DRAFT—Draft for Clean Air Act Advisory Committee Workgroup..2-10-09

MEMORANDUM

SUBJECT: Submittal of Section 185 Fee State Implementation Revision (SIP) or an Alternative Equivalent Program for the 1-Hour Ozone National Ambient Air Quality Standard (NAAQS)

FROM: Steve Page, Director
Office of Air Quality Planning and Standards

TO: Regional Office Air Division Directors

Purpose of Memorandum

In December 2006, the United States Court of Appeals for the District of Columbia Circuit, issued an opinion determining that EPA improperly waived the application of the section 185 penalty provision for severe and extreme nonattainment areas that failed to attain the 1-hour ozone national ambient air quality standard (NAAQS or standard) by their attainment date. South Coast Air Quality Management District v. EPA, 472 F.3d 882 (D.C. Cir. 2006) (SCAQMD). The purpose of this memorandum is to provide guidance on the section 185 state implementation plan (SIP) revisions required of severe and extreme 1-hour ozone nonattainment areas under EPA's anti-backsliding rules for the transition to the 8-hour ozone NAAQS and to provide guidance on alternative programs that may be acceptable consistent with section 172(e) of the CAA, which allows EPA through rulemaking to accept alternative programs that are "no less stringent." Section 185 fee SIP revisions for 1-hour ozone nonattainment areas were due to be submitted to EPA by December 31, 2000 [see section 182(d)(3)]. .

While the purpose of this memorandum is to provide guidance for areas that were classified as severe or extreme for the 1-hour ozone standard as of the effective date of designation for the 8-hour ozone standard, we note that section 185 applies to areas that are classified as severe or extreme for any ozone standard. CAA section 182(d)(3) requires States with severe and extreme areas that are nonattainment for the 1997 8-hour ozone NAAQS are to submit section 185 SIP revisions as applicable for the 1997 8-hour ozone standard to EPA by June 15, 2014. Currently, States with severe and extreme ozone nonattainment areas for the 1997 or 2008 ozone NAAQS could not adopt alternative programs that would apply where an area fails to attain those standards by the applicable attainment date, as can potentially be done for the 1-hour standard as described in this guidance, because those standards still apply and the areas thus must comply with section 185.

Section 185

Section 185 of the CAA requires each major stationary source of VOCs (and NOx[1]) located in severe and extreme nonattainment areas to pay a penalty to the state for failure to attain the ozone NAAQS. In 1990, the CAA set the fee as $5,000 per ton of VOC and NOx emitted by the source during the calendar year in excess of 80 percent of the "baseline amount" for each year beginning after the attainment date until the area is redesignated to attainment for ozone [see section 185(b)(1)]. The fees must be adjusted for inflation based on the Consumer Price Index (CPI) on an annual basis. See Appendix A for the amount of fees adjusted for inflation for the years 2006, 2007 and 2008.

The CAA provides that the computation of a source's "baseline amount" must be the lower of the amount of actual or allowable emissions under the permit applicable to the source (or if no permit has been issued for the attainment year, the amount of VOC and NOx emissions allowed under the applicable implementation plan) during the attainment year. The CAA also provides that EPA may issue guidance on the calculation of the "baseline amount" as the lower of the average actual emissions or average allowable emissions over a period of more than one year in cases where a "source's emissions are irregular, cyclical or otherwise vary significantly from year to year." On March 21, 2008, EPA issued a memorandum entitled "Guidance on Establishing Emissions Baselines under Section 185 of the CAA for Severe and Extreme Ozone Nonattainment Areas that Fail to Attain the 1-hour Ozone NAAQS by their Attainment Date."

The CAA does not specify how states may spend or allocate the fees collected under a section 185 fee program. Therefore, states have discretion in how to use the fees. We believe that one beneficial approach would be to channel the fees into innovative programs to incentivize emissions reductions from stationary or mobile sources, or for other purposes aimed at reducing ambient ozone concentrations in the affected area.

