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Proposed Action Memo: EPA Rollbacks to Project Emissions Accounting for New Source Review Permitting

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I. Summary

The New Source Review (NSR) program is one of the core pillars of the Clean Air Act. It governs the regulation of new major stationary sources of air pollution and existing stationary sources that will undergo major modification. The Trump administration's changes to the longstanding two-step process to determine what constitutes a "major modification" would allow a large class of sources to escape NSR permitting and regulation, resulting in greater emissions of criteria air pollutants.

Rollbacks

- Memorandum, New Source Review Preconstruction Permitting Requirements: Enforceability and Use of the Actual-to-Projected-Actual Applicability Test in Determining Major Modification Applicability (December 2017)
- Memorandum, Project Emissions Accounting under the New Source Review Preconstruction Permitting Program (March 2018)
- Proposed Rule, Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting (August 2019)
- Final Rule, Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting (October 2020)

Agency

- Environmental Protection Agency

Impact

- Altered longstanding two-step project emissions accounting process that determines whether planned changes to a regulated stationary source would constitute a "major modification" under NSR program.
- Allows stationary sources to claim unenforceable and non-contemporaneous *decreases* in emissions to offset planned *increases* in emissions for purposes of determining "major modification."
- Entities wishing to evade heightened NSR pollution control standards can expansively define projects that encompass physically and temporally distant emissions reductions to offset the increases of the actual modification at issue.

Proposed actions

- **Issue interim guidance reverting to pre-2018 interpretation for project emissions accounting.**
- **Issue memorandum (can be combined with guidance) stating EPA's position that 2018 Memorandum and October Rule were substantively and procedurally deficient.**
- **Manage anticipated litigation by petitioning to hold litigation in abeyance while EPA reconsiders rule.**
- **Begin process to rescind October Rule through notice-and-comment rulemaking.**

II. Justification

The EPA's changes to project emissions accounting for determining "major modifications" to facilities that would trigger New Source Review (NSR) permitting will allow a wide range of sources to evade stricter pollution control requirements.[1] Relative to the agency's prior accounting method, the new approach will lead to significant increases in the emissions of criteria pollutants regulated under the Clean Air Act (CAA). Deteriorating air quality, causing a variety of human health and environmental harms, will trigger substantial economic and quality-of-life consequences for Americans.

NSR permitting applies to new major sources or major modifications to sources regulated under the CAA. NSR is the "indispensable, community-level cornerstone of the CAA's strategy for preventing excessive air pollution."[2] The heightened NSR requirements reflect Congress' intent that new installations and significant expansions of existing industrial infrastructure are ideal opportunities to incorporate cost-effective pollution-reducing technologies so as to create an equitable transition period for existing sources.[3] While it may be more expensive and less feasible to retrofit old facilities to reduce pollutants, new construction and plant modification allow a facility to design and incorporate modern control technology into a proposed project in a more comprehensive fashion. Congress' design included the grandfathering of existing sources as of the CAA's 1970 passage.[4] However, this concession for existing industrial sources was meant to be counterbalanced by the heightened NSR control requirements for new and modified sources. Thus, the CAA allowed for air quality improvements to occur in stages gradually over time, rather than requiring all facilities to make immediate, potentially expensive investments at once. Such a staged rollout allowed sources to upgrade to cutting-edge control technology after the benefit of learning from subsequent research on pollution-reduction strategies and gaining hands-on experience with control methods.

This statutory design highlights the importance of the meaning of the phrase "major modification." Existing facilities that undergo a major modification trigger the application of NSR permitting requirements; other existing facilities escape NSR pollution controls. The EPA uses a two-step process to determine whether a change to an existing facility is a "major modification," and thus subject to NSR.[5] Its assessment takes account of both operational and physical plant changes. The prior two-step process first asks whether the actual modification, by itself, will result in a significant increase in emissions.[6] The second step asks whether the change will contribute a net emissions

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[1] While the focus of this memo is on the changes to the two-step process for project emissions accounting, it should be noted that the EPA has taken a number of other significant steps to change the administration of the NSR program. *See generally* Harvard Energy & Environmental Law Program, New Source Review (last updated Nov. 2, 2020), *available at* https://eelp.law.harvard.edu/2018/12/new-source-review/.

