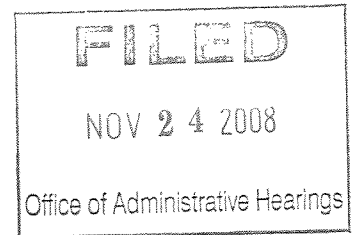


**COMMONWEALTH OF KENTUCKY
OFFICE OF ADMINISTRATIVE HEARINGS
ENERGY AND ENVIRONMENT CABINET
FILE NO. DAQ-29109-039**



KENTUCKY MOUNTAIN POWER, LLC.

PETITIONER

VS. **HEARING OFFICER'S REPORT AND RECOMMENDED
SECRETARY'S FINAL ORDER**

ENERGY AND ENVIRONMENT CABINET

RESPONDENT

and

SIERRA CLUB

INTERVENING RESPONDENT

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I. INTRODUCTION / BACKGROUND

In this action, which is before the undersigned Hearing Officer upon the parties' cross-motions for summary disposition, Kentucky Mountain Power, LLC (KMP) challenges the Energy and Environmental Cabinet's (Cabinet's) determinations made respectively on January 17, 2008, and March 6, 2008, that: i) KMP's Prevention of Significant Deterioration (PSD) permit to construct a 600 megawatt (MW) coal-fired electrical generating power plant in Knott County, Kentucky, has expired due to KMP's failure to meet the construction requirements required by law to maintain the PSD permit's validity; and ii) KMP's renewal application for its final Title V Operating Permit and Final Phase II Acid Rain Permit for the same proposed coal-fired power

plant should be terminated for KMP's failure to timely respond to the Cabinet's Notices of Deficiencies (NODs) concerning said renewal application.

KMP was originally issued these permits by the Cabinet's Division of Air Quality (DAQ) on May 4, 2001. In Kentucky, the Title V operating permit program and the PSD construction permit program for major air pollution sources, like this proposed coal fired power plant of KMP, are issued as a combined permit but the operating portion of the permit expires after five years. Thereafter, a permittee is authorized to continue operations under an "application shield" if a timely and complete application for renewal of the permit has been filed with DAQ. KMP did file a timely application for renewal in this case, which was probably sufficiently complete for application shield purposes (a complex issue), but which issue is moot (and need not and is not resolved herein) since nothing had been constructed to operate under the permit and nothing was being constructed to operate during the time DAQ was actually processing KMP's renewal application. Over the strong objection of KMP, the Sierra Club (Sierra) has been allowed to intervene into this action as an Intervening Party Respondent and supports the Cabinet's determinations. (Collectively, the Cabinet and Sierra will be referred to as Respondents).

All parties have argued that there are no disputed issues of material facts for their respective motions and that they are entitled to summary disposition as a matter of law. The undersigned agrees that there are no disputed issues of material fact and that summary disposition can be recommended as a matter of law. The standards for summary disposition are set out fully in the Conclusions of Law, below.

After first summarizing the construction requirements to maintain a PSD construction permit's validity in the next section of this report, the undersigned will then provide an executive

summary of his recommendation and its bases that the Respondents' motions for summary disposition should both be granted, and that Petitioner KMP's motion for summary disposition should be denied.

II. SUMMARY OF CONSTRUCTION REQUIREMENTS

In summary, construction authority under a PSD permit automatically expires if any of the following events occur: i) construction of the source does not commence within 18 months of approval of the permit; ii) construction is discontinued for a period of 18 months or more; or iii) construction is not completed within a reasonable time. See 401 KAR 51:017 Section 16(2)(a) for these requirements.¹ However, under Section 16(2)(b) of this regulation, the Cabinet may extend the 18 month period of the regulation "upon a satisfactory showing that an extension is justified" and in the present case, the Cabinet did extend the original 18-month period for commencement of construction by another 18 months. The legitimacy of this extension request by KMP and its approval by the Cabinet are not an issue in this proceeding. Thus, the initial deadline date for commencement of construction in this case is agreed to be May 4, 2004, which is a full three years following issuance of the permit.

