

ENVIRONMENTAL PROTECTION AGENCY**40 CFR Part 73****[FRL-5513-6]****RIN 2060-AG75****Acid Rain Program, SO₂ Allowance Auction and Electronic Allowance Transfer****AGENCY:** Environmental Protection Agency (EPA).**ACTION:** Advanced notice of proposed rulemaking; notice and request for comment.

SUMMARY: Title IV of the Clean Air Act, as amended by the Clean Air Act Amendments of 1990, (the Act) authorized the Environmental Protection Agency (EPA or Agency) to establish the Acid Rain Program to reduce the adverse health and ecological effects of acidic deposition. Under the Acid Rain Program, electric utilities must have an allowance for each ton of sulfur dioxide (SO₂) that their generating facilities emit.

Title IV mandates that EPA hold or sponsor yearly auctions and direct sales of allowances for a small portion of the total allowances allocated each year. The United States General Accounting Office has recommended that EPA change the design of the auction to a single-price auction, in which each bidder would pay the market-clearing price. Currently, the auction is a "price-discriminating" auction, meaning that all bids are ranked beginning with the highest dollar amount and that each winning bidder pays what he or she bids until all allowances are sold. EPA is soliciting comments on whether to change the current design of the acid rain allowance auctions. EPA is also seeking comment on whether to change the requirement that additional allowances offered in EPA auctions have a set minimum price in whole dollars. Lastly, EPA is seeking comment on whether to change the timing of the annual auctions from late March to late October.

Title IV also provides for the transfer of allowances and states that a transfer will not be effective until EPA receives and records a written certification of the transfer signed by a responsible official of each party. EPA is considering development of a system to allow electronic submittal of allowance transfers. EPA is seeking comment on whether to propose allowing such electronic transfers.

DATES: Comments must be received on or before August 5, 1996.

ADDRESSES: All written comments must be identified with the appropriate docket number (Docket No. A-96-19) and be submitted in duplicate to: EPA Air Docket Section (6102), U. S. Environmental Protection Agency, Waterside Mall, Room M1500, 1st floor, 401 M Street SW., Washington, DC 20460.

FOR FURTHER INFORMATION CONTACT:
Linda Reidt Critchfield, U. S.

Environmental Protection Agency, Acid Rain Division (6204J), 401 M Street SW., Washington, D.C. (202) 233-9087, call the Acid Rain Hotline at (202) 233-9620, or visit the Acid Rain Program web page at <http://www.epa.gov/docs/acidrain/ardhome.html>.

SUPPLEMENTARY INFORMATION: EPA's Acid Rain Program established an innovative, market-based allowance trading system to reduce SO₂ emissions, one of the primary precursors of acid rain. Under this system, fossil fuel-fired power plants, the principal emitters of SO₂, were allocated tradeable allowances based on their past fuel usage and emissions. Each allowance entitles a unit to emit 1 ton of SO₂ during or after the year specified in the allowance serial number. At the end of the year, the number of allowances a unit holds must equal or exceed total emissions at that unit; otherwise, stringent penalties will apply. After the year 2000, the total number of allowances allocated each year will be about half of what the utility industry emitted in 1980.

Allowances may be bought, sold, or banked like any other commodity. If a unit has surplus allowances, it may sell them to units whose emissions levels exceed their allowance supply, or it may save them for future years.

Allowance Auctions

Because the availability of allowances is crucial to ensure the economic efficiency of emissions limitations and facilitate the addition of new electric-generating capacity, title IV of the Act mandates that EPA hold or sponsor yearly auctions and direct sales of allowances for a small portion of the total allowances allocated each year. In addition, title IV requires that EPA provide a written guarantee ensuring priority for certain new independent power producers (IPPs) in purchasing allowances in the direct sales. The auctions, sales, and IPP guarantee provisions of title IV help ensure that units, including new IPPs, have a public source of allowances beyond those allocated initially. Moreover, the auctions, which began in 1993, provide price information to the allowance

market early in the regulatory program, 1995 being the first year in which allowances are required to be held.

