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EPA Issues Final Rule Establishing Equipment Replacement Exemption Under RMRR Exclusion

On August 27, 2003, EPA Acting Administrator Marianne Lamont Horinko signed EPA's final rule adopting an "equipment replacement provision" (ERP) to specify activities that will automatically qualify for the "routine maintenance, repair and replacement" (RMRR) exclusion. In the ERP rule, EPA states that it is not taking final action at this time on the annual maintenance, repair and replacement allowance that it proposed along with the ERP. In most respects, the ERP final rule is consistent with comments industry submitted on that provision. One major exception is that EPA established a 20% threshold for the replacement cost of equipment that will be covered by the ERP, rather than the 50% proposed in comments of industry commenters. EPA confirms in the final rule that equipment replacements that do not come within the terms of the ERP will be assessed based upon the case-by-case criteria that have been applied in the past.

Equipment Replacement Provision

The following describes the principal features of the ERP.

- Under the ERP rule, an activity (or aggregations of activities) can qualify if: (1) it involves replacement of any existing component(s) of a process unit with a component(s) that are identical or that serve the same purpose as the replaced component(s); (2) the fixed capital cost of the replaced component(s), plus costs of any activities that are part of the replacement activity (e.g., labor, contract services, major equipment rental, and associated repair and maintenance activities), does not exceed 20% of the current replacement value of the process unit; and (3) the replacement(s) do not alter the basic design parameters of the process unit or cause the unit to exceed any emissions limitation or operational limitation (that has the effect of constraining emissions) that applies to any component of the process unit and that is legally enforceable.

- The rule specifies procedures by which a source selects the basic design parameters for process units. For process units other than electric utility

units, the rule authorizes the parameters to be maximum rate of fuel or material input, but also allows a maximum rate of heat input or maximum rate of product output. For electric utility units, the parameters authorized are maximum hourly heat input and fuel consumption rate, but also can be maximum hourly electric output rate or maximum steam flow rate. In addition, the rule authorizes proposal of alternative parameters if these options are inappropriate.

- The rule approves the use of a number of different approaches for determining replacement value of a new process unit. These are: (1) replacement cost; (2) invested cost, adjusted for inflation; (3) the insurance value, where the insurance value covers complete replacement of the process unit; or (4) another accounting procedure to establish a replacement value of the process unit if such accounting procedure is based on Generally Accepted Accounting Principles. The source must send a notice to the permitting authority if it intends to use option 3 or 4. The first time the source submits such a notice, it may be submitted at any time, but any subsequent notice for the process unit may be submitted only at the beginning of the unit's fiscal year.

- EPA defined a "process unit" as "any collection of structures and/or equipment that processes, assembles, applies, blends, or otherwise uses material inputs to produce or store an intermediate or a completed product. Pollution control equipment is not part of the process unit unless it serves a dual function as both process and control equipment. Also, administrative and warehousing facilities are not part of the process unit. Components shared between two or more process units are proportionately allocated based on capacity. In addition, EPA specifically describes in the rule process units at steam electric generating facilities, petroleum refineries, and incinerators. It also described in the preamble process units for natural gas compressor stations, flat glass manufacturing plants, fiberglass production facilities, precipitated amorphous silica, and chemical manufacturing plants.

Legal Basis for ERP

EPA sets out a lengthy legal defense of the ERP in the preamble. Some of the highlights of the legal analysis are as follows:

- EPA states that the "NSR program's scope is closely related to the scope of the NSPS program."

- EPA points out that the definition of "modification" under the NSR program is the definition that was established initially for the NSPS program.

- EPA quotes from the legislative history in which the conferees for the 1977 Amendments stated that Congress

"intended to conform the meaning of the term 'modification' to usage in other parts of the Act." EPA states that the Agency has understood this "to be a reference to our preexisting rules interpreting the term 'modification' in the NSPS context."

- EPA points out that the 1978 NSR rules based applicability on an increase in a source's "potential to emit," like the NSPS program, except that the NSR rule was based on annual emissions and the NSPS program is based on short-term potential emissions. It implicitly makes the point that the D.C. Circuit in ruling on the *Alabama Power* case left in place the potential-to-potential test in the 1978 rules, while striking down other provisions.

