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July 8, 2005

VIA FEDERAL EXPRESS

Stephen L. Johnson, Administrator
U.S. Environmental Protection Agency
Headquarters
Ariel Rios Building
1200 Pennsylvania Avenue, N. W.
Mail Code: 1101A
Washington, DC 20460

Re: Petition for Reconsideration of Elements of the Clean Air Interstate Rule

Dear Mr. Johnson:

On behalf of Northern Indiana Public Service Company ("NIPSCO"), we hereby file with you a Petition for Reconsideration of portions of the Clean Air Interstate Rule ("CAIR"), promulgated by the U.S. Environmental Protection Agency ("EPA") on May 12, 2005, at 70 Fed.Reg. 25161. As developed in greater detail in the Petition enclosed herewith, NIPSCO requests reconsideration of the following portions of the CAIR:

1. The nullification of vintage 2009 nitrogen oxide ("NOx") allowances allocated under the NOx Budget Trading Program, 40 CFR Part 96, as EPA's failure to provide notice and the opportunity for comment on this nullification is contrary to law, arbitrary and capricious, and a violation of the Fifth Amendment to the U.S. Constitution; and

2. The effective retirement ratio of Title IV allowances for sulfur dioxide ("SO_2") for Acid Rain Section 405(a)(2) units, as the retirement ratio is arbitrary and capricious; further, the Agency failed to meaningfully respond to comments on this point, contrary to law.

SCHIFF HARDIN LLP

If you have questions regarding NIPSCO's Petition, please do not hesitate to contact me.

Sincerely,

Sheldon A. Zabel

Enclosure

cc, w/ enclosure: Jeffrey R. Holmstead, Assistant Administrator for Air & Radiation
Brian McLean, Director, Office of Atmospheric Programs
Steve Page, Director, Office of Air Quality Planning and Standards

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BEFORE THE HONORABLE STEPHEN L. JOHNSON, ADMINISTRATOR
UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

IN RE PETITION FOR RECONSIDERATION OF THE RULE TO REDUCE INTERSTATE TRANSPORT OF FINE PARTICULATE MATTER AND OZONE (CLEAN AIR INTERSTATE RULE); REVISIONS TO ACID RAIN PROGRAM; REVISIONS TO THE NOx SIP CALL 70 Fed.Reg. 25161 (May 12, 2005)	)

Submitted by:

NORTHERN INDIANA PUBLIC SERVICE COMPANY

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I. INTRODUCTION

On May 12, 2005, the United States Environmental Protection Agency ("EPA" or the "Agency") published the final Clean Air Interstate Rule ("CAIR"). *See* 70 Fed.Reg. 25161 (May 12, 2005). Pursuant to 42 U.S.C. § 7607(d)(7)(B), and for the reasons outlined more fully below, Northern Indiana Public Service Company ("NIPSCO") hereby petitions the Agency for reconsideration of the CAIR.

First, the provisions of the CAIR requiring reductions of emissions of nitrogen oxides ("NOx") were improperly promulgated. (1) Contrary to the provisions of 42 U.S.C. §7607(d)(3), EPA failed to provide proper public notice of and the opportunity to comment on its intent to nullify vintage 2009 allowances allocated under the NOx SIP Trading Program[1] codified at 40 CFR Part 96, Subparts A-I. (2) Contrary to law, EPA failed to provide any basis for the nullification of allocated vintage 2009 NOx SIP Trading Program allowances. 42 U.S.C. § 7607(d)(6)(A). (3) Contrary to EPA's own criteria, EPA did not consider the impact of the CAIR as to a significant subset of electrical generating units ("EGUs") and, therefore, it cannot be determined whether the CAIR meets EPA's highly cost effective criterion.[2] (4) Contrary to law, EPA's decisions are arbitrary and capricious. Failure to consider the impact of the exclusion of previously allocated vintage 2009 NOx SIP Trading Program allowances from the

[1] In 1998, EPA called for amendments to states' implementation plans ("SIPs") to address downwind impacts on 1-hour ozone levels ("the NOx SIP call"), at 63 Fed.Reg. 57355 (October 27, 1998). As a compliance tool, EPA agreed to administer an interstate NOx trading program ("the NOx SIP Trading Program").

[2] In determining the appropriate level for the cap on NOx emissions required under the NOx SIP call, EPA developed its "highly cost effective" criterion. In brief, one of the criteria that EPA considers in establishing the level of a regionwide emissions cap is what level of controls can be achieved within the preferred timeframe in a highly cost effective manner. This approach was upheld in *Michigan v. EPA*, 213 F.3d 663 (D.C. Cir., 2000), and EPA relied upon it again in the proposed Interstate Air Quality Rule ("IAQR"), the supplemental proposed CAIR, and the final CAIR.

CAIR Seasonal NOx Trading Program is arbitrary and capricious. 42 U.S.C. § 7607(d)(9). EPA has been arbitrary and capricious in its application of, or failure to apply, its "highly cost effective" criterion to the subset of EGUs to whom 2009 NOx SIP call allowances have been allocated. (5) EPA's failure to comply with Sections 307(d)(3) and (d)(6) of the Clean Air Act is arbitrary and capricious, pursuant to Section 307)(9)(D). *Kennecott Corporation v. Environmental Protection Agency*, 684 F.2d 1007 (D.C. Cir. 1982).

Second, EPA's reduction in the value [3]of allowances for emissions of sulfur dioxide ("SO_2") allocated under the federal Acid Rain Program of Title IV of the Clean Air Act, 42 U.S.C. §§ 7651-7651o [Sections 401 *ff*], improperly penalizes the very units Congress chose to address an inequity resulting from the Acid Rain SO_2 allowance allocation methodology in the 1990 Clean Air Act Amendments. (1) Certain units were provided allowances pursuant to Section 405(a)(2) ("Section 405(a)(2) allowances") for the period 2000 through 2009 because their low SO_2 emission rates or low utilization rates during the baseline period for the Acid Rain Program resulted in extremely low allowance allocations ("Section 405(a)(2) units"). However, the CAIR, by effectively reducing these units' allocations at a rate greater than that for non-§ 405(a)(2) units, penalizes these Section 405(a)(2) units, impermissibly contravening the intent of Congress. (2) Contrary to law, EPA failed to provide a basis, as required by Section 307(d)(6)(A), for this decision. (3) The reduction in the value of the allowances allocated to this subset of units is at a percentage rate that is greater than what EPA determined in the CAIR to be highly cost effective. Therefore, EPA's failure to abide by its own criterion renders application of the CAIR to this subset of units arbitrary and capricious. 42 U.S.C. 7607(d)(9). (4) EPA

[3] This "value" of allowances is expressed in tons emitted per allowance. That is, under the Acid Rain Program, an allowance has a "value" of one ton of SO_2 emitted. Under Phase 1 of the CAIR, that allowance has a "value" of only half a ton of SO_2 emitted.

failed to respond to comments on this issue in a meaningful manner, violating Section 307(d)(6)(B). (5) Failure to comply with Section 307(d)(6) is arbitrary and capricious. 42 U.S.C. 7607(d)(9)(D). *Kennecott*, 684 F.2d 1007.

The issues identified above relative to the nullification of vintage 2009 NOx SIP Trading Program allowances arose after the public comment period and only with publication of the final CAIR. Therefore, EPA must reconsider the CAIR on this point. With respect to the SO_2 retirement ratio, EPA explained neither how application of the CAIR to an entire subset of units in a manner that is not highly cost effective is supportable nor how application of the CAIR to this subset of units is not contrary to Congress' intent regarding these units. Therefore, reconsideration of this issue is appropriate.

The CAIR should be revised to properly resolve these issues. EPA should revise the CAIR to recognize and preserve the value of vintage 2009 NOx SIP Trading Program allowances already allocated under the NOx SIP call and to include an SO_2 retirement scheme that does not punish Acid Rain Section 405(a)(2) units, consistent with the intent of Congress.

II. PROCEDURAL HISTORY

A. The Notice of Proposed Rulemaking

On January 30, 2004, in a Notice of Proposed Rulemaking ("NPR") for the IAQR, EPA proposed to find that emissions from certain states in the eastern United States[4] significantly contribute to nonattainment or interfere with maintenance of attainment of the national ambient air quality standards ("NAAQS") for 8-hour ozone ("ozone") and/or fine particulate matter ("PM2.5") in downwind states. *Generally see* 69 Fed.Reg. 4565 (Jan. 30, 2004). EPA proposed an annual, regionwide cap on emissions of NOx to address both downwind ozone and PM2.5

[4] The "eastern" U.S. under the IAQR and carried forward into the final CAIR is that portion including the Dallas-Fort Worth and Houston nonattainment areas eastward.

impacts. Based on a formula described in the NPR, EPA then proposed to establish proportionate caps of NOx emissions for each of the states which it had determined contribute significantly to levels of ozone and/or PM2.5 in downwind states. Both the regionwide cap and the states' caps were based upon emissions from EGUs. EPA announced that it would administer a regional, annual NOx trading program for states that chose to reduce NOx emissions only from EGUs[5] and to participate in such a trading program in order to comply with this rule. 69 Fed.Reg. at 4627, 4634. EPA also proposed to cap emissions of SO_2 in upwind states that contribute significantly to PM2.5 nonattainment or interfere with maintenance of the PM2.5 NAAQS. EPA expressed an intention to require retirement of Acid Rain allowances at a rate greater than that established under Title IV of the Clean Air Act for sources in those states that chose to reduce emissions from EGUs in order to comply with their respective caps. *See* 69 Fed.Reg. at 4632.

