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Richard M. Sandusky
Deputy Director for Regulatory Analysis
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333 Market Street
Harrisburg, PA 17101

Re: Regulation Number 7-345

Dear Mr. Sandusky:

On Thursday, August 17, 2000, the Commission will be considering the final form regulation submitted by the Department of Environmental Protection establishing the Interstate Ozone Transport Reduction Program. In order to assist the Commissioners in their review of the regulation, the Department has prepared the attached background document. Could you please fax this document to the Commissioners today to aid in their review of the regulation.

Thank you for your assistance. Please contact me if you have questions or would like to discuss this matter further.

Sincerely,

M. Dukes Pepper, Jr.
Assistant Counsel

MDP/pjd

Attachment

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**DEPARTMENT OF ENVIRONMENTAL PROTECTION
INTERSTATE OZONE TRANSPORT REDUCTION
25 PA. CODE CHAPTER 145**

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INTRODUCTION

The Environmental Quality Board has proposed a final form air pollution regulation that is the most important air quality public health regulation in Pennsylvania since Congress adopted the 1990 Clean Air Act amendments. The regulation will improve the health of citizens of Pennsylvania and citizens of states downwind of Pennsylvania. This rule continues Pennsylvania's leadership role in doing its fair share to address ozone pollution.

This background document provides the Commission with technical and legal information related to the final form regulation. Commission staff have identified a concern with one section of the regulation (located on the last 3 pages of the 183 page regulation). This background document addresses that concern.

OZONE POLLUTION

What is ozone pollution ?

Ozone is the chemical term for smog. Ozone pollution is a problem in the summertime when it is hot and the air is still. Ozone is formed from the combination of two other types of pollutants, **nitrogen oxides or NOx** and **volatile organic compounds or VOCs**. These pollutants come from cars, factories, power plants and products used around the home (paints and lawnmowers for example).

In 1990 Congress established a national classification system for the ozone standard (the **one-hour ozone National Ambient Air Quality Standard or NAAQS**) to protect public health.¹ Pennsylvania counties are classified based on how bad the ozone problem is in the county. Philadelphia and the four counties surrounding Philadelphia have a severe ozone problem. There are only 9 other areas in the United States with such a severe problem. Ozone pollution is also a problem in the counties in the center of the state from York County up to Lehigh County and in Pittsburgh and the 7 surrounding counties.

What is the effect of ozone pollution ?

Ozone pollution makes it hard for some people to breathe. It mostly affects **children, seniors or anyone with lung problems**. In 1995, the American Lung Association found that 1½ million people in Pennsylvania had

chronic or long-term lung problems. In addition, 8 million people in Pennsylvania had acute or short-term lung problems that year.² Ozone pollution makes children's asthma attacks more frequent and more severe.³ As the number of seniors increase, ozone pollution affects on that group of people increases as well.

Ozone pollution also causes problems for the environment. It affects the growth of plants, including food crops, and makes them more susceptible to disease and insects.⁴ The NOx that causes ozone pollution also puts nitrogen in streams and lakes causing water pollution. Studies have identified this "nitrogen deposition" to be a serious problem for coastal waters like the Chesapeake Bay.⁵

What has been done to stop ozone pollution ?

Pennsylvania has been a leader in taking steps to stop ozone pollution. Since 1990, Pennsylvania has implemented all of the programs that Congress required to reduce ozone pollution. This includes requirements for factories, power plants and cleaner cars.

Emissions of NOx from power plants are a major cause of ozone pollution. Pennsylvania has put in place two programs to reduce these emissions. First, by May of 1995, power plants had to reduce emissions to meet the "reasonably available control technology or RACT" requirements that Congress included in the Clean Air Act.⁶ Then, beginning in May of 1999, Pennsylvania started a program that further reduces emissions from power plants and allows the plants to work together to get emission reductions in the most cost effective manner. This program is called a "cap and trade" program because it sets a cap or maximum amount of NOx pollution from a power plant and allows that plant to trade emission allowances with other plants to meet the requirement.⁷

These programs are working. Ozone pollution has been going down since Pennsylvania put its programs in place, but the problem is not yet solved. There is still more to do to protect people's health and the environment.

What else needs to be done to solve the ozone pollution problem ?

Power plants and other large facilities located in Pennsylvania and in states to the west and south of Pennsylvania need to reduce their emissions of NOx.

It is well documented that in Pennsylvania 1/3 of the ozone pollution is caused by emissions of nitrogen oxides from power plants located in other states.⁸ That means that no matter how much Pennsylvania does, the ozone pollution problem cannot be fully solved without reducing emissions from these power plants located in other states.

In 1995, Governor Ridge called on everyone to do his or her fair share to solve the ozone problem. He asked other states to be good neighbors by reducing the emissions of NOx that are causing ozone pollution in Pennsylvania. Power plants in Ohio, West Virginia, Virginia, Maryland, Washington D.C. and North Carolina are a major cause of ozone pollution in Pennsylvania.⁹

Power plants in Pennsylvania are a major cause of ozone pollution in Pennsylvania, New Jersey, New York, Massachusetts and Connecticut.¹⁰ As part of its "fair share" Pennsylvania needs to reduce the emission of NOx from power plants located in Pennsylvania.