To supply the sales and auctions with allowances, EPA has set aside in a Special Allowance Reserve 2.8 percent of the total annual allowances allocated to all units. During Phase I, when the allowances allocated total 5.7 million allowances annually, 150,000 allowances are available every year for auctions. During Phase II, when allowance allocations total 8.95 million allowances annually, 200,000 allowances are earmarked annually for auctions and 50,000 designated for the direct sales. Private allowance holders (such as utilities or brokers) also may offer their allowances for sale at the EPA auctions, provided that the allowances are dated for the year in which they are offered, for any previous year, or for 7 years in the future.

The auctions and sales are conducted for EPA by the Chicago Board of Trade (CBOT). Section 416 of the Act gives EPA the authority to delegate the administration of the auctions and sales.

EPA is soliciting comments on whether the Agency should propose to change the design and timing of the annual acid rain allowance auctions. The United States General Accounting Office (GAO) recommended changing the design of the auction from a "price-discriminating" auction to a uniform or single-price auction. See Air Pollution: Allowance Trading Offers an Opportunity to Reduce Emissions at Less Cost, GAO/RCED-95-30 (December 1994). A price-discriminating auction is an auction in which all bids are ranked, beginning with the highest dollar amount, and each winning bidder pays what he or she bids until all allowances are sold. Such a design produces a range of winning prices. In a uniform or single-price auction, bids are ranked the same way, but all winning bidders pay only the market-clearing price. The market clearing price is the price of the last available allowance that is sold.

Section 416(d)(2) of the Act provides that "the auctioned allowances shall be allocated and sold on the basis of bid price, starting with the highest-priced bid and continuing until all allowances for sale at such auction have been allocated" 42 U.S.C. 7651o(d)(2). EPA has interpreted this language to require auction sales based on bid price (i.e., a price-discriminating auction where bidders pay what they bid) as opposed to auction sales based on a single, market-clearing price paid by all of the winning bidders, as proposed by the GAO report. 56 FR 23744, 23746 (May 23, 1991) (proposed rule); see 56 FR 65592, 65603 (December 17, 1991) (final

rule). EPA is considering whether the statutory language provides flexibility to change to a single-price auction. A single-price auction may have the benefit of producing a less confusing price signal for utilities participating in each auction since there will be only one winning price, the clearing price.

In the first three auctions, the gap between the average price paid (the price utilities received for the sale of their allowances withheld for auction) and the market-clearing price has narrowed. In 1993, the average price paid in the spot auction was \$156 and the market-clearing or lowest successful bid was \$131. In 1994, the average price paid in the spot auction was \$159 and the market-clearing price was \$150. In 1995, the average price paid in the spot auction was \$132 and the market-clearing price was \$130. In 1996, the average price paid in the spot auction was \$68 and the market-clearing price was \$66. Therefore, over the course of four auctions, the gap between the average spot price paid and the market-clearing price has narrowed from \$25 in 1993 to \$9 in 1994 and to \$2 in 1995 and 1996. This narrowing of the gap may indicate that the current format does not impede the market, but the Agency would like to receive comments on how the auction design affects allowance market participants.

EPA also is seeking comment on whether the timing of the auctions should be changed from "no later than March 31 of each year" (40 CFR 73.70(b)) to no later than October 31 of every year. Aside from price discovery, one of the initial purposes of the allowance auctions was to provide a source of allowances to new units. In the existing regulations, EPA timed the auction to precede the direct sale, which begins on June 1 each year (56 FR 65598). This reason for the timing of the auction may no longer be applicable. No direct sales have actually been made, and EPA is eliminating the direct sale program and the related IPP written guarantee. By October 31, new (or existing) units will have three quarters of emissions data and therefore will have a better idea of their allowance needs for the year and be better able to use the auction in planning for program compliance. Furthermore, auctions completed by October 31 would allow utilities to freely offer their allowances in the auctions and avoid conflicting with the transfer restrictions that are imposed after the allowance transfer deadline has passed and before the compliance deductions have been completed. § 73.50(b)(2).

