UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

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THE ADMINISTRATOR

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Re: Petition to the U.S. Environmental Protection Agency to Require California to Follow Mandatory Procedures for Amending a State Implementation Plan, and Secure EPA Approval of an Amended SIP Prior to Relying on Any Offsets Generated Pursuant to a New Rule

Dear Mr. Martinez, Ms. Lazerow and Ms. Johnson-Mezsaros:

This letter is in response to your Petition to me dated December 10, 2009. You submitted the Petition on behalf of Petitioners California Communities Against Toxics, Coalition for a Safe Environment, Communities for a Better Environment, Desert Citizens Against Pollution and Natural Resources Defense Council (collectively "Petitioners"). The Petitioners are requesting the U.S. Environmental Protection Agency to issue a written statement to the South Coast Air Quality Management District ("District") informing the District that it will be in violation of the applicable State Implementation Plan ("SIP"), which the EPA approved pursuant to Section 110 of the Clean Air Act, if the District issues new source review ("NSR") permits that rely on the District's internal bank of offsets. Specifically, Petitioners contend that the District's approved SIP does not allow the District to fund its internal bank with a category of offsets that are collected when "minor stationary sources"[1] cease or reduce operations without requesting

[1] The Clean Air Act defines a "major stationary source" or "major emitting facility" as any stationary source "which directly emits or has the potential to emit, one hundred tons per year or more or any air pollutant." 42 U.S.C. 7602(j). Title 1, Subpart 2 of the Act contains additional provisions for ozone non-attainment areas. Section 182(e) provides that the definition of a major stationary source in an extreme ozone non-attainment area is one "that emits, or has the potential to emit, at least 10 tons per year of volatile organic compounds." Id. 7511a(e). The EPA set the same amount of emissions of oxides of nitrogen as a major stationary source in extreme ozone non-attainment areas. See id. 7511a(c)(2)(C). For a serious PM_{10} non-attainment area, the Act defines a major stationary source as one "that emits, or has the potential to emit, at least 70 tons per year of PM_{10}." Id 7513a(b)(3). For $PM_{2.5}$, the Act's

emission reduction credits ("ERCs") (hereinafter "minor source orphan shutdowns"). From this premise, the Petition characterizes California State legislation known as SB 827[2] as an impermissible SIP revision. The Petition alleges that the EPA's failure to issue such a written statement prior to January 1, 2010, would constitute unreasonable delay actionable under the Administrative Procedures Act.

The District submitted a lengthy Response and numerous exhibits to the Petition on December 29, 2009. The District contends that the existing, federally approved SIP allows it to fund its internal bank with offsets that are collected from minor source orphan shutdowns. The District does not view the legislation as revising the SIP.

Although the procedural background leading to the Petition is lengthy and factually complicated, the substantive question of whether the existing, federally approved SIP *precludes* the District's internal bank from continuing to operate is substantively straightforward. The Petition and the District's Response persuade me that the existing SIP does not preclude the internal bank from operating and I deny the Petition for the reasons set forth below.

STATEMENT OF FACTS

I. EPA's 1996 SIP Approval.

A. Federal Clean Air Act Requirements

The South Coast Air Basin is an extreme non-attainment area for the 1-hour and 8-hour ozone standards, a serious non-attainment area for PM_{10} and non-attainment for $PM_{2.5}$. 40 C.F.R. 81.305; 75 Fed. Reg. 24,409 (Apr. 2, 2010). Subpart 1, Part D of the Clean Air Act establishes requirements for non-attainment area SIPs. 42 U.S.C. 7501-09a. Section 172(c)(5) requires SIPs for non-attainment areas to include a permitting program for new and modified major stationary sources. Id. 7502(c)(5). The elements that are necessary for the permitting program for new and modified major sources are set forth in Section 173 the Act. In pertinent part, Section 173(a)(1)(A) requires the permitting agency to determine that:

> by the time a source is to commence operation, sufficient offsetting emissions reductions have been obtained, such that total allowable emissions from existing sources in the region, from new or modified sources which are not major emitting facilities, and from the proposed source will be sufficiently less than total emissions from existing sources . . . prior to the application for such permit to construct or modify so as to represent . . . reasonable further progress. . . .

Id. 7205(a)(1)(A). Although the term "offset" is not defined in Part D of the Act, Section 173(c) establishes parameters for acceptable offsets. Id. 7503(c). Section 173(c)(1) describes offsets providing:

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default definition of 100 tons per year controls. Id. 7602(j). Any source below these thresholds is considered a "minor stationary source" for purposes of the federal Clean Air Act.