III. EXECUTIVE SUMMARY OF RECOMMENDATION; BACKGROUND ARGUMENTS AND FACTS; AND BASES FOR RECOMMENDATION

A. Executive summary of recommendation

After carefully considering the record for summary disposition in the light most favorable to KMP, the undersigned concludes that: i) the Cabinet's determination must be affirmed that

¹ For the reasons explained in the Conclusions of Law below, the undersigned rejects KMP's argument that this expiration is not automatic, but instead requires notice and hearing rights under the permit revocation procedures established at 401 KAR 50:060 prior to being effective. The Cabinet's failure to follow these procedural rules is the gravamen of KMP's own motion for summary disposition challenging issuance of the Cabinet determinations. Thus, KMP's motion must be denied.

KMP's PSD permit has expired due to KMP's failure to meet the construction requirements required by law to maintain the PSD permit's validity; and ii) that since KMP has not constructed any of the facilities proposed in its original permit and cannot by law construct any such facilities now without first obtaining a new PSD permit, the Cabinet's determination to terminate KMP's renewal application must also be affirmed regardless of the issues concerning the adequacy and timeliness of KMP's responses to the NODs issued by the Cabinet during its processing of KMP's renewal application, as there is nothing to operate and a new combined PSD/Title V permit must be obtained before any construction can now occur. Thus, if KMP desires to continue to proceed with this project, it must pursue a new combined Title V/PSD/Phase II Acid Rain permit, which will require an updated best available control technology analysis (BACT) to be performed.

B. Background arguments and facts

For purposes of these cross-motions only, the undersigned assumes that KMP met its initial "commencement" of construction requirements following permit issuance on May 4, 2001, as that issue was not expressly raised in the Respondents' motions as a separate basis for determining KMP's permit expired. Sierra, at least, would argue a failure by KMP to timely commence construction as a separate basis for permit expiration if this matter proceeds to hearing, but did not pursue this argument in its dispositive motion. As to the Cabinet's position on timely commencement, on May 9, 2006, the Cabinet made a determination that KMP continued to meet its ongoing construction requirements using a "commencement" type of analysis even though the May 10, 2004 deadline for commencement had already passed. "Commence"[ment] is a defined regulatory term which can be satisfied by the permittee entering

into “binding agreements or contractual obligations, which cannot be canceled or modified without substantial loss to the owner or operator to undertake a program of actual construction of the source to be completed within a reasonable time.” See 401 KAR 51:001 Section 1(46). KMP is also arguing a “commencement” type of analysis, based on the existence of a contract to construct the plant, for not only meeting its commencement obligation, but for also meeting the two separate additional ongoing construction obligations which are, again, to not discontinue construction for any 18 month period and to complete the project within a reasonable time. KMP is also arguing that the Cabinet’s May 9, 2006 determination that KMP’s construction authority was valid is a superior final determination to the January 17, 2008 determination challenged herein that KMP’s construction authority has expired. Thus, while the parties have not sought a ruling on whether the first prong (“commencement”) of the construction requirements is met on this record, the commencement analysis permeates this proceeding.

The assumption that KMP timely commenced construction is best supported by KMP’s entry into a February 4, 2004 contract with a specified contractor consortium for engineering, procurement, and construction of the proposed plant (the EPC contract). However, this assumption is stronger if the EPC contract can be construed consistent with the terms of a preliminary contract entered on October 10, 2003 (the CATS contract or contract agreement and terms sheet to negotiate an EPC contract), which contract contained a deadline for actual construction to proceed by December 31, 2006, or that KMP would be obligated to pay the contractor a sum of \$71,000,000. (The undersigned actually concludes this would be necessary for the EPC contract to be sufficient to satisfy the commencement requirements). It was the assumption that said deadline and penalty provision would be carried over to the final EPC

contract (which was not provided to the Cabinet until this litigation) that led to the May 9, 2006 determination by the Cabinet that KMP's construction authority continued on that date.²