[2] JOSEPH GOFFMAN, JANET MCCABE & WILLIAM NIEBLING, EPA'S ATTACK ON NEW SOURCE REVIEW AND OTHER AIR QUALITY PROTECTION TOOLS 3 (2019).

[3] *See* Jonathan Remy Nash & Richard L. Revesz, *Grandfathering and Environmental Regulation: The Law and Economics of New Source Review*, 101 NW. U. L. REV. 1677, 1724–25 (2007).

[4] Under the statute, only new and modified sources are required to achieve emissions limits consistent with use of the best available pollution control technology. CAA § 169(3) (42 U.S.C. § 7479(3)).

[5] *See* EPA, NEW SOURCE REVIEW WORKSHOP MANUAL (Oct. 1990) (draft), *available at* https://www.epa.gov/nsr/new-source-review-publications.

[6] 40 C.F.R. §§ 51.165(a)(1)(vi)(A), 51.166(b)(2)(i).

increase, taking account of other increases and decreases in emissions throughout the facility (a process also known as "netting"). The second step encourages operators to decrease emissions in other parts of the facility when undergoing changes to avoid heightened NSR requirements. If the proposed facility change will not yield a significant increase in emissions, or if it is offset by reductions in other areas of the facility, then it is not subject to the NSR program. If both steps are met, meaning the modification will yield significantly more emissions *and* the net facility-wide emissions will increase, then the facility will fall under NSR and be subject to heightened requirements. Thus, how a modification's emissions are calculated under the two-step test has great import for implementing NSR permitting and effectuating the CAA's goal of improved air quality.

The EPA's series of actions culminating in a final rule published in October 2020 ("October Rule")[7] significantly alter the two-step accounting process. Under the EPA's revisions, if a source simply claims that its facility-wide decreases offset the project increases, then it is automatically exempt from NSR, ultimately allowing a number of facilities to avoid heightened NSR pollution control requirements under the CAA.

III. Current State

A. Substantive Changes to Project Emissions Accounting

The EPA's October Rule codified then-Administrator Scott Pruitt's March 2018 Memorandum[8] putting forward a new interpretation of the two-step process for project emissions accounting to determine a "major modification" subject to the NSR program. EPA revised Step 1 of the accounting process to require that the EPA would consider the "sum of the difference" in emissions stemming from the project instead of the "sum of the emissions increases."[9] This would mean that "emissions increases and decreases can be considered in Step 1 of the NSR major modification applicability test."[10] Under this new interpretation, net emissions impacts would be considered in Step 1 which was previously only allowed in Step 2. In effect, this partially collapses the two-step process into a one-step process as a project would not move to Step 2 if it will not result in a significant net-emissions increase.

The EPA also made substantial changes to what kind of *decreases* in emissions can be counted in Step 1. Under the traditional test, in Step 2, where net-emissions changes are considered, claims of emissions decreases in other parts of a facility must be enforceable and contemporaneous with the proposed emissions increase. In the October Rule, by contrast, in the Step 1 netting analysis, the EPA will defer to the facility's own claimed decreases, regardless of when and where they are made.

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[7] EPA, Final Rule, Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting (Oct. 22, 2020) [hereinafter October Rule] (to be codified at 40 C.F.R. pts. 51-52), *available at* https://www.epa.gov/sites/production/files/2020-10/documents/frl-10016-21-oar_10-21-20_admin.pdf.

[8] Memorandum from E. Scott Pruitt, EPA Administrator, to Regional Administrators (Mar. 13, 2018) [hereinafter 2018 Memorandum], *available at* https://www.epa.gov/sites/production/files/2018-03/documents/nsr_memo_03-13-2018.pdf.

[9] *Id.*

[10] October Rule, *supra* note 7, at 19.