- EPA points out that its revision to the NSR program to base it on increases in actual emissions rather than potential emissions did not reflect a decision "that the purpose of the NSR program never allows [the Agency] to exclude from the definition of 'change' any activity at a plant that may increase its actual emissions but does not increase its 'potential' emissions." EPA specifically notes that it retained the exclusion for "routine maintenance, repair and replacement" in the 1980 NSR rule even though it can result in emissions increases.

- EPA includes a discussion of what constitutes a "physical change" that points out that there are many changes that are not expressly excluded but nonetheless do not come within the meaning of "physical change" under the Act and regulations. It notes that chemical and pharmaceutical manufacturing operations often are designed, operated and permitted as "multi-function" facilities. These facilities have numerous pieces of equipment that can be configured to accommodate a wide variety of products and operating conditions and that, when switching from one product to another, a plant may make substantial "changes" in the "types of equipment used, the processing conditions, and the raw materials, reagents, solvents, and other processing materials." It then states that "as long as the facility is operated as designed and permitted, [EPA] would not consider (and [has] not considered over the 20+ year life of the NSR program) such changes to be physical or operational 'changes' for purposes of administering the NSR program." EPA indicates that it has taken a different position regarding the scope of "change" in the TVA case and in recent enforcement briefs, but that it is now taking a different view that will be applied prospectively.

- EPA states that the NSPS interpretation of "modification," while it is not the only one EPA could have adopted for NSR purposes, "at the very least it delineates a zone of discretion within which EPA may operate." Also, EPA

states that it has followed a different interpretation for NSR than for NSPS "from 1980 until today." In other words, EPA seems to be stating that it is now adopting a position that NSR requirements can clearly be written to accord with the NSPS modification definition.

Other Observations on ERP Preamble Statements

- EPA, in a number of places, makes it clear that replacements of identical or functionally equivalent equipment that exceed 20% of the replacement value of the process unit will be assessed against the case-by-case criteria applied in the past. EPA states that "[b]efore promulgation of today's rule, we interpreted the phrase 'routine maintenance, repair and replacement' to be limited to the day-to-day maintenance and repair of equipment and the replacement of relatively small parts of a plant that frequently require replacement." It then says it is expanding the former definition of RMRR. However, in stating that it is making a change in policy, it does later state that the new approach represents "a change from the approach we have taken in the **recent** past." This last statement seems to be an acknowledgment that the approach taken in the "recent past" differed from that taken previously.

- The ERP preamble explicitly states that the rule "does not distinguish between the replacement of components that are expected to be replaced frequently or periodically and the replacement of components that may occur on a less frequent or one-time basis. It likewise does not distinguish between the replacement of larger and smaller components, instead requiring greater scrutiny if the replacement in question is part of an activity that exceeds 20% of the replacement value of the process unit." EPA later states that "the approach taken by our final rule thereby differs in some respects from the multi-factor, case-by-case approach we have been using in identifying RMRR, and particularly from some of our applications of that test to certain equipment replacements."

- EPA states that none of the ERP rule revisions "apply to any changes that are the subject of existing enforcement actions that the Agency has brought and do not constitute a defense thereto. Furthermore, prior applicability determinations or major modifications that result in control requirements in an NSR permit that currently applies to a source remain valid and enforceable as to that source." While it is clear that EPA intends that the rule have prospective application, the foregoing

language does not broadly refer to any changes made in the past, but specifically only refers to ones that are the subject of existing enforcement actions and to prior applicability and permit determinations.

It is expected that the rule will be published in the Federal Register shortly. ″

District Court Issues Favorable NSR Applicability Rulings in Duke Energy Case

On August 26, 2003, a district court judge issued rulings on cross-motions for summary judgment in EPA's enforcement action against Duke Energy, another of the cases EPA has brought in connection with the electric utility NSR enforcement initiative (*U.S. v. Duke Energy Corp.*, No. 1:00CV01262 (M.D.N.C.)). In stark contrast to the decision in *U.S. v. Ohio Edison* (*see* July 2003 *Washington Report* at WR-484), the court's rulings on NSR applicability issues are extremely favorable for industry and, indeed, accept in every respect Duke's arguments on the principal NSR applicability issues. However, the court issued an unfavorable ruling on application of the statute of limitations.

