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VIA HAND DELIVERY

November 16, 2004

CONFIDENTIAL

Mr. Marc Conklin, Esq.
Board of Public Utilities
540 Minnesota Avenue
Kansas City, KS 66101

Re: Liability Analysis of Projects Identified as Responsive to Anticipated
Demand for Information Under Clean Air Act, Section 114(a), 42
U.S.C. § 7414(a).

Dear Marc:

This letter contains the results of our liability analysis of the 73 BPU projects we reviewed under the Clean Air Act's New Source Review Program. 40 C.F.R. Part 52.

I. EXECUTIVE SUMMARY

The federal Clean Air Act requires that Best Available Control Technology be installed when a major source of air pollutants makes a major physical modification. The Act also requires that the source obtain a permit to make major modifications. Major sources are required to perform New Source Review prior to making major modifications to determine whether a permit and Best Available Control Technology are required.

Nationally, EPA has pursued many coal-fired utilities for failure to conduct New Source Review and to obtain required permits and install Best Available Control Technology for major modifications made since 1980. Region VII EPA is participating in the enforcement initiative and currently is pursuing at least four utilities.

BPU wishes to best posture itself in the face of the enforcement initiative and the likelihood that BPU at some point will be required to account for New Source Review and install Best Available Control Technology. In order to do so BPU has chosen to perform a liability analysis to estimate the number of projects performed on BPU coal-fired units since 1980 that under EPA's judgment should have been subject to New Source Review and permitting and the installation of Best Available Control Technology. BPU engaged this firm to perform that liability analysis.

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Our firm identified 73 BPU work orders representing the types of projects for which EPA has sought information to use in pursuing New Source Review enforcement. BPU gathered documents relating to those work orders according to a descriptive protocol we developed. We then evaluated those documents according to criteria established in EPA rulemakings, court decisions, and through EPA settlements with utilities and placed each project into one of these categories:¹

1. **Probably Defensible:** The project probably can be defended as exempt from New Source Review permitting and triggering Best Available Control Technology upgrades on the basis of an established exemption to New Source Review - a) routine maintenance, repair or replacement, b) pollution control project, or c) no causal link between the project and increased emissions;
2. **Questionable:** The project cannot be estimated to be defensible or not defensible due to either the nature of the project and lack of guidance to perform an adequate analysis or due to extreme uncertainty in the law of New Source Review as it would apply to that project; or
3. **Probably Not Defensible:** The project was subject to New Source Review permitting and Best Available Control Technology upgrades and would be expected to be the subject of New Source Review enforcement.

The liability analysis yields the following:

1. **Probably Defensible:** Seven (7) Kaw Projects
Twenty-one (21) Quindaro Projects
Thirteen (13) Nearman Projects
2. **Questionable:** Six (6) Kaw Projects
Seven (7) Quindaro Projects
Two (2) Nearman Projects
3. **Probably Not Defensible:** Four (4) Kaw Projects
Six (6) Quindaro Projects
Five (5) Nearman Projects

This liability analysis, the Best Available Control Technology analysis performed by Burns & McDonnell, and BPU's strategic planning decisions regarding retirement of units and use of alternative fuels at some units, together with decisions regarding sale or banking of sulfur dioxide credits will be fully analyzed to determine how BPU should move forward as to New Source Review liability. The evaluation is

¹ Projects 1 and 2 of the original 73 projects were ultimately determined not to be within the scope of EPA's New Source Review enforcement interest based on the information requests that EPA has made of numerous utilities.

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whether it is in the best interest of BPU to approach EPA to voluntarily initiate settlement of New Source Review issues and negotiate Best Available Control Technology upgrades or whether BPU should wait until EPA initiates actions regarding BPU New Source Review.

II. BACKGROUND

For purposes of our continuing discussions and to be sure we have a common understanding of key terms, it is useful to set out the essential elements and methodology of EPA's New Source Review/Prevention of Significant Deterioration rules (NSR/PSD).² As you know, a "major modification" to a "major stationary source" results in triggering a requirement that the "Best Available Control Technology", or "BACT", be installed on the source.³ BACT is defined as:

an emissions limitation (including a visible emission standard), based on the maximum degree of reduction for each pollutant subject to regulation under the [Clean Air] Act which would be emitted from any proposed major stationary source or major modification which the Administrator, on a case-by-case basis, taking into account energy, environmental, and economic impacts and other costs, determines is achievable for such source or modification through application of production processes or available methods, systems, and techniques, including fuel cleaning or treatment or innovative fuel combustion techniques for control of such pollutant

² If NSR/PSD is triggered, then generally New Source Performance Standards (NSPS) are also triggered. However, since BACT cannot be less stringent than NSPS, but may be more stringent, NSPS is generally subsumed in BACT. 40 C.F.R. § 52.21(b)(12). NSPS will not be discussed separately in this letter.

