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WHITE PAPER

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EPA Memo Signals Plant Improvement Opportunities

A policy memorandum issued by the U.S. Environmental Protection Agency ("EPA") during December 2017 clarifies how the agency will apply and enforce certain facets of the New Source Review regulations following a pair of recent U.S. Court of Appeals opinions. The policies announced in *New Source Review Preconstruction Permitting Requirements: Use of the Actual-to-Projected-Actual Applicability Test in Determining Major Modification Applicability*, allow existing facilities with major air permits the opportunity to increase efficiencies and improve operations without triggering the lengthy permit process and implementing additional pollution control technology.

This Jones Day *White Paper* reviews key points from the EPA's memo and addresses some of the policy implications for the electric power industry moving forward.

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On December 7, 2017, the U.S. Environmental Protection Agency ("EPA") released a policy memorandum entitled *New Source Review Preconstruction Permitting Requirements: Use of the Actual-to-Projected-Actual Applicability Test in Determining Major Modification Applicability* ("NSR Memo"). The stated purpose of the NSR Memo is to clarify how EPA intends to apply and enforce certain aspects of the NSR regulations in light of two recent opinions of the U.S. Court of Appeals for the Sixth Circuit—*U.S. v. DTE Energy Co.*, 711 F.3d 643 (6th Cir. 2013) and *U.S. v. DTE Energy Co.*, 845 F.3d 735 (6th Cir. 2017).

The policies announced in the NSR Memo offer existing major stationary sources a significant opportunity to increase efficiency or improve operations without triggering the lengthy process for obtaining major air permits and installing additional pollution control technology. To take advantage of this opportunity, sources must develop records showing the projected increase in actual emissions resulting from the efficiency or improvement project, file any applicable notices of those projections before construction begins, and be prepared to operate the modified facility consistent with the projections. In many cases, emissions increases that the source was already capable of achieving before the project will be excluded in determining the emissions increase caused by the project.

ACTUAL-TO-PROJECTED-ACTUAL TEST AND THE DTE CASES

The NSR regulations, promulgated under the federal Clean Air Act ("CAA"), require owners and operators to obtain an air quality permit prior to beginning construction of a major modification at an existing major source.[1] A "major modification" is a physical or operational change that results in a "significant" emissions increase of any NSR pollutant.[2] Since 2002, EPA has allowed existing sources to opt for using the "actual-to-projected-actual" ("ATPA") test to calculate whether a physical or operational change will cause a significant emissions increase.[3] Under the ATPA test, a source determines the emissions increase by comparing baseline (past) actual emissions to a projection of post-change (future) emissions.[4] The test allows the source to exclude from its projection any emissions increases that "could have been accommodated" during the baseline period and that are "unrelated" to the change under review (often referred to as the "demand growth" or "independent factors" exclusion).[5]

As described in the NSR Memo, the DTE cases have created uncertainty about EPA's ability to disagree with ATPA calculations prepared by a source owner or operator. In the first decision, two out of three judges on the Sixth Circuit panel agreed that EPA could pursue enforcement based solely on a source's alleged failure to comply with the NSR regulations governing the projection of future emissions, even if post-change emissions do not amount to a significant emissions increase. [6] In the second decision, those same two judges were unable to agree about the extent to which EPA could "second guess" the source's calculations.[7] The U.S. Supreme Court declined to hear an appeal of the 2017 DTE decision, leaving the Sixth Circuit opinions intact without comment.[8]

Other courts, too, have reached varying conclusions about EPA's ability to challenge pre-project emission projections. For example, in 2015 the Western District of Oklahoma dismissed a declaratory judgment action that was brought on the theory that a power plant had improperly projected future emissions associated with certain modifications.[9] In dismissing the case, the district court distinguished the Sixth Circuit holdings on the grounds that, unlike in the DTE cases, the plaintiffs did not seek any relief beyond a declaration on the sufficiency of the projections.[10]

EPA acknowledges in the NSR Memo that the DTE decisions and similar cases leave sources wondering what they must do to comply with ATPA emission projection requirements. To provide clarity, the Memo explains how EPA will apply and enforce the ATPA requirements in the federal NSR Rules (and approved state regulations that reflect the content of those rules) with respect to several topics of considerable importance to source owners and operators.