The rulings set forth the court's interpretation of applicable legal principles in the case. A trial will now be held at which the court will make factual findings and then apply the law to those findings. EPA has targeted 29 major replacement projects.

Scope of Routine Maintenance, Repair and Replacement (RMRR) Exclusion

The court states that the "central disagreement between [the utility] and EPA is whether 'routine' should be defined relative to an industrial category or to a particular unit." The court states that "[t]hrough the EPA's statements in the Federal Register, its statements to the regulated community and Congress, and its conduct for at least two decades, the EPA has established an interpretation of RMRR under which routine is judged by reference to whether a particular activity is routine in the industry." The court concludes that it has insufficient evidence to make a final ruling that all of the projects are routine, but that "EPA should appropriately bear the burden of making [a showing that projects are non-routine] at trial." The court expressly states that it "respectfully disagrees" with the contrary RMRR interpretation of the court in the *Ohio Edison* case.

Determination of Net Emissions Increase

The court points out that EPA and Duke also present two competing methods for quantifying emissions increases. EPA advances the "actual-to-projected-actual" methodology, after abandoning its argument that the "actual-to-potential" test should be applied. Duke argued that an "actual-to-actual" test should be applied under which a comparison is made of "pre-project actual emissions and future 'actual' emissions, assuming constant hours and conditions of operation." The court finds,

based on the PSD rules, the contemporaneous interpretation of the PSD rules, and the statutory language incorporating the NSPS concept of modification into PSD, post-project emissions must be calculated on an annual basis, measuring emissions in tons-per-year, and in calculating post-project emissions levels, the hours and conditions of operation must be held constant. Accordingly, a net emissions increase can result only from an increase in the hourly rate of emissions.

The court's analysis contains a wholesale rejection of EPA's recent NSR applicability interpretations. Notable aspects of the emissions increase analysis are:

- The court begins with a review of EPA's interpretations issued contemporaneously with its adoption of the NSR regulations. It particularly focuses on two interpretations issued by Ed Reich, then Director of the Division of Stationary Source Enforcement, in which Reich points out that emissions increases resulting from an increase in the hours of operation are "specifically exempt from PSD review" and thus cannot be the basis for finding NSR applicability. The court states that "these contemporaneous interpretations provide compelling evidence of the rules' original meaning and cannot simply be ignored out of blind deference to the EPA's current interpretation."

- Next, the court reviews the legislative history of the adoption of the NSR requirements and concludes that, because the NSPS modification definition requires an increase in the maximum hourly rate of emissions, "in order to undergo 'construction' as defined in PSD, an existing source must also undergo a 'modification' as defined in NSPS, *i.e.*, to undergo PSD construction a physical change must result in an increase in the hourly rate of emissions." The court concludes that EPA's "interpretation of the regulations is inconsistent with the congressional design of defining PSD construction in terms of NSPS modification and should therefore be accorded little deference."

- The court also relies on language in the *WEPCO* decision. The court points out that the Seventh Circuit in *WEPCO* "ordered the EPA to determine 'whether the renovated plant would cause a significant net emissions increase if it were operated under present hours and conditions.'"

- The court then states that this "remand instruction explicitly sets forth the 'actual-to-actual' test advocated by Duke Energy and previously applied by the EPA." It requires that "the hours and conditions of operation be held constant

and places the focus on an increase in the hourly emissions rate."

! The court also states that the "fact that the 1980 PSD regulations do not provide the methodology that EPA seeks to apply is further highlighted by the EPA's decision to add through notice-and-comment procedures the very methodology it now contends the 1980 regulations provide." This is a reference to the 1992 promulgation of the WEPCO rule. The court states that the "addition of the new WEPCO rule appears to have been unnecessary if the 1980 regulations already provided this method."

! The court also "respectfully disagrees" with the finding in the *Ohio Edison* case that the determination of an emissions increase at existing units should be made through application of an "actual-to-projected-actual" test in which a projection is made of future utilization after a change.

