Testimony of

Mr. Bob Slaughter

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Chairman Jeffords, Chairman Leahy, Senators Smith and Hatch and other Members of the Committees, I am Bob Slaughter, President of the National Petrochemical & Refiners Association (NPRA). NPRA thanks you for asking us to appear before you today on the subject of reform of the New Source Review (NSR) program. NPRA is a national trade association which represents nearly all owners or operators of U.S. refining capacity, as well as petrochemical manufacturers with processes similar to refiners. The petroleum and chemical products made by our members are vital to continued U.S. economic health and national security, and we welcome the opportunity to underscore the importance of NSR reform to maintaining a secure and adequate supply of those products.

NSR Review Has Been A Public Process

This is our third appearance before the Senate Environment and Public Works Committee on this subject. On February 28, 2000, I appeared before a hearing of the Subcommittee on Clean Air, Wetlands, Private Property and Nuclear Safety to explain many of the problems that our members were experiencing under the NSR program. On April 5, 2001, I appeared before the same subcommittee to stress our members' continued need for NSR reform and our hope that this matter would be reviewed as part of the Administration's forthcoming recommendations for changes in national energy policy. The problems with and concerns about the NSR program we expressed at those times are already on the record, but we have included them as an appendix to this statement for ease of access by Committee members and staff.

In May, 2001, the National Energy Policy Development Group, in its National Energy Policy report, recommended that "the Administrator of the Environmental Protection Agency, in consultation with the Secretary of Energy and other relevant agencies, review New Source Review (NSR) regulations, including administrative interpretation and implementation, and report to the President on the impact of the regulations on investment in new utility and refinery generation capacity, energy efficiency and environmental protection." That review was to be concluded by August 15, 2001.

On July 10, 2001, NPRA appeared at one of the four public hearings held by EPA across the country. The hearings were held to accept comments on industry experience with the NSR program in general, and specifically on the EPA paper (published June 22, 2001) providing background and a preliminary overview of NSR performance and related issues. Some of our member companies also appeared during these EPA public hearings. We have attached the statement delivered on behalf of NPRA in Cincinnati as part of the appendix to this testimony.

On June 27, 2001, NPRA and representatives of 12 member companies met with the Environmental Protection Agency Office of Policy, Economics and Innovation. This meeting was

held to discuss specific problems with the NSR program and our suggestions for ways in which the program could be improved in order to maintain environmental progress while promoting energy efficiency, the production of cleaner fuels and the installation of improved technology. On July 23, 2001 NPRA sent EPA a written summary of the points brought forward at that meeting. This material is a part of EPA's docket of the review process, but we are attaching a copy as part of the appendix to today's testimony.

On June 13, 2002, EPA Administrator Whitman sent a letter to the President transmitting EPA's report to the President and a separate New Source Review Recommendations document summarizing actions to improve the NSR program. It should be noted that the Administration took ten months beyond the originally anticipated August 15, 2001 date to receive and review input and to formulate its recommendations. NPRA issued a press release supporting the Administration's decision to move forward with NSR reform; a copy is attached as part of the appendix.

NSR Reform Is Necessary

NPRA continues its strong support for reform of the New Source Review program. Our members need both increased certainty as to the application of that program and greater flexibility in meeting its requirements. Considerable uncertainty still exists about the NSR program, and our members tell us that state regulators who actually administer most of the program's requirements have expressed their concern about its many complexities and shifting interpretations.

Refiners Have A Heavy Regulatory Agenda

Refiners in particular are in urgent need of NSR reform. The industry is facing a blizzard of new regulatory requirements in this decade, all of which are environmental in nature. The number and compressed timing of these requirements are compellingly demonstrated on the attached chart which we call the Regulatory Blizzard.

To mention only the most significant of these programs: refiners must implement a greater than 90% reduction in gasoline sulfur content outside of California in the 2004-2006 timeframe, at an estimated cost of $8 billion. By mid-2006 the industry must achieve a 97% reduction in the sulfur content of 80% of highway diesel fuel, at an additional cost approaching that of the gasoline sulfur reduction. EPA is currently considering severe sulfur reductions in the off-road diesel pools, which will also be quite expensive and, which will be partially implemented in this decade as well.