KEY POINTS FROM EPA'S NSR MEMO

Sources Can Actively Manage Emissions. In a significant departure from the previous administrator's policy, EPA will allow source owners and operators to consider their own plans to manage emissions following a project when developing future emission projections. In other words, a source can develop emission projections that reflect its own plans to

avoid a NSR significant emissions increase by actively managing operating hours or other factors that influence emissions after a project. EPA bases this policy on two grounds. First, the NSR regulations broadly allow a source to consider "all relevant information" when projecting future emissions.[11] Second, EPA already decided when promulgating the 2002 NSR amendments that sources are not required to incorporate future emission projections into enforceable permit conditions.[12] EPA shifted away from this original position during the previous administration and began insisting that voluntary plans to control emissions are not allowed as the basis for future emission projections unless they are supported by a federally enforceable permit condition.[13] The NSR Memo signals a return to EPA's original intent on this issue.

No Second-Guessing of Future Emission Projections. The NSR Memo indicates that the agency does not intend to substitute its judgement for that of a source's owner or operator by "second guessing" emissions projections that comply with the letter of the NSR regulations. Therefore, EPA will not challenge the sufficiency of emission projections unless there is "clear error," such as applying the wrong NSR significance threshold to a projected emission increase.[14]

EPA's memo also clarifies that the agency does not intend to initiate enforcement unless post-project actual emissions data indicate that, contrary to the source's projections, the modification resulted in a significant emissions increase. In other words, although the DTE cases may allow EPA to pursue enforcement for improper projections even in the absence of actual post-project emissions data indicating a significant increase, EPA intends to exercise its enforcement discretion in not prioritizing such actions. This is a significant departure from the position taken by EPA and the Department of Justice during the Obama Administration and the DTE litigation.

The Predominant Cause Test Applies to Demand Growth Increases. With regard to the demand growth exclusion, EPA will not presume that emissions increases following a project are necessarily caused by the project and therefore ineligible for the exclusion. In fact, EPA cites the 2002 NSR preamble in favor of the opposite presumption for emissions increases occurring more than five years after a project (i.e., such increases are presumed not to be related to the project).[15]

Citing to a 1992 regulatory preamble,[16] EPA also suggests that post-project emission increases will be considered "unrelated" to a project and therefore eligible for the exclusion if the project is not the "predominant cause" of the increased emissions. This is in direct contrast to historical positions taken by the agency. For instance, in at least one enforcement case, EPA argued that the same 1992 rule "does not say that the particular change must be the 'predominant cause' of the emissions increase …"[17] In addition, previous EPA guidance has taken a broad approach to determining if increases in actual emissions following a project were caused by the project or should instead be excluded from the emissions calculations because they were unrelated to the project. EPA previously reasoned, for instance, that when a source undertakes a project involving a change in fuel, all post-change emissions are "related to" the project (and cannot be excluded) because all future emissions would be the result of burning the new fuel.

IMPLICATIONS AND OPEN QUESTIONS

The policy stated in the NSR Memo creates new opportunities for the regulated community. It makes the preparation of emission projections before a project substantially easier by allowing the source to establish a simple and straightforward internal emissions cap that avoids NSR rather than preparing complex estimates of expected business activity (and associated production and emissions). It also suggests a marked shift away from EPA's older interpretations when evaluating the sufficiency of a source's demand growth exclusion calculations. This will likely create more opportunities to use the demand growth exclusion. Overall, the NSR Memo will reduce the number of projects at existing facilities for which EPA requires major air permits so long as the NSR Memo remains in effect.

To benefit from EPA's new policy, however, sources must understand and fulfill their obligations under the NSR regulations. First, the source must prepare ATPA emission calculations, including future emissions projections, before implementing a project. Failing to prepare such calculations leaves a source susceptible to EPA or other third-party calculations in enforcement actions and to claims of having violated NSR preconstruction requirements.

In preparing ATPA calculations, the source must avoid "clear error" and must consider all relevant information, which can include the source's own plan to manage emissions. The meaning of "clear error" is one area of uncertainty in the NSR Memo. EPA gives the straightforward example of applying the wrong NSR significance threshold to a projected emissions increase. Presumably, clear error also includes a miscalculation of baseline (past) actual emissions, which EPA refers to as one of the few "objective calculation requirements" in the NSR regulations.[18] Beyond those two examples, though, it remains to be seen what counts as "clear error." Careful documentation of demand growth calculations may be critical in this respect.

