BEFORE THE ILLINOIS POLLUTION CONTROL BOARD

IN THE MATTER OF:	)	
	)	
PROPOSED NEW CAIR SO_2, CAIR NOx	)	
ANNUAL TRADING PROGRAMS,	)	**R06-26**
35 ILL.ADM.CODE 225,	)	**(Rulemaking – Air)**
CONTROL OF EMISSIONS FROM LARGE	)	
COMBUSTION SOURCES,	)	
SUBPARTS A, C, D, AND E	)	

NOTICE OF FILING

To:

Dorothy Gunn, Clerk
Illinois Pollution Control Board
James R. Thompson Center
Suite 11-500
100 West Randolph
Chicago, Illinois 60601

Persons included on the
ATTACHED SERVICE LIST

PLEASE TAKE NOTICE that we have today filed with the Office of the Clerk of the Pollution Control Board **POST-HEARING COMMENTS OF DYNEGY MIDWEST GENERATION, INC., AND SOUTHERN ILLINOIS POWER COOPERATIVE**, copies of which are herewith served upon you.

Kathleen C. Bassi

Dated: January 5, 2007

Sheldon A. Zabel
Kathleen C. Bassi
Stephen J. Bonebrake
SCHIFF HARDIN, LLP
6600 Sears Tower
233 South Wacker Drive
Chicago, Illinois 60606
312-258-5500

BEFORE THE ILLINOIS POLLUTION CONTROL BOARD

IN THE MATTER OF:	)	
	)	
PROPOSED NEW CAIR SO_2, CAIR NOx	)	
ANNUAL TRADING PROGRAMS,	)	**R06-26**
35 ILL.ADM.CODE 225,	)	**(Rulemaking – Air)**
CONTROL OF EMISSIONS FROM LARGE	)	
COMBUSTION SOURCES,	)	
SUBPARTS A, C, D, AND E.	)	

POST-HEARING COMMENTS
OF DYNEGY MIDWEST GENERATION, INC.,
AND SOUTHERN ILLINOIS POWER COOPERATIVE

NOW COME Participants, DYNEGY MIDWEST GENERATION, INC., and SOUTHERN ILLINOIS POWER COOPERATIVE (collectively "the Companies"), by and through their attorneys, SCHIFF HARDIN LLP, pursuant to the Hearing Officer's December 20, 2006, Order that post-hearing comments in the above-captioned matter are due by January 5, 2007, and to 35 Ill.Adm.Code § 102.108, and offer the following post-hearing comments:

I. INTRODUCTION

The Illinois Environmental Protection Agency ("Agency" or "Illinois EPA") invited the Companies and other affected entities and interested parties to attend meetings at which the Agency provided information regarding its development of the rule proposed in this Docket, as well as the mercury rule (Docket R06-25). At the outreach meetings, the Agency provided information regarding its proposal to comply with the federal Clean Air Interstate Rule ("CAIR") and established a structure where participants were to email questions to the Agency that the Agency would answer during the next weekly outreach meeting. Initially, the Agency provided concepts, and these concepts were ultimately converted to regulatory language. The concepts

presented by the Agency on January 24, 2006, have not changed in any substantive way to this date despite industry arguments concerning the size of the Clean Air Set-Aside ("CASA") and an allocation methodology based upon only a two-year look-back and gross electrical output. The only concession has been to allow the conversion of heat input to gross electrical output for the first several years of the program.

The Companies have consistently expressed their position that a set-aside of 25% for the CASA is not justifiable. The Agency's apparent view is that "big ticket" pollution control projects should and would be incentivized by the CASA. Any incentive should be directed at the environmental benefit that results, not merely at the cost of the project. The Companies have also expressed deep concerns about the two-year look-back and the demonstrated inability of the Agency to consistently and timely submit allocations to the U.S. Environmental Protection Agency ("USEPA"). With the lack of "levelizing" of a two-year look-back, failure on the part of the Agency to timely submit allocations could be devastating to the Companies. In addition, the Companies generally prefer that allocations be based upon heat input rather than gross electrical output as proposed by the Agency. Finally, the Companies do not support any change to the proposed reliance on fuel weighting as included in the rule.

II. CASA

The Agency argues that as a matter of public policy, the CASA is necessary to encourage projects that would benefit air quality and to support the Governor's various energy plans. The benefits to air quality would be incentivized by the CASA by two means: (1) rewarding the generators for taking steps to control emissions in various ways and (2) encouraging the development of "green" projects. The Agency never explains why it chose 25% of the total cap

for the size of the CASA, and the size of the CASA has been a matter of disagreement from the first stakeholder meeting last January.

Absent retirement of unused CASA allowances that "may" occur far into the future, the Agency did not demonstrate how the CASA will result in improvements to air quality in Illinois. The Agency repeated throughout its oral testimony, contrary, at the least, to the implications of its written testimony and to the documents submitted to the Board with the initial proposal on May 30, 2006, that the CASA would not reduce the overall emissions cap, either in Illinois or regionally. In fact, modeling by the Agency's consultant, ICF, indicated that emissions of nitrogen oxides ("NOx") in Illinois would not be reduced with a 25% CASA even if all of the 25% were retired. Springfield Transcript ("S Tr.") October 10, 2006, a.m., p. 20; Technical Support Document ("TSD"), pp. 67-68; ICF, *Analysis of Illinois NOx Budget Reductions* (March 25, 2006), Agency's Documents Relied Upon # 33 ("ICF Report"), p. 3. Therefore, the proposed CASA has only the potential to merely displace the location of the emissions.

A. Use of Unused, Accrued CASA Allowances for Clean Air Act Demonstrations

At least one of the Agency's purposes for proposing a 25% CASA has changed since January 2006 when it first announced that it would seek such a large set-aside. In January and throughout the stakeholder meetings, the Agency contended that the large set-aside was necessary for attainment and that the Agency would retire unused, accrued allowances from the collective set-aside pools. When challenged as to the means for claiming such credit, the Agency evaded answering and finally merely stated that there is guidance. That guidance was included in the Agency's initial regulatory submittal, which continued the theme that the unused, accrued set-aside allowances were necessary for purposes of attaining and maintaining the national ambient air quality standards ("NAAQS"). *See* Statement of Reasons, Ex. F. However,

by the time of hearing, the Agency appeared to have backed off the position it held from the stakeholder meetings through submittal of the initial regulatory proposal: at the Springfield hearing, the Agency acknowledged that it could not quantify the number of allowances that would be available for retirement and that such retirements could not occur until after the attainment date. Therefore, such retirements are not usable in the attainment demonstration. The Agency reinforced the statement that emissions represented by the CASA allowances would remain in the regional pool at the Chicago hearing. *C.f.*, Chicago Transcript ("C Tr."), November 29, 2006, pp. 31-32. The same frailties that attach to reliance on the unused, accrued set-aside allowances for purposes of demonstrating attainment also apply to reliance on these allowances in a maintenance plan: they cannot be quantified and their number is not permanent.

As Exhibit F to the Statement of Reasons in the Agency's initial regulatory submittal sets forth, for emissions reductions to be creditable for purposes of meeting various federal demonstration requirements, such as demonstrations of attainment, demonstrations of Reasonable Further Progress (RFP), or maintenance plan demonstrations, the reductions must be quantifiable, permanent, surplus, and federally enforceable. Statement of Reasons, Ex. F, pp. 4-7. The retirement of unused, accrued set-aside allowances would be federally enforceable. Whether they are surplus is perhaps arguable, if Illinois EGUs not allocated those allowances must replace them with purchases in the marketplace. While the retirement of a given allowance, identified by its serial number, is permanent, the Agency cannot guarantee into the future the number of allowances that would be retired under the regulatory scheme currently before the Board. Rather, the Agency provides in the proposed rule that it <u>may</u> retire the unused, accrued allowances. § 225.475(b)(5). Therefore, the Agency cannot say that there is a permanent number of allowances that would be retired into the future. Moreover, the Agency

was unable or unwilling to describe the process it would follow when making such decisions, including whether that process would be public. October 11, 2006, p.m., pp. 38-40. Finally, part and parcel with the lack of a permanent number of allowances that can be identified to be retired into the future, the reductions are not quantifiable. Because the allowances are those that are unused and accrued from the CASA and because the CASA depends, on an annual basis, upon applications from project sponsors, the Agency cannot predict with certainty how many allowances will be used from year to year and the rate at which unused allowances will accrue and thereby be eligible for retirement.

