McGUIREWOODS

Legal Updates

5/26/2010

EPA's New Greenhouse Gas Tailoring Rule: Analysis of Immediate Air Permitting Considerations

While a comprehensive climate bill addressing climate change may be stalled in Congress, EPA has now mapped out when it will begin to require permits for greenhouse gases (GHG) under the Clean Air Act (CAA). On May 13, 2010, EPA released the final version of what is known as the "Tailoring Rule." Absent Congressional action or a judicial stay, these new air pollutants will be subject to regulation in some facility construction and modification permits beginning January 2, 2011 - just seven months from now. At this point, no one knows what monitoring, capture, control or reductions will be required for this ubiquitous and entirely different category of pollutants.

The rule is called a "Tailoring Rule" because it is designed to cut the task of GHG permitting down to a size that is administratively workable. EPA has decided that GHG regulation, at least in the near term, will apply only to facilities or modifications to facilities with the potential to emit 75,000 tons and 100,000 tons per year (tpy) - rather than at the 100 tpy or 250 tpy levels applicable to traditional pollutants or the 25,000 tpy level EPA originally proposed for GHG.

EPA explains that without limiting GHG regulation to sources that emit GHG emissions at these thresholds state permitting agencies could be facing the impossible task of regulating 81,000+ facilities, a three hundred fold increase, in permit applications under the Clean Air Act "Prevention of Significant Deterioration" (PSD) permitting program and 6.1 million facilities, a 400-fold increase, under the Clean Air Act Title V permitting program. Even with the "regulatory relief" provided by the higher thresholds for GHG permitting, EPA anticipates an additional 900 facilities will require pre-construction and modification permits for the first time and 550 facilities will require CAA operating permits for the first time. Many other facilities already subject to PSD and Title V permitting will also now be required to address GHG emissions for the first time.

Given the potential impact of this rule in the immediate future, any company currently in an air pollution pre-construction permitting process or contemplating new facility projects or existing facility modifications should calculate its facility-wide and/or project-specific GHG potential to emit to determine whether GHG permitting will be triggered. If GHG emissions exceed the thresholds in the Tailoring Rule, companies should consider options either for avoiding GHG permitting or for demonstrating compliance with still undefined "best available control technology" (BACT) requirements for GHG.

GHG PSD Permits

The Tailoring Rule creates a three step phase-in of Clean Air Act "Prevention of Significant Deterioration" (PSD) preconstruction permits and Title V operating permitting requirements for GHG. The first two phases begin within 7 and 14 months, respectively, from now.

In Step One, only new and modified sources that have the potential to emit 75,000 tons or more of GHG

annually and that are already required to obtain Clean Air Act "New Source Review" permits for traditional air pollutants are required to address GHG emissions by January 2, 2011. This has an immediate effect on a relatively small number of proposed new facility projects or modifications of existing facilities that are involved in the PSD permitting process, and a longer term effect on new and modified sources at the 75,000 tpy level. EPA explains that any PSD permits that are issued by the permitting authority before January 2, 2011 are not required to address GHG emissions. However, EPA takes the position that permit applications that remain pending on that date will have to be revised to include data on GHG potential to emit.

This interpretation creates a narrow window of opportunity for any source that is already in this process to escape GHG regulation - at least in its pre-construction permit. While EPA commits that it will not attempt to delay pending permit decisions to capture these sources, those facilities that are in a state or EPA PSD permitting process right now are well advised to make every effort to expedite issuance of their permits in order to avoid the added delay, ambiguity and appeals that undoubtedly will accompany the first-time development of GHG BACT requirements. Note also that in states that have not been authorized to implement their own PSD permitting programs, but rather "stand in EPA's shoes," PSD permits are not considered issued until any appeal to the EPA Environmental Appeals Board is resolved. Therefore, companies currently involved in permit appeal proceedings will want to resist any unnecessary delay in those proceedings to avoid having their permits remanded back to permitting authorities for consideration of GHG BACT starting on January 2, 2010.

Beginning July 1, 2011, under Step 2 of the Tailoring Rule, EPA extends PSD GHG permitting requirements to any new source or modification of an existing source with the potential to emit 100,000 tpy of GHG that would *not otherwise trigger PSD permitting* for traditional pollutants. GHG permitting is triggered for these existing facilities only if a physical modification or change in the method of operation will increase GHG emissions by 75,000 tpy or more. In this case, to avoid GHG regulation, the facility needs to not only obtain its pre-construction permit before July 1, 2011, it must also "begin actual construction" before that date. Again, this creates a narrow window for these projects to move forward without the delay and ambiguity that will certainly surround this initial round of GHG permitting.

