



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

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October 1, 1999

Ref: 8P-AR

Ms. Margie Perkins, Director
Air Pollution Control Division
Colorado Department of Public Health Environment
4300 Cherry Creek Drive South
Denver, CO 80246-1530

Re: Source Definition Issue for KN Power/Front Range Energy Associates, LLC/PSCo
Generating Facility

Dear Ms. Perkins:

This letter outlines the U.S. Environmental Protection Agency's (EPA's) views on whether the proposed power generating facility at Fort Lupton (Facility) to be constructed by Front Range Energy Associates (Front Range) and the existing generating facility at Fort Lupton owned by Public Service Company of Colorado (PSCo) constitute a single source for purposes of permitting under the prevention of significant deterioration (PSD) program of the Clean Air Act ("Act") (42 U.S.C. § 7401 *et seq.*, § 7475). We have reviewed information presented by KN Energy, Inc. and Quixx Corporation, the two owners of Front Range, in letters, in documents, and in the meeting we held with the companies, the Colorado Air Pollution Control Division (APCD), and the state Attorney General's office on September 22, 1999. Based on this review, it is our interpretation of the PSD regulations that the Facility and existing PSCo generating facility constitute a single source. As the PSCo facility is a major source for PSD, see 40 C.F.R. § 51.166, it is also our interpretation of the relevant regulations that the Facility, if constructed as proposed, would be a major modification of this major source and therefore, is subject to the requirement to obtain a PSD permit in accordance with section 165 of the Act and 40 C.F.R. § 51.166(i) through (r).

The operative definitions for "major stationary source" and "stationary source" in 40 C.F.R. § 51.166(b) include the following provision:

(6) *Building, structure, facility, or installation* means all of the pollutant emitting activities which belong to the same industrial grouping, are located on one or more contiguous or adjacent properties, and are under the control of the same person (or persons under common control).



See also, Colorado Air Quality Control Commission Regulation 3.Part A.I.B.59 (“Source Definitions”). We understand there to be no dispute that the Facility belongs to the same industrial grouping as the PSCo facility and that the two facilities are located on adjacent properties. The issue is whether the two facilities are under the control of the same person. We believe that they are. Our analysis supports a finding that control by PSCo is established by the power supply agreement between Front Range and PSCo which obligates Front Range to provide electricity to PSCo on demand. Control is also indicated by ownership interest in the Facility held by PSCo’s parent company, New Century Energies, Inc. Because the pollutant emitting activities of the Facility and the existing PSCo facility are under the control of the same person, or persons under common control, the two facilities should be treated as a single source for purposes of regulation under the Act. Our analysis follows.

1. PSCo has control over the Facility through contract: EPA regulations do not supply a definition of “control.” Instead, EPA is guided in making case-by-case source determinations by the definition of “control” found in the regulations of the Securities and Exchange Commission (SEC”). See 45 Fed. Reg. 59874, 59878 (Sept. 11, 1980). The SEC definition provides:

Control is the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person (or organization or association) whether through the ownership of voting shares, contract, or otherwise.

17 C.F.R. § 240.12b-2. EPA has applied this guiding definition in numerous determinations over the past nineteen years. In the past, EPA has looked to see if control has been established through ownership of two entities by the same parent corporation or subsidiary of the parent corporation. EPA has also considered whether control has been established by a contractual arrangement giving one entity decision-making authority over the operations of a second entity. EPA also has looked for a contract for service relationship between two entities, in which one sells all of its product to the other under a single purchaser contract. Finally, EPA has considered whether there is a support or dependency relationship between the two entities, such that one would not exist “but for” the other. Such determinations are factually driven. We believe that the facts related to the proposed Facility evidence control through contract.

Front Range has a power supply agreement with PSCo (dated April 30, 1999) to provide “all the net generating capacity available at any time at the Facility” to PSCo. For the next seven years, Front Range may not sell power from the proposed Facility to anyone other than PSCo. The Facility is claimed to be a “peaking station,” which will provide all the power it can generate and all that PSCo requires at times of high electricity use, in order to prevent “brown-outs” in the Denver metropolitan area. The Facility has no other function than to supply power to PSCo during such times. Under the agreement, PSCo will pay Front Range an amount sufficient to guarantee a profit, even if the facility sits idle and is never used.