INTERSTATE OZONE TRANSPORT REDUCTION PROGRAM

Summary of the Pennsylvania Program

On July 18, 2000, the Environmental Quality Board approved a final form regulation establishing an ozone transport reduction program to address the serious public health and environmental problems caused by ozone pollution in Pennsylvania. Chapter 145 is now before IRRC for review. The interstate ozone reduction transport program (program) establishes a cap on the total tons of summertime NOx emissions from a discrete group of facilities and then allocates those emissions to individual facilities based on historic fuel input data. Facilities can meet their allocation either by installing emission controls or by purchasing allowances from other facilities. This market-based approach allows the emission reductions to be achieved at the lowest marginal cost.

The program is similar in approach to an existing cap and trade program for NOx contained in 25 *Pa. Code* Chapter 123. The new Chapter 145 program will replace the existing program beginning in the summer of 2003. The program is consistent with the requirements of the remedy established under section 126 of the Clean Air Act by EPA in response to a 126 Petition filed by Governor Ridge.¹¹ Section 126 of the Clean Air Act allows a state to petition the EPA requesting that emission limitations be imposed on a category of sources located in another state or states. The program is also consistent with the EPA requirement that states develop a State Implementation Plan (SIP) to address interstate ozone pollution.¹²

The program regulates large electric generating units and large industrial boilers that burn fossil fuels. The program will be implemented in Pennsylvania through the existing air quality permitting system soon after the regulation is published in the *Pennsylvania Bulletin*. Because a significant portion of Pennsylvania's ozone problem is caused by emissions from facilities located in other states, the program will be extended to include these facilities if and only if the

three programs established by EPA under the Clean Air Act fail to achieve the necessary reductions. In other words, the Pennsylvania requirements related to upwind states never became effective unless all applicable Clean Air Act programs fail.

Scientific Support for the Pennsylvania Program

In 1995, the Environmental Council of States and EPA formed the Ozone Transport Assessment Group (OTAG) to identify a strategy to reduce transported ozone in order to attain the NAAQS. OTAG was composed of the 37 eastern most states, EPA, industry and environmental groups. OTAG conducted the largest available modeling effort to evaluate ozone transport. The modeling demonstrates the nature and scope of ozone transport in the eastern part of the U.S. The model found that Regional NO_x reductions are effective in producing ozone benefits; the more NO_x reduced, the greater the benefit.¹³ The modeling results were upheld by the United States Court of Appeals for the District of Columbia Circuit.¹⁴

In addition to the modeling, Pennsylvania relies on data from the EPA approved State and Local Air Monitoring System (SLAMS). SLAMS data from the Ohio, West Virginia boarder demonstrates that transport from outside of Pennsylvania accounts for between 85 and 94 percent of the ozone problem in the Pittsburgh area. Pennsylvania also conducted back trajectory and meteorological and air quality analyses that demonstrates that transported ozone from the west and south significantly contribute to nonattainment of the NAAQS in Pennsylvania.¹⁵

Ozone Transport Program Litigation

There has been a great deal of litigation relating to the federal and state regulation of interstate ozone pollution. DEP has been an active participant in this series of state and federal litigation matters and has been successful in advancing Governor Ridge's fair share approach.

At the state level, there were 27 litigation matters challenging the implementation of the Department's Chapter 123 NO_x Allowance Requirements, the existing cap and trade program. Two preenforcement review challenges were filed in Commonwealth Court. One was withdrawn and the Department prevailed in the other.¹⁶ A Petition for Review to the Pennsylvania Supreme Court seeking to overturn the Commonwealth Court decision was withdrawn.¹⁷ In addition, a preenforcement review challenge was filed before the Environmental Hearing Board, which the Department successfully had dismissed.¹⁸ Finally, 23 appeals of individual permit decisions implementing the rule were settled¹⁹ and the rule has been successfully implemented since May of 1999.

On the federal level, when EPA failed to act in a timely fashion on the section 126 Petitions filed by Governor Ridge and the Governors of 7 other northeastern states, the States filed a Clean Air Act citizen suit in the United States District Court for the Southern District of New York to compel EPA to act. That suit resulted in a time frame for EPA action.²⁰ EPA subsequently granted the Petitions filed by Pennsylvania and 5 other states.²¹

EPA's action granting the Section 126 Petitions has been challenged in the United States Court of Appeals for the District of Columbia Circuit. A Motion to Stay implementation of the rule pending judicial review was denied by the Court. The parties are currently briefing the merits. Pennsylvania is a party to this litigation.²²

In addition to granting the Section 126 Petitions, EPA promulgated a regulation requiring 22 states and the District of Columbia to submit a State Implementation Plan establishing an enforceable cap on NOx emissions in the state. This "NOx SIP Call" was subsequently challenged in the United States Court of Appeals for the District of Columbia Circuit. On March 3, 2000, the Court issued an opinion that, generally, upholds EPA's NOx SIP call rule.²³ SIPs are now due to EPA by October 30, 2000. Pennsylvania is a party to this litigation.

