

Verdeo Group Alert, January 2010

EPA GHG Regulation: More Pain, Less Gain

The Environmental Protection Agency (EPA) is moving forward with proposed regulation to control emissions of greenhouse gases (GHGs) from motor vehicles. If successfully implemented, this regulation will also have significant impacts on the operations of thousands of companies operating within the U.S. with stationary sources of emissions. These include delays in permitting for companies that propose development of new facilities or modification of existing facilities, new costs associated with the requirement to install Best Available Control Technology (BACT), and reduced opportunities for many companies – particularly those with methane emissions – to generate carbon offset credits. This Issue Brief provides an overview of EPA's efforts and how companies may be impacted.

Background

EPA's efforts to regulate GHG emissions originate from a 2007 Supreme Court decision, *Massachusetts v. EPA*, which determined that GHG emissions from motor vehicles are air pollutants under the Clean Air Act. This landmark decision set the stage for EPA to begin promulgating rules to build a federal regulatory framework to address GHG emissions from motor vehicles. In September 2009, EPA issued a proposed rule to reduce GHG emissions from motor vehicles, and in December 2009 finalized its Endangerment Finding, which formalizes the Agency's conclusion that GHG emissions threaten public health and the welfare of current and future generations. The Endangerment Finding sets a foundation for the finalization of EPA's proposed GHG rule for motor vehicles, which is expected in March 2010. In addition, EPA also recently finalized a rule that requires mandatory reporting of GHG emissions from sources throughout the economy that emit over 25,000 metric tons of carbon dioxide equivalent (CO₂e) per year. While the reporting rule itself does not impose any GHG controls, it is expected that data collected from the reporting rule will be used to inform regulations to address GHG emissions.

The Tailoring Rule

Once the proposed GHG rule for motor vehicles is finalized by the EPA, it will automatically trigger Prevention of Significant Deterioration (PSD) and Title V applicability requirements under the Clean Air Act for new or modified stationary sources of GHG emissions. If PSD and Title V requirements are applied at the level currently provided under the Clean Air Act for other pollutants – 250 metric tons per year – millions of small sources of GHG emissions across the economy would be regulated. In response to the administrative infeasibility and inefficiency of regulating small sources, EPA has issued what's known as the "Tailoring Rule" to exempt new or modified stationary sources with the potential to emit less than 25,000 metric tons of CO₂e per year from Clean Air Act GHG regulations.

Under EPA's proposed Tailoring Rule, major new stationary sources emitting more than 25,000 metric tons of CO₂e per year and existing major sources that undergo modifications that increase emissions by more than 10,000 metric tons of CO₂e per year would be required to obtain PSD permits and install BACT to minimize GHG emissions.

Implications

The finalization of the motor vehicle rule and subsequent trigger of Clean Air Act GHG regulation for stationary sources is expected to have significant implications for companies, including those in the mining, oil & gas, and landfill sectors. While it is currently unclear how long the BACT determination process will take and what criteria EPA will use to determine BACT for various sources, it is expected that the influx of new PSD permit applications will cause significant delays in the permitting process for all companies that propose to develop new facilities or modify existing facilities.

PSD Permits: Potential Impacts

PSD permit requirements could have an impact on companies' planned operational improvements or capital investments as early as 2010. Companies that become subject to PSD requirements will be obligated to bear significant new costs associated with the installation and use of BACT to control GHG emissions. These regulatory requirements could also eliminate the ability for companies to generate carbon offset credits.

In addition, a PSD permit requirement that mandates installation of BACT to reduce GHG emissions threatens the ability of companies to generate carbon offset credits. Because carbon offset credits can only be generated from emission reductions that are additional (i.e., not required by any legal mandate or regulation) sources that are subject to PSD permitting requirements and BACT will not be eligible to serve as hosts for carbon offset projects. As a result, many companies may be required to invest in GHG controls in order to obtain a PSD permit, which is required for operation. In contrast, under a market-based cap-and-trade program, many of these same companies would be eligible to earn carbon offset revenue from implementing the same GHG controls.

Best Available Control Technology (BACT)

BACT at the federal level is determined on a case-by-case basis. It can involve installation of new equipment, or a modification of company processes to reduce emissions, and is based on consideration of energy, environmental and economic impacts. BACT for GHG emissions is currently undefined for source categories – a source of uncertainty for companies – and is likely to be established through the permitting process as companies submit the first PSD permit applications.

