

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION10
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Seattle, Washington 98101

Reply To
Attn Of: OAQ-IO7

OCT 12 2001

Grant Cooper
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Raymond McKay
EPCOR Power Development
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Subject: PSD Applicability for Frederickson Power L.P.

Dear Mr. Cooper and Mr. McKay:

This letter is in response to the Preston Gates & Ellis letter of June 22, 2001, written to the State of Washington Department of Ecology (Ecology) on behalf of Frederickson Power and EPCOR Power Development (EPCOR). In addition to constructing a 249 megawatt (MW) power generation facility (current project) at a site in Frederickson, Washington, the companies are considering the construction of an additional combined cycle combustion turbine project (proposed project) of less than 350 MW on the same property. It is our understanding that the proposed project will be constructed sufficiently close to the current project such that the two projects will be considered one stationary source given their common ownership and Standard Industrial Classification (SIC) code.

The United States Environmental Protection Agency (EPA) has concluded that it is permissible to permit the proposed project separately from the current given the facts of this situation as discussed below. In particular, the fact that both projects would likely be required to install the same pollution control technology regardless of permitting process (minor NSR vs PSD) significantly diminishes any potential environmental benefit that would otherwise be gained by permitting the projects together through PSD. Moreover, the fact that Ecology's minor NSR and PSD programs both require the installation of BACT does not provide EPCOR an incentive to intentionally space out the projects so as to circumvent PSD.

Background

The current project was originally developed by Tenaska Washington Partners (Tenaska) to supply electricity to the Bonneville Power Administration (BPA) as part of BPA's 1991 Competitive Acquisition Program. The two parties entered into a power-purchase agreement in April 1994. Prior to the agreement, BPA conducted an extensive environmental review of the project and subsequently issued an environmental impact statement in January 1994. The Puget Sound Clean Air Agency (PSCAA), the local permitting authority, issued Tenaska a synthetic minor New Source Review (NSR) permit on April 14, 1994.

Construction of the current project commenced in September 1994 with the intent of starting up the project by fall 1996. In June 1995, however, after only 40 percent of the project was completed, construction was suspended when BPA withdrew from its agreement to purchase power from Tenaska. After protracted litigation and subsequent arbitration, Tenaska transferred the partially completed project to BPA in March 1998.

In December 1999, Frederickson Power entered into an asset purchase and sale agreement with BPA which would allow completion of the original project. Before construction was allowed to recommence, however, Frederickson Power was required to obtain a synthetic minor NSR permit from PSCAA, which it did, on April 25, 2000. The minor NSR permit limits individual criteria pollutant emissions from the current project to less than 100 tons per year. As of May 1, 2001, construction of the current project was 60 percent complete and engineering 99 percent complete. The project is expected to be in commercial operation by July 2002.

In light of the recent Northwest energy crisis, Frederickson Power is considering constructing another combined cycle combustion turbine project near the current project, which is already under construction. The proposed project would operate separately from the current project as illustrated by the fact that the two projects would not share the same transmission line, fuel supply contracts, power sales contracts, gas metering stations, or connections to water and wastewater systems.

Frederickson Power is requesting a Prevention of Significant Deterioration (PSD) applicability determination from EPA and Ecology as to whether the proposed project can be permitted separately from the current project for purposes of construction authorization. Separating the projects in such a manner would allow the existing minor NSR permit to remain in place and would require Frederickson Power and/or EPCOR to obtain a separate synthetic minor NSR permit for the proposed project. Combining the projects would essentially nullify the existing synthetic minor permit and would require one PSD permit for both projects together. Generally, PSD permitting is more rigorous than minor NSR permitting. A PSD permit, unlike a typical minor NSR permit, requires the installation of Best Available Control Technology

¹January 26, 2001, Proclamation by the Governor; Gary Locke, of the State of Washington declaring an energy supply alert, most recently extended through October 22, 2001.

(BACT) and an ambient impact analysis demonstrating not only protection of the National Ambient Air Quality Standards, but also acceptable increment consumption and protection of Air Quality Related Values in Class I areas. Notably in Washington, however, Ecology's minor NSR program requires all sources to install BACT and thereby results in one of the environmental protections that is required under PSD permitting.

