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UNITED STATES
NUCLEAR REGULATORY COMMISSION

WASHINGTON, D.C. 20555-0001

June 12, 1996

NOTE TO COMMISSIONER ASSISTANTS

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FROM: James L. Blaha *[Signature]*
Assistant for Operations, OEDO

SUBJECT: FEDERAL ENERGY REGULATORY COMMISSION ORDER

Attached is the Federal Energy Regulatory Commission (FERC) Order objecting to the EPA's decision to refer a FERC EIS to the Council on Environmental Quality. Since the Order states that FERC or an independent agency cannot be bound by the processes conducted by an Executive Branch agency, it is provided for your information.

Attachment:
As stated

cc: J. Taylor, EDO (w/attachment)
J. Milhoan, DEDR (w/o attachment)
H. Thompson, DEDS (w/o attachment)
J. Blaha, AO/OEDO (w/attachment)
M. Lopez-Otin, DSP (w/o attachment)
SECY (w/attachment)
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OCA (w/o attachment)
OPA (w/o attachment)

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Manney, and Donald P. Santa, Jr.

[Docket Nos. RM95-8-000 and RM94-7-001]

Promoting Wholesale Competition Through Open Access
Non-discriminatory Transmission Services by Public Utilities;
Recovery of Stranded Costs by Public Utilities
and Transmitting Utilities

CPDER RESPONDING TO REFERRAL TO COUNCIL ON ENVIRONMENTAL QUALITY

[Issued May 29, 1996]

On May 13, 1996, the Administrator of the Environmental Protection Agency (EPA) referred to the Council on Environmental Quality (CEQ), pursuant to section 305 of the Clean Air Act, 42 U.S.C. § 7609, and 40 C.F.R. Part 1504 of the CEQ regulations, Order No. 888, the Final Rule promulgated by the Federal Energy Regulatory Commission (FERC or Commission), "Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities" (Final Rule or Rule). 1/ This order responds to the referral.

Background

The Final Rule requires public utilities that own, control or operate facilities used for transmitting electric energy in interstate commerce to have on file open access non-discriminatory transmission tariffs that contain minimum terms and conditions of non-discriminatory service. The Final Rule also permits public utilities and transmitting utilities to seek recovery of legitimate, prudent and verifiable stranded costs associated with providing open access and Federal Power Act section 211 transmission services.

Because of questions raised about the possible environmental consequences of the Final Rule, the Commission undertook an environmental analysis which included the publication of a Draft Environmental Impact Statement reflecting extensive modeling and analysis of possible impacts, receipt and analysis of public comment, and adoption of the Final Environmental Impact Statement (FEIS) which contained significant additional analysis including

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model studies requested by EPA. The FEIS focused largely on concerns that the open access policy adopted in the Rule would increase emissions of nitrogen oxides (NO_x) from utility power plants.

The FEIS shows that with or without the Rule NO_x emissions from all electric generation sources are likely to decrease through the year 2000, but thereafter are expected to increase. Thus, the FEIS concludes that there is a significant long-term environmental problem that should be addressed. However, the FEIS also shows that the key factors influencing the contribution of electric utilities to this problem are the relative price and competitive market conditions of natural gas and coal. Depending on whether these factors favor gas or coal, the Final Rule will result in either a slight decrease or slight increase in NO_x emissions levels over the emissions trends otherwise expected to occur.

The FEIS also studied possible results under a set of assumptions suggested by EPA as more likely to show greater NO_x increases attributable to the Rule (assumptions the Commission believes to be wholly unlikely). Under these assumptions, the results are basically the same until the year 2010, when somewhat greater emission increases would occur under scenarios in which competition favors coal.

The Referral

On May 13, 1996, the EPA Administrator referred the Final Rule to the CEQ. Also on that day, the Chair of the CEQ asked for the Commission's comments on the referral.

In its referral letter, EPA concurred with the Commission's view in concluding "that the open access rule is unlikely to have any significant adverse environmental impact in the immediate future, and that in light of its anticipated economic benefits, implementation of the Rule should go forward without delay." In a letter of May 22, 1996, 2/ forwarding a further review of the Commission's FEIS, EPA also stated that on the basis of that analysis, "EPA concludes that the FERC has conducted an adequate

2/ Letter of May 22, 1996 to Kathleen A. McGinty, Chair, Council on Environmental Quality from Mary D. Nichols, Assistant Administrator for Air and Radiation, Environmental Protection Agency.

