

Policy: How to Evaluate the “Federal Offsets Baseline Shortfall” When Making the Equivalence Demonstration Required By Regulation 2-2-412

Policy When undertaking an Equivalence Determination pursuant to Regulation 2-2-412, the Engineering Division will evaluate the amount of offsets required under the federal offset baseline calculation procedures in 40 CFR § 51.165 as being **the same as** the amount of offsets required under the District’s baseline calculation procedures in Regulation 2-2-606. This interpretation of 40 CFR § 51.165 is compelled by the language of the regulation; the Clean Air Act’s statutory requirements for offsets in CAA § 173; the purpose and intent of the regulation’s offsets baseline provision in 40 CFR § 51.165(a)(3)(ii)(J); EPA’s treatment of the offsets provisions in the NSR programs of other California air districts; and the basic policy rationales underlying the offset requirement.

This means that **there will be no Federal Offsets Baseline Shortfall** to be addressed in the Equivalence Demonstration, because **there is no difference between the District’s baseline calculation procedures and the federal baseline calculation procedures applicable under 40 C.F.R. § 51.165.**

Pertinent Regulations Regulation 2-2-412 requires the District to undertake an analysis of the Major NSR permits it issues each year to determine whether there is any shortfall between (i) the amount of offsets the District has obtained from such permits and (ii) the amount of offsets that would have been required under the federal NSR regulations in 40 C.F.R. Section 51.165. If there is any shortfall with respect to Major NSR permits, the District must show that this shortfall is made up for by offsets obtained from Minor NSR permits, which are not subject to the federal offsets requirements. This analysis is called the “Equivalence Demonstration.”

The Equivalence Demonstration must address any potential shortfall in two areas: the Federal Surplus-at-Time-of-Use Shortfall, and the Federal Offsets Baseline Shortfall. This Policy addresses the latter, which is defined in Regulation 2-2-229 (in relevant part) as follows:

2-2-229 Federal Offsets Baseline Shortfall: For purposes of the offsets equivalence demonstration provisions in Sections 2-2-412 and 2-2-415, the difference between:

- 229.1 The amount of offsets required for the Authority to Construct and/or Permit to Operate using the District’s baseline calculation procedures under District Regulation 2, Rule 2; and
- 229.2 The amount of offsets that would be required under the federal baseline calculation procedures applicable under 40 C.F.R. section 51.165, including (but not limited to) the actual emissions baseline provision in 40 C.F.R. section 51.165(a)(3)(ii)(J).

Policy: How to Evaluate the “Federal Offsets Baseline Shortfall” When Making the Equivalence Demonstration Required By Regulation 2-2-412
(continued)

Rationale

The District adopted the Federal Offsets Baseline Shortfall provision in 2017. The District added this requirement to the Equivalence Demonstration process to address a new interpretation of 40 CFR § 51.165 that EPA took in 2016. *See Revisions to California State Implementation Plan; Bay Area Air Quality Management District; Stationary Source Permits*, Final Rule, 81 Fed. Reg. 50,339 (Aug. 1, 2016).

Specifically, EPA took the position that subsection 51.165(a)(3)(ii)(J) requires that the emissions increase that must be offset when an existing source is modified must always be based on the source’s pre-modification actual emissions, even if the source has already provided offsets for the full amount of its allowable emissions – i.e., its full Potential to Emit (PTE). This interpretation contrasted with the District’s offset calculation methodology as set forth in District Reg. 2-2-606.2, which provides that where an existing source has already provided offsets for all of its PTE, it needs to provide additional offsets only to the extent that a future modification increases the PTE above what has already been offset. In these situations, the District uses the source’s pre-modification PTE (allowable emissions) – not its actual emissions – as the baseline for calculating the amount of additional offsets required.

EPA had never taken this position before, and it has historically approved the District’s offsets requirements without objection. But in 2016 the agency adopted this new position that Reg. 2-2-606.2 was inconsistent with § 51.165(a)(3)(ii)(J). EPA disapproved Reg. 2-2-606.2 on that basis in the August 1, 2016, Final Rule referenced above.

The District strongly disagreed with EPA’s new interpretation, and it filed a legal challenge to EPA’s position in the Ninth Circuit Court of Appeals. But EPA’s disapproval of Reg. 2-2-606 required the District to revise its regulations within 18 months or face sanctions under the Clean Air Act. This required the District to take action while the Ninth Circuit legal challenge was pending, because the litigation was not expected to be completed within 18 months, and if the District did not act during that time, it would become subject to sanctions.