Additional and expensive gasoline specification changes involving the use of MTBE in reformulated gasoline must be implemented in the same timeframe. At the same time, stationary source programs such as the MACT hammer and compliance with the new 8-hour ozone standard will require additional environmentally-related investments at refineries and petrochemical facilities.

Many industry experts have told us that they believe that the refining industry faces a total of $20-25 billion in additional investments before 2010. The vast majority of these requirements are

related to mandatory environmental programs. Other experts think that the $20-25 billion price tag may be underestimated.

The unfortunate fact is that most, if not all of these regulatory requirements were imposed in relative isolation and with little attention paid to their cumulative effect on the domestic refining industry. In 1999 a study done by the National Petroleum Council (NPC), a joint government-industry body co-chaired by the then Secretary of Energy, warned about the impact of these uncoordinated investment requirements on the refining industry. In its Report, the NPC recommended more reasonable timing and better sequencing of these requirements to avoid domestic refinery closures and reduced supply of petroleum products. The NPC's recommendation has been largely ignored to date.

NSR Reform Is Needed To Meet This Regulatory Agenda

Confusion and controversy over NSR requirements and applicability contribute to the problems facing our industry. Assuming their ability to secure sufficient investment capital to meet these regulatory requirements, refiners still face many logistic challenges in meeting the ambitious goals and deadlines of these new regulations. Refiners must make infrastructure and process changes to comply with these regulations. The current NSR program makes it extremely difficult for refiners to determine just what the legal requirements are as they do so. This situation illustrates why the unreformed NSR program hinders our industry's efforts to produce the cleaner fuels that consumers want and which are needed for continual environmental progress.

Current disarray in the NSR program has had an even more direct, negative effect on refiners. Enforcement actions against the refining industry based upon unanticipated and shifting NSR interpretations have sought to add significant and uncoordinated new investment requirements to those already mandated in this decade. Given the magnitude of the tasks facing the refining industry, and the cost of contesting these claims, some of our members have decided to settle these enforcement actions rather than to contest them. Other members are still discussing these matters with agency personnel.

It is NPRA's position that the enforcement activity against refiners is inappropriate and should cease. We believe that the NSR program's application and requirements must be clarified and the industry allowed to proceed with the many challenges it faces in complying with its vast suite of new regulatory requirements with the help of a reformed NSR. Regulatory improvements resulting from NSR reform should be made available to those companies which have already settled at their option. Given the immense job ahead of the industry it is inconceivable that this would have anything but a positive effect on the environment.

The U.S. Refining Industry is Essential, But Faces Challenges

Domestic refining is an essential industry. It is also a tough business. Refining is a heavily-regulated, capital-intensive industry that requires huge amounts of capital to continue its significant environmental progress and to maintain and expand production capacity. Thus, it is very important to provide clear and efficient means to comply with environmental regulation. Unnecessary costs mean reduced domestic production of crucial energy supplies and further

reductions in the number of U.S. refineries.

No new refinery has been built in the United States since 1976. It is unlikely that any new grassroots refinery will be built in the U.S. in the foreseeable future. This is due to the industry's relatively low return on capital invested (which is in part attributable to the costs of environmental compliance) and to the NIMBY factor, which makes it difficult to site new heavy industry facilities.

Petroleum Product Demand Is Increasing

No new U.S. refineries have been built, but our demand for petroleum products continues to increase. The Energy Information Administration (EIA) projects continued growth in demand for petroleum products at roughly 1.5% per year through 2020. As the number of U.S. refineries declines, overall U.S. capacity has increased at existing sites just enough to offset the reduction in capacity. But this is not enough to keep pace with the growing demand for petroleum products, which must be met through more product imports. In order to maintain--and hopefully increase--domestic production of basic fuels, NSR reform is needed to continue capacity additions and other efficiencies at existing sites. Otherwise, we will gradually but inexorably become more dependent on imports of key petroleum products like gasoline, diesel fuel, home heating oil, and jet fuel, with a significant impact on national security. Currently, the United States imports large quantities of crude oil, but the useful petroleum products are largely made in the United States at domestic refineries.