³ "Major stationary source" means, *inter alia*, a particular category of source (there are twenty-seven categories including coal-fired power plants) which emits, or has the potential to emit, 100 tons per year of a priority pollutant. 40 C.F.R. § 52.21(b)(1). KDHE applies the same definition. See K.A.R. 28-19-17 et seq. "Major modification" means any physical change, or change in method of operation, that results in a significant net emissions increase of a priority pollutant. 40 C.F.R. § 52.21(b)(2). "Significant" net emissions increase means, *inter alia*, increases in emissions of the following pollutants in the indicated amounts, referred to as "increments:"

CO - 100TPY
NO_x - 40 TPY
SO₂ - 40 TPY
PM - 25TPY total; PM₁₀ - 15TPY
O₃ - 40TPY
Hg - 0.1TPY
H₂S - 10TPY
Total Reduced S - 10TPY
H₂SO₄ mist - 10TPY

40 C.F.R. § 52.21(b)(23). KDHE applies the same definition. See K.A.R. 28-19-17 et seq.

40 C.F.R. § 52.21(b)(12). From the definition it is apparent that a BACT determination for a particular facility is the subject of some negotiation with EPA or the state permitting authority. Further, a review of recent consent decrees entered into by EPA and various electric utilities indicates that BACT for power plants boils down to controls for NO_x, SO_x, and particulate matter (PM).⁴

EPA conducts a BACT analysis according to the routine set out in the "New Source Review Workshop Manual" (Manual).⁵ The Manual sets out a so-called "top-down" method for determining BACT for a particular facility. The Manual summarizes this top-down method as follows:

In brief, the top-down process provides that all available control technologies be ranked in descending order of control effectiveness. The PSD applicant first examines the most stringent – or "top" – alternative. That alternative is established as BACT unless the applicant demonstrates, and the permitting authority in its informed judgment agrees, that technical considerations, or energy, environmental, or economic impacts justify a conclusion that the most stringent technology is not "achievable" in that case. If the most stringent technology is eliminated in this fashion, then the next most stringent alternative is considered, and so on.

An analysis of BPU's coal fired units by Burns & McDonnell Engineers, dated November 14, 2003, estimates that a system-wide BACT upgrade for BPU would entail a capital cost of about \$160 million.⁶

EPA, northeastern states and public interest groups have sued dozens of utilities for NSR violations. Many of these lawsuits have been resolved by consent decrees, however, many are still in litigation. EPA's enforcement initiative for the NSR program began in earnest in Region 7 on December 4, 2002. On that day, Region 7 sent demands for information under Section 114 of the CAA to four (4) utilities, one in each state within Region 7. The targeted utilities were the Nebraska Public Power District in Nebraska, Westar in Kansas, MidAmerican in Iowa and AECI in Missouri. Based on recent reports, other utilities expect to receive similar demands for information from Region 7 in the foreseeable future.

⁴ Tampa Electric Company (TECO), PSEG Fossil LLC (PSEG), Virginia Electric and Power Company (VEPCO), Wisconsin Electric Power Company (WEPCo), and Southern Indiana Gas and Electric Company (SIGECO). Mercury controls are also required at PSEG and WEPCo.

⁵ This 1990 Manual is somewhat dated but John Knodel, EPA Region 7, confirms that it is still used by EPA and, in particular, it is used to perform a BACT analysis.

⁶ We recommend revisiting Burns & McDonnell's analysis in light of revised BACT parameters suggested by Region 7 and BPU's strategic planning decisions regarding retirement of units and use of alternative fuels.

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The enormous cost of a system-wide BACT upgrade and EPA's aggressive NSR enforcement initiative in Region 7 prompted BPU to retain this firm to work with BPU to:

1. Identify projects that are responsive to typical prior demands for information by EPA under CAA § 114(a);
2. Perform a liability analysis of those projects under NSR; and
3. Counsel BPU regarding the advantages and disadvantages associated with voluntarily entering into NSR settlement discussions with Region 7 or waiting until EPA approaches BPU which appears likely under the current EPA enforcement strategies.