The Agency's next air quality argument for such a large set-aside is that the-more-NOx-reduced-the-better principle should apply. This phrase first gained widespread popularity as a reason for reducing NOx on a regional basis during development of the NOx SIP call[1] and was coined by the modelers at the Lake Michigan Air Directors Consortium (LADCO), who had a leading role in that process. However, the Agency has not demonstrated that several aspects of this approach are applicable. First, Robert Kaleel explained the concept of the NOx disbenefit, where reductions of NOx result in an increase in ozone in the vicinity of the reductions. S Tr., October 10, 2006, p. 97. Where the reductions are large enough, such as significant reductions from a coal-fired power plant, the NOx disbenefit can impact ozone levels in a nonattainment area, if the power plants are located in a nonattainment area. In recognition of this phenomenon, Congress included Section 182(f) in the 1990 Clean Air Act Amendments, and Illinois obtained a waiver from NOx requirements under that section relative to the 1-hour ozone standard. 61 Fed.Reg. 2428 (January 26, 1996). Mr. Kaleel noted that Illinois' NOx waiver was rescinded

[1] USEPA's requirement that states it found significantly contributed to downwind 1-hour ozone nonattainment revise their state implementation plans ("SIPs") to comply with a cap on NOx emissions. 63 Fed.Reg. 57355 (October 27, 1998).

with the rescission of the 1-hour ozone standard and implied that Illinois has not sought a waiver from ozone NOx requirements pursuant to Section 182(f) relative to the 8-hour standard. S Tr., October 10, 2006, a.m., pp. 96-98. However, the Agency did not provide any discussion or explication of the air quality effects of reducing NOx in the nonattainment areas in this proceeding. The Agency claimed in the TSD and Mr. Kaleel's testimony that various additional reductions of NOx are necessary in order for the state to demonstrate attainment of the ozone and PM2.5 NAAQS but provided no elucidation of those claims. TSD, pp. 35-50; S Tr., October 10, 2006, a.m., p. 20; Agency Ex.4, pp. 6-7.

Mr. Kaleel also revealed that preliminary monitoring data indicate that the Chicago area has attained the 8-hour ozone standard. S Tr., October 10, 2006, p.m., p. 33. He gave no indication or reason to believe that the preliminary data is likely to substantially change through quality assurance/quality control procedures. This calls into question Table 3-5 in the TSD and Mr. Kaleel's testimony. Air quality data and modeling data are apparently not matching. Further, requesting redesignation of those areas that have attained the 8-hour ozone standard removes a fair number of statutory requirements that the Agency must contend with, thus reducing the amount of administrative detail with which the Agency must deal. Also, relevant for this rulemaking, attainment of the 8-hour ozone standard in Chicago was achieved without the implementation of any part of the CAIR. This calls into serious question the need for a 25% CASA for air quality purposes relative to ozone.

B. Comprehensive Approach to Clean Air Act Requirements

Another recurrent theme in the Agency's submittal is that reductions are needed for numerous requirements: PM2.5 attainments, ozone attainment, haze, the new PM2.5 standard, BART, RACT, and on and on. Yet the Agency's analysis of the CASA, as discussed above,

demonstrates that the CASA will not decrease NOx emissions in Illinois. Further, the Agency presented no comprehensive plan, either in this proceeding or otherwise, that illustrated an organized, developed approach to the myriad of federal requirements with which the Agency must comply. Industry is not obstructionist in opposing the Agency's approach and recognizes that there may be a need for some level of reduction of NOx and sulfur dioxide ("SO_2") and is quite willing to make it. However, industry cannot support the *ad hoc*, willy-nilly approach – or lack of comprehensive, organized approach – that the Agency has put forth so far. This approach has forced individual companies, including the operators all of the EGUs subject to this proposed rule except City Water Light & Power to enter into negotiations with the Agency on an individual basis, sometimes successfully and sometimes not, resulting in the inconsistent hodge podge of regulation that Part 225 is or will become. These companies find this necessary in order to protect their future interests and to gain as great a level of certainty as they can regarding future regulation for their business purposes.

If the Agency claims that the proposed rule plays a role in the attainment demonstrations that must be submitted to USEPA, it must explain exactly the role that the proposal will play in the overall plan for the attainment demonstrations, particularly when asked about it. The Agency has failed to do so. It included tables in the TSD and Mr. Kaleel's testimony (TSD p. 39; S Tr., October 10, 2006, p.m., pp. 57-59) indicating the percentage reduction of local (*i.e.*, within the nonattainment area) emissions of volatile organic compounds ("VOC"), regional (*i.e.*, outside the nonattainment area and within the larger geographic region included in the CAIR) NOx, and regional SO_2 necessary for Illinois to demonstrate attainment through modeling but could not point to which part this rulemaking plays in the entire plan for demonstrating attainment. Moreover, the Agency did not provide information regarding the amount of local NOx reduction

necessary for attainment. While the entire scheme is not the scope of this rulemaking and may not even be within the purview of the Board, the Board and public are, nevertheless, entitled to know what piece of the scheme this is, particularly when the proposed rule deviates so significantly from the federal requirement, which addresses these same overarching air quality concerns. That is, USEPA promulgated the federal CAIR to address the regional aspects of PM2.5 attainment, ozone attainment, and haze; further USEPA has stated that states may rely on their participation in the federal CAIR trading programs to satisfy the Clean Air Act's RACT[2] and BART requirements. 70 Fed.Reg. 25161, 25260, 25300 (May 12, 2005); 70 Fed.Reg. 39103, 39137 (July 6, 2005). Inclusion of a 30% set-aside (including the New Unit Set-Aside ("NUSA")), where USEPA proposed only a 5% set-aside, reduced to 3% in 2015, magnifies the need for the Agency to explain how the proposal fits into its overall plan for meeting the numerous requirements of the Clean Air Act, particularly when the implication is that this same industrial sector, the coal-fired power plants, will be the source of future reduction requirements if they become necessary. With no demonstrated air quality benefit deriving from the 25% CASA, it is incumbent upon the Agency to explain in detail how this all works.

The Agency has a duty to explain what is necessary and how the proposed rule satisfies some of the air quality needs and, most particularly, how a 25% CASA accomplishes satisfaction of those needs – when any reductions accomplished by the set-aside are not certain and when the emissions represented by the CASA remain in the regional pool of allowances and when the Agency's own consultant found that the CASA would not result in NOx reductions in Illinois.

[2] Please note that USEPA has granted a petition for reconsideration and will reconsider whether CAIR satisfies RACT. 71 Fed.Reg. 75902 (December 19, 2006).

C. Lack of Identified Projects

The Agency was not able to identify projects that justify the size of the set-aside. The Agency's Ross Cooper indicated that there are several wind generation projects in Illinois, which industry acknowledges. Mr. Charles Kubert, witness at the Chicago hearing for the Environmental Law and Policy Center, could not state that there are sufficient EE/RE projects to use up anywhere near the 9,150 allowances that comprise this sector of the CASA. C Tr., November 29, 2006, p. 192. The megawatts that wind power, landfill gas, biomass, and solar photovoltaics will generate are very small – Mr. Kubert stated that there are only about 2,000 MW under development – certainly not equal to 25% of Illinois' budget. C Tr., November 29, 2006, p. 192. Thus, the number of expected EE/RE projects, and resulting allowances, is quite small and does not justify the proposed enormous 25% set-aside

The Agency identified a number of new coal-fired projects either permitted or under review that could obtain allowances from both the NUSA and the CASA. The Agency also recognized that Ameren, through opting in to the Multi-Pollutant Standards ("MPS") adopted in the R06-25 mercury rulemaking, would be eligible for early adopter CASA allowances. As proposed, Southern Illinois Power Cooperative ("SIPC") would be eligible for a small number of CASA allowances under the clean technology category, and the Taylorville Energy Center, if that project proceeds, will be eligible for a number of allowances from that same category plus from the NUSA.

