

2011 Quarterly Report on Climate Change – Regulatory Update

March 16, 2011

Lawrence A. Demase

Todd O. Maiden

Jennifer A. Smokelin

David W. Wagner

ReedSmith

The business of relationships.™

A Delay in The Implementation of The Tailoring Rule? An Exemption For GHG Permit Applications In Process Prior to January 2, 2011? Changing Permits on Appeal.

Lawrence A. Demase, Esq.
Reed Smith LLP
ldemase@reedsmith.com

ReedSmith

The business of relationships.™

Follow the Reed Smith Blog at:
www.environmentallawresource.com

GHG Tailoring Rule

- EPA's Endangerment Finding triggers the requirement for new and modified sources of GHG to apply BACT.
- The Tailoring Rule increases the threshold governing when GHG sources must have a PSD permit. EPA has withdrawn SIP approval for 24 states where GHG emission thresholds were more stringent than the Tailoring Rule.

GHG BACT Guidance

- Guidance not a Rule – nevertheless, EPA insists that delegated permitting authorities should follow guidance when issuing permits.
- State Implementation Plan (“SLP”) approved permitting authorities allegedly have discretion to establish alternative approaches to determining BACT.
- Guidance explains general PSD applicability requirements for new and modified GHG sources.
- Reviews applicability thresholds based on both a mass and CO emissions.

GHG BACT Guidance (continued)

- Demonstrates how to calculate GHG emissions using the Global Warming Potential.
- Uses EPA's 5 step "top-down" process to establish BACT:
 - BACT a case by case determination;
 - Focuses on BACT options that reduce GHG emissions by improving energy efficiency;
 - States that Carbon Capture and Sequestration should be an available control option, but consideration of technical feasibility and/or costs likely to rule out CCS for now;
 - A BACT analysis for GHG emissions does not need to consider a fuel source that would fundamentally redefine the source.
- GHG "Mandatory" Reporting Rule not combined in applicable requirements under Title V regulations.

ReedSmith

The business of relationships.™

Avenal – The Regina McCarthy Declaration¹

- Declaration of Regina McCarthy, Assistant Administrator of the Office of Air and Radiation in EPA.
- EPA has determined that it is appropriate to grandfather certain PSD applications from the requirement to demonstrate that a proposed facility will not cause or contribute to a violation of the hourly NOx standard which came into effect when the permit application as pending.
- EPA intends to issue a notice that will request comment on EPA's proposal not to require Avenal to meet emission limitations for GHGs.

1. Found in Appendix A.

Can A PSD Permit Be Changed To Add New Requirements That Come Into Effect During An Appeal?

- The EPA has generally recognized that the proper point in time for fixing applicable standards is when the permit issuer initially issues the permit.
- The Administrator has also recognized that the permit issuer need not include a rule only “proposed” when the permit was issued and need not apply the rule on appeal.
- Order of the Environmental Appeal Board in Russel City Emerging Company (“RCEC”) PSD Appeal.
- Issues in the appeal included: (1) Whether the permit should be remanded again to consider NO_x rules which came into effect a few days after the final permit was issued and two months before the rule was to go into effect; (2) whether GHG emission limitations should be included even though they were not to come into effect until after the appeal had been decided.

ReedSmith

The business of relationships.™

Can A PSD Permit Be Changed To Add New Requirements That Come Into Effect During An Appeal? (continued)

- The EAB in the RCEC case recognized that there were circumstances under which a permit on appeal might be remanded to add new conditions which went into effect when the appeal was pending. Those circumstances recognized by the EAB included: (1) when a separate permit modification by the permittee had been requested based on a regulatory change, (2) where the new rule required the permit applicant to apply for a permit modification to meet the new standards of the new rule.
- EAB refused a remand of the RCEC permit to apply the new NOx rule because (a) the rule did not indicate it was intended to apply retroactively, (b) the length of time the application had been pending (November 2006), (c) the public and private resources that had been consumed in considering the permit application, and (d) the potential for an endless loop of new permits based on new regulations issued during the remand.

ReedSmith

The business of relationships.™

Can A PSD Permit Be Changed to Add New Requirements That Come Into Effect During an Appeal? (continued)

- The EAB refused a claim that the permit should be denied because BAAQMD had failed to consider GHG emissions as regulated pollutant because the Tailoring Rule was not yet in effect.

Efforts In Congress To Derail GHG Regulation

Despite the budget battle, efforts are also pending in Congress to derail EPA's Climate Change Rules.

