

Clean Energy & Climate

E-ALERT

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EPA'S NEW ENDANGERMENT FINDING: WAITING FOR THE SECOND SHOE TO DROP

On December 7, 2009, the opening day of the United Nations Climate Change Conference in Copenhagen, the Environmental Protection Agency ("EPA") took an important step toward the regulation of greenhouse gases ("GHGs") by announcing its long-awaited decision that emissions from motor vehicles "cause or contribute to air pollution which may reasonably be anticipated to endanger public health or welfare." Coupled with regulations requiring nationwide GHG emissions monitoring and reporting which take effect next month, this "endangerment" finding sets the stage for EPA to regulate emissions from power plants, factories, automobiles, and other significant sources under the Clean Air Act ("CAA"). Published December 15, 2009, the finding will take effect January 14, 2010.

This e-Alert discusses the contents of the proposed endangerment finding, as well as its role as a trigger that will almost surely set in motion next spring a broader scheme by EPA to regulate GHG emissions from both mobile and stationary sources. As discussed below, contrary to the impression created by some popular media coverage, significant new GHG regulation in 2010 does not require any additional strategic decisions by EPA. Regulation will likely flow automatically from the endangerment finding and the resulting final EPA rule governing vehicle mileage/tailpipe standards expected in March 2010 — but great uncertainty exists about the shape it will take. The agency's plans to regulate emissions from stationary sources are likely to be especially controversial given the broad range of affected sources and the complexity of selecting control technologies for GHG emissions under the CAA.

BACKGROUND

In 2003, EPA denied a petition seeking regulation of GHGs from new motor vehicle sources, concluding at the time that it lacked the authority under the CAA to regulate GHGs. The United States Supreme Court concluded otherwise in *Massachusetts v. EPA*, 549 U.S. 497 (2007), and held that GHGs are "air pollutants" covered by the CAA. As a result of that decision, EPA was required to determine whether or not GHG emissions from new motor vehicles "cause or contribute" to air pollution which may be reasonably be anticipated to "endanger" public health or welfare.

On April 24, 2009, EPA issued a proposed endangerment finding. After receiving and reviewing over 380,000 public comments raising a host of scientific and legal issues, EPA made the following findings in the final rule:

- **Endangerment Finding** — EPA concluded that current and projected concentrations of six key GHGs — carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs),

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and sulfur hexafluoride (SF6) — in the atmosphere threaten the public health and welfare of current and future generations.

- Cause or Contribute Finding — EPA also concluded that the combined emissions of these six GHGs from new motor vehicles and new motor vehicle engines contribute to the greenhouse gas pollution which threatens public health and welfare.

REGULATION OF GREENHOUSE GAS EMISSIONS FROM MOBILE SOURCES

Although the findings do not by themselves regulate GHGs, or otherwise impose any requirements on industry, they form the foundation for EPA to regulate (and indeed, EPA is now obligated to regulate) GHGs from new motor vehicles and new motor vehicle engines under section 202(a)(1) of the CAA.

On September 28, 2009, EPA and the National Highway Traffic Safety Administration (“NHTSA”) issued a joint proposed rule aimed at reducing GHG emissions from various passenger vehicles and light-duty trucks, as well as improving their fuel economy. According to EPA’s analysis, the proposed GHG standards for light-duty vehicles would reduce GHG emissions by nearly 950 million metric tons and conserve 1.8 billion barrels of oil over the lifetime of model year 2012-2016 vehicles.

In June 2009, EPA granted California’s request for a waiver of preemption under the CAA that would allow it to set its own, more stringent, tailpipe emissions standards. In the interest of national uniformity, California agreed to revise its proposed standards so that compliance with the new federal GHG emissions requirements will satisfy the state’s standards as well.

The joint EPA/NHTSA rule is expected to be finalized at the end of March 2010, though there is some theoretical possibility that the agencies could delay the “effective date” of the rule for a year until the first of the 2012 model year vehicles are certified for fuel mileage.

FUTURE REGULATION OF GREENHOUSE GAS EMISSIONS FROM STATIONARY SOURCES

The Light Duty Vehicle Rule will trigger permitting requirements for a wide variety of stationary sources under both the Prevention of Significant Deterioration (“PSD”) and Operating Permit (“Title V”) programs for GHG emissions.

The PSD Program requires pre-construction permitting and installation of pollution controls for new sources or from existing sources undergoing “major modifications” that result in a significant increase in emissions. The program can apply to any major source that emits a “pollutant subject to regulation under the CAA.” As soon as the Light Duty Vehicle Rule is finalized, GHG emissions become a “regulated pollutant” under the CAA.

Title V requires that every major industrial source of air pollution (and some other sources) obtain an operating permit. The permits, which are reviewed every five years, contain all air emission control requirements that apply to the facility, including the requirements established as part of the preconstruction permitting process. Entities renewing their five-year permits will have to describe how they are treating GHG emissions.

