the agency. In other words, the cap on sulfur emissions might actually be lower than initially proposed.

The agency treats this as a dilemma with only two answers. The first is to reduce the proposition to 2.86 allowances per ton. The second option is to retain the 3.1 -- 3 to 1 retirement ratio to allow the states to pool the excess allowances and distribute

them as they see fit. We would propose a third option, that of no change.

Public comments already received by EPA in the docket support this third option. The Adirondack Council previously asked EPA to propose additional reductions in the emissions of sulfur dioxide from electric generating units. Many other regional and national environmental organizations, some of which have already spoken today, share that view, including the Citizens Campaign for the Environment, Chesapeake Bay Foundation, Clean Air Task Force, and the Natural Resources Defense Council.

Commentators from state agencies, like the New York State Department of Environmental Conservation and their counterparts from Vermont, Massachusetts, South Carolina, Wisconsin, Pennsylvania, Maine, Minnesota, and North Carolina also are in agreement. Deeper cuts were also recommended by the State and Territorial Air Pollution Program Administrators and Association of Local Air Pollution Control Officials, as well as the Ozone transfer -- Transport Commission, as you heard today.

If, however, the agency will only consider one of the two alternatives it poses here, then the creation of a bank of excess allowances with each state

makes more sense. As suggested by EPA, the states could then allocate these allowances as intended to achieve pollution reductions from other sources or even retire them at their discretion, which I assure you we'll be urging New York State to do.

Finally, a word about regional haze and the BART rule. The agency proposes in this supplemental rule to make a legal determination that the participation of EGUs in the cap-and-trade program of the Clean Air Interstate Rule will suffice as better than BART in determining compliance with regional haze provisions of the Clean Air Act. At the same time, the agency seeks to rationalize the fact that it has not done the modeling that it would normally undertake to make such a determination.

We strongly object on two obvious grounds. First, specific modeling of the effects on regional haze should be complete prior to taking such an action. We believe that the attempt here to interpret the modeling conducted for other purposes will end up with the acronym, T-R-O-U-B-L-E.

Second, the better than BART debate belongs in the Regional Haze rule revisions now under consideration, which will be the subject of upcoming hearings, in fact, tomorrow. It should not be

cluttering up the already complicated issues surrounding the proposed interstate rule, some of which we've heard about today already. If EPA wanted to signal the states and the affected EGUs of its intention, that's been accomplished. But the council urges you to withdraw the Regional Haze provision -- revisions from these proceedings and address them in a more appropriate venue.

Thank you for the opportunity to share our views. The council may supplement our testimony, will supplement our testimony with additional comments as we continue to review the proposed rules as they are published. And I wanted to second the comment of the previous speaker that we do appreciate all of your work.

MR. NAPOLITANO: Thank you. Questions? Thank you very much. Our next speaker will be Mr. Jeffrey Loveng from FirstEnergy Corporation.

MR. LOVENG: Good morning. My name is Jeffrey Loveng, and I represent FirstEnergy Corporation. FirstEnergy operates a diversified portfolio of generating assets, primarily in Ohio, Pennsylvania, and New Jersey. At FirstEnergy, we are committed to operating our 20 power plants in a safe, efficient, and environmentally compliant manner. Of our 13,387

1 megawatts of generation, approximately 55 percent is
2 coal, 48 percent nuclear, 12 percent natural gas or
3 oil, and 5 percent pumped-storage hydro.
4 Since the passage of the Clean Air Act, we have
5 spent more than $5 billion on pollution controls and
6 environmental systems. These investments have resulted
7 in significant emissions reductions. Since 1990 alone,
8 we have reduced emissions of sulfur dioxide and
9 nitrogen oxides by more than 50 percent. FirstEnergy
10 has 6155 megawatts of scrubbed coal-fired and nuclear
11 generation, and we're committed to doing more.
12 Our diversified generation portfolio provides
13 flexibility in meeting increasingly stringent
14 environmental regulations. However, we rely on
15 base-load, coal-fired generation to meet our customers'
16 growing needs for electricity. While we support the
17 EPA's efforts to reduce sulfur dioxide and nitrous
18 oxide emissions, we believe this issue requires an
19 approach that promotes fuel efficiency and diversity,
20 energy diversity, and that allows flexibility in
21 planning and implementing emissions reduction
22 strategies. The allocation of allowances is an
23 important part of our overall strategy to meet
24 environmental compliance.
25 Some key points that we have. First of all,

FirstEnergy supports the allocation of allowances to existing power plants based on total electrical output of all sources, rather than a heat input. A heat input-based approach gives emissions allowances to a relatively dirtier electric generator that relies solely on fossil fuels. An output-based approach would give emissions allowances to all generators of electricity, including nuclear, hydro, wind, and solar, thus providing incentives for renewables and not-emitting sources.

