

**EVALUATION OF ALLOTMENT FORMULA FOR NATIONAL
POLLUTANT DISCHARGE ELIMINATION SYSTEM (NPDES)
PERMIT FEE INCENTIVE FOR CLEAN WATER SECTION 106
GRANTS**

TECHNICAL MEMORANDUM

Prepared for:

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The Office of Advocacy, an independent office within the U.S. Small Business Administration, has primary responsibility for government-wide oversight of the Regulatory Flexibility Act of 1980 (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA). The principal goal of the RFA is to identify, and, if possible, lessen the burdens Federal regulations place on small entities. The Office of Advocacy sponsored this report under contract SBAHQ-03C0020. This report was developed under a contract with the Small Business Administration, Office of Advocacy, and contains information and analysis that was reviewed and edited by officials of the Office of Advocacy. However, the final conclusions of the report do not necessarily reflect the views of the Office of Advocacy.

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I. INTRODUCTION AND PURPOSE

Section 106 of the Clean Water Act (CWA) authorizes the U.S. Environmental Protection Agency (EPA) to provide grants to State and Interstate Agencies to administer water pollution control programs. Section 106(b) directs the EPA Administrator to make allotments "in accordance with regulations promulgated by him on the basis of the pollution problem in respective States." The current allotment formula for Section 106 grants establishes an allotment ratio for each State based on six components that reflect the extent of the water pollution problem and scope of work in the respective States: surface water area, ground water use, water quality impairment, potential point sources, nonpoint sources and the population of urbanized areas.

On January 4, 2007, EPA proposed a rule that would affect how EPA Section 106 grants are provided to States. The proposed rule would establish financial incentives for States that fund most of the cost of their National Pollutant Discharge Elimination System (NPDES) program with permit fees. The rule specifically sets aside up to 3 percent of the total allotment of Fiscal Year (FY) 2008 Section 106 funds to be distributed to States that certify that 75 to 100 percent of NPDES program costs are paid for by the permit fees they collect.

The U.S. Small Business Administration's Office of Advocacy (Advocacy) requested that E.H. Pechan & Associates, Inc. (Pechan) evaluate the impact on small governments and small businesses who would pay increased permit fees as a result of the proposed rule. The purpose of this memorandum is to discuss Pechan's evaluation of EPA's proposal on small entities.

II. BACKGROUND

The NPDES is the Federal water pollution control program that affects municipal, industrial, construction site, and livestock operation discharges. The Section 106 grant program helps States, interstate agencies, and tribes administer programs that prevent, reduce, and eliminate water pollution. Section 106(b) of the CWA directs the EPA Administrator to make allotments for Federal grants from sums appropriated by Congress in each fiscal year "in accordance with regulations promulgated by him on the basis of the extent of the pollution problem in the respective states." 40 CFR 35.162 identifies the process EPA uses to allocate these grant funds. EPA's current allotment formula for Section 106 grants establishes an allotment ratio for each State based on six components selected to reflect the extent of the water pollution problem in each State.

The EPA's proposed rule directs funds above FY 2006 levels to a separate account that is distributed among States with at least 75 percent of their NPDES program costs funded through permit fees. The proposed rule defines eligibility for this incentive, identifies the process for determining the amount each eligible State will receive, and establishes procedures and guidelines—including reporting requirements—for eligible States to follow when applying for the incentive. The total permit fee allotment incentive pool is capped at \$5.1 million.

III. SMALL ENTITY IMPACTS OF PROPOSED CHANGES TO SECTION 106 GRANT ALLOCATION FORMULA

The following describes Pechan's evaluation of the small entity impacts of EPA's proposed Section 106 grant changes. This discussion is organized into three sections:

- A summary of the major impacts of EPA's rule asserted in public comments supplied on the rule;
- An explanation of the difficulties associated with quantifying the impacts of EPA's rule; and
- A qualitative assessment of potential rule impacts.

A. PUBLIC COMMENTS ON RULE IMPACTS

In public comments on EPA's proposed rule, a number of common concerns were raised about how EPA's proposed Section 106 grant allocation incentive would impact States, municipalities, and small businesses.