[2] SB 827 allows the District to issue permits based on its internal bank of offsets without conducting a review under the California Environmental Quality Act.

> Such emission reductions shall be, by the time a new or modified source commences operation, in effect and enforceable and shall assure that the total tonnage of increased emissions of the air pollutant from the new or modified source shall be offset by an equal or greater reduction, as applicable, in the actual emissions of such air pollutant from the same or other sources in the area.

Id. 7503(c)(1). Put more succinctly, an offset "is a reduction of non-attainment pollutant emissions in an amount equal to, or somewhat greater than, the emissions increase of the same pollutant from the proposed new or modified stationary source of equipment." *Natural Resources Defense Council v. South Coast Air Quality Management District,* 2010 U.S. LEXIS 35865 (C.D. Cal. Jan. 7, 2010) *(appeal pending)* (granting District's FRCP 12(b)(6) motion to dismiss for lack of jurisdiction).

The EPA's regulations at 40 C.F.R. 51.165(a)(3) provide more details concerning offsets. One provision pertains to offsets created by shutting sources down, stating: "Emission reductions achieved by shutting down an existing emission unit or curtailing production or operating hours may be generally credited for offsets if they meet the requirements in paragraphs (a)(3)(ii)(C)(1)(i) through (ii) of this section." 40 C.F.R. 51.165(a)(3)(ii)(C)(1).[3] These provisions require offsets to be surplus, permanent, quantifiable and federally enforceable. Id. 51.165(a)(3)(ii)(C)(1)(i). The Clean Air Act, therefore, allows permitting authorities to accept offsets that are provided from the shutdown or curtailment of emissions from stationary sources if certain provisions are met.

B. South Coast Air Quality Management District's Regulation XIII

EPA Region 9 worked with the District and a coalition of environmental and industry organizations over several years in the 1990s to ensure the permitting rules the District submitted for the SIP would be at least as stringent as required by Section 173 of the Clean Air Act. The EPA allows and encourages local authorities to tailor SIP programs, including permitting programs, to account for that community's particular needs – provided the SIP is not less stringent than the Act's requirements. See generally CAA Section 116, 42 U.S.C. 7416; *Train v. Natural Res. Defense Council,* 421 U.S. 60, 79 (1975); *Union Electric Co. v. EPA,* 427 U.S. 246, 250 (1976). The District's nonattainment permitting rules contained in District Regulation XIII went through numerous public workshops and stakeholder meetings prior to adoption in December 1995. EPA Region 9 participated in many of these meetings and workshops and submitted written comments on early drafts of Regulation XIII. For example, in December 1994, EPA Region 9 commented:

> Under 40 CFR 51.165(a)(1)(v), Major Modification, the EPA defines projects that may be exempt from New Source Review. Among those facilities, sewage treatment facilities and publicly (or privately owned) and operated landfill gas control or processing facilities are not included. Because the District exempts essential public services from offsets,

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[3] To allow use of an offset from a shutdown that occurred prior to the construction of the major stationary source or modification at such source, the Act requires the State to meet certain planning requirements. See Memorandum from John Sietz to Addressees on Use of Shutdown Credits for Offsets dated July 21, 1993.

> unless the District is proposing to include such facilities as sources which will be tracked in the District tracking system for the purpose of demonstrating equivalence with the federal NSR program, and the District shows that it will provide offsets for these sources prior to their construction and issuance of air pollutants. The EPA recommends that the District modify this definition in accordance with the federal definition.

EPA Region 9 Comment Letter dated December 1994 at Comment I-5. The District responded, stating:

> The AQMD will track the NSR activities of all sources and will demonstrate compliance with federal NSR offset requirements through an equivalency demonstration. The AQMD will use an aggregate approach to demonstrate that Regulation XIII and the overall attainment strategy is equivalent to the federal requirements. To demonstrate that the federal NSR offset requirements are met, the AQMD has designed a comprehensive NSR tracking system.

Response to EPA Region 9 Comment Letter dated April 18, 1995 at Comment 1-5.

