February 13, 2002

Ms. Nancy Wrona, Director
Air Quality Division
Arizona Department of Environmental Quality
3033 N. Central Avenue
Phoenix, AZ 85012-2809

Re: Tucson Electric Power Springerville Generating Station - Permit #1001554

Dear Ms. Wrona:

Thank you for the opportunity to review the proposed Title V permit ("proposed permit") for Tucson Electric Power Company's Springerville Generating Station, which currently consists of Units 1 and 2 and associated equipment. Your proposed permit would allow the construction of Units 3 and 4 at the Springerville Generating Station without subjecting those new units to full review under the Clean Air Act ("CAA") regulations concerning Prevention of Significant Deterioration ("PSD"). As explained more fully in an attachment to this letter, Tucson Electric Power Company cannot utilize the identified emissions reductions from those units to net Units 3 and 4 out of full PSD review. Our objection to this permit is based on CAA Section 505, Part 70.8 of Volume 40 of Code of Federal Regulations (40 CFR 70.8), and Arizona Department of Environmental Quality Rule R18-2-306. Under Section 505(c) of the Clean Air Act and 40 CFR § 70.8(c)(4), Arizona Department of Environmental Quality has 90 days to address EPA's objection.

While we are formally objecting to your proposed permit, we want to work with you over the next 90 days to address the issues we have identified and we are optimistic that we can reach a successful resolution. We have recently proposed to TEP a path that could expedite construction of the proposed additional units and would like to discuss these matters with all parties as soon as possible. I know we all have the common goal of protecting air quality and visibility in Arizona.

I look forward to discussing this further. Please contact me at your convenience at (415) 947-8715. In addition, if your staff have specific questions about the issues raised, please have them call Matt Haber at (415) 947-4154 or Gerardo Rios at (415) 972-3974.

Sincerely,

/ s /

Jack Broadbent
Director, Air Division

Enclosure
cc: Cosimo de Masi, TEP

EPA Objection to Tucson Electric Power ("TEP") Title V Permit

We are objecting to the proposed TEP Title V Permit #1001554 ("proposed permit") because it does not contain all applicable requirements under the approved state implementation plan ("SIP") for Arizona. Under the SIP, all major new sources and major modifications must undergo full review under the regulations concerning Prevention of Significant Deterioration ("PSD"). This review would, among other things, require an analysis of what air pollution control equipment or practices would be the best available control technology ("BACT") for the source or modification, the installation and operation of BACT, and an analysis of the air quality increment being consumed by the new source or modification.

Under the proposed permit, TEP's new units at the Springerville Generating Station would avoid full PSD review through "netting." Under this netting proposal, the entire Springerville Generating Station (Units 1, 2, 3, and 4) would take an emissions cap to ensure that the Station, as a whole, would not have a net emission increase despite the addition of emissions from Units 3 and 4. If performed in accordance with the law, netting is an appropriate method to avoid full PSD review under the SIP.

We have recently learned, however, that the netting scheme set forth in the proposed permit is not valid because Units 1 and 2 were not properly permitted under the PSD rules which were applicable at the time that TEP commenced construction of those units. In the absence of such appropriate permits, the level of emissions from Units 1 and 2 are higher than allowed by the SIP and the Clean Air Act ("CAA") and, therefore, TEP cannot rely on the identified reductions in these emissions for netting purposes.

<u>Changing Rules on "Grandfathering" and Chronology of TEP Actions</u>

To clarify why we have concluded that Units 1 and 2 at the Springerville Generating Station were not properly permitted at the time TEP commenced construction of those units, we are setting forth the relevant portions of the PSD rule making actions which occurred in the 1970s, the key activities undertaken by TEP, and further information provided by TEP. Importantly, as the regulations changed in the late 1970s, identifying when and if a source had "commenced construction" was critical in determining which set of regulations applied to the source and whether a permit obtained under prior versions of the regulations remained valid, which was known as being "grandfathered."

In December 1974, EPA published a final version of PSD rules ("1974 PSD rules"). 39 Fed. Reg. 42510 (December 5, 1974). Under the 1974 PSD rules, "'commenced' means that an owner or operator has undertaken a continuous program of construction or modification or that an owner or operator has entered into binding agreements or contractual obligations to undertake and complete, within a reasonable period of time, a continuous program of construction or modification" and "'construction' means fabrication, erection, or installation of an affected facility." No definition was created for "facility," and the necessary scope of the binding agreements or contractual obligations was left undefined.

