UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAR 15 2006

THE ADMINISTRATOR

Mr. Sheldon A. Zabel
Schiff Hardin LLP
6600 Sears Tower
Chicago, Illinois 60606

Dear Mr. Zabel:

The Environmental Protection Agency has considered the requests in the two petitions you filed on behalf of Northern Indiana Public Service Corporation (NIPSCO or Petitioner) for reconsideration of the Clean Air Interstate Rule (CAIR). Your July 8, 2005 petition asks EPA to reconsider two aspects of the CAIR. Specifically, NIPSCO asks EPA to reconsider its treatment of previously allocated 2009 NOx Budget Trading Program allowances and to reconsider the SO2 retirement ratio for units that currently receive bonus allocations under section 405(a) (2) of the Acid Rain program. Your August 30, 2005, petition raises any additional issue related to the impact of the decision in New York v. EPA 413 F.3d 3 (D.C. Cir. 2005), on certain analyses prepared for CAIR. As you are aware, EPA has already responded to the August 2005, petition and granted reconsideration on the issues raised in it. EPA also has carefully considered the issues in your July 2005 petition and for the reasons below now denies the requests in that petition.

The CAIR, published in the Federal Register on May 12, 2005 (70 FR 25162) is a powerful component of the Bush Administration's plan to help over 450 counties in the Eastern United States meet air quality standards for ozone and fine particles. EPA determined that reductions in upwind precursor emissions will assist downwind areas in meeting the national ambient air quality standards (NAAQS). EPA also determined that attainment will be achieved in a more equitable, cost-effective manner than if each nonattainment area attempted to achieve attainment with the ozone and fine particle NAAQS by implementing local emissions reductions alone. The CAIR was developed through a process that involved extensive public participation. We received and responded to thousands of comments and held public hearings in February and June of 2005. The robust public dialogue was an important part of the rulemaking process.

EPA recognizes the continuing significant public interest in the CAIR. Following publication of the rule, EPA received twelve separate petitions for reconsideration. In response, EPA granted reconsideration on and reopened for public comment the following six issues:

(1) definition of "EGU" as it relates to solid waste incinerators (70 FR 49708, 49738);

(2) claims that inequities result from the sulfur dioxide (SO2) allocation methodology to be used by States participating in the EPA-administered trading program (70 FR 72268, 72272);

(3) EPA's use of fuel adjustment factors (1.0 for coal, 0.6 for oil, and 0.4 for gas) in establishing State nitrogen oxides (NOx) budgets (70 FR 72268, 72276);

(4) certain inputs to the fine particle (PM2.5) modeling used to determine whether Minnesota should be included in the CAIR region for PM2.5 (70 FR 72268, 72279);

(5) EPA's determination that Florida should be included in the CAIR region (70 FR 72268, 72280); and

(6) the impact of New York v. EPA on certain analyses prepared for the final CAIR (70 FR 77101).

EPA published Federal Register notices announcing the reconsideration processes and requested public comment on the issues under reconsideration. EPA is taking final action on reconsideration of these issues in a separate rulemaking signed today.

One of the issues EPA decided to reconsider, relating to the impact of the New York v. EPA decision, was raised in your August 2005 petition for reconsideration. Further discussion of that issue appears in the final action on CAIR reconsideration signed today. This letter addresses only the two issues raised in your July 2005 petition. As explained below, EPA has determined that reconsideration of these two issues is not warranted under section 307(d)(7)(B) of the Clean Air Act (CAA). Consequently, EPA is not required to respond to Petitioner's substantive arguments. Nonetheless, EPA briefly discusses each issue of concern to Petitioner.

Previously Allocated NOx Budget Trading Program Allowances

The petition submitted on behalf of NIPSCO asks EPA to reconsider an additional aspect of the CAIR, not covered by the reconsideration process described above. Petitioner argues that language in the final CAIR "nullified" vintage 2009 nitrogen oxide ("NOx") allowances allocated under the NOx Budget Trading Program, 40 CFR Part 96, and asks EPA to grant reconsideration of that issue and to revise CAIR to "preserve" the value of the 2009 NOx Budget Trading Program allowances. For the reasons below, EPA denies this request.

The CAIR establishes emission reduction requirements for States that significantly contribute to downwind PM2.5 and/or 8-hour ozone nonattainment problems. States must achieve the required emission reductions by either meeting the State's emission budget by requiring power plants to participate in an EPA administered interstate cap and trade system that caps emissions in two stages, or by meeting an individual State emissions budget through measures of the State's choosing (70 FR 25167). States that choose to participate in EPA administered cap and trade system will allocate CAIR NOx allowances to sources in their States for each year, starting with 2009 -- the first year the CAIR NOx trading program will be operational. These 2009 CAIR NOx allowances are the only vintage 2009 allowances that can

be used by sources to comply with the CAIR. Any NOx Budget Trading Program allowances allocated for 2009 thus cannot also be used to comply with the CAIR NOx trading program.