III. PROJECT IDENTIFICATION

The process used to select documents and information from BPU's files was based upon the process that would be used to respond to a typical EPA "Request for Information Pursuant to Section 114(a) of the Clean Air Act" ("Section 114(a) Request") that has been issued to various other electric generating companies throughout the country. Based upon a typical Region 7 Section 114(a) Request, we developed questions and defined the types of documents that we believe would be of interest to EPA and responsive to an EPA request. BPU was instructed to be over-inclusive in gathering the documents, as it is easier to set aside unnecessary documents than it is to perform a second search.

Within that context, we developed a list of document types to be gathered for review. The list includes the following:

1. Work orders for the period January 1, 1980 forward and for \$200,000 or more and work orders for less than \$200,000 that might be aggregated with other work orders pursuant to EPA practice in NSR enforcement and which work orders represent a project identified as an EPA-identified project of interest (i.e., (a) boiler casing and boiler floor/wall tube replacements for each unit; (b) economizer, reheater(s), primary and secondary superheaters, steam drums, and/or primary and secondary air pre-heater replacements for each unit; (c) induced draft (ID) fans, forced draft (FD) fans and fan motor replacements for each unit; (d) condenser, boiler feed pump and/or feed water heater replacements for each unit; (e) flue gas recirculation (FGR) replacements or deactivations for each unit; (f) pulverizer, exhauster, burner and/or cyclone replacements for each unit; (g) balanced draft conversion projects; (h) turbine rotor/turbine shell replacements or design changes; (i) low-NOx burner (LNB), overfire air, staged

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- combustion, gas or coal reburn installation and modifications/ retrofits including any model or size changes made to the burners for each unit, and including changes to the ignitors [i.e., include model and size (in MMBTU/hour)]; (j) scrubber retrofits and/or design change projects; (k) any electrostatic precipitator (ESP) or fabric filter retrofits or design changes; (l) coal handling system changes to increase feed rate or other changes to coal preparation; and (m) changes made to equipment to accommodate the burning of used oil in each boiler).
2. Contracts that correspond with the identified work orders.
 3. All documents (memoranda, meeting notes, reports, etc.) that discuss the benefits or provide the justification for the projects.
 4. Equipment specifications for the projects. This includes drawings if the drawings contain bill of material information or have other unique information regarding the function and structure of the components. This excludes detail drawings and construction drawings.
 5. Proposals from outside contractors related to the work performed under the work orders – only proposals from successful bidders, and only if the proposals contain information about the project that is not available elsewhere, i.e., equipment specifications, justifications, descriptions.
 6. Documents representing communications with EPA, KDHE, or DAQ regarding the projects and specifically any applicability determinations for the projects.
 7. Documents providing life extension and life optimization studies, evaluations, assessments and reports.
 8. Documents regarding increasing the performance and/or reliability of the coal fired units, including studies and project information, but only for projects actually completed.
 9. For each project, whether the project was performed during a scheduled outage, a forced outage, or otherwise.

We assisted BPU in tasking Omaha Legal to transfer micro-fiche and main frame accounting work order records to searchable CDs in order to have a data base that could be used to identify the work orders of interest. We identified all work orders authorizing expenditures greater than \$200,000 and then reviewed each identified work order to determine whether it relates to EPA-identified projects of interest. We and BPU then worked to identify as accurately as possible whether work orders with ambiguous project descriptions should be included in the projects for review.

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Ms. Debbie Rich (BPU, Administration) gathered contracts based upon Work Order reference numbers that were potentially responsive, and in excess of a \$200,000 threshold (*note*: this criterion is more inclusive than the \$250,000 threshold contained in Question 2 of a typical Section 114(a) Request) as determined through a joint evaluation effort by Stinson Morrison Hecker and BPU. All contracts were compiled by project number and subsequently reviewed by Stinson Morrison Hecker. Each contract file was analyzed for responsive information, typically including cover page, table of contents, general project description, executed contract, significant change orders, detailed specifications and, occasionally, representative drawings.

