

**BEFORE THE ILLINOIS POLLUTION CONTROL BOARD**

<b>IN THE MATTER OF:</b>	)	
	)	
<b>PROPOSED NEW CLEAN AIR</b>	)	<b>R06-26</b>
<b>INTERSTATE RULES (CAIR)</b>	)	<b>(Rulemaking – Air)</b>
<b>SO<sub>2</sub>, NO<sub>x</sub> ANNUAL AND NO<sub>x</sub></b>	)	
<b>OZONE SEASON TRADING</b>	)	
<b>PROGRAMS, 35 ILL. ADM. CODE 225,</b>	)	
<b>SUBPARTS A, C, D AND E</b>	)	

**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 the POST-HEARING COMMENTS OF MIDWEST GENERATION, LLC, a copy of which is herewith served upon you.

/s/ Karl A. Karg  
Karl A. Karg

Dated: January 5, 2007

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**POST-HEARING COMMENTS OF MIDWEST GENERATION, LLC**

NOW COMES Participant MIDWEST GENERATION, LLC, by and through their attorneys, LATHAM & WATKINS, LLP, pursuant to the Hearing Officer's Order of December 20, 2006, and pursuant to 35 Ill. Adm. Code §102.108, and offers the following post hearing comments:

**NO<sub>x</sub> Allowance Look-Back Period and Annual Updating**

The IEPA's proposed rule for allowance trading includes a two-year look-back period to determine an EGU's allowances, to be updated annually. Midwest Generation is concerned that the two-year look-back will, from time to time, encompass periods when the EGUs experience outages of various lengths of time. Under the current language of the proposed rule, this situation cannot be avoided. IEPA concludes that the affected 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.

In addition, Midwest Generation is concerned about the process of annual updating and the relevant look-back period. 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.

Importantly, USEPA has suggested a permanent baseline for sources in the model rule. *See* 70 Fed.Reg. 25161, 25279 (May 12, 2005). New sources roll into 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 units 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). We find USEPA's reasoning sound and urge the Board to give it due consideration.

Midwest Generation believes that USEPA's approach is the best approach for providing certainty to existing plants, integrating new plants into the allowance system, and minimizing the resource burden on IEPA associated with annual updating. Nonetheless, should IEPA believe that annual updating is necessary, Midwest Generation urges the Agency to consider using a five-year look-back (3 highest years of operational heat input over a five year period). We believe that this approach will help ensure a levelizing of the allowances for EGUs in Illinois and

will avoid inappropriate allowance windfalls or penalties associated with unexpected or extended outages.

When the Agency presented the approach of annual updating at one of the very early outreach meetings, Power Companies raised the issue of the Agency's failure to timely allocate allowances under Part 217, Subpart W with Laurel Kroack, Air Bureau Chief. In fact, the allocation was late by several years. At the Springfield hearing, the Agency assured the Board and the public that the lack of timely allocation was due to a situation where the employee responsible for the work had left the Agency, 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. While Midwest Generation appreciates the Agency's forthright comments on this issue, we remain concerned that future human error could result in an identical situation, and we believe 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 NO<sub>x</sub> trading rules that when a state fails to allocate allowances in a timely manner, USEPA will rely upon the previous allocation to cover the unallocated period. 40 CFR §§ 96.141(b)(2) and 96.341(b)(2). If, in the future, a timely allocation is not made for the two NO<sub>x</sub> 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 the current language of the proposed rule. Either of Midwest Generations' proposed alternatives would avoid this adverse outcome.

Moreover, the upshot of a failure to timely allocate 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 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, Midwest Generations' main concern with the proposed rule is that it fails to provide an assurance that we will be allocated the allowances to which the rule entitles us in a timely fashion. That certainty is an absolute necessity for Midwest Generation. Further, Midwest Generation needs some level of protection against future human error. That level of protection should come through an allocation methodology that provides "levelizing" to cover those times when there are outages and when allocations are not made in a timely manner. 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. Midwest Generation respectfully urges the Board to revise the rule to reflect this three-year averaging concept and the five-year look-back period.

### **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.. 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 Midwest Generation believes is 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. Midwest Generation requests 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 Midwest Generation requests 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.

Midwest Generation also requests 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). Midwest Generation has 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.

RESPECTFULLY SUBMITTED,  
MIDWEST GENERATION, LLC

By: /s/ Karl A. Karg  
Karl A. Karg

Dated: January 5, 2007

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**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 MIDWEST GENERATION, LLC, upon the following person:

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

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

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