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EPA Process vs. Texas Results

Flexible Permits: Understanding the Dispute Between the World's Two Largest Environmental Agencies

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Introduction

On June 15, 2010, the U.S. Environmental Protection Agency (EPA) ruled that the Texas Flexible Permit Program (FPP) does not comply with federal law.[1] This decision to reject and nominally federalize a major Texas air quality permitting program occurs at a perplexing juncture. **See Sidebar.**

Over the last decade, as the Texas population grew by over 4 million people and the state economy grew by a rate of 40 percent, Texas air quality dramatically improved—thanks in large part to the FPP. The Houston region, in years past vying with Los Angeles as the most ozone-polluted part of the country, reduced ozone levels from 119 parts per billion (ppb) in 1999 to 84 ppb in 2009. The home of the nation's largest petrochemical industrial complex, Houston, TX, *met* the still legally binding 85 ppb federal ozone standard.[2]

In spite of the evidence that it is working, EPA decided that the Texas FPP violates the Federal Clean Air Act (CAA). Through this action, EPA is rejecting a state regulatory program that is key to the air quality improvement in Texas over the last 10 years. The Texas FPP is an optional performance-based permitting regime. The permit sets strict emission caps for each facility and allows some flexibility to operate under the caps. By contrast, the traditional federal permitting regimes require emission limits on individual pieces of equipment and prescribe methods to reduce emissions. EPA claims the Texas FPP "hides" emissions, shields industrial facilities from more stringent federal requirements and lacks enforceability.

This disagreement between the world's two largest environmental agencies is technical in nature, but it has high stakes for the Texas environment and economy. EPA's invalidation of the Texas FPP leaves hundreds of Texas businesses without a solid legal authorization to operate, putting thousands of jobs at risk. The regulatory resolution for this legal limbo, however, EPA has yet to spell out.

- Will EPA take over the issuance of new 'non-flexible' permits? Or will TCEQ retain its delegated authority to issue and enforce the federal permits?
- Will EPA accept TCEQ's proposed changes to the FPP? Or will EPA reject the flexible approach and demand new, command and control permits, the administrative process for which can take two to three years?
- Will EPA allow current flexible permit holders to operate under provisional state permits? Or will EPA enforce against industries with flexible permits?
- Will EPA try to fast-track regulation of carbon dioxide into these permits under its self-proclaimed new authority to regulate greenhouse gases?
- Will the federal courts hold that the Texas FPP complies with the CAA and that EPA arbitrarily and capriciously exceeded its authority in violation of the Administrative Procedures Act ?

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SIDEBAR: Flexible Permitting Results

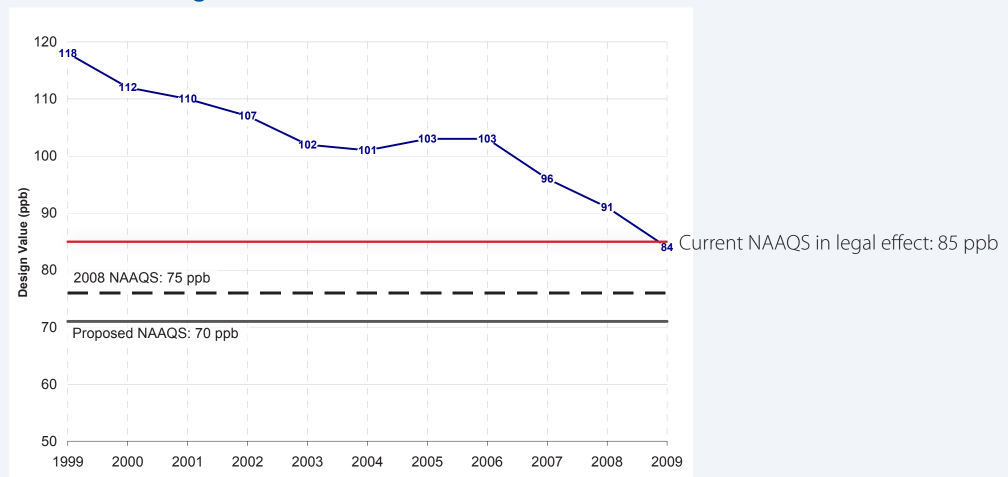
Texas has become a national leader in effective and innovative environmental programs. From 2000-08, Texas lowered nitrous oxides (NOx) levels by 46 percent and ozone levels by 22 percent. Over the same period, national NOx levels fell by only 27 percent and ozone levels declined by only 8 percent. Stationary sources in the Houston area decreased ozone-forming NOx emissions from 650 tons per day in 1993 to 156 tons per day in 2008. All major urban areas in Texas currently meet the federal eight-hour ozone standard of 85 ppb, with the exception of the Dallas-Fort Worth area (DFW) at only 1 ppb above the limit. DFW, however, reduced ozone levels from 96 ppb in 2006 to 86 ppb in 2009, a remarkable improvement.