- Democratic Senator Jay Rockefeller has proposed a bill which would to delay EPA's GHG Regulations.
- The Energy Tax Prevention Act of 2011 sponsored by Senator James Inhofe and Representatives Fred Upton and Ed Whitfield would block each of EPA's GHG-related efforts under the Clean Air Act, except the Tailpipe Emission Standards.

Efforts In Congress To Derail GHG Regulation (continued)

- Senator John Barasso has also introduced a Senate Bill entitled “Defending America’s Affordable Energy and Jobs Act,” which in addition to blocking EPA GHG efforts (except the Tailpipe Emissions Standards), would prevent all federal agencies from considering GHG-related effects under laws other than the CAA.

Efforts In Congress To Derail GHG Regulation (continued)

- Specifically, these bills if passed affect the following EPA Rules:
 - All of EPA's GHG-related actions, except the initial Tail Pipe Emission Rules.
- In addition these bills also address:
 - California's CAA Waivers
 - The ability of EPA to enforce state GHG-related laws
 - Federal GHG Reporting Requirements
 - Civil Tort claims based on the impact of GHGs
 - GHG consideration under NEPA, the Clean Water Act and the Endangered Species Act

Questions?

- Larry A. Demase
 - (412) 288-4050
 - ldemase@reedsmith.com



GHG Permitting and Biomass

Jennifer A. Smokelin, Esq.

Reed Smith LLP

jsmokelin@reedsmith.com

ReedSmith

The business of relationships.™

GHG Guidance: Biomass

- EPA received requests to exclude emissions of GHG from bioenergy and other biogenic sources for the purposes of the BACT analysis and PSD applicability.
 - **Why special treatment?**
 - **Biogenic CO₂ emissions are defined** as emissions of CO₂ from a stationary source directly resulting from the combustion or decomposition of biologically-based materials other than fossil fuels.
- **The applicability to both PSD and the Title V programs is dependent on whether the stationary source meets certain emissions thresholds.**
- On June 3, 2010, EPA issued the **Tailoring Rule and established two steps to implement PSD and Title V.**
 - Tailoring Rule Step 1 began on January 2, 2011. Step 1 applies to sources **75,000 tpy CO₂e** (or increase emissions by that amount for modifications);
 - Tailoring Rule Step 2 begins on July 1, 2011. In addition, Step 2 applies to new facilities emitting **GHGs in excess of 100,000 tpy CO₂e and facilities making changes that would increase GHG emissions by at least 75,000 tpy CO₂e, and that also exceed 100/250 tpy of GHGs on a mass basis.**

ReedSmith

The business of relationships.™

Recent Developments: Biomass and GHG Permitting

- EPA published a Call for Information in **July 2010** to obtain scientific and technical information concerning GHG resulting from the use of biomass and PSD
 - Some data supporting the conclusion that certain biomass such as waste materials whose inevitable decomposition will result in greenhouse gas emissions anyway and have only very limited climate impacts when combusted as fuel.
 - However, other data received indicating that the use of certain other biomass as fuel could have more significant climate impacts
- **January 12, 2011:** EPA announced will undertake an expedited rulemaking to be completed by July 1, 2011 to defer application of pre-construction permitting requirements to biomass-fired CO₂ and other biogenic CO₂ emissions for a **period of three years**.
 - EPA will initiate a **scientific examination** with partners from other federal agencies and scientists outside the government with relevant expertise to assist the agency in determining how CO₂ emissions from biomass should be handled under PSD.
 - In the interim, EPA has said it will issue guidance that will provide a basis for states and local agencies can use to conclude that BACT for GHG at such sources is combustion of biomass fuels alone.

ReedSmith

The business of relationships.™

Current status of Interim Guidance and Proposed Deferral rulemaking

- The proposed deferral/interim guidance promulgated 3.11.2011
 - See, <http://www.epa.gov/NSR/> :**Proposed Deferral (96 pgs) and Guidance (35 pgs)**
 - public comments on the proposed deferral for 45 days following publication in the Federal Register. www.regulations.gov.
 - public hearing will be held in Washington, DC. Details will be available shortly.

Summary

Proposed Deferral:

- Scope of the Proposed Deferral wider than the scope of the Interim Guidance: all sources of biogenic CO2 emission v. "bioenergy facilities"
- EPA final action on the proposed deferral rule: July 2011

Interim Guidance:

- applies to bioenergy facility
 - "bioenergy facility" is defined as a facility that generates energy via the combustion of biologically-derived material other than fossil fuels, for example wood, biosolids, or agricultural products. This could be undertaken either alone or in addition to traditional fossil fuels.
- Interim Guidance intended to supplement the 2010 GHG BACT Guidance and not to supersede it. If not a Bioenergy facility, 2010 GHG BACT Guidance applies
- EPA believes the analysis described in guidance will be sufficient in most cases to support the conclusion that utilization of biomass fuel alone is BACT for a bioenergy facility.

