February 15, 2001

US EPA Inspector General Nikki Tinsley

Office of the Inspector General

U.S. Environmental Protection Agency

1200 Pennsylvania Ave., NW

Washington, D.C. 20004

RE: REQUEST FOR INVESTIGATION

Inspector General Tinsley:

Recently the Environmental Protection Agency has taken several actions to proceed with air emissions trading despite numerous cautionary findings by the Inspector General that such programs may be deeply flawed and would pose a hazard to public health. Worse yet, it has taken this course without correcting material deficiencies previously identified by the Inspector General (IG).

Accordingly, Public Employees for Environmental Responsibility (PEER) requests that you:

(1) analyze the Agency's actions to determine the degree to which public health is jeopardized by the Agency's failure to implement key recommendations made in previous investigations; and

(2) investigate unauthorized commitments made by Agency officials to key private stakeholders, as described herein, with regard to violations of the Administrative Procedures Act and criminal statutes at 18 USC 208.

The most recent Agency actions include the December 27, 2000 proposed approval of the Illinois trading program (65 FR 81800), January 9, 2001 proposed approval of the New Jersey trading program (66 FR 1796), February 7, 2001 proposed approval of Michigan and New Hampshire trading programs (66 FR 9264 and 66 FR 9278 respectively) and the January 19, 2001 issuance of final guidance for economic incentive programs (EIP).

All of the programs and policies involve an "alternative compliance" approach the Agency has labeled "open market trading", referring to a set of policies first advanced publically by the Agency in 1995.

The previous Inspector General reports referred to include "EPA's Development of its Proposed Open Market Trading Rule" (March 28, 1996, Report No. E1KAB5-01-0126-6400046), "Emission Factor Development" (September 30, 1996, IG Report No. 6100318), "The Effectiveness and Efficiency of EPA's Air Program" (February 27, 1998, Report No. E1KAE4-0500246-8100057), and the "Consolidated Report on OECA's Oversight of Regional and State Air Enforcement Programs" (September 25, 1998, Report No. E1GAE7-03-0045-8100244).

SUMMARY

When first proposed in 1995, so called open market trading (OMT) represented a radical departure from previous Agency trading policies in several ways: in its crediting of "discrete" or temporary reductions (as opposed to a continuous "stream" of reductions); post facto quantification; intertemporal use (meeting current emission reduction requirements with non-contemporaneous reductions which may have occurred several years earlier); and the broad exchange of credits between different sectors (stationary, area and mobile sources).

The fundamental problems with this approach, as indicated in the IG's 1996 OMT report, pertain to quantification and enforcement**.** Simply put, there is a lack of assurance that these programs will provide emissions reductions equivalent to the requirements they replace, and enforceability of emission reduction requirements will be seriously undermined. As the IG's 1996 emission factor report observed, if these programs are not effective, the result is worse air quality and an increased public health hazard.

It is PEER's contention that the Agency has failed to make the practical and material corrections necessary to respond to these concerns and that the IG has a responsibility to follow up on these concerns to ensure that the identified problems are corrected before the Agency proceeds any further with these programs.

PEER maintains that there are available solutions to the problems, but that the Agency has systematically avoided those solutions. PEER has raised these issues in detail in our previously submitted comments on the Agency's 1999 EIP proposal and in a June, 2000 White Paper,[(1)] both of which are included with this request

The Agency has generally advanced two responses to the IG's concerns:

1. Increased commitment of Agency resources would improve the technical quality of quantification procedures. Indeed the Agency committed such increased resources in response to the IG reports in 1997. However, the commitments were not adhered to and the needed technical work never occurred.[(2)]

2. The issue of quality control will take care of itself in a "buyer beware" approach, as both the sellers and buyers of credits will have an interest in that quality, since EPA retains ultimate enforcement authority.[(3)] Subsequent experience with numerous trading programs have shown, as discussed below, that this assumption was not only erroneous at the time, but has been proven erroneous in practice since.

Unable to finalize the OMT policies proposed in 1995,[(4)] the Agency proceeded nevertheless to promise industry and the states that their federal clean air plans could be revised based on the proposal.[(5)] By the time the IG studies cited above had pointed out the potential fallacies of the first two Agency arguments, state agencies and sources had built up too much equity for the Agency to comfortably back away from these essentially political commitments. Instead the Agency embarked in a policy direction before the necessary technical, legal and policy work had been completed, and has proceeded over the substantial and continuing objections of its own staff experts as well as those of the Office of the Inspector General.