EPA proposed that both the NOx and SO_2 programs should be phased, with compliance dates of January 1, 2010, and January 1, 2015, for both. Based upon its analysis of what is highly cost effective, EPA proposed that a phased approach was necessary. Among many issues, EPA sought comments on the phased approach and the compliance dates. 69 Fed.Reg. at 4623.

B. The Supplemental Notice of Proposed Rulemaking

The Supplemental Notice of Proposed Rulemaking ("SNPR") was published at 69 Fed.Reg. 32683 (June 10, 2004). The SNPR identified the specific state budgets that EPA proposed. It also included proposed regulatory text and integration of what it now called the Clean Air Interstate Rule or CAIR with the existing NOx SIP Trading Program, created pursuant

[5] Inclusion of other source categories in addition to EGUs would require special permission from EPA.

to the NOx SIP call, and with the SO_2 trading program, created pursuant to the Acid Rain Program.

EPA again requested comment on SO_2 retirement ratios, this time including in the proposal a potential retirement ratio of 2.86:1 (69 Fed.Reg. at 32686), and repeated its proposal regarding the phased approach and the dates of compliance , *i.e.*, January 1, 2010, and January 1, 2015, and again sought comments (69 Fed.Reg. at 32690). The proposed NOx program was an annual program only. 69 Fed.Reg. at 32690.

C. The Final CAIR

The final CAIR was promulgated at 70 Fed.Reg. 25161 (May 12, 2005). This rule establishes the annual regionwide caps for SO_2 and NOx emissions as proposed (reflecting the latest data). The final CAIR, for the first time, presents a compliance date of 2009 for the annual CAIR NOx Trading Program. EPA had not proposed a seasonal CAIR NOx Trading Program in the NPR or SNPR (*see* 69 Fed.Reg. at 4565 and 32702), but it establishes a new seasonal NOx trading program in the final CAIR, also to begin in 2009. The NPR and SNPR both indicated that banked NOx allowances from the current NOx SIP Trading Program through vintage 2009 would carry forward or be banked into the annual CAIR NOx Trading Program, 69 Fed. Reg. at 4633; 69 Fed.Reg. at 32743, but the final CAIR provides for allowances through only vintage 2008 to be banked from the NOx SIP Trading Program into only the CAIR Seasonal NOx Trading Program, 70 Fed.Reg. at 25263, 25285, 25324; 40 CFR § 51.123(q)(4).

The final CAIR establishes uniform retirement ratios of Acid Rain Allowances for the CAIR SO_2 region rather than allowing states any flexibility, as had been included among the proposed options. The ratios, reflecting EPA's preferred alternative from the NPR and SNPR, are 2:1 and 2.86:1 for nominal SO_2 reductions of 50% and 65% in 2010 and 2015, respectively.

70 Fed.Reg. at 25226.[6] EPA specifically rejected a retirement ratio of 3:1 because it was not highly cost effective. 70 Fed.Reg. at 25258.

III. ARGUMENT

A. Standard for Reconsideration

The Clean Air Act provides for reconsideration of rulemakings, stating as follows:

> Only an objection to a rule or procedure which was raised with reasonable specificity during the period for public comment (including any public hearing) may be raised during judicial review. If the person raising an objection can demonstrate to the Administrator that it was impracticable to raise such objection within such time or if the grounds for such objection arose after the period for public comment (but within the time specified for judicial review) and if such objection is of central relevance to the outcome of the rule, the Administrator shall convene a proceeding for reconsideration of the rule and provide the same procedural rights as would have been afforded had the information been available at the time the rule was proposed. If the Administrator refuses to convene such a proceeding, such person may seek review of such refusal in the United States court of appeals for the appropriate circuit (as provided in subsection (b) of this section). Such reconsideration shall not postpone the effectiveness of the rule. The effectiveness of the rule may be stayed during such reconsideration, however, by the Administrator or the court for a period not to exceed three months.

42 U.S.C. 7607(d)(7)(B). This Petition for Reconsideration complies with the standards set forth in Section 307(d)(7)(B). With respect to the nullification of the 2009 NOx SIP Trading Program allowances, the issue arose upon EPA's finalization of the CAIR, after the close of the public comment period. Resolution of the issue is of central relevance to the outcome of the rule. With respect to the SO_2 allocations to Section 405(a)(2) units, EPA failed to address the issue when it

[6] SO_2 vintage 2010-2014 allowances offset emissions at 0.5 ton; 2015 and later vintage allowances offset emissions at 0.35 ton. 70 Fed.Reg. at 25274; *see* 70 Fed.Reg. at 25289; 40 CFR § 96.202 (definition of *CAIR allowance*).

was raised in comments, and its resolution is of central relevance to the outcome of the rule. Therefore, reconsideration of these issues is warranted.

B. CAIR Was Improperly Promulgated.

In the matter of vintage 2009 NOx SIP Trading Program allowances, EPA's actions in promulgating the CAIR are (1) contrary to law (Section 307(d)(6)) because EPA failed to provide notice of and opportunity to comment on its intent to nullify the vintage 2009 NOx SIP Trading Program allowances that have been already allocated, and in some cases already traded, and because EPA did not provide a basis for this nullification, and (2) arbitrary and capricious (Section 307(d)(9)) because EPA failed to correctly apply its own highly cost effective criterion by failure to consider the impact on the subset of EGUs to whom vintage 2009 NOx SIP Trading Program allowances have been allocated, as well as because EPA's actions are contrary to the requirements of Section 307(d)(6). Additionally, the nullification of the vintage 2009 NOx SIP Trading Program allowances constitutes a taking in violation of the Fifth Amendment to the U.S. Constitution.

EPA's promulgation of SO_2 allowance retirement ratios as applied to the significant subset of Acid Rain Section 405(a)(2) units is arbitrary and capricious (Section 309(d)(9)) because EPA failed to apply its own highly cost effective criterion to this group of EGUs. Additionally, EPA's final promulgation with respect to the Acid Rain Section 405(a)(2) units is contrary to law (Section 307(d)(6)(A)) because EPA failed to provide a basis for its decision to disregard the intent of Congress to address the inequity in the Acid Rain SO_2 allowance allocation system by acknowledging the paltry allowance allocation by providing additional allowances for units with low emissions and to meaningfully respond to comments. EPA's failure to meaningfully respond to comments on this point is also contrary to law (Section

307(d)(6)(B)). These actions, contrary to Section 307(d)(6), are arbitrary and capricious (Section 307(d)(9)), as well.

Section 307(d)(3) of the Clean Air Act, 42 U.S.C. § 7607(d)(3), requires EPA to provide adequate notice of and the opportunity to comment on the elements of its rulemakings:

> In the case of any rule to which this subsection applies, notice of proposed rulemaking shall be published in the Federal Register, as provided under section 553(b) of title 5, shall be accompanied by a statement of its basis and purpose and shall specify the period available for public comment (hereinafter referred to as the "comment period"). The notice of proposed rulemaking shall also state the docket number, the location or locations of the docket, and the times it will be open to public inspection. The statement of basis and purpose shall include a summary of—
>
> (A) the factual data on which the proposed rule is based;
>
> (B) the methodology used in obtaining the data and in analyzing the data; and
>
> (C) the major legal interpretations and policy considerations underlying the proposed rule.
>
> The statement shall also set forth or summarize and provide a reference to any pertinent findings, recommendations, and comments by the Scientific Review Committee established under section 7409(d) of this title and the National Academy of Sciences, and, if the proposal differs in any important respect from any of these recommendations, an explanation of the reasons for such differences. All data, information, and documents referred to in this paragraph on which the proposed rule relies shall be included in the docket on the date of publication of the proposed rule.

42 U.S.C. § 7607(d)(3). *See Michigan*, 213 F.3d 663.[7] As discussed below, EPA's failure to provide notice of and the opportunity to comment on the nullification of already allocated

[7] The court found EPA's attempt to cure a deficiency in notice of its revision of the definition of *EGU* two months after finalization of the NOx SIP call insufficient. The court also found that EPA had failed to provide notice of the requirement for a 90% reduction in emissions from major, stationary internal combustion engines, despite the fact that EPA has stated that it

vintage 2009 NOx SIP Trading Program allowances violates the notice and opportunity for comment requirements set forth in *Michigan*.