Ruling on Statute of Limitations

After issuing the very favorable rulings on the RMRR exclusion and emissions increase determination methodology, the court finds that the five-year statute of limitations does not bar penalties for construction activities undertaken more than five years prior to EPA's filing suit, because the failure to obtain a PSD permit is a "continuing violation." The court concludes that "the requirement of obtaining a preconstruction permit amounts to a condition of operation and establishes ongoing obligations." The court states that other courts finding that claims more than five years old are barred have focused on the language regarding

construction "to the exclusion of the language in the statute stating that the PSD permit shall set forth emission limitations for that source following the construction activity." The court finds that "compliance with these emission limitations is just as integral to achieving the objectives of PSD as the preconstruction analysis and review." By finding that the statute of limitations does not preclude EPA's obtaining penalties based on projects commenced more than five years before bringing suit, the court's ruling conflicts with a number of other courts' opinions. ″

EPA Opines That It Lacks Authority to Regulate Greenhouse Gases

On August 28, 2003, EPA's General Counsel, Robert Fabricant, issued an opinion regarding whether EPA can treat CO_2 and other greenhouse gases as "air pollutants" under the Clean Air Act and regulate them under the Act's regulatory provisions. Two prior EPA General Counsel opined that EPA could treat CO_2 as an "air pollutant" and regulate it under the Act. General Counsel Fabricant's opinion reaches the opposite conclusion and specifically finds that EPA does not have the authority to regulate greenhouse gases.

The General Counsel's opinion relies heavily on the Supreme Court's decision in *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 120 S. Ct. 1291 (2000) (*Brown & Williamson*). Under that decision, EPA's opinion concludes that "it is clear than an administrative agency properly awaits congressional direction on a fundamental policy issue such as global climate change, instead of searching for new authority in an existing statute that was not designed or enacted to deal with that issue." The opinion points out that the prior General Counsel opinion issued by Jon Cannon was issued before the *Brown & Williamson* case was decided. The Cannon memorandum concluded that, if CO_2 were an "air pollutant" under the Act, EPA would have authority to regulate it to the extent the Act's criteria for regulation were met. Fabricant states that the Cannon memorandum concluded that the Act's broad definitions confer broad regulatory authority, "without considering the potential significance of the policy issues raised or any contrary indications of congressional intent."

The Fabricant opinion states that, in light of the *Brown & Williamson* decision, he has found it clear that there is a need for a more thorough inquiry and, accordingly, examined the fundamental issue of whether the Act authorizes regulation for global climate change purposes. Fabricant then proceeded to review the various statutory provisions that bear on Congress' intent and other statements viewed as relevant to his opinion. Fabricant concluded:

> In view of consistent congressional action to learn more about global climate change, the absence of express authority to regulate global

climate change, no indication of congressional intent to provide such authority, and the far-reaching implications of regulation to address climate change, I believe EPA cannot assert jurisdiction to regulate in this area. The Cannon memorandum and the statements by [former General Counsel Gary Guzy] concerning this matter no longer represent the views of EPA's General Counsel.

General Counsel Fabricant's opinion was issued in connection with a petition by the International Center for Technology Assessment and a number of other organizations to regulate motor vehicle emissions of carbon dioxide and other greenhouse gases under the Act. Based upon Fabricant's opinion, EPA denied the organizations' petition. ″

EPA Develops Draft Routine Maintenance and Repair Proposal

In the course of reviewing comments on its routine maintenance, repair, and replacement (RMRR) proposal, EPA recognized that many industry commenters believed that EPA should clarify that all maintenance and repair activities qualify for the RMRR exclusion. In finalizing the equipment replacement provision, EPA made clear that maintenance and repair activities undertaken in connection with equipment replacements automatically qualify for exclusion from NSR applicability if the "equipment replacement provision" (ERP) criteria are satisfied. But, some commenters seemed concerned about maintenance and repair activities that are unaccompanied by equipment replacements.

In response to comments requesting that EPA clarify that all maintenance and repair activities come within the RMRR exclusion, EPA developed a proposal that would elaborate on what constitutes "routine maintenance and repair." Key elements of this draft proposal are as follows:

- The draft proposal would define "routine maintenance and repair" as an "activity that facilitates the efficiency, availability, reliability, or safety of a process unit or a part of a process unit." It specifically states that replacements covered by the ERP are not routine maintenance or repair.