Legal support for the Pennsylvania Program

Some commentators on the Advance Notice of Final Rulemaking for the Interstate Ozone Polluting Reduction Program have asserted that a portion of the Department's regulation is unconstitutional. Specifically, they have asserted that Section 145.100 violates the Commerce Clause and that the Clean Air Act preempts Pennsylvania from regulating out of state facilities. As discussed in greater detail below, Section 145.100 does not violate the Commerce Clause and is not preempted by the Clean Air Act. It is important to point out, that the provisions of Section 145.100 never become effective unless the remedies established by EPA under the Clean Air Act fail.²⁴ Currently, the U.S. Court of Appeals for the District of Columbia Circuit has upheld EPA's NOx SIP call and refused to stay implementation of the 126 remedy pending review. Given these court decisions, it is likely that Section 145.100 will never become effective.

As a part of the Advance Notice of Final Rulemaking, the Department developed a document, *Interstate Pollution Transport Reductions; Assuring All States Do Their Fair Share* that contains, inter alia, an evaluation of the Commerce Clause. A copy of that document is attached. In sum, where a state requirement does not discriminate between in state and out of state entities, promotes a legitimate state interest and imposes no excessive burden on interstate commerce, it does not violate the Commerce Clause. Section 145.100 establishes consistent

requirements for entities located in Pennsylvania and other states. It advances a legitimate state interest in protecting Pennsylvanians, particularly children, seniors and those with health problems, from ozone pollution and it imposes no burden on interstate commerce.

As to preemption, the Clean Air act does not preempt Pennsylvania's regulation of facilities that directly pollute the air that Pennsylvanians breath. First, the provision does not become applicable unless all three EPA remedies; Section 126, the NOx SIP Call and the EPA FIP, are not implemented. Next, the seminal United States Supreme Court case concerning preemption cited by a number of commentators does not support preemption.

In *International Paper Co. v. Ouellette et al.*,²⁵ the Supreme Court held, in a 5/4 decision, that the Clean Water Act preempts state common law nuisance actions filed by citizens. It held that the private common law nuisance action was preempted in view of the express language of the Clean Water Act state law savings provisions. The Clean Water Act expressly reserves state authority to be more stringent "with respect to waters (including boundary waters) of such states."²⁶ The Court held that the language "of such states" limited the state authority to regulate waters of another state.

Like the Clean Water Act, the Clean Air Act has a provision, Retention of State Authority, describing the area of regulation left to states.²⁷ However, the Clean Air Act does not contain the limitation of state authority as contained in the Clean Water Act. The Clean Air Act provides, in part, "...nothing in this chapter shall preclude or deny the right of any state or political subdivision thereof to adopt or enforce (1) any standard or limitation respecting emissions of air pollutants or (2) any requirement respecting control of abatement of air pollution...". Section 145.100 is an emission limitation within the authority expressly reserved to states under the Clean Air Act.

Finally, there has been some question concerning the mechanics of regulating out of state sources and enforcing the regulation against those sources. Again, it is important to point out that Section 145.100 will not become applicable unless all of the EPA remedies fail. However, in that unlikely event, the Department would publish a state budget and proposed allocations for affected facilities in the *Pennsylvania Bulletin* and would, after comment, finalize the budget and allocation. Facilities would have the opportunity to appeal the allocations to the Environmental Hearing Board. In terms of enforcement, the Department would use the enforcement provisions of the Air Pollution Control Act, which includes issuance of orders,²⁸ assessment of civil penalties,²⁹ and suits filed in Commonwealth Court.³⁰ Again, the facilities would have the opportunity to either appeal (in the case of orders and penalties) or defend in the case of Commonwealth Court action. Failure to implement the provisions of an order or to pay a civil penalty would be

prosecuted in Commonwealth Court and, if necessary, the Department would have that judgment enforced by the Court's in the state where the facility was located through the full faith and credit provisions of the United States Constitution. Finally, jurisdiction is obtained over the offending companies under the Pennsylvania long arm statute, which provides for jurisdiction over a person who acts directly or by an agent and who causes harm or tortuous injury by an act or omission in Pennsylvania or by an act or omission outside of Pennsylvania.³¹

Finally, Pennsylvania has established other requirements applicable to facilities in other states in order to protect the health of Pennsylvania citizens. Title 31 of the *Pennsylvania Code*, related to Food, contains numerous examples of this regulatory approach. Pennsylvania has, likewise, established requirements related to safe packaging that are applicable regardless of where the packaging is produced.³²

Pennsylvania Program Implementation in a Deregulated Environment

Pennsylvania has established and is implementing the most sweeping electric utility restructuring program in the country. The Department's approach is consistent with the General Assembly's findings in the Pennsylvania Electric Generation Consumer Choice and Competition Act, related to interstate pollution transport regulation.³³

The implementation of rigorous NOx emission limitations for power plants has not resulted in a competitive disadvantage for Pennsylvania facilities. In fact, as a result of deregulation, Pennsylvania generation assets have become an extremely valuable and sought after investment. Acquisitions and mergers related to existing generation assets and proposals for additional construction of generation capacity in Pennsylvania have been occurring at an unprecedented pace.³⁴ These transactions have come in the face of one of the most protective set of NOx regulatory requirements in the country. In Pennsylvania, environmental regulation has been occurring hand in hand with robust competition.