In a separate, but related effort, and based upon our specific requests to BPU, Mr. Curt Deitz (BPU, Environmental) proceeded to search files and compile documents associated with the previously identified work orders and contracts. Mr. Deitz' document search involved the following file retention and storage areas: file room in Nearman Creek office; Mr. Dong Quach's office (as searched by Mr. Quach); file room in Nearman Engineering office; file area behind Ms. Marijane Green's Nearman work station; Quindaro file room in engineering building; Mr. Richard Montemayer's old files in Mr. Aaron Mabon's office; Mr. Jim Peterson's old files in Quindaro's maintenance office; Environmental Service's archived and active files; Kaw mezzanine file room; Kaw "back" file room (Mr. John Frick's old office); files on Kaw second floor outside Mr. Darrell Dorsey's Kaw office; file drawers outside Kaw "back" file room; and file boxes marked "Meinder's Old Files from Demineralizer Room" at the Quindaro engineering room.

After all project-related documents were gathered, Mr. Deitz consolidated them in one location and organized them into 73 specific project files. At that point, Stinson Morrison Hecker attorneys reviewed each project file by selecting specific documents, and sections of documents, that were responsive to a typical Section 114(a) Request. All of the selected documents were copied and used as the basis for this Liability Analysis.

IV. METHODOLOGY AND ANALYSIS

We subjected each of the 73 projects to a liability analysis of whether BPU should have performed NSR prior to beginning the project. The results of the analyses are shown on Exhibit A, which characterizes each project as "Probably Defensible", "Questionable", or "Probably Not Defensible" in the face of an alleged NSR violation. In addition, each project is entered into the Exhibit A grid to identify the plant at which the project was performed.⁷ Finally, each project is described in the tables in Exhibit B.

⁷ Where work done under a work order/contract was at more than one BPU plant we attempted to discern the plant to which most work as directed and then identify the project with that plant on the grid.

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Obviously, the liability characterization of the projects is somewhat subjective and imprecise. This is unavoidable given the uncertain and evolving law of NSR. The evolving and uncertain nature of the law of NSR will be apparent from the discussion below of the criteria and methodology used for categorizing the projects. Each of the projects was evaluated against the following criteria:

1. Whether BPU conducted NSR for the project.
2. Whether the project is routine maintenance, repair or replacement.
3. Whether the project is a pollution control project.
4. Whether there is a causal link between the project and flue gas emissions.
5. Whether the project should be aggregated with other projects for NSR purposes.

In applying these criteria to the various projects we have used a conservative construction of the criteria, i.e., we have generally construed the criteria according to the opinion in *Wisconsin Electric Power Co. v. Reilly*, 893 F.2d 901 (7th Cir. 1990) (*WEPCo.*) as refined and interpreted by the Court in *U.S. v. Ohio Edison Co.*, 276 F.Supp.2d 829 (S.D. Ohio 2003) (*Ohio Edison*). We will discuss alternative constructions of these criteria where useful in understanding this liability analysis.

A. Whether BPU Conducted An NSR For The Project.

We are informed that BPU did not conduct NSR for any of the projects. As a result, BPU will be foreclosed from arguing that a particular project is not a "major modification" solely on the basis that it did not result in an emissions increase in excess of the allowable increment. See, footnote 2 *supra*. Under the *Ohio Edison* Rule, ". . . for a planned project at a major source that will effect a non-exempt physical change, the NSR/PSD regulations require a pre-construction evaluation of whether the change would result in a significant net emission increase of any pollutant subject to regulation under the Act." *Ohio Edison* at 863. (Internal quotes omitted; emphasis added). In addition to the pre-construction evaluation of the projects' effect on air emissions, the regulations require post-construction monitoring to demonstrate that allowable increments are, in fact, not exceeded. 40 C.F.R. § 51.21(b)(21)(v). Thus, failure to conduct pre-project NSR and failure to monitor post-project emissions constitutes a violation itself, unless the project is exempt, even if the project does not increase actual emissions above the allowable increment. *Ohio Edison* at 865 (" . . . even though actual data exists as to the emissions resulting from the eleven (11) projects, the law does not permit an after-the-fact analysis of the

effect of a plant modification, which otherwise was required by law to obtain a pre-construction permit.")⁸

Based on *Ohio Edison*, we conclude that, as a matter of law, none of the BPU projects is "Probably Defensible" under an argument that the project did not result in an emissions increase in excess of the allowable increment.