Houston also decreased highly reactive volatile organic compounds (HRVOCs) by 50 percent. In 2008, all benzene monitors in and around Houston measured levels below the long-term level for healthy air. According to EPA's acid rain data base, the NOx emission rate at Texas power plants is 38 percent less than the national average. Texas attains the national Ambient Air Quality Standards for nitrogen dioxide, sulfur dioxide and carbon monoxide.[3]

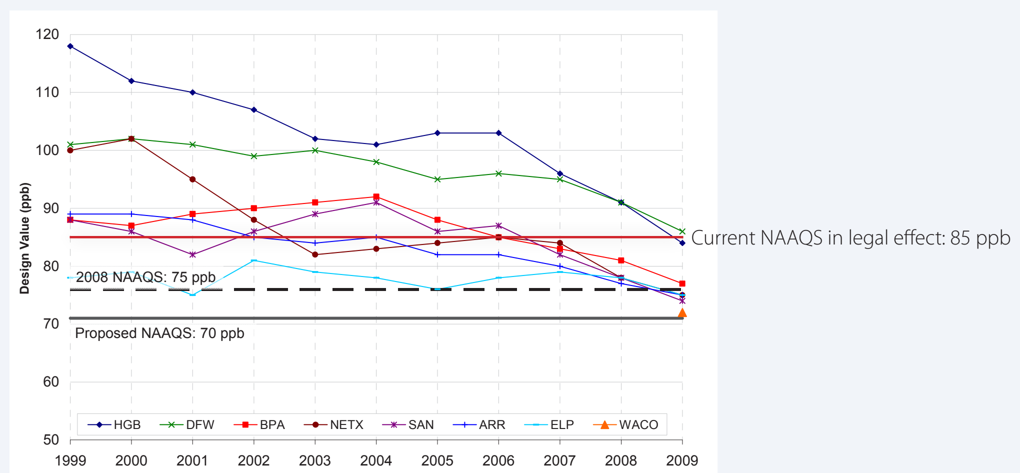
Stringent, innovative, and targeted controls along with voluntary efforts based on cutting-edge science drove these improvements in Texas air quality. Thousands of Texans worked on this effort. The Governor, the Texas Legislature, TCEQ, EPA, local governments, industry, business, private organizations, and individual Texans rolled up their sleeves and cleaned the air of Texas.

The Texas Flexible Permitting Program significantly contributed to the dramatic improvement in air quality, particularly in the Houston region. Coal and petroleum coke-fired power plants with flexible permits have decreased sulfur dioxide (SOx) by 25,803 tons per year (tpy) and NOx by 10,330 tpy and particulate matter by 795 tpy. For refineries, flexible permits decreased SOx by 3.9 tpy, NOx by 15,844 tpy and volatile organic compounds by 920 tpy.[4]

Eight-Hour Ozone Design Values for the Houston-Galveston-Brazoria Area



Eight-Hour Ozone Design Values by MSA



"Regulatory uncertainty is the enemy of economic development," said one senior executive for the largest refinery company in Texas recently. "If you can't estimate the value of a project, you don't make the investment."[5]

Core of the Issue

As a performance-based regulation, Texas flexible permits put the priority on "what;" i.e., the bottom-line environmental results. Under the emission caps, the operator of a complex industrial facility may choose how most efficiently to achieve the environmental mandates. EPA's quarrel with the Texas FPP puts more priority on "how"—how the permit details every mandate and how legal compliance is proved. Although EPA has yet to conclude what will make the FPP legally acceptable, EPA apparently wants TCEQ to impose more prescriptive dictates for individual pieces of equipment instead of facility-wide emission caps.

Federal and State Authorities—Conflicting or Cooperating?

The legal relation between EPA and TCEQ involves overlapping authorities. EPA's rejection of the state's FPP relies on an EPA power to approve all state rules relevant to the State Implementation Plans (SIP). Yet EPA, acting under SIP authority, is superseding the state authority otherwise federally delegated to TCEQ. The federal Clean Air Act (CAA), Federal New Source Review (FNSR) permitting rules, federal Title V operating permits rules, Texas State Implementation Plans for Ozone, and the Texas Clean Air Act are all interwoven in the current dispute.