With output-based allocations of allowances, the only competitive difference between companies is properly based on the amount of pollution they produce per unit of power. The company that produces 1 percent of the power should get 1 percent of the allowances.

There are clear benefits from incorporating an output-based allocation approach. Output-based allocation recognizes and encourages efficiency; it promotes and forces emerging technologies by creating strong incentives to improve existing and develop new methods to reduce emissions; it allows the market to decide rather than favoring one form of power generation over another; it produces substantial copollutant benefits; it more fully internalizes externalities and creates dynamic incentives to invest

more in nonpolluting and less polluting technologies; it promotes liquidity by creating a pool of readily available allowances; and it prompts energy diversity and creates room for coal under caps.

EPA made an affirmative, last-minute decision to omit discussion of an output-based allocation method from the supplement to its proposed Clean Air Interstate Rule. The version of the proposed rule that was sent for OMB to review included the discussion of the output-based method for existing plants, Docket No. OAR-2003-0053-1344. However, that language was removed before the EPA released its supplemental notice of proposed rule making. This omission is inconsistent with the CAA Section 126 rule, which stated that the agency has committed to finalizing an output-based allocation method for the subsequent updates.

We are submitting for the record the May 11, 2004, draft of the supplemental rule that was deleted. We urge EPA to issue a supplemental notice that notifies interested parties of the addition of the draft text to the record and explains that a substantial number of commenters have requested that EPA consider output-based as well as other allocation methods for supporting state budgets.

While the May 11, 2004, draft language

illustrated the output method for fossil generation only, any output-based strategy should be generation neutral. That is, it should not be limited to fossil fuel only but should include nuclear, hydro, wind, and solar.

Thank you for the opportunity to speak on behalf of FirstEnergy and the other organizations which support an output-based method of allocating allowances. Output-based allocation allowances provides a true incentive to achieve better environmental performance and by providing maximum flexibility in doing so, allows generators to employ solutions that make the most economic sense for the industry and the consumers. We respectfully submit our comments for your consideration. Thank you.

MR. NAPOLITANO: Thank you. Any questions? Thank you very much. Okay. The next speaker is Mr. Michael Marvin from the U.S. Council for Sustainable Energy.

MR. MARVIN: Good morning. I'm Michael Marvin, M-a-r-v-i-n, president of the U.S. Business Council for Sustainable Energy. The council was created in 1992 by companies in energy efficiency, renewable energy, natural gas, electric utility, and independent power industry. Our membership spans across the energy

spectrum, including companies such as the Sacramento Municipal Utility District, NiSource, Calpine Corporation, Sempra Energy, Honeywell, GE Wind, Maytag, as well as industry trade associations representing the wind, solar, insulation, energy efficiency, and natural gas industries.

The council is committed to promoting policies that reduce the environmental footprint of energy production and use while simultaneously encouraging economic growth and U.S. energy independence. We have sister organizations in the U.K., Europe, and Australia, and together represent more than 550 companies and associations on five continents.

My testimony has an eerie familiarity to Mr. Loveng's, so I'll try and be brief. The members of the council asked that I come here today to respectfully request that EPA issue a new supplemental rule that gives consideration to output-based approaches in calculating state NO_x budgets.

One of the key messages that the council promotes is the idea of fuel neutrality and performance-based environmental regulation. Frankly, from a public policy perspective, it's not clear why the U.S. government would want to promote anything but output-based environmental regulation since the

putative objective of environmental policy is to reduce airborne emissions at the lowest total cost to society.

