Introduction

The U.S. Environmental Protection Agency ("EPA") recently promulgated the first portion of the Bush Administration's long-awaited rule-making package to reform the New Source Review ("NSR") program under the federal Clean Air Act ("CAA"). NSR is a preconstruction permitting program that requires state-of-the-art control technology and certain other requirements when major new sources of pollutants are constructed or when existing major sources undergo modifications that result in significant emissions increases. The rule-making package is intended to provide important elements of flexibility previously lacking in the NSR program and to reduce regulatory barriers to plant improvements. Because of their broad scope, the reforms will dramatically change how government determines when existing sources trigger CAA permitting requirements.

The reform package includes two major rule-making actions. First, the EPA has finalized, with modifications, many of the reform provisions that were originally proposed under the Clinton Administration in July 1996. In this final rule making (the "Final NSR Rule"), which took effect on the federal level on March 3, 2003, the EPA revised the applicability analysis for NSR permitting requirements and established voluntary alternatives for sources seeking to bubble their plantwide emissions under NSR. Second, the EPA proposed a new rule clarifying the longstanding exemption to NSR permitting requirements for routine maintenance, repair, and replacement activities (the "Proposed RMRR Rule").

Both the Final NSR Rule and the Proposed RMRR Rule are controversial. Numerous states, localities, and environmental groups have already filed a legal challenge to the Final NSR Rule in the D.C. Circuit. The Proposed RMRR Rule will be subject to heated debate in coming months and will likely give rise to a legal challenge once finalized.

I. Legal Background

NSR consists of two separate permitting programs: nonattainment New Source Review ("NNSR") and Prevention of Significant Deterioration ("PSD"). Both programs prohibit the construction of a major new source or the modification of an existing major source resulting in emissions increase above applicable thresholds, unless the source first obtains a preconstruction permit from the appropriate state agency or from the EPA. NNSR applies to pollutants in which a given area does not meet applicable National Ambient Air Quality Standards ("NAAQS"), and PSD applies to pollutants for which the area meets the applicable NAAQS or for which NAAQS have not been established. Sources that trigger NNSR must obtain emissions offsets for the net emissions increases associated with their projects and must comply with the Lowest Achievable Emissions Rate...
("LAER") for the project, a strict control requirement that typically does not take cost into account. Sources that trigger PSD must demonstrate that their project will not cause an NAAQS violation or result in significant degradation of air quality and must also install the Best Available Control Technology ("BACT"), a less rigorous standard than LAER. Under both NNSR and PSD regulations, a two-part test applies to determine whether a change to an existing source triggers NSR permitting requirements. First, the source must determine whether the project involves a "modification." A modification is defined as a physical change or change in the method of operation of the unit, except for routine maintenance, repairs, and replacement, increases in hours of operation or production rates, and other exempted activities. Second, the source must determine whether the modification results in a significant net emissions increase of a regulated pollutant. Under NSR regulations promulgated in light of the Seventh Circuit's decision in Wisconsin Electric Power Co. v. Reilly ("WEPCo"), sources making changes to electric utility steam generating units ("EUSGUs") may compare past actual emissions with future projected actual emissions in order to determine whether the planned project will result in a significant net emissions increase. However, all other sources must compare their past actual emissions with their future potential to emit. The premodification emissions baseline is generally the actual emissions during the two-year period immediately preceding the project. Sources must then "net" the calculated emissions changes with other contemporaneous changes at the facility to determine whether the project results in a significant net emissions increase and therefore triggers NSR.

These applicability provisions apply regardless of whether federal regulations or state NSR regulations govern a project because state programs, as approved by the EPA in State Implementation Plans ("SIPs"), generally track the federal program. In practice, most states implement the NNSR program through SIP-approved NNSR rules. Many states also implement the PSD program, either through SIP-approved PSD rules or through delegation agreements with the EPA.

II. The New Rules Regarding NSR Applicability

Five of the reforms in the EPA’s Final NSR Rule are particularly significant and will alter the NSR applicability analysis for existing sources.

A. Emissions Baseline

The EPA expands the time frame for establishing the premodification emissions baseline. Sources may generally look to actual emissions from any consecutive twenty-four-month period during the ten years preceding the project or (for EUSGUs) during the five years preceding the project.

B. Actual/Future-Actual Emissions

The EPA expands the WEPCo emissions analysis to non-EUSGU units, providing an alternative to the past-actual/future-potential calculus previously applicable outside the power industry. Rather than assume maximum postchange utilization, existing sources may look to the projected level of unit utilization and may generally exclude demand growth and other increases unrelated to the project itself. Sources that do not wish to comply with these record-keeping requirements may opt to use a future-potential calculus.