Section 307(d)(6) requires EPA to provide the bases for its rules and explanations for any major changes in the final rule as compared to the proposed rule. It also requires EPA to respond to significant comments. It states:

> (A) The promulgated rule shall be accompanied by (i) a statement of basis and purpose like that referred to in paragraph (3) with respect to a proposed rule and (ii) an explanation of the reasons for any major changes in the promulgated rule from the proposed rule.
>
> (B) The promulgated rule shall also be accompanied by a response to each of the significant comments, criticisms, and new data submitted in written or oral presentations during the comment period.
>
> (C) The promulgated rule may not be based (in part or whole) on any information or data which has not been placed in the docket as of the date of such promulgation.

42 U.S.C. § 7607(d)(6). EPA failed to provide its basis for nullifying the already allocated vintage 2009 NOx SIP Trading Program allowances, *i.e.*, provide its analysis of the impact of the nullification. Likewise, EPA failed to provide its basis for the rule and analysis of the impact of requiring an effective SO_2 retirement ratio of the Acid Rain Section 405(a)(2) units that is nominally three times that of all other Acid Rain units, as explained later in this Petition. Also, EPA failed to meaningfully respond to comments on the impact of the proposed CAIR to Acid Rain Section 405(a)(2) units, violating Section 307(d)(6)(B) of the Clean Air Act.

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was continuing to review reduction levels and had placed its determination in the docket prior to finalizing the rule.

Section 307(d)(9) states:

> (9) In the case of review of any action of the Administrator to which this subsection applies, the court may reverse any such action found to be—
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
>
> (B) contrary to constitutional right, power, privilege, or immunity;
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; or
>
> (D) without observance of procedure required by law, if (i) such failure to observe such procedure is arbitrary or capricious, (ii) the requirement of paragraph (7)(B) has been met, and (iii) the condition of the last sentence of paragraph (8) is met.

42 U.S.C. 7607(d)(9). Further, pursuant to Section 307(d)(9)(D), EPA's actions that are contrary to law are arbitrary and capricious. *Kennecott*, 684 F.2d at 1018.

EPA's failure to correctly apply its highly cost effective criterion to the impact of the nullification of already allocated vintage 2009 NOx SIP Trading Program allowances and to the effective SO_2 retirement ratio imposed upon Acid Rain Section 405(a)(2) units is arbitrary and capricious. Moreover, EPA's failure to provide the basis for these actions and its failure to provide its analysis of these actions and meaningful responses to comments pursuant to Section 307(d)(6)(B) is both contrary to law and arbitrary and capricious. Likewise, in addition to being contrary to law, EPA's failure to provide notice of and opportunity to comment on its intent to nullify the already allocated vintage 2009 NOx SIP Trading Program allowances pursuant to Section 307(d)(3) is arbitrary and capricious. *Kennecott*, 684 F.2d at 1018.

C. EPA Should Reconsider and Revise That Portion of the CAIR That Nullifies Previously Allocated NOx Allowances.

EPA is obliged by the Clean Air Act to provide notice sufficient for the public to understand the scope and detail of a rulemaking and an opportunity adequate for the public to comment on the rulemaking. In this case, failure to provide notice of and an opportunity to comment on its intent to nullify previously allocated vintage 2009 NOx SIP Trading Program allowances, precluding these allowances from being banked into the CAIR Seasonal NOx Trading Program, meant that those persons who trade emissions allowances or manage generation continued to conduct business relying upon their validity. NIPSCO conducted a number of transactions involving the acquisition of vintage 2009 allowances after the IAQR/CAIR was proposed but before it was finalized. The risk inherent in emissions trading should not include government nullification of issued and registered or recorded allowances. EPA has been cognizant of emissions currency and its value and relied on the importance of maintaining the credibility of the currency and trading programs in this same rulemaking with respect to Title IV allowances. The same rationale should apply to NOx allowances.

The previously unannounced nullification of the allocated 2009 allowances and the resultant undermining of the transactions involving them is legally flawed because it:

(a) deprived the public of the opportunity to comment on an important aspect of the rulemaking, contrary to the requirements of Section 307(d)(3);

(b) resulted in a taking contrary to the Fifth Amendment of the Constitution of the United States;

(c) threatens the credibility of existing emissions trading programs and the value of emissions currency, contrary to EPA's goals as stated in the CAIR, 70 Fed.Reg. at 25229, 25295;

(d) failed to consider the increase in the cost of compliance to those sources holding 2009 vintage allowances, causing EPA's cost analysis to be improperly applied, violating EPA's highly cost effective criterion; and

(e) was arbitrary and capricious, in violation of Section 307(d)(9).

1. The lack of opportunity to comment on an important aspect of the rulemaking is contrary to the requirements of Section 307(d)(3).

EPA did not comply with the requirements of Section 307(d)(3) in the final CAIR as to the nullification of vintage 2009 NOx SIP Trading Program allowances. For this reason and because of the likelihood that a court would remand this issue to EPA on appeal, EPA should reconsider its nullification of allocated vintage 2009 NOx SIP Trading Program allowances and revise that portion of the CAIR to preserve the value of the vintage 2009 NOx SIP Trading Program allowances.

The CAIR parallels the NOx SIP call in its approach to emissions reductions, its analytical approach, the type of sources regulated,[8] model rule language, SIP approval criteria, and plans for implementation. Clearly, the NOx SIP call served as a template for the CAIR. The differences are minor, even with the inclusion of an additional pollutant – SO_2 – and the use of the Acid Rain Trading Program for obtaining reductions of that pollutant. All this being the case, EPA has relied upon *Michigan*, 213 F.3d 663, both to provide it guidance on acceptable rulemaking and to justify proceeding with aspects of the CAIR that were questioned during the comment period.[9]

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[8] EGUs; non-EGUs represent such a small minority of the sources affected by the NOx SIP call that EPA claims their emissions are not significant in this rulemaking. 70 Fed.Reg. at 25214.

[9] *C.f.* 70 Fed.Reg. at 25183 ("The DC Circuit accepted EPA's collective contribution approach upholding most of the NO_x SIP Call regulation in *Michigan v. EPA*. . . . EPA considers that the phenomenon of 'collective contribution' is associated with $PM_{2.5}$ as well."); 70 Fed.Reg. at 25177 ("Petitioners challenging the NO_x SIP Call in *Michigan v. EPA* used the same arguments to contend that EPA's analytical approach in the NO_x SIP Call was arbitrary and capricious. The Court dismissed these arguments. . . . By the same token, in today's action, EPA's approach should be accepted. . . .")

The holdings in *Michigan* relative to insufficient public notice and the opportunity to comment on changes that EPA makes to a proposed rulemaking upon promulgation support NIPSCO's position that EPA should reconsider the issue raised here, *i.e.*, that there was not notice that EPA would "adjust" the vintage of NOx SIP Trading Program allowances that could be banked into the CAIR, thereby eliminating the previously allocated 2009 NOx SIP Trading Program allowances, and there was not an opportunity for the public to comment upon this "adjustment."

In the NPR and SNPR, EPA requested comment in numerous places on whether the commencement date of the NOx program should be changed. EPA acknowledged that the proposed NOx program did not align with the ozone attainment date on a practical basis. However, in its requests for comments on the commencement date of the NOx program, EPA never raised the question or requested comment on the effect of changing the commencement date of the program on the vintage of allowances that could be banked into the new NOx program. There was never the merest hint that EPA would nullify the vintage 2009 allowances that were allocated and traded under the NOx SIP Trading Program before and during the pendency of the NPR and SNPR for the CAIR. It was not logical to assume that the regulated public could divine that EPA would nullify vintage 2009 NOx SIP Trading Program allowances that had been allocated, recorded by EPA, and traded with the transactions recorded by EPA.

In response to comments on the commencement date question, EPA moved the start date for the NOx program to 2009. However, unannounced and without providing public notice and the opportunity for comment, it also "adjusted" the vintage of NOx SIP Trading Program allowances that can be banked into the CAIR Seasonal NOx Trading Program. 70 Fed.Reg. at 25285. This "adjustment" was that "pre-2009 NO_x SIP Call allowances can be banked into the

program and used by CAIR-affected sources" but "NO_x SIP Call allowances of vintages 2009 and later cannot be used for compliance with any EPA-administered cap and trade programs." 70 Fed.Reg. at 25274. EPA effectively nullified, without notice and comment, the NOx allowances already issued under the NOx SIP Trading Program and, at least in some cases, already traded in reliance on the integrity of the NOx SIP Trading Program.