The federal CAA sets out different roles for the federal and state governments. Once characterized as an example of cooperative federalism, the CAA directs EPA to establish standards and gives states discretion to establish the path to attain them. In an early iteration of the federal CAA, Congress found "that prevention and control of air pollution at its source is the primary responsibility of the States and local government."[6] Subsequent amendments increased EPA's oversight authority over state decisions, but always re-affirmed the state's role in implementing federal dictates.

For decades, EPA and TCEQ have predominantly cooperated as partners. In recent years, however, EPA has assumed a more heavy-handed and adversarial role, treating the state agency more as an instrument of the federal government than as a partner. TCEQ has long been in discussions with EPA about federal approval of the FPP. But, in 2007, instead of acting on the FPP rules, EPA sent letters to all flexible permit holders in Texas, implying their flexible permits were not federally valid.

Faced with uncertainty about the legal status of their permits, a business group filed suit in 2008 to compel EPA to make a final decision on the FPP as well as 30 other state rules which EPA had suspended in legal limbo for years.[7] Federal law requires EPA's final decisions on these SIP related state rules within 18 months of the state's submission. EPA's decisions were over 10 years late for many of the 30 state rules in question. In a settlement of the litigation, EPA agreed to a schedule for final action through a Consent Decree issued by a federal court in Dallas.[8]

This lawsuit heightened TCEQ's negotiations with EPA about the state's FPP. To accommodate EPA's concerns, TCEQ proposed revisions to the rules in question on May 28, 2010.[9] Acting on the timetable in the Consent Decree, EPA, however, issued its final rule disapproving the Texas FPP. EPA's invalidation of the state rules acknowledged but gave no consideration to TCEQ's proposed rule changes.[10]

On July 23, 2010, Attorney General Greg Abbott challenged EPA's disapproval in a Petition for Review before the U.S. Court of Appeals for the Fifth Circuit.[11] TCEQ continues negotiating with EPA to resolve this dispute. In addition to changes in the FPP rules, TCEQ has proposed an alternative permitting mechanism to "de-flex" the current flexible permits—intended as a quick means of putting the many businesses with flexible permits back into compliance. In the meantime, EPA has created a cloud of regulatory uncertainty that can only reduce business activity, weaken the state's economy, and eliminate jobs.[12]

Impact on Texas

The full consequences of EPA's action are still unclear. EPA's final disapproval, however, apparently suspends the permitting authority delegated to the state by EPA. In addition, EPA has asserted federal control over several flexible permits and threatened enforcement against over 120 entities operating under state flexible permits. These permits cover most refineries, chemical plants, large manufacturing plants and some power plants, a large portion of the Texas industrial base. Thousands of Texas jobs flow from these

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industries. Among the many businesses left hanging are the new $6.5 billion Motiva Refinery in Port Arthur and Total's $3 billion investment in a refinery expansion. As a result of EPA's action, the predictable regulatory system that business needs to remain efficient and competitive is now fractured.

Although the dispute is between EPA and TCEQ about rule language, EPA now considers the hundreds of facilities, *although in full compliance with state rules*, to be in violation of the federal Clean Air Act and subject to enforcement if EPA so chooses. Even before final invalidation of the TCEQ rules in late June, EPA brandished the coercive club of enforcement authority. EPA proposed in the Federal Register an Audit Program for Texas Flexible Permit Holders accompanied by a Consent Agreement and Final Order; i.e., an enforcement decree. Labeled as voluntary, the audit agreement to *allow continued operation* "is not subject to negotiation," requires an admission of violating federal law, and mandates payment for a "community project," none of which is required by federal law.[13]

The Texas Flexible Permit Program

In 1994, EPA delegated air quality permitting authority under the CAA to the Texas Natural Resource Commission (TNRCC), the predecessor agency of the TCEQ. The agency then developed the Flexible Permitting Program to encourage grandfathered facilities to adopt emission controls not otherwise legally required. The rules were designed to allow some operational flexibility under an enforceable emission cap instead of individual limits on individual emission sources. Although EPA was required to approve—or disapprove—TCEQ's rule within 18 months after the state's submission, EPA did not respond until the June 30, 2010 disapproval. Over those 16 years, the state issued over 120 flexible permits with no formal EPA opposition. As result, Texas, unlike many other states, no longer has any grandfathered facilities under the federal CAA.