1/ 51 Fed. Reg. 21,940 (1996).

analysis under the National Environmental Policy Act of the environmental impacts of the open access rule under a range of possible scenarios." 1/

EPA's referral is based on its concern with potential longer term effects of the Rule. In the report accompanying the May 22 letter, EPA has looked at another set of assumptions that it believes will show greater effects attributable to the Rule. Nevertheless, EPA now shares the Commission's view that NO_x emissions increases associated with the Rule, if any, should be addressed as part of a comprehensive NO_x emissions control program developed by EPA and the States under mechanisms available under the Clean Air Act. This includes support for the efforts of the Ozone Transport Assessment Group to develop standards for measuring the scope of the ozone transport problem and developing emissions reduction strategies. EPA has indicated its intent to use its authority under Title I of the Clean Air Act to support successful completion of the OTAG process. EPA states it is prepared, if necessary, to establish a NO_x cap-and-trade program for the OTAG region through Federal Implementation Plans "if some States are unable or unwilling to act in a timely manner."

EPA further suggests that if "the OTAG and Clean Air Act processes fail to produce the necessary pollution limitations in a timely manner, EPA will call upon all other interested federal agencies to assist in solving the problem." In this context EPA would ask FERC to contribute by further examining, through a Notice of Inquiry, possible strategies for mitigating NO_x emissions increases associated with the Rule. EPA also suggests that if EPA determines that the problem must be addressed through EPA initiation of Federal Implementation Plans, FERC could then initiate a rulemaking to propose "suitable means under the Federal Power Act" for mitigating impacts attributable to the Rule.

EPA's Analysis

In making its referral decision, EPA has relied upon an EPA staff analysis entitled Technical Analysis of FERC Final

- 1/ The EPA further concludes that "[t]he FERC made a reasonable choice of models (CEQM) and made assumptions for various factors input into the model that lie within the range of reasonable assumptions. EPA notes that the FERC performed the specific additional analyses that we requested in our comments on the draft EIS."

Environmental Impact Statement on Open Access Rule (Order 888). That report concludes that:

EPA believes that the FEIS provides a credible basis for understanding the possible environmental impacts of the open access rule. EPA believes that the FERC selected appropriate analytic models, designed several informative policy scenarios and responded to the concerns that EPA raised with the draft EIS. However, after reviewing the FEIS and its underlying input assumptions in detail, EPA concludes that there are several key assumptions that drive the results on NO_x emissions which could have been specified differently. Other reasonable assumptions in these areas could have led the FERC to attribute greater potential NO_x increases to the open access rule.

While it is true that reasonable minds may differ over appropriate assumptions for analysis, we continue to believe that the assumptions made in the FEIS and our further analysis in the Final Rule are the appropriate analysis to use in evaluating the effects of the Final Rule. The EPA staff report offers little rationale to support changing the assumptions underlying our analysis. It only contends that changing the assumptions leads to higher emissions. Significantly, EPA concedes that if it believed a change to an assumption would produce no change in emissions, it did not analyze that assumption. As a "word of caution", EPA states that it offered only tentative conclusions about the effects of individually changing certain key assumptions. EPA did not estimate the joint impact of changing several assumptions simultaneously. Nor did EPA present the effects on emissions if a different set of assumptions were substituted in the model for those used in the FEIS. Finally, the assumptions offered in the staff report contradict those EPA offered in its comments earlier in this proceeding. For example, in comments on the draft EIS EPA said that the lower gas price scenario was more likely; now it suggests that the higher gas price scenario is more likely. Earlier, EPA asked for an analysis of a 40 percent increase in transmission capacity. We conducted that analysis. Now, without explanation, EPA suggests an even greater increase in transmission capacity. Such an increase is unrealistic. Thus, notwithstanding the more recent report from EPA, we stand by our prior analysis.

We make the following specific observations: The key difference between our analysis and EPA's most recent analysis is EPA's assumption that the High-Price-Differential base case and the Competition-Favors-Coal scenario are more likely to occur than other scenarios analyzed in the FEIS. EPA states that "increases in NO_x levels from the open access rule are likely to

be at least as large as these scenarios suggest. This conclusion is not supported by analysis.

The Commission believes that the FEIS provides a reasonable range of assumptions of equal likelihood and that the base case and scenario indicated by EPA as "the most reasonable starting point" are no more likely than the Constant-Price-Differential base case and the Competition-Favors-Gas scenario. It should be noted that this statement by EPA contradicts the belief expressed in its comments on the DEIS that the Constant-Price-Differential base case is the more likely of the two base cases.

The two base cases differ from one another in the assumptions about the relative prices of natural gas and coal. In the High-Price-Differential case a typical price projection for natural gas projected gas prices rising as compared to coal. In the Constant-Price-Differential case the price of natural gas is projected to continue following the pattern of the last ten to fifteen years and track the price of coal, rising when coal prices rise and falling when they fall. History has shown price projections for gas have been uniformly higher than prices realized in the market throughout that period. We believe that it is entirely reasonable to project a continuation of that history. Thus we stand by our predicted low range for gas prices.