² However, this provision was not carried over into the EPC contract. This is evident by reading the EPC contract itself but requires that the document be parsed through carefully in its entirety in an objective manner, as the undersigned has done in reviewing and deliberating on these cross-motions. This is a time consuming process. More important than the undersigned's reading of the contract, is that counsel for KMP not only conceded this point during oral argument, but actually argued strenuously for this very point apparently believing it somehow supported KMP's position in this case. (This was in response to Cabinet counsel's emphasis that there was no evidence this \$71 million dollar penalty had ever been paid by KMP for its failure to timely give the NTP). The Cabinet had clearly expected this penalty to be owed if the NTP had not been given as of December 31, 2006. This leaves the EPC contract with a completely unbridled discretionary date for commencement of the project with the permittee alone exercising the discretion, which is completely inconsistent with the express language of the regulations establishing the construction requirements and completely defeats the two primary purposes for those requirements, as those purposes are otherwise noted herein. It is clear that when the Cabinet made its May 9, 2006 determination of ongoing construction by KMP as to this project, which KMP is now attempting to rely upon as a final determination superior to the challenged determination at issue, that the documentation the Cabinet relied upon for said determination was the CATS documentation provided by KMP to the Cabinet, which established a deadline of December 31, 2006 for the NTP to be given and provided this substantial penalty would be obligated to be paid, if the NTP was not given by said deadline date. The penalty is now contemplated in the EPC contract to be paid only if KMP voluntarily withdraws from the project but the penalty, if still effective, is not tied to any failure by KMP to give the NTP by any specified date. (This also now results in an overwhelming inducement for KMP to never admit the project is dead regardless of the project's possible lack of viability otherwise). However, this is assuming the EPC contract is still a valid contract, which the undersigned questions but has assumed for purposes of the Cabinet's and Sierra's motions, since this is a disputed mixed issue of both fact and law, which now must be resolved in favor of KMP for purposes of these motions. The EPC contract calls for renegotiation of certain critical terms such as the construction schedule and the overall contract price, assuming the NTP was not given by July 31, 2004. It was not. There is no evidence of record of any further negotiations having taken place but there is evidence of record that further negotiation is needed. See e.g. April 20, 2006 letter from Black & Veatch's Executive Vice President stating his company, the lead contractor, would still "honor" the contract subject to renegotiation of these terms, as opposed to stating it was bound to do so. However, he references the date of the CATS agreement and not the date of the EPC contract in this letter. Finally, when the Cabinet sought documentation from KMP beginning in late 2005, and into early 2006 that construction was still ongoing after an additional 18 months had passed following the Cabinet's 2004 voiding its earlier 2004 determination that construction authority had lapsed, which is discussed further below, KMP did not provide the EPC contract itself but only copies of selected portions of the CATS agreement. (Any 18 month lapse of construction invalidates the PSD permit, even assuming "commencement" of construction had otherwise timely occurred. Thus, the Cabinet wanted a construction update 18 months following its earlier 2004 determination to assure construction was still ongoing, as required). The CATS agreement was more favorable to KMP's argument to meet the definition of "commencement" of construction, than the EPC contract which lacked any penalty for not meeting a specified commencement date or which actually had no actual required commencement date at all. As noted above, by KMP's current admission, the CATS agreement had already been replaced by the February 4, 2004 entered EPC contract. Yet, upon the Cabinet's request for documentation in late 2005 and early 2006, KMP provided portions of the superseded CATS agreement to the Cabinet, as opposed to the then allegedly effective EPC contract. This constituted significant misrepresentation to the Cabinet by KMP. An actual hard copy of the EPC contract was not provided to the Cabinet until this litigation had progressed to a significant degree. Thus, the undersigned concludes that KMP lacks clean hands to rely on either the July 12, 2004 determination (discussed further below), which was based on KMP's false/erroneous representation that an ongoing program of actual site construction had begun on April 28, 2004; or the May 9, 2006 determination, which was based on the provisions of the CATS agreement that stated the NTP would be given no later than December 31, 2006, or a substantial penalty of \$71 million would be owed by KMP, if that specific deadline for the NTP was not met. KMP provided this CATS