EPA disagrees with Petitioner's argument that EPA failed to provide notice of this issue and opportunity to comment. As explained above the issue of what allowances may be used for compliance with the NOx Budget Trading Program is directly linked to the start of the CAIR NOx trading program. In the Supplemental Notice of Proposed Rulemaking (SNPR), EPA noted that several commenters had expressed concern about the proposed 2010 compliance dates and explicitly "request[ed] comment on all aspects of the issues concerning the timing of the proposed CAIR compliance dates in relation to NAAQS attainment dates" (60 FR 32690). In response, EPA received and responded to numerous comments on issues relating to those compliance dates. Ultimately, EPA decided to finalize a 2009 compliance date for the first phase of NOx emission reductions, and thus also determined that vintage 2009 and later NOx Budget Trading Program allowances could not be used to comply with the EPA administered CAIR trading program. Petitioner neither has shown that it was impracticable to raise its objection during the comment period, nor has shown that the grounds for this petition arose after the period for public review had ended. Thus, reconsideration of this issue is not warranted under section 307(d)(7)(B) of the CAA.

Further, Petitioner has not provided information sufficient to convince EPA that any change to CAIR is warranted. As discussed above, States participating in the EPA administered trading program would allocate the CAIR NOx allowances to sources in their State. EPA would not decide the recipients of these allowances or limit the allocation options available to the States. The first year for which CAIR NOx allowances would be allocated is 2009. As EPA explained, these CAIR NOx allowances, not the NOx Budget Trading Program allowances, would be used for compliance with the CAIR trading program (70 FR 25274).

EPA believes that under CAIR, States have adequate flexibility to address equity issues relating to previously allocated NOx Budget Trading Program allowances. Only three States (Alabama, Indiana, and Michigan) have already allocated 2009 NOx Budget Trading Program allowances to sources. EPA has had discussions with each of these States and has offered to provide assistance in developing an approach to allocating 2009 CAIR NOx ozone season allowances that considers the already allocated 2009 NOx budget allowances. The Indiana Department of Environmental Management (IDEM) published a notice of proposed rulemaking in the Indiana Register on December 1, 2005, that includes draft trading program rules for the CAIR NOx Ozone Season Trading Program. In this rule, IDEM proposes that the 2009 CAIR NOx Ozone Season Trading Program allowances be the 2009 NOx Budget allowances already allocated under the NOx Budget Trading Program. The value of the previously allocated 2009 allowances would be preserved under this proposal. The Alabama Department of Environmental Management proposed a similar approach in its February 28, 2006, public notice and the Michigan Department of Environmental Quality has indicated to EPA that it is considering a similar approach. For these reasons, EPA believes States have the ability under CAIR to address the equity issues raised by Petitioner. In sum, the Petition failed to provide information sufficient to convince EPA either that procedural errors require EPA to reconsider this issue or that the underlying claim warrants revision of the CAIR.

SO2 Retirement Ratio for Section 405(a)(2) Units

Petitioner also asks EPA to reconsider the retirement ratio for Title IV allowances as applied to so called section 405(a)(2) units. Section 405(a)(2) of the CAA requires EPA to allocate additional allowances to certain units from 1990 to 2009. These units will be referred to as section "405(a)(2) units." Beginning in 2010, however, these units will receive only the standard Title IV allowances. Petitioner argues that because these units lose their bonus section 405(a)(2) allocations in 2010, the same year that the new Title IV retirement ratios will apply to sources covered by the CAIR SO2 trading program, they are unfairly penalized by the CAIR. Petitioner thus asks EPA to reconsider and revise the portion of CAIR concerning the SO2 retirement ratio as applied to these units. It also argues that reconsideration is warranted under Section 307(d)(7). EPA disagrees. As discussed below, Petitioner has not presented information sufficient to convince EPA that reconsideration is warranted under section 307(d)(7)(B) of the CAA. Furthermore, Petitioner has not convinced EPA that the requested changes to the CAIR are warranted. Therefore, EPA denies this request.

Petitioner has not shown either that it was impractical for it to submit comments on this issue during the comment period, or that the issue arose after the comment period had ended. Therefore, Petitioner has not established that reconsideration of this issue is warranted under section 307(d)(7)(B) of the CAA.

Instead, Petitioner argues that EPA failed to respond meaningfully to comments on the issue of whether a separate retirement ratio should be used for section 405(a)(2) units. EPA disagrees with this assertion. Petitioner has not presented evidence sufficient to convince EPA that there was any procedural error in responding to comments on this topic. EPA responded to numerous comments regarding the proposed Title IV retirement ratio and explained its decision to use a uniform retirement ratio for all sources. Petitioner identifies three specific comments for which it asserts EPA's responses were deficient. None of these comments specifically discuss the retirement ratio as applied to section 405(a)(2) units or suggest that this particular subcategory of Acid Rain units deserves preferential treatment. The first two comments raise the argument that a different surrender ratio should be used for units with low SO2 emission rates during the 1985-87 Acid Rain baseline period. EPA responded to these comments, explaining that EPA believes that, in a trading program that uses trading ratios, the same ratio must be used for all sources in order to ensure that all emission reductions are achieved. The third comment addressed general alleged inequities from the application of the proposed SO2 retirement ratio. EPA responded to this comment, explaining that the Agency has found that the use of the proposed retirement ratio is highly cost effective, and that EPA believes the same ratio must be used for all sources to ensure all emissions reductions are achieved.