EPA noted that no one commented on the vintage of allowances that should be banked into the CAIR: "The EPA did not receive comment on the proposed use of NO_x SIP Call allowances of vintage years 2009 and earlier for compliance with the CAIR." 70 Fed.Reg. at 25285. The lack of comment on the issue confirms that no one considered that vintage 2009 NOx allowances would be affected by a change in the commencement date of the CAIR for NOx. In fact, NIPSCO conducted transactions involving vintage 2009 NOx allowances[10] during the comment period for the SNPR, and EPA recorded the transactions on May 26, 2004

[10] Indiana's allocation methodology, approved at 68 Fed.Reg. 69025 (December 11, 2003), includes, in addition to other provisions not pertinent to this Petition, three-year block allocations made by December 31 of the year four years prior to the first year for which they are allocated. 326 IAC 10-4-9(b)(1). By December 31, 2003, the Indiana Department of Environmental Management ("IDEM") had instructed EPA to allocate allowances in vintages 2007, 2008, and 2009, and these allowances were duly recorded in the accounts of Indiana sources subject to Indiana's NOx SIP Trading Program, including NIPSCO. In addition to Indiana, a review of the various state NOx SIP Trading Programs indicates that Michigan and Alabama have also already allocated allowances for 2009 but that other states have not. Alabama allocated to EGUs 23,169 vintage 2009 NOx SIP Trading Program allowances. Telephone conversation between Lisa Cole, Alabama Department of Environmental Management, and Kathleen Bassi, Schiff Hardin LLP (June 17, 2005). Indiana allocated to EGUs 43,654 vintage 2009 NOx SIP Trading Program allowances in December 2003. 326 IAC 10-4-9(a)(1)(A). Michigan allocated to EGUs 28,150 vintage 2009 NOx SIP Trading Program allowances by April 1, 2004. Mich. Admin. Code R. 336.1810, Rules 810(1)(a), 810(2)(a)(ii), and 810(4). The NOx SIP Trading Program allowances allocated to EGUs in these three states amount to a total of 94,973, worth approximately $225 million (at *ca.* $2,400/allowance, based upon trades of vintage 2009 NOx SIP Trading Program allowances during 2004). Note that this amount does not include the value of the vintage 2009 NOx allowances allocated to non-EGUs. One must surmise that non-EGUs' vintage 2009 NOx allowances will also be nullified as they move into the CAIR Seasonal NOx Trading Program from the NOx SIP Trading Program.

(allowances originated with a non-EGU in Alabama, traded through a broker), June 10, 2004, and June 15, 2004. *See* Exhibit 1, attached hereto. Therefore, EPA knew, prior to finalizing the CAIR on May 12, 2005, that vintage 2009 NOx SIP Trading Program allowances existed. The Clean Air Markets Division of EPA had allocated vintage 2009 allowances to EGUs' and non-EGUs' accounts as directed by the States of Alabama, Indiana, and Michigan in late 2003 and early 2004. EPA had recorded the various trades of vintage 2009 NOx allowances by transferring them from one account to another. EPA knew that the "adjustment" of the NOx SIP banking forward provisions would nullify these allowances. EPA was obliged to raise this substantive issue in the context of requesting comments on the commencement date of the CAIR for the NOx program. There was no notice to the public and the regulated community that the loss of vintage 2009 allowances would result from the earlier start date of the CAIR NOx program.

Failure to provide an opportunity for comment is contrary to the provisions of Section 307(d)(3). *Michigan* provides guidance on when notice and opportunity to comment are not adequate in the rulemaking that is the template for the CAIR. In this case, EPA failed to provide the notice and opportunity for comment as required by law concerning EPA's decision that 2009 vintage NOx allowances that have been allocated and traded will no longer be valid or have value. *Michigan*, 213 F.3d 663. Moreover, because of the interstate nature of the transactions that have already occurred and inherently of the trading programs themselves, EPA must address this issue.

2. The final CAIR results in a taking of vintage 2009 NOx SIP Trading Program allowances, contrary to the guarantees of the Fifth Amendment to the U.S. Constitution.

The Fifth Amendment to the U.S. Constitution states that "private property [shall not] be taken for public use, without just compensation." The vintage 2009 allowances allocated to NIPSCO pursuant to the NOx SIP Trading Program are commodities.[11] Under Indiana law, commodities are treated like property. *See In re American Financial Advisors*, 1994 WL 406157, at *4 (Ind. Div. Sec.) Despite statements in the NOx SIP call model rule and Indiana's regulations to the contrary (*see* 326 IAC 10-4-4(b)(7)), the NOx SIP Trading Program allowances – commodities – are property and cannot be taken without just compensation.

The Supreme Court has used common sense reasoning to conclude that something possessing traditional characteristics of property rights is property protected by the Fifth Amendment,[12] and common sense indicates that the allowances are property. "Property in its legal sense means a valuable right or interest in something rather than the thing itself, and is the right to possess, use and dispose of that something in such a manner as is not inconsistent with law." *State v. Ensley*, 164 N.E.2d 342, 348-49 (Ind. 1960). The owners of emissions allowances can receive, possess, and alienate allowances. Daniel H. Cole, *Clearing the Air: Four Propositions About Property Rights and Environmental Protection*, 10 Duke Envtl. L. & Pol'y

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[11] "Allowances are fully marketable commodities that may be bought, sold, or banked." EPA, *Cap and Trade: Acid Rain Program Basics*, at http://www.epa.gov/airmarkets/capandtrade/airbasics.html. "The [SO_2 and NOx trading] systems are identical other than the types of allowances they track." EPA, *Clean Air Market Programs: Allowance Data*, at http://www.epa.gov/airmarkets/tracking/index.html. "The [Clean Air] Act provides that emissions allowances may be bought and sold as any other commodity." *Ormet Corp. v. Ohio Power Co.*, 98 F.3d 799, 802 (4th Cir. 1996) (noting Congress' intent for emissions allowances to function as commodities).

[12] *Ruckelshaus v. Monsanto,* 467 U.S. 986, 1002-03 (finding that trade secrets are property, in part, because they are assignable, can form the *res* of a trust, and pass to a trustee in bankruptcy).

F. 103, 114 (1999) (*construing* 42 U.S.C. § 7651b(f)). An owner of emissions allowances has the right to exclude others from using, or interfering with its own use, of an allowance. *See Ormet*, 98 F.3d at 804. Emissions allowances are among the assets that must be divided in bankruptcy. *In re New Boston Coke Corp.*, 299 B.R. 432, 436 (Bankr. E.D. Mich. 2003). Common sense should mandate the conclusion that the an allowance owner's interest in the allowances is a property interest, since that owner has the right to receive the allowances, possess them as an asset, exclude others from them, and alienate them.

EPA does not have the authority to define the NOx SIP Trading Program allowances as non-property. Because government may not define words so as to change the nature of the acts or things to which the words are applied, *Carter v. Carter Coal Co.*, 298 U.S. 238, 289 (1936), government may not create an emissions allowance, which is by its nature property, and then escape the conclusion that an allowance is property by defining it as non-property. Moreover, government does not acquire greater authority to define the scope of a property interest just because it creates the property. *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155, 163, 164 (1980).

A regulation that denies all economically beneficial or productive use of property is a regulatory taking. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992). In the CAIR, EPA nullified the vintage 2009 NOx SIP Trading Program allowances, resulting in their complete devaluation. A devaluation of real property is a *per se* taking "where regulation denies all economically beneficial or productive use of land." *Lucas*, 505 U.S. at 1015. By extension, the same is true of the vintage 2009 NOx SIP Trading Program allowances: EPA's regulatory nullification denies all economically beneficial use of those allowances. Although the *Lucas*

court considered only real property, there is no distinction between the analysis there and the actions here.

Because the emissions allowances, which are commodities, would be considered property under Indiana law, and EPA did not have the authority to define the allowances as non-property, NIPSCO's property interest in the vintage 2009 NOx SIP Trading Program allowances is protected by the Fifth Amendment. That property has been completely devalued by EPA's promulgation of the CAIR. Unless reconsideration is granted and the nullification of the vintage 2009 NOx SIP Trading Allowances corrected, NIPSCO would be entitled to just compensation.

3. The loss of 2009 NOx SIP Trading Program allowances threatens the credibility of existing emissions trading programs and maintenance of the value of emissions currency, contrary to EPA's goals as stated in the CAIR.

By nullifying the allocated vintage 2009 NOx SIP Trading Program allowances, EPA is undermining the credibility of its trading programs, which jeopardizes the viability of such programs and is contrary to its justifications for various other decisions reflected in the CAIR. EPA recognizes that NOx allowances have value. *See* 70 Fed.Reg. at 25280. Further, EPA recognizes that existing trading programs create a currency that engenders reliance and requires confidence and continuity. Without that confidence and reliance, trading programs will not work, as EPA recognizes. For example, in the context of the Title IV program, EPA says that it "believes that basing budgets on title IV allowances is necessary in order to ensure the preservation of a viable title IV program[,] . . . includ[ing] the desire to maintain the trust and confidence that has developed in the functioning market for title IV allowances." 70 Fed.Reg. at 25229. EPA went on to state, "The EPA believes it is important not to undermine such confidence (which is an essential underpinning to a viable market-based system) recognizing that it is a key to the success of a trading program under the CAIR." 70 Fed.Reg. at 25229.