EPA's deference to a facility's claimed decreases was established in a December 2017 Memorandum issued by Administrator Pruitt.[11] As a result of the lack of clear guidance for what is included within the "scope of the project," companies wishing to evade regulation can expansively define projects that encompass physically and temporally distant emissions reductions to offset the increases of the actual modification at issue.[12] Put simply, the EPA's policy will "allow facilities to conduct physical and operational changes that significantly increase emissions source-wide, but evade NSR, by selecting unrelated activities within the source, and deeming those activities a 'project' that produces no net increase in emissions—even while the sum total of contemporaneous activities at the source in fact produce an increase in emissions."[13]

The EPA justifies its new interpretation of the two-step rule based on the apparent statutory ambiguity of section 111(a)(4) concerning how to calculate "increases" in emissions for purposes of determining a "major modification."[14] The EPA states: "[B]ecause the statutory text does not itself dictate how to determine whether a physical change or change in the method of operation 'increases' emissions . . . the 'EPA has the authority to choose an interpretation' of the term 'increases' in 'administering the NSR program and filling in the gaps left by Congress.'"[15] The statutory ambiguity in the CAA, however, does not give the EPA a blank check to rewrite the emissions accounting process. As environmental petitioners argued in their comment on the October Rule, the D.C. Circuit has long held the view "that in evaluating whether a change will increase source-wide emissions, a source can count 'offsetting changes' only if they are 'within the same source' and 'contemporaneous' with the change in question."[16] The D.C. Circuit reached this conclusion based on a close reading of section 111(a)(4) of the CAA, which defines the word "modification" as applied to the NSR program. The effect of the EPA's new rule contravenes this longstanding interpretation of Section 111(a)(4) of the CAA.

B. Procedural Issues in Promulgating October Rule

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[11] Memorandum from E. Scott Pruitt, to Regional Administrators, New Source Review Preconstruction Permitting Requirements; Enforceability and Use of the Actual-to-Projected-Actual Applicability Test in Determining Major Modification Applicability, at 8 (Dec. 7, 2017), *available at* https://www.epa.gov/sites/production/files/2017-12/documents/nsr_policy_memo.12.7.17.pdf ("The EPA does not intend to substitute its judgement for that of the owner or operator by 'second guessing' the owner or operator's emissions projections.").

[12] Following a separate Nov. 2018 rule, EPA now requires sources to combine emissions from independent but related projects for NSR purposes only if the projects have a "substantial technical or economic relationship." Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Aggregation; Reconsideration, 40 Fed. Reg. 57,324 (Nov. 15, 2018) [hereinafter "Project Aggregation Rule"]. As the EPA explains, this would allow a source to "carve up a higher-emitting project into two or more lower-emitting 'projects' and avoid triggering major NSR requirements." *Id.* at 57,326.

[13] Joint Environmental Petitioners, Comment Letter on Proposed Rule: Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting (Oct. 15, 2019), *available at* https://www.regulations.gov/contentStreamer?documentId=EPA-HQ-OAR-2018-0048-0079&attachmentNumber=1&contentType=pdf.

[14] "While the CAA defines a 'modification' as any physical or operational change that 'increases' emissions, it is silent on how to calculate such 'increases' in emissions." *New York v. EPA*, 413 F.3d 3, 22 (D.C. Cir. 2005).

[15] October Rule, *supra* note 7, at 17.

[16] *Supra* note 13, at 6 (citing *Alabama Power Co. v. Costle*, 636 F.2d 323, 400-402 (D.C. Cir. 1979)).

The EPA identifies the October Rule to be a "significant regulatory action" as defined by Executive Order 12,866.[17] The White House Office of Information and Regulatory Affairs (OIRA) accordingly instructed the EPA to provide a cost–benefit analysis when the proposed rule was being drafted.[18] The EPA, however, failed to provide a cost–benefit analysis in the final October Rule, simply asserting that the rule is a "deregulatory action" pursuant to Executive Order 13,771 that will provide "burden reduction" for regulated parties. In responding to OIRA's instruction, the EPA argued that the proposed rule was a codification of the March 2018 Memorandum, which had already modified the two-step rule on interpretive grounds. Therefore, according to the EPA, a cost–benefit analysis was unnecessary, because the proposed rule "will not provide cost savings nor reduce permitting authority burden beyond any cost savings or burden reduction that is currently occurring in the absence of this rule."[19]