It is very important to note that Step 2 of the Tailoring Rule applies to facilities and modifications that are otherwise "minor" except for GHG emissions. The effect of this is to extend federal PSD permitting and all of its trappings, including public notice and comment, an opportunity for hearing, USEPA right to object to issuance, and third party rights of appeal, to new facilities and modifications that are otherwise eligible for faster and simpler state "minor source" pre-construction permits.

GHG Title V Permits

In addition to establishing deadlines for GHG regulation of new and modified sources seeking pre-construction permits, the Tailoring Rule also requires that Clear Air Act operating permits, known as "Title V" permits, be issued and/or revised to include provisions addressing GHG emissions for sources with a potential to emit 100,000 tpy or more of GHG.

Beginning on July 1, 2011, permit applications for Title V permits must include GHG data. Companies that are otherwise subject to Title V permitting requirements and have Title V applications pending for traditional air pollutants or that apply for Title V permits anytime after July 1, 2011, will need to include or add GHG data to their applications. Although new "traditional pollutant" Title V "major sources" have 12 months from the date that they commence operation in which to apply for Title V permits, after July 1, 2011 those applications must include GHG data.

Sources that would not otherwise be subject to Title V permitting except for GHG emissions (Step 2 "minor"

sources) will have until July 1, 2012 to submit Title V applications addressing GHG. As discussed above, these otherwise "minor" sources will now be facing the much lengthier and more complicated Clean Air Act Title V permitting process than they would for state minor source operating permits.

For companies that already have Title V permits for traditional pollutants, EPA will treat new GHG regulation as it does other new regulations. Permitting authorities are required to reopen Title V permits that have three or more years remaining before renewal in order to incorporate GHG provisions. Otherwise, upon renewal, the company must supply GHG data with its application.

Prospect of Future Regulation of Smaller Sources

In Step 3, EPA will solicit comment and undertake a study to consider regulating sources with lower GHG emissions. The earliest any regulation of sources with emissions less than 50,000 tpy can occur is 2016.

Actions Companies Should Consider Now

There are a number of reasons that Clean Air Act GHG permitting is undesirable from the perspective of businesses attempting to build new facilities or modify existing facilities. The first reason is simply delay. The second is uncertainty. The third is the prospect of permit appeals by third parties motivated to hold up project development. Companies that are caught in the first phase of this new regulatory program minimally will have to supplement their permit applications with facility-wide GHG data and wait for state or federal permitting authorities to decide how to regulate GHG. Once these decisions are made, many will undoubtedly be challenged as not going far enough or not considering all available GHG reduction alternatives - such as fuel switching or carbon capture and sequestration. Many previously "minor" facilities that now trigger PSD review for the first time will be surprised to be similarly hamstrung when they apply to build or modify plants.

Unlike traditional air pollutants such as particulate matter or SO2, there is no known technology for "controlling" or reducing CO2 emissions - so this is new ground for both EPA and the state permitting agencies. While EPA has promised to streamline this process and to identify "presumptive" BACT technologies, possibly including energy efficiency and other innovative approaches, EPA has issued no guidance or proposed rules on this as of this date. Furthermore, environmentalists are pushing for redesigning entire projects to use cleaner fuels. Given the lack of precedent for GHG control or reduction technologies, businesses should expect delay in obtaining necessary permits and uncertainty as to what the permits will ultimately require.

In another blow to affected businesses, facilities that are required to reduce GHG under EPA regulations or permit requirements will lose the ability to create saleable emission reduction credits or "offsets" under any subsequently adopted cap-and-trade program because the reductions will no longer be considered "additional."

Given the potentially large down side of stepping into GHG regulation any earlier than necessary, companies with pending permit applications will want to make every effort to expedite issuance of those permits before the Tailoring Rule compliance dates. Companies that are considering applying for permits should determine whether they are likely to trigger GHG regulation and whether the permits can be issued before the Tailoring Rule deadlines. Even if companies believe their potential to emit GHG is below the 75,000 and 100,000 thresholds, they should ensure that they have conducted a comprehensive analysis of facility-wide GHG emissions (not necessarily just combustion sources, as required for some sources under EPA's GHG Mandatory Reporting Rule) and be prepared to document their conclusion. If companies find they will trigger GHG permitting, they may want to consider steps that can be taken to reduce those

emissions below the Tailoring Rule thresholds before the compliance dates.

EPA's Final Rule titled "Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule" is available online.

If you would like to receive our legal news updates by e-mail, please use our online sign-up form.

MORE INFORMATION

Patricia F. Sharkey
312.750.8601
psharkey@mcguirewoods.com

Neal J. Cabral
202.857.1727
ncabral@mcguirewoods.com

Gordon R. Alphonso
404.443.5716
galphonso@mcguirewoods.com

David L. Rieser
312.849.8249
drieser@mcguirewoods.com