PEER further contends that the Agency made inappropriate and unauthorized commitments in the 1995 - 1996 time frame which flowed directly from dealings with private parties who had a direct material interest in the policies. The Agency's commitments appear to violate the Administrative Procedures Act (APA) and its dealings with these parties were in direct contradiction of a permanent recusal signed by the Assistant Administrator for Air and Radiation, Mary Nichols, in 1994.

Even after Nichols left the Agency in 1997, the current director of the Agency's office of Air Quality Planning and Standards (OAQPS) was made aware of the violation of the recusal, but has persisted despite these ethical and legal considerations, the concerns of the Agency's own technical, legal and enforcement staff, and finally those of the IG.

PEER believes that these serious allegations warrant investigation by the Inspector General.

PREVIOUS INSPECTOR GENERAL REPORTS

This request pertains to the Agency's trading policies and rule-making actions as they have evolved subsequent to its 1994 Economic Incentive Program (EIP) policy, finalized on April 7, 1994,[(6)] and its predecessor, the Emissions Trading Policy Statement of 1986.[(7)] In August of 1995 the Agency moved substantively beyond these policies in proposing a drastically new approach to trading under the rubric of "open market trading" (OMT).[(8)]

By the conclusion of the public comment period on EPA's 1995 open market proposal, several issues, including the issues of quantification protocols and enforcement had become quite contentious, both within and outside the Agency. The Office of the Inspector General (IG) was also concerned, and consequently conducted a number of investigations, issuing four reports between 1996 and 1998, three of them directly relevant to open market trading, the fourth pertaining to enforcement in general.

The Inspector General Reports

1. March, 1996 Report: "EPA's Development of its Proposed Open Market Trading Rule", Eastern Audit Division, Boston, Massachusetts:

This was a "special review" conducted within the context of the IG's comprehensive assessment's of EPA's air program. It is based on surveys conducted between June and October, 1995, and is framed as an "advisory report" with a stated goal to "produce timely constructive change". The timeliness of the investigation was EPA's stated intention to finalize the OMTR proposal later in 1996.

State officials and EPA's own Office of Enforcement and Compliance Assistance (OECA) "were concerned that enforcement could be weakened due to a lack of protocols" (p1). OECA staff felt that "enforcement is aided by clear protocols" and is "concerned whether protocol development guidance was adequate" (p7).

"We believe EPA should consider taking a more definitive stand on the concerns raised to us by the states and OECA over the verification process and lack of protocols" (p1).

The IG also noted that the OMTR eliminated up front "certification" of credits, and that "while this...should accelerate trading transactions", it may "inadvertently allow(s) use of invalid credits or weaken(s) enforcement", destroy public confidence and discourage companies to engage in trading. (p5).

The IG's "own limited testing of Emission Credit applications showed that 83.4% of the sampled applications were not sufficiently documented for approval by the state" (p5).

In the IG's concluding recommendation, it stated "...we encourage EPA to take a more definitive stand on some of the concerns brought to their attention by the states" (p9).

EPA's reply: Before finalizing the report the IG presented its conclusions to Agency management. In a reply included in the final report, EPA's Director of the Office of Air Quality Planning and Standards (OAQPS), John Seitz, stated "You raise several points in the body of your report and in the recommendations section concerning the appropriate policy direction....We appreciate you providing your point of view and will consider it...However, Mary Nichols and I remain committed to developing a model rule which minimizes the Federal government's involvement in the development and day-to-day operation of the market for these trades"[(9)]. (Emphasis added.)

The IG clearly felt this was an unfortunate position, and pointed out it had never advocated involvement in "day-to-day" operations. They replied that "[while we can understand the agency's desire to let the states or market dictate the ground rules, we urge EPA to reconsider this position. Development of protocols and a strong system of control in our opinion is necessary to ensure the success and integrity of the program" (p11).

