



Supplemental Environmental Projects (SEPs) and Their Importance for Reducing Diesel Emissions

Although Congress appropriated \$49.2 million to fund the Diesel Emissions Reduction Act (DERA) in FY2008, this action could potentially REDUCE the available funding to promote diesel retrofit projects due to EPA's interpretation of the Miscellaneous Receipts Act (MRA). The overly broad and varying interpretation of the MRA has the potential to undermine DERA by eliminating an important source of diesel retrofit funding. The following questions and answers are intended to bring clarity to this issue.

What is a SEP? SEPs are environmentally beneficial projects that can be included in enforcement settlements with EPA and the Department of Justice in lieu of civil monetary penalties. They must be related to the violation at issue and further EPA's goal of protecting and enhancing public health and the environment. SEP funds may not be used for purposes of meeting a violator's responsibilities under law or regulation.

What restrictions exist on the use of these funds? EPA has broad discretion to settle enforcement actions and include SEPs as part of any settlement. Nevertheless, the type of permissible project is governed by program guidelines, the most relevant of which for this issue is outlined in its original policy document dated May 1, 1998 which states, *inter alia*, that "SEP projects may not provide to the EPA or another Federal agency additional resources to perform a particular activity for which Congress has specifically appropriated funds, and may not be used to satisfy EPA's statutory obligation to perform a particular activity."

Have these funds been used for retrofits in the past? SEPs have been an important funding stream for diesel retrofit projects. In 2004, Toyota agreed to spend \$20 million on school bus retrofits as part of a SEP. In 2006, Daimler Chrysler entered into a settlement which included a \$3 million SEP for diesel retrofits. As late as last year, settlements with Bunge North America and Equistar Chemicals resulted in more than \$1.5 million worth of diesel retrofits.

Why would diesel retrofit projects now be ineligible for SEP funding? This ineligibility stems from an EPA policy memorandum, "Expanding the Use of Supplemental Environmental Projects," dated June 11, 2003 which cites the Miscellaneous Receipts Act (MRA) as the rationale for prohibiting the use of SEP funds for projects which are otherwise eligible for funding under related programs, such as DERA. The EPA has construed the MRA to preclude "an improper augmentation of the agency's appropriation." *Thus, while diesel retrofit projects are clearly eligible for SEP support under its stated program purposes, specific retrofit projects for which appropriated funds are also available may fall victim to EPA's assumption of an MRA prohibition*

Did the appropriation of Clean School Bus USA funds beginning in 2004 preclude the use of SEPs for school bus retrofit projects? No. Since that time several school bus retrofit projects have been funded from EPA settlements, including some as recently as 2007. According to updated policy memoranda dated 2004 and 2006, EPA concluded that while it “cannot enter SEP agreements which augment EPA’s appropriations by providing the Agency with additional resources to carry out any grant program..., SEPs which are related to a grant-funded activity may be appropriate.” Under this rationale, SEP funds have been used to support established technologies and applications rather than demonstration projects, which are the ostensible purpose of Clean School Bus USA. Moreover, SEP payments to state and local governments are held by EPA not to violate the MRA prohibition. At the least, EPA’s policy has created a very confusing environment.

Why is this issue being raised now? With the first appropriation of \$49.2 million for the broad DERA Program in FY2008, EPA is expected to apply its MRA policy, precluding the use of SEP funds for diesel retrofits, one of the most cost-effective, clean air projects available.

What would H.R. 3754 and S. 2146 do? This legislation would authorize the EPA Administrator to fund diesel retrofit projects as SEPs regardless of Congressional appropriations for this purpose, such as DERA, provided that SEPs meet existing policy guidelines and requirements.

What justification exists for exempting diesel retrofit projects from EPA’s SEP policy and its interpretation of the MRA? 1) Diesel retrofit projects have been found to be among the most cost-effective air quality improvement projects and can significantly improve air quality conditions, particularly in counties which are in nonattainment for particulate matter and nitrogen oxides; 2) A proper interpretation of EPA’s current policy suggests, that notwithstanding the availability of appropriated funds for a particular diesel emission reduction project, EPA may approve a SEP that likewise relates to diesel emission reductions; 3) While SEPs cannot be used to help meet a violator’s legal obligations, diesel retrofit projects can be undertaken in cooperation with state and local governments; 4) The MRA has been applied too broadly and can be justifiably applied in a stricter fashion to not limit the Administrator’s program discretion on SEPs; 5) The appropriated amount remains far short of the \$200 million authorized annually