In November 1977, EPA published final amendments to the 1974 PSD rules to incorporate immediately effective changes required by the 1977 Clean Air Act amendments. 42 Fed. Reg. 57461 (November 3, 1977). Under these amendments, "'commenced' as applied to construction of a stationary source means that the owner or operator has obtained all necessary preconstruction approvals or permits required by Federal, State, or local air pollution emissions and air quality laws or regulations and either has (i) begun, or caused to begin a continuous program of physical on-site construction of the source, or (ii) entered into binding agreements or contractual obligations, which cannot be canceled or modified without substantial loss to the owner or operator, to undertake a program of construction of the source to be completed within a reasonable time." While this definition was more comprehensive, no definition was created for "source" and, therefore, the necessary scope of the binding agreement or contractual obligation was still left somewhat ambiguous.

In December 1977, EPA Region 9 issued a permit under the 1977 PSD rules for Units 1 and 2. These units were pulverized coal-fired electric generating facilities producing about 375 megawatts of electricity each with SO_2 scrubbers designed for an emissions control efficiency of approximately 65% removal. The 1977 permit did not require the installation of air pollution controls for NOx emissions.

In February 1978, TEP submitted a letter stating that they had entered into a contract in January 30, 1978 for construction of the boilers for the Units 1 and 2. TEP's letter states that "In accordance with this, we 'commenced construction' on that date." The letter further stated that "We are proceeding with bids for turbines and other activities in order that the first unit will be available in 1985." However, TEP did not mention that the contract lacked any penalty provision for cancellation or modification; in other words, no particular "substantial loss" was attributed to TEP in the event of cancellation or modification of the contract.

In June 1978, EPA published a new version of PSD rules ("1978 PSD rules"). 43 Fed. Reg. 26388 (June 19, 1978). Pursuant to specific Congressional direction, the 1978 PSD rules significantly changed the requirements for "commencing construction." As stated in the preamble to the 1978 PSD rules, "From the legislative history, it is clear that boiler contracts, even those with penalty clauses, will typically not suffice. See S. Rep. No. 95-127, at 32-33 (1977). The source must enter into a site-specific commitment through contracts." Thus, while the definitions of "commence" and "construction" were modified slightly, the most relevant additions to implement this Congressional direction were the definitions of "source" and "facility." "'Source' means any structure, building, facility, equipment, installation, or operation (or combination thereof) which is located on one or more contiguous or adjacent properties and which is owned or operated by the same person (or by persons under common control)." "'Facility' means an identifiable piece of process equipment. A source is composed of one or more pollutant-emitting facilities."

These new definitions are extremely important for grandfathering sources. To commence construction via binding agreements or contractual obligations, those agreements or contracts

must cover the "source," which means all the pollutant-emitting facilities at the Springerville Generating Station, not just the boilers. For TEP and the Station, the "source" included such additional major emissions units as the coal silos, coal handling units, feedwater heaters, turbines, and the smoke stacks. Under the 1978 PSD rules, if a permit holder had not commenced construction, as that is defined under the 1978 PSD rules, by March 19, 1979, then the old permit became ineffective and a new permit was required.

In a letter dated March 14, 1979, five days before the grandfathering deadline, TEP informed EPA Region 9 of "activities which have taken place since our last report of February 27, 1978." The letter listed 16 items which TEP characterized as "the main activities in which I felt you [EPA] would be interested." Only one of those items, #13, even indirectly referred to contracts for pollutant-emitting facilities at the source: "Architect-engineer contract signed for detailed engineering design, Springerville Generating Station, Units 1 and 2." Materials subsequently submitted by TEP to EPA show that physical on-site construction of Units 1 and 2 did not commence until well after March 19, 1979.

Conclusion

The discussion above shows that TEP failed to commence construction on Units 1 and 2 at the Springerville Generating Station by March 19, 1979, as required by the 1978 PSD rules, and hence was not grandfathered out of the need to obtain a PSD permit under the 1978 PSD rules. TEP did not begin physical on-site construction by that date. The contractual obligation incurred by TEP prior to March 19, 1979, did not cover the "source" as defined by the 1978 PSD rules. In addition, the contractual obligation incurred by TEP prior to March 19, 1979, did not include penalties or "substantial loss" in the event of TEP's cancellation or modification of that contract. Either of these latter two flaws in the contract would preclude a finding that TEP had commenced construction in a timely manner. As a result, Units 1 and 2 were constructed and are operating without a valid PSD permit, in violation of the SIP and the CAA. Thus, the NOx and SO2 emissions reductions TEP proposed to use to net Units 3 and 4 out of full PSD review are not available for that purpose. Therefore, Units 3 and 4 must go through full PSD review and permitting under the SIP.