

Sithe Global Power, LLC (Sithe) Mitigation Proposal
for the Desert Rock Energy Project (DREP)¹
April 2006

Option A: For the purposes of mitigating potential air quality impacts, including potential visibility and acid deposition impacts, of the DREP at Class I and Class II air quality areas in the region potentially affected by DREP, Sithe² shall obtain Emission Reduction Credits from physical and/or operational changes that result in real emission reductions at one or more Electric Generating Units³ (EGUs) within 300 km of the DREP and retire sulfur dioxide⁴ Allowances in accordance with the following:

- The number of sulfur dioxide Emission Reduction Credits required for the respective calendar year shall be determined by DREP's actual sulfur dioxide emissions, in tons, plus 10%.
- The amount of Emission Reduction Credits achieved would be determined by comparing the emission rate (in tons) during the year for which the reduction is claimed to a baseline emission rate. The baseline emission rate shall be the average emission rate (in tons per year) during the two-year period prior to any emission reduction taking place.
- Acceptable sulfur dioxide Emission Reduction Credits under this condition shall be from facilities that were allocated sulfur dioxide Allowances under 40 CFR 73⁵ and that are located within 300 km of the DREP facility.
- The vintage year of the Emission Reduction Credits shall correspond to the year that is being mitigated. Sithe shall retire the required Emission Reduction Credits by transferring an equivalent number of Allowances into account #XXX with the U.S. EPA Clean Air Markets Division⁶. Except for Sithe's purposes under Title IV, these retired Allowances can never be used by any source to meet any compliance requirements under the Clean Air Act, State Implementation Plan, Federal Implementation Plan, Best Available Retrofit Technology requirements, or to "net-out" of PSD. However, surplus Emission Reduction Credits could be used at the discretion of the holder of the credits.
- Sithe shall submit a report to the EPA Region 9 Administrator (or another party acceptable to the Federal Land Managers) no later than 30 days after the end of

¹ For purposes of measuring distances from the DREP as set forth in this Agreement, DREP shall mean the property boundary of the DREP lease site.

² References to Sithe include its subsidiary "Desert Rock Energy Company, LLC" which will be the owner of DREP (referred to herein as the Desert Rock Project Company).

³ Provided that Sithe proposes a method acceptable to the Federal Land Managers for determining emission reductions, Sithe may obtain real emission reductions at sources other than EGUs.

⁴ Provided that Sithe proposes a method acceptable to the Federal Land Managers for determining and tracking emission reductions, nitrogen oxides reductions may be substituted for sulfur dioxide reductions by a ratio of three tons of nitrogen oxides to one ton of sulfur dioxide.

⁵ Provided that Sithe proposes a method acceptable to the Federal Land Managers for determining emission reductions, Sithe may obtain physical emission reductions at sources not granted allowances under 40 CFR 73.

⁶ Provided that Sithe proposes a method acceptable to the Federal Land Managers for determining and tracking Emission Reduction Credits, Sithe may obtain real emission reductions at sources other than EGUs. Nitrogen oxides reductions may be substituted for sulfur dioxide reductions by a ratio of three tons of nitrogen oxides to one ton of sulfur dioxide.

each calendar year which shall contain the amount of sulfur dioxide emitted; amount, facility, location of facility, vintage of Emission Reduction Credits retired; proof Emission Reduction Credits/Allowances have been transferred into account #XXX; and any applicable serial or other identification associated with the retired Emission Reduction Credits/Allowances.

Due to the actual emission reductions obtained from nearby sources under this Option, the Federal Land Managers prefer this approach to mitigating DREP's air quality impacts.

Or,

Option B: For the purposes of mitigating potential air quality impacts, including potential visibility and acid deposition impacts, of the DREP at Class I and Class II air quality areas in the region potentially affected by DREP, Sithe shall obtain and retire sulfur dioxide "Mitigation Allowances" from one or more EGUs within 300 km of the DREP in accordance with the following:

- In addition to those Allowances required under Title IV, the required number of sulfur dioxide "Mitigation Allowances" for the respective calendar year shall equal DREP's actual total sulfur dioxide emissions, in tons.
- Acceptable sulfur dioxide "Mitigation Allowances" under this condition shall be from facilities that were allocated sulfur dioxide Allowances under 40 CFR 73 and that are located within 300 km of the DREP. However, the total annual cost of "Mitigation Allowances" purchased beyond those regular Allowances required by Title IV is not to exceed three million dollars. Provided that Sithe proposes a method acceptable to the Federal Land Managers for determining emission reductions, Sithe may obtain physical emission reductions at sources not granted allowances under 40 CFR 73.
- The vintage year of the "Mitigation Allowances" shall correspond to the year that is being mitigated. Sithe shall retire these "Mitigation Allowances" by transferring them into account #XXX with the U.S. EPA Clean Air Markets Division. These retired "Mitigation Allowances" beyond Title IV can never be used by any source to meet any compliance requirements under the Clean Air Act, State Implementation Plan, Federal Implementation Plan, Best Available Retrofit Technology requirements, or to "net-out" of PSD.
- Sithe shall submit a report to the EPA Region 9 Administrator (or another party subject to approval of the Federal Land Managers) no later than 30 days after the end of each calendar year which shall contain the amount of sulfur dioxide emitted from the DREP; amount, facility, location of facility, vintage of Allowances retired; proof Allowances have been transferred into account #XXX; and any applicable serial or other identification associated with the retired Allowances.