The California Air Resources Board submitted Regulation XIII along with supporting regulations and documents to EPA Region 9 on August 28, 1996. On December 4, 1996, EPA Region 9 published a direct final approval of Regulation XIII in the Federal Register. 61 Fed. Reg. 64291 (December 4, 1996) (codified at 40 C.F.R. 52.220). The rulemaking was supported by EPA Region 9's Technical Support Document. The record for the rulemaking included a document entitled "Submitted Summary of the NSR Tracking System." did not receive any comments on its direct final approval of Regulation XIII and it became effective on February 3, 1997.

The EPA Region 9's approval of Regulation XIII in 1996 noted that Regulation XIII differed from but was, overall, equivalent to or not less stringent than the federal requirements. Of particular relevance here and as discussed in the correspondence in 1995, the District either exempted certain relatively insignificant sources from the offset requirement (Rule 1304)[4] or provided the offsets for other sources generally known as essential public services (Rule 1309.1)[5]. As further shown from the 1995 correspondence and EPA Region 9 Federal Register Notice and Technical Support Document, the District would provide internal banked offsets for Rule 1304 and 1309.1 sources, which would otherwise trigger federal offset requirements, to

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[4] Rule 1304 exempts replacement equipment with no increase in potential to emit, emergency equipment operating less than 200 hours per year, voluntary air pollution control projects and regulatory compliance, resource recovery and energy conservation projects undertaken pursuant to state law, relocations where the potential to emit remains the same, concurrent facility modifications resulting in a net emissions decrease, certain portable equipment, and facilities with potential to emit less than 4 tons per year of the pollutant or less than 29 pounds per day for carbon monoxide.

[5] Rule 1309.1 allows the District's internal bank to provide offsets for innovative technology which would result in emissions below BACT levels, research operations that would advance state-of-the-art control technology, and essential public services which are publicly owned sewage facilities, prisons, police facilities, fire-fighting facilities, schools, hospitals, construction and operation of landfill-gas control facilities, water-delivery operations and public transit.

make Regulation XIII equivalent to the Act's requirements to offset new and modified *major* source emissions increases. Although the District submitted its Summary of the NSR Tracking System as part of their SIP submittal, EPA'a Region 9 did not require the District to codify its internal bank's tracking system in rule language as a condition of full approval of Regulation XIII in 1996.

EPA Region 9 Technical Support Document for its 1996 SIP approval of Regulation XIII provides a somewhat fuller discussion of the tracking system. EPA Region 9 states that sources of internal credits include:

> emission reductions obtained from orphaned shutdowns, Best Available Control Technology discounting (rule 1306(c)) or emission reduction credits generated, surplus reductions created from external offset factor for sources less than 10 TPY VOC, and emission reductions created from the application of the zero BACT threshold.

Technical Support Document at 17. EPA Region 9's reference to offsets from "orphaned shutdowns" that the District may use to fund its internal bank does not distinguish between major orphan shutdowns and minor orphan shutdowns.

II. South Coast Annual Equivalency Reports

From 1997 through 2005, the District submitted annual equivalency reports to its Board for approval and provided copies to EPA Region 9. The public was invited to the District's Board meetings at which the annual reports were approved and the annual equivalency reports were publicly available.

The first report submitted after Regulation XIII became part of the SIP was approved by the District Board on February 14, 1997. It states:

> Sources of Creditable Emission Reductions, listing "Orphan Shutdowns" described as "Orphan shutdowns are emission decreases from stationary sources that go out of business, permanently cease emitting activities, and do not apply for emission reductions credits (ERCs). These emission decreases are retained by the AQMD to fund the NSR program."

Table 1-1 provides the quantity of offsets deposited into the internal bank from orphan shutdowns. The amount of orphan shutdown offsets recorded in the internal bank is small relative to the amount of offsets recorded from the District's "NSR Balances". The offsets in these NSR Balances were collected by the District in 1990. Prior to 1990, the District maintained a computerized emissions balance for all sources that obtained permits. If a source made a change that decreased emissions, the District would record it as a "negative NSR balance" for the source. In 1990, the District "reduced these credit balances by 80 percent to generate emission reductions to fund the Community Bank, Priority Reserve and Rule 1304 exemptions." 1997 Annual Report at p. 5. See also Rule 1315 Staff Report at p. 6-7 (Sept. 8, 2006). The Board approved a similar annual equivalency report covering 1997-98 on March 13, 1998, and

substantially similar Annual Reports for the next three years. See 1998 Annual Report, 1999 Annual Report and 2000 Annual Report.