EPA attempted to avoid transition issues by integrating the CAIR SO_2 Program with the Acid Rain Program through maintaining the Acid Rain Program and merely altering the allowance retirement ratio for CAIR EGUs. EPA does have transition issues, however, with respect to the integration of the NOx SIP Trading Program with the CAIR Seasonal NOx Trading Program because of the nullification of the 2009 NOx SIP Trading Program allowances, but EPA failed to address the particular transition issue that is the subject of this Petition. Commenters raised many issues growing from the transition from the NOx SIP Trading Program to the CAIR Annual NOx Trading Program,[13] many of which prompted EPA to create the CAIR Seasonal NOx Trading Program. Among those issues were orphaned states (*i.e.*, those that were subject to the NOx SIP call and still had the requirement to comply but were not covered by the CAIR findings), orphaned non-EGUs from the NOx SIP Trading Program (*i.e.*, by excluding non-EGUs from the CAIR NOx Trading Program, the pool of trading partners available for the non-EGUs subject to the NOx SIP call was largely decimated, essentially gutting that program and increasing the costs to the non-EGUs unreasonably), and the need to maintain lower emissions during the ozone season (*i.e.*, sources could ramp up generation in the ozone season and offset the increase in allowance requirements during the off-season months in an annual-only program).

In all its requests for comments relative to the start date of the CAIR NOx Trading Program, however, EPA never intimated that it would invalidate vintage 2009 or any other NOx SIP Trading Program allowances if it moved the start date to 2007, as advocated by some commenters, or to 2008. There was no notice of this possibility, and it apparently never occurred to commenters. Vintage 2009 allowances had been allocated, and business proceeded as usual,

[13] None of those comments addressed the issue of the vintage 2009 NOx SIP Trading Program allowances. 70 Fed.Reg. at 25285.

with trades of these allowances occurring and the parties relying upon EPA to maintain the integrity of these transactions.

Had EPA provided sufficient notice and opportunity for comment on its intent to nullify vintage 2009 allowances, it would have been brought to EPA's attention, emphatically, that vintage 2009 NOx allowances had been allocated and traded and that EPA had been involved in those trades in its ministerial capacity. Based upon EPA's stated concerns for the viability and credibility of the trading programs, it is reasonable to believe that EPA would have, at the least, addressed the issue of the destruction of the value of these vintage 2009 NOx allowances. Failing to maintain the value of the allocated 2009 NOx allowances is contrary to EPA's stated views and policies regarding maintaining the viability and credibility of the trading programs.[14]

4. EPA violated its highly cost effective criterion by not including the impact of the increase in the cost of compliance to those sources holding vintage 2009 NOx allowances in its analysis.

The loss of the value of the vintage 2009 banked NOx SIP Trading Program allowances to the sources to whom they were allocated and to whom they were traded is a cost that EPA must consider in its analysis of highly cost effective control measures.

While not part of its highly cost effective analysis for the CAIR, EPA did consider that the severe reduction of the trading pool that would result under the IAQR/CAIR proposal for non-EGUs in the NOx SIP Trading Program would increase non-EGUs' costs of compliance

[14] In addition to EPA's concerns with maintaining the viability of emissions trading programs discussed earlier in this section, EPA said, "While in a market-based program like the Acid Rain Program, investments are necessarily subject to the vagaries of the market, EPA believes that it should try, to the extent possible consistent with statutory requirements, to avoid taking administrative actions that would cause such extensive disruption of the Acid Rain Program. Allowing such disruption to occur could significantly reduce the willingness of owners of sources in new cap and trade programs to invest in measures that would result in excess allowances for sale or to purchase allowances for compliance." 70 Fed.Reg. at 25295. EPA should take its own advice with respect to the CAIR Seasonal NOx Trading Program.

with the NOx SIP call and provided in the final CAIR that states could allow their non-EGUs to participate in the CAIR Seasonal NOx Trading Program. A number of commenters discussed this, and EPA considered those comments. This increase in cost is similar to the increased cost to sources that have received and relied upon the validity of vintage 2009 NOx SIP Trading Program allowances, but EPA failed to consider the costs associated with nullifying the 2009 NOx SIP Trading Program allowances.

Further, in its analysis of the effect of the CAIR SO_2 Trading Program on the Acid Rain Program, one of EPA's justifications for basing that program on a retirement ratio of Acid Rain allowances is to avoid devaluing the Acid Rain Trading Program as a whole. EPA posits that the CAIR SO_2 Trading Program will increase the value of Acid Rain allowances. Following the same line of thought, EPA should not allow the complete devaluation of 2009 NOx allowances that have already been allocated, at the least without evaluating the effect of that devaluation to the cost of the program and the impact to the sources that would be affected by that devaluation.

5. EPA's action is arbitrary and capricious and contrary to the requirements of § 307(d)(9).

EPA's failure to provide the public notice and opportunity for comment on and an analysis of its nullification of vintage 2009 NOx SIP Trading Program allowances in the transition to the CAIR Seasonal NOx Program as required by Sections 307(d)(3) and (d)(6) is arbitrary and capricious, pursuant to Section 307(d)(9) of the Clean Air Act.

Section 307(d)(3) clearly requires such notice and opportunity to comment. The first time that EPA provided any notice of its intent to "adjust" the vintage of the allowances that could be banked into the CAIR from the NOx SIP Trading Program was in the final CAIR. As EPA noted and as discussed above, no one commented upon the vintage of allowances that could be banked into the CAIR. No one realized it was an issue because EPA did not include the

possible nullification of allocated 2009 allowances in its requests for comments on the commencement date of the CAIR NOx program or in its discussions of possibilities and ramifications of the commencement date. There was never any indication at all that the vintage of NOx SIP Trading Program allowances to be banked into the CAIR would change, regardless of the logic that may underlie the change that EPA made to the final rule.

Further, Section 307(d)(6)(A) very clearly requires EPA to provide the bases for both its proposed and final rules. EPA refers to its decision to nullify millions of dollars in 2009 NOx allowances in the final CAIR only in passing, merely mentioning that it had "adjusted" this particular banking provision. 70 Fed.Reg. at 25285. There was no discussion, let alone support or analysis of the effect of this "adjustment," provided by EPA in the NPR or SNPR – and as a result, not surprisingly, there were no comments on the issue. EPA has not met the standards of either *Northeast Maryland Waste Disposal Authority v. Environmental Protection Agency*, 358 F.3d 936, 948 (D.C. Cir. 2004) (EPA retains an affirmative duty to examine key assumptions, even where there is no objection during the comment period), or Section 307(d)(6)(A), discussed above.

In failing to provide the basis for this very significant change in the CAIR NOx Trading Program, applied to the new Seasonal NOx Trading Program, EPA also demonstrated that it had failed to consider the effects of nullifying vintage 2009 NOx SIP Trading Program allowances in its highly cost effective analysis of the CAIR NOx Trading Program. While only three states have allocated vintage 2009 NOx SIP Trading Program allowances, the value of those allowances is millions of dollars, and there have been numerous trades of those allowances, including with sources or other holders of allowances located in other states or with non-EGUs.

For example, NIPSCO acquired a number of vintage 2009 NOx allowances from an Alabama non-EGU through Morgan Stanley, a broker, and from an in-state non-EGU. *See* Exhibit 1.

Failure to apply its own highly cost effective criterion and to discuss or propose for comment nullification of millions of dollars' worth of allocated 2009 NOx allowances is arbitrary and capricious under Section 307(d)(9). *Bluewater Network v. EPA*, 370 F.3d 1 (D.C. Cir. 2004).

D. EPA Should Reconsider and Revise That Portion of the CAIR That Effectively Requires a Higher Retirement Ratio from Acid Rain "Section 405(a)(2)" Units Than Required from "Non-Section 405(a)(2)" Units.

When Congress created the Acid Rain Program in the 1990 Amendments to the Clean Air Act, it recognized that there were a number of EGUs that were low emitters of SO_2, either because they had already significantly reduced SO_2 emissions or because they were not greatly utilized during the baseline period or both. As a result, the basic allocations for these Section 405(a)(2) EGUs were not on a par with EGUs that had not been early reducers. The EGUs that received only the basic allowances were high SO_2 emitting EGUs with higher utilization rates. Congress acknowledged the problem of the low emitters and included special provisions in the 1990 Amendments to the Clean Air Act to redress this inequity. Congress determined that EPA should allocate these EGUs additional SO_2 allowances for the period from 2000 through 2009. The Section 405(a)(2) allowances had the same value as "regular" SO_2 allowances: they could be traded, banked, or surrendered for a ton of SO_2 emissions.