Not only is there no evidence of EE/RE projects that would justify anything approaching a 25% CASA, through the "tipping" provisions of the CASA, ultimately, a significant portion of the CASA allowances could go to Ameren. It boils down to the five other power generators in Illinois subject to this rule subsidizing Ameren's reductions, largely in SO_2, under the MPS

through the CASA. We note that Ameren's base rate for SO_2 was significantly higher than the other Illinois generators because Ameren chose to purchase SO_2 allowances under the Acid Rain Program (42 U.S.C. §§ 7651-7651*o*) rather than to install add-on control equipment or to switch to low-sulfur coal. We also note that Ameren, after making all those SO_2 reductions, would arrive at an SO_2 rate that is still the highest in the state. We find it extremely inequitable that the five other power generation companies in the state should be expected to subsidize Ameren through the CASA when the other companies had reduced SO_2 emissions, thus benefiting the environment, for many years prior to implementation of the MPS.

So, it appears that while many CASA allowances will be allocated and will not be available for retirement, many of the allocated CASA allowances will be issued to Ameren to accomplish, by 2012, what the other companies had accomplished many years earlier – in the case of Midwest Generation, by 1980, and in the case of Dynegy, in stages from 1999-2005. SIPC, of course, already has a scrubber on its Unit 4 and its circulating fluidized bed boiler ("CFB") is designed to control sulfur emissions.

D. Effect of 25% Set-Aside on Economic Analysis of the Proposed Rule

Setting aside 25% of Illinois' cap is the equivalent of providing no allowances to approximately a 4,250 MW EGU. This is equivalent to not allocating allowances to the entirety of Dynegy's system plus City Water Light & Power plus SIPC – with 102 MW still not accounted for. *See* Midwest Generation ("MWG") Ex. 1. This is significant.

James Ross testified on behalf of the Agency that the proposed rule is highly cost effective as defined by USEPA, even with the 25% CASA. S Tr., October 10, 2006, a.m., p. 58. However, Mr. Ross could not say whether the revenues associated with allowance trading, part of what makes the federal CAIR highly cost effective, that are lost by the companies because of

the 25% set-aside were considered in the IPM analysis. Apparently, the Agency's logic is that the cap is not affected by the 25% CASA and the CASA allowances remain in the regional pool to be purchased by Illinois EGUs[3] that are not allocated a number of allowances sufficient to cover their emissions, and so the rule remains within the scope of USEPA's determination of highly cost effective. Mr. Ross stated that the CASA is available to offset the costs associated with installing pollution control equipment to comply with the CAIR. However, this is circular reasoning. If EGUs must purchase allowances that USEPA intended be allocated to them without cost, then the Illinois rule is significantly different from USEPA's assumptions in its highly cost effective analysis and significantly more costly than for EGUs in states with set-asides the same as or at least closer to the 5% NUSA in the model rule. Indeed, ICF predicted additional allowance purchase costs of more than $25 million per year as a result of the proposed CASA, a cost not included in USEPA's analyses. ICF Report, pp. 4-5.

Had USEPA believed that the cap for Illinois should be 25% less, then it would have made the cap 25% smaller. USEPA's highly cost effective analysis was based upon an annual cap of 76,230 tons and a seasonal cap of 30,701 tons of NOx.[4] USEPA's assumption was that 95% of the cap would be allocated without cost to affected EGUs,[5] with unused allowances to be returned to the EGUs from whom they were set-aside. USEPA's analysis did not assume a CASA of any size. The proposed rule departs from these assumptions of what is highly cost effective significantly – by 25%.

---

[3] Which clearly admits that the set-aside will not contribute towards attainment.

[4] These numbers reflect the Phase I caps. The Phase II caps are 63,525 and 28,981 tons, respectively.

[5] The remaining 5% was to be allocated to the NUSA, reduced to 3% in 2012.

The Agency argues that USEPA granted flexibility to states with respect to inclusion of a set-aside for EE/RE projects. USEPA does not suggest anywhere in the Preamble to the CAIR that there should be an additional set-aside for early adopters, clean coal technology, and so forth. In fact, USEPA added the Compliance Supplement Pool ("CSP") to the annual NOx program for the purpose of encouraging early reductions and to help EGUs that could not comply without threatening the integrity of the grid. The Agency proposes to first retire the CSP of 11,299 allowances allocated to Illinois and to twist USEPA's intent to encourage early reductions by then taking away an additional 19,058 allowances from the general pool annually and redistributing a portion of them to early adopters, touting this as an incentive. To call the Agency's machinations an incentive is stretching the concept to the extreme. This is exhibiting pretzel-like flexibility, very bent but rigid.

E. Extremely Large Proposed CASA Neither Mandated Nor Supported by the Governor's Sustainable Energy Plan (February 2005) and Governor's Energy Plan (August 2006)

The Agency relied upon the Governor's Sustainable Energy Plan to justify the size of the EE/RE portion of the CASA. However, the Agency's witness presenting and supporting that reliance was unable to answer questions about the Sustainable Energy Plan, and some of the questions still have not been answered, such as whether the Agency is a member of the Illinois Sustainable Energy Advisory Council, how the Council is to function, whether the Council's findings or decisions are enforceable and if so how, and who is responsible for actually ensuring that the requisite percentage of power generated in Illinois is renewable – the power generators or the distributors of power in Illinois. In the Agency's Post-Hearing Comments, filed October 27, 2006, the Agency states that it is still researching this issue. Agency's Post-Hearing Comments (October 27, 2006), p. 8. The Companies assert that, based upon the language in the

Governor's Sustainable Energy Plan (Statement of Reasons, Ex. G), the responsibility for ensuring that the requisite percentage of power utilized in Illinois lies with the distributors of power. The distributors of power are the only persons who can control where their power comes from. The EGUs, on the other hand, are not distributors (with the possible exception of Ameren) and have no way of knowing what level of renewable energy is being used in Illinois and, moreover, have no control over usage of renewable energy in Illinois. They must sell their power pursuant to contracts or spot bids or as their independent power dispatcher dispatches the power.

At the second hearing, we learned from Mr. Kubert that the Governor has yet another plan, the Governor's Energy Plan. He advocated increasing the size of the CASA to accommodate that new plan. Through its cross-examination of Mr. Kubert, the Agency established that it does not bear responsibility for developing the program to implement that plan and that there are no regulations or other mandates with respect to that plan. C Tr., November 29, 2006, pp. 191-192. The Companies agree. The Companies believe that it would be more appropriate to eliminate the CASA for that very reason. The Agency's logic expressed through its cross-examination of Mr. Kubert applies to the EE/RE portion of the CASA to the extent that the Agency has relied on the Governor's energy plans as justification for the set-aside.

F. Disparate Treatment of EGUs Subject to Consent Decrees

In carving out reductions not eligible for CASA allowances, the Agency included EGUs subject to consent decrees entered into on or before May 30, 2006. The clear purpose of this carve-out was to exclude Dynegy from participation in the CASA for reductions it will achieve pursuant to its consent decree with USEPA, which just happened to become effective approximately a year before the Illinois CAIR proposal was filed. The Agency's rationale is that

a consent decree is the result of an enforcement action and assumes that there has been some wrong-doing on the part of the defendant and that such activity should not be rewarded through the CASA. S Tr., October 12, 2006, pp. 50-51. Inconsistent with this view, however, the Agency allows for projects required by consent decrees entered into subsequent to May 30, 2006, to be eligible for CASA allowances, reasoning that if the parties to the consent decree do not want the projects to be eligible for CASA allowances, such exclusion should be explicitly included in the consent decree. S Tr., October 12, 2006, pp. 58-59.

