

The Honorable Stephen Johnson  
Administrator  
U.S. Environmental Protection Agency  
Ariel Rios Building  
1200 Pennsylvania Avenue, N.W.  
Washington, DC 20460

June 27, 2005

Dear Administrator Johnson:

Enclosed for your consideration is the Report of the Small Business Advocacy Review Panel (SBAR Panel or Panel) convened for EPA's planned proposed rulemakings entitled Federal Implementation Plan (FIP) for the Clean Air Interstate Rule and Response to North Carolina's Petition Pursuant to Section 126 of the Clean Air Act. These regulations are under development by the U.S. Environmental Protection Agency (EPA) under the Clean Air Act, sections 301 and 126. They would regulate the interstate transport of air pollution. The rulemakings will address emissions of SO<sub>2</sub> and NO<sub>x</sub> which are transported interstate and affect downwind states' ability to attain and maintain air pollution standards. The former rule would address utilities in states which have not adopted State Implementation Plans (SIPs) to address the requirements of the recently final Clean Air Interstate Rule (CAIR). The latter would address utilities in states which emit pollution which is transported downwind to North Carolina and hinders its ability to attain and maintain air pollution standards. Such utilities are a subset of those to be covered by the CAIR FIP rule. When fully implemented, CAIR will require SO<sub>2</sub> emissions in the region to be reduced by approximately 73% from 2003 levels, and will require NO<sub>x</sub> emissions in the region to be reduced from 2003 levels by approximately 61%.

The schedule for the planned Section 126 rulemaking is included in a consent decree between EPA and Earthjustice. The deadline for that proposal is August 1, 2005 and the deadline for final action is March 2006. The schedule for the FIP rulemaking is set for the same time-frame, since the two cover overlapping sources, pollutants and control methodologies.

On April 27, 2005, EPA's Small Business Advocacy Chairperson convened this Panel under section 609(b) of the Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA). In addition to the Chairperson, the Panel consists of the Director of the Air Quality Strategies and Standards Division, Office of Air Quality Planning and Standards within EPA's Office of Air and Radiation, the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget (OMB), and the Chief Counsel for Advocacy of the Small Business Administration (SBA).

It is important to note that the Panel's findings and discussion are based on the information available at the time this report was drafted. EPA is continuing to conduct analyses relevant to the planned rules, and additional information may be developed or obtained during this process as well as from public comment on any rules that are proposed. The options the Panel identified for reducing the rule's regulatory impact on small entities will require further

analysis and/or data collection to ensure that the options are practicable, enforceable, protective of public health, environmentally sound and consistent with the Clean Air Act.

## SUMMARY OF SMALL ENTITY OUTREACH

EPA is involving stakeholders very early in the rule development process in order to ensure the quality of information on affected entities, identify and understand potential implementation and compliance issues, and explore regulatory alternatives. In the process, EPA received direct input from small electricity generators about the impacts the rules under development might have on the industry.

Prior to convening the panel, EPA conducted outreach with small entities that will potentially be affected by these planned regulations. In March 2005, EPA invited SBA, OMB, and the potentially affected small utilities and cooperatives to a conference call and solicited comments from the small entities on the preliminary information sent to them. EPA shared the small entities' written comments with the Panel as part of the Panel convening document.

After the SBAR Panel was convened, it distributed additional information to the small entity representatives (SERs) on May 5, 2005, for their review and comment and in preparation for another outreach meeting. Sixteen SERs were selected to advise the panel. Small entities were generally identified for this panel as electrical utilities that generate under 4 million megawatt hours annually. On May 19, 2005, the Panel met with the SERs to hear their comments on the information distributed in these mailings. The Panel received written comments from the SERs in response to the discussions at this meeting and the outreach materials. The Panel asked SERs to evaluate how they would be affected and to provide advice and recommendations regarding early ideas to provide flexibility. See Section 8 of the Panel Report for a complete discussion of SER comments. Their full written comments are also attached to the Report. In light of these comments, the Panel considered the regulatory flexibility issues specified by RFA/SBREFA and developed the findings and discussion summarized below.