The distinguishing feature of the Texas FPP is the use of pollutant-specific emission caps in contrast to emission limits for individual pieces of equipment as required in traditional federal New Source Review (NSR) permitting programs such as Prevention of Significant Deterioration (PSD) and New Source Non-Attainment Review (NNSR) permits. In Texas Flexible Permits, the emission caps are established according to Best Available Control Technology (BACT) limits for all facilities contributing to the cap and use worst case scenarios to calculate the caps.[14]

Stricter than federal rules, the Texas FPP requires BACT emission controls even on minor (smaller) sources of emissions. Emission caps are set for specific emission categories, typically for federal criteria pollutants and Volatile Organic Compounds (VOCs). Individual emission limits for specific pollutants, such as toxics, may also be applied.

The "flexibility" in the Texas permits extends to control technology and operation. Control flexibility means the permit holders may "over control" one facility by going beyond BACT established emission caps "in order not to add additional controls at another facility, provided that the net sum of emissions is at least as stringent as BACT being applied to each existing facility."[15] Operational flexibility is allowed "to the extent that a permit holder may vary throughput rates, charge rates, firing rates, etc., as long as control requirements are met and compliance with emission caps and/or individual emission limits is maintained."[16]

EPA Concerns

EPA's concerns revolve around two primary issues: federal applicability and federal enforceability. EPA claims the Texas flexible permits likely conceal the full volume of pollutants at issue and thus shield the business from more onerous federal requirements. EPA also maintains that the permit terms are not detailed enough to prove compliance. TCEQ's extensive responses to EPA explain how the state rules, indeed, prevent the flexible permit holder from circumventing federal (NSR) rules and establish enforceability.[17] In truly cooperative federal-state programs, a measure of mutual trust is necessary.

Later amendments to the original CAA diminished the basis for federal trust of state decisions. As David Schoenbrod, former senior litigator for the Natural Resources Defense Council and current professor at the New York Law School, has observed, "The EPA is built on the premise that no one below it in the chain of command, including state and local government, can be trusted."[18]

Under the Texas FPP, when a permit application for new emission source or an amendment to an existing permit triggers additional federal requirements because of emission volumes, pollutant type or location in a non-attainment area, TCEQ imposes all the federal requirements. As an example, one of the facilities whose flexible permit was recently federalized by EPA had its emission cap for NOx, over time, lowered 90 percent from when the first emission cap was set in 1994. If the analysis triggers more stringent limits, such as for federal PSD or NNSR (non-attainment review) requirements, the tighter limits, such as Lowest Available Emission Rate (LAER), are plugged into the emission cap and offsets are stipulated. TCEQ consolidates the state flexible permit and the federal NSR permit into one document with different permit numbers. Nothing in the CAA prohibits this use of emission caps.

TCEQ's rules require flexible permit holders to conduct monitoring and record-keeping sufficient to assure compliance. Special conditions stipulate the methods to verify compliance. TCEQ requires the same methods used in traditional federal permits: compliance stack testing, periodic stack testing, continuous emissions monitoring and other parametric monitoring, as well as record keeping. Because of the wide variety of industries authorized under flexible permits in Texas, the TCEQ may tailor the compliance requirements to the specific facility, process and equipment involved. One size has never fit all in Texas! EPA, however, tends to view site-specific variation with suspicion.

EPA's Previous Support for Federal Flexible Air Permits

Oddly, EPA headquarters has for years supported flexible permitting schemes conceptually identical to the Texas program.

Since the milestone amendments to the CAA in 1990, EPA has promoted the environmental benefits of emission caps. When EPA promulgated rules for the new Title V of the CAA in 1990, EPA required states to create permitting programs that allow operational flexibility.[19] "It is possible to use … these regulations to allow for operational flexibility around federally enforceable emission limits or caps."[20]

Even before Texas developed the FPP in 1994, EPA carried out a study on the effectiveness of regulating under emission caps versus individual emission limits. "Regulators had set limits on the amounts of pollution that could come out of each of [the refinery's] many smokestacks, pipes, and vents and, further, prescribed the methods to be used to achieve those limits. Researchers asked the refinery managers whether, if freed from these highly particular instructions, they could achieve similar environmental results more economically."[21] The refinery proved that it could get 97 percent of EPA's required emission reductions when it chose the methods of control and at 25 percent of the cost of EPA's detailed approach. "These savings could be achieved if a facility-wide release reduction target [emission cap] existed […] if regulations did not prescribe the methods to use, and if facility operators could determine the best approach to reach that target."[22]

