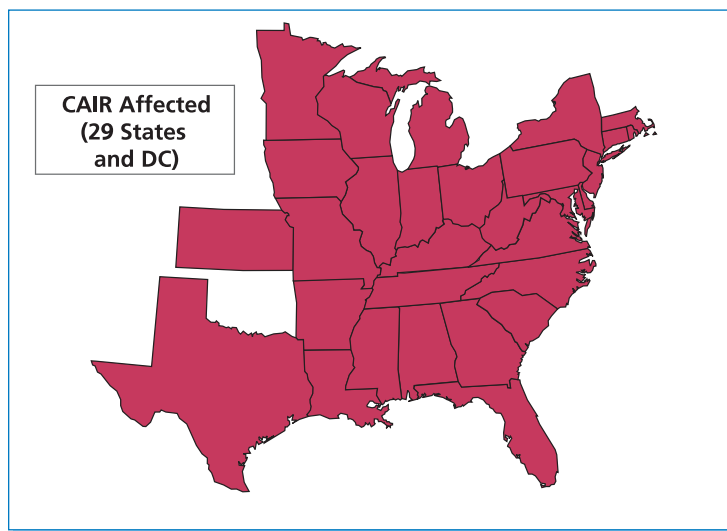


From Legislation to Regulation:

U.S. EPA's Proposed Clean Air Interstate and Mercury Rules Take Center Stage in Multi-Pollutant Debate

In the two years since President Bush unveiled his *Clear Skies Initiative* — which proposed to regulate electric power sector emissions of sulfur dioxide (SO₂), nitrogen oxides (NO_x), and mercury (Hg)—members of Congress, the Bush Administration, electric utilities, and interest groups have been engaged in a vigorous debate over what form such a multi-pollutant policy might take.



With legislation stalled, the Administration was motivated to move forward with air pollutant regulation under the existing Clean Air Act (CAA) and under the subsequent court decisions to further regulate NO_x, SO₂, and mercury emissions from power plants. EPA's proposed Clean Air Interstate Rule (CAIR, formerly the Interstate Air Quality Rule) and Mercury Rule were published on January 30, 2004. The CAIR would

Meanwhile, alternative proposals have been introduced by members of Congress and detailed analyses performed by both affected utilities and the U.S. Environmental Protection Agency (EPA). ICF Consulting has performed many of those analyses, including work for EPA, the Clean Energy Group (a coalition of private utilities supporting an alternative to the President's proposal), the Clean Air Task Force, and several utilities and generating companies.

However, debates over the scope, stringency, timing, and the inclusion of pollutants such as carbon dioxide (CO₂) limits have prevented any such law from moving forward in Congress. Senator Inhofe (R-OK), chairman of the Senate Committee on Environment and Public Works, has said that he does not expect to revisit the Clear Skies Act (CSA), the proposed law based on the President's initiative, until 2005.

mandate reductions in SO₂ and NO_x in 29 states and the District of Columbia while the Mercury Rule would require Hg emissions reductions on a national basis. If passed, the combined impact of these new rules will result in substantial investments in SO₂, NO_x, and Hg control technologies over the next 15 years. By 2020, it is possible that two-thirds of coal capacity will be controlled for all three pollutants.

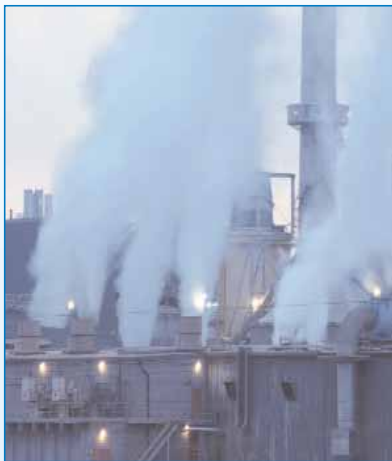
EPA has structured CAIR to encourage state participation in a cap-and-trade market, where affected units could trade allowances much as they do now under the NO_x SIP Call. Because allowance allocations are "predetermined" by the existing national Title IV SO₂ program, EPA is taking a novel approach in reducing SO₂ emissions. It plans to maintain the cap-and-trade market, but devalue allowances

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of units in the affected region by a 2-to-1 ratio, gradually changing to a 2.86-to-1 ratio to reduce emissions. In other words, power plant owners in CAIR-affected states would be required to turn in two (or 2.86) allowances at the end of every year for every ton of SO₂ emissions they produce. Such a system would create separate SO₂ allowance markets for each vintage of the allowances themselves, thus adding complexity to the accounting systems and compliance planning.

Under the CAA, EPA also was required by the end of last year to propose regulations to control mercury emissions from power plants as a hazardous pollutant. EPA intends the Hg Rule to respond to this requirement, but leaves open the critical question of whether the regulation will come in the form of a cap-and-trade system or a unit-by-unit command-and-control requirement, commonly known as Maximum Achievable Control Technology (MACT). While EPA clearly favors a cap-and-trade solution, it is far from certain whether this will be the ultimate course of action.

The proposal has become even more uncertain over the past weeks, with the EPA Administrator pledging to review



the proposed emissions targets and perform further analyses. Electric companies face significant uncertainty under the Hg Rule, with the eventual outcome of the cap-and-

trade versus MACT question, as well as the reconsideration of the target, leaving the range of compliance methodologies and costs wide open. Due to the contentious nature of Hg debate, ongoing litigation is almost certain.

EPA expects to complete the CAIR this year and is preparing to issue a final Hg Rule in 2005, but the details of the Hg Rule and prospects for CO₂ reductions remain highly uncertain.

Faced with the prospect of making large capital investments on projects with long lead times, this uncertainty is problematic for the electric power industry. ICF Consulting continues to work with its power sector clients to assist them in developing robust compliance plans in the face of this tremendous uncertainty.

For more information on ICF Consulting's capabilities in emissions management, please visit www.icfconsulting.com/energy.