2. September, 1996 Report: "Emission Factor Development" [(10)]

Six months later, another IG office published the results of its investigation of the Agency's development and use of "emission factors". This investigation was motivated

by the increasing "need for reliable emission factors" for several of the programs initiated under the 1990 Clean Air Act Amendments, including the federal operating permits program (Title V) and "economic incentive programs, such as open market trading." (11) Noting that the expansion of trading via OMT to new categories of sources would increase the reliance on emission factors, the report provided a number of observations:

"Most state and local officials we spoke with believed that the need for reliable emission factors will be critical to the success of open market trading programs", mainly because "for these trading programs to be successful a wide range of sources should be allowed to participate. This would include small stationary sources that will not be able to afford monitoring techniques to estimate emissions and emission reductions...In addition, for some pollutants, for example VOCs, the processes involved do not lend themselves to monitoring." (p14)

"We believe the status of emission factor development is a significant weakness that impedes achievement of major air program goals and is, therefore, a material weakness" (p3, Executive Summary). "Emission factor development has not met air pollution control programs demands for new and revised emission factors" (p5). "Emission factor development has not met statutory requirements and the inadequate extent of its progress is significantly impairing fulfillment of an important component of the Agency's mission". (p16)

"Without reliable emission factors, EPA and the states who rely upon them cannot be fully assured that the...emission trading programs are effective in reducing air pollution. If these programs are not effective, *the nation's air quality could be adversely affected and persons could be subjected to the health hazards associated with excessive exposure to various airborne pollutants*" (p12, emphasis added).

"OAQPS (trading) Group Leader told us that their group's position was that (AP-42) emission factors could be used for emissions trading since they were being used in other regulatory capacities". According to the IG, the OAQPS office working on protocol development said "it will recommend that emission factors rated 'E' (poor) or unrated should not be used for trading." (12)

The IG also noted EPA's intent to rely increasingly on industry partnerships in developing emission factors, and observed that due to potential "financial benefit to industries "to produce inaccurate factors, "the use of this method increases the risk of developing biased or unrepresentative factors. Accordingly it is important that (EPA) maintain sufficient control over this development method to ensure that representative factors result". The IG went on to observe, however, "our audit found indications that

(EPA's) ability to oversee these partnerships may be diminishing." (p19).

3. February, 1998 Report: "The Effectiveness and Efficiency of EPA's Air Program", Northern Audit Division, Chicago, Illinois.

In February of 1998 the IG issued a comprehensive report on EPA's overall air program and its effectiveness. In that report it followed up on the 1996 report on emission factors, concluding that "we still believe the program should be declared a material weakness, until OAR implements the corrective actions." (13)

The IG noted that OAR had submitted an "emission factor strategy" to the EPA Senior Leadership Council and the IG on November 25, 1997. In that strategy EPA described a substantial increase in resources (add two full time staff, quadruple funding to $4.2 million dollars) that would be required to improve the emission factor situation. Three years later there has been *no increase* in resources. Further, even if the improvement plan were to be implemented, by the plan's own admission it would still not remedy the problems related to trading:

- The focus of the increase resources would be on particulate and toxics, mainly for SIP planning purposes. As noted earlier, SIP inventory accuracy is substantially less than is needed, according to EPA's own guidance, for permitting and compliance determinations; further, most trading programs are aimed at ozone precursors.

- The plan defers development of emission factors for trading and permitting to the states and industries despite the IG's cautionary note that such an approach would require both increased oversight, and increased resources which are not provided for in the plan.

- Even with the program, the results would be "inadequate for most sources and, generally inappropriate to use for permit limits." (See OAQPS "5 Year Plan for Refocused Program Priorities")

- The report referenced the lack of closure of trading issues from the 1996 report, in a discussion of "issues needing further study." Stating that EPA had, instead of finalizing the OMT rule proposal, "issued guidance," the IG

recommended that "we may want to perform additional work once some trades have been completed under this guidance to evaluate the internal controls over the process" (page 45). In light of the following the "additional work" is long overdue:

- At the time of the IG recommendation (February, 1998) EPA had issued no guidance subsequent to the August, 1995 proposal, so we question the IG reference and the premise of waiting for further guidance..

- Even now (February, 2001) the only subsequent guidance is the January, 2001 EIP. As noted above, that document not only failed to finalize the 1995 policies, it did not respond to the substantial comments submitted in response to the 1995 proposal (see footnote 4.)

- New Jersey, with EPA's encouragement, has proceeded to implement its program under the 1995 proposal since at least 1996. Five years of implementation would appear to make this particular program ripe for review and evaluation. Neither EPA not New Jersey claim that the program complies with the recent EIP guidance, and instead maintain that the program should be "grandfathered".

- The Chicago trading program is also in operation.