The District therefore revised its Equivalence Determination procedures in December of 2017 to add the requirement to evaluate whether there is any Federal Offsets Baseline Shortfall, as outlined above. The District made clear that it did not agree with EPA’s interpretation, and it revised the regulation solely to avoid sanctions while the litigation was pending.

In December of 2018, however, EPA informed the District and the court that it has abandoned the position it took in 2016. *See Federal Respondents’ Reply In Support Of Motion To Dismiss Petition For Review As Moot, BAAQMD v. EPA*, 9th Cir. Case No. 16-73197, Docket Entry No. 44 (Dec. 10, 2018). EPA stated that the position it took in 2016 “has no legal effect”; does not represent “a continuing practice” by the agency; “does not establish a

Policy: How to Evaluate the “Federal Offsets Baseline Shortfall” When Making the Equivalence Demonstration Required By Regulation 2-2-412
(continued)

formal position” regarding how the agency interprets the federal offsets baseline calculation requirements of 40 CFR § 51.165(a)(3)(ii)(J); and “has no ... ongoing impact on the Air District....” EPA stated that it does not consider the position it took in 2016 to be enforceable, and it took the position that it is not aware of any legal requirement that prohibits the use of a source’s pre-modification PTE (allowable emissions) in the situations covered by Reg. 2-2-606.2. EPA stated that, in its view, there is no “actual, existing law that proscribes” using the Reg. 2-2-606.2 methodology.

These statements establish that EPA has abandoned the interpretation of 40 CFR § 51.165(a)(3)(ii)(J) it put forward in 2016. Furthermore, EPA has never published any other formal policy or guidance document setting forth the agency’s interpretation of 40 CFR § 51.165(a)(3)(ii)(J) regarding this issue. Without any guidance or policy from EPA, the District must evaluate 40 CFR § 51.165(a)(3)(ii)(J) from first principles to determine how the provision was meant to be applied.

The District has carefully considered all relevant indications of how 40 CFR § 51.165(a)(3)(ii)(J) was intended to be interpreted, and they all support the conclusion that this provision authorizes the use of allowable emissions (PTE) as the baseline in the situations covered by Reg. 2-2-606.2 – i.e., where offsets have already been provided for the source’s PTE.

First, the relevant regulatory language explicitly states that a permitting authority can use “allowable emissions” in appropriate circumstances. 40 CFR § 51.165(a)(3)(ii)(J) says that the baseline must be the source’s “actual emissions before the modification (as defined in paragraph (a)(1)(xii) of this section)....” Paragraph (a)(1)(xii), in turn, defines “actual emissions” to allow multiple alternative baseline approaches. It states that in general the baseline should be based on the source’s actual operating data, but it also explicitly authorizes the permitting agency to “presume that source-specific allowable emissions for the unit are equivalent to the actual emissions of the unit” for purposes of determining the federal offsets baseline under Section 51.165(a)(3)(ii)(J). Using allowable emissions as the equivalent of actual emissions, 40 CFR § 51.165(a)(3)(ii)(J) provides that the baseline for calculating the amount of offsets required is the source’s “[allowable emissions] before the modification....”

Second, this is the only interpretation that is consistent with the statutory mandate in the Clean Air Act’s offsets provisions in CAA § 173. Section 173 requires the District to obtain offsets sufficient to ensure that the region maintains “Reasonable Further Progress” towards attainment of the National Ambient Air Quality Standards – and not any more. Reasonable Further Progress is accomplished by ensuring that a source’s full PTE has been offset, so that all of the source’s emissions are offset by corresponding emission reductions even if it operates up to its maximum permitted emissions rate. Once the source’s PTE has been offset, no additional offsets are required to maintain Reasonable Further Progress; additional offsets are required only to the extent a subsequent modification increases the PTE. The

Policy: How to Evaluate the “Federal Offsets Baseline Shortfall” When Making the Equivalence Demonstration Required By Regulation 2-2-412
(continued)

only way to achieve this result is to use the source’s PTE (allowable emissions) as the baseline for calculating the amount of additional offsets that are required for a modification. Using the source’s actual emissions in situations where the PTE has already been offset would result in “double counting” of the source’s emissions, and a requirement to provide *more* offsets than are necessary to ensure Reasonable Further Progress towards attainment. This would be inconsistent with CAA Section 173’s mandate, so it cannot be the correct interpretation of 40 CFR § 51.165(a)(3)(ii)(J). The only consistent interpretation is that the source’s PTE (allowable emissions) should be used to establish the baseline in situations where the PTE has already been offset.