Under Title IV, EPA would no longer issue Section 405(a)(2) allowances in 2010. At that time, these "Section 405(a)(2) EGUs" would revert to receiving only the number of allowances that they were originally allocated based upon the Acid Rain baseline. Congress provided these EGUs 20 years, from 1990 through 2009, to plan for this loss of the Section

405(a)(2) allowances. As EPA is aware, EGUs engage in long-term planning, and Congress determined that 20 years was an appropriate length of time for them to make these plans.

Congress never contemplated that a reduction would be made from the basic Acid Rain SO_2 allocation to the Section 405(a)(2) units that were acknowledged to suffer an inequitable allowance distribution. The CAIR SO_2 Program, which begins in 2010, requires a retirement ratio of two allowances for each ton of SO_2 emitted during Phase 1. In other words, Phase 1 will require a 50% reduction from 2009. However, for the Acid Rain Section 405(a)(2) EGUs, the retirement ratio is effectively greater. The Acid Rain Section 405(a)(2) EGUs will be allocated fewer allowances in 2010 than they had received during 2009 and preceding years, and then that substantially reduced number of allowances must be retired at the 2:1 ratio. This is an unforeseen double whammy.

Based upon EPA's Acid Rain databases, there are 587 units in the CAIR region[15] that were allocated a total of 419,893 Section 405(a)(2) allowances.[16] This represents approximately 6% of the basecase emissions.[17] 70 Fed.Reg. at 25228. From these calculations and from its own statements, EPA clearly did not include the Section 405(a)(2) allowances in its calculation of the emissions caps: "The regionwide annual SO_2 budget for the years 2010-2014 is based on a 50 percent reduction from title IV allocations for all units in affected States." 70 Fed.Reg. at 25229 (emphasis added). Likewise, EPA says, "State annual budgets for the years 2010-2014

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[15] Our analysis included all units in Texas.

[16] *See* EPA, "Boiler/Generator-Level, Boiler-Level, and State-Level Allocations," *Clean Air Markets – Allowance Trading: SO2 Allowance Allocations*, October 29, 2002, www.epa.gov/airmarkets/allocations/index.html, (June 23, 2005).

[17] NIPSCO was not able to equate the basecase emissions identified in Table IV-14 in the final CAIR with any known numbers, and so NIPSCO multiplied the CAIR emissions caps by two and divided by 419,893 to arrive at 6%.

(Phase I) are based on a 50 percent reduction from title IV allocations for all units in the affected State." 70 Fed.Reg. 25229 (emphasis added); *see also* EPA, *Technical Support Documents for the Clean Air Interstate Rule Notice of Final Rulemakings Regional and State SO_2 and Nox Emissions Budgets* (March 2005). These statements imply very strongly that EPA considered only the Acid Rain allowance allocations established for 2010 and are clearly wrong if Title IV allowance allocations for 2009 were considered.

1. EPA applied its highly cost effective criterion to establish regionwide SO_2 reductions in the CAIR.

In applying the highly cost effective criterion to determine the SO_2 cap for the CAIR, EPA considered the control measures that would result in reductions in SO_2 emissions, the costs of various control measures, the amounts of emissions that could be reduced, the effective emissions rates, and the availability of boilermakers. It determined from these analyses that highly cost effective SO_2 emissions reductions equated to a 65% reduction from the level achieved by the Acid Rain Program. However, the availability of boilermakers meant that full implementation of the 65% reduction could not occur for 10 years, although some work could be completed in the near term. To ensure that some reductions occur sooner rather than not until another decade has passed, EPA included a 50% reduction within five years, also highly cost effective.

2. EPA did not meaningfully respond to comments on the impact of the CAIR SO_2 retirement ratio on Acid Rain Section 405(a)(2) units, in violation of Sections 307(d)(6)(B) and 307(d)(9).

A number of persons commented on the impact of the retirement ratio on Acid Rain Section 405(a)(2) units. One commenter has three coal-fired units that had scrubbers during the Acid Rain baseline period and so were operating below 1.2 lb/mmBtu. The commenter stated that "the proposed one-size-fits all surrender ratio approach effectively penalizes units that

installed post-combustion controls early and rewards units that never installed post-combustion controls." OAR-2003-0053-2165, p. 764. EPA does not respond to the substance of this comment. *See* OAR-2003-0053-2165. This same commenter suggested differing surrender ratios based upon emission rates because of the inequity to low emitting units. OAR-2003-0053-2165, p. 749. EPA's response was that differing ratios are too confusing and so would disrupt the market and that it would be too great an administrative burden. OAR-2003-0053-2165, p. 750. This is rather disingenuous, given the facts: (1) EPA first proposed that participating states could each determine the retirement ratio appropriate to its needs;[18] (2) the final CAIR provides for retirement of fractions of allowances rather than whole allowances; (3) EPA will be administering a complex program with multiple retirement ratios already (*i.e.*, the Acid Rain Trading Program for units in states not covered by CAIR, with retirement ratios of 1:1, and the CAIR SO_2 Trading Program, with retirement ratios that are fractions), and (4) trading between CAIR and non-CAIR EGUs will be allowed. EPA provided no reasons as to why such a system with multiple retirement ratios would be so confusing and so great an administrative burden. The system that EPA devised, with the surrender of portions of a whole allowance, is certainly not a model of administrative simplicity.

Another commenter pointed out that its emission rates are about half the national average for coal combustion and that the retirement ratios proposed would leave it short of allowances despite its already low emission rate, resulting in "double payment" – one for being low emitting sources during the baseline period and the second in the retirement ratio, *i.e.*, the double whammy. OAR-2003-0053-2165, pp. 741-742. EPA did not respond.

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[18] EPA justified a uniform retirement ratio both as a nod to commenters and also as being, in its view, fairest.

A third commenter opined that states that are low emitters of NOx and SO_2 should be rewarded for being clean rather than punished. OAR-2003-0053-2165, p. 293. EPA's response applauded such states and then discussed incentives for early compliance, never addressing the comment that there should be some consideration for such states. OAR-2003-0053-2165, p. 294.

None of these comments or responses were included in the Preamble to the final CAIR. Obviously, EPA did not determine this issue to be significant, as it claimed to include only the "most important" issues in the Preamble.[19] 70 Fed.Reg. at 25166. EPA never meaningfully assessed the issue; EPA never directly addressed it, even in the Response to Comments in the docket.

EPA's failure to meaningfully respond to comments is contrary to law and a violation of Section 307(d)(6)(B), which requires EPA to respond to significant comments. *See Sierra Club v. Gorsuch*, 715 F.2d 653 (D.C. Cir. 1983) (Rules must be accompanied by a response to each of the significant comments submitted in written or oral presentations during the comment period). Even though EPA may not have considered the comments and issues significant, or failed to recognize the significance, EPA's view is not determinative. Additionally, as a violation of Section 307(d)(6)(B), it is also arbitrary and capricious and a violation of Section 307(d)(9). *Bluewater Network*, 370 F.3d 1.

[19] "The remaining sections of the preamble describe the final CAIR requirements and our responses to comments on many of the most important features of the CAIR." 70 Fed.Reg. at 25166 (emphasis added). As the issue of the Section 405(a)(2) EGUs was not addressed in the Preamble, clearly it was not one of the "most important" issues for EPA, and its lack of direct response to the issues in the Response to Comments at OAR-2003-0053-2165 emphasizes that point.

3. EPA did not consider whether the CAIR is highly cost effective when applied to the Acid Rain Section 405(a)(2) units.

Had EPA adequately responded to comments on the impact of the CAIR as proposed on Acid Rain Section 405(a)(2) units, it would have had to apply the highly cost effective criterion specifically to the subset of Acid Rain units that received Section 405(a)(2) allowances through 2009. EPA would have been forced to view the highly cost effective criterion from a different vantage point, *i.e.*, not just the costs of additional control equipment and the analyses of other relevant factors, but also the impact of the retirement ratio on EGUs that have just had their allowance allocations reduced pursuant to the Acid Rain Program, a situation unique to the Section 405(a)(2) EGUs. EPA would have discovered that the cost of compliance to this subset of sources significantly exceeds that of sources who enjoyed their full operational and emitting status during the Acid Rain baseline.

For instance, NIPSCO has six EGUs that are Acid Rain Section 405(a)(2) units. Their Acid Rain basecase allowances total 15,559. The total of the additional, Section 405(a)(2) allowances allocated for these units is 17,279. The number of Section 405(a)(2) allowances, of course, is based upon a complex formula intended to place the Section 405(a)(2) units on at least somewhat of an equitable basis with those Acid Rain units that had higher SO_2 emissions prior to or during the Acid Rain baseline determination period. *See* 42 U.S.C. § 7651d. With the "loss" of the Section 405(a)(2) allowances after 2009, the allowance allocations for NIPSCO's units will be cut by 53%. The Phase 1 CAIR allocations to these units, representing an additional reduction of 50%, will effectively be 7,780 for a total reduction of 76% from the 2009 allocations to these Section 405(a)(2) EGUs, clearly exceeding what EPA has determined is highly cost effective in 2015, let alone 2010. In 2015, these units will effectively be allocated 5,446 allowances under the CAIR. This is a reduction of 83% from their 2009 allowance level,

resulting in an effective allocation that is 50% more restrictive than what EPA has considered highly cost effective.