- The Agency has just recently proposed approval of four state trading programs (Illinois, New Jersey, Michigan and New Hampshire), three of those approvals based on the 1995 OMT proposal, one on the 1994 EIP policies, none on the 2201 EIP.

4. **September of 1998 Report: "Consolidated Report on OECA's Oversight of Regional and State Air Enforcement Programs".**

Produced by the IG's Mid-Atlantic Audit Division, Philadelphia, Pennsylvania, this investigation reviewed six states' enforcement programs and EPA oversight of those programs:

The IG audit "disclosed fundamental weaknesses with state identification and reporting of significant violators of the Clean Air Act."

"This occurred because states either did not want to report violators or the inspections were inadequate to detect them."

"Without information about significant violators, EPA could neither assess the adequacy of the states' enforcement programs, nor take action when a state did not enforce the Clean Air Act."

"State and even EPA regions disregarded Agency requirements, or were uncertain whether enforcement documents were guidance or policy." (14)

While the states found only 18 significant violators to report to EPA out of 3300 inspections, the IG review of 430 of the 3300 files identified an additional 103 significant violators(15).

The significance of the overall weakness in EPA and state enforcement programs with respect to emissions trading is discussed in greater detail below.

ALLEGATIONS

1. The concerns raised in the IG reports have not been resolved, but rather have been confirmed by real world experience with trading programs. As a result, public health is being compromised.

The quantification issues raised in the IG's 1996 reports have proven valid and there has been real world confirmation of the seriousness of this issue. For instance, in the South Coast (Los Angeles) both the District and the EPA were subject to Title VI Civil Rights Act proceedings challenging the effects of substitution of mobile source credits for Clean Air Act (State Implementation Plan) reductions under District Rule 1610.(16) After citizen

suits were filed against sources using the credits, EPA also took enforcement action against the sources. EPA's investigation, as well as testimony by District inspectors, revealed that the quantification of these credits was extremely faulty and in some instances was off by a factor of two orders of magnitude.

At the time of these investigations EPA's guidance for mobile source credits[(17)] had been issued some 4 years earlier, and the District's program was in apparent compliance with the guidance. Even today there has been no revision to the guidance to address the problems which were surfaced in the South Coast case.[(18)]

Further, the IG's recommendations have been ignored and the concerns have not been resolved. In 1998 the IG tentatively approved a corrective action plan, but (1) that plan addressed the original trading concerns only tangentially, and (2) the corrections committed to have not been implemented.

2. The enforcement role upon which, according to both the IG and program advocates, open market trading programs rely has failed.

There has been a vast chasm between the role attributed to enforcement by open market trading's proponents and the reality of enforcement programs.

The role of enforcement in trading

The role of enforcement in OMT programs was described rather elegantly in EPA's 1995 OMT proposal:

"Open market trading programs can begin operating without waiting for agreement on...pre-established emissions measurement methodologies...The open market system would shift review and approval...from the front end...to the time of use as a compliance determination and enforcement matter...harnessing private sector resources to assist government in assuring quality control. Responsibility for compliance would motivate arms-length users to inspect carefully and choose wisely among the (credits) offered on the market, and to protect themselves...In order to minimize risk, buyers would look for quality and favor (credits) that present low risks of placing users in non-compliance...The EPA believes that the principle of buyer liability will work the best to assure (credit) quality." [(19)] (Emphasis added.)

The Agency explicitly credited OMT's "original developers" [(20)] with the liability driven model. In the Ayres report under the heading of "Protection of the Public Interest:

Enforceability" he states:

"...the open market system in effect deputizes the buyer's commercial interest to assure the environment is protected." [(21)] (Emphasis added.)

At a subsequent public hearing on the OMT proposal, Ben Henneke, president of Clean Air Action Corporation, provided the rationale behind his belief that the market would naturally tend towards high standards of quantification:

"Trying to get it (certainty) through protocol approvals...trying to use EPA-approved methods and the perfect quantification...I don't think are as effective as some of the new things we are working on...Enforcement clarity will do more for certainty for companies than anything else. If you end up with a clear enforcement policy...that will be a clear signal...you will end up with people banking more tons to take care of that environmental uncertainty. Consistent enforcement, which you can give guidance on but which is a state issue, is also going to be terribly important."[(22)] (Emphasis added.)

The reality of enforcement

In contrast to this picture of clear, consistent enforcement, however, the 1998 IG report on EPA and state enforcement programs concluded that the current state of enforcement is quite questionable and therefore cannot support market-based trading approaches. Further, EPA's own studies and policies, and a 1999 study by Congressman Henry Waxman, show that current federal and state enforcement programs are inadequate to support open market trading programs.