NSR reform will not remove all the challenges facing domestic refiners, but it will eliminate unnecessary and counterproductive costs of unnecessary regulation and uncertainty that can make the difference between life and death for many facilities.

This is not an idle concern. The Oil Price Information Service (OPIS) recently reported that at least 15 U.S. refineries that represent more than 10% of U.S. production may change hands or be closed down by January 2003. The facilities identified by OPIS are in every region of the country other than the West Coast, which already suffers from a sharply reduced refinery population. OPIS adds "It's the rare unit these days that is sought after by qualified buyers."

EIA is projecting that U.S. refineries capacity will continue under pressure, even with capacity utilization at levels of 94-95% which is far more than in other industries, where maximum utilization is considered to be 75-85% of capacity. EIA forecasts: "Imports of light products are expected to nearly triple by 2020, to 4.5 million barrels per day. Most of the projected increase is from refiners in the Caribbean basin and in the Middle East, where refining capacity is expected to expand significantly."

Given such warnings, and the impact on U.S. national security, it is hard to argue that NSR reform should not proceed expeditiously. And U.S. petrochemical production, also directly linked to U.S. economic progress and national security, confronts challenges equal in magnitude to those of the refining industry and could also operate more efficiently and economically with NSR Reform.

Many Other Regulatory Programs Control Plant Emissions

Opponents of NSR reform attempt to leave the impression that the current NSR program is the source of all industry environmental regulation; this is not the case. The refining industry, for example, is heavily regulated through many other programs. (A compilation of those programs is included in the appendix. It was prepared by the American Petroleum Institute.) NSR, on the other hand, was intended to require the use of up-to-date emission control technology on new or substantially rebuilt facilities; and routine maintenance, repair and replacement activities were specifically exempted from NSR requirements.

NSR reform will also help enable the refining industry continue its strong record of environmental progress. The industry has dramatically reduced its direct and indirect emissions since Clean Air Act regulation began. According to EPA's figures, between 1980 and 1996 the refining industry reduced its criteria pollutant air emissions by 74%. Congress and the EPA have required the industry to attain additional dramatic emission reductions in the next few years, largely through rulemaking activities taken under the authority of the 1990 Clean Air Act amendments.

The refining industry's contributions to improved air quality reflect the progress made by the nation as a whole. On June 26, 2001 the EPA announced that between 1970 and 1999 total emissions of the Clean Air Act's six criteria pollutants decreased 31% at a time of considerable growth in both the economy and population. The agency attributed the improved air quality to effective implementation of clean air laws and regulations and improved efficiency of industrial technologies. Updating and improving the NSR program should be viewed in the context of improving air quality and considered as a way to maintain its environmental progress.

NSR Reform Has Been A Bipartisan Effort

Finally, NSR reform has been urged by a bipartisan group of Executive Branch and Congressional policymakers over the past several years. In 1996 during the previous Administration, EPA initiated a rulemaking to revise NSR, proposing what appear to be the same changes that are the core of the present Administration's recommendations. Former EPA Air Administrator

Bob Perciasepe, who served until the end of the previous Administration, publicly stated his support for NSR changes which are similar to those recommended by this Administration. A memo expressing Mr. Perciasepe's opinions is attached in the appendix. Also, in May 2002 a bipartisan group of U.S. Senators wrote to the Administration strongly urging NSR reform.

In closing, NPRA urges Congress to continue its support for this bipartisan effort to modernize and reform the NSR program. Additional regulatory flexibility in the form of plant wide applicability limits (PALS), clean-unit treatment, and clarification of the definition of routine maintenance will help our members improve energy efficiency, produce cleaner fuels, and install the latest technology. NSR in its current form impedes, rather than advances, achievement of these goals. We hope that we can count on continued Congressional support for reforming NSR,

so that our members can meet the growing need for environmentally-sensitive products and procedures in ways that are both effective and efficient. I look forward to responding to your questions.