The Companies disagree with the Agency's rationale for excluding EGUs that entered into consent decrees prior to May 30, 2006. Part of the Agency's rationale for excluding pre-May 30, 2006 consent decrees is that a consent decree is somehow not voluntary. S. Tr., October 12, 2006, pp. 50-51. This is flatly incorrect, and the Agency concludes as much by its proposed disparate treatment.

First, no source is compelled to enter into a consent decree, and quite often, perhaps even more often than not, a consent decree contains no admission of liability or guilt. This is true for consent decrees involving the Agency as well. Entry into a consent decree does not conclude or presuppose an adjudication of liability or guilt. Entry into a consent decree is a totally voluntary action, quite often driven by financial considerations. Defending enforcement suits is expensive. It is no secret that prosecuting authorities often propose penalties that are slightly less than the costs of pursuing a defense in order to "encourage" or "force" settlement. In other words, one cannot defend against an enforcement suit, regardless of the defendant's guilt or innocence, for the cost to avoid the suit by settling. Therefore, entry into the consent decree is a business decision and not in any way an involuntary act. Likewise, the projects that may be included in a

consent decree, while enforceable after the consent decree is entered, are negotiated and voluntary up until entry of the consent decree.

Second, this transparent rationale is shown to be exactly what it is – pretext – by the fact that future consent decrees are eligible for allowances unless the consent decree specifically excludes such eligibility. If the "compulsion" rationale truly applied to consent decrees, it would apply equally to all decrees, regardless of the date they happen to become effective. Certainly if, as the Board has ruled, electing to comply with the MPS in the mercury rule, with the resulting imposition of SO_2 and NOx emissions limits and allowance surrenders, is voluntary, then entering into a consent decree is at least equally voluntary.

G. Review of CASA Allowance Allocations

The Agency testified, through David Bloomberg, that it has provided for no Board review of the Agency's decisions regarding the allocation of allowances from the CASA. S Tr., October 11, 2006, p.m., pp. 31-31, 36. The Companies note that while the regulations do not provide for Board review of the Agency's final decisions regarding CASA allocations, the Environmental Protection Act ("Act") provides for the review of permits issued by the Agency. 415 ILCS 5/40 and 40.2. Section 225.410(d)(8) says that every allocation or transfer of an allowance to a NOx compliance account is an automatic revision to the account holder's permit. The Agency's response to questions about appeal raise several issues.

First, the authority to appeal an agency's final decision or final action does not rest with the Illinois EPA to grant or deny through regulations. Only the General Assembly has the authority to do that. So the presence or absence of a provision for appeal of the Agency's decisions on CASA allocations is irrelevant. Second, an agency's final actions or decisions should be appealable to some authority, in this case probably the Board or possibly review in the

circuit court would even be preferable. The CAIR as proposed creates a situation where the Agency is taking final actions or making final decisions that do not all squarely fit under the appeal provisions of the Act, because the Agency has not issued permits to the universe of probable project sponsors eligible to receive CASA allocations. Arguably, then, the Administrative Procedure Act ("APA"), 5 ILCS 100/1-1 *et seq.*, applies for those project sponsors who do not have air permits and if those decisions by the Agency would be reviewed by the circuit court, possibly all comparable decisions should be. Third, for EGUs and other project sponsors who do hold permits issued by the Agency, the Companies presume that the permit appeal procedures of the Act and the Board's regulations apply to denials of applications for CASA allowances, just as those appeal procedures apply to permits issued with conditions that are not acceptable to the permittee. The proposal already provides that project sponsors who do not comply with the Subpart must return an equivalent number of allowances to the Agency. § 225.455(b). While an upheld appeal of a CASA allocation would not likely qualify as noncompliance with the Subpart, it could result in a readjustment of the distribution of CASA allowances for the given time period, which could involve the return of allowances to the Agency for redistribution. The language of Section 225.455(b) should be amended to reflect this potentiality.

H. Adding Overfire Air to the CASA

Ameren proposed to add "advanced" overfire air ("OFA") to the CASA – or delete the exclusion of OFA from the CASA. *See generally* testimony of Michael Menne and cross-examination of Steven Whitworth, C. Tr. November 29, 2006, pp. 88-89. It appears that, if the Board were to accept Ameren's proposal without certain qualifications, Ameren would again be rewarded merely for coming to par with the other generators in the state. Specifically, Mr.

Whitworth testified that only two of Ameren's Illinois units, Coffeen 1 and 2, are currently fitted with OFA. C Tr., November 29, 2006, p. 101. Mr. Whitworth acknowledged that OFA is a fairly common technology. C Tr., November 29, 2006, pp. 80-81.

Perusal of the CAAPP permits of the other power plants in Illinois will demonstrate that most of the non-Ameren units are already equipped with OFA. Moreover, the Companies believe that Mr. Whitworth underestimates the removal efficiency of OFA systems that are not "advanced." The claimed differentiation in emission reductions between existing and so-called "advanced" OFA is really no difference at all, as many OFA systems will achieve reductions in the range touted by Mr. Whitworth. Therefore, Ameren's proposal should be rejected.

Unless the regulated community as a whole would be given credit for OFA systems, regardless of the date of installation, that achieve a specified level of NOx removal (rather than by use of some type of ambiguous "advanced" OFA scheme), the Companies cannot support Ameren's requested addition to the CASA. If a previously installed OFA and a newer one achieve comparable results, the label "advanced" warrants no special treatment.

I. Annual Operation of SCRs

Dominion suggested that annual operation of SCRs installed since adoption of Part 217, Subpart W should be eligible for CASA credit. *See* Dominion Ex. 1; C Tr., November 29, 2006, pp. 13-14. If the Agency and the Board consider inclusion of Dominion's suggestion, the Companies request that the resulting CASA language should also include annual operation of previously-installed SNCRs, as well.

J. Purpose of the CASA

A purpose of the CASA is to encourage early reductions, principally obtained through construction and operation of new or upgraded pollution control devices. S Tr., October 10,

2006, a.m., pp. 116-117. However, the Agency very specifically proposes to retire the CSP established in the federal CAIR for Illinois. § 225.480. USEPA allotted 11,299 CSP allowances to Illinois for use in the annual NOx program. 70 Fed.Reg. 25161, 25320 (May 12, 2005). CSP allowances may be used for early reductions. Rather than using the CSP for early reductions, the Agency proposes to carve out "incentives" for those who reduce early from the general pool of annual NOx allowances.

Not only does the Agency propose to take away allowances from the general pool for early adopter projects, it became rather obvious, through the Agency's cross-examination of witnesses at the Chicago hearing, that a purpose of the CASA was also to subsidize the costs of installation, if not operation, of "big-ticket" (more expensive) pollution control equipment installed to achieve early reductions regardless of their efficacy as compared to less expensive controls. *C.f.*, C Tr., November 29, 2006, pp. 115-121. While the Companies do not quarrel with the Agency's decision to attempt to allow EGUs installing equipment to recoup some of the cost, the Companies do see some inconsistencies in the Agency's "policies" that favor only more expensive technologies and an apparent skewing of the direction of the allocations of the CASA. Moreover, this attempt to subsidize "big-ticket" pollution control equipment through the CASA has illogical underpinnings.

A purported purpose of the CASA is to encourage projects that will benefit the environment. S Tr., October 10, 2006, a.m., pp. 70-71. With respect to pollution control projects, the project does not have to be a "big-ticket" project in order to benefit the environment. Low NOx burners and OFA are less "big ticket" than SNCR, yet they benefit the environment without exposing the environment to ammonia slip or leaks. While the Companies do not support the inclusion of new OFA or low NOx burners in the CASA without allowances

for those who have already installed comparable levels of control, as discussed above, the Agency's reasoning that OFA should be disallowed because it isn't a "big-ticket" item is not supportable. A more supportable reason would be that low NOx burners and OFA have been installed on almost all of the EGUs in the state except those owned by Ameren, who claims to have taken OFA to a new level. If so, Ameren has had plenty of opportunity to employ that new level in Illinois as well as in Missouri. Low NOx burners and OFA should be the minimum standards of NOx control that the Agency would expect; therefore, they should not eligible for CASA allowances. Moreover, if "advanced" OFA really is better, then those installing it will have some extra allowances after installing it and that should be enough benefit for being late in controlling NOx emissions; those sources should not receive an extra bonus from the CASA.