Environmental policy trends are now beginning to favor the ends rather than the means. Given the diversity of the energy industry and the ever-improving efficiencies of many energy generation technologies, this is a trend that should be encouraged. Council members often have said that an environmental policy should do three things: First, tell the industry where it needs to be; second, tell us when we need to get there; and then third, get out of the way, please.

While this oversimplifies the complexity of EPA's task, the underlying message is clear. If government creates incentives for cleaner and more productive energy generation, industry will respond.

What's not clear, however, is what public policy good is being served by removing the discussion of output-based standards from the agenda. Your May 11 draft supplemental rule appropriately included this optional approach. Even if EPA believes that the input-based approach is more appropriate, it's certainly not the only approach that should be considered

Output-based regulation allows the market to make decisions about fuel choices, rather than favoring

one type of generation over another. An output-based approach is also more effective in incorporation externalities in the pricing of fuel choices and when done properly, an output-based approach would include all technology, not just central station thermal plants.

Output-based allocation creates a more powerful incentive to generate energy efficiently. In the 1999 EPA report entitled, Economic Analysis of Alternative Methods of Allocating NO_x Emission Allowances, the analysis concluded that an allocation system based on fuel input results in higher fuel use and higher emissions levels. That report can be found on the EPA website, and I've referenced the address in my written testimony.

The agency has made commitments over the past several years to consider output-based allocation methodologies, including a reference in the rule for Section 126. We believe the environmental and economic benefits of output regulatory standards are compelling. As an alternative that is being chosen by an increasing number of states and being considered in the U.S. Congress, at a minimum, a serious public policy discussion on its merits should be undertaken.

To conclude, we again request that EPA issue a

new supplemental rule proposal that gives consideration to an output-based or performance-based approach to calculating state NO_x budgets. Thank you for your time this morning.

MR. NAPOLITANO: Thank you. Our next speaker this morning is Ms. Yvonne McIntyre for Calpine Corporation.

MS. McINTYRE: Good morning. My name is Yvonne McIntyre, and I'm director of federal regulations for Calpine Corporation. Calpine is a leading natural -- North American power company dedicated to providing electricity from clean, efficient, natural gas-fired and geothermal energy centers. Calpine currently has 88 energy centers in operation, representing about 23,000 megawatts of generating capacity and is both the nation's largest producer of renewable geothermal energy and the nation's largest operator of combined heat and power, CHP, facilities. Another 14 additional energy facilities are under construction, and by the end of 2005, Calpine will be the country's seventh largest generator of electricity with more than 29,000 megawatts of generating capacity.

Calpine submitted written comments on the EPA's originally proposed Clean Air Interstate Rule, formerly referred to as IAQR, that appeared in the Federal

Register on January 30, 2004. While I will not reiterate all the comments today, there are some that I would like to address.

Calpine agrees that significant reductions in NO_x and SO_2 emissions from the power sector are required to reach attainment of the National Ambient Air Quality Standards, or NAAQS, for ground-level ozone and $PM_{2.5}$. Calpine also agrees with the EPA that properly designed emissions trading programs can be the most cost-effective method to achieve emission reductions in conjunction with breakthroughs in efficiency from this sector.

Calpine believes that the most effective route to achieving a needed major reduction in air emissions is through comprehensive Clean Air Act revision legislation, specifically, as proposed in the Clean Air Planning Act of 2003. The Clean Air Planning Act would provide a comprehensive treatment of the emissions trading program, stricter regulation of NO_x, SO_2, and mercury, along with sensible regulation of CO_2.

However, realizing that the legislative process is uncertain, Calpine recognizes that EPA must address the air quality issues associated with nonattainment of the new eight-hour ozone and $PM_{2.5}$ NAAQS. Therefore, Calpine supports EPA's action in promulgating the CAIR,