Discussion

EP A has issued several guidance documents that relate to the issue of whether two projects that are located near each other and undertaken within a relatively short time frame may be permitted as two minor sources, or whether it is appropriate to obtain a single PSD permit for the projects². Those guidance documents emphasize the importance of evaluating a source's intent - specifically, whether the source intends to circumvent PSD permitting - in undertaking two such projects. As stated in the October 1986 memo:

In the extreme case where the source has made a deliberate effort to circumvent PSD review (by the systematic construction of carefully sized emissions units which only in the aggregate would trigger review) a permitting agency may, however, make a finding that PSD applies to the total plant. Such a finding would have to be based on clear evidence that the source made a conscious effort to escape review by knowingly misrepresenting the intended source size through the calculated juggling of actual and scheduled construction of emission units.

The June 1989 *Federal Register* notice along with memos addressing "Potential to Emit" and the June 1993 3M Memo provide specific criteria for permitting and enforcement authorities to apply when evaluating whether a source intends to circumvent major NSR through the minor NSR permitting process. An outline of the criteria is presented here along with a case-specific assessment.

1. Filing of More than One Minor Source Application Associated with Emissions Increases at a Single Plant Within a Short Time Period

As stated in the June 1993 3M Memo:

² EPA Guidance on this topic includes: October 21, 1986, memo entitled, "Applicability of PSD to Portions of a Plant Constructed in Phases Without Permits" (October 1986 Memo); June 13, 1989, memo entitled, "Limiting Potential to Emit in New Source Permitting"; June 28, 1989, *Federal Register* Notice Promulgating Revisions to 40 CFR Parts 51 and 52, 54 Fed. Reg. 27274, 27280-27281 (June 1989 Federal Register Notice); September 18, 1989, memo entitled, "Request for Clarification of Policy regarding the Net Emission Increase"; October 1990 Draft NSR Workshop Manual, pages A.36 & A.37; June 17, 1993, memo entitled, "Applicability of New Source Review Circumvention Guidance to 3M - Maplewood, Minnesota." (June 1993 3M Memo).

If a source files for more than one minor source permit application simultaneously or within a short time period of each other, this may constitute strong evidence of an intent to circumvent the requirements of preconstruction review. Authorities should scrutinize applications that relate to the same process or units that the source files either before initial operation of the unit or after less than a year of operation.

Although Tenaska obtained the original plant permit from PSCAA in April 1994, Frederickson Power submitted its minor NSR application for the current project to PSCAA in October 1999. We find it appropriate only to consider the time frame in which Frederickson Power became actively involved at the plant. We are assessing Frederickson Power's intent in October 1999 and not Tenaska's intent in 1994. Frederickson Power is now considering submitting another application for additional power generation approximately 24 months after the application for the current project and before the current project finishes construction. Thus, this second permit is being requested outside, but close to, the short time frame characterized by previous EPA guidance as less than 18 months. See June 1993 3M Memo.

It is our estimation that the frequency of major construction permitting at a typical power plant spans well beyond two years given the historical stability in the market. However, recent dramatic and unanticipated fluctuations in wholesale energy prices in the Western United States have understandably motivated wholesale energy producers to react quickly to favorable market conditions. In the Pacific Northwest alone, thousands of megawatts are being developed in a few months after years of inactivity. Frederickson Power has provided evidence³ stating, "[The proposed project] is being developed primarily in response to the energy crisis that has emerged in the Pacific Northwest over the past several months." Because the unanticipated shift in marketplace conditions could certainly justify the companies' shortened permitting cycle and minor NSR permitting approach, we believe the 24-month span between the two applications is a reasonable time period supporting separation of the projects. However, we proceed with our review of other criteria to ascertain the companies' intent when applying for the current project's permit because a 24-month span is relatively short.

2. Applications for Funding

As stated in the June 1993 3M Memo:

Applications for commercial loans, or, for public utilities, bond issues, should be scrutinized to see if the source has treated the projects as one modification for financial purposes. If the project would not be funded or if it would not be economically viable if operated on an extended basis (at least a year) without the other projects, this should be considered evidence of circumvention.

³May 8, 2001, Declaration of Harvie Campbell before the State of Washington Energy Facility Siting Evaluation Council in support of petition for declaratory order.

Frederickson Power has not applied for a commercial loan to fund the current project. According to a certified statement⁴ of Mr. Brian Vaasjo, Executive Vice President of EPCOR, "The [current] project has, to date, been self-financed." Documentation unrelated to Frederickson Power's financing illustrates the financial independence of the two projects. Mr. Harvie Campbell, Vice President of Westcoast Power Inc. (parent company to Frederickson Power), provided a sworn declaration (Declaration) to the State of Washington Energy Facility Site Evaluation Council (EFSEC) in May 2001, related to the purchase, permitting and construction of the current project along with the initiation of the proposed project. In his Declaration, Mr. Campbell provides evidence of the companies' original intent to solely develop the current project, and he speaks to the economic viability and independent nature of the projects. Mr. Campbell states:

Frederickson Power did not plan to develop a second unit when it purchased and repermitted the existing Frederickson Project. We acquired the Frederickson Project on a stand-alone basis. Its' economic and technical feasibility were evaluated and found desirable on the assumption that it would be the only unit on the parcel.