B. Whether The Project Is Routine Maintenance, Repair or Replacement.

Projects that are "routine maintenance, repair or replacement" (RMRR) are expressly exempted from the NSR definition of "major modification". 40 C.F.R. § 52.21(b)(2)(iii)(a). RMRR is not defined in the NSR regulations and, as a result, the scope and application of the RMRR exemption has resulted in much confusion and litigation.

Since *WEPCo*, there is general agreement that whether a project is RMRR should be determined by considering:

- The nature and extent of the project;
- The purpose of the project;
- The frequency of the project; and,
- The cost of the project.

WEPCo at 910. We will apply these criteria to the projects according to the methodology set out in *Ohio Edison*, except where noted to the contrary.

1. Nature and extent of project. We will follow the *Ohio Edison* Court in applying the "nature and extent" criteria to projects by considering whether the project involved replacement or upgrade of a major component, whether performance of the work required the unit to be shut down for weeks or months at a time, whether the project was "large", whether the project extended the life of the unit, whether the project would reduce forced outages, whether the work was performed by outside contractors, and whether the project was funded as a capital improvement. *Ohio Edison* at 858 et seq. "Yes" answers to these questions tend to reduce the likelihood that the project will be viewed as RMRR.

2. Purpose of project. We will follow the *Ohio Edison* Court in applying the "purpose of project" criterion by determining whether the project was

⁸ However, the argument that emissions did not, in fact, increase may be useful in any future settlement negotiations with EPA even though the argument does not rise to the level of a defense.

intended to extend the life of the unit. *Ohio Edison* at 860. If so, the project is less likely to be RMRR.

3. **Frequency of project.** The *Ohio Edison* Court determined that the "frequency of project" criterion could take into account similar repairs done in other plants but, in the Court's view, such evidence was not as probative as the frequency of the project at the unit at which the project was carried out. *Ohio Edison* at 861.

The Court in *U.S. v. Duke Energy Corp.*, 278 F. Supp.2d 619 (M.D.N.C. 2003) (*Duke*) disagreed with *Ohio Edison*. The *Duke* Court adopted a "routine within the industry" standard. *Duke* at 635.

Since the *WEPCo*, *Ohio Edison* and *Duke* decisions EPA now has apparently adopted yet another test for "routine". In its brief on appeal in the *Duke* case, EPA interprets the RMRR exclusion ". . . to entail an inquiry into whether the act in question is frequent in the life of the particular type of unit rather than prevalent in the industry as a whole . . ." (Emphasis added). The United States brief in *U.S. v. Duke Energy Corp.*, Case No. 04-1763 in the United States Court of Appeals for the Fourth Circuit; Brief at 53. EPA expressly states that industry practice can "inform" the analysis. Brief at 54. We will utilize this test to apply the "routineness" criterion to the projects at issue. We are using this test because it has received the imprimatur of EPA and because it falls between the *Ohio Edison* test (routine at the particular unit) and the *Duke* test (routine in the industry).

4. **Cost of project.** The final criterion for consideration in determining whether the project qualifies for the RMRR exemption is cost. We will follow the *Ohio Edison* Court in applying the "cost" criterion to projects by considering whether the project was funded as a capital improvement or funded via the maintenance budget. *Ohio Edison* at 862. In addition, we will subjectively compare the dollar cost of each project to the costs of the various projects at issue in *Ohio Edison*. The cost of projects in *Ohio Edison* ranged from about \$1 million to over \$30 million. *Ohio Edison* at 861. Thus, a project may be disqualified from the RMRR exemption partly on the basis of cost if the project was capitalized and the cost exceeded \$1 million.⁹

⁹ The RMRR exclusion from the definition of "major modification" was the subject of recent rule making by EPA, i.e., EPA's "Equipment Replacement Rule" (ERR).

On December 31, 2002 EPA published for notice and comment a cost-based proposal for providing more certainty to the RMRR exclusion from the NSR rules. 67 Fed.Reg. 80,290 (December 31, 2002). In the proposed rule, EPA established a bright-line cost-based threshold for determining whether certain equipment replacement activities should automatically qualify as RMRR or whether the activity should continue to undergo case-specific consideration. EPA's proposal defined as RMRR any identical or functionally equivalent equipment replacement if the fixed capital cost of the replacement plus the cost of any repair and maintenance activities that are part of the replacement do not exceed 20% of the replacement value of the process unit.