Two major concerns have been raised regarding the potential scope and compliance costs of applying the PSD program to GHGs: (1) the low emissions thresholds in the CAA and (2) the burden of determining and installing the best available control technology (“BACT”) for

reducing GHGs.

EMISSION THRESHOLD REQUIREMENTS AND THE “TAILORING RULE”

First, the current thresholds for other regulated pollutants under the CAA — e.g., sulfur dioxide, nitrogen oxides, lead, or particulate matter — are set at numbers (100 or 250-tons/year, depending on the type of source) that are extremely low for CO₂ and other GHGs. Although the 100/250-tons/year level for traditional pollutants generally limits PSD permit requirements to medium and large facilities, like coal-fired power plants, a similar threshold for CO₂ would subject tens of thousands of smaller facilities to PSD requirements. EPA estimated that, if the statutory thresholds for Title V and PSD permitting were applied to GHGs, the number of regulated entities could jump from 300 new PSD permit applications each year to 40,000, and would include schools, hospitals, small farms, and restaurants. This would effectively paralyze EPA and state agencies.

In response to this critical problem, on September 30, 2009, EPA proposed regulations to limit the scope of facilities that would be subject to GHG regulation by raising the thresholds for GHG permit applications. In what has become known as the “Tailoring Rule,” EPA proposed, for a period of at least six years, to: (1) significantly increase the major source applicability thresholds for both programs to 25,000-tons/year of CO₂-equivalent emissions and (2) designate a PSD significance level between 10,000-tons/year and 25,000-tons/year of CO₂-equivalent emissions. Under the proposed emissions thresholds, EPA estimated that:

- 400 new and modified sources would be subject to PSD review each year for GHG emissions.
- Less than 100 of these would be newly subject to PSD.
- In total, approximately 14,000 large sources would need to obtain operating permits for GHG emissions under the operating permits program.
- About 3,000 of these sources would be newly subject to CAA operating permit requirements as a result of this action. The majority of these sources are expected to be municipal solid waste landfills.

Thus, if the Tailoring Rule is finally issued in its present form, it will affect primarily those large industrial sources who already file regularly under the CAA and new projects of significant size. We expect that a final rule will be in place by March 2010.

EPA has acknowledged that increasing the source thresholds would be contrary to the plain language of the CAA, which expressly establishes the current 100 to 250-tons/year for the PSD program. Anticipating the potential legal challenges to the rule, EPA presented a lengthy discussion of its legal authority for its approach in the preamble to the proposed Tailoring Rule. Based on the rarely applied legal doctrines of “absurd results” and “administrative necessity,” EPA argued that heightened limits are necessary due to the extraordinary increase in the scope of covered sources and heavy regulatory burden on state and federal authorities. To buttress its legal position, EPA emphasized that the proposed rule is merely the “first phase,” and that EPA will be prepared to revise the regulations at the end of a five-year study.

The Tailoring Rule, once finalized, will be almost certainly subject to vigorous and protracted litigation. Although EPA has made considerable efforts to anticipate defenses to any challenge, a court may not agree with EPA’s administrative necessity justification or the balance that EPA strikes. It might take a year for a legal challenge to be resolved by the courts. If the provisions for major sources remained intact while the rule is remanded to EPA for further consideration and rulemaking, a judicial decision that the rule is invalid

might not have an immediate effect. One “quick fix” would be for Congress to amend the CAA’s language on threshold levels, but this solution is unlikely given the current push for comprehensive climate legislation and the widespread hostility to using the CAA to regulate GHGs.

BEST AVAILABLE CONTROL TECHNOLOGY FOR GREENHOUSE GAS EMISSIONS

Even assuming the Tailoring Rule survives judicial review, another challenge looms on the immediate horizon: the determination of “best available control technology” or “BACT”. The BACT provision of the CAA requires that new power plants, or existing plants undergoing major modifications, employ the most effective, readily available pollution control technologies for regulated pollutants in order to receive the necessary air quality permits.

In a majority of the states, the actual determination of what constitutes BACT is made by a state environmental agency on a facility-by-facility basis, taking into account source-specific “energy, environmental, and economic impacts and other costs.” EPA generally publishes “guidance” to the states to inform their permitting decisions. To assist the states agencies and prospective applicants, EPA has established a searchable central database of air pollution technologies to help in the selection of appropriate emissions control for any given project. With respect to coal-fired power plants, for example, BACT for sulfur dioxide emissions is typically some form of flue gas desulfurization device or “scrubber”.

But unlike conventional pollutants such as sulfur dioxide, there are no current EPA endorsed technologies for controlling CO₂. Widescale carbon capture and sequestration technologies, for example, are considered years from commercial viability. EPA is thus faced with the difficult task of writing guidelines for states to address, on a case-by-case basis for each covered facility, the environmental benefits of reducing CO₂ with the economic costs of certain emissions control technologies (some of which have yet to be developed). And until EPA does so, businesses looking to construct new sources or modify existing ones will have no basis for anticipating regulatory requirements, which could threaten investment in energy infrastructure and improvements.