If the state fails to adopt or implement a program under section 185, EPA is required to collect the unpaid section 185 fees and may also collect interest on any unpaid fees. Any fees collected by EPA are required to be deposited in a special fund in the United States Treasury for licensing and other services and may be used to fund the Agency's activities for collecting such fees. See, CAA section 185(d) and 502(b)(3)(C).

As a result of the 2006 court decision, States with severe and extreme 1-hour ozone nonattainment areas are obligated to submit section 185 SIPs that would apply if an area fails to attain the 1-hour standard by its attainment date. We believe that this obligation can be met through a SIP revision containing either the fee program in section 185, or an equivalent alternative program, as further explained below. As soon as possible, states should submit their section 185 SIPs for the 1-hour ozone NAAQS or contact EPA if they are interested in developing an alternative equivalent program.

[1] While section 185 expressly mentions only VOC, section 182(f) extends the application of this provision to NOx, by providing that "plan provisions required under [subpart D] for major stationary sources of [VOC] shall also apply to major stationary sources…of [NOx]."

When does the Section 185 Fee Obligation Begin and End?

As stated above, severe and extreme ozone nonattainment areas that do not attain by their attainment date are subject to the section 185 penalty fees beginning in the calendar year after their attainment date. The CAA states that the fees continue until an area is redesignated to attainment; however, we will not be redesignating areas for the 1-hour NAAQS now that it has been revoked under the Phase 1 Rule. We are in the process of developing a proposed rule which will take public comment on options for when the section 185 fee requirement goes away for purposes of anti-backsliding of the 1-hour NAAQS. The final rule will describe at what point major stationary sources of VOC and NOx no longer have to pay the fee.

Section 172(e) and Potential for Alternative Programs

Section 172(e) is an anti-backsliding provision of the CAA that requires EPA to develop regulations to ensure that controls are "not less stringent" than those that applied prior to relaxing a standard. In the Phase 1 Ozone Implementation Rule, EPA determined that although section 172(e) does not directly apply where EPA has strengthened the NAAQS, as it did in 1997, it was reasonable to apply the same principle. Applying this principle, EPA can either require States to retain programs that applied for purposes of the 1-hour standard, or alternatively can allow States some flexibility to adopt alternative programs, but only if such alternatives are "not less stringent" than the mandated program.

If a state chooses to adopt an alternative program to the section 185 fee program, the state must demonstrate that the alternative program is equivalent to the section 185 fee program. The alternative program cannot rely on emissions reductions already claimed in the applicable SIP. If EPA's preliminary assessment indicates that the alternative program is equivalent, we would then propose and take action making such a finding under section 172(e) at the same time we propose and take action on the SIP revision pursuant to section 110(k). Depending on when, if any, SIPs with alternative programs are submitted, there could be more than one case-by-case rule establishing alternative equivalent programs.

EPA Consultation with Stakeholders on Possible Alternative Programs

EPA held a number of meetings with state and local agencies to get their perspective on options for alternative equivalent programs. We also had discussions with environmental groups and industry representatives to solicit their thoughts on alternative equivalent programs. While we did get valuable input from these discussions, the stakeholders did not identify any programs which the State program representatives showed interest in adopting.

Some stakeholders have noted that there may be a situation in a state where a major source is well controlled but under a state's rule following the section 185 fee

provisions in the CAA, the source would still be required to pay penalty fees. These stakeholders have expressed interest in alternative programs that would not assess fees on these sources. In addition, a Task Force comprised of members of the Clean Air Act Advisory Committee (CAAAC) is being formed to discuss their ideas on how to proceed on section 185.

Potential Equivalent Alternative Options to Section 185

Following is a summary of concepts for alternative programs that may be no less stringent than a section 185 fee program. For any alternative program adopted, a demonstration of equivalency might be related to the emissions reductions or fees that could result under the CAA Section 185 fee program, as explained below. These concepts garnered the most interest in stakeholder meetings; other approaches might also be available. EPA cannot conclude at this time whether programs relying on these concepts would be approvable because such a determination requires a notice-and-comment rulemaking and would be based on the specific parameters of the adopted program.