Even more compelling, though, is the concept that if the Agency did not set aside 25% of the allowances USEPA anticipated would be allocated to EGUs, there would not be a need to find machinations to return allowances to EGUs through the CASA.

Finally, the CASA as it is currently structured subsidizes the construction of pollution control equipment by some companies at the expense of others. Perhaps the most shocking example of this is Kincaid. Dominion has improved the operation of the Kincaid facility exponentially since obtaining it from Commonwealth Edison. C Tr., November 29, 2006, pp. 12-13. Its SO_2 emission rate is far below Ameren's, and it has installed SCRs. Likewise, SIPC has installed the CFB, a clean coal technology, baghouses, a scrubber, and an SNCR. There is nothing more these EGUs should have to do to comply with the CAIR other than to operate their NOx controls year-round. Yet they are effectively penalized 25% of the allowances USEPA anticipated they would receive. Although SIPC may receive some allowances from the CASA, as it should for installing and operating a well-controlled CFB, that number of allowances does

not come close to the 25% it will lose to the CASA. For example, USEPA would allocate SIPC 1,270 allowances.[6] SIPC estimates that it will receive 1,023 base allowances under the Agency's proposed system and no allowances from the CASA, based upon 2005 operations under the language as proposed.[7] The shortfall is particularly significant to a small company such as SIPC.

K. CASA Allowances for MPS Reductions

Despite the Agency's proposal in its Motion to Amend to clarify that projects undertaken pursuant to the MPS are not included within the scope of the exclusion from CASA eligibility of "Projects required to meet emission standards or technology requirements under State or federal law or regulation" (Attachment to Motion to Amend, p. 44, § 225.460(d)(2)), it appears that the MPS requires such allowances to be surrendered to the Agency. Specifically, the MPS provides as follows:

> The owner or operator of EGUs in an MPS Group must not sell or trade to any person or otherwise exchange with or give to any person NOx allowances allocated to the EGUs in the MPS Group for vintage years 2012 and beyond that would otherwise be available for sale, trade or exchange as a result of actions taken to comply with the standards in subsection (e) of this Section. Such allowances that are not retired for compliance must be surrendered to the Agency on an annual basis, beginning in calendar year 2013.

Docket R06-25, Second Notice Order, § 225.233(f)(1) (in part), p. 113 (November 2, 2006). The proposed CASA provides that, beginning in 2009 (§ 225.470(b)), sponsors of early adopter projects may apply for CASA allowances for 10 years (§ 225.470(d)(2)), and sponsors of upgrade projects may apply for CASA allowances for 15 years.

---

[6] Notice of Data Availability, <epa.gov/airmarkets/cair/noda/allocations>.

[7] Please note that it appears that there was an error in the equation applying to CFBs in Section 225.465(b)(5)(ii). It is SIPC's understanding that the Agency will include a correction to that formula in the comments that the Agency will file on January 5, 2007.

When the provisions of the CASA are read with the provisions of the MPS, it appears that project sponsors who have NOx projects operational prior to 2012 and SO_2 projects operational prior to 2013 (*see* Docket R06-25, Second Notice Order, § 225.233(f)(1), p. 113 (November 2, 2006)), may be allocated and may bank allowances from the CASA early adopter or upgrades categories. Beginning in 2012 for NOx projects and 2013 for SO_2 projects, however, the project sponsors may apply for allowances from the CASA, but under the language quoted above from Section 225.233(f)(1) of the MPS, the project sponsors would have to surrender those allowances back to the Agency because those allowances would have been generated "as a result of actions taken to comply with the standards of subsection (e) of this Section [225.233]." Docket R06-25, Second Notice Order, § 225.233(f)(1), p. 113 (November 2, 2006). The Agency giveth, and the Agency taketh away.[8]

L. Conclusion

Because industry has not been presented with a comprehensive plan regarding the reduction requirements that are necessary from the power generation sector through the next number of years while the state attains the ozone standard in Metro-East, the PM2.5 standard, and its haze obligations, industry is very reluctant to agree that a 30% set-aside is justifiable or even beneficial to other interests the state appears to attempt to promote through creation of this set-aside. It is either a misguided attempt to support so-called green projects, or it is skewed to benefit one company. Neither is acceptable. The CASA represents 4,521 MWe (25% of 17,007 MWe). MWG Ex. 1. This is a significant amount of generation, greater than any single plant in Illinois and greater than any single entire system in Illinois other than Midwest Generation's and

[8] Presumably, the allowances that are surrendered to the Agency pursuant to the MPS will be retired. However, although the Agency stated that such allowances would be retired, a requirement that the Agency do so is not included in the language of the MPS.

Ameren's, but only if EEI is included in the Ameren system. MWG Ex. 1. At $2,500.00/allowance, this represents $47,643,750.00 value lost to the existing power generators on an annual basis plus $9,528,750.00 in allowance value for the NUSA. This is significant. Absent a comprehensive plan, the Agency must constantly chip away at emissions from the coal-fired power plants, imposing more and more control, making it very difficult to plan, and creating inconsistencies, such as the conflict inherent in the MPS allowance surrender requirement discussed above. As the Agency appears to prefer the fragmented, chipping-away approach to a consistent, comprehensive plan approach, industry cannot afford for the Agency to remove 25% of the allowances that USEPA intended be allocated to industry, for a purpose that is nebulous and without any demonstrated air quality improvement. Indeed, USEPA derived its more comprehensive approach after considering the interplay between various existing and future requirements.[9]

Moreover, the Agency has specifically omitted the CSP of 11,299 allowances, worth $28,274,500.00 at $2,500.00/allowance. This, too, is not insignificant. Since the Agency proposes to encourage early reductions, the cost of the lost CSP is actually double that, or $56,495,000.00, since the allowances necessary to provide that encouragement are taken from the general pool and then ultimately returned to the Agency through the language of the MPS.

III. ALLOCATION METHODOLOGY

There are several aspects of the allocation methodology proposed by the Agency that are troubling to the Companies.

[9] For example, Phase 1 of the CAMR relies on the CAIR. Phase 1 of the CAIR NOx program relies upon the NOx SIP call. The federal approach exemplifies a multi-pollutant strategy and is seamless in its applicability and implementation.

A. Heat Input v. Gross Electrical Output

Departing from USEPA's position in the federal CAIR and the model rule, the Agency has proposed that allowance allocations be based upon gross electrical output rather than the traditional basis of heat input. USEPA does recommend gross electrical output as the basis for allowance allocations for new units, converting the gross electrical output to heat input. *See* conversion factor, 71 Fed.Reg. 25328, 25357 (April 28, 2006). The Agency justifies the use of gross electrical output on two factors: (1) that it encompasses projects that do not have heat input and (2) that it encourages efficiency.

USEPA retained its reliance on heat input as the basis for allocations in the CAIR FIP, as well. Explaining this reliance, USEPA stated:

> EPA believes, as it stated in the final CAIR, that allocating to existing units based on a baseline of historic heat input data, rather than output data, is desirable because accurate protocols currently exist for monitoring this data and reporting it to EPA, and several years of certified data are available for most of existing units.

71 Fed.Reg. 25328, 25356 (April 28, 2006). It became clear at the hearing in Springfield that the Agency believed that gross electrical output data is already reported to USEPA and that the data reported is as reliable as heat input data. USEPA's statement in the FIP appears to contradict that belief.

The Agency initially proposed that all units install wattmeters by January 1, 2007, to measure gross electrical output, apparently not understanding the costs of the wattmeters, the costs of operation of the wattmeters, and the complexities involved with installation. At the Springfield hearing, it became apparent that what the Agency thought was a relatively simple process is not, and the Agency clarified that its intent was to capture the information currently provided to USEPA. S Tr., October 11, 2006, a.m., pp. 21-26. Subsequently, the Agency

submitted a Motion to Amend Rulemaking (November 27, 2006) in which this issue is addressed. Motion to Amend, pp. 6-7, 39, 71. The language proposed by the Agency in the Motion to Amend still includes some issues, and the Companies suggest that the language merely require whatever is submitted to USEPA under 40 CFR Parts 60 and/or 75. *See* Response to Motion to Amend, pp. 5-6.