While there is a wide divergence of opinion as to what BACT for CO₂ would likely be, some believe that the most cost-effective means of controlling GHGs from power plants include fuel burning efficiency improvements, co-generation (making use of waste heat from electricity generation), or co-firing with biomass. Others have even gone so far as to suggest that applicants must include a process called integrated gasification combined cycle (“IGCC”), a costly, but clean, technology that turns coal into “synthesis gas” that would be burned in a combustion turbine power unit. New Mexico, for example, believes the CAA is clear in that it intended to require the consideration of innovative fuel combustion techniques like IGCC during the BACT analysis, and requires an applicant for a coal-fired power plant to consider IGCC technology when determining BACT for that facility.

The EPA’s Environmental Appeals Board, in *In re Desert Rock Energy Co. LLC*, recently asked EPA to demonstrate why IGCC should not be considered BACT for a 1,500 MW coal-fired power plant. Although this decision did not require IGCC for coal-fired power plants, it sets the stage for EPA to address the costs and benefits of such technology in the near future.

Arguments could also be made that BACT includes demand management and conservation programs to reduce total power usage, thus reducing emissions. Similarly, smart grid

technologies could potentially cut the peak power demand in the United States by up to 20% in the next decade, according to a new report from the Federal Energy Regulatory Commission. The reduction in energy consumption could result in significantly lower GHG emissions.

Even if EPA settles on technologies that would qualify as BACT for CO₂, there is the additional problem of synthesizing those technologies with BACT for other regulated pollutants under the CAA. For example, BACT for carbon monoxide is an oxidizer or incinerator, which controls emissions by converting them into CO₂. Under the new GHG regulations, a facility could theoretically be required to obtain a permit due to the secondary emissions from its carbon monoxide control device, posing significant financial and regulatory burdens.

Ultimately, EPA will be responsible for determining how BACT is defined for CO₂, a process that is estimated to take at least a year. Expect EPA to develop sector and source specific guidance that would help state permitting authorities and affected industries better understand available GHG measurement and monitoring techniques, methodologies for estimating alternative future emissions paths, and the most cost effective and reliable industrial control processes.

In October 2009, EPA's CAA Advisory Committee established the Climate Change Work Group composed of about twenty stakeholders from industry, states, environmental groups and others, to identify and address some of these issues. The Work Group is charged with developing information on the technical, economic, and environmental performance characteristics of potential control technologies, and identifying approaches to enable state and local permitting authorities to apply control technology criteria in a consistent, practical and efficient manner. A draft interim report is due on or before December 31, 2009, and a draft final report is due on or before March 2010. The draft final report is anticipated to be approximately ten pages (or less) and to include recommendations for EPA to address the issues and potential barriers associated with implementation of BACT for GHGs. The proposed length of the draft suggests that the report will be no more than a starting point for developing regulatory precedent for GHG BACT analysis.

LOOKING FORWARD

Given the potential implications of EPA's regulation of GHGs, a large number of uncertainties linger. On the regulatory level, there are questions of what facilities will be covered, what EPA guidance will look like, how state agencies will apply that guidance, what specific agency action might trigger regulatory requirements, and when such action might occur. For the most part, state regulatory agencies will be on the front lines of implementation, confronting many of these issues on a case-by-case basis through the permitting process. Unless EPA can issue guidance quickly, state efforts are likely to be uneven.

On the legislative and judicial levels, there are questions of whether Congress might attempt to preempt EPA's authority to regulate GHGs — even before enacting a comprehensive energy/cap-and-trade bill of its own — and whether EPA's proposed rules will survive potential court challenges. The Competitive Enterprise Institute, a non-profit group, has already announced that it plans to challenge the endangerment finding in federal court on the grounds that EPA failed to consider all relevant scientific material. Others have promised a challenge to the Tailoring Rule. And while we would expect that passage of a cap and trade bill would provide clearer authority for EPA and more compliance flexibility for affected industry, the prospects for such legislation are

increasingly cloudy.

Despite these uncertainties, EPA appears determined to move ahead with GHG regulation of mobile and stationary sources alike. Indeed, further congressional delay could well prompt EPA by late spring to issue its own proposed GHG cap-and-trade system under section 111(d) of the CAA. EPA staff have already said they believe they possess the authority to promulgate such regulations, and the Administrator and the White House have begun to mention this possibility, albeit as a "less desirable" outcome than legislation. Unless Congress intervenes, EPA will be exercising considerable discretion as this program goes forward. Affected companies who want to influence EPA's decisions should be monitoring developments and making their views known as appropriate.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Clean Energy & Climate Group:

George Frampton	212.841.1260	gframpton@cov.com
Theodore Garrett	202.662.5398	tgarett@cov.com
Robert Fleishman	202.662.5523	rfleishman@cov.com
Henry Liu	202.662.5536	hliu@cov.com
Sharon Jacobs	202.662.5988	sjacobs@cov.com

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