What to Expect Next

Despite the consequences that EPA GHG regulation could hold for companies, the path forward is uncertain. It is likely that the proposed rule for motor vehicles and the Tailoring Rule will be challenged in the courts, though the success of such challenges is far from certain. Further, challenges to the Tailoring Rule are unlikely to successfully halt GHG regulations for stationary sources. Since the underlying trigger for stationary source regulation is the finalization of the motor vehicle rule, a successful legal challenge to the Tailoring Rule may only result in EPA exercising discretionary authority to enforce PSD permit requirements for larger stationary sources. In addition, even if the GHG rule for motor vehicles is finalized in March 2010, it is not clear whether EPA will immediately move forward to enforce PSD

Offsets Under Proposed Cap-and-Trade Legislation

Cap-and-trade legislation introduced in Congress offers many companies – particularly those with methane emissions – a financial incentive to implement GHG control technology through an offsets program. In contrast, EPA regulation will require companies to incur costs for the same emission reduction activities.

permit requirements for large stationary sources or whether the Agency will decide to delay the enforcement of such requirements until a later date.

There have also been several recent attempts by members of Congress to block EPA's regulatory efforts, though it's unclear whether these will garner significant Congressional support. Senator Lisa Murkowski (R-AK) just announced she may introduce an amendment to prohibit EPA from regulating GHG emissions from power plants and stationary sources for one year, an action which has prompted strong criticism from a number of Senate Democrats. In addition,

Representative Earl Pomeroy (D-ND) recently introduced a House bill that would strip EPA of its authority to regulate GHG emissions unless provided explicit authority from Congress to do so, though support for this effort in the House is uncertain, as well.

Even if EPA GHG regulation does go into effect for stationary sources this spring, there may still be a role for offsets within the regulatory framework. For example, we are aware that the Clean Air Scientific Advisory Committee is considering ways that offsets could be incorporated into a PSD program for GHG emissions; one way to do this would be to recognize offsets as a method to satisfy BACT requirements. A facility seeking a PSD permit could submit offsets as its solution for "controlling" GHG emissions, particularly where source controls are unavailable, technically unproven, or exceedingly expensive.

Advantages of Cap-and-Trade

While any policy designed to control GHG emissions will impose new costs on companies, it is widely expected that many companies will fare more favorably under a Congressionally-approved cap-and-trade program than under EPA regulation, particularly when it comes to offsets. For example, the Kerry-Boxer cap-and-trade bill that was passed by the Senate Environment and Public Works Committee in November 2009 included a robust offset program that explicitly recognized the collection and combustion of methane at underground coal mines and landfills, and the capture of fugitive emissions from oil and natural gas systems, as eligible offset project types. The bill also required that EPA not regulate emissions under the Clean Air Act before 2020 from sources recognized as eligible offsets, thereby giving companies a guaranteed window of opportunity to develop offset projects. In addition, an independent offsets bill released this fall by Senator Stabenow (D-MI) and a host of co-sponsors also recognized these same project types as eligible offsets.

Consequences of Congressional Inaction

"If Congress does not pass legislation dealing with climate change, the administration will use the Environmental Protection Agency to impose new regulations. Imposed regulations are likely to be tougher and they certainly will not include the job protections and investment incentives we are proposing...Industry needs the certainty that comes with Congressional action."

Senators Kerry (D-MA) and Graham (R-SC), Op-Ed in *The New York Times*, October 10, 2009.

EPA Administrator Lisa Jackson and President Obama have expressed a clear preference for Congress to address GHG emissions by passing cap-and-trade legislation. Despite their preference, they have also made it clear that EPA will continue to act if Congress does not.

Conclusion

In Verdeo's view, it is no longer a question of whether U.S. companies will face future GHG controls. Rather, we believe it is a question of whether these controls come in the form of a market-based cap-and-trade program or EPA regulation under the Clean Air Act. As EPA moves forward to finalize the proposed motor vehicle rule in 2010, it becomes increasingly likely that companies – including those with stationary sources of GHG emissions – could be subject to regulation in the very near future.

For companies with stationary sources of methane emissions, including those in the mining, oil & gas, and landfill sectors, a Congressionally-approved GHG cap-and-trade program is emerging as the most feasible way to avoid the costly and inefficient consequences of EPA regulation and maximize opportunities to generate offsets that yield financial benefits. Despite the threat of EPA regulation and the uncertainty of Congressional legislative action in 2010, we still believe that eventual enactment of cap-and-trade with a robust offset program is a likely outcome. We expect that support for such an outcome will continue to increase over the next few months, especially as EPA's efforts put the pressure on Congress to act.

Verdeo continues to be actively involved with policymakers on these issues to best meet the needs of our customers, and we believe there are many actions that companies can take to promote their interests. If you're interested in speaking with us further, please contact John Savage (jsavage@verdeogroup.com) or Marisa Buchanan (mbuchanan@verdeogroup.com).