1 particularly in structuring it as a market-based
2 program. In addition to achieving emissions goals for
3 the regulated pollutants, a well-designed program can
4 help to achieve other significant goals, including
5 promoting generation efficiency and reducing uncapped
6 emissions, include contributing to the voluntary
7 reduction of greenhouse gas emissions.
8 With respect to the supplemental rule proposal
9 recently released by EPA, Calpine is pleased that EPA
10 provides credit for the thermal output of cogeneration,
11 or CHP, facilities. In Calpine's original comments, we
12 supported the inclusion of output-based allocation for
13 thermal output from CHP. Credit for CHP will provide a
14 significant incentive for this highly efficient form of
15 energy generation. An input-based system will not
16 appropriately accommodate CHP since it disregards the
17 efficiency of the cogeneration of the thermal energy.
18 The CAIR supplemental rule, taking the same approach as
19 the new mercury SNPR, includes updating allocations for
20 new units based on output with credit for cogeneration.
21 While this approach does not go as far as Calpine would
22 like, we see it as a significant advance over past EPA
23 proposals and are encouraged that EPA has moved in this
24 direction.
25 On another issue, however, Calpine is, like

1 those in line today, express our disappointment that
2 EPA decided to omit discussion of an output-based
3 allocation method for establishing state NO_x budgets
4 from the CAIR supplemental rule. As previously noted,
5 a May 11 draft of the proposed supplemental rule that
6 was sent to OMB for review included discussion of the
7 output-based method for allocating allowances to
8 plants. Along with my written testimony, I am
9 submitting for the record a copy of the May 11 draft
10 version of Section II of the preamble of the proposed
11 supplemental rule.
12 In comments on the original proposed rule,
13 Calpine recommended that the state budgets in the CAIR
14 be based on generation output criteria and that EPA
15 promote the concept of output-based allowance
16 allocations to affected sources in its model trading
17 rule. Allocation based on output encourages the
18 construction and operation of more efficient plants.
19 The principle of an allowance trading program is to
20 monetize emissions and allow plant operators to
21 determine the most cost-effective way of meeting the
22 limit through technology, fuel choice, or emissions
23 trading. This allows the market, not the regulators,
24 to determine the most cost-effective business response
25 to meeting the new air quality standards. An

output-based trading program levels the playing field between those who have already invested in controls or in low-emitting technology and those who will need to invest in the future. While the language in the May 11 draft addressed the output-based method for fossil generation only, we believe that it should apply to all affected units regardless of fuel, vintage, or technology.

There is an increasing recognition by policymakers that output-based regulation is an important method of rewarding and encouraging efficiency. As previously noted, EPA considered recommending output-based allocations late in the development of the NO_x SIP Call rule. A judgment was made that it was too late in the process to change to an output-based approach. But EPA made the commitment to apply an output-based approach in the second round of the Section 126 trading program. In 1999, EPA convened an Updating Output Emission Limitation Workshop -- Workgroup to work through perceived problems in implementing an output-based emissions trading program. Based on the input received from this workgroup, EPA published a guidance document for states participating in the NO_x Budget Trading Program under the NO_x SIP Call entitled, Developing and Updating

Output-Based NO_x Allowance Allocations. Numerous states have adopted the output-based method for allowances -- method for allocating of allowances in their state NO_x SIP Call allocations, and these programs are proving effective and easy to administer.

Considering the clear policy benefits associated with output-based approach, Calpine respectfully requests that EPA issue a supplemental notice regarding the addition of the May 11 draft language to the record and soliciting comments on the output-based approach. We strongly believe that opportunity for public review and comment on this important issue should be provided. Calpine will be submitting more detailed comments on the supplemental rule and proposal in its written comments to the agency. Thank you.

MR. NAPOLITANO: Thank you. Any questions? Did you give the registration desk a copy?

MS. McINTYRE: Yes, I did.

MR. NAPOLITANO: Thank you very much.

MS. McINTYRE: Last name, M-c, capital "I", n-t-y-r-e.

MR. NAPOLITANO: The next speaker on the agenda is Mr. Kenneth Carroll from Entergy Corporation, if he is here. We will wait for Mr. Carroll to join us

sometime in the morning or early afternoon. And the next person who will be on our agenda is Mr. Jim Moore.

MR. MOORE: James C. Moore, II. M-o-o-r-e. I apologize. I just made this up this morning. I don't have a transcription for you.

Just basically, I'm here and I wanted to talk a little bit. I really came to listen. I want to thank you for curing my insomnia. This is the proposal, and it didn't include mercury, so it kept me busy. I also want to thank EPA for the people that work for you, people like Melanie and Alex Salpeter and Paula Branch and Kennan Smith. They make my job a lot easier. They have done, with what they've done with the accounting system and how we keep track of allowances makes my job as a trader a lot easier. I thank you for that.