5. **Application of the criteria.** The *Ohio Edison* Court found that application of each of the above four criteria resulted in disqualifying the projects at issue there from the RMRR exemption. However, the *Ohio Edison* Court did not assign more importance to any of the criteria over the others nor did it provide a method of applying the criteria to a specific project. *Ohio Edison* at 858 *et. seq.* In short, there is no explicit teaching in the cases as to how to evaluate application of the four RMRR criteria to projects where application of some, but not all, criteria indicates that the project is, or is not, RMRR. Instead, the courts use a "soft" benchmark for application of the RMRR criteria by arriving at a "common sense finding." *Ohio Edison* at 852.

Although there is no hard and fast guidance from the case law, we believe a court would disqualify a project from RMRR status if application of "most" of the criteria resulted in a finding that the project was not RMRR. Thus, we will not disqualify a project from RMRR status unless application of at least three of the four criteria tend to illustrate that the project is not RMRR. If two of the four criteria tend to illustrate that the project is not RMRR we will consider the project "Questionable", if it is not otherwise exempt. Finally, we will consider a project "Questionable" if there is simply not enough information available to evaluate the project.

C. **Whether The Project Is A Pollution Control Project.**

Like RMRR, Pollution Control Projects (PCPs) are exempted from the definition of "major modification." On July 21, 1992, the EPA promulgated a final rule concerning PCPs, as part of the "WEPCo Rule", which established specific requirements for qualification as a PCP. 57 F.R. 32314. On July 1, 1994, EPA issued a guidance memorandum entitled "Pollution Control Projects and New Source Review (NSR) Applicability" (Guidance Document) to provide more specificity concerning qualification for PCP status. This memorandum was to be used by EPA and other permitting authorities to determine the approvability of PCPs until the time of EPA's future final action on a formal regulatory exclusion. On December 31, 2002, EPA promulgated a revised final rule (2002 Final Rule) concerning PCPs which specifically identified projects (i.e., "listed projects") that are presumed to: (1) be "environmentally beneficial" and (2) have a "primary purpose" of pollution reduction. The 2002 Final Rule is currently applicable to all non-SIP-approved states and to any SIP-approved states that have already incorporated the rule into their revised SIP.¹⁰

Unfortunately, EPA has withdrawn the proposed rule and is reconsidering several aspects of the rule including whether the 20% safe harbor is too high.

¹⁰ States may establish their own programs to comply with the CAA if they construct, and obtain EPA approval of, a "State Implementation Plan" (SIP).

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Kansas is a SIP-approved state, but has not revised its SIP to incorporate the 2002 Final Rule. Consequently, the federal NSR/PSD rules in effect as of July 1, 1997 (the *WEPCo* Rule) are applicable for purposes of PCP analysis in Kansas. The 2002 Final Rule (or an equivalent or more stringent regulation) must be incorporated into Kansas's SIP by March 2, 2006.

The PCP provision contained in the *WEPCo* Rule established an exclusion from the definition of "physical change or change in the method of operation," which is the first element of a "major modification" under NSR analysis. Basically, the PCP exclusion under the *WEPCo* Rule does not include projects which, in the opinion of the Administrator, "render the unit less environmentally beneficial," or "would result in a significant net increase in representative actual annual emissions of any criteria pollutant over levels used for that source in the most recent air quality impact analysis in the area conducted for the purpose of title I, if any, and . . . the increase will cause or contribute to a violation of any national ambient air quality standard or PSD increment, or visibility limitation." 40 C.F.R. § 52.21(b)(2)(iii)(h).

In the *WEPCo* Rule, EPA defined "Pollution Control Project" as "any activity or project undertaken at an existing electric utility steam generating unit for purposes of reducing emissions from such unit," but limited to:

- (i) the installation of conventional or innovative pollution control technology, including but not limited to advanced flue gas desulfurization, sorbent injection for sulfur dioxide and nitrogen oxides controls and electrostatic precipitators; [or]
- (ii) an activity or project to accommodate switching to a fuel which is less polluting than the fuel in use prior to the activity or project,¹¹ including, but not limited to, natural gas or coal re-burning, or the co-firing of natural gas and other fuels for the purpose of controlling emissions . . .