Congress provided Acid Rain Section 405(a)(2) units 20 years to plan for the loss of the Section 405(a)(2) allowances in 2010. EPA is allowing Section 405(a)(2) units five years to plan for an increase in the retirement ratio of the remaining allowances allocated to these units. NIPSCO knew that it would "lose" the Section 405(a)(2) allowances in 2010 and had carefully planned for this eventuality. EPA, however, has not considered that reductions of 76% in 2010 and then ultimately 83% in 2015, which is the effect on the Acid Rain Section 405(a)(2) units, is contrary to Congress' actions in providing these units 20 years to plan for a 53% reduction in 2010.

EPA had proposed and then rejected an Acid Rain allowance retirement ratio of 3:1 because that ratio would result in surrender of more allowances than EPA had determined was highly cost effective. 70 Fed.Reg. at 25258. A retirement ratio of 2.86:1 equates to the 65% reduction in SO_2 emissions that EPA has determined is highly cost effective, yet NIPSCO's Acid Rain Section 405(a)(2) units would be retiring allowances at an effective percentage of 83%, which is a retirement ratio of approximately 6:1 in 2010.

Explaining why EPA did not proceed with the option it presented in the proposed rule to retire allowances at 3:1 and allow states to use the excess allowances as incentives or compensation for early reductions, EPA says that it "must employ a uniform ratio across sources to ensure consistency and the same cost-effectiveness level across sources." 70 Fed.Reg. at 25258. Obviously, one of two things is true: (1) EPA is not being fully candid, as the cost to the Acid Rain Section 405(a)(2) units at the "uniform" retirement ratio is not consistent with the cost to non-Section 405(a)(2) units; or (2) EPA did not evaluate the cost of any retirement ratio

to the Acid Rain Section 405(a)(2) units. The fact is that the "uniform" retirement ratio does not result in consistency and the same cost-effectiveness across all sources, EPA's stated justification for choosing the 2.86:1 retirement ratio for all CAIR states. In fact, as discussed above, when compared to the 2009 allowance allocations to the Section 405(a)(2) units, 2.86:1 is not even a "uniform" retirement ratio. The concern is with an entire subset of approximately 587 units[20] identified by Congress as deserving of special attention. That the CAIR begins just as Congress' special treatment is ending exacerbates the inconsistency of the CAIR as applied to the Acid Rain Section 405(a)(2) units compared to the rest. If EPA "must . . . ensure consistency and the same cost-effectiveness level across sources," then it must provide, at least initially, a different retirement ratio for the Acid Rain Section 405(a)(2) units, perhaps as suggested by Exelon in its comments. *See* OAR-2003-0053-2165, p. 749.

Moreover, EPA's failure to effectuate Congress' clear directives to consider and address the inequity in the basic allocation for the Acid Rain Section 405(a)(2) units and allow them adequate time to plan contradicts EPA's purported intent to preserve the integrity of the Acid Rain Program by tiering the CAIR SO_2 program with the Acid Rain Program rather than creating a parallel SO_2 program. That is, Congress granted, as pointed out previously, 20 years' "make-up" for the Acid Rain Section 405(a)(2) units. Owners and operators were able to carefully plan for that point in the future, 2010, when they would no longer receive the Section 405(a)(2) allowances for these units. These owners and operators relied upon this configuration of the Acid Rain Program. EPA has undercut those plans and thus the companies' ability to rely on the integrity of the program by reducing the nominal number of allowances available to the Section 405(a)(2) units and providing only five years' planning time to address this drastic reduction in

[20] This includes all Phase I and Phase II units in Texas.

allowances for these units. In addition to being directly contrary to Congress' intent with respect to this subset of units, EPA's action brings into question whether the power generating community and those who engage in trading emissions allowances under programs created and administered by EPA can rely, with confidence, on the continuity of those programs. Particularly coupled with the nullification of the 2009 NOx SIP Trading Program Allowances, EPA's disregard of the Acid Rain Section 405(a)(2) units strikes at the very heart of the integrity and credibility of its trading programs. Further, EPA is sending very mixed messages to the regulated community: EPA must preserve the Acid Rain Trading Program because it is established and relied upon and there are millions of dollars dependent upon its unaffected continuance, but EPA has no qualms about cavalierly chopping off one arm of this program, *i.e.*, the Acid Rain Section 405(a)(2) units, as the Title IV Trading Program merges with the CAIR SO_2 Trading Program, despite those units' reliance upon the Acid Rain Program.

As units already emitting SO_2 at lower rates, Acid Rain Section 405(a)(2) units and Acid Rain units subject to the Subpart Da New Source Performance Standards will reach the point of technological infeasibility in order to operate in compliance under the reduced fixed cap of the CAIR SO_2. As utilization of such units increases – which should be preferred over increasing the utilization of older and higher-emitting units – their effective emission rates will be reduced, eventually to the point of infeasibility. In many instances, these units have already expended large sums of capital to achieve these extremely low emission rates. The costs of coming into compliance technologically will be higher for them, as they have little room for flexibility in achieving technological compliance, if it is achievable at all, and they will have to expend the additional funds to purchase allowances to operate in compliance because their extremely low emission rates and increased utilization will not reduce emissions to the point of meeting their

CAIR SO_2 allocation. Moreover, unlike under the unadulterated Acid Rain Program where owners or operators had a choice as to whether to comply through technology or buying allowances, the Section 405(a)(2) EGUs will quickly be faced with technological infeasibility and will lose that choice: they will have to buy to comply.

This action is obviously not highly cost effective, is clearly contrary to Congress' intent as expressed in the Clean Air Act, and frustrates Congress' actions in granting Section 405(a)(2) allowances to these units. As expressed by several of the commenters, EPA's objective relative to the Acid Rain Section 405(a)(2) units punishes their earlier good deeds – "no good deed goes unpunished."

4. EPA's failure to apply the highly cost effective criterion to the Acid Rain Section 405(a)(2) units and to meaningfully respond to comments as required by Section 307(d)(6)(B) is arbitrary and capricious and contrary to Section 307(d)(9).

EPA's failure to apply its own highly cost effective criterion to the impact on the Acid Rain Section 405(a)(2) units of a 2:1 surrender rate of Acid Rain allowances in 2010 is arbitrary and capricious, pursuant to Section 307(d)(9), as discussed above. Section 307(d)(6)(A) very clearly requires EPA to provide the bases for both its proposed and final rules, typically provided in the preambles. EPA does not discuss the effect of the allowance retirement ratio on the Acid Rain Section 405(a)(2) units. EPA did not considered them in its highly cost effective analysis. Its responses to comments on the issue confirm that it did not. Certainly, this significant subset of units deserved at least some direct discussion in the Preamble rather than merely "responses" that were not responsive and buried in the docket.

Given EPA's failure to provide any discussion of the highly cost effective criterion as applied to the Acid Rain Section 405(a)(2) units and to meaningfully respond to comments raising the issue, EPA has not satisfied its obligations under Section 307(d)(6) to provide the

basis for the SO_2 allowance retirement ratio. *Northeast Maryland Waste Disposal Authority*, 358 F.3d 936; *Sierra Club v. Gorsuch*, 715 F.2d 653. These failures also render EPA's actions arbitrary and capricious under Section 307(d)(9). *Bluewater Network*, 370 F.3d 1.

IV. IMPACT OF CAIR ON UNITS ALREADY ALLOCATED 2009 NOx ALLOWANCES AND ON ACID RAIN SECTION 405(A)(2) UNITS

Three states (Alabama, Indiana, and Michigan) have instructed EPA to allocate vintage 2009 NOx SIP Trading Program allowances to the affected units within their jurisdictions, and EPA has done so. Relying upon the credibility and continuity of the emissions trading programs administered by EPA, at least some of the sources to whom these allowances were allocated have conducted transactions, worth millions of dollars, involving the vintage 2009 NOx SIP Trading Program allowances. The CAIR nullifies the allowances that were the subject of the transactions. This has a reverberating impact on the parties involved in the trades and, more importantly, upon the integrity and credibility of emissions trading programs developed and administered by EPA. The economic impact to the individual parties involved in the trades is huge. Not only have parties conducted transactions involving vintage 2009 NOx allowances worth millions of dollars, but those who acquired NOx allowances for compliance purposes will not have the NOx allowances upon which they were relying because of the nullification, thus potentially interfering with NOx compliance planning where the purchasers were NOx emitters. It threatens the credibility of EPA's trading programs because now no one can know when EPA will, unannounced, nullify allowances.