ReedSmith

The business of relationships.™

Questions?

- Jennifer Smokelin
 - (412) 288-3016
 - jsmokelin@reedsmith.com



Will a Clean Energy Standard Win the Future?

David W. Wagner, Esq.
Reed Smith LLP
dwwagner@reedsmith.com

ReedSmith

The business of relationships.™

The 2011 State of the Union

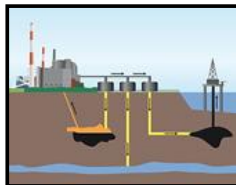
- President urged lawmakers to establish a clean energy standard (CES)
- Goal: 80% of the nation's electricity to come from "clean" sources by 2035
- Framed CES in larger context of improving US competitiveness in global economy.

What Is a CES?

- Would require electric utilities to generate a portion of power from sources that emit less carbon dioxide such as solar and wind power.
- Not just renewable energy

CES Would Include:

- Nuclear, coal with carbon capture and storage, and natural gas, as well as solar, wind, bioenergy, geothermal and hydroelectric power.



ReedSmith
The business of relationships.™

How a CES Would Work

- Electricity supply companies would have to produce a certain percentage of their electricity from clean energy sources, purchase a like amount of credits, or a combination of both.
- Certified clean energy generators would earn credits for every unit of electricity they produce and could sell these along with their electricity to supply companies.
- The electricity companies submit the credits to a regulatory body to demonstrate compliance.

CES Design Elements to Consider

- Determining Partial Credits for Carbon Capture & Storage and Natural Gas

How to calculate?

- Cost Caps on Utilities
- Scope of Program Coverage



ReedSmith
The business of relationships.™

More CES Design Considerations

- Status of State RPS Programs

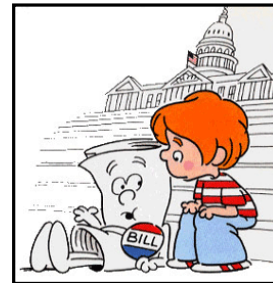
What would happen to the varying Renewable Portfolio Standards (RPS) currently in place in about 30 states?

- Penalties for Non-Compliance

- Cost Recovery by Utilities

Political Wrangling

- More gas means less coal
- Strong support for coal
- Government mandate
- Will the prospect of suspending EPA's greenhouse gas regulations in exchange for a clean energy standard be used as a negotiating tool?



For More Information

See our blog, the Environmental Law Resource:

[www.environmentallawresource.com/2011/02/articles/
climate-change/will-a-clean-energy-standard-win-
the-future/](http://www.environmentallawresource.com/2011/02/articles/climate-change/will-a-clean-energy-standard-win-the-future/)

Questions?

- Dave Wagner
 - dwwagner@reedsmith.com
 - (412) 288-4056

ReedSmith
The business of relationships.™

**AB32 Litigation:
Protecting the Environment or Simply
“Irritating” Your Prospective Business Plans?**

Todd O. Maiden, Esq.

Reed Smith LLP

tmaiden@reedsmith.com

ReedSmith

The business of relationships.™

Background

- 2006: CA passes Global Warming Solutions Act (AB32) to regulate GHGs
 - By 2020, cut GHGs to 1990 levels
 - Reliance on “Scoping Plan” as a blueprint
 - Incorporation of a cap and trade program

California Environmental Quality Act

- Requires assessment of environmental impacts from government approvals, actions, programs
- Must address potentially significant impacts
- Must discuss “feasible alternatives” to proposed program or actions
- Allow for adequate public notice and comment on proposed actions

Subsequent CARB Actions to Implement

- 2008: CARB adopts Resolution 08-47: decision to implement Scoping Plan
- 2009: CARB holds workshop and responds to public comments

June 2009 Petition for Writ of Mandate from Environmental Justice Community

- Association of Irritated Residents (AIR)
- Communities Against Toxics
- Communities for a Better Environment
- Society for Positive Action
- West County Toxics Coalition

ReedSmith

The business of relationships.™

Two Arguments

- CARB improperly interpreted and failed to comply with substantive provisions of AB32
- CARB violated California Environmental Quality Act by over-reliance on Functional Equivalent Document (FED)

AB32 Arguments

- Scoping Plan improperly used statewide emissions limit as emissions reduction target (min. vs. max.)
- Failed to ID cost effectiveness of Max. Technologically Feasible Measures
- Cap & Trade: not the max. feasible and cost effective alternative

CEQA Arguments

- CARB failed to adequately consider or analyze feasible alternatives
 - Functional Equivalent Document insufficient replacement for full CEQA analysis