40 C.F.R. § 52.21(b)(32).

The Preamble to the *WEPCo* Rule provides additional insight into EPA's intent and implementation strategy. "By focusing on whether a Pollution Control

¹¹ In some instances, where the emissions unit's capability would otherwise be impaired as a result of the fuel switch, this may involve certain necessary changes to the pollution generating equipment (e.g., boiler) in order to maintain the normal operating capability of the unit at the time of the project." Guidance Document, p. 10. *Note:* The 2002 Final Rule specifically lists certain types of fuel switch projects that qualify as PCPs, including "switching from high sulfur coal to low sulfur coal (maximum 1.2 percent sulfur content)." 40 C.F.R. § 52.21(b)(32)(e).

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Project is a physical or operational change within the meaning of the NSR regulations, the [WEPCo Rule] avoids the need to take a quantitative emissions increase calculation in every case, as would be necessary if such projects were deemed to be physical or operational changes. The EPA expects that most, if not all, Pollution Control Projects will reduce net actual emissions." Preamble, WEPCo Rule, 57 F.R. 32319.

Although the definition of PCP relates to an activity or project undertaken "for purposes of reducing emissions," the rule, per se, does not expressly require that it be a primary purpose or function of the project. However, both the Preamble to the WEPCo Rule and the EPA Guidance Document contain interpretations of that provision as requiring the reduction of air pollutants to be a "primary function" or primary purpose of the project.¹²

Despite EPA's stated intent in both the WEPCo Rule Preamble and the Guidance Document, past EPA rules (e.g., the NSPS provisions defining "modification") have expressly used and incorporated the phrase "primary function" as follows: "The addition or use of any system or device whose primary function is the reduction of air pollutants, except when an emissions control system is removed or replaced by a system which the Administrator determines to be less environmentally beneficial", 40 C.F.R. § 60.14(e)(5). (Emphasis added). Thus, EPA could have expressly provided in the PCP exclusion a requirement that the reduction of air pollutants must be a primary function, not just an ancillary function, purpose, or result of the project.

The Guidance Document indicates a concern about the PCP exclusion becoming too expansive and therefore issues guidance regarding the intent to limit the exclusion to certain types of projects that will, in fact, lower annual emissions at a source. The Guidance Document indicates that "permitting authorities should not exclude as PCPs any pollution prevention project that can be reasonably expected to result in an increase in the utilization of the affected emissions unit(s). For example, projects which significantly increase capacity, decrease production costs, or improve marketability can be expected to affect utilization patterns . . . [these types of projects] should not be excluded as PCPs under this guidance." Guidance Document, pp. 11 and 12.

¹² "EPA is today adopting revisions to its PSD and non-attainment regulations for the addition, replacement or use at an existing electric utility steam generating unit of any system or device whose primary function is the reduction of air pollutants (including the switching to a less-polluting fuel where the primary purpose of the switch is the reduction of air pollutants)." Preamble, WEPCo Rule, 57 F.R. 32320 (Emphasis added). The pollution control project exclusion "only applies to physical or operational changes whose primary function is the reduction of air pollutants subject to regulation under the Act at existing major sources." Guidance Document, p. 2 (Emphasis added).

In contrast to the foregoing EPA interpretations, the Preamble to the 2002 Final Rule states that: "The 'primary purpose' test was proposed as an initial screening mechanism for reviewing authorities to screen out inappropriate projects and to streamline the approval process." Preamble, 202 Final Rule, 67 F.R. 80232, 80238. However, EPA purposely omitted the "primary purpose" requirement from the 2002 Final Rule because EPA found it to be "unnecessarily restrictive." *Id.* Furthermore, EPA's "primary objective in allowing for PCP exclusion is to offer NSR relief for those projects that create a net environmental benefit," therefore "a source's motivation for undertaking its project" becomes a secondary consideration. *Id.* Finally, EPA agreed that the "primary purpose" test would force administrative agencies to unnecessarily "devote scarce resources to making these decisions." *Id.* The end result of this rationale is that the "primary purpose" test has been eliminated from the NSR/PSD PCP exclusion provisions and "even if a project's primary purpose is not to reduce emissions, it can still qualify for the PCP exclusion if it meets the 'environmentally beneficial' and air quality tests." *Id.*

We will consider a project "Probably Defensible" as a PCP if its effect is to reduce emissions without regard to the primary purpose of the project or if the project was necessary to accommodate a switch to Powder River Basin coal.