- Permits are not being issued correctly. While the IG investigations looked at whether source permits, *as written*, were being enforced, the permits were not being written correctly in the first place. According to publically available documents from the EPA and the National Park Service, the permitting program is in no better shape than the enforcement programs[(23)] and permits are not being written consistent with the requirements of the Clean Air Act. Note that neither of these studies involved trading programs. By all accounts, issuance and enforcement of permits to accommodate innovative compliance schemes will require even greater permitting expertise and resources.[(24)]

- Enforcement cutbacks. Over the past several years EPA has moved in the direction of de-emphasizing classic enforcement in favor of what it describes as "compliance assistance." As a "former high level EPA official" stated in a 1999 feature article,

Administrator "Browner has massively disinvested in enforcement." [25] Even federal prosecutors have noted the overall decline in environmental enforcement over the past eight years. [26]

- Waxman refinery study. On November 10, 1999 Representative Henry Waxman released a Report prepared by the staff of the House Committee on Government Reform showing massive non-compliance by refineries with the basic requirements of the Clean Air Act. The study found that the sources were under-reporting the incidence of fugitive leaks by a factor of four, that "the failure to properly detect and repair leaking valves has a substantial adverse impact on air quality in the United States." The study also noted "the vast majority of oil refineries are located near crude oil sources or in heavily industrialized areas," "refineries are the single largest stationary source of VOCs, the primary precursor of urban smog," "40% of the oil refineries 66 out of 164 are located in 'nonattainment ' areas that do not meet federal air quality standards..." and that these unreported emissions amounted to more than 80 million pounds of volatile organic compounds and over 15 million pounds of toxic pollutants.[27]

- California and New Jersey trading programs both show the failure of current enforcement policies in trading policies. California's RECLAIM program is currently on the verge of collapse in large part because it failed to motivate installation of readily available and inexpensive controls. Controls that would have been installed 3 and 4 years ago under the command and control scheme that was subsumed by the RECLAIM program have simply not been installed.

Without adequate controls, the sources have consumed the available credits and are facing widespread violation of their caps, yet they have displayed a remarkable confidence that they will be bailed out by regulators and politicians. This is occurring despite the fact that RECLAIM is perhaps the most fully developed incentive and enforcement scheme of any attainment trading program in the country. Even now only two of the several hundred sources in the program have engaged in negotiation of abatement orders, and the District's most recent recommendations for resolution of the problem make virtually no reference to enforcement or deterrence aspects of the program.[28]

New Jersey's program, which is perhaps the most direct result of the 1995 proposed policies, is the most blatant example of failure of enforcement. This program has been used to meet the Clean Air Act's most fundamental technology requirement, the section 182(b) requirement for Reasonably Available Control Technology (RACT) for six years,[29] yet the program has never been acted on by EPA, and was only recently even proposed for action. Nevertheless, sources have used this never approved program both to generate credits and to use them to demonstrate "compliance" with the Clean Air Act's requirements. Despite this absence of authorization, there have been no enforcement

actions taken against these sources.

As illustrated by the experience in both the South Coast RECLAIM program and the New Jersey OMET program, enforcement is clearly not playing the role forecast for it when OMT policies were first advocated and proposed by the Agency.

Unclear Basis for Enforcement Discretion

If there is any policy at all at work here it is best characterized as "enforcement discretion," yet the basis for such discretion has not been made evident. In fact, the lack of legality for trading authority was made quite explicit in the New Jersey scheme. When the open market trading policies were being debated in 1995, Clean Air Action Corporation chief Ben Henneke testified to EPA:

"...there have been five more RACT customers pop up in New Jersey, and all but one of them already have the tons transferred...they are already done...*you are not getting them yet legally...but you need to review them unofficially and basically say nice things about them.*" (Emphasis added. August 31, 1995 hearing transcript)

Henneke's testimony was simply elaborating on a position developed by his counsel Richard Ayres, of O'Melveny and Myers, a few months earlier:

"...*enforcement discretion* is needed because it is impossible for EPA to put generic regulations in place in time to allow sources to use (open market credits) for compliance with the RACT requirements by the May 31, 1995 deadline provided for in the Clean Air Act." (Emphasis added. February 23, 1995 memo from Ayres to EPA).