C. PALs

The EPA establishes a voluntary Plantwide Applicability Limit ("PAL") program for facilities seeking greater flexibility to make changes to emissions units without triggering NSR requirements. A PAL is a rolling pollutant-specific emissions cap (measured in tons/year) based on facility-wide actual emissions plus an additional emissions margin that will reflect the applicable NSR significance threshold for the pollutant. Participating facilities may make modifications to their emissions...
units without triggering NSR so long as facility-wide emissions remain under the PAL. If the source needs to increase its PAL, NSR is automatic because the original PAL already incorporated the applicable significance threshold for the pollutant. PAL renewals are subject to procedures established under the new rules.

D. Clean Units
The EPA establishes a special applicability test for "Clean Units." Any emissions unit that has undergone NSR permitting automatically qualifies as a Clean Unit, provided that the required BACT/LAER determination for the unit results in some degree of emissions control. In addition, units that have not undergone NSR may still be deemed Clean Units if the permitting authority concludes that the permitted controls for the units are substantially as effective as BACT or LAER and the emissions will not cause or contribute to any NAAQS or PSD increment violation. Under the new Clean Unit test, changes to a Clean Unit will not trigger NSR so long as the unit does not lose its Clean Unit designation.

E. Pollution Control Projects
The EPA codifies a NSR exclusion for Pollution Control Projects ("PCPs") that are known to be environmentally beneficial. The EPA’s list of PCPs includes a variety of technologies for each of the NSR pollutants. Examples include flue gas recirculation, low-Nox burners, selective catalytic reduction for NOx, and electrostatic precipitators for particulates. In addition, technologies not included on the EPA’s list may be deemed PCPs on a case-specific basis. Sources seeking to install listed PCPs must notify their permitting agency prior to construction; sources seeking to install nonlisted PCPs must apply for and receive a PCP determination prior to commencing construction.

These changes to the NSR regulations took effect in federally administered programs (generally PSD programs) on March 3, 2003. For programs administered by states pursuant to EPA-approved SIPs, the effects of the reform package will likely be more gradual. States must generally include these changes as minimum program elements in their SIPs no later than January 2, 2006. States retain authority to impose requirements that are more stringent than the revised federal NSR rules, and in theory, a state could avoid implementing one or more of these changes. For instance, proposed legislation in California would require the California Air Resources Board to implement the NSR requirements in effect prior to the NSR reform package. Because the EPA has already concluded that these changes will result in an overall environmental benefit, it is uncertain how the EPA may respond to the California proposal. In practice, the EPA will evaluate alternative provisions on a case-by-case basis.

III. Legal Challenges to the Final Rule
On December 31, 2002, nine northeastern states (New York, Connecticut, Maine, Maryland, New Hampshire, New Jersey, Rhode Island, Vermont, and Massachusetts, collectively the "Northeastern States") jointly filed a Petition for Review of the Final NSR Rule in the D.C. Circuit. Many other parties then filed separate petitions for review, including Pennsylvania, Delaware, Wisconsin, Illinois, California, the District of Columbia, various California air districts, numerous cities, and many environmental groups, councils, and alliances. All of these petitions have since been consolidated with the New York case, and still more parties (including various United States senators) have filed notices of intention to participate as amicus curiae on behalf of the Northeastern States. At the same time, numerous other parties have intervened in the litigation on behalf of the EPA and in defense of the NSR reforms, including Indiana, Kansas, Nebraska, North Dakota, South Carolina, South Dakota, Utah, Virginia, and various industry groups. The number of parties on both sides of this dispute will likely continue to increase in the coming months.

The consolidated litigation is still in its incipient stages, and it is too early at this point to predict the arguments that will frame the court's analysis. However, an emergency stay motion filed by the Northeastern States and Pennsylvania as
well as preliminary issue statements reveal at least some of the legal bases for the petitioners' challenge. According to the petitioners, there are at least three significant problems with the Final NSR Rule:

1. The new future-actual methodology for calculating baseline emission increases is unenforceable and unsupported by the record and vesting such discretion in the regulated entity would lead to enforcement problems;

2. The emissions baseline, PAL, and clean unit exclusion regulations conflict with the requirements of the CAA as interpreted by the courts because they allow for non-de minimis emissions increases without imposing NSR permitting and pollution control requirements;

3. The Final NSR Rule impermissibly allows regulated sources to take advantage of less stringent air pollution control requirements without otherwise being required to reduce their emissions in violation of the CAA's "antibacksliding" prohibition.