D. Whether There Is A Causal Link Between The Project and Flue Gas Emissions.

EPA's commentary to the *WEPCo* Rule states ". . . NSR will not apply unless EPA finds there is a causal link between the proposed change and any post-change increase in emissions." 57 F.R. 32314; (Emphasis added). Thus, if our analysis discloses there is no "causal link" between a project and flue gas emissions we will consider that project "Probably Defensible".

E. Whether The Project Should Be Aggregated With Other Projects For NSR Purposes.

"Aggregation" refers to the practice of combining two or more ostensibly separate projects for NSR purposes. There are no statutes or regulations setting rules for aggregating projects and the cases are silent on this issue. However, synthesizing a series of letters between Honda (the automobile company), Ohio EPA and EPA, circa 1996, results in the following EPA interpretation of "aggregation": A project will be aggregated with other projects for NSR purposes if: (1) the project increases emissions; (2) the project occurs within one year of the other projects; (3) the project occurs at the same facility as the other projects; and (4) the project was in the mind of management when the other projects occurred. We will use these factors to aggregate projects.

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V. RESULTS

Our liability analysis of the projects is displayed on attached Exhibit A. The presence of a single "Questionable" or "Probably Not Defensible" project puts BPU at risk for an NSR enforcement action by EPA, Kansas or a citizens' group which might affect the unit on which the project was performed, resulting in demands that the unit be retrofitted with BACT and that BPU pay penalties consistent with prior settlements.¹³

Very truly yours,

STINSON MORRISON HECKER LLP



Stanley A. Reigel

SAR:rock

¹³ Penalties for settling utility violations of NSR have been averaging about \$1,000 per coal-fired MW.

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Exhibit A
November 15, 2004
Letter to Mr. Marc Conklin, Esq.

	PROBABLY DEFENSIBLE	QUESTIONABLE	PROBABLY NOT DEFENSIBLE
KAW	5, 6, 15, 22, 30, 40, 70	7, 8, 9, 32, 39, 51	4, 20, 23, 58
QUINDARO	10, 13, 14, 17, 21, 26, 27, 28, 29, 33, 36, 46, 53, 54, 55, 57, 64, 65, 67, 71, 73	11, 12, 16, 44, 45, 56, 66	24, 25, 34, 41, 42, 72
NEARMAN	3, 18, 19, 31, 37, 38, 43, 47, 48, 49, 60, 68, 69	52, 59	35, 50, 61, 62, 63

Exhibit B
November 16, 2004
Letter to Mr. Marc Conklin, Esq.
Board of Public Utilities
Clean Air Act Work Order Review

	Bates Number	Work Order No.	Contract No.	Approval Date	Project Name	Project Description	Total Costs	§114(a) Reference	Liability
1	EPA-0000008	50-0-12328	Westinghouse Note: Projects 1 & 2 both are under Contract 260	12/8/1980	Kaw Power Station - Generator Rotor Modernization Program Unit K-2	Modernize the turbine for the Kaw Unit 2 generator by rewinding the generator rotor.	\$519,430 bid \$538,981 work order	2.h	Non-responsive
2	EPA-0000010	50-0-12333	260 Westinghouse	12/23/1980	Kaw Power Station Generator Rotor Modernization Program, Unit K-1	Rewind the generator rotor on Unit K1. See Project 1 files	\$519,430 bid \$425,000 work order	2.h	Non-responsive
3	EPA-0000015	50-1-12339	277 - \$122,787 Babcock & Wilcox, overhaul of N-1 generator 291 - \$139,170 Croole Overhaul N-1 Turbine	1/14/1981	Overhaul of N-1 Generator - Contract 277 Nearman Plant Turbine Repair Overhaul - Contract 291	Repairs and replacement due to turbine bearing failure. Complete 4-21-83.	\$500,000 on a cost accumulation basis, less \$25,000 insurance deduction	2.h	Probably defensible
4	EPA-0000038	50-5-06-001 (replacing 50-4-13163)	298-305	8/15/1985	Kaw Power Station Fabrication of Two Cyclone Furnace Units - K-3 Cyclone, Contract 298, Installation of Two Cyclone Furnace Units, K-3, Contract 305	Fabrication of two cyclone furnace K-3 units, Contract 298 Replacement (K-3) of the two K-3 boiler cyclones and headers, throat tubes and air ducts to improve availability of the unit. Install 3 cyclone furnace units. Outage required	\$1,162,920 actual	2.a and/or 2.f	Probably NOT defensible