- Five alternatives offered
 - No action (required by law)
 - Remaining four alternatives covered in three pages – insufficient

- “Adoption” of Resolution 08-47 premature
 - CARB lacked public comments at the time

ReedSmith

The business of relationships.™

Outcome

- Dec. 19, 2010: Hearing on Petition
- Jan 24, 2011: **Tentative** ruling
 - Package of measures in the Scoping Plan was Legal
 - CARB's "quasi-legislative authority"
 - wide latitude" under **arbitrary and capricious standard** of review
 - Analysis of the alternatives to measures, and the process used to pass the plan was defective
 - **set aside certification** of FED
 - **postpone implementation** of Scoping Plan until compliance with CEQA
 - **Abuse of discretion standard** of review

Feb. 8: Parties File Objections

- CARB: objections and request for rehearing
 - CEQA analysis adequate – cited October 2010 CARB staff report analyzing GHG reduction alternatives
 - Asks that CARB be allowed to keep on track while remanding to re-analyze the alternatives

Final Ruling and Business Implications

- Final ruling by March 18?
- Assume Tentative will be Final
- Assume Ultimate CEQA Compliance
- Expect guidance on balance of AB32 programs (both parties want this)
- Plan as if AB32 on track – Jan. 1, 2012
- Interim impacts expected

Questions?

- Todd O. Maiden
 - (415) 659-5918
 - tmaiden@reedsmith.com



APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

AVENAL POWER CENTER, LLC)

Plaintiff,)

v.)

U.S. ENVIRONMENTAL PROTECTION)
AGENCY and LISA P. JACKSON, in her)
capacity as Administrator of the)
U.S. Environmental Protection Agency)

Defendants.)

Case No.: 1:10-cv-00383-RJL
(Hon. Richard J. Leon)

DECLARATION OF REGINA MCCARTHY

I, Regina McCarthy, declare under penalty of perjury under the laws of the United States of America that the following is true and correct to the best of my knowledge, information and belief, and is based on my own personal knowledge or on information contained in the records of the United States Environmental Protection Agency (EPA) or supplied to me by EPA employees.

1. I am the Assistant Administrator of the Office of Air and Radiation in EPA, a position I have held since June 2009. The Office of Air and Radiation (OAR) is the EPA office that develops national programs, technical policies, and regulations for controlling air pollution. OAR's assignments include the protection of public health and welfare, pollution prevention and energy efficiency, air quality, industrial air pollution, pollution from vehicles and engines, acid rain, stratospheric ozone depletion, and climate change.
2. OAR is responsible for development of National Ambient Air Quality Standards and the development and implementation of regulations, policy, and guidance associated with the Prevention of Significant Deterioration (PSD) permitting program.
3. Prior to joining EPA, I served as the Commissioner of the Connecticut Department of Environmental Protection. I have worked at both the state and local levels on critical environmental issues, and helped coordinate policies on economic growth, energy, transportation and the environment. I have a B.A. in Social Anthropology from the University of Massachusetts at Boston and a joint M.S. in Environmental Health Engineering and Planning and Policy from Tufts University.
4. On February 9, 2010, EPA issued a National Ambient Air Quality Standard (NAAQS) for hourly concentrations of nitrogen oxides ("hourly NO₂ standard").

5. In a prior declaration, I testified that applicants seeking PSD permits to construct stationary sources of air pollution have experienced unforeseen challenges with the preparation and review of information to predict the impact of proposed sources on hourly NO₂ concentrations. This gave rise to an EPA policy review that has now proceeded to the point that the agency can more specifically explain how it intends to move forward with action on the PSD permit application submitted by Avenal Power Center ("Avenal"). See paragraphs 5-8, Declaration of Regina McCarthy (January 7, 2011).

6. As part of this policy review, EPA has determined that it is appropriate, under certain narrow circumstances, to grandfather certain PSD applications from the requirement to demonstrate that the proposed facility will not cause or contribute to a violation of the hourly NO₂ standard. In addition, EPA believes the factors that justify such an approach for the hourly NO₂ standard also provide a basis not to subject these same permit applications to additional permitting requirements that have taken effect during the period of time these permit applications have been pending and permit applicants have been seeking to compile the additional information necessary to demonstrate that the source will not cause or contribute to a violation of the hourly NO₂ standard. The PSD permit application submitted by Avenal in 2008 is among those PSD permit applications that EPA believes it is appropriate to grandfather from these additional requirements, particularly in light of EPA's statutory obligation to grant or deny a complete PSD permit application within one year and other circumstances present in this case. EPA will propose to extend similar relief to other permit applicants that can show they are similarly situated. This determination represents a change in the position EPA has taken in this matter and in previous interpretive statements issued by EPA, including statements cited by EPA to support its Cross Motion for Summary Judgment in this litigation.