On November 9, 2001, the Board approved a status report on Regulation XIII. In that report, the District provided some clarification of its tracking system, stating:

> Only emission increases originating at major stationary sources are subject to federal offset requirements, while state offset requirements apply to all increases of VOC or NO_x from equipment subject to AQMD's permitting program and to increases of SO_x, CO and PM_{10} from facilities that emit 15 or more tons per year. These same thresholds are used to assign credits generated through emission reductions to the federal and state offset accounts, respectively (e.g., only emission reductions occurring at major stationary sources are creditable for federal equivalency purposes). Therefore, AQMD tracks two sets of accounts, one each for purposes of demonstrating equivalence with federal and state offset requirements.

2002 Status Report at p. 5.[6] Table 3 lists the offset amounts in the District's federal offset accounts for 1999 - 2000 in lbs/day. Table 6 lists the offset amounts in the District's state offset accounts for 1999 -2000 in lbs/day. The balance of offsets credited from "orphan shutdowns" in the state account are substantially greater than the quantity in the federal account (e.g. for PM_{10}, 1038 lbs/day and 0 lbs/day, respectively). The subsequent annual reports approved by the District's Board and submitted to EPA Region 9 continue to show this significant difference between the quantity of offsets from orphan shutdowns counted for the state and federal accounts. Appendix A to the November 2001 status report provides further discussion of the orphan shutdown offsets in the District's internal bank, stating: "Only orphan shutdown reductions originating at major stationary sources are credited to AQMD's federal accounts." Therefore, it appears the District has historically counted and included minor orphan shutdown offsets in its state accounts but not in its federal accounts.

III. EPA's Discussions with the District Regarding Changes to the 1996 Tracking System

In January 2002, the District Board instructed the District to study potential sources of additional federal offsets. The District submitted essentially three options to the Board in May 2002: 1) allowing mobile and area sources to generate offsets, 2) creating an "offset budget" which would be an additional internal bank of offsets that companies needing federal offsets could purchase as a last resort, and 3) extending the time in which companies could apply for offsets to use privately. Staff Report – Regulation XIII, p. 2, November 2002. The District intended to fund the internal bank that would be available for the federal offset budget primarily by collecting offsets from minor orphan shutdowns (which were historically tracked only against the state offset accounts). Id. p. 23. Thus, from at least 2002, the District had identified offsets collected from minor orphan shutdowns to be available for its internal bank to offset federal major sources and that those offsets were not being counted for attainment or reasonable further progress.

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[6] As explained more in the subsequent sections, the District explained that it had historically only relied on emissions reductions from major sources because it had more than adequate balances in its bank from pre-1990 offsets.

EPA Region 9 informed the District beginning in 2002 that if it were significantly expanding the sources that were allowed to access federal offsets from the internal bank through a new offset budget rule, the tracking system's transparency should be improved. In September 2002 the District and EPA Region 9 began to look in detail at the existing SIP approved tracking system. These discussions continued for many months. In 2004-05 the District determined that the best solution would be to draft regulatory language, now known as Rule 1315, which would lay out with clarity how offsets are credited and debited to the District's internal bank accounts.

IV. The District's Use of Offsets from Minor Source Shutdowns

In its discussions during 2002-03, the EPA also noted that the District's use of the negative NSR balances and other pre-1990 era offsets to fund the internal bank would be inconsistent with federal requirements unless the District had sufficient records for those offsets. The District responded to EPA's request for documentation for the offsets from the negative NSR balances by reviewing its records. The District concluded that it did not readily have sufficient documentation for many of the offsets it had collected from the negative NSR balances and other pre-1990 era offsets.

The District responded to the EPA's request to eliminate offsets originating before 1990 without documentation on October 14, 2005. The District proposed to 1) eliminate "all pre-1990 credits for which the AQMD no longer retains any documents", 2) "use only the revised and re-verified pre-1990 credits for which all or some records exist today", 3) "eliminate any unused portion of the pre-1990 credits remaining in its accounts at the end of 2003-2004 reporting period", 4) "account for certain post-1990 surplus reductions (i.e. minor source orphan shutdowns) for which, due to the large sum of credits in its offset accounts, AQMD had not previously accounted", 5) "make changes post 2004 to eliminate the BACT discount of ERCs as a source of credits to its accounts", 6) "make other changes post 2004 to further adjust credits in its accounts for surplus discount at the time of use and actual emissions baselines", and 7) "discontinue accounting for certain other sources of credits." Letter from Barry Wallerstein to Deborah Jordan, October 14, 2005, pp. 3-4. An attachment to the letter provided details, stating:

