

September 19, 2003

Ms. Kelly E. Lease  
Commonwealth of Virginia  
Department of Environmental Quality  
Northern Virginia Regional Office  
13901 Crown Court  
Woodbridge, VA 22193-1453



Dear Ms. Lease:

I am writing on behalf of Mirant Potomac River, LLC ("Mirant") in response to the Notice of Violation issued by the Department of Environmental Quality ("the Department" or "DEQ") on September 10, 2003 alleging violations of Conditions 3 and 4 of Mirant's Virginia Stationary Source Permit to Operate the Potomac River Generating station ("Operating Permit"). In broad overview, Mirant contends: 1) that the Conditions of the Operating Permit it is alleged to have violated are void and unenforceable for the 2003 ozone season; and 2) that in issuing the NOV, the Department has reversed the position taken in on-going negotiations with Mirant, upon which Mirant relied throughout the Summer to its detriment. As a result, DEQ jeopardizes significant environmental improvements Mirant has offered to make and other benefits to the community.

#### Background

When the Department proposed issuing the Potomac River Operating Permit on April 24, 2000, it published a "Statement of Basis" that articulated the reasons for permit issuance. As the Statement demonstrates, the Department was utilizing this permit to accomplish compliance with Virginia's Clean Air Act ("CAA") obligations to respond to EPA's call for a State Implementation Plan ("SIP call"), to address the Washington area's nonattainment with the ozone standard and to comply with obligations imposed as a result of Northern Virginia being subject to EPA's companion rulemaking promulgated pursuant to CAA § 126. (Statement of Basis at 1-2, attached as Ex. A).

Consistent with the requirements of the SIP Call and CAA § 126 rulemaking, the Operating Permit provided for "cap" and "trade" compliance. Recognizing the success that the Northeast States (including Maryland) have had with their regional "cap and trade" program<sup>1</sup>, EPA adopted the cap and trade approach in both its SIP Call and § 126 programs. The cap and

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<sup>1</sup> Virginia elected not to sign the Memorandum Of Understanding for the Northeast Ozone Transport Region and thus did not promulgate regulations pursuant to that agreement. *Ozone Transport Commission Memorandum of Understanding 94-1*. However, Virginia is expressly included in both the expanded region subject to the SIP Call rule and CAA § 126 rule issued by EPA.

trade approach allows a company to *elect* either to reduce emissions to a cap level utilizing add-on pollution control technology or to acquire "allowances" from other facilities through trading to cover emissions that exceed the cap. This cap and trade option allows companies the flexibility to install the most advanced and expensive controls on selected plants to achieve the greatest reduction of NOx emissions and to obtain allowances through trading for those plants that will exceed the emission cap. Under a cap and trade program, while some plants will emit above the 0.15 lb/MM Btu emission rate target (acquiring allowances for the excess), others will emit below that level and generate allowances to trade. In this way, the affected sources *average* the targeted emission rate on a regional basis, which is the objective of the program.

When Virginia issued the Potomac River Operating Permit, it established the "cap" in Conditions 3 and 4 of the permit by applying the SIP Call/CAA § 126 regional NOx emissions rate goal of 0.15 lb/MM Btu to the Potomac River units, which calculated as 1019 tons of NOx per ozone season. The permit established the "trade" feature of the cap and trade program in Condition 7, which reads:

As an alternative to compliance with Condition 3, the permittee may comply with 40 CFR Part 97 or a regulation of the Board approved by EPA as meeting the requirements of 40 CFR Part 96. This condition may be implemented for the units covered by either of the cited regulations once they become effective. The DEQ reserves the right to amend this permit as may be necessary should it determine that the use of this alternative compliance measure will prevent the attainment or maintenance of the air quality standards in the Washington, DC Ozone Nonattainment area.

There can be no doubt that Condition 7, quoted above, was meant to provide the plant with flexibility on how to comply. As DEQ wrote in the Statement of Basis with respect to this feature of the Operating Permit:

PEPCO [succeeded by Mirant] may control its NOx emissions by any means it chooses, so long as emissions of other pollutants are not significantly increased. The reductions necessary to stay within the emissions cap for the Potomac River G.S. may even be taken at other facilities and credited to the Potomac River G.S. if they are reductions that would benefit the air quality within the Washington, DC nonattainment area and are not otherwise required. As of this writing, an SAPCB rule is under development that will authorize trading of allowed NOx emissions ("allowances") to meet federally-imposed emissions budgets such as in the Section 126 Petition Rule. That rule may be utilized by PEPCO to comply with this permit, but only to the extent that it benefits the Washington, DC area. This flexibility allows PEPCO to contribute to improvement of the DC area air quality by the most cost-effective means with the least disruption of services.