Nearly 6 years after Ayres provided that direction to the Agency, "enforcement discretion" has become the Agency's *de facto* policy.

3. EPA's actions are driven by commitments which appear to be in violation of the Administrative Procedures Act (APA) and criminal conflict of interest statutes.

The Agency made unauthorized commitments to state authorities and private interests in 1995 and 1996 which violate the Administrative Procedures Act (APA) and the formal recusal signed in 1994 by the chief Agency official responsible for the open market

trading policies.

Illegal commitments.

EPA's recent actions on state trading programs state plainly that the proposed approvals are based in part on commitments made in the 1995-1996 time frame. For instance, the New Jersey proposal describes, under the heading "basis for today's proposal," that "New Jersey relied on EPA's statements that New Jersey could base its SIP revision on the 1995 open market trading proposal." EPA cites five documents in which the Agency made this commitment, noting that "on several occasions...EPA and State officials confirmed EPA's support for New Jersey's reliance on the 1995 proposal." [(30)]

Regarding the specific issues of quantification and protocols, EPA's Technical Support Document (TSD) describes how these commitments were determinative. In its most detailed discussion of the protocol issue EPA states plainly its basis for approving New Jersey's approach of not requiring that protocols be included in the SIP:

"...EPA proposes to approve New Jersey's OMET program on the basis that at the time New Jersey adopted and submitted it to EPA, New Jersey relied on the guidance provided in 1995. *As a result*, EPA proposes to approve the provisions of the OMET program that the SIP must include criteria for protocol development but not the protocols themselves." [(31)] (Emphasis added.)

Thus, EPA states rather clearly that its current approval, in the year 2001, is based substantively on commitments provided by the Agency in 1995 and 1996 to abide by a policy proposed in 1995 but never finalized. This is a fundamental violation of the Administrative Procedures Act (APA) as it pertains to agency decision-making. It concedes discretion which is not the Agency's to give away and it eliminates the role of the public in exercising its right under the law to provide advice and comment on such proposals and to have those comments considered before the Agency takes final action based on any proposals.

The use of such credits in New Jersey for the past 6 years, credits generated under a state trading program never federally approved, based on proposed federal regulations and policies which have never been finalized, is plainly illegal under the Clean Air Act. [(32)]

Violation of recusal.

These actions and commitments are directly related to the inappropriate influence allowed to parties who benefitted materially and substantially from those commitments. The two most prominent beneficiaries in the private sector are Clean Air Act Corporation chief Ben Henneke and his counsel, Richard Ayres of O'Melveny and Myers. Their influence is perpetuated even today by senior EPA officials.

The role of these two men and New Jersey industrial stakeholders has been quite central in the evolution and deal-making surrounding open market trading since its inception in the early 1990's. [(33)] By early 1995 open market trading had become a centerpiece of the Administration's regulatory reinvention program, and on March 16, President Clinton and Vice President Gore announced that open market trading was their number one initiative. [(34)] In EPA's first formal proposal of open market policies on August 3, 1995, Administrator Carol Browner stated plainly that the proposal "is derived from the 'open market' concept developed by the EPA-supported NESCAUM-MARAMA demonstration project and elaborated in a recent article." [(35)] The article referenced was a lengthy "analysis and perspective" authored by attorney Richard Ayres of O'Melveny and Myers. In the April, 1995 "Phase II" report for the project, 12 trades are proposed. All of the credits were generated by New Jersey sources, all of them were brokered by Henneke's company. [(36)] To this day Henneke and his Clean Air Action Corporation remain the largest broker of New Jersey RACT credits.

The Senior EPA official who embraced and carried out their policies for the next several years was Assistant Administrator for Air and Radiation Mary Nichols. However, at the time she was covered by a "permanent recusal" forbidding her, under federal criminal statutes, from participating "in any EPA matter in which the law firm of O'Melveny and Myers is providing representational services" (Nichols memo to Deputy Assistant Administrator and office directors for OAR, July 6, 1994). [(37)]

Less than seven months after signing the recusal, AA Nichols strongly urged state environmental directors to grant "flexibility" to industry and adopt the Henneke-Ayres scheme for "open market trading" (January 23, 1995 memo). [(38)] Two weeks later EPA launched its internal workgroup to operationalize the Ayres scheme, [(39)] the senior officials of which were Mary Nichols' Special Counsel David Doniger and OAQPS Director John Seitz. Three weeks after that ,[(40)] Nichols directed EPA Regional Administrators to de-emphasize the Clean Air Act's deadlines for attainment plans and instead shift to an emphasis on what she described as "market-based alternatives". Five months later EPA Administrator Carol Browner signed a formal proposal of their scheme in a notice which paid explicit tribute to Ayres and a policy paper he had written on the program. [(41)]