> However, shutdowns of permitted *minor* sources also can meet the federal requirements that credits be real, permanent, enforceable, quantifiable, and surplus in the same way as do major source shutdowns. ERCs generated from minor sources are commonly used to fulfill the offset requirements for emission increases at major sources which are not exempt from offset requirements under SCAQMD's rules. Therefore, although SCAQMD has not previously used these credits due to the large balances available in its offset accounts, it is appropriate to include emission reductions from minor orphan shutdowns as credits in SCAQMD's offset accounts.

Proposed SCAQMD NSR Offset Tracking System, October 14, 2005, at pp. 12-13.

Unlike many areas, the District requires almost all minor sources to obtain a permit and offset its emission increases.[7] The District stated that "all of the minor sources which [*sic*] SCAQMD proposes to use as sources of orphan shutdown credits as described above have been through the permitting process." Id. p. 13.

The adjustments the District proposed to make in October 2005 significantly decreased the quantity of offsets for most of the pollutants in the existing tracking system. For example, this adjustment reduced the internal bank's balance for PM_{10} by 92 percent. The District informed EPA Region 9 that it had not previously included the offsets it collected from minor orphan shutdowns only because the offsets from the negative NSR balances were far greater than demand for these offsets from the Rule 1304 exempt sources and Rule 1309.1 essential public services.

The EPA and the District had further discussions about the changes to the tracking system resulting in a revised letter dated February 23, 2006. The revisions primarily resolved issues the EPA raised regarding the District's method of reporting its balances and the remedy if a shortfall were projected. EPA Region 9 responded on April 11, 2006, indicating that the District's proposed revised system funded with offsets from minor orphan shutdowns and other sources appeared to be sufficient for EPA to propose approval of Rule 1315.

Both the October 2005 and February 2006 letters from the District appended a document called the Federal Running Balances. The Federal Running Balances contained details concerning the credits added to the internal bank and the debits subtracted from it.

V. EPA's 2006 Approval of the District's Amendment of Rule 1309.1

In 2001-02 California experienced shortages of electricity leading to several applications for NSR permits allowing construction of new electricity generating facilities in the South Coast Air Basin. The cost of offsets was considered a barrier to construction of these facilities and the District amended Rule 1309.1 on April 20, 2001, and again on May 3, 2002, to allow qualifying electricity generating facilities to purchase offsets from the District's internal bank. These amendments sunsetted after three years.[8] The District submitted Rule 1309.1 to EPA Region 9 as a SIP revision on December 23, 2002.

On March 29, 2006 (71 FR 15656), EPA Region 9 proposed to approve the District's revision to Rule 1309.1 into the SIP. EPA Region 9 received comments on the proposed SIP revision from California Unions For Reliable Energy ("CURE"). CURE attached the District's February 23, 2006, explanation of the revised tracking system and commented that EPA Region 9 should not finalize the SIP revision because the District would be using offsets "that are not based on any official or reliable tracking system." CURE Letter at 1. EPA Region 9's response to

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[7] Rule 1304 exempts sources emitting less than 4 tons per year. In effect, therefore, the District requires offsets for minor sources that have the potential to emit between 4 and 10 tons per year.

[8] Following expiration of the amendments, offsets from the District's internal bank were again limited to essential public services.

comments supported the validity of the offsets in the internal bank for purposes of federal law. (71 FR 35158). The EPA also responded to CURE's comment that the SIP revision should be postponed until after the EPA approved Rule 1315 into the SIP, stating: "Our work to improve the Tracking System does not indicate or imply that our approval of the Priority Reserve Fund in Rule 1309.1 in 1996 was incorrect or erroneous." Response to Comments, p.4

Other than CURE, no party commented on the EPA's proposal to approve amended Rule 1309.1 into the SIP, and CURE did not seek judicial review of the final SIP revision in 2006.

VI. California State Legislation

A. SB 827

The California Legislature enacted and the Governor signed two pieces of legislation, SB 827 and AB 1318, both of which became effective on January 1, 2010. Prior to the legislation, a California court had issued an injunction prohibiting the District from issuing permits relying on offsets from its internal bank until the District completed an environmental review under the California Environmental Quality Act ("CEQA").[9] SB 827 allows the District to issue permits to Rule 1304 and 1309.1 sources without completing CEQA review provided the District relies on the NSR Tracking System in use prior to its adoption of Rule 1315. This means that the District is required to apply the general provisions of the NSR Tracking System that the EPA approved into the SIP in 1996.