(Statement of Basis at 3).

At the time this permit was issued on September 18, 2000 the regulations at 40 CFR Part 97 provided for a cap and trade program that established allowance trading beginning in 2003. It was known at the time that the Potomac River plant would be subject to the federally-mandated "cap and trade" program by way of regulation anyway and so there was no reason to object to inclusion of these provisions in the Operating Permit. Similarly, when Mirant acquired the Potomac River plant from PEPCO in December, 2000, allowance trading in 2003 was provided under 40 CFR Part 97 and thus available to Mirant for Potomac River by virtue of Condition 7 of the permit quoted above.

Mirant's generating asset acquisition from PEPCO included all of the Washington area plants, the largest of which are located in Maryland. Mirant developed a broad strategy for compliance with the requirements of the impending regional SIP Call under which Potomac River would obtain allowances for emissions above the cap and the largest initial emission reductions would occur at Mirant's Maryland plants—all of which are in the Washington ozone non-attainment area. This strategy complied fully with the cap and trade program that was anticipated to begin in 2003.

On April 30, 2002—a little over one year ago—as a result of litigation delays associated with the SIP Call and CAA § 126 rulemakings, EPA changed the cap and trade program in 40 CFR Part 97 to provide for a commencement date of May 31, 2004. 67 FR 21522, 21524 (April 30, 2002). The implementing regulations promulgated by Virginia similarly provided for a commencement date of 2004 for the Virginia cap and trade program. 9 VAC 5-140-60C(3). While the 2004 commencement date benefited utilities in the states subject to the SIP Call (including VA), this change left Mirant with a "cap" obligation under Conditions 3 and 4 of its Operating Permit that commenced in 2003, but no "trade" opportunity because Condition 7 of the Operating Permit cross-referenced federal and state regulations that delayed the cap and trade program until 2004. Neither the federal mandate nor Mirant's Operating Permit (as evidenced by the Statement of Basis) ever contemplated imposition of a "cap" without a trading opportunity.

#### Conditions 3 and 4 of the Permit Are Void and Unenforceable for the 2003 Ozone Season

The practical effect of the elimination of the trading opportunity under the permit was to place Mirant Potomac River in an untenable position where it was not realistically *possible* to comply with the 2003 permit "cap." April 30, 2002—when the trading opportunity was eliminated by operation of law—was too late for Mirant to comply in the Summer of 2003 by any means. Absent a trading opportunity, Mirant Potomac River would have had to reduce electricity generation during the Summer, 2003 by 60% to comply with this cap, without a trading opportunity. Obviously a permit provision that amounted to reducing power production by more than half during the peak demand season of the year would have been appealed by the permittee. In this case, however, the permit was modified by operation of law which left Mirant with no opportunity to appeal. The Virginia law guarantees a permittee the right to appeal unacceptable permit conditions. 9 VAC § 5-170-160 (2003). The draconian modification of this permit without opportunity to appeal the change is a violation both of Virginia law and due process. 9 VAC § 5-80-1000, *Tennessee Valley Auth. v. Whitman*, 336 F.3d 1236 (11th Cir.

2003) The bringing of an enforcement proceeding based on this draconian permit modification would just add insult to injury.

To reach the extremely low NOx emission levels prescribed by this permit cap without reducing electricity generation by 60% would have required the use of Selective Catalytic Reduction ("SCR") technology on many if not all of the five Potomac River units. Only SCR technology has pollutant removal efficiencies that would accomplish this level of reduction at the Potomac River units. Even with adequate time, Mirant could not comply in this way. SCR is not a feasible alternative at this site because of the physical space limitations. Moreover, SCR would cost approximately \$100 million and would not yield NOx emission reductions as favorable as retrofitting on other Washington area plants with SCR technology. Thus, SCR at Potomac River is neither feasible nor prudent. Even if it were feasible, SCR retrofitting at a fifty year old coal plant such as Mirant Potomac River is hugely complex, requiring a minimum of two years for the engineering, development of specifications, custom parts ordering and installation during a Spring or Fall outage period. As EPA wrote in relation to the SIP Call, "lead time for installation of controls on complicated SCR retrofits at facilities with up to six boilers ranges from 21 to 34 months." 63 FR 57448 (October 27, 1998). Consequently, the modification in 2002 of Mirant Potomac River's Operating Permit to eliminate the "trading" option made it practically impossible for Mirant to comply with these conditions of the Operating Permit in 2003 by any means and deprived Mirant of any opportunity to appeal.