Although Nichols left the Agency in 1997, her commitments continue to affect Agencies actions today. In response to the IG's 1996 recommendations with regard to open market

trading in early 1996, OAQPS Director John Seitz stepped forward on behalf of himself, Nichols and the Agency and stated their allegiance to the well established Henneke-Ayres position:

"You raise several points in the body of your report and in the recommendations section concerning the appropriate policy direction....We appreciate you providing your point of view and will consider it...However, **Mary Nichols and I** remain committed to developing a model rule which minimizes the Federal government's involvement in the development and day-to-day operation of the market for these trades." [(42)] (Emphasis added.)

Since that time and continuing to this day, Seitz' day-to-day role in advocating and implementing the "commitments" has been very direct and determinative.[(43)] It is noteworthy that in the summer of 1999 a fellow Agency executive brought to Seitz' attention the Nichols' recusal problem, to no apparent effect.

Based on those agreements several parties, among them PSE&G and the Clean Air Action Corporation, proceeded to invest resources and funds, much of that investment is reflected on the OMET's public Registry.

Given the transition to new EPA Administrator Christine Todd Whitman, PEER believes that this request is extremely timely. This is an opportune time to revisit these policies and correct them before they become ingrained in, and undermine the administration of the Clean Air Act.

As the new Administrator seeks to expand market-based approaches to pollution control, it is imperative that these market-based programs contain the necessary safeguards to both protect both public health and meet industry's need for regulatory certainty. Lacking such a review by your office, the only certainties are that public health will suffer and participants in ill-founded trading programs will find themselves tied up in the courts.

Sincerely,

Jeffrey Ruch

Executive Director

Cc: Christine Todd Whitman, Administrator

Rob Brenner, Acting Assistant Administrator for Air and Radiation

John Seitz, Director, Office of Air Quality Planning and Standards

Office of the General Counsel

1. PEER submitted comments on the September, 1999 EIP policy proposal on November 30, 1999; the White Paper, entitled "Trading Thin Air, EPA's Plan to Allow Open Market Trading of Air Pollution Credits", was issued in June, 2000.

2. It should be noted that in subsequent negotiations between the Regional offices and OAQPS Director John Seitz, similar commitments were made OAQPS to resolve quantification procedural issues prior to finalization of the EIP, but with issuance of the January, 2001 policy those promises also have proved hollow.

3. The 1995 OMT proposal referred to this as "harnessing private sector resources to assist government in assuring quality control", and that "buyer liability will work the best to assure quality" (see 60 FR 39671-39676).

4. Even in the January 19, 2001 Final EIP, the Agency claims that the document "supercedes" the 1995 proposal, and that "this document addresses the public comments received for the proposal" (section 1.0, page 4). The former is meaningless, the latter is patently untrue. The proposal remains un-finalized.

5. The Agency confirmed this in its January 9, 2001 New Jersey proposal (see 66 FR 1803). Three of the five cited assurances occurred in the March - May, 1996 time frame, bracketing the issuance of the IG's 1996 report.

6. 59 FR 16690, April 7, 1994.

7. 51 FR 43814, December 4, 1986.

8. 60 FR 39668, August 3, 1995 and 60 FR 44290, August 25, 1995.

9. Seitz to Paul McKechnie, Divisional Inspector General, Eastern Audit Division, February 15, 1996; included in the IG report at page 12.

10. "Emission Factor Development", IG Report No. 6100318, September 30, 1996, available at http://www/epa.gov/oigearth/emisexsm.htm and http://www.epa.gov/oigearth/emisrept.htm.

11. Executive Summary, p2.

12. According to AP-42, factors rated "D" "are based on a generally unacceptable method, but the method may provide an order-of-magnitude value for the source". (Emphasis added; P9, Introduction, "Compilation of Air Pollutant Emission Factors AP-42, Fifth edition, Volume I: Stationary Point and Area Sources.).

13. Nichols resisted reporting the material weakness to the President and Congress, as required by law, claiming that she "believed the problem to be one of insufficient resources rather than a management control weakness." (Nichols to Michael Simmons, Deputy Assistant Inspector General for Internal Audits, April 11, 1997.)