SIPC, for reasons discussed further below, adamantly opposes reliance on gross electrical output as the basis for allowance allocations. Dynegy is in the process of installing upgraded wattmeters at all of its plants because the independent system operator, who dispatches electricity in Dynegy's region, requires them. This, however, is a multi-year process because the meters can be installed only during a planned outage. Dynegy prefers reliance on gross electrical output as the basis for allocations, but because of the great deal of historical data on heat input, because quality assurance procedures for heat input reporting are well-established, because it was the basis USEPA used for establishing the states' caps under the federal CAIR, and because the Agency has put forth no compelling reason to switch from heat input as the basis for allocations, Dynegy would find heat input as a basis for allocations acceptable.

The Agency has included a formula in its proposal at Section 225.435(a)(2) to convert heat input to gross electrical output. The efficiency assumed in the formula is not representative of actual efficiencies at the plants. This formula disadvantages the vast majority of the regulated entities to varying degrees and is particularly disadvantageous to SIPC, as discussed below. If gross electrical output can be determined from heat input through application of a formula, the reverse is true as well: heat input could be determined through application of a reverse formula to gross electrical output; USEPA has provided such a formula in the CAIR (71 Fed.Reg. 25328, 25357 (April 28, 2006)). Therefore, retaining heat input as the basis for allocations would not

discourage CASA projects with no or difficult-to-determine heat input, and it would flow more seamlessly from the existing allocation formula included in Part 217, Subpart W. That some CASA projects will not have heat input is not a valid reason for basing an allocation methodology on gross electrical output both because heat input can be determined through application of a formula and because the relative amount of gross electrical output without a heat input in Illinois is extremely small. This rationale is an example of the tip of a dog's tail wagging the entire dog.

Dr. Kunkel, testifying on behalf of Christian County Generation ("CCG"), stated that his integrated gasification/combined cycle ("IGCC") project would be greatly disadvantaged by an allocation methodology that relies upon heat input. C Tr., November 28, 2006, pp. 126-129. However, if an appropriate conversion formula were applied, or if there were a formula that CCG or Dr. Kunkel could suggest that would be more appropriate to IGCC plants, that issue is set aside. Moreover, if Illinois followed the federal example, Dr. Kunkel's problem would not even be a problem, because, as a new source, CCG would be allocated allowances based upon gross electrical output pursuant to USEPA's formula.

With respect to encouraging efficiency, the Companies note that not all boiler types that are considered environmentally beneficial or clean coal technology are exceedingly efficient. CFBs are an example in point. CFBs are considered a clean coal technology and are eligible for allowance allocations under the CASA in that category. As the Agency testified at hearing, a purpose of the CASA is to incentivize such projects, and SIPC, who has the only CFB in the state that is subject to this rule, appreciates that the Agency has recognized that it is deserving of such consideration. However, operation of the CFB, particularly in a setting such as that at SIPC where recovered fine coal is the fuel, is not as efficient as other types of boilers from a gross

electrical output standpoint. SIPC's CFB is approximately 23% less efficient than SIPC's cyclone unit.[10] Compared to USEPA's list of the top 25 most efficient boilers, SIPC's CFB is almost 40% less efficient. Yet SIPC'S CFB has inherently lower NOx and SO_2 emissions than the comparable cyclone or pulverized coal boiler and has been designed to burn recovered fine coal, thus benefiting the environment significantly. In fact, much of the environmental benefit of the CFB comes from the way the boiler operates, but it is this very type of operation that creates a heat rate penalty, a less efficient boiler. In other words, the environmental controls of a CFB occur inside the boiler resulting in a gross heat rate penalty, whereas other types of boilers, because controls are external to the boiler, appear more efficient when comparing gross heat rates. Moreover, SIPC's CFB is further controlled by SNCR and a baghouse. These design features and control equipment use up electricity generated by the unit or require greater Btu to generate electricity, thus further reducing its efficiency. As a result, SIPC's CFB is penalized, probably more than any other unit in the state, by the use of gross electrical output as the basis for allowance allocations, particularly egregious when the CFB, as discussed above, has inherently lower emissions and was designed to burn recovered coal fines, thus providing additional environmental benefit by reducing acid run-off.

B. Acceptable Gross Electrical Output Data

It became clear in the Springfield hearing that the Agency intended that EGUs would have the choice of submitting actual gross electrical output data or heat input data that would be converted to gross electrical output values during the first several years of the new CAIR NOx trading programs but that the language proposed did not reflect that intent. The Agency also indicated at the Springfield hearing that there is "other data" that the Agency may find

[10] That is, it requires 23% more Btu to generate a kilowatt-hour from Unit 123, the CFB, than from Unit 4, the cyclone unit.

"acceptable," but the Agency offered no indications as to how it would determine what is "acceptable." S Tr., October 11, 2006, a.m., p. 26. The Agency was operating under the assumption that gross electrical output data is submitted regularly to USEPA's Clean Air Market Division ("CAMD"), which administers the national trading programs, including the future CAIR trading programs. S Tr., October 11, 2006, a.m., p. 17. Apparently, a part of that assumption was that the data submitted was uniform and quality assured, in the manner that heat input is.

Since the Springfield hearing, the Companies understand that the Agency has inquired of CAMD what is submitted to them. Representatives of the Companies discussed this issue with the Agency prior to the Agency's filing of its November 27th Motion to Amend Rulemaking. The Companies responded to the Motion to Amend on December 7th and attempted to further qualify the issue in their Response.

The Companies' understanding is that the Agency will accept as gross electrical output data any data that is acceptable to USEPA pursuant to 40 CFR Part 60 or 75. The Companies are concerned with the inclusion of language that suggests there must be an actual measurement device installed on the generator, effectively a wattmeter, when such is not required by USEPA pursuant to 40 CFR Part 60 or 75. The Companies urge the Board to ensure that the language included in the rule reflects the parties' intent.

C. Fuel Weighting

The Companies support the Agency's proposal regarding weights assigned to fuel types. Jason Goodwin testified on behalf of Zion Energy LLC, a peaking facility, and requested that the Board remove the fuel weighting or, in the alternative, take the approach of South Carolina and assign a factor of 1.0 for coal and 0.6 for all other fuels. Such a change would result in even

fewer allowances to be allocated to the Companies, which provide the baseload rather than just the peaking generation in the state, and with a 25% CASA, the Companies cannot support any amendments to the proposal that would further reduce the number of allowances to be allocated to them. Both USEPA and the Agency proposed use of fuel factors, and the Companies believe that use of fuel factors is appropriate for the reasons set forth by these agencies. Zion Energy can offer no reason to deviate from the fuel factors other than its own financial benefit. USEPA, in its reconsideration of this issue, retained the fuel factors, and the Board should retain them here as proposed by the Agency.

D. Look-Back Period and Annual Updating

The Companies are very deeply troubled by the Agency's approach to annual allowance allocations. The proposed rule includes a two-year look-back period to determine an EGU's allowances, to be updated annually. The Companies' concern with the two-year look-back is that the look-back period will, from time to time, encompass periods when the EGUs experience outages of various lengths of time. This cannot be avoided. The Agency reasons that the Companies will know that they have experienced such outages and can save allowances not needed during the year in which the outage occurred for that future year when the EGU will receive a "short" allocation because of the current outage. It is not clear how companies that opt in to the MPS will be able to bank their allowances to cover outage years, since allowances generated as a result of MPS emissions limitations must be surrendered. The second part of the Companies' concern lies with the annual updating. Clearly, where the look-back is so short with no "levelizing" allowed through the averaging of a number of years' operations chosen from a larger number of years, such as the highest three years' operation out of a specified five-year

period, it becomes critical that the updating occur annually and timely. The Agency's approach might work as the Agency intends in an ideal world. The world, unfortunately, is not ideal.