As to SO_2, there is no evidence that EPA considered the special treatment that Congress afforded the subset of Acid Rain units who received Section 405(a)(2) allowances to reward them for low SO_2 emissions during the Acid Rain baseline period. The Section 405(a)(2) allowances were to reward these units and to place them on a more equal footing with those units

that had not reduced SO_2 emissions during the baseline period. By applying the same CAIR retirement ratio to the Section 405(a)(2) units as EPA is applying to non-Section 405(a)(2) units, EPA is effectively now punishing the very units that Congress sought to reward. This is exacerbated by the timing of the CAIR: just as the Section 405(a)(2) units will no longer receive the Section 405(a)(2) allowances, EPA is requiring a 2:1 retirement ratio of the lessened number of allowances that will be allocated to the Section 405(a)(2) units. Given the 20-year planning period that Congress granted the Section 405(a)(2) units for the "loss" of the Section 405(a)(2) allowances, the CAIR retirement ratio in 2010 impermissibly frustrates Congress' intent for these units. These units have only five years now to plan for a situation drastically changed from what they have been planning for over the last 15 years.

V. RELIEF REQUESTED

WHEREFORE, for the reasons stated above, pursuant to 40 U.S.C. § 7607(d)(7)(B), Petitioner NIPSCO requests that EPA convene a proceeding for reconsideration of the final CAIR and afford the interested public the procedural rights due them under 42 U.S.C. § 7607(d)(3) and 42 U.S.C. § 7607(d)(6). NIPSCO further requests that EPA grant this petition for reconsideration and reconsider the decision to nullify allocated vintage 2009 NOx SIP Trading Program allowances and whether the impact of the CAIR on the subset of Acid Rain units that received Section 405(a)(2) allowances is highly cost effective. NIPSCO further requests that EPA stay the effectiveness of the rule as to the units specifically affected by these two components of the CAIR, *i.e.*, the subset of EGUs to whom vintage 2009 NOx allowances have already been allocated and the subset of EGUs that are Acid Rain Section 405(a)(2) units. NIPSCO suggests that EPA reinstate the vintage 2009 NOx SIP Trading Program allowances as CAIR allowances *in situ*, as currently recorded, merely replacing their NOx SIP Trading

Program serial numbers with corresponding CAIR NOx Seasonal Trading Program serial numbers and adjusting the NOx seasonal emissions caps for the States of Alabama and Michigan upward to provide for appropriate and substantially equal allocations to those EGUs that are new to NOx trading programs with the CAIR in those states. NIPSCO further suggests that EPA adopt the following SO_2 allocation methodology for the Acid Rain Section 405(a)(2) units, to more closely correspond to Congress' intent regarding these units: a retirement ratio of 1:1 for Acid Rain Section 405(a)(2) units through 2014; a retirement ratio of 2:1 for Acid Rain Section 405(a)(2) units from 2015 through 2019; and then the CAIR SO_2 retirement ratio of 2.86:1 for the Acid Rain Section 405(a)(2) units commencing in 2020.

Dated: July 8, 2005

Respectfully submitted,

FOR NIPSCO

By: 

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Christopher Rogers
<Chris.Rogers@morganstanley.com>

05/28/2004 01:15 PM
Please respond to
Chris.Rogers

To: Thomas Pysh/NCS/Enterprise@NiSource
cc:
Subject: [Fwd: NOx Allowance Transfer: May 26, 2004 Interactive Transfer (Confirmation)]

-------- Original Message --------
Subject:NOx Allowance Transfer: May 26, 2004 Interactive Transfer (Confirmation)
Date: Wed, 26 May 2004 08:30:37 -0400 (EDT)
From: Allowance Transfer <AllowanceTransfer@epa.gov>
To: Deborah Hart <deborah.hart@morganstanley.com>,"Arthur E Smith Jr." <aesmith@nisource.com>
CC: Christopher Rogers <chris.rogers@morganstanley.com>,Allowance Transfer <AllowanceTransfer@epa.gov>

Transaction Number 73396 **Recorded On** May 26, 2004

	TRANSFER FROM	TRANSFER TO
Account Number	999900000164	999900000262
Account Name	Morgan Stanley Capital Group Inc	NIPSCO Corporate
Representative ID	2215	738
Representative Name	Deborah Hart	Arthur E Smith Jr.
E-mail Address	deborah.hart@morganstanley.com	aesmith@nisource.com

Year	Start Serial	End Serial	Amount	Status
2008	67008	67060	53	
2008	67115	67167	53	
2008	67222	67274	53	
2008	67329	67367	39	
2008	67407	67445	39	
2008	67485	67523	39	
2008	67563	67605	43	
2008	67649	67720	72	
2008	77841	77846	6	
2008	77847	77848	2	

2008	77853	77861	9	
2008	77862	77865	4	
2008	77873	77938	66	
2008	77940	77968	29	
2008	78016	78079	64	
2008	78080	78108	29	
2009	11236	11288	53	
2009	11343	11395	53	
2009	11450	11502	53	
2009	11557	11595	39	
2009	11635	11673	39	
2009	11713	11751	39	
2009	11791	11833	43	
2009	11877	11948	72	
2009	22069	22074	6	
2009	22075	22076	2	
2009	22081	22089	9	
2009	22090	22093	4	
2009	22101	22166	66	
2009	22168	22196	29	
2009	22244	22307	64	
2009	22308	22336	29	
Total Allowances Transferred:			**1200**	

A confirmation of this transfer has been sent to your e-mail address: chris.rogers@morganstanley.com. If you do not receive an e-mail confirmation, please contact Alex Salpeter at (202) 343-9157.

40296842.xml

NO_x Allowance Tracking System Report

ALLOWANCE TRANSFER CONFIRMATION

Date: 6/15/2004

Transaction Number 73475

Date Request Received 06/15/2004
Transaction Date 06/15/2004

TRANSFER FROM:

Authorized By Lewis L. Staley
AAR Number 2239
Account Number 999900000107
Account Name Lockport Cogeneration Facility

MAILED TO AAR:
Thomas J. Gesicki
5087 Junction Road
Lockport, NY 14094

TRANSFER TO:

Authorized By Frank A. Venhuizen
AAR Number 2514
Account Number 999900000262
Account Name NIPSCO Corporate

MAILED TO AAR:
Frank A. Venhuizen
801 E. 86th Avenue
Merrillville, IN 46410

ALLOWANCES TRANSFERRED:

Allowance Serial Numbers			Number of Allowances	Transfer Status	Early Reduction Credit Status
Start Number	-	End Number			
200900010786	-	200900010798	13	(Approved)	
200900010828	-	200900010909	82	(Approved)	
200900010938	-	200900011018	81	(Approved)	
200900010307	-	200900010358	52	(Approved)	
200900010444	-	200900010495	52	(Approved)	
200900010581	-	200900010632	52	(Approved)	
		2009 TOTAL	332		

U.S MAIL:
U.S. Environmental Protection Agency
Attn: NOx Allowance Tracking System
Mail Code 6204J
1200 Pennsylvania Ave., NW
Washington, DC 20460

NOx Budget Program

Hotline: 202-343-9620

OVERNIGHT MAIL:
U.S. Environmental Protection Agency
Attn: NOx Allowance Tracking System
Mail Code 6204J
1310 L Street, NW
Washington, DC 20005

NO_x Allowance Tracking System Report

ALLOWANCE TRANSFER CONFIRMATION **Date: 6/15/2004**

Transaction Number 73475

Please review the information shown above and report any errors, along with supporting documentation, to the address listed below, within 15 business days of the notification date printed at the top of the page.

U.S MAIL:
U.S. Environmental Protection Agency
Attn: NOx Allowance Tracking System
Mail Code 6204J
1200 Pennsylvania Ave., NW
Washington, DC 20460

NOx Budget Program

Hotline: 202-343-9620

OVERNIGHT MAIL:
U.S. Environmental Protection Agency
Attn: NOx Allowance Tracking System
Mail Code 6204J
1310 L Street, NW
Washington, DC 20005

Transaction Detail Report
June 16, 2005

Your query affects 1 transaction blocks.

You specified: **Program(s):** NBP **Transaction number:** 73627

Program	Transaction Number	Transaction Total	Transaction Type	Account Number (Transferor)	Account Name (Transferor)	State (Transferor)	Representative (Transferor)	Account Number (Transferee)	Account Name (Transferee)	State (Transferee)	Representative (Transferee)	Confirmation Date	Allowance (Vintage) Year	Serial Number Start	Serial Number End	Block Totals
NBP	73627	1000	Private Trade	999900000273	CG&E General NOx Account		Barry E Pulskamp	999900000262	NIPSCO Corporate		Arthur E Smith Jr.	07/08/2004	2009	45641	46640	1000
Total																1000