In fact, several companies have already installed the pollution controls necessary to meet the Chapter 145 requirements. Edison Mission Energy's Homer City Plant and PPL Montour Plant are but two examples. With the voluntary controls already installed along with the compliance supplement pool, Pennsylvania is positioned to meet the 2003 NOx budget established by the regulations. These companies investment in pollution controls will be returned when they are able to "over comply" with the Chapter 145 requirements and sell excess allowances to other facilities at less than the marginal costs of the installation of pollution controls.

Finally, New York, New Jersey, Maryland, Connecticut and Massachusetts have already adopted control programs similar to Pennsylvania's. Sources in Ohio, West Virginia and Virginia are subject to the same control requirements as Pennsylvania sources through the requirements of the 126 remedy established by EPA in response to Governor Ridge's Section 126 Petition.

FOOTNOTES

1. 42 U.S.C. § 7511
2. **Estimated Prevalence and Incidence of Lung Disease by Lung Association Territory, American Lung Association, April, 1999.**
3. **62 *Fed. Reg.* 38856 (1997); Air Quality Criteria for Ozone Related Photochemical Oxidants. EPA/600/P-93/004aF. July 1996 Section 1.7**
4. **Air Quality Criteria for Ozone Related Photochemical Oxidants. EPA/600/P-004aF. July 1996 Section 1.5 and Volume III**
5. **63 *Fed. Reg.* 56321 Section IV (1998)**
6. **25 *Pa. Code* § 129.91-95 through 129.95**
7. **25 *Pa. Code* § 123.101-120 through 123.120**
8. **Findings of Significant Contribution and Rulemaking for Certain States in the Ozone Transport Assessment Group Region for Purposes of Reducing Regional Transport of Ozone Rule. 63 *Fed. Reg.* 57, 356 (1998).**
9. **Findings of Significant Contribution and Rulemaking on Section 126 Petitions for Purposes of Reducing Interstate Ozone Transport. 64 *Fed. Reg.* 28250, 28294 Table II (1999).**
10. **Id. See also: Approval or Promulgation of Air Quality Implementation Plans; Pennsylvania; One-Hour Ozone Attainment Demonstration for the Philadelphia-Wilmington-Trenton Ozone Nonattainment Area.**
11. **Findings of Significant Contribution and Rulemaking on Section 126 Petitions for the Purposes of Reducing Interstate Ozone Transport 65 *Fed. Reg.* 2674 (2000).**
12. **Findings of Significant Contribution and Rulemaking for Certain States in the Ozone Transport Assessment Group Region for Purposes of Reducing Regional Transport of Ozone Rule. 63 *Fed. Reg.* 57,356 (1998).**
13. **Id at Section IV (1998)**
14. **213 F 3.d 663 (March 3, 2000)**

15. **Petition of the Commonwealth of Pennsylvania for Abatement of Excess Emissions; Thomas J. Ridge, Governor, August 14, 1997**
16. ***PP&L, Inc., PECO Energy Company and West Penn Power Company (d/b/a Allegheny Power) v. DEP*, Commonwealth Court Docket No. 1000 M.D. 1997; *Duquesne Light Company, Inc. v. DEP*, Commonwealth Court Docket No. 188 MD 1998.**
17. ***Duquesne Light Co. v. DEP*, Pennsylvania Supreme Court Docket No. 0036 MD Appeal Docket 1999.**
18. ***Duquesne Light Co. v DEP*, Environmental Hearing Board Docket No. 97-258-C**
19. ***Duquesne Light Co. v. DEP*, Environmental Hearing Board Docket No. 99-023-L, 99-024-L, 99-025-L, 99-026-L, 99-027-L, 99-028-L, 99-029-L, 99-030-L, 99-031-L, 99-032-L, 99-033-L, 99-034-L, 99-035-L, 99-036-L, 99-037-L, 99-038-L, 99-039-L, 99-041-L; 99-042-L; 99-43-L; *Willamette Industries, Inc. v DEP*, Environmental Hearing Board Docket No. 99-0444-L; *P.H. Glatfelter Co. v DEP*, Environmental Hearing Board Docket No. 99-022-L**
20. ***State of Connecticut et al. v. EPA*, United States District Court, Southern District of New York, 98 C.V. 1376 (LAK)**
21. **Findings of Significant Contribution and Rulemaking on Section 126 Petitions for Purposes of Reducing Interstate Ozone Transport 64 *Fed. Reg.* 28250 (1999); 65 *Fed. Reg.* 2674 (2000)**
22. ***Appalachian Power Company et al. v EPA*, U.S. Court of Appeals for the District of Columbia Circuit No. 99-1200 and Consolidated cases.**
23. **213 F.3d 663 (March 3, 2000) *State of Michigan v. EPA* Order June 2000**
24. **Section 145.100**
25. **479 U.S. 481 (1987)**
26. **33 U.S.C. Section 1370 "State Authority"**
27. **42 U.S.C. Section 7416 "Retention of State Authority"**
28. **35 P.S. § 4010.1**
29. **35 P.S. § 4009.1**