USEPA suggested a permanent baseline for sources in the model rule. *See* 70 Fed.Reg. 25161, 25279 (May 12, 2005). New sources roll in to the existing source permanent baseline once they have five years' operating data, causing an adjustment of all existing sources' allocations. 70 Fed.Reg. 25161, 25279 (May 12, 2005). USEPA reasoned that the permanent baseline "will eliminate the potential for a generation subsidy (and efficiency loss) as well as any potential incentive for less efficient existing unit to generate more." 70 Fed.Reg. 25161, 25279 (May 12, 2005). USEPA states that the permanent baseline approach is easier to implement administratively. 70 Fed.Reg. 25161, 25279 (May 12, 2005).

USEPA retained the permanent baseline in the CAIR FIP:

> EPA has chosen not to utilize an updating system for allocating allowances, in order to avoid the subsidization of increased fuel use (or increased electricity generation) and the associated market distortions. If allocations were based upon updated heat input (or updated output) data then increased fuel use (or increased electricity generation) would result in increased future allocations and thus would in effect be subsidized.

71 Fed.Reg. 25328, 25356 (April 28, 2006). The Companies find USEPA's reasoning sound and urge the Board to give it due consideration.

When the Agency presented the approach of annual updating at one of the very early outreach meetings, the Companies raised the issue of the Agency's failure to timely allocate allowances under Part 217, Subpart W with Laurel Kroack, Air Bureau Chief. Ms. Kroack appeared not to realize that the Agency had been tardy in its allocations. It is troublesome that the Agency was tardy, and it is troublesome that management did not know and do something about it more quickly. In fact, the Agency was tardy by several years. At the Springfield hearing, the Agency assured the Board and the public that the situation was because an employee

responsible for the work had left and that his work had not been picked up. S Tr., October 11, 2006, a.m., p. 125. The Agency further assured the Board and the public that this situation could never happen again. S Tr., October 11, 2006, a.m., pp. 125-126. If it happened once, it could happen again. This person's supervisors surely knew that he was responsible for allowance allocations, they surely knew when he left the Agency, and they knew or should have known that responsibility needed to be shifted.[11] The Companies are not reassured by the Agency's protestations that the situation has been cured. The lapse is a function of human error, and human error happens. The rules should be written in a manner to ensure against – or at least to minimize – the negative outcomes of human error, to provide a safety net in a rule such as this one, *i.e.*, participation in a national trading program.

USEPA has provided in its NOx trading rules that when a state fails to allocate allowances timely, USEPA will rely upon the previous allocation to cover the unallocated period. 40 CFR §§ 96.141(b)(2) and 96.341(b)(2). If the Agency falls again into a pattern of not timely allocating allowances for the two NOx programs proposed by these rules, some EGUs will, without question, be frozen at an allowance level that reflects extensive outages. This cannot be avoided under this aspect of the proposed rule.

Moreover, the upshot of the Agency's tardiness in allocating allowances is not only the peril in which the Agency places EGUs in terms of their holding sufficient allowances to comply with the rule, but also the impact of the failure to timely allocate on the business of emissions trading. The business of emissions trading is not restricted to EGUs, and certainly the Agency's proposed rule expands the participation of others beyond the regulated community to an even greater extent. The failure to allocate allowances as set forth in a rule reverberates throughout

[11] If they knew and did nothing, they were irresponsible; if they did not know, they were irresponsible. Either way, the failure was not of just one person.

the emissions trading industry and could have an effect on that market beyond the direct economic impact to the EGUs entitled by the rule to their allowances.

The large economic impact aside, the Companies' main concern is that they be assured that they will be allocated the allowances to which the rule entitles them in a timely fashion. That certainty is a paramount necessity. Further, the Companies need some level of insurance against human error. That level of insurance should come through an allocation methodology that provides "levelizing" to cover those times when there are outages and when allocations are not made timely. Illinois EGUs are accustomed to an allocation methodology based upon the average of the three highest years' heat input during a five-year look-back period. The averaging of the three highest years levelizes the effects of outages. All EGUs are treated the same, in that all EGUs are looking at their three highest years' heat input during the look-back period, thus avoiding skewing the allowances to some EGUs to the detriment of others. Further, relying on an average of the highest three years avoids the disastrous effect of being frozen at an allowance level established on years that included extensive outages. The five-year look-back is necessary to afford the three years' average. The Companies urge and request the Board to revise the rule to reflect this three-year averaging concept and the five-year look-back.

Dr. Kunkel of CCG testified that the continued allocation of allowances for retired units is not an incentive for retirement of those units (C Tr., November 28, 2006, pp. 134-136) while the ability to obtain allowances is an incentive for the construction of new sources (C Tr., November 28, 2006, pp. 136-137). Dr. Kunkel did not elaborate as to why he believed these statements to be the case. Indeed, USEPA reasoned quite the opposite with respect to the retirement of sources in the Preamble to the federal CAIR. USEPA said, "Retired units will continue to receive allowances indefinitely, thereby creating an incentive to retire less efficient

units instead of continuing to operate them in order to maintain the allowances allocations." 70 Fed.Reg. 25161, 25279 (May 12, 2005). Further, USEPA said in the CAIR FIP, "Retired units will continue to receive allowances indefinitely, thereby avoiding creation of a disincentive to retire less efficient units." 71 Fed.Reg. 25328, 25357 (April 28, 2006). Dr. Kunkel appears to apply the same logic to the effect of the availability of allowances for new sources, yet he disagreed with this logic with respect to the incentive to retire sources. It would seem that the logic would work both ways: the incentive of allowances would encourage the shutdown of less efficient sources just as it would, under Dr. Kunkel's thinking, encourage the construction of new sources.

E. Conclusion

A permanent baseline comprised of the three highest years' operational heat input or converted heat input over a five-year period would provide the level of certainty of the allowance stream that Dr. Kunkel sought. A permanent baseline is, administratively, much easier to implement, requiring less intense man-hours on the part of the Agency and less subject to the vagaries of state personnel practices. The baseline would be adjusted only as new units roll in to the permanent baseline. Similarly, a block allocations based upon a baseline derived from a five-year look-back updated every five years would provide the certainty and levelizing that the Companies believe important. While proponents of new units appear to prefer the quicker roll-in that the Agency describes in its approach, the relative certainty of the allowance stream would overcome the more lengthy stay in the NUSA. The Companies request that the Board seriously consider the values of a permanent baseline or a five-year updating baseline compared to the disadvantages of the Agency's proposed annual updating system. If the Board believes that an updating allocation methodology is preferable, then the Companies request that the Board

consider extending the look-back to five years, with the allocations based upon the average of the three highest years of operation, the system that is currently in place in Illinois under Part 217, Subpart W.

The Companies also request that the Board seriously consider heat input as the basis for allocations. USEPA has provided the formula for converting gross electrical output into heat input: the gross electrical output is multiplied by the heat input conversion factor of 7,900 Btu/KWh to calculate the heat input value. 71 Fed.Reg. 25328, 25357 (April 28, 2006). The Companies have reported and certified heat input data for years. In contrast, though output data is reported, the manner of its measurement and its quality assurance is not uniform; therefore, the data is not as reliable as heat input data. Some of the regulated community will be advantaged by this sudden switch to a different form of regulating emissions, while others, particularly SIPC, will be severely disadvantaged, even through use of the formula proposed by the Agency to convert heat input into a gross electrical output value. New units, however, that do not have easily measured heat input will have notice of how their gross electrical output will be converted to heat input. Therefore, basing allowance allocations on heat input is the most equitable and acceptable approach for this rule.

IV. SUGGESTED IMPROVEMENTS TO THE RULE AS PROPOSED

Assuming that the Board will adopt the Agency's proposal with only limited adjustment necessitated by the evidence in the record, the Companies offer the following suggestions to improve the rule in addition to those contained it their Response to the Agency's Motion to Amend Rulemaking.

A. CASA Size

The Companies strongly encourage the Board to reduce the CASA size to 5% of the state's cap. This 5% number would cover the allowances necessary to address the projects that Mr. Kubert stated were in development.