The existing Frederickson Project and any second unit will be designed and planned as separate facilities. Planning, design and approval of construction of the Frederickson II Project will not affect the construction and initiation of operation of the Frederickson Project.

The existing Frederickson Project and the proposed Frederickson II Project would have separate gas metering stations. Although the natural gas lateral from Northwest Pipeline has the capacity for the Frederickson II Project, the fuel metering station does not. Therefore, a second metering stations would have to be designed and installed.

Thus, the evidence before the agencies supports the conclusion that there was no intent to construct the proposed project when Frederickson Power purchased the current project. No one has presented information contrary to our conclusion. In addition, in coming forward to the agencies and explicitly requesting clarification relating to proper permitting of the existing and proposed project, the companies emphasized their concern that nothing interfere with the uninterrupted completion of the current project. The current project is unquestionably economically independent and can operate even if the proposed project is never constructed.

3. Reports on Consumer Demand and Projected Production Levels

As stated in the June 1993 3M Memo,

⁴Undated certification statement of Brian Vaasjo concerning existing loan documents for Frederickson Power L.P.

Stockholder reports, reports to the Securities and Exchange Commission, utility board reports, or business permit applications should be reviewed for projected operation or production levels. If reported levels are necessary to meet projected consumer demand but are higher than permitted levels, this is additional evidence of circumvention.

Frederickson Power has entered into power purchase agreements⁵ with three public utilities for the sale of 125 MW-hours; well below the 249 MW generating capacity of the current project. According to Mr. Campbell's Declaration, neither project's production level will be influenced by the other given the likelihood of separate contracts with generally different customers. Mr. Campbell states:

Separate power sales contracts would be negotiated and entered into for the Frederickson II Project. Although there may be some overlap in the power customers of the Frederickson II Project and the Frederickson Project, the two facilities will probably serve different customers for the most part.

Thus, there is no evidence that the proposed project is required to fulfill Frederickson Power's power generation obligations with respect to the current project.

4. Statements of Authorized Representatives of the Source Regarding Plans for Operation

As stated in the June 19933M Memo:

Statements by representatives of the source to EPA or to State or local permitting agencies about the source's plans for operation can be evidence to show intent to circumvent preconstruction review requirements.

In his Declaration, Mr. Campbell speculates as to the plans for the proposed project. Mr. Campbell states:

Westcoast and EPCOR are both interested in participating in the Frederickson II Project if it goes forward. It is also possible that a third partner could be brought into the partnership. No decisions have been made about ownership of the Frederickson II Project. However, the Frederickson Project and the proposed

⁵March 26, 2001, Wholesale Power Purchase and Sale Agreement by and between Frederickson Power L.P. and P.U.D. No. I of Gray Harbor County, WA; March 27,2001, Wholesale Power Purchase and Sale Agreement by and between Frederickson Power L.P. and P,U.D. No.1 of Benton County, WA; March 27,2001, Wholesale Power Purchase and Sale Agreement by and between Frederickson Power L.P. and P.U.D. No.1 of Franklin County, WA

Frederickson II Project would probably be owned and operated by different legal entities.

The proposed project is still in its earliest phases of development as it has not yet even been determined who will own and operate the proposed project. Based upon the information available, we have no evidence of an intent by Frederickson Power to circumvent the PSD permitting process.

Conclusion

As stated in the June 1989 *Federal Register* notice, a source's intent is central to an evaluation of whether two projects may be permitted under two minor source permits or whether they must be permitted under a single PSD permit. *See* 54 Fed. Reg. at 27228. It is our finding that no clear evidence exists demonstrating an intent by Frederickson Power and/or EPCOR to circumvent PSD permitting. Based upon our review of the facts and permitting history of the projects, the companies made no deliberate effort to circumvent PSD review. Given our findings noted above, the timing of the projects, and the certainty that both projects would be required to install the same pollution control technology regardless of permitting process, EPA advises that the projects may be permitted separately. Our conclusion is founded upon the record presented to EPA.

Sincerely,

Doug Cole, Acting Manager
Federal & Delegated Air Programs Unit

cc: Bernard Brady, P.E., Ecology
Kirk A. Lilley, Preston Gates & Ellis, LLP
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