The EPA in essence has obscured the regulatory impacts of its proposed rule by first making the policy change—under the guise of interpretation—through the 2018 Memorandum. The agency, however, is still required to provide a reasoned explanation for its policy change.[20] The EPA therefore must provide a cost–benefit analysis relative to the pre-2018 project emissions accounting policy.[21] Without doing so, the EPA has violated Executive Order 12,866 as well as the "arbitrary-and-capricious" standards of both the CAA and the Administrative Procedure Act by not providing a reasoned explanation for its change in policy.

IV. Proposed Action

The impact of the 2018 Memorandum and the October Rule on the NSR program necessitates swift action by the EPA. In anticipation of litigation and changes in the behavior of regulated parties, the

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[17] October Rule, *supra* note 7, at 65.

[18] *See* EO 12866 Office of Management and Budget Comments on U.S. Environmental Protection Agency Draft Proposed Rule Titled, "Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting," (ID: EPA-HQ-OAR-2018-0048-0026), at 28 (May 8, 2019), *available at* https://www.regulations.gov/contentStreamer?documentId=EPA-HQ-OAR-2018-0048-0026&attachmentNumber=1&contentType=pdf ("EPA needs to provide an estimate of the cost savings and emissions impacts of this proposed rule.").

[19] EO 12866 Office of Management and Budget Comments on U.S. Environmental Protection Agency Draft Proposed Rule Titled, "Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting," (ID: EPA-HQ-OAR-2018-0048-0029), at 31 (July 17, 2019), *available at* https://www.regulations.gov/contentStreamer?documentId=EPA-HQ-OAR2018-0048-0029&attachmentNumber=1&contentType=pdf.

[20] Institute for Policy Integrity at New York University School of Law ("Policy Integrity"), Comment Letter on Proposed Rule: Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NNSR): Project Emissions Accounting 4 (Oct. 8, 2019), *available at* https://policyintegrity.org/documents/PolicyIntegrity_ProjectEmissionsAccountingComments_2019.08.10.pdf ("[A]n agency cannot evade its responsibility to provide a reasoned explanation for a policy change—including a discussion of the relevant factor of cost—simply by announcing the change in a memorandum prior to codifying it in a regulation.") (citing Pac. Gas & Elec. Co. v. Fed. Power Comm'n, 506 F. 2d 33, 38–39 (D.C. Cir. 1974) ("An agency cannot escape its responsibility to present evidence and reasoning supporting its substantive rules by announcing binding precedent in the form of a general statement of policy.")).

[21] Policy Integrity argues that a cost-benefit analysis would be necessary regardless because "even measured against the *inappropriate* baseline of the March 2018 Memorandum, the Proposed Rule could result in changed investment decisions by some sources and thus have incremental costs and benefits." *Id.* at 9.

EPA must signal that it will revert to the pre-2018 interpretation of the two-step project emissions accounting policy and subsequently undertake notice and comment to rescind the October Rule.

1. Issue Interim Guidance

The new EPA Administrator should revoke the December 2017 and October 2018 Memoranda and issue interim guidance that the EPA will revert to the two-step test published in the 1990 New Source Review Workshop Manual and codified in the 2002 NSR regulations.[22] It should clarify that *increases* in emissions can only be offset by contemporaneous and creditable facility-wide emissions *decreases*, as under the prior policy; and these decreases can only be considered in Step 2. The memo should remind industry that EPA will not defer to the estimates of operators and will initiate enforcement actions for those emissions decreases that fail to occur within the contemporaneous period. EPA should state that it will verify emissions estimates calculated by operators before and after the time of construction for the upgrade. Furthermore, the submission of emissions estimates by operators will not be a per se guarantee that the estimates will satisfy pre-construction requirements for NSR determination—the EPA will make this determination.