30. 35 P.S. § 4013.6
31. 42 Pa. 5322 C.S.A. Sections (a)(3) and (4).
32. Safe Packaging Act 35 P.S. 6024.101 through 6024.905.
33. 66 P.S. § 2802(21)
34. For example the generation assets of GPU and PENNELEC have been sold twice, once to SITHE and now to Reliant. PECO is in the process of merging with Unicom. Duquesne Lights' generation assets have been purchased by several parties. The Department also has at least six permit applications in process for peak generation units.

**COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF ENVIRONMENTAL PROTECTION**

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INTERSTATE POLLUTION TRANSPORT REDUCTIONS

ASSURING ALL STATES DO THEIR FAIR SHARE

January 7, 2000

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INTRODUCTION

Ozone Transport Is A Regional Problem

The last decade has seen a significant improvement in our scientific understanding of the formation, transport and effect of ground level ozone. The Clean Air Act of 1990, for the first time, recognized the regional nature of ozone pollution and established the Ozone Transport Commission (OTC) to focus on regional problems in the Northeast. Congress also commissioned a National Academy of Science study to evaluate the impact of nitrogen oxide emissions on ozone formation and transport. As it became clear that ozone transport impacts in the Northeast could not be addressed without the help of our Midwest and Southern neighbors, the Ozone Transport Assessment Group (OTAG) was formed to develop a consensus approach for dealing with the issue. The work of these groups demonstrates that nitrogen oxides (NO_x) play a major role in the formation and transport of ozone, and that large fossil-fired combustion units are the major emitter of NO_x. Without reductions of NO_x from these large sources, both within Pennsylvania and in upwind states, it will be impossible for Pennsylvania to achieve and maintain the one-hour National Ambient Air Quality Standard for ozone.

States Must Do Their Fair Share To Address The Problem

Pennsylvania has done and will continue to do its fair share to address nitrogen oxide emissions and ozone transport. Since 1994, Pennsylvania has achieved over 200,000 tons per year of reductions from stationary sources, primarily utilities, emitting NOx through implementation of the Reasonably Achievable Control Technology or RACT Phase I program required by the Clean Air Act. Unfortunately, because EPA granted waivers of the RACT Phase I control requirements in upwind states, our upwind neighbors have not achieved similar reductions.

Pennsylvania has also adopted NOx Phase II rules, consistent with the recommendations of other states in the Northeast. These rules require reductions of 55% to 65% of NOx emissions from 1990 levels through a market-based cap and trade program. Reductions from this program began in May 1999. Unfortunately, again, many of Pennsylvania upwind neighbors have not adopted these requirements.

There is an important related issue. When the Federal Energy Regulatory Commission (FERC) adopted the open access rules to foster competition in the electric power industry, Pennsylvania took a leadership role in deregulating public utilities in the state. In the Pennsylvania Electric Generation Customer Choice and Competition Act, the General Assembly recognized the importance of addressing the ozone transport problem in order to protect the environment and ensure a level playing field between electric generators. 66 Pa. C.S.A. §2802.

These programs are moving Pennsylvania towards a market-based approach to both providing utility services and regulating emissions.

Fair Share Initiatives at the Federal Level

In 1995, Gov. Ridge called for a uniform market-based NOx cap and trade program for the Midwest and South consistent with the program developed for Pennsylvania and the Northeast. Without such an approach, Pennsylvania could find itself at a competitive and environmental disadvantage. Pennsylvania chaired the trading workgroup at OTAG that advocated the Governor's approach in 1997.

Pennsylvania was pleased when EPA recognized the merits of this approach and developed the Section 110 NOx SIP Call and a model cap and trade program rule in the October 27, 1998 Federal Register notice (63 F.R. 57356) that would have facilitated similar NOx reduction requirements in 22 states.

Unfortunately, EPA's Section 110 NOx SIP Call was stayed by the U.S. Court of Appeals for the District of Columbia Circuit on May 25, 1999. In addition, EPA's promulgation of the 8-hour standard has been overturned by the same court and there are remaining questions about reinstating the 1-hour ozone standard in areas where it was previously revoked.

To back up Pennsylvania's position, Gov. Ridge filed a Section 126 Petition with the U.S. EPA calling for market-based NOx controls in August of 1997. On May 25, 1999, EPA promulgated an interim final rule finding that Midwestern and Southern states significantly contribute to ozone nonattainment in the

Northeastern states and establishing a mechanism to address that significant contribution. On December 17, 1999 EPA granted the petition of Pennsylvania and three other states under Section 126 of the Clean Air Act.