And,

⁷ All costs referenced in this document are base-year 2006 dollars that will be adjusted for inflation by using the consumer price index.

If Sithe chooses Option A, they will contribute \$300,000 annually toward environmental improvement projects that would benefit the area affected by emissions from DREP, including the Class I areas and the Navajo Nation. If Sithe chooses Option B, they will contribute toward environmental improvement projects an amount equal to the \$3 million cap minus the cost of the Mitigation Allowances, up to a maximum of \$300,000. Appropriate projects will be determined jointly by the Federal Land Managers, Navajo Nation EPA, the Desert Rock Project Company and Dine Power Authority, and may include projects that would reduce or prevent air pollution or greenhouse gases, purchasing and retiring additional emission reduction credits or allowances, or other studies that would provide a foundation for air quality management programs. Up to 1/5 of the contributions can be dedicated to air quality management programs. The remaining contributions shall be used to support projects that mitigate greenhouse gas emission impacts. The Desert Rock Project Company shall have the ability to bank the greenhouse gas emission reduction credits achieved through these projects and be entitled to these credits to comply with future greenhouse gas emission mitigation programs.

And,

Sithe will agree to reduce mercury emissions by a minimum of 80% on an annual average using the air pollution control technologies as proposed in the permit application, i.e. SCR, wet FGD, hydrated lime injection, and baghouse. In addition, Sithe will agree to raise the mercury control efficiency to a minimum of 90% provided that the incremental cost effectiveness of the additional controls (such as activated carbon injection or other mercury control technologies) does not exceed \$13,000/lb of incremental mercury removed. Compliance with this provision will be determined by installation and operation of an EPA-approved mercury monitoring and/or testing program. In operating periods when a minimum of 80% mercury control (or 90% as noted above) is not technically feasible due to extreme low mercury concentrations in the burned coal, Sithe agrees to work with EPA to establish a stack mercury emission limit in lieu of a percent reduction, for the purposes of demonstrating compliance.

Example #1:

Suppose DREP emits 3,000 tons of SO₂ in 2010. Under Option A, Sithe would be required to reduce SO₂ emissions at another source (or sources) within 300 km by 3,300 tons. These credits can be used to meet the requirements of the acid rain program under Title IV of the Federal Clean Air Act provided that the physical and/or operational change occur on one or more EGUs.

Example #2:

Suppose DREP emits 3,000 tons of SO₂ in 2010. Under Option A, suppose Sithe reduces SO₂ emissions at another source (or sources) within 300 km by 4,000 tons. In this case,

Sithe would have created 700 tons of surplus SO₂ Emission Reduction Credits that it may use as it sees fit.

Example #3:

Suppose DREP emits 3,000 tons of SO₂ in 2010. Under Option B, Sithe would purchase its "regular" 3,000 tons of Title IV Allowances from any source, anywhere, plus up to 3,000 tons of SO₂ "Mitigation Allowances" from another source (or sources) within 300 km, provided that the total cost of the "Mitigation Allowances" does not exceed \$3 million (in 2006 dollars). If each "Mitigation Allowance" cost at least \$1,000, Sithe would be done.

Example #4:

Suppose DREP emits 3,000 tons of SO₂ in 2010. Under Option B, Sithe would purchase its "regular" 3,000 tons of Title IV Allowances from one or more EGU sources. For the remaining 3000 SO₂ "Mitigation Allowances", Sithe may choose, as an option, to obtain 9000 NO_x emission reduction credits from physical or operational changes of one or more NO_x emission sources within 300 km.

Example #5:

Suppose Sithe obtains the necessary SO₂ reductions through a capital investment project (Option A), or purchases SO₂ Mitigation Allowances (Option B) at a cost of \$2.7 million or less. Sithe would then contribute the maximum \$300,000 to the environmental improvement fund because the total annual costs (allowances plus contribution) would be below the \$3 million cap. On the other hand, if the mitigation allowances cost more than \$2.7 million, Sithe would contribute the difference between the \$3 million cap and the actual cost of the Mitigation Allowances (i.e., if allowance costs equal \$2.9 million, the environmental improvement fund contribution would be \$100,000).