In an analogous situation in Maryland, the state court invalidated Maryland's first cap and trade regulation because the Maryland Department of the Environment had required BGE to comply within one year of promulgation or face enforcement. The trial judge invalidated those regulations from the bench, stating:

But I do want them to take serious consideration of the fact that it's physically impossible for these utilities to comply by May 1<sup>st</sup>, 1999 and that to impose penalties automatically for failure to comply, to me seems grossly unfair and wrong to comply by that date.

(Order and Excerpt of bench ruling, attached as Ex. B.)

DEQ cannot modify Mirant's Operating Permit (even by operation of law) in the draconian manner that it has without giving Mirant an opportunity to appeal. Likewise, it cannot sustain a civil enforcement proceeding for violation of a permit requirement with which Mirant could not realistically comply as a result of the elimination of the trading opportunity. An effort to do so would be a violation of Virginia law and administrative due process. *United States v. Hoechst Celanese Corp.*, 128 F.3d 216, 224 (4<sup>th</sup> Cir. 1997), *Cf. Tennessee Valley Auth., supra*.

#### DEQ Has Precipitously Reversed Its Position and Jeopardized Major Environmental Benefits Offered by Mirant

When Mirant became aware of the delay in its trading opportunity, it entered into discussions with DEQ regarding an alternative approach to compliance. Mirant was reassured by

DEQ that the disparity between the 2003 "cap" requirement and 2004 "trading" opportunity could be addressed either in the context of Mirant's superseding Title V operating permit or as a separate agreement with DEQ. In the course of those discussions, DEQ offered Mirant a higher "cap" to cover its emissions at the Potomac River plant in the Summer, 2003. As of July 1, 2003, DEQ offered a cap of 1807 tons and, most recently, in exchange for further reductions to which Mirant was willing to commit at its Maryland plants, DEQ agreed to a cap of 2336 tons at Potomac River for the Summer, 2003 ozone season. The 2336 cap represented a 10% reduction in emissions from the prior year. Mirant has honored these discussions and been careful to maintain its operations so as to comply with the 2336 cap that had been agreed to in principle by DEQ. In fact, at Mirant's current pace, it projects that the ozone season NOx emissions at this plant will be in the 2100 ton range, representing almost a 20% reduction from the prior year.

To justify the 2336 ton cap at Potomac River, Mirant had offered further reductions of the NOx emissions from the Maryland plants during the 2003 ozone season. Mirant offered reductions of approximately 20%, but in fact will have achieved NOx emission reductions in the 35% range during the 2003 ozone season at those plants.

Perhaps most significantly, as a result of the issuance of this NOV near the end of the 2003 ozone season in which DEQ has totally reversed its position, other significant local environmental improvements offered by Mirant are in jeopardy. Specifically, Mirant had offered to install Separated Over-fired Air (SOFA) pollution controls, the first of which would commence operation in 2004. In the context of a larger settlement, Mirant had offered to follow-up with installation of SOFA at two additional Potomac River units. In addition, Mirant had offered to fund a significant environmental initiative in the DC Ozone Nonattainment area. These considerable environmental benefits to the community are not legally required and are at risk as a result of DEQ's action.

For all of the above reasons, Mirant Potomac River asserts that it has not violated its permit. Although it would prefer not to have to do so, Mirant is prepared to defend this position in an enforcement proceeding if necessary. Nevertheless, Mirant requests the opportunity to meet with DEQ to discuss these issues and is prepared to honor the offers it made and continue its on-going discussions with DEQ with a view toward resolving outstanding issues.

Sincerely,



Wesley L. McNealy  
Director of Environmental, Safety and Health

CC: Michael G. Dowd - VADEQ