Despite the disappointments at the federal level, Pennsylvania is continuing its leadership role by developing its Interstate Ozone Transport Reduction Program. As described below, Pennsylvania's program is being designed to be consistent with the Section 126 remedy established by EPA in December 1999. In addition, Pennsylvania's regulatory approach will "level the playing field" for all utilities generating NOx emissions that significantly contribute to nonattainment of the ozone standard in Pennsylvania and will promote electric competition.

PENNSYLVANIA'S INTERSTATE OZONE TRANSPORT REDUCTION REGULATORY APPROACH

NOx Cap And Trade Program

On March 6, 1999, the Department proposed a new regulation to address nitrogen oxide (NOx) emissions: Chapter 145 Interstate Ozone Transport Reduction. Subchapter A of that proposed rule establishes a NOx budget trading program for fossil-fired combustion boilers and electric generators (NOx Budget Units). The “cap and trade” program sets a regulatory limit on mass emissions from the NOx Budget Units, allocates allowances (an allowance is the authorization to emit one ton of NOx from May 1 through September 30) to the units authorizing emissions up to the regulatory limit or cap, and permits trading of allowances to effectuate cost-efficient compliance with the cap. This proposed rule was consistent with the Section 126 remedy requested by Pennsylvania and approved by EPA in its May 25, 1999 interim final rule. It was also consistent with the NOx SIP Call model rule.

Pennsylvania's Approach For “Leveling The Playing Field”

During the public comment and public hearing process, the Department received comments from a number of commentators requesting that the Department ensure that NOx Budget Units in upwind states of the Midwest and South do their fair share to reduce ozone transport into Pennsylvania. These commentators suggested that Pennsylvania's NOx Budget Units should not be

placed at a competitive disadvantage through implementation of a rule only in Pennsylvania. This concern was echoed by House Resolution 182 adopted by the Pennsylvania House of Representatives' on June 8, 1999.

In response to these comments, the Department is revising Chapter 145 to make the proposed Pennsylvania program applicable to NOx Budget Units in upwind states that significantly contribute to ozone nonattainment in Pennsylvania. This provision "levels the playing field" by imposing NOx emission reduction requirements on NOx Budget Units that cause Pennsylvania to violate the ozone standard. Implementation of a Section 126 remedy or implementation, by an upwind state, of a SIP that addresses ozone transport is an alternate mechanism to meeting Pennsylvania's regulatory requirement.

Under the revised Chapter 145 provisions, NOx-Budget Units in upwind states are subject to the same requirements as NOx-Budget Units in Pennsylvania. In other words, facilities located in Ohio, West Virginia, Virginia, Maryland, Delaware, New Jersey, New York, North Carolina and Washington, D.C. must meet the Chapter 145 requirements applicable to facilities located in Pennsylvania. This proposal is based on the Environmental Quality Board's authority to address air pollution in Pennsylvania caused by sources not otherwise subject to Pennsylvania's permitting requirements, to protect public health during the ozone season, to abate nuisances affecting the public health of Pennsylvania citizens and to implement the provisions of the Clean Air Act.

In order to provide further opportunity for public involvement, the Department is publishing an Advance Notice of Final Rulemaking to seek additional comments on Pennsylvania's Chapter 145 program. At this time, Pennsylvania is only moving forward with its NOx cap and trade program. The provisions of proposed Chapter 145 related to stationary reciprocating internal combustion engines and cement manufacturing are being temporarily removed from the Advance Notice of Final Rulemaking. The Department may move these provisions forward separately at a later date.

For the reasons discussed below, Pennsylvania believes that its regulatory approach is consistent with the Commerce Clause of the United States Constitution and is not preempted by FERC under the Federal Power Act.

FAIR SHARE APPROACH TO OZONE POLLUTION

Introduction

Pennsylvania's regulatory approach to achieving interstate pollution transport reductions establishes consistent requirements for both in-state and out-of-state electric generators and other NOx Budget Units. It is also consistent with EPA's Section 126 remedy. This even-handed approach promotes a legitimate state interest in protecting Pennsylvania's citizens from the adverse health effects of air pollution in Pennsylvania resulting from NOx emissions from all NOx Budget Units. The regulatory approach does not affect the sale, distribution, rates or other aspects of interstate transmission of electricity. Consequently, the Commerce Clause and Federal Power Act should not be an issue. If, however, the regulation does incidentally affect interstate commerce, as discussed in more detail below, Pennsylvania's regulatory approach is consistent with the Commerce Clause.