In addition to this evidence of a dependent buyer-seller relationship based on a single purchaser contract, there is evidence that PSCo has the authority under the agreement to exert direct control over operations of the Facility. The power supply contract provides that PSCo's system-wide control center has "the sole right" to determine start-up, shut-down, and levels of electricity generation at the Facility. To that end, a direct connection will be established between PSCo's system-wide control center and the Facility that will allow the facility to be "remotely started and stopped" by PSCo. PSCo thus will exert decision-making authority over the day-to-day operations of the Facility. Moreover, the facility must be sited to allow PSCo to easily interconnect the facility into PSCo's power transmission system, requiring the facility to be collocated with or located near an existing PSCo facility. PSCo will supply all the fuel (natural gas) to be used at the Facility, free of charge to Front Range. Front Range will rely on PSCo to provide interconnection to PSCo's existing gas pipelines, as well as to PSCo's transmission lines. Thus, Front Range is dependent on PSCo for its fuel as well as for purchase and delivery of its product.

Given these facts, EPA believes that generation of electrical power at the Facility -- the essential function of the facility and the source of its air pollution emissions -- is under the control of PSCo. PSCo exerts control over the Facility, as that word has been applied by EPA in prior circumstances.

One could draw an analogy to a manufacturer who decides to increase production but, instead of adding additional production capability to its existing plant, contracts with another company to build a second plant next door. For example, Company A, which paints widgets, might wish to increase its output of painted widgets at times of high demand. Company A contracts with Company B to build two new painting lines on adjacent property owned by Company B. Company A will buy all of Company B's output, but Company B may only paint widgets when ordered by Company A. Furthermore, Company A supplies all the paint and all the widgets to be painted by Company B. Company A controls both input and output. To make the agreement workable, Company A pays Company B a certain amount for sitting idle in between rush orders. In essence, Company A is contracting to use Company B's paint lines, like leasing a vehicle. Alternatively, one could say that Company B's facility is an annex to the Company A plant, an adjunct facility that allows Company A to increase production at a nearby site. If there were no contract, one could say that Company B's facility is independent of Company A's, that it has the capability of painting and selling widgets to other customers. That it "stands alone." But, given the contract between the two, Company A has control over painting activities at Company B's plant and thus over its air polluting activities. In terms of air pollution control regulation, Company B's facility must be considered part of Company A's facility.

Similarly, PSCo needs to add electrical generating capacity, apparently under an order by the Colorado Public Utilities Commission (PUC). Rather than build a peaking station at the existing Fort Lupton facility, PSCo has contracted with Front Range to build and operate a peaking station several hundred yards away. PSCo will determine when power must be

generated at the new facility and will purchase all the power. PSCo will determine when the new facility will be started up, when it will be shut down, and at what levels it will generate electricity. PSCo will not only relay orders to the Facility, to bring it on line or take it down, but will have the ability to start and stop operation of the Facility at any time by throwing a switch at PSCo's own remote control center. Since PSCo has the power to determine when the Facility will operate and at what levels it will generate electricity, PSCo controls the emission of pollutants from the facility. PSCo therefore has the "power to direct or cause the direction of the management and policies" of another entity with respect to the very activities which the Clean Air Act regulates, that is, with respect to the other entity's "pollutant emitting activities."

We believe that the facts presented strongly support a finding that PSCo controls the Facility through the power supply agreement. Because PSCo exerts such control, the proposed Facility is properly considered a modification to the existing PSCo facility at Fort Lupton.

2. The existing PSCo facility and the proposed Front Range facility at Fort Lupton are under the control of persons under common control:

The ownership relationship between PSCo and Front Range provides additional evidence of common control. Front Range is a limited liability company, which is owned by two entities, FR Holdings (FRH) and Quixx Mountain Holdings (Quixx). FRH, in turn is a wholly owned subsidiary of KN Power Company, which is a wholly owned subsidiary of KN Energy, Inc. On the other side of the company, Quixx is a subsidiary of Quixx Corporation, which is a subsidiary of New Century Energies, Inc (New Century). New Century is also the parent company of PSCo, which is its wholly-owned subsidiary. Thus, the same parent company owns PSCo and one of the two owners of Front Range.

Letters from Martha Rudolph, attorney for KN, dated September 22 and 27, 1999, appear to place significant weight on the fact that FRH, an entity not related in its corporate structure to PSCo, "will possess virtually all responsibility for, and control of, the operations of the Project." First, as discussed above, EPA believes that PSCo exerts significant direct control over the Facility under the contract agreement. Second, for the reasons discussed below, we do not necessarily agree that the limited liability agreement conclusively prevents Quixx, an entity related to PSCo in its corporate structure, from having managerial and operational responsibilities at the Facility.¹

We understand that a contractual relationship has been established between a New Century subsidiary, Quixx and FRH through the limited liability company agreement that created Front Range. We believe that the current ownership relationship of the two parties is

¹ Here, as in the case of Dupont and Dupont Dow Elastomers, EPA agrees that Front Range may not be considered a subsidiary of New Century or of one of its subsidiaries. See letter from Steven C. Riva, Region 2 Air Programs Branch Permitting Chief, to Michael L. Rodburg, Esq. (November 25, 1997).