14. All of the observations, unless noted otherwise, are from page i of the Executive Summary. Note that the fieldwork for this investigation was performed between October 1, 1997 and February 17, 1998.

15. Page 7, I.G. Report.

16. The District was allowing the use of car scrappage credits generated under Rule 1610 to show compliance with Rule 1142, a stationary source rule.

17. Interim Guidance for Generation of Mobile Source Emission Reduction Credits", 58 FR 11133, February 23, 1993. This "interim" guidance was never finalized.

18. This is not to say that the District's practices have not been challenged. Region IX, for example, has lodged extensive comments and recommendations. Despite some limited local impact, none of the Regional recommendations have made their way into national guidance.

19. 60 FR 39671 - 39676.

20. 60 FR 39675

21. "Developing a Market in Emissions Credits Incrementally: an 'Open Market' Paradigm for Market-based Pollution Control", Bureau of National Affairs, December 2, 1994, page 1525.

22. Henneke testimony, OMTR hearing, August 31, 1995, transcript at pp 184-185.

23. The Park Service reviewed 47 PSD permits and found that about half had a "fatal flaw", including faulty applicability determinations, control technology determinations, application of NSPS requirements and environmental impact analyses (NPS memo, December 4, 1998). OAQPS Director John Seitz called for a national review of implementation problems in an April 14, 1999 memorandum to the Regional Air directors. This evaluation has not been concluded.

24. See for instance EPA's "White Paper 3", 65 FR 49803, August 15, 2000.

25. "Asleep on the Beat", *Washington Monthly*, November, 1999, Robert Worth.

26. See *Boston Globe* article "Enforcement Lagging," November 16, 1999.

27. "Oil refineries Fail to Report Millions of Pounds of Harmful Emissions", November 10, 1999, prepared by the Minority Staff, Special investigations Division. Committee on Government Reform.

28. "White Paper on Stabilization of NOx RTC Prices", SCAQMD, January 11, 2001.

29. Section 182(b)(2) of the Clean Air Act requires "implementation of the required measures as expeditously as practicable but no later than May 31, 1995."

30. 66 FR 1803, January 9, 2001. The Agency did not admit the existence of these documents in response to PEER's 1999 FOIA requests.

31. Technical Support Document, December 21, 2000, Table 36, pages 48 - 50.

32. The sources are in violation of the federally approved SIP.

33. Their role is described in more detail in PEER's previously submitted comments and White Paper (see footnote 1).

34. See 60 Federal Register 39669, August 3, 1995. This role for OMT is reconfirmed in EPA's recent actions. See, for instance, the December 21, 2000 Technical support Document for the proposed approval of New Jersey's trading program. (Section II.B., pages 7-8.)

35. See 60 Federal register 39675, August 3, 1995.

36. Chapter IV, page 46.

37. The applicability of Nicholas' recusal is confirmed in a March 7, 1995 GAO report ("Conflict-of-Interest Controls; Documented Recusal Obligations of Top Political Appointees in DOE and EPA"). According to this report the recusals were required under the Ethics in Government Act of 1978, and the recusal and any remedial actions are governed by 18 USC 208.

38. Nichols to Dennis Lunderville, January 23, 1995.

39. February 8, 1995, Scott Mathias to Workgroup. The charter for the Workgroup explicitly directed members of the group to familiarize themselves with the Ayres paper.

40. Nichols to Regional Administrators, "Ozone Attainment Demonstrations", March 2, 1995.

41. See 60 FR 39675.

42. Seitz to Paul McKechnie, Divisional Inspector General, Eastern Audit Division, February 15, 1996.

43. Among the highlights: (1) Seitz was co-chair (with Nichols' Special Counsel David Doniger) of the "external component" of OMT development (Mathias to workgroup, February 8, 1995); (2) Seitz was avowedly Nichols' partner and voice per the February 15, 1996 memo to the Inspector general; (3) in order to quell internal disagreement over the pending release of the proposed EIP policy in the summer of 1999, Seitz committed to the Regional and other EPA offices to immediately convene a workgroup to further develop the quantification criteria causing much of the internal dissension(44)

44. These commitments are memorialized in the proceedings of two national gatherings of EPA's air directors, one in Las Vegas in February of 1999, the other in Chicago in December of 1999. ' ' ' - '