2. Issue Memorandum on October Rule

A Memorandum on the October Rule can be combined with the interim guidance that the EPA Administrator issues. In the Memorandum, the EPA Administrator should declare that the October Rule was procedurally and substantively unlawful.

a. Procedural Deficiencies of October Rule

Citing Executive Order 12,866 as well as the CAA and the APA's arbitrary and capricious standard (see above), the Memorandum should state that the EPA deems the October Rule to be invalid on procedural grounds for failing to include a cost–benefit analysis. If data is available, the EPA should show that since the 2018 Memorandum, new NSR permitting has dropped from prior baselines. In the absence of conclusive data on the effects of the 2018 Memorandum and the October Rule, the EPA can still argue that allowing facilities to consider emissions decreases in Step 1 allows sources that would trigger NSR under the prior policy to avoid NSR regulation under the October Rule. These sources will not be subject to the more stringent pollution control standards under NSR, resulting in greater emissions of criteria pollutants with health and environmental costs. Failure by the EPA to take these costs into consideration in both the 2018 Memorandum and the October Rule is a clear violation of Executive Order 12,8666 and the APA.

b. Substantive Deficiencies of October Rule

The Memorandum should emphasize that the EPA is not engaging in a policy choice to revert back to the pre-2018 project emissions accounting policy. Rather, the EPA is making a legal determination that the interpretation of CAA Section 111(a)(4) put forward in the 2018 Memorandum and the October Rule is unlawful based on the plain text of the statute and relevant

[22] *See* 40 C.F.R § 52.21(a)(2)(iv)(a).

case law. Section 111(a)(4) of the CAA defines "modification" as "*any* physical change in, or change in the method of operation of, a stationary source which *increases* the amount of any air pollutant emitted by such source."[23] The changes to the two-step rule run afoul of the statute because they "would enable a physical or operational change to escape NSR at Step 1 . . . based on emission decreases that do not result from the change but are instead the result of a separate change packaged into the same 'project.'"[24] Only at Step 2 would the requirement be imposed that the emissions decreases claimed are contemporaneous with increases.

The October Rule therefore codifies an interpretation that could conceivably result in a facility's emissions increasing but not being subject to NSR, because of unenforceable and non-contemporaneous emissions decreases claimed by the operator. The October Rule and the 2018 Memorandum do not simply re-interpret Section 111(a)(4) on the basis of statutory ambiguity, they instead carve out an exemption from the NSR program. The same D.C. Circuit decision that the EPA relied upon to claim statutory ambiguity declares that "[a]bsent clear congressional delegation . . . EPA lacks authority to create an exemption from NSR by administrative rule."[25] In its Memorandum, the EPA should clarify that the statutory ambiguity that the D.C. Circuit found in Section 111(a)(4) pertained to the methodology of how "increases" in emissions are calculated, but not on the question of "whether EPA can exclude from NSR a change that causes a significant source-wide emissions increase."[26] Additionally, the new EPA Administrator should include a caveat in the Memorandum that even if the prior EPA was acting lawfully in re-interpreting an ambiguous statute, the EPA is now making a policy choice to revert to a prior longstanding interpretation acting under the same authority.

3. Manage Anticipated Litigation

While no legal challenges to the October Rule have been filed at this time, a challenge from environmental petitioners is expected. The EPA should promptly communicate to the Department of Justice (DOJ) the agency's change in position via the Guidance / Memorandum issued by the new Administrator. The DOJ on behalf of the EPA should subsequently petition the court to hold the litigation in abeyance while the EPA reconsiders the October Rule.

4. Initiate Rulemaking to Rescind October Rule

The EPA should seek to restore the pre-2018 NSR permitting process by initiating notice-and-comment rulemaking to rescind the rule. With efficiency considerations in mind, the EPA may choose to rescind in tandem the various other rollbacks to the NSR program.[27] The EPA may also consider improvements to the NSR permitting process, in which case it may issue an Advance Notice of Proposed Rulemaking to seek input while relying on its interim guidance to govern the NSR permitting process.

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[23] 42 U.S.C. § 7411(a)(4) (emphasis added).
[24] Environmental Petitioners, *supra* note 13, at 6-7.
[25] New York v. EPA, 413 F.3d at 41.
[26] Environmental Petitioners, *supra* note 13, at 8.
[27] *See* supra note 1.