The comments from SERs generally focused on the potential for small electric generating units (EGUs) to face higher costs of control than larger EGUs, and for many small entity facilities that only operate one unit to have limited options for compliance. A few SERs noted that small entity EGUs also have to deal with premium charges by installers of control technologies, competition from large EGUs for scarce engineering resources, and relatively higher costs of retrofitting. A few SERs commented that the most significant cost advantage to a large electric generating company with many units is the ability to spread control costs over many units. Additionally, some SERs representing cooperatives indicated that their customers would experience a greater impact on rates under these rules than customers of larger utility companies, particularly because these cooperatives might need to purchase electricity from the

grid to meet customer demand. One SER provided comments during the panel process that noted that the numerous existing emission reduction and reporting requirements are particularly burdensome for small entities. The SERs also provided written comments on the regulatory flexibility alternatives being considered by the Panel, summarized in the following section.

## PANEL FINDINGS AND DISCUSSION

Under the RFA, the Panel is to consider four regulatory flexibility issues related to the potential impact of the rule on small entities (i.e., small businesses, small governments, and small organizations):

1. The type and number of small entities to which the rules will apply.
2. Record keeping, reporting and other compliance requirements applicable to small entities.
3. The rule's interaction with other Federal rules.
4. Any impacts on small entities of the proposed rules or significant alternatives to the proposed rules that would minimize the impact on small entities consistent with the stated objectives of the statute authorizing the rule.

The Panel's most significant findings and discussion with respect to each of these issues and the methodological issues are summarized below. For a more detailed discussion of the RFA requirements, see Section 1 of the Report. To read the full discussion of the Panel findings and recommendations, see Section 9 of the Report.

1. The type and number of small entities affected

Approximately 140 of the approximately 3,000 EGUs affected by CAIR are owned by the 58 potentially affected small entities identified in EPA's analysis. Of the 140, 49 units are owned by small entities that also share ownership with large entities. Of these units, 34 are believed to be more than 50% owned by a large entity. An additional 189 units owned by small entities in these states could be exempted because they have a nameplate capacity less than 25 MW. The above estimates include a number of units that are owned jointly by small and non-small entities. In addition, these estimates represent the maximum number of units potentially affected by the CAIR FIP. Only units in states that fail to submit an approved SIP would be directly regulated under the CAIR FIP. The actual number of affected units will depend on the number of states that do not submit a SIP or do not get their SIP submittal approved.

Regarding the 25 MW and below exemption that is included in the final CAIR, the Panel received a number of comments from SERs in support of such an exemption.

## 2. Record keeping, reporting and other compliance requirements

Discussion in this area focused on the potential complexity of requirements for small entity sources, and the cost of monitoring and reporting for small sources. EPA intends for reporting requirements of the planned section 126 rule and the planned CAIR FIP rule to be similar to the CAIR model trading rules. EPA expect that sources would need to monitor and report NO<sub>x</sub> and SO<sub>2</sub> mass emissions. The CAIR model trading rules, if implemented by affected states, would require sources to monitor their emissions using Part 75 of the Acid Rain regulations (40 CFR part 75). Generally Part 75 requires the use of continuous emissions monitoring systems (CEMS), but it does have other options for certain oil and gas fired units. The majority of affected sources are already monitoring and reporting SO<sub>2</sub> emissions under the Acid Rain program. Most sources are also monitoring and reporting NO<sub>x</sub> emissions under the NO<sub>x</sub> SIP call.

One SER noted that EPA should coordinate emissions monitoring reporting among this and other related rules as much as possible. EPA has developed emission monitoring and reporting provisions under CAIR intended to do just that. Sources will submit one quarterly report that will account for emissions under any of the following programs that they are subject to: Title IV SO<sub>2</sub> and/or NO<sub>x</sub>, CAIR FIP SO<sub>2</sub>, annual NO<sub>x</sub> and/or ozone season NO<sub>x</sub>.

## 3. Related Federal Rules

The Panel discussed four other Federal rules that also apply to fossil fuel-fired EGUs: the Clean Air Interstate Rule (CAIR); the Regional Haze Rule; the Acid Rain program, and; the NO<sub>x</sub> SIP call. Particular emphasis was given to the interaction between CAIR and the Acid Rain Program, since CAIR relies on the use of Acid Rain Program allowances for SO<sub>2</sub>, and this feature of the program limits the flexibility of EPA in its design of regulatory flexibility alternatives for the CAIR FIP/126 rules. The Panel did not make specific recommendations in this area.