The two scenarios ascribe competitive effects in the industry to the Rule and are intended to provide a range of impacts, each of no greater likelihood than the other. The Competition-Favors-Coal scenario attributes all generation efficiencies to coal generators and assumes that no efficiencies occur in the gas industry--the Competition-favors-Gas scenario does the opposite. It is more likely that both sets of generators will pursue efficiency improvements as a result of the competitive effects of open Access than that either will do so to the exclusion of the other. Again, both scenarios are equally likely.

Transmission Expansion. EPA continues to argue that the Rule will result in increased expansion of the transmission system. The Commission believes that relief of bottlenecks in the system is an important goal. However, the Final Rule provides no new authority to compel transmission expansion than was contained in the Energy Policy Act of 1992. As a result, no difference in transmission capacity is assumed between the base cases and the Rule scenarios.

Further, the sensitivity analysis recommended by EPA and done for the FEIS effectively expanded the transmission system by up to 40 percent on every line in the country. Less than one percent difference in emissions was seen in each of the years

projected. The new analysis provides no rationale as to why the 40 percent expansion case previously requested by EPA is not now sufficient. Indeed, we believe that even the 40 percent expansion case is not a reasonable one. It simply is not likely to occur. It is not at all clear from EPA's report why greater emissions differences were ascribed to transmission expansion than the actual model runs showed.

Planning Reserve Margins. EPA argues that the FEIS did not actually lower the planning reserve margins to 11 percent in the Rule scenarios, but to 14.2 percent, and that actually lowering them the remaining 1.2 percent would result in higher emissions because fewer new gas plants would be built. The difference described in EPA's report comes from a different way of aggregating reserve margin figures across regions with differing reserve margin requirements. It is true that lower reserve margins might cause greater emissions. However, if the same methodology for aggregating reserve margins across regions were used for the base case as for the Rule scenario, the result could be higher emissions in the base case as well as the Rule scenario, and as a consequence, roughly the same difference ascribable to the Rule as projected in the FEIS.

Increased Generation of Electricity. EPA suggests that the FEIS should have incorporated assumptions reflecting price elasticity effects--i.e., that when prices go down consumption goes up. Studies that indicate such an effect are questionable in attempting to model the emerging competitive electricity industry. Further, even if there are price elasticity effects we believe that they would likely be offset. We believe a competitive marketplace will give customers at the wholesale and retail level more choices in resources, and may well allow customers to make power purchase and use decisions that will offset price elasticity effects that may come from lowering of prices. 1/

Increased Emissions from Improved Heat Rate Maintenance. EPA argues that the FEIS should have ascribed improved heat rate maintenance and the accompanying efficiencies to the base case as well as the Rule scenarios, resulting in lower emissions in the base case and higher emissions ascribable to the Rule. This is a reversal of EPA's previous position in their comments on the DEIS that all efficiency improvements should be attributed to the Rule.

The FEIS assumed that the Rule results in general efficiency improvements in both plant availability and heat rate. EPA's comments do not provide sufficient reason to consider one type of

1/ This is discussed more fully in the FEIS.

efficiency improvement (availability) without the other (heat rate).

Order No. 888 comments extensively on the proposals and assumptions of EPA and other parties. Fundamentally, EPA and this agency agree that the Rule will not have immediate adverse impact. However, we hold divergent views as to possible future impacts. We believe that the outcome of the FEIS represents a reasonable range of projections of future emissions attributable to the Rule and that the High-Price-Differential base case and the Competition-Favors-Coal scenario are no more likely than the other cases and scenarios modelled in the FEIS.

The Referral Process

We disagree for both substantive and institutional reasons with EPA's decision to refer the Rule to the Council on Environmental Quality. First, we note that referral is an extraordinary action, appropriate to circumstances posing the demonstrable risk of severe environmental harm. ^{5/} It is particularly important that EPA use this authority judiciously based only upon strong, well-tested evidence, given that referral typically involves a request that the referred action be stayed or delayed pending CEQ resolution.

The Rule violates no established national environmental law or policy. Its environmental consequences are not likely to be significant and are as likely to be beneficial as harmful. The Commission has complied fully with NEPA and has identified a sensible approach to mitigation that would address any adverse long-term effects as a part of a comprehensive program to address NO_x emissions overall.

We appreciate that EPA has specifically agreed that the Rule should go forward, based upon its conclusion that the Rule poses no immediate environmental harm. Indeed, it is difficult to understand why EPA believes a referral is necessary where there is no immediate adverse effect and, as EPA notes, our analytic differences over longer term consequences are in effect differences in assumptions that lie within a reasonable range of each other. We believe it is inappropriate for EPA to refer this agency's action based upon narrow analytic differences in the absence of strong and well-tested evidence of environmental harm. This is particularly the case where, as here, the agency's NEPA obligations have been satisfied.