EPA introduced a federal Plant-Wide Applicability Limit (PAL) permitting mechanism similar to the Texas FPP in 1996, described as "an emissions cap or an emissions budget, an annual emissions limit that allows managers to make almost any change anytime as long as the plant's emissions do not exceed the cap."[23] In a subsequent rule making, EPA again underlined the benefits of emission caps. "Overall, we found significant environmental benefits [….] We found that in a cap-based program, sources strive to create enough headroom [under the emission cap] for future expansions by voluntarily controlling the emissions."[24] And as recently as October 2009, EPA promulgated rules for federal Flexible Air Permitting (FAP). "The purpose of this rulemaking is to clarify and reaffirm opportunities within the existing regulatory framework to encourage the wider use of the FAP approaches."[25]

Why has EPA invalidated the Texas Flexible Permitting Program, taken over several major facilities' permits, and threatened enforcement against more than 100 major Texas businesses in full compliance with their Flexible Permits? If Texas air quality were declining, EPA's actions might be warranted. Measured levels at the many Texas air quality monitors, however, demonstrate the success of the state's air quality programs.

The large capital investments and advanced planning necessitated in complex industries cannot long operate in a capricious legal climate or one that not only dictates *what* environmental standard business must meet but also how business must operate.

Most of the flexible permits are held by large industrial facilities in the Houston region where the greatest air quality improvement has occurred. Why is EPA not applauding Texas as an example for other states lagging far behind the environmental record of this state? The conflict between EPA and TCEQ about permit terms is absorbing resources more prudently focused on actual environmental improvement. Federal law, however, gives EPA broad authority to trump state authorities—if EPA elects to fully use the federal club. As Schoenbrod observes, "EPA talks flexibility but generally practices rigidity."[26]

Over the last four decades, the scope of EPA's regulatory authority has steadily increased to the point where regulation of environmental impact is tantamount to regulation of basic economic activity. A federal air quality permit may directly control only emissions but indirectly controls what is produced and how it is produced. In the words of one founding trustee of the Environmental Defense Fund whose view of EPA has changed over the years: the EPA's regulation "has grown to the point where it amounts to nothing less than a massive effort at Soviet-style planning of the economy in order to achieve environmental goals."[27]

Rule of Law

The protracted disagreement between EPA and TCEQ about air quality rules may seem an idle dispute. EPA actions, however, jeopardize the economic vigor, environmental improvement, and stable regulatory climate Texas has achieved over the last decade. The stakes are high. EPA's actions have ruptured the stability of the regulatory system and the constitutional due process guarantees that have long distinguished federal regulation in the U.S. from governmental actions typical of autocratically-ruled countries.

To plan and thus prosper, business depends upon a predictable legal system in which to operate. When environmental regulations and permits no longer secure clear and reliable obligations, legal uncertainties freeze business decisions. Industries then relocate to more stable legal environments in which to operate. The large capital investments and advanced planning necessitated in complex industries cannot long operate in a capricious legal climate or one that not only dictates *what* environmental standard business must meet but also how business must operate. The heretofore reasonable regulatory climate is a major reason why the U.S., and particularly Texas, has attracted and kept more successful businesses than countries like Venezuela and states like California. The issue is not primarily how stringent are the rules but how reliable the rules and regulatory process will remain.

It is vital that Texas retain the state air quality permitting authority through the "cooperative federalism" originally intended by the CAA. Texas authority will provide greater environmental accountability. Local knowledge matters. The state, through TCEQ, is closer to the regulated entity and the communities in which businesses operate. TCEQ staff has hands-on knowledge of the regulated entities, and a far more practical understanding of real world effects, than distant bureaucrats in Washington, D.C. Texans care deeply about healthy air quality and a healthy economy. Measured, ongoing environmental results in Texas must trump process and paper control by an EPA turned adversarial. ✩

Endnotes

[1] EPA, Approval and Promulgation of Implementation Plans; Texas; Revisions to the New Source Review (NSR) State Implementation Plan (SIP); Flexible Permits; Final Rule, 75 Fed. Reg. 41,312 (July 15, 2010) Docket ID No. EPA-R06-OAR-2005-TX-0032.

[2] Comments attachment from Texas Commission on Environmental Quality on EPA proposed rulemaking, Approval and Promulgation of Implementation Plans; Texas; Revisions to the New Source Review (NSR) State Implementation Plan (SIP); Flexible Permits, 74 Fed. Reg. 48,480 (Sept. 23, 2009) Docket ID No. EPA-R06-OAR-2005-TX-0032.