Third, this interpretation is supported by the history and purpose of 40 CFR § 51.165(a)(3)(ii)(J). EPA adopted subsection (a)(3)(ii)(J) as part of its “NSR Reform” revisions in 2002. NSR reform changed the NSR applicability rules to allow the use of an “actual-to-projected-actual” test for determining when a modification is subject to NSR. This raised the question of whether an applicant can also use the “actual-to-projected-actual” test to calculate the amount of offsets required if a modification does trigger NSR and has to apply for a permit. Such a rule would be problematic because a source would only have to provide offsets for what it reasonably expects to emit in the near future, not the most it could emit under a worst-case scenario. EPA therefore added subsection (a)(3)(ii)(J) to clarify that the pre-NSR-Reform offsets calculation rules continue to apply, not the new NSR Reform approach for determining the amount of an emissions increase for NSR applicability purposes. The provision was thus intended to preserve the status quo that offsets are required for the source’s maximum PTE (allowable emissions), but not more. It was not intended to expand the NSR program to require more offsets than a source could possibly emit. Using PTE (allowable emissions) to establish the offsets baseline in cases where the PTE has already been offset is the only interpretation that is consistent with this purpose and intent.

Fourth, EPA has allowed many other California air districts to use a source’s allowable emissions (PTE) as the baseline for calculating the amount of offsets required for a modification. This reflects an implicit recognition that the federal offset baseline provisions in 40 CFR § 51.165 authorize the use of allowable emissions as the baseline. If not, there is no way EPA could have approved these provisions.

Fifth, the policy considerations underlying the offsets requirement fully support using a source’s PTE (allowable emissions) as the baseline where the PTE has already been offset. The offsets requirement was adopted to ensure that growth from new major sources and major modifications does not increase emissions in the region, which would undermine all of the region’s other efforts to reduce emissions and bring air quality back within the applicable ambient air quality standards. This goal is accomplished by using a source’s PTE (allowable emissions) as the offsets baseline in situations where the PTE has already been offset, as it ensures that all of the source’s

Policy: How to Evaluate the “Federal Offsets Baseline Shortfall” When Making the Equivalence Demonstration Required By Regulation 2-2-412
(continued)

emissions are offset even if it operates at its maximum emissions rate. Using the source’s actual emissions would result in “double counting” as noted above – it would require sources to provide *more* offsets than they can possibly emit even under a worst-case scenario. There is no legitimate policy reason why additional emission reductions should be required to offset the same emissions that have been offset previously.

For all of these reasons, the District has concluded that 40 CFR § 51.165(a)(3)(ii)(J) should be interpreted to authorize a source to use its pre-modification PTE (allowable emissions) as the baseline for calculating the amount of additional offsets required from a modification in cases where the source has already offset that PTE. All relevant indications of how this provision was intended to be interpreted and applied support this conclusion, and there is no indication to the contrary (other than EPA’s 2016 interpretation, which the agency has since abandoned).


This means that the federal regulations in 40 CFR § 51.165 use the same baseline approach in this situation as the District’s regulation in Reg. 2-2-606.2. As a result, **there is no discrepancy between the amount of offsets required by the District’s regulations and the amount of offsets required by the federal regulations.** The Federal Offsets Baseline Shortfall as defined in Reg. 2-2-229 is therefore (by definition) zero for every Federal Major NSR Source, and there is no shortfall that needs to be addressed in the Reg. 2-2-412 Equivalence Demonstration with respect to this issue.

The Equivalence Demonstration will still need to discuss this issue, because an evaluation of whether there is any Federal Offsets Baseline Shortfall is still required under Reg. 2-2-412. But the discussion can simply state that 40 CFR § 51.165 as properly interpreted authorizes the use of a PTE (allowable emissions) baseline in situations where the source has already offset its PTE, with a brief outline of the reasons why as explained above. (Referencing this Policy will help convey these reasons in a succinct manner.) After this brief explanation, the discussion can conclude that there is no Federal Offsets Baseline Shortfall that needs to be addressed.

Effective date Immediately

Contact Greg Stone, extension 4745

Approval

Name & Title	Signature	Date
Pamela Leong, Director of Engineering		4/30/2019