The EPA disputes each of these arguments, alleging that the future-actual emissions calculus will not generally lead to enforcement difficulties, that states are free to adopt more stringent record-keeping requirements; that the emissions calculus will not exempt non-de minimis emissions increases from NSR but will rather clarify how to calculate emissions increases in the first place; and that the reforms as a whole provide equivalent or greater environmental protection than the current NSR program and thus do not violate the CAA antibacksliding prohibition.

The D.C. Circuit denied the emergency motion, noting simply that the petitioners had failed to meet the stringent standards for a stay. As a result, the Final NSR Rule took effect on March 3, 2003. However, the court did find that these petitions met the court's standards for expedition and directed the clerk "to process expeditiously all remaining matters and to designate promptly a complex panel to decide these cases as quickly as practicable." Id. A scheduling order is expected to be developed by the court by approximately May 2003.

In addition to the focal dispute between EPA, states and industry groups on the one hand, and various states, cities and environmental groups on the other, several of the industry group-intervenors also filed petitions for review challenging the Final NSR Rule to address certain discrete issues with the Final NSR Rule. In addition to challenging various aspects of previous EPA NSR rules, the industry groups have raised in their preliminary issue statements various issues with the Final NSR Rule, including the following:

1. The Final NSR Rule violates the CAA by failing to require in the definition of a "major modification" to an existing major source that the physical or operational change results in an increase in the maximum achievable emission rate of that unit (not just a "projected" increase in annual emissions);

2. The Final NSR Rule definition of "regulated NSR pollutant" violates the CAA by incorporating certain hazardous air pollutants, including hydrogen fluoride;

3. The Final NSR Rule is unlawful by requiring NSR permits for PCPs to "net out" of NSR; and

4. The Final NSR Rule preamble’s statement that NSR prior to the Final NSR Rule mandated a past-actual/future-potential calculus outside the power industry for determining whether a change to an existing major source is a "major modification" is unlawful.

IV. The Proposed Rules Regarding the Routine Maintenance Exemption

The Proposed RMRR Rule establishes clear categories of activities that will be eligible for the RMRR exclusion. This proposal was subject to a full public comment process which ended on May 24, 2003. Comments have been extensive due to the visibility and controversy surrounding the proposed reforms. For example, on March 31, 2003 EPA held five public hearings in New York, Texas, North Carolina, Michigan and Utah on the Proposed RMRR Rule, at which environmental and citizens groups and certain state agency officials criticized the Proposed RMRR Rule while generally
business and industry groups supported it.

EPA officials predict that the proposed rule will be finalized in twelve months at the earliest and could be delayed until after the 2004 elections.

Since 1980, RMRR activities at existing facilities have been excluded from NSR permitting requirements, but the existing regulations do not define this term. In a small number of source-specific RMRR applicability determinations, the EPA has looked to the nature, extent, purpose, frequency, and cost of the activity as well as other factors. The scope of the RMRR exclusion has been central to the EPA’s recent NSR enforcement initiative against electric utilities, refineries, and other industrial sectors, and it is the subject of ongoing litigation. The interpretation relied on by the EPA in this initiative conflicts with traditional industry practice and the common understanding of the term within the regulated community.

The Proposed RMRR Rule addresses some of the concerns raised by the EPA’s evolving interpretation of the term and is intended to provide greater certainty to the regulated community. The Proposed RMRR Rule addresses some of the concerns raised by the EPA’s recent NSR enforcement initiative against electric utilities, refineries, and other industrial sectors, and it is the subject of ongoing litigation. The interpretation relied on by the EPA in this initiative conflicts with traditional industry practice and the common understanding of the term within the regulated community.

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Under the Proposed RMRR Rule, two categories of activities would automatically constitute RMRR:

**Annual Maintenance, Repair, and Replacement Allowance**

A facility-wide annual allowance for maintenance activities will be calculated for each facility based on the replacement cost of the stationary source multiplied by an industry-specific percentage based on typical costs incurred in the facility’s relevant industry for maintaining, replacing, and repairing equipment. If the total costs for all activities undertaken for these purposes came within the annual allowance, these activities automatically would be considered RMRR activities. If total annual costs exceed the annual allowance, the most expensive activities exceeding the allowance would be excluded and evaluated through the existing case-by-case analysis to determine whether they are RMRR.

**Equipment Replacement Provision**

Most replacements of existing equipment with functionally equivalent new equipment would qualify as RMRR. The EPA would establish a percentage of the replacement value of a “process unit” as a cost threshold. If the replacement component is functionally equivalent to the replaced component, does not change the process unit’s essential design parameters, and does not exceed the cost threshold, it would qualify as RMRR. The threshold is intended to exclude major renovations while allowing component replacement if such replacement is typical for the particular industrial category to promote the safe, efficient, and reliable operation of the unit.