1. Rural State Impacts

Many commenters assert that rural States will be singularly harmed because they are unable to obtain the economies of scale of larger, more populated States. Commenters observe two outcomes from this phenomenon. First, they note that their permit fees are disproportionately higher because they have fewer permittees among which to spread NPDES program costs — "In many cases, the per citizen or per employee cost of a fee increase will far exceed that paid by larger cities and businesses" (ASIWPCA, 2007). Second, they note that rural States will be put at a disadvantage in terms of competing for Section 106 funds because they will be unable to set permit fees high enough to cover 75 percent or more of total program costs. Therefore, they see more highly urbanized States as benefiting from EPA's new grant incentive program.

2. Small Municipality Impacts

Many officials have noted that fee increases imposed by States in response to EPA's program will disproportionately harm small towns. These impacts could be particularly burdensome in communities that have high proportions of citizens that are older and on fixed incomes, given that fee increases will ultimately be passed on to them:

Consider that the greatest number of traditional NPDES discharge permits in South Dakota have been issued to municipalities. Therefore, local governments would be the most adversely affected by a proposal to increase NPDES fees. As you know, more than 60 percent of our 309 municipalities have less than 500 people. These small towns simply have no additional resources available to pay higher fees (Pimer, 2006).

3. Small Business Impacts

Additional commenters suggest that EPA's proposed Section 106 grant incentive plan will significantly harm small businesses as States that currently exempt such smaller sources from fees start charging fees, while others that are currently paying fees face precipitous fee increases. These commenters generally rely on projections of the large percentage increase in permit fees that would be needed for a State to achieve EPA's goals as evidence for the likelihood for large impacts on small businesses.

B. CHALLENGES FACED IN QUANTIFYING IMPACTS

There are many challenges to quantifying the impacts of EPA's proposal, starting with the fact that it does not require State participation. Answers to the following questions would be needed in order to quantify the impacts of the permit fee incentive program on small entities:

- How many/which States will choose to apply for the funds?
- What are the NPDES program costs for each of these States?
- What is the percentage of these State's program costs that will be covered via permit fees (States can receive varying shares of money depending on whether they achieve 75, 90, or 100 percent cost recovery)?
- What will be the projected new permit fees for the small entities in these States (i.e., how will States allocate the permit fee increases among each permittee)?
- What resources (e.g., revenues) do these small entities have to pay for these new fees?

Of these questions, the last two bullet items are the most problematic to resolve, and would require resources far beyond those available for this analysis. Given the many challenges involved in quantifying the small entity impacts of EPA's proposed rule, the following section provides a qualitative evaluation of the potential impacts of the incentive program.

C. ASSESSMENT OF POTENTIAL IMPACTS

One approach to estimating the impacts of EPA's proposal is to focus on the potential size of the permit fee increases for States that choose to apply for the incentive funds. Pechan compiled projected fee increase estimates from the public comments supplied on the rulemaking. The most extensive estimates were reported by the Association of State and Interstate Water Pollution Control Administrators (ASIWPCA). ASIWPCA compiled both existing and projected fees for a sample of permits in a number States. In each case, the State developed projected fee estimates assuming 100 percent program cost recovery. Table 1 presents a summary of the information for States that reported at least three sample permit fees.

Table 1. Current and Projected Sample Permit Fees

State	Existing	Projected ¹	Difference	Percentage Increase
Washington	488,417	708,630	220,213	45%
New York	1,027,500	2,140,625	1,113,125	108%
South Dakota	110,650	276,625	165,975	150%
Arkansas	6,926	17,295	10,369	150%
Oklahoma	20,419	83,717	63,298	310%
Iowa	1,825	12,775	10,950	600%

Notes: Figures are for a sample of permits in State (are not State totals).

¹ Assuming 100 percent program cost recovery.

Given the small number of sample permits, and the uncertainties associated with projecting permit fee increases, it is not reasonable to draw firm quantitative conclusions about the impacts of EPA's proposal from these estimates. However, the data do indicate the potential for major impacts as all but one of the six States project permit fees to more than double (the one exception is a State that already obtains more than 75 percent of their program costs from fees).