B. CASA Categories

The Companies recommend that the CASA be limited to EE/RE projects if the size of the CASA is reduced as urged above. If the existing companies are not effectively penalized by the loss of an additional 20% of their allowances as anticipated by USEPA in establishing the state's cap, then the additional CASA categories are not necessary. As proposed, they merely amount to a redistribution of a very large number of allowances, essentially resulting in the subsidization of a company that did not act to reduce emissions and is only now catching up, to some extent, with the emissions levels of other systems in the state, by companies that have reduced their emissions over a longer period. To do otherwise does not recognize the good faith in which the Companies and other EGUs in the state exhibited in reducing emissions to meet NOx SIP call and Acid Rain Program obligations rather than merely relying on purchasing allowances in those programs.

If the Board determines that it will not reduce the size of the CASA as requested in these Comments, the Companies urge the Board to accept the changes to the CASA indicated in their Response to the Agency's Motion to Amend Rulemaking.

With respect to Ameren's request to include OFA in the CASA, the Companies agree that reductions obtained through advanced OFA, equivalent to the reduction levels of SNCR, may be more beneficial to the environment than reductions achieved via SNCR because of the use of ammonia, urea, or other NOx-reducing reagents with SNCR. However, OFA cannot be operated in certain types of boilers and neither of the Companies and probably none of the other EGUs in

Illinois have what Mr. Whitworth described as "advanced" OFA, though the level of NOx reduction at many of the existing OFA systems equals or exceeds Ameren's proposed "advanced" OFA reduction level. If the Board determines that it is appropriate to include OFA as a CASA category, it should include eligibility for historical OFA systems that meet or exceed the 30% reduction threshold that Mr. Whitworth suggested regardless of whether upgrades to existing OFA systems are necessary to achieve such a reduction level.

C. Compliance Supplement Pool

One of USEPA's purposes in establishing the CSP for the annual NOx CAIR program was to reward early adopters, one of the CAIR categories. The Companies urge the inclusion of the CSP in the rule, rather than its retirement. This would effectuate one of the CASA categories in a manner that does not amount to most of the regulated community subsidizing one member.

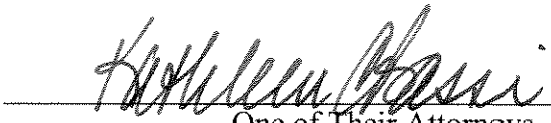
D. Allocation Methodology

The Companies strongly urge the Board to reject the allocation methodology proposed by the Agency and to adopt one that reflects USEPA's model rule. Such an allocation methodology would have a permanent baseline based upon the highest three years' heat input during 2001 through 2005 and, for new units, based upon their three highest years' gross electrical output converted to heat input once they have five years' operation, reflecting the fuel factors currently included in the proposal. In the alternative, block allocations based upon a five-year updating baseline would provide a level of certainty that would be preferable to the proposed annually updating two-year look-back system. The Companies have very serious concerns with the proposed annual updating methodology based upon a two-year look-back. The Companies fear that the Agency will fail to consistently manage such a process for two trading programs plus the CASA in the timeframes set forth in the rule.

Respectfully submitted,

DYNEGY MIDWEST GENERATION, INC., and
SOUTHERN ILLINOIS POWER COOPERATIVE

by:



One of Their Attorneys

Dated: January 5, 2007

Sheldon A. Zabel
Kathleen C. Bassi
Stephen J. Bonebrake
SCHIFF HARDIN, LLP
6600 Sears Tower
233 South Wacker Drive
Chicago, Illinois 60606
312-258-5500
Fax: 312-258-5600

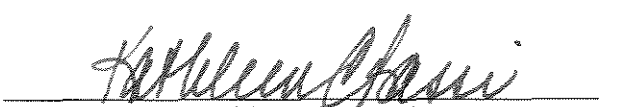
CH2\ 1612018.1

CERTIFICATE OF SERVICE

I, the undersigned, certify that on this 5th day of January, 2007, I have served electronically the attached **POST-HEARING COMMENTS OF DYNEGY MIDWEST GENERATION, INC., AND SOUTHERN ILLINOIS POWER COOPERATIVE**, upon the following persons:

Dorothy Gunn, Clerk
Illinois Pollution Control Board
James R. Thompson Center
Suite 11-500
100 West Randolph
Chicago, Illinois 60601

and electronically and by first-class mail with postage thereon fully prepaid and affixed to the persons listed on the **ATTACHED SERVICE LIST**.



Kathleen C. Bassi

Sheldon A. Zabel
Kathleen C. Bassi
Stephen J. Bonebrake
SCHIFF HARDIN, LLP
6600 Sears Tower
233 South Wacker Drive
Chicago, Illinois 60606
312-258-5500

SERVICE LIST
(R06-26)

John Knittle Hearing Office Illinois Pollution Control Board James R. Thompson Center 100 W. Randolph Suite 11-500 Chicago, Illinois 60601 knittlej@ipcb.state.il.us	Rachel Doctors, Assistant Counsel John J. Kim, Managing Attorney Air Regulatory Unit Division of Legal Counsel Illinois Environmental Protection Agency 1021 North Grand Avenue, East P.O. Box 19276 Springfield, Illinois 62794-9276 rachel.doctors@illinois.gov john.j.kim@illinois.gov
Matthew J. Dunn, Division Chief Office of the Illinois Attorney General Environmental Bureau 188 West Randolph, 20th Floor Chicago, Illinois 60601 mdunn@atg.state.il.us	Virginia Yang, Deputy Legal Counsel Illinois Department of Natural Resources One Natural Resources Way Springfield, Illinois 62701-1271 virginia.yang@illinois.gov
David Rieser James T. Harrington Jeremy R. Hojnicki McGuireWoods LLP 77 West Wacker, Suite 4100 Chicago, Illinois 60601 drieser@mcguirewoods.com jharrington@mcguirewoods.com jhojnicki@mcguirewoods.com	William A. Murray City of Springfield, Office of Public Utilities 800 East Monroe, 4th Floor, Municipal Building Springfield, Illinois 62757-0001 bmurray@cwlp.com
Katherine D. Hodge N. LaDonna Driver HODGE DWYER ZEMAN 3150 Roland Avenue, P.O. Box 5776 Springfield, Illinois 62705-5776 khodge@hdzlaw.com nldriver@hdzlaw.com	S. David Farris Manager, Environmental, Health and Safety City Water Light & Power 201 East Lake Shore Drive Springfield, Illinois 62757 dfarris@cwlp.com
Faith E. Bugel Environmental Law and Policy Center 35 East Wacker Drive, Suite 1300 Chicago, Illinois 60601 fbugel@elpc.org	Keith I. Harley Chicago Legal Clinic, Inc. 205 West Monroe Street, 4th Floor Chicago, Illinois 60606 kharley@kentlaw.edu

SERVICE LIST
(R06-26)

Sasha M. Reyes Steven J. Murawski Baker & McKenzie One Prudential Plaza, Suite 3500 130 East Randolph Drive Chicago, IL 60601 sasha.m.reyes@bakernet.com steven.j.murawski@bakernet.com	Bruce Nilles Sierra Club 122 West Washington Avenue, Suite 830 Madison, Wisconsin 53703 bruce.nilles@sierraclub.org
Daniel D. McDevitt General Counsel MIDWEST GENERATION, LLC 440 South LaSalle Street, Suite 3500 Chicago, Illinois 60605 dmcdevitt@mwgen.com	James H. Russell Winston & Strawn LLP 35 W. Wacker Drive, 40th Floor Chicago, Illinois 60601 jrussell@winston.com
Bill S. Forcade Katherine M. Rahill JENNER & BLOCK LLP One IBM Plaza Chicago, Illinois 60611 bforcade@jenner.com krahill@jenner.com	Karl A. Karg Cary R. Perlman Andrea M. Hogan Latham & Watkins LLP 5800 Sears Tower 233 South Wacker Drive Chicago, Illinois 60606 karl.carg@lw.com cary.perlman@lw.com andrea.hogan@lw.com