Even if an activity does not fall within one of these categories, it could still qualify as RMRR under the existing case-by-case analysis.

While the proposed rule articulates a basic framework for improving the RMRR exclusion, it fails to resolve a number of basic issues that will be important to the regulated community. For example, the EPA suggests that it may abandon the annual allowance provision altogether. Even if the EPA proceeds with the allowance approach, the agency has left open several significant issues, including:

1. The appropriate time period for the allowance (a calendar/fiscal year vs. a multiyear allowance);
2. Whether to base the annual allowance at the source or process unit level;
3. The best basis (such as replacement costs or invested costs) and method for calculating source costs;
4. How to determine typical costs for particular industries;
5. What the industry-specific allowance percentages should be;
6. Whether to provide discount factors accounting for variability within the industry; and
7. Whether and how to safeguard against inclusion of non-RMRR activities in the allowance.

Opinions regarding these issues will likely vary from industry to industry and even from one company to another. Because the contours of the RMRR provision are still largely undefined, the regulated community
should evaluate the RMRR options carefully and provide thoughtful input to the EPA during the comment period.

Conclusion

The EPA's NSR reform package dramatically affects whether an existing source will trigger NSR permitting requirements under the CAA. Because of the scope and the importance of the NSR reform package, companies should track the developments in the legal challenge to the Final NSR Rule as well as the EPA's progress on the Proposed RMRR Rule. In addition, the regulated community may wish to work closely with local and state permitting authorities as these authorities evaluate the EPA's reform package and consider revisions to their own NSR programs.

Endnotes


5 See id. §§ 7470-7492.

6 See id. § 7503(a)(2).

7 See id. § 7475(a)(4).


10 Wis. Elec. Power Co. v. Reilly, 893 F.2d 901 (7th Cir. 1990).


12 See, e.g., Final NSR Rule, 67 Fed. Reg. 80,186, 80,247 (Dec. 31, 2002) (to be codified at 40 C.F.R. § 51.165(a)(1)(xxvii)) (describing the NNSR SIP requirements); id. at 80,263 (to be codified at 40 C.F.R. § 51.166(b)(47)) (describing the PSD SIP requirements); id. at 80,273 (to be codified at 40 C.F.R. § 52.21(b)(48)) (describing the PSD requirements). The EPA intends to implement similar language at 40 C.F.R. § 52.24 and Appendix S. To avoid duplicate parallel citations, this article cites only the relevant PSD SIP provisions at 40 C.F.R. § 51.165.

13 See, e.g., Final NSR Rule, 67 Fed. Reg. at 80,246 (to be codified at 40 C.F.R. § 51.165(a)(1)(xxvii)(B)); id. at 80,248 (to be codified at 40 C.F.R. § 51.165(a)(2)(C)).

14 See, e.g., id. at 80,246 (to be codified at 40 C.F.R. § 51.165(a)(1)(xxvii)(A)).

15 See, e.g., id. at 80,247 (to be codified at 40 C.F.R. § 51.165(a)(1)(xxvii)(B)(4)).

16 See, e.g., id. at 80,255 (to be codified at 40 C.F.R. § 51.165(f)(1)(v)).

17 See, e.g., id. (to be codified at 40 C.F.R. § 51.165(f)(1)(iii)).

18 See, e.g., id. at 80,257-58 (to be codified at 40 C.F.R. § 51.165(c)).

19 See, e.g., id. at 80,249-51 (to be codified at 40 C.F.R. § 51.165(c)).

20 See, e.g., id. at 80,251-54 (to be codified at 40 C.F.R. § 51.165(d)).

21 See, e.g., id. at 80,249-50 (to be codified at 40 C.F.R. § 51.165(c)(2)).

22 See, e.g., id. at 80,246 (to be codified at 40 C.F.R. § 51.165(a)(1)(xxv)); id. at 80,254-55 (to be codified at 40 C.F.R. § 51.165(e)).

23 See, e.g., id. at 80,246 (to be codified at 40 C.F.R. § 51.165(a)(1)(xxv)).

24 See, e.g., id.

25 See, e.g., id. at 80,254 (to be codified at 40 C.F.R. § 51.165(e)(1)).

26 See id. at 80,240-41.

27 See id. at 80,241.


29 See id.


32 See id. at 6-9.

33 See id. at 9-19.

34 See id. at 19-20; 42 U.S.C. § 7515 (setting forth the CAA’s antibacksliding prohibition).
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