[3] Susana Hildebrand, TCEQ Chief Engineer, *Update of Air Quality in Texas* (presented at Oct. 29, 2009 Commission Work Session) http://www.tceq.com.

[4] TCEQ, *supra note* 2.

[5] Valero Energy Corporation Vice President Rich Walsh, Oral Testimony to the Texas Senate Natural Resources Committee, August 18, 2010.

[6] 42 U.S.C.S. § 7401. (For original language on "primary responsibility of States and local governments" see "Amendments—1990—Subsec. (a)(3)" in the annotations to §7401).

[7] Complaint, *BCCA Appeal Group v. EPA*, No. 3-08CV1491-G (N.D. Texas 2008). A large group of businesses filed a citizen's suit under the CAA to compel EPA to perform a non-discretionary duty to take final action on the over thirty state rules requiring EPA approval. The CAA dictates that EPA must take final action on the state rules within 18 months after the state submits the rules for EPA consideration. Many of the state rules at issue had been pending before EPA for over a decade.

[8] Consent Decree, *BCCA Appeal Group v. EPA*, No. 3-08CV1491-G (N.D. Texas 2008).

[9] TCEQ, Flexible Permit Program Revisions, 2010-007-116-PR (June 16, 2010) http://www.tceq.state.tx.us/rules/prop.html.

[10] Supra Note 3. EPA could have delayed final disapproval of the FPP and given full consideration to TCEQ's changes to the flexible permit rules. The Consent Decree explicitly provides for modification of the stipulated schedule: "Any motion to modify the schedule established in this Consent Decree may be accompanied by a motion for expedited consideration. Neither Party to the Decree shall oppose such a motion for expedited consideration."

[11] Petition for Review, Texas v. EPA, No. ___ (5th Cir. July 23, 2010).

[12] Letter from Bryan Shaw, Chairman, TCEQ, to Alfredo Armendáriz, Regional Administrator, EPA (Aug 9, 2010).

[13] EPA, Audit Program for Texas Flexible Permit Holders, 75 Fed. Reg. 34,445 (June 17, 2010).

[14] 30 Tex. Admin. Code §§ 116.710 et seq. (2010).

[15] TCEQ, *supra note* 2.

[16] Ibid.

[17] Ibid.

[18] David Schoenbrod, *Saving our Environment from Washington*, 64 (Yale 2005).

[19] 40 C.F.R. § 70.4 (b)(12)(iii).

[20] 57 Fed. Reg. 32,250 at 32, 627 (July 21, 1992).

[21] Schoenbrod, *supra*, p. 183, quoting, Howard Klee, Jr. and Mahesh Podar, Amoco/USEPA Emission Prevention Project: Executive Summary (Amoco & EPA, May 1920, at v).

[22] Ibid.

[23] 61 Fed. Reg. 38,250 at 38,251 (July 23, 1996).

[24] 67 Fed. Reg. 80,186 at 20,027 (Dec. 31, 2002).

[25] 75 Fed. Reg. 51,418 (Oct. 6, 2009).

[26] Schoenbrod, *supra*, p.184.

[27] Richard B. Stewart, Controlling Environmental Risks through Incentives, 13 *Columbia Journal of Environmental Law* 153, 154. (1988).

About the Author

Kathleen Hartnett White joined the Texas Public Policy Foundation in January 2008. She is a Distinguished Senior Fellow-in-Residence and Director of the Armstrong Center for Energy & the Environment. Prior to joining the Foundation, White served a six-year term as Chairman and Commissioner of the Texas Commission on Environmental Quality (TCEQ). With regulatory jurisdiction over air quality, water quality, water rights & utilities, storage and disposal of waste, TCEQ's staff of 3000, annual budget of over $600 million and 16 regional offices make it the second largest environmental regulatory agency in the world after the U.S. Environmental Protection Agency.

Prior to Governor Rick Perry's appointment of White to the TCEQ in 2001, she served as then Governor George Bush appointee to the Texas Water Development Board where she sat until appointed to TCEQ. She also served on the Texas Economic Development Commission and the Environmental Flows Study Commission. A writer and consultant on environmental laws, free market natural resource policy, private property rights, and ranching history, White received her bachelor *cum laude* and master degrees from Stanford University where for three years she held the Elizabeth Wheeler Lyman Scholarship for an Outstanding Woman in the Humanities. She was also awarded a Danforth National Fellowship for doctoral work at Princeton University in Comparative Religion and there won the Jonathan Edwards Award for Academic Excellence. She also studied law under a Lineberry Foundation Fellowship at Tech University.

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