Further, Petitioner has not submitted information sufficient to convince EPA that a different, unique retirement ratio should be applied to section 405(a)(2) units. As explained in the CAIR preamble, CAIR requires States that significantly contribute to downwind PM2.5 nonattainment to reduce emissions of SO2. States may choose, but are not required, to meet these requirements through participation in an EPA administered SO2 trading program. The CAIR model SO2 trading rules, relevant only to States participating in this trading program, achieve emissions reductions by increasing the retirement ratios for Title IV allowances (70 FR

25230). Specifically, the model trading rules would require participating sources to retire vintage 2010-2014 Title IV allowances at a rate of 2:1 and vintage 2015 and later Title IV allowances at a rate of 2.65:1. Petitioner argues these retirement ratios for 2010 and 2015 are inappropriate for the section 405(a)(2) units.

Petitioner claims they are being hit with an "unforeseen double whammy" because they loose the bonus allocations in 2010, and in that year they will also, like all other sources in the CAIR trading programs, be subject to a 2:1 retirement ratio that reduces the value of their Title IV allowances. Petitioner argues that the "reduction in the value of allowances allocated to this subset of units is at a percentage that is greater than what EPA determined the CAIR to be highly cost effective." In other words, they appear to argue that EPA should have conducted a separate highly-cost-effective analysis to examine separately the impact of the retirement ratios on the section 405(a)(2) "bonus" units alone.

EPA disagrees. When Congress amended the CAA in 1990, it provided special provisions for section 405(a)(2) "bonus" units in which they would receive additional SO2 allowances through 2009. Congress allotted 10 years (2000 -2009) of extra allowances to these units so they would have adequate time to make adjustments, and reduce their emissions to levels equal to their original Acid Rain allowance allocations. After this 10-year grace period, they were not to receive special treatment regarding SO2 allowances.

In addition, Petitioner compares their CAIR phase 1 effective allocations of 7,780 tons to their 2009 allocations of 32,838 tons to exaggerate the retirement ratio into an apparent 4:1 total reduction. To observe the impact of CAIR, NIPSCO must compare their 2010 phase 1 effective allocations of 7,780 tons to their anticipated 2010 Title IV baseline of 15,559 tons. This reduction is equivalent to a 2:1 retirement ratio. The section 405(a)(2) units are not subjected to higher reductions as claimed in the petition.

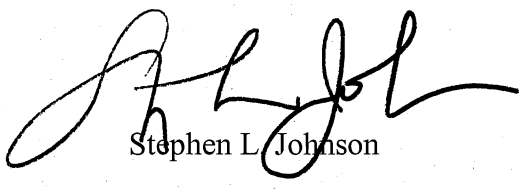
EPA thus disagrees that the retirement ratio creates a "double whammy" for section 405 (a)(2) units. The first part of the claimed "double whammy" does not pertain to CAIR, but stems from the cessation of bonus allowances for section 405(a)(2) units. As noted by Petitioner, "Congress determined that 20 years (from 1990 Title IV passage to 2009) was an appropriate length of time to plan for these reductions." Accordingly, section 405(a)(2) units should be prepared for title IV base case allowances in 2010. As such, in 2010 these units are similarly situated with all other Acid Rain units and the retirement ratios apply equally to all such units.

In sum, EPA disagrees with Petitioner's claim that "an entire subset of 587 units deserves special attention....and must be provided a separate retirement ratio." Title IV only distinguishes between section 405(a)(2) units and other units through 2009. The "bonus" allocations were intended to help the section 405(a)(2) units prepare for base case allocation levels in 2010. It was intended to bring all units to a uniform standard in 2010, not to continually exempt one group of units from future emission reduction measures. EPA, therefore, believes it is appropriate to treat all units fairly and consistently with a uniform retirement ratio of 2:1 in phase 1 and 2.65:1 in phase 2.

As explained above, Petitioner has neither convinced EPA that reconsideration of this issue is warranted under section 307 of the CAA, nor shown that EPA's use of the SO2 retirement ratio in CAIR was flawed. For these reasons, EPA denies Petitioner's request to reconsider this issue.

Thank you for your interest in the final CAIR rule. EPA looks forward to working with you as implementation of the rule proceeds. If you have any questions about this letter, please contact Sonja Rodman in the Office of General Counsel at 202-564-4079.

Sincerely,



Stephen L. Johnson