- The draft contains the following safeguards: (1) the activity could not include the replacement of, or addition to, any process unit or any part of a process unit; (2) the activity could not cause the process unit to exceed any

emissions limitation, operational limitation (that has the effect of constraining emissions), or work practice requirement (that has the effect of constraining emissions) that applies to any part of the process unit and that is legally enforceable; and (3) the activity could not result in any emissions of a new NSR regulated pollutant from the process unit.

- The draft also asks for comment on an exclusion for maintenance and repair activities that are not considered capital improvements for tax purposes, but are instead considered "expensed items" under IRS regulations.

- The draft specifically solicits comments on whether the proposed safeguards are adequate to assure that an activity would not significantly increase emissions and asks for examples of maintenance and repair activities that do not involve equipment replacement or additions, if there are any, that could result in a significant increase of a regulated NSR pollutant or an increase in process unit capacity.

After giving further consideration to whether to proceed with rulemaking on what constitutes routine maintenance and repair, EPA staff indicate that they have no current plans to publish the draft proposal and seek public comments on it. In the course of developing it, EPA attempted to determine whether there had been specific instances where maintenance and repair activities that involve no equipment replacement have been challenged as not coming within the RMRR exclusion. EPA's tentative conclusion apparently is that such maintenance and repair activities have not been targeted as falling outside the exclusion.

It appears that EPA is currently of the opinion that there are higher priority items on which the Agency should expend its resources than publishing the draft routine maintenance and repair proposal and proceeding to finalize it as a clarification to the RMRR exclusion. EPA has indicated, however, that, if there are examples of circumstances where maintenance and repair activities that involved no equipment replacement have been challenged as not constituting RMRR, such examples should be provided to the Agency. ″

State and Local Agency Petitioners in NSR Rule Litigation File Second Stay Motion

On August 19, 2003, the state and local air pollution control agency petitioners ("State Petitioners") filed a motion with the D.C. Circuit for leave to file a second motion for a

stay of the NSR final rule. The court granted their motion for permission to file the stay motion on September 30. State Petitioners argue that there are "significantly altered circumstances" that have developed since the court denied the earlier motion for a stay. The principal focus is on confusion that they allege is now being created by EPA's partial grant of state and environmental group petitioners' reconsideration petitions. Particularly notable is their claim that "EPA's actions have frustrated the state's efforts to obtain expedited briefing." The stay motion gives much attention to the alleged difficulties that states will have in proceeding to implement the final NSR rule, which State Petitioners assert has been substantially complicated by the grant of the reconsideration petitions. Most of the argument regarding changed circumstances is premised on claims about EPA/state interactions regarding adoption and implementation of the final NSR rule. There is little new in the motion that addresses State Petitioners' likelihood to prevail on the merits.

The responses of EPA and intervenors are due on October 14. Any reply is due on October 27. EPA has indicated that it intends to take final action on the reconsideration petitions by October 28 and recently confirmed that it is on schedule to complete the reconsideration process by that date. ″

Sierra Club Files a Motion to Stay the Final General Provisions/Section 112(j) Rule

As expected, the Sierra Club filed a motion with the D.C. Circuit asking that the Court stay not only EPA's section 112(j) rule published on May 30, 2003, but also the Agency's prior section 112(j) rule published on April 5, 2002.[1/] The environmental group also asked that the Court grant expedited consideration of its challenges to the final rules.

The Sierra Club claims that the bifurcated section 112(j) permit application process and the deadlines for submitting a complete application contained in the rules are unlawful and causing irreparable harm. The Sierra Club fails to explain how there could be irreparable harm in light of the fact that the permit application process and deadlines are identical to those included in a Settlement Agreement entered into between Sierra Club and EPA. EPA and industry intervenors have filed oppositions to Sierra Club's stay motion and Sierra Club has filed a reply to their opposition. The court has not yet taken action on the stay motion. ″

1/ The May 30 rule and the history of the litigation involving the General Provisions/Section 112(j) are discussed in more detail in the May 2003 *Washington Report* at WR-473 and the July 2003 *Washington Report* at WR-487