^{5/} See 40 C.F.R. § 1504.2.

* Of even greater concern, however, are the difficulties associated with the referral of an action of an independent regulatory agency. The Commission is interested in maintaining the proper relationship between Executive Branch agencies and processes and its status as an independent regulatory agency. The regulations of the CEQ are useful as a mechanism for resolving disputes in the Executive Branch. They raise significant questions, however, when applied to the actions of independent regulatory agencies.

The CEQ regulations establish a dispute resolution process that typically involves mediation by CEQ and efforts by the Executive Branch to modify the referred action or delay its implementation. Such a process runs counter to the requirements of this Commission as an independent regulatory agency that, by law, must make its decisions with respect to the Final Rule based on the record in this proceeding and not within the councils of the Executive Branch. While we will, when appropriate, engage in consultations and exchanges of information in order to facilitate resolution of disputes with other agencies, we are obligated to maintain the independence of our decision-making process. The processes identified in the Council on Environmental Quality regulations are wholly unsuitable for resolving disputes with an independent agency. This agency cannot be bound by the processes conducted by an Executive Branch agency. Decisions with respect to Order No. 888 will be made by the Commission pursuant to our established processes for decision-making under our governing statutes and regulations. *

Mitigation Strategies

As noted above, EPA in its referral letter indicates that it will address the NO_x problem comprehensively under the Clean Air Act by supporting the OTAG process and using other authorities under the Clean Air Act if necessary to establish a NO_x cap-and-trade program. The Commission endorsed such an approach in Order No. 888 and welcomes EPA's decision to step forward and address the NO_x problem comprehensively.

EPA has indicated that it wishes the Commission to consider playing a role in mitigating possible emission increases attributable to the Rule in the event its efforts with the States to address this problem comprehensively do not succeed. Given EPA's commitment to address air pollution issues, it is appropriate for EPA to seek assurances that if its best efforts are not successful, other agencies will examine their abilities to address the problem within the scope of their respective statutory authorities. Given the broad powers vested in EPA by the Clean Air Act, we fully expect EPA to succeed. We also note that if EPA is unable ultimately to address the issue, either

through the voluntary OTAG process or by means of its authority under the Clean Air Act, we doubt that other agencies will be able to resolve the NO_x emissions problem under more limited authority. In such circumstances, action by the Congress may be necessary.

Nevertheless, we believe that the Commission should be willing, if called upon under the circumstances EPA describes, to consider whether, under the Federal Power Act, it can and should attempt to address NO_x emissions issues attributable to the Rule. Therefore, if EPA concludes that the OTAG process has not succeeded in meeting its objectives in a timely manner, we will initiate a Notice of Inquiry to further examine what mitigation might be permissible and appropriate under the Federal Power Act. Such an inquiry would solicit public comment on how to assess appropriately the air pollution impacts attributable to the Final Rule, suitable ways in which to address such impacts, if any, and the scope of the Commission's authority to address such impacts.

Additionally, under the extraordinary circumstances in which EPA would undertake a Federal Implementation Plan, the Commission would agree to initiate contemporaneously a rulemaking to propose possible mitigation that could be undertaken by the Commission under the Federal Power Act. Such a rulemaking would be undertaken on the basis of the NOI mentioned above and would be appropriate only if environmental harm attributable to the Rule that warranted mitigation is demonstrated. The Commission would rely upon information gleaned in the NOI in proposing possible mitigation strategies that are workable, tailored to address consequences attributable to the Rule, and consistent with our statutory authority. In no event would the Commission propose a mitigation strategy that would undermine the purposes of the Rule to provide open transmission access on a non-discriminatory basis. We emphasize that neither the NOI nor the rulemaking, if they occur, will affect the implementation of the Rule as required under Orders of the Commission.

Conclusion

The Commission objects to the decision by EPA to refer the Rule and believes that there is not a sufficient factual basis to justify that action. In addition, as an independent regulatory agency, the Commission cannot be bound by the decisions of the Council on Environmental Quality. Therefore, beyond this response, we do not intend to participate further in the referral process. *

The Commission nevertheless agrees to examine the issue of mitigation in the event that EPA and the OTAG States are unsuccessful in addressing the NO_x problem, as discussed above,

and EPA seeks the assistance of all Federal agencies. We emphasize however, that a meaningful solution to the NO_x problem overall lies far beyond any action that this Commission or other Federal agencies could take outside the framework of the Clean Air Act. We therefore strongly encourage EPA, the States and all parties who seek a meaningful solution to this problem to commit themselves to the OTAG process and to using the authorities under the Clean Air Act to address this problem fairly and comprehensively.

The Commission orders:

The Secretary of the Commission shall transmit this Order to the Council on Environmental Quality.

By the Commission.

(S E A L)

Lois D. Cashell
Lois D. Cashell,
Secretary.