## 4. Regulatory Impact and Alternatives

The Panel discussed four options to provide additional flexibility to small entities:

1. Provide an alternative compliance method for units with low emissions, whereby facilities could adopt a voluntary limit on emissions;
2. Provide an option to buy allowances from EPA at a fixed price, which would protect units from market volatility in the price of allowances;
3. Provide sources owned by small entities with a greater share of allowances, and;
4. Recognize and utilize the existing flexibilities within the CAIR model trading rules.

In considering the four regulatory alternatives, the Panel evaluated the feasibility of implementing each option, as well as the extent to which the analysis of each option showed effective relief for financially-impacted small entities. Implementation of Options 1, 2, or 3 would require adjusting the number of allowances available to non-small-entity sources, in order to ensure that the overall reduction requirements of CAIR are achieved. As is discussed in Section 3 of the Report, these adjustments could introduce administrative complexity and uncertainty in the case of SO<sub>2</sub> as to whether the reduction requirement is being met. The Panel also discussed how to set appropriate exemption levels, allowance adjustments, or price levels if EPA were to decide to implement one of the first three alternatives. Additionally, the Panel had to consider how to determine small entities' eligibility for potential relief, as well as treatment of sources that were primarily owned by large entities, but had minority ownership by small entities.

The Panel undertook detailed review of the four regulatory flexibility alternatives, and the comments and discussion provided by the SERs during the Panel process. Consensus was not reached as to the final recommendation of the Panel. Two Panel members recommended that EPA pursue Option 4 as the means of providing flexibility to small entities under the CAIR FIP/126. In general, this recommendation was made based on the ability of the existing CAIR rule to provide a number of flexibilities to small entity sources, as well as consideration of the possible trade-offs in terms of administrative ease and the ability to effectively target sources that would need relief.

One Panel member recommended Option 3 with a hardship demonstration as a way to provide relief under the CAIR FIP/126, based on the ability of this approach to accommodate the needs of small entities with severe hardships and burden of administering this added program element, while preserving the identical benefits of the CAIR program. Essentially, this Panel member suggested that EPA could provide meaningful relief to entities expected to experience severe hardship by setting aside some percentage of States' annual NO<sub>x</sub> budgets, and providing these allowances to small entity sources that demonstrate the potential for severe economic hardship as a result of the rules. Analysis conducted by this Panel member suggested that setting aside less than 15,000 NO<sub>x</sub> allowances annually could provide significant relief to entities projected to experience severe hardship as a result of the CAIR FIP/126 rules. All Panel members agree that for the great majority of affected small entities, the current CAIR cap and trade approach, or Option 4, provides the appropriate mechanism for limiting economic burdens, by allowing the purchase and sale of allowances in the market by all units.

The Panel did not recommend that EPA incorporate Option 1 or Option 2 into the CAIR FIP/126 rules. Regarding Option 1, the Panel generally agreed that this option would not provide a mechanism for providing relief to many small entity sources. Additionally, EPA noted that this option was made available under the NO<sub>x</sub> SIP call, and was used very sparsely. The majority of SERs did not express support for this option. Option 2 could be implemented using a safety valve price for small entity sources that falls either below the projected allowance prices,

or above projected allowance prices. Given the implementation issues discussed in Section 3 of the Report, and the uncertainty about what type of relief this option might provide, the Panel did not recommend that EPA consider this option further.

Sincerely,

/S/

---

Alexander Cristofaro  
Small Business Advocacy Chair  
Office of Policy, Economics and Innovation  
U.S. Environmental Protection Agency

/S/

---

John D. Graham  
Administrator  
Office of Information and Regulatory Affairs  
U.S. Office of Management and Budget

/S/

---

Thomas M. Sullivan  
Chief Counsel  
Office of Advocacy  
U.S. Small Business Administration

/S/

---

Lydia N. Wegman  
Director  
Air Quality Strategies and Standards Division  
Office of Air and Radiation  
U.S. Environmental Protection Agency