The District commenced issuing permits on January 2, 2010, to Rule 1304 and 1309.1 sources using the 1996 NSR Tracking System, as revised in 2005-06 to replace offsets from pre-1990 sources with offsets from minor orphan shutdowns.

B. AB 1318

AB 1318 is limited to a single stationary source. AB 1318 allows the District to provide offsets to allow construction of the Sentinel Power Plant, provided those offsets are approved by the California Energy Commission. The District submitted an offset package to the CEC on March 4, 2010. According to the District's statement with the submission, it intends to submit the offset package to EPA Region 9 for adoption as a SIP revision. On Friday, July 9, 2010, the Board approved a District resolution to submit the offset package to EPA as a source-specific SIP revision.

Therefore, the only offsets that will be allowed for constructing a power plant will go through the public process required for SIP submittals as well as the public process that EPA must follow to conclude a source-specific SIP revision.

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[9] The Court held that CEQA applied to the District's adoption of Rule 1315. *NRDC et al. v. South Coast AQMD et al.*, Los Angeles Super. St. No. BS 110792, July 28, 2008.

BASIS FOR DECISION TO DENY PETITION

The Existing 1996 Approved SIP Regulation Does Not Preclude Using Minor Source Orphan Shutdown Offsets

The Petition contends that the District's reliance on SB 827 and AB 1318 to issue permits that rely on internally banked offsets collected from minor orphan shutdowns constitutes an invalid SIP revision. The bulk of Petitioners' argument concerns whether State legislation can legally revise a SIP. The crux of the question, therefore, is whether Regulation XIII as approved into the SIP in 1996 precludes the District from funding its internal bank with offsets collected from minor orphan shutdowns to show equivalency with federal NSR. If the EPA determines Regulation XIII as approved in 1996 does not preclude such a funding mechanism, there is no SIP revision and the Petition must be denied.

Rule 1303(b)(2) provides that the District shall deny a permit to construct a new source or modify an existing source "[u]nless [it is] exempt from offsets requirements pursuant to Rule 1304, [or] emissions increases [are] offset by either Emission Reduction Credits approved pursuant to Rule 1309, or by allocations from the Priority Reserve in accordance with the provisions of Rule 1309.1." Rule 1302(j), as approved into the SIP, defines an Emission Reduction Credit as:

> The amount of emissions reduction which is verified and determined to be eligible for credit at a facility in accordance with all District rules and regulations. An ERC represents final eligible emission reductions and may be used as such, in accordance with the provisions of Regulation XIII.

Rules 1306(e) and 1309 contain specific requirements for quantifying emissions increases and applying for Emission Reduction Credits resulting from emissions decreases that can be traded on the open market. These provisions, however, apply only to Emission Reduction Credits as defined in Rule 1302(j).

Offsets for Rule 1304 exempt sources (e.g. replacement equipment that does not increase the potential to emit, emergency equipment used fewer than 200 hours, portable internal combustion engines) and allocations for Priority Reserve sources (e.g. research operations, prisons, schools, hospitals, public transit) are not subject to the provisions of Rules 1306 and 1309. When an exempt or priority reserve source triggers federal NSR because it is a federal major source or major modification at a federal major source, the District demonstrates that its system is equivalent to the requirements of Section 173 by debiting (i.e. subtracting) offsets from its internal bank's balances. By debiting these offsets, the District demonstrates that sufficient offsets are provided to cover federal major sources and major modifications, subject to Rules 1304 and 1309.1.

The majority of the exempt sources listed in Rule 1304 will likely never emit pollutants at levels defined as a new federal major source or a modification at a federal major source. The statutory non-attainment major source thresholds are 10 TPY for NO_x and VOC, 70 TPY for PM_{10} (and its precursors) and 100 TPY for $PM_{2.5}$ (and its precursors). The District is in

attainment for CO and SO_2. Rule 1304 exempt sources are, for the most part, sources with a potential to emit less than 4 TPY. In general, the other exemptions in Rule 1304 apply to modifications that either result in a decrease in emissions or do not change the source's potential to emit. The Priority Reserve sources are marginally more likely to produce increased emissions at federal major source. Nevertheless, the District debits offsets from its internal bank for all major sources otherwise required to provide offsets to ensure equivalency with federal non-attainment NSR.