EPA would also like comment on whether additional allowances offered

by utilities to be sold in EPA auctions must have a minimum price in whole dollars. Under 40 CFR § 73.70, authorized account representatives (AARS) may offer allowances for sale at EPA auctions and must notify EPA of their minimum price in whole dollars. All bids in previous EPA auctions were required to be in whole dollars. Beginning with the March 1996 auction, bids were accepted in increments of \$0.01. Since bids are now accepted in increments other than whole dollars, EPA is seeking comment on whether or not allowance offers should also be accepted with unrestricted minimum prices.

Electronic Transfer

Title IV states that allowance transfers are effective when "written certification of the transfer, signed by a responsible official of each party to the transfer, is received and recorded by" EPA. 42 U.S.C. 7651b(b). Accordingly, EPA's current regulations require that, to record an allowance transfer with EPA, parties must submit an Allowance Transfer Form that includes "signatures of the authorized account representatives [AARS] of both the transferor and transferee accounts." 40 CFR 73.50(b)(1)(ii). An Allowance Transfer Form also lists the serial numbers of the allowances to be transferred. Once a complete Allowance Transfer Form is submitted to the EPA, EPA records the transfer in the Allowance Tracking System within 5 business days if the transfer meets all applicable requirements.

In order to facilitate "the orderly and competitive functioning of the allowance system" (42 U.S.C. 7651b(c)), EPA is investigating methods for electronic submission of allowance transfers. This would eliminate the need to mail the transfer forms between AARS and then to EPA, allowing the transfer to be recorded more quickly and saving money for the buyer and the seller. The most straightforward option for submitting an electronic transfer is to allow the seller to submit the transfer information. If allowances are transferred to the wrong account or the incorrect number of allowances are transferred to the correct buyer, these errors would be corrected through EPA's normal error correction procedure. Another option is to have both the buyer and seller submit transfer forms, and if the transfer information on the forms matches perfectly, EPA processes the transfer. This raises a potential problem if there are the slightest differences in the transfer information on the two forms, since the computer will reject the transfer. A third option is to have the

seller submit the transfer form to EPA and have the buyer approve it prior to processing by EPA. This option may be more difficult to implement using existing software that has been developed for transferring information electronically, since that software does not provide "signoff" capability.

EPA is interested in learning whether participants in the allowance market would like to forego the requirement that both AARS "sign" a single transfer form in order to implement the electronic transfer capability. Comment is also requested on the three options described above and any other options and how such options can be implemented consistent with statutory requirements.

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All written comments will be considered carefully in determining whether a subsequent proposal to change future auctions and to allow for electronic transfers will be prepared.

Administrative Requirements

A. Executive Order 12866

Under Executive Order 12866, 58 FR 51735 (October 4, 1993), the Administrator must determine whether the regulatory action is "significant" and therefore subject to Office of Management and Budget (OMB) review and the requirements of the Executive Order. The Order defines "significant regulatory action" as one that is likely to result in a rule that may:

(1) have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities;

(2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;

(3) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof, or

(4) raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

Pursuant to the terms of Executive Order 12866, it has been determined that this notice is a "significant regulatory action" because the notice seems to raise novel legal or policy issues. As such, this action was submitted to OMB for review. Any written comments from OMB to EPA, any written EPA responses to those comments, and any changes made in response to OMB suggestions or

recommendations are included in the docket. The docket is available for public inspection at the EPA's Air Docket Section, which is listed in the **ADDRESSES** section of this preamble.

B. Miscellaneous

Requirements under the Unfunded Mandates Act, Paperwork Reduction Act, and Regulatory Flexibility Act will be addressed if and when the Agency issues a proposed rule based on the comments received in this advanced notice of proposed rulemaking.

Dated: May 24, 1996.

Carol M. Browner,
*Administrator, U.S. Environmental Protection
Agency*

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