Pennsylvania's Approach Does Not Discriminate

The analysis of whether a state regulation violates the Commerce Clause first evaluates whether the regulation discriminates between in-state and out-of-state entities. When a state regulation imposes additional obligations on out-of-state entities or establishes other disparate treatment of out-of-state entities, courts have universally found that the state law discriminates and apply a "strict scrutiny" analysis. In virtually every case, the discriminatory requirement is overturned as violative of the Commerce Clause. *See Chemical Waste Management,*

Inc. v. Hunt, 504 U.S. 334, 112 S.Ct. 2009 (1992); *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dept. of Natural Resources*, 504 U.S. 353, 112 S.Ct. 2019 (1992); *City of Philadelphia v. New Jersey*, 437 U.S. 617, 98 S.Ct. 2531 (1978); *National Solid Waste Management Ass'n v. Meyer*, 63 F.3d 652 (1995); *SDDS, Inc. v. South Dakota*, 47 F.3d 263 (8th Cir. 1995); *BFI Med. Waste Sys. v. Whatcom County*, 983 F.2d 911 (9th Cir. 1993); *Government Suppliers Consolidating Services, Inc. v. Bayh*, 975 F.2d 1267 (7th Cir. 1992); *In re Southeast Arkansas Landfill v. Arkansas*, 981 F.2d 372 (8th Cir. 1992); *National Solid Waste Management Ass'n v. Voinovich*, 959 F.2d 590 (6th Cir. 1992); *Southern States Landfill v. Georgia Dept. of Resources*, 801 F.Supp. 725 (M.D. Ga. 1992); *Industrial Maintenance Serv., Inc. v. Moore*, 677 F.Supp. 436 (S.D.W.V. 1987).

In general, where discrimination is found, there is an attempt to restrict the free flow of commerce through either an import ban or an increased fee.

“In essence, the “negative” or “dormant” aspect of the Commerce Clause prohibits States from advancing their own commercial interest by curtailing the movement of articles of commerce, either into or out of the state.”

National Solid Waste Management Association v. Meyer, 63 F.3d 652 (1995).

There is one case involving strict scrutiny that bears additional discussion. In *National Solid Waste Management Association*, Wisconsin passed a statute providing that no solid waste could be disposed of in that state unless the community in which the waste originated enacted an ordinance meeting Wisconsin's

specifications for recycling. The statute established identical requirements for waste generated in Wisconsin and in other states. Nonetheless, the 7th Circuit:

... held that the law was unconstitutional for four reasons: first, it applied to all waste originating in a jurisdiction whether or not it was bound for Wisconsin; second, it required municipalities outside of Wisconsin's borders to enact ordinances favoring Wisconsin's system and thus had extraterritorial application; third, the prospect for conflict (if other states required municipalities to enact different kinds of ordinances) invited balkanization; fourth, the law made interstate commerce in waste more costly than intrastate commerce in that commodity ...

National Solid Waste Management Association v. Wisconsin Department of Natural Resources, 165 F.3d, 1151 (7th Cir. 1999); citing *National Solid Waste Management Association v. Meyer*, 63 F.3d 652 (1995). Pennsylvania's approach is fundamentally different and distinguishable from the Wisconsin statute.

First and foremost, Pennsylvania is not establishing a ban on importing electric power or any other commodity. Pennsylvania is not regulating the flow of electric power or goods in interstate commerce at all, but rather the emission of NO_x resulting from the generation of electrical power at the source of generation and from operation of NO_x Budget Units at industrial facilities. This fundamental difference makes the Wisconsin analysis wholly inapplicable to Pennsylvania's regulation of interstate pollution transport.

Second, Pennsylvania is not telling other states how to conduct their affairs and is not requiring other states to develop state laws to overcome a ban being imposed on importing power or other commodities. Instead, Pennsylvania is

establishing a rule to control air pollution in Pennsylvania in order to protect the health of Pennsylvania's citizens.

Third, Pennsylvania's approach will not "invite balkanization". Instead, it establishes requirements on power generators and other NOx Budget Units, in Pennsylvania, to prevent air pollution in Pennsylvania. The Pennsylvania program does accept a SIP or Section 126 remedy under the provisions of the Clean Air Act as an alternative to meeting the air pollution limitations of the Pennsylvania program. The SIP and Section 126 process are expressly established by Congress to address interstate transport of air pollution. Pennsylvania's approach invites consistency rather than balkanization. EPA has already promulgated a "model rule" establishing a cap and trade program consistent with the Pennsylvania program and has finalized a remedy under Section 126 of the Clean Air Act that establishes a federal program identical to the Pennsylvania approach.

Fourth, the approach does not establish any distinction between requirements applicable to interstate vs. intrastate commerce. Pennsylvania's approach establishes identical requirements for both.

As described above, Pennsylvania's approach to regulating interstate pollution transport reductions does not discriminate against out-of-state entities. Instead, the Pennsylvania approach "levels the playing field" by requiring both in-state and out-of-state facilities to do their fair share to assure that

Pennsylvania's citizens are protected from the public health impacts resulting from failure to meet the National Ambient Air Quality Standards for ozone.