Despite the absence of specific regulatory language, the EPA's 1996 SIP approval contemplated and provided some guidance on the appropriate sources for the District to use as credits to fund its internal bank. The Technical Support Document for the 1996 SIP approval lists "orphan shutdowns" as one of several potential sources of offsets for the internal bank. The EPA did not distinguish between major orphan shutdowns and minor orphan shutdowns in the Technical Support Document. The absence of any distinction between funding the internal bank with minor orphan shutdowns or major orphan shutdowns is further supported by the staff reports the District submitted before the 1996 SIP approval. See Staff Report at E-2 and pages 2-7 (stating: "Orphan shutdowns are emission decreases from stationary sources that go out of business, permanently cease emitting activities, and do not apply for ERCs. These emissions decreases are retained by the AQMD to fund the NSR program.")(Oct. 12, 1995). A similar reference is provided in the Summary of Tracking System listed in the record for the 1996 SIP approval. The Annual Reports submitted after the 1996 SIP approval also include a line item for "orphan shutdowns" that does not distinguish between major and minor sources.

The reason that EPA Region 9 did not distinguish between offsets arising from major and minor sources of orphan shutdowns is based on the District's permitting program. Rule 201 in the District's SIP requires all sources that will emit any amount of a regulated air pollutant to obtain a District permit, except as provided in Rule 219 – Permit Exemptions. Rules 1303(b)(2), 1304 and 1309.1 then require the emissions from all sources – both federal major sources and minor sources – to be offset either through surrendering Emission Reduction Credits from the open market or from the District debiting its internal bank and tracking its balances. Together, the District's permitting and tracking system ensure that all sources, both federal major and minor sources, are fully offset prior to construction. The offsets from minor orphan shutdowns, therefore, meet the requirements of 40 C.F.R. 51.165(a)(3)(C)(1)(i), and I have found nothing in Regulation XIII that would preclude the District from using those offsets to demonstrate equivalency with federal NSR requirements.

The District Recalculated Its Federal Running Balances and Has Been Operating Its Tracking System in Compliance with the Approved SIP Since 2004, Resulting in Substantially Reduced Balances.

Prior to 2002 the District provided Annual Reports to EPA Region 9 showing substantial balances for all regulated non-attainment pollutants. As noted above, beginning in 2002 EPA Region 9 requested the District to revise its NSR Tracking System based on the absence of documentation for the credits created before 1990. The documents exchanged between EPA and the District in 2002 through 2006 demonstrate that the EPA was aware of and supported the District's plan to fund its internal bank with offsets collected from minor orphan shutdowns. In

October 2005 the District stated it had eliminated "all credits for which the SCAQMD no longer retains documentation. SCAQMD has also included additional classes of credits in the tracking system, namely orphan shutdowns of minor sources and other surplus reductions." Proposed SCAQMD NSR Offset Tracking System, October 14, 2005, at p. 2. These changes reduced the balances in the District's internal bank by 12 percent to 74 percent depending on the pollutant. The explanation provided by the District was that it "has in the past only utilized orphan shutdowns of major sources as credits. This in part has been due to the fact that SCAQMD's offset account has held a large balance of credits and there has been no need for additional sources of credits to fund the offset account." Id. p. 3. Further, the District explains:

> *Rule 1303*- Requirements specifies [sic] that minor sources must offset their emission increases by surrendering ERCs unless otherwise exempt pursuant to Rule 1304 but the CAA does not require emission offsets from minor sources. Therefore, emission offsets supplied by minor sources in the form of ERCs represent creditable, surplus, reductions. The [1996] TSD only specifically identifies this source of emission reductions/credits for minor VOC sources, but the underlying logic applies equally to minor sources of NO_x, SO_x, CO and PM_{10}.

Id. p. 5. The District also addressed how it accounts for minor orphan shutdowns in its planning inventories. Id. p. 14.