I also want to mention now how far we've come. What a lot of people get lost in this debate is, is how clear the air has become over the past 50 years. My grandma told me when I was younger that when she was a girl in St. Louis, the, in the middle of winter, the air was so dirty, you couldn't see. The lights were on in the middle of the day because we burn coal for heat in St. Louis. I'm sure that's the same here on the East Coast. So you guys, EPA, has done a commendable job in getting us to where we are today, and I thank

you for that.

I was in Moscow a year ago in February, and they're still putting it out. I mean, you can stand by, in Red Square there's a power plant across the river and it's just belching it out. So you guys have done a great job.

But there's room for improvement, and that's where the Clean Air Interstate Rule comes in. And I want to make a few comments on that, but one of my favorite quotes is Sir Isaac Newton said a long time ago, I've seen further by standing on the shoulders of giants. And you guys have put us on the shoulders of giants to get us where we are today.

It refers, on page 15, you talk about from a trading viewpoint, do we use three tons in 2015 or later, or do you do it at 2.86? At first, I saw that, I was like, well, how am I going to trade a 0.86 of a ton? And then as I got thinking about it, we trade in 2500-ton blocks, so that's not a problem.

And I would encourage the 2.86 tons in that if you use three and give the rest to the states, it becomes a political thing, and we're going to spend a lot of effort going back and forth in Illinois and Missouri, which is where we operate, to try to determine what do you do with those extra fractions of

allowance. And I would encourage to use the 2.86 for that reason. It keeps it simple, and we don't have to take our time and everybody else's time arguing over what we do with the extra. It makes your life difficult, I guess, because I'm not sure how you track that with a serial number system. And right now, it's pretty simple. I can keep track of every single allowance I have and where it came from and where it went and when I did it. And I'm not sure how that worked out, and I look forward to seeing how you guys will do that.

I'd like to echo what some other people have said. We in the utility industry, and you've heard this before and it's outside of your control, all the legislative things that takes into account everything, because right now, we're operating in a, we're trying to figure out what to do. And we have to decide now what we are going to do now in 2008, -9, and -10.

We're spending a lot of time with our engineering staff and Sargent Allendi and others trying to figure out what controls we put on which unit when we put them, because it takes, three, four, five years to do this. And we can't put them all on at the same time. We can't put an SCR on every one of our units in one year. It's a two-year outage schedule. We have to

plan these things way in advance. So I encourage us to, whatever we end up doing to fix the rules and keep them steady for quite a while.

Early reduction, I wanted to make sure you -- the elimination of the flow control, which is stated in your proposal is beneficial from a trading viewpoint. It makes my job a lot easier. Right now, flow control complicates things unnecessarily, in my opinion. And it would make it a lot easier if we knew that a NO_x ton today is worth a ton tomorrow and the next day and the day after that, similar to the way SO_2 is right now.

One thing that hasn't been mentioned and I think it might have to be a legislative fix is the annual auction, the EPA auction in March every year. I would encourage elimination of that. It's, it was put in place initially to ensure that allowances were available to people that needed them for the fear that there would not be a market. But the market has developed into there, and it's pretty efficient. I can't say it's super liquid, but it's there and people will be able to get allowances if they need them. So if that could be eliminated, I would encourage that.

I feel that -- there's been a full-court press on changing the allocation system today. I just wanted to mention another side of it. I would caution you on

1 changing the allocation system in that it would give a
2 windfall profit to entities that haven't spent the
3 money. At AMRON, we spent several hundred million
4 dollars to comply with the Clean Air Act Amendments of
5 1990, and my manager tells me we're looking forward
6 to -- not looking forward to it, but we think we're
7 going to spend about a billion dollars by the mercury
8 rules and the Clean Air Interstate Rules. If we have
9 to spend a billion dollars to put controls on our units
10 and then have to go spend another several hundred
11 million dollars to buy allowances to comply, it's going
12 to be a massive redistribution of wealth in this
13 country from areas that have spent the money to clean
14 up their units to areas that just happen to have
15 different kinds of generation. So I caution you on
16 that.
17 I would also like to encourage you, the EPA and
18 Congress, that we have come a long, long way in this
19 cleaning up the air in the states and we've done a
20 great job in the electric generating utilities of doing
21 that. I would encourage you to look elsewhere. You
22 are, you have done some work with off-road diesel and
23 other areas. Transportation, I think, needs to be
24 looked at.
25 And the big opportunity, in my opinion, is