The NSR Memo does not elaborate on what is meant by "predominant cause"—a phrase that could broaden the demand growth exclusion. Nevertheless, in instances where calculated emissions increases from previously unused capacity make the difference in whether a project needs a major air permit, it will be important to document the reasons why the project should not be considered the predominant cause of utilizing the previously unused capacity. For all these reasons, sources would be well-advised to develop documentation of the relevant technical and legal justification for projects that have the potential to increase emissions.

Perhaps most importantly under the NSR Memo, sources must ensure that actual emissions in the years following a project are consistent with the preproject emissions projections. The regulations and NSR Memo are clear that NSR applies if there is a significant emissions increase as a result of a project, regardless of whether the source projected one to occur before the project was implemented.[19] Postchange recordkeeping and reporting under the NSR regulations can help to ensure consistency with preproject emission projections. Even where such requirements do not apply, sources need to internally track their emissions and manage them as needed to be consistent with projections.

There also will need to be discussions with the states as to whether they intend to interpret their rules in a way that is consistent with the NSR Memo. Not all states have adopted the federal ATPA test, and there are varying state agency approaches to its implementation. EPA's NSR Memo does not alter this patchwork system, and in fact emphasizes that states with NSR permitting authority should be the primary enforcers. In addition, the DTE cases remain good authority (applicable within the Sixth Circuit and potentially persuasive in other jurisdictions) pending additional litigation or regulatory amendments. State agencies and citizen groups may continue to rely on those opinions despite the NSR Memo.

Even at the federal level, the NSR Memo is merely a guidance or policy document for EPA regions. It does not have the legal significance of a rule or other final agency action. It is therefore subject to change, and will likely be developed through subsequent interpretation, enforcement, and litigation. To fully protect sources against NSR allegations for compliance with the policies in the Memo, EPA will need to promulgate rule changes to codify its clarifications instead of relying on policy. The Memo indicates that EPA is still at the beginning of its review of the NSR program. Sources should continue to monitor future EPA pronouncements, enforcement actions, and proposed rule notices for additional clarification of the ATPA test and other NSR requirements.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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ENDNOTES

1 A major stationary source is one that emits, or has the potential to emit, either 100 or 250 tons per year or more of a NSR regulated pollutant, depending on the industry type. § 52.21(a)(2)(ii).

2 § 52.21(b)(2)(i).

3 67 Fed. Reg. 80,186 (Dec. 31, 2002).

4 40 C.F.R. § 52.21(a)(2)(iv)(c).

5 § 52.21(b)(41)(ii)(c).

6 *U.S. v. DTE Energy Co.*, 711 F.3d at 649-50, 652.

7 *U.S. v. DTE Energy Co.*, 845 F.3d at 738-40, 751-55.

8 Case No. 17-170 (certiorari denied December 11, 2017).

9 *U.S. v. Oklahoma Gas and Electric Co.,* 2015 U.S. Dist. LEXIS 4875 (Jan. 15, 2015).

10 *Id*. at *20 (noting that EPA sought injunctive relief to stop construction in the DTE cases and also alleged that a major modification had occurred).

11 40 C.F.R. § 52.21(b)(41)(ii)(a).

12 68 Fed. Reg. at 80,204 ("[I]t is not necessary to make . . . future projections enforceable in order to adequately enforce the major NSR requirements.")

13 *See U.S. v. Oklahoma Gas and Electric Company,* W.D. Okla. Case No. 5:13-cv-00690-D, Doc. No. 8-1 (filed Aug. 30, 2013) (asserting that "an operator's unsupported and unenforceable plans do not satisfy the regulations' projection requirement …").

14 NSR Memo at 8.

15 *Id*. at 5; 67 Fed. Reg. at 80,197 ("We will presume that any increases that occur after 5 years are not associated with the physical or operational changes.").

16 57 Fed. Reg. 32,314, 32,327 (July 21, 1992) (explaining that if efficiency improvements, rather than demand growth, is the predominant cause of an emissions increase, then the demand growth exclusion would not be available).

17 *See U.S. v. Cinergy Corp.*, S.D. Ind. Case No. IP99-C-1693-M/S, Doc. No. 640 (filed Oct. 17, 2005).

18 NSR Memo at 4.

19 *Id*. at 4; 40 C.F.R. § 52.21(a)(2)(iv)(b) ("Regardless of any such preconstruction projections, a major modification results if the project causes a significant emissions increase and a significant net emissions increase.").