All of these points were repeated by the District to the EPA in February 2006. SCAQMD's Revised NSR Offset Tracking System, February 23, 2006. On April 11, 2006, the EPA indicated that Rule 1315 appeared to be sufficient for the EPA to propose approval if the Rule was submitted by California as a SIP revision. This letter demonstrates that in 2006 the EPA understood that the District would use credits from its minor orphan shutdowns as a source of funding its internal bank. The EPA did not indicate in 2006 that the SIP approved version of Regulation XIII precluded replacing the internal bank balances with minor orphan shutdown credits. Had the EPA considered the SIP approved version of Regulation XIII deficient, Section 110(a)(5) of the Clean Air Act provides the mechanism for the EPA to use. Rather than indicating that the 1996 SIP was deficient, the EPA encouraged the District to draft rule language specifying its mechanisms for crediting (with minor orphan shutdowns) and debiting its internal bank accounts. The EPA continues to encourage the District to submit Rule 1315 for adoption into the SIP to enhance transparency and reliability but not as a necessity to correct a deficiency in the existing SIP.

The EPA's approval of amendments to Rule 1309.1 in 2006 also supports finding that Regulation XIII did not preclude the District from funding its internal bank with offsets from minor orphan shutdowns rather than the pre-1990 negative NSR balances. The EPA received only one comment on its proposal to approve the amendments to Rule 1309.1 in 2006. In response to that comment, the EPA acknowledged the ongoing work to restructure the funding of the District's internal banks. The EPA stated: "Our work to improve the Tracking System does not indicate or imply that our approval of the Priority Reserve Fund in Rule 1309.1 in 1996 was incorrect or erroneous." 71 FR 35158.

Therefore, the EPA has consistently viewed minor orphan shutdowns as a legitimate source of offsets to fund the District's internal bank accounts and has not found that the SIP approved version of Regulation XIII precludes using those offsets to demonstrate equivalency with federal requirements.

Because the Existing 1996 SIP Allowed the District to Collect and Use Minor Orphan Shutdowns, the State Legislation Does Not Constitute a SIP Revision.

The District's reliance on State legislation exempting its permitting Rule 1304 and 1309.1 sources from compliance with the California Environmental Quality Act is not an issue of federal Clean Air Act law. Moreover, the District's issuance of permits to allow construction and operation of Rule 1304 and 1309.1 sources is not precluded by Regulation XIII as approved into the SIP in 1996. Therefore, issuing permits based on the state legislation does not constitute any revision to the SIP.

The District Has Identified Specific Offsets That It Intends to Submit to EPA as a SIP Revision for the Sentinel Power Plant.

The Petition contends that the District will permit a significant number of federal major sources such as power plants from its internal bank accounts. Pet. P. 3, n. 3. The contention is factually unsupported. The California legislature also passed AB 1318 when it enacted SB 827. AB 1318 allows the District to provide offsets to allow the construction of a single natural gas fired power plant called the Sentinel Energy Project. The District published a notice and requested public comment on a supplement to the District permit for the Sentinel Energy Center, called Appendix N. The District's Board approved a resolution regarding Appendix N on July 9, 2010. Based on this resolution, the EPA expects that the District (through the California Air Resources Board) will submit Appendix N to the EPA to consider as a source-specific SIP revision.

Appendix N identifies the specific offsets from its internal bank that the District is debiting (i.e. subtracting). The District also provided background documentation for each of the identified offsets in Appendix N, showing the name of the company that surrendered the offset, the date the permit to that company was cancelled and other relevant information.

The District's board has considered public comments on Appendix N and the procedure of submitting it as a SIP Revision. The public had an opportunity to review and comment on the specific offsets in Appendix N during this process. If the District and the California Air Resources Board submit Appendix N to the EPA as a SIP revision, the EPA will conduct further public notice and comment on the EPA's proposed action.

Accordingly, I do not consider the Petition ripe with respect to the offsets that the District will be providing to the Sentinel Energy Center and the Petition's challenge to matters arising in connection with AB 1318.

CONCLUSION

The Petition contains a number of claims of irregularities that will arise if the District issues permits to Rule 1304 exempt and Rule 1309.1 Priority Reserve sources beginning on January 1, 2010. These claims all rise or fall on the EPA's determination of whether Regulation XIII as approved into the SIP in 1996 precludes the District from funding its internal accounts with credits from minor orphan shutdowns. Because I have determined that the NSR Tracking System approved into the SIP in 1996 did not preclude such funding, I deny the Petition in its entirety.

If you have any questions regarding this matter, please contact Scott Jordan in the Office of General Counsel at 202-564-7508.

Sincerely,

Lisa P. Jackson

cc: Barry Wallerstein, Executive Officer SCAQMD
James Goldstene, California Air Resources Board
Mary Nichols, Chairman, California Air Resources Board