7. Because this change in position requires that EPA modify or narrow previous interpretations of EPA regulations and the position EPA has taken in public statements to this court regarding this permit, the Agency reads applicable regulations and case law to require that the EPA provide the public with an opportunity to comment on this proposed action before the Agency can issue a final decision on the pending permit application that exempts Avenal from these additional requirements.

8. EPA intends to issue a supplemental public notice that will request comment on EPA's proposal to approve Avenal's application without requiring a demonstration that this source will not cause a violation of the hourly NO₂ standard. In addition, this notice will also request comment on EPA's proposal not to require this source to meet emissions limitations for greenhouse gases or to demonstrate that the proposed source will not cause or contribute to a violation of the National Ambient Air Quality Standards for hourly concentrations of sulfur dioxide which became effective on August 23, 2010. The notice will also inform interested persons of the opportunity to provide comments on these subjects at a public hearing.

9. As a result of a recent ruling by the EPA Environmental Appeals Board, EPA has also determined that it is necessary to supplement its analysis of whether minority and low income communities may be disproportionately affected by emissions of NO₂ from the Avenal facility. See, *In re: Shell Gulf of Mexico, Inc. and Shell Offshore, Inc.*, OCS Appeal Nos. 10-1 to 10-4, Slip. Op. at 63-81 (EAB December 30, 2010). A copy of this decision may be obtained at

[http://yosemite.epa.gov/oa/EAB_Web_Docket.nsf/OCS+Permit+Appeals+\(CAA\)?OpenView](http://yosemite.epa.gov/oa/EAB_Web_Docket.nsf/OCS+Permit+Appeals+(CAA)?OpenView).

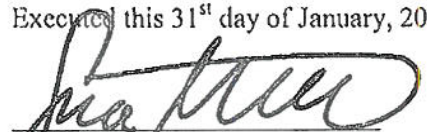
10. EPA is in the process of drafting a supplemental statement of basis to explain its justification for exempting Avenal from these additional requirements described above and to provide a supplemental analysis concerning disproportionate impacts to minority and low income communities. EPA requires an additional 3 weeks to complete this document.

11. Once the document described in paragraph 10 is completed, EPA requires an additional 3 weeks to complete and arrange for publication and direct mail distribution of the public notice. This time is necessary to translate the public notice into Spanish, book the public hearing venue and court reporter to transcribe the hearing, provide advanced copies of the public notice to newspapers for publication, and complete the procurement processes for such services. From the date this notice is published and distributed, EPA will require approximately 5 weeks to complete the public comment and hearing process, in order to allow the 33 days for public comment required by 40 CFR 124.10(b) and 124.20(d) and several additional days for completion of the public hearing. EPA is required to hold a public hearing if requested by any interested person, to provide 33 days notice of such a hearing, and to keep the public comment period open until the hearing concludes. 40 CFR 124.12; 40 CFR 124.10(b)(2); 124.20(d). EPA anticipates based on prior public comments on this permit that a public hearing will be requested. Thus, to expedite the public comment process as much as possible, EPA will provide public notice of the hearing at the same time as public notice of the supplemental statement of basis. In light of the scope of the issues addressed in the supplemental statement of basis, public interest in such matters, and volume of public comments EPA expects to receive, once the comment period ends, EPA will require an additional 6 weeks to consider public comments, prepare responses thereto, and issue a final permit decision in accordance with 40 CFR 124.15.

12. A least four EPA career staff persons and several additional supervisors already familiar with the subject matter are assigned to prepare and review these actions by EPA. The career staff preparing initial drafts of the necessary documents include an Environmental Engineer and Air Permits Manager in EPA's Region 9 office and staff attorneys from both the Region 9 Office of Regional Counsel and the Office of General Counsel at headquarters. At least 5 additional staff and supervisors in Region 9, the headquarters Office of Air and Radiation, and the Office of General Counsel will need to review and approve these actions. The timetable described above cannot be expedited by reassigning additional EPA staff because the time required for such persons to obtain the necessary familiarity with the technical and factual background on this permit application and the issues it presents (and already-assigned staff to train such persons) would offset any benefit from having more manpower involved.

13. After consideration of public comments the Agency may receive in response to this public notice, EPA will be able to complete final action on this permit application by May 27, 2011, as I have previously testified.

Executed this 31st day of January, 2011.



Regina McCarthy

Assistant Administrator
Office of Air and Radiation
United States EPA