Pennsylvania's Approach Meets The Commerce Clause "Balancing Test"

Where a state requirement regulates even-handedly to effectuate a legitimate interest and its effects on interstate commerce are incidental, it will be upheld unless the burden imposed on interstate commerce is clearly excessive in relation to the putative state benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970) (citations omitted). In this case, Pennsylvania clearly has a legitimate police power interest in protecting the public health of its citizens. The courts have interpreted the term "incidental burdens" to which Pike refers as the burdens on interstate commerce that exceed the burdens on intrastate commerce. *Gary D. Peake Excavating, Inc. v. Town Bd. of Hancock*, 93 F.3d 681 (2d Cir. 1996), citing *U.S.A. Recycling, Inc. v. Town of Babylon*, 66 F.3d 1272, 1287 (2d Cir. 1995) (quoting *New York State Trollers Association v. Jorling*, 16 F.3d 1303, 1308 (2d Cir. 1994), cert. denied 116 S.Ct. 1452, 134 L.Ed.2d 571 (1996)). In the case of interstate pollution transport, the Pennsylvania program imposes no additional burdens on interstate commerce than those applied to intrastate commerce. The party challenging the requirement bears the burden of proving that the burdens placed on interstate commerce outweigh the benefits that accrue. *Eastern Kentucky Resources v. The Fiscal Court of Magoffin County*, 127 F.3d 532 (6th Cir. 1997), cert. denied 1998 U.S. Lexis 2530, 118 S.Ct. 1512 citing *U.S.A. Recycling, Inc. v. Town of*

Babylon, 66 F.3d 1272, 1282 (2d Cir. 1995). Even if a court would find some minimum burden on interstate commerce, that burden is outweighed by the substantial public health and environmental benefits provided by this Pennsylvania program.

The interstate pollution transport requirements being established by Pennsylvania are consistent with the provisions determined necessary by EPA under Sections 110 and 126 of the Clean Air Act to protect public health in Pennsylvania. In addition to being consistent with those provisions, implementation of requirements to address interstate pollution transport approved by EPA or implementation of emission limitations on electric generating units established by EPA provide an alternative mechanism for meeting the Pennsylvania requirements.

Conclusion

The Pennsylvania regulatory approach does not discriminate against out-of-state electric generating units and other NOx Budget Units, clearly flows from a legitimate interest in regulating air pollution in Pennsylvania to protect public health and does not burden interstate commerce in a way different than intrastate commerce.

EFFECT ON ELECTRIC UTILITY RESTRUCTURING

Introduction

Pennsylvania has established and is implementing the most sweeping electric utility restructuring program in the country. The Pennsylvania program provides the opportunity for retail customers to choose among competing electric generating facilities. Pennsylvania's program dovetails with the program established by FERC to provide open access to electric distribution services. The Department's regulatory approach is consistent with both the Public Utility Commission's (PUC's) and FERC's direction toward competition. As described above, the Department's program "levels the playing field" by imposing NOx emission reduction requirements on NOx Budget Units that cause Pennsylvania to violate the ozone standard. This approach is consistent with the General Assembly's findings in the Pennsylvania Electric Generation Consumer Choice and Competition Act, 66 Pa. C.S.A. §2802(21). As discussed in more detail below, by focusing on environmental regulation of electric generation, the Department's approach avoids interference with and preemption by the Federal Power Act.

Pennsylvania's Approach Is Not Preempted By FERC

Section 824 of the Federal Power Act provides that FERC has jurisdiction over all facilities for transmission of electric energy in intrastate commerce but does not have jurisdiction, in general, "... over facilities used for the generation of electric energy ...". 16 U.S.C. §824(b)(1). The Federal Power Act also provides that "nothing

in this act shall relieve any public utility from keeping any accounts, memoranda or records which the public utility may be required to keep by or under authority of the laws of any state.” 16 U.S.C. §825(a). On its face, the Federal Power Act makes clear that FERC’s jurisdiction does not apply to generation nor prevent states from establishing recordkeeping and reporting requirements applicable to electric generating facilities. Pennsylvania’s regulatory program does just that -- it does not, in any way, regulate or restrict the sale of power or the sellers of power.

In addition, in response to the request of a number of parties, including the Pennsylvania PUC, to specifically establish environmental controls for NO_x emissions as part of its open access rules, FERC provided “these recommendations would have the Commission embark on an extensive environmental regulatory regime that appears ... beyond our lawful authority.” FERC Rule 888 at 710. Further, the Final Environmental Impact Statement to the rule concludes that to implement the open access rule the Federal Power Act and NEPA, either singly or conjointly, do not authorize the Commission to adopt and implement the proposed mitigation measures. FEIS at 7-48.

In the August 4, 1995 staff report prepared by the PUC investigating competition, the Commission correctly determined that FERC will “regulate the wires” while states will be left to deal with a host of other issues including “environmental problems”. *Staff Report of the Commonwealth of Pennsylvania Public Utility Commission*, August 4, 1995, page 124.

Conclusion

In conclusion, the Federal Power Act and statements by FERC related to the control of NO_x emissions from electric generators demonstrate that the Department regulatory approach is not preempted by the Federal Power Act.