To assure a valid equivalency determination, states should work with EPA to determine if their submittal is equivalent, considering the facts of each individual case. Some of the issues that should be addressed in any alternative program include: the emissions baseline year, type of emissions reductions, and time period for implementation of the program.

Emissions-Equivalent Alternative Program

EPA believes that a state could adopt an alternative emission reduction program rather than a section 185 fee program if the alternative program will clearly obtain emissions reductions within the nonattainment area that are equal to or greater than the emissions for which fees would be assessed under the section 185 fee program. The alternative program could apply to a different set of sources than would be subject to the fee program, to the same sources, or a combination.

For purposes of estimating the necessary emissions reductions the state would assume that sources would reduce their emissions to the fee applicability threshold rather than pay fees. This conservative approach would assure that emissions from the alternative program are at least as great as those that might have occurred if the statutory fee program applied.

Under such an approach, states would first calculate the emissions baseline for the major stationary sources of VOC and NOx in accordance with the methodology described in the March 21, 2008 guidance memorandum. Once a state calculates the baseline amount for each source affected by section 185, the amount of emissions in excess of 80 percent of the baseline would be the amount of emissions that sources within the area would need to reduce on a calendar year basis in each year following the 1-hour

ozone attainment year until such time as the fee program no longer applies for the 1-hour standard.

Section 185 fees apply to both VOC and NOx emissions (except in areas with a NOx waiver). Therefore, we expect that an equivalency demonstration for an alternative program will need to consider potential differences in VOC and NOx emissions relative to a section 185 fee program, and the conditions under which reductions in one pollutant could be considered equivalent to reductions in the other pollutant.

Equivalency Concepts Related to Fee Revenues

We anticipate (subject to notice and comment rulemaking as noted above) that we could approve a program that clearly raised at least as much revenue as the section 185 fee program if the proceeds would be spent to pay for emissions reductions of the same pollutant in the same geographic area subject to the section 185 program. Under this approach the State would estimate revenues that would result under the section 185 fee program if all section 185 sources paid fees rather than reducing emissions, and show that the alternative program would raise at least that much revenue and that the revenues would be used to pay for emissions reductions.

Demonstration of Equivalent-or-Better Air Quality Impact

EPA is seeking input on the concept of demonstrating that an alternative program is no less stringent than a section 185 fee program by showing that the alternative program would achieve equivalent-or-better air quality improvement than a section 185 fee program. We anticipate that a state using this approach would need to address issues such as potential location of hypothetical emissions reductions under a section 185 fee approach vs. the anticipated location of reductions under a proposed alternative program, modeling uncertainties, and the potential for different air quality impacts in different locations under a section 185 fee approach versus an alternative program. As a result this approach is likely to be more complex than an emissions equivalency approach.

EPA is considering this issue of whether equivalency could be based on air quality impact and will be discussing this with the CAAAC Task Force and other interested stakeholders.

Other Program Concepts Raised to EPA

We also considered an option that would allow electric generating utility sources to retire to the state retirement account NOx ozone season allowances equivalent in cost to the section 185 fees applicable to those sources. Although we believe the specific approach discussed with stakeholders involving regional trading program allowances would raise complicated policy and legal issues, we believe that retiring emissions from a local bank or allowance program may be a viable option for states to consider when developing an alternative equivalent program. Additionally, states can consider other possible options that would result in an equivalent program consistent with how that term is used in section 172(e), such as a renewable energy program.

We will work with any state that wants to develop an approvable alternative equivalent program to the section 185 fee program and provide additional guidance if necessary. Any State that wishes to pursue an alternative program should contact Denise Gerth, 919-541-5550, as soon as possible.

Appendix

From: Bureau of Labor Statistics Inflation Calculator
at web site: http://data.bls.gov/cgi-bin/cpicalc.pl

Year	Inflation Adjusted Amount
1990	$5,000
2006	$7,712
2007	$7,932
2008	$8,126
2009 +	Not yet available

Note that the inflation calculator for the latest year will provide different values over the course of that year.