50 percent/50 percent, but that the agreement may be amended to create a 49 percent/51 percent relationship. Under the amended agreement, Quixx would have 49 percent voting interest, presumably to eliminate its ability to veto decisions by FRH, the managing entity. The agreement may be amended again, to create a 49 percent/49 percent two percent relationship with a third unnamed party, giving neither major owner voting control or veto power, but reinstating equal interest between the two.²

According to the limited liability company agreement (dated September 17, 1999; unsigned), FRH is the “sole manager” of the Facility. It appears from this agreement that Quixx has no role in management of day-to-day operations at the facility, particularly with respect to pollution control. As we have discussed, however, the power supply agreement already gives PSCo significant authority over facility operations. Indeed, it appears that even the “sole manager” (FRH) has little ability to manage actual operations of the facility, apparently being limited to management of personnel and contracts and maintenance of the facility. Limiting Quixx’s authority in this sphere may be of relatively little significance given PSCo’s direct control pursuant to the contract.

Other pertinent facts we find problematic are that the limited liability agreement may be amended by agreement of the two owners, FRH and Quixx. Presumably such amendment could include lifting the limitation on Quixx’s involvement in operations. Furthermore, the manager of operations, now FRH, may be removed for cause by the unanimous vote of the non-manager owners. At present, Quixx is the only non-manager owner.

The fact is that the Facility is dependent on both owners, FRH and Quixx, who have undertaken to construct and operate an emitting facility and who, singly or together, may decide to disband the company, sell the property, declare bankruptcy, or make any other decision related to the existence or nonexistence of the project. The provisions of the agreement that wall off the Quixx side of the company from any authority over contracting with PSCo may satisfy PUC requirements, but similar walling-off with respect to operations may have no effect for purposes of PSD permitting. For PSD applicability, the issue is whether these two facilities are so separate in structure and control that their emissions should not be considered those of a single source; or, whether, in fact, an appearance of separate status is contradicted by actual connection(s) so significant and so intrinsic that the two should be treated as a single source of air pollution. We believe the latter is the case.

² As noted before, the determination whether two facilities should be treated as a single source is factually driven. Historically, EPA has viewed the percentage of voting interest as important, but not the sole criterion. EPA guidance published in 1979 indicates that an ownership interest as low as 10 percent may result in control, while ownership of 50 percent necessarily results in control. See 44 Fed. Reg. 3279 (January 16, 1979). Other criteria must be considered.

3. Conclusion

Even if control may not be established solely through ownership, it is EPA's belief that the power supply agreement creates a contractual relationship that confers direct control on PSCo. Because both the proposed and existing facilities are under common control, have the same first 2-digit SIC code, and are adjacent, they together constitute a single stationary source. Thus, because the existing PSCo facility is a major stationary source and the new Facility will have potential emissions exceeding the PSD significance levels not only for nitrogen dioxide and carbon monoxide, but also for particulate matter, PM-10, and volatile organic compounds, it is EPA's interpretation that the Facility is a major modification for purposes of PSD applicability.

KN has urged EPA to consider this proposed facility differently than other adjacent sources with close connections through contract or ownership. Because of the regulated environment in which the Facility will operate, they urge us to use a different set of criteria for determining when one entity exerts so much control over another that two facilities may be considered a single source. It may be that the nature of utility regulation in Colorado makes our finding a foregone conclusion in this case -- or in any other where a generating facility locates near an existing power plant to which it is linked by ownership or control. That does not mean that the conclusion is an incorrect one. The purpose of the PSD program is to assure that industrial development will only be allowed in clean air areas when it is controlled in such a way as to minimize impacts of air pollution and preserve clean air resources. The criteria for source determination, developed through regulation, guidance, and many years of application, help assure that outcome. EPA believes that the result in this case is that PSD will be triggered for the Facility, unless the State issues a permit that effectively limits its potential to emit below PSD significance levels.

Sincerely,

/s/ Richard R. Long

Richard Long, Director
Air and Radiation Program

cc: Martha Rudolph, KN Energy, Inc.
Casey Shpall, Colorado Attorney General's Office
Frank Prager, Public Service Company of Colorado