Other entities report wide-ranging projected fee increases. Citing diseconomies of scale for their State, Alaska estimates particularly large increases: "Alaska communities with populations of less than 150 that are currently paying state wastewater permitting fees of \$550 per year would see their fees increase to \$4,125 per year. Communities with populations between 150 and 2,500 would see their fees increase from \$700 per year to \$5,250" (Murkowski, 2006). However, the American Forest and Paper Association (AF&PA) estimated only a 70 percent increase for AF&PA Members. The AF&PA specifically estimated that members would pay "...at least \$2.8 million on top of the almost \$4 million we have documented they currently pay" (Schwartz, 2007). The AF&PA's projected increase was estimated by asking members what their current fees are and what states they are located in, then increasing these fees by the percentage needed for the State in which they are located to achieve 100 percent program cost recovery.

It is reasonable to assume that the aforementioned large percentage increases would generate significant impacts on some small entities. However, it is difficult to assess the likelihood that these increases will occur. This issue is further emphasized given that many commenters assert that EPA's grant incentive rule will not create a sufficient incentive for States to revise their permit fees. Numerous commenters described the major political effort that was involved in legislating their current fee schedules, and suggest that obtaining buy-in on revisions to achieve an uncertain level of additional funding from EPA (since pay-outs from fund depend on the number of participating States and the level at which each participates) will be impossible. For example, ASIWPCA states that "USEPA's redirection of Section 106 funds will not accomplish the desired result. This incentive proposed will hardly be sufficient for a governor's office or State legislature to justify battling the political pressure against establishing or raising fees and the workload that entails" (ASIWPCA, 2007).

Table 2 displays the results of a survey of 39 States by ASWIPCA/Environmental Council of the States (ECOS)¹ on the percentage of NPDES service costs that are recovered via permit fees. As indicated by the table, a significant majority of respondent States (70 percent) report less than 50 percent cost recovery.

Table 2. Recovery of State NPDES Program Costs through Permit Fees

% of Total Program Cost Recovery	None	Up to 10%	11-24%	25-49%	50-75%	76-100%	No Response
Number of States	5	4	7	10	5	6	2

Source: "Results on ASWIPCA/ECOS Survey on Permit Fee Incentive Rule," accessed from <http://www.asiwpc.org>, May 2007.

The most likely scenario would seem to be that States that already have a large percentage of program costs covered by fees would be the ones likely to participate in EPA's incentive program, while States with no or little program cost recovery from fees will choose not to participate. This scenario would serve to considerably diminish potential small entity impacts.

Furthermore, discussions with ASIWPCA, and a review of permit fee schedules in a few States indicates that permit fees are typically set such that at least a portion of the fee is based on a size measure that may often correlate with size of the permitted entity (e.g., population served by municipality, volume of discharge flow, etc). Small entity impacts will be further reduced by the extent that States achieve permit fee increases via a progressive fee schedule. However, the political realities of each State will ultimately guide the fee schedules adopted in the States that choose to participate in the incentive program.

IV. REFERENCES

ASIWPCA, 2007: Association of State and Interstate Water Pollution Control Administrators, "Notice of Proposed Rulemaking, NPDES Permit Fee Incentive for Clean Water Act Section 106 Grants; Allotment Formula, Summary of Public Comments," March 5, 2007.

Murkowski, 2006: Murkowski, Frank, Governor, State of Alaska, letter to The Honorable Ted Stevens, The Honorable Lisa Murkowski, and The Honorable Don Young, November 22, 2006.

Pimer, 2006: Pimer, Steven M., South Dakota Department of Environment and Natural Resources, letter to Senators Tim Johnson and John Thune and Representative Stephanie Herseth, October 5, 2006.

Schwartz, 2007: Schwartz, Jerry, American Forest & Paper Association, letter to Water Docket, Re: AF&PA Comments on NPDES Permit Fee Incentive for Clean Water Section 106 Grants; Allotment Formula, 72 Federal Register 293 (Jan. 4, 2007): Docket ID No. OW-2006-0765, March 5, 2007.

¹ ECOS is a national non-profit, non-partisan association of state and territorial environmental agency leaders.