overseas. Like I said before, Moscow, if we could, spend a billion dollars in Moscow and in China and just make light-years of improvements in air quality. And I've read recently that 50 percent of mercury that's deposited in the States comes from overseas. And the amount of bang for our buck we could get overseas is huge. And I realize that's outside of your control, but I just want to encourage it in that regard. Thank you very much.

MR. NAPOLITANO: Thank you. Any questions? Thank you very much. At this point, Ken has arrived. Is Mr. Kenneth Carroll here? Okay. Well, at this point, all the speakers that were slated this morning that are here have spoken. The next speaker was to be Kris Knudsen, Duke Energy. I don't know if he happens to be here and perhaps wants to catch an earlier flight. You can speak now, if you'd like. Well, at this point, we're in session waiting for speakers.

We think it would be a reasonable thing to do at this point with no speakers on the docket is to go ahead and take a 20-minute break. And we will then come back and see if anybody has come by 11. Then go from 11 to 12, and then unless Mr. Knudsen has come here from Duke, we will basically adjourn for lunch from 12 to 1:30 and then be available in the afternoon.

So we will take a break until 11 at this point and then reconvene to see if anybody else has joined us to talk. Thank you.

(A recess was taken from 10:40 a.m. until 11:00 a.m.)

MR. NAPOLITANO: Good morning. We still have a lack of speakers, so we're going to remain in recess but stay here until noon, at which point, then, we'll go to lunch till 1:30. So we'll be available, should somebody register to speak, we will call ourselves back into session between now until noon. And I'll announce if somebody is here, if you want to get up and just be in microphone range. . .

(A recess was held from 11:00 a.m. until 1:30 p.m.)

MR. NAPOLITANO: Good afternoon, and welcome back to the public hearing on the SNPR for the Clean Air Interstate Rule. We would like to start now with the first speaker scheduled for the afternoon and then we can then move to Kenneth -- excuse me. Yeah, Kenneth Carroll, if he's arrived or anybody else that has come in that has signed up. But the next speaker on the docket would be Kris Knudsen from Duke Energy. Please come on up and join us and give us your testimony, please.

MR. KNUDSEN: Okay. Thank you. I guess I'll stand here at this microphone.

MR. NAPOLITANO: Basically, if you'll just ballpark, talk about ten minutes, a little longer, if you'd like given that, the time available that we have. This clock is not working. We've had clock problems all day.

MR. KNUDSEN: I'm not sure if I'll take ten minutes, but we'll go forth and see where it goes.

MR. NAPOLITANO: Yes. Do you want me to introduce the panel to you, or do you know?

MR. KNUDSEN: If anybody else needs the panel introduced.

MR. NAPOLITANO: Most people were here this morning, so. . .

MR. KNUDSEN: I think that would be all right, then. We don't need to really. . .

Well, thank you. My name, again, is Kris Knudsen. I'm representing Duke Energy. I'm a senior technical consultant for Duke Energy Corporation for air quality regulations for basically about 25 years now.

We at Duke are generally supportive of EPA's approach to applying cap-and-trade program to address the future emissions reduction requirements. However,

we have continuing concerns with the technical and scientific bases of the proposed SO_2 and NO_x requirements of the EPA's Clean Air Interstate Rule. And further, we believe the proposed SO_2 trading program, which is described in the supplemental notice, is not equitable, is contrary to law, and it clearly violates specific provisions of the Title IV Clean Air Act.

Duke Energy provided comments on the proposed Clean Air Interstate Rule, or the Interstate Air Quality Rule, as it was known at the time, back on February 6 in the snowstorm at Research Triangle Park. And we followed up with detailed written comments on March 30. Our comments describe specific legal, regulatory, and technical concerns we had with EPA's proposal with, particularly, the proposed method of allocating the SO_2 allowances. However, rather than simply complaining that the rule was unfair or illegal, we went on to provide an alternative that would leave Title IV whole while allowing a separate program to achieve the purpose of the Clean Air Interstate Rule, mainly to create a SIP-based program to address fine particulate and ambient standards.

We are very disappointed that the decision was made ultimately to exclude from the supplemental notice

all mention of alternatives to the proposal to use Title IV SO_2 allowances as the basis for allocation under the Clean Air Interstate Rule. Rather than enhancing the public's opportunity to consider alternatives, the supplemental notice therefore has taken options off the table and deprived the public from the opportunity to consider valid alternatives that were offered during the comment period on the original proposal.

We think this is most unfortunate and unreasonable, and we urge EPA to correct this mistake. We call on EPA to immediately issue a revised supplemental notice that includes the full discussion of alternative SO_2 allocation methodology and then solicit public comment on those. EPA has no pressing deadline or binding schedule to complete this rule making, so EPA should take the time to seek more input and to more carefully consider a broader range of alternatives. Revising the supplemental notice will allow this additional input in the most expedient manner.

As EPA has acknowledged, the proposed allocations to states based on Title IV allowances does not account for any of the significant changes in the power sector that have occurred since 1987. Such

changes include differences in demand growth, changes in fuel, additional regulatory requirements, and construction of new units. These changes make use of Title IV allowances entirely inappropriate for purposes of a new and unrelated program. Under EPA's approach, entities in each state would essentially be regulated to different and widely varying emissions standards. The alternative approach that Duke Energy has recommended would eliminate this inequity.

In addition, I'd like to mention that our approach retains the input-based system in comparison to other output-based approaches that others have been advocating. EPA has also acknowledged that it cannot change statutory requirements. However, EPA's proposal would change Title IV in fundamental ways and is clearly contrary to specific provisions of the law. That could subject the final rule to legal challenge, which could delay or undermine the EPA's regional SO_2 reduction goals. Such delay may also undermine EPA's proposed mercury cap-and-trade program. Duke Energy's recommendation to EPA has been to keep the Title IV program and the Clean Air Interstate Rule entirely separate to avoid the statutory concerns and to allow each program to achieve its own goals.

We will be submitting additional written

comments once the supplemental notice does appear in the Federal Register. Our comments will also be addressing continuing concerns we have with other aspects of the program, particularly the NO_x program. We remain concerned about the lack of a growth factor adjustment for the NO_x rule and also the lack of a provision for early reduction credits.

But once again, we urge EPA to immediately look at this issue again and issue a revised supplemental notice that identifies and invites public comment on alternatives to EPA's proposed SO_2 allocation program. We look forward to the opportunity to provide more meaningful input on alternatives that may allow EPA to develop a successful program to achieve the stated goals. And that concludes my remarks. Thank you.

MR. NAPOLITANO: Thank you, Kris. Does anybody have clarifying questions? Thank you very much for joining us.

MR. KNUDSEN: You're very welcome. Thanks.

MR. NAPOLITANO: Now, by any chance, is Kenneth Carroll here? Is there anybody else in the audience who has signed up to speak or would like to speak? What we'd like to do is something we did this morning, which is we'll go into recess until somebody comes to want to speak and be sitting here at the table and then

call the session back into action when we have speakers come out throughout the afternoon.

We will be here till five, and we'll be available to listen as people come and, you know, basically, from the microphone let people know that we've got additional speakers as they arrive. But otherwise, we're going to sit in recess until somebody does come or five o'clock, whichever comes first. Thank you.

(A recess was held from 1:37 p.m. until 5:00 p.m.)

MR. NAPOLITANO: It is now five o'clock. There are no other speakers present. I would like to close the hearing of the SNPR of the Clean Air Interstate Rule.

(The hearing concluded at 5:00 p.m.)

STATE OF NORTH CAROLINA

COUNTY OF DURHAM

C E R T I F I C A T E

I, Susanne M. Newman, Notary Public/ Court Reporter, before whom the foregoing public hearing was conducted, do hereby certify that the witnesses whose unsworn testimony appears in the foregoing public hearing was taken down by me to the best of my ability and thereafter transcribed under my supervision and that I am neither counsel for nor employed by the agency conducting this hearing.

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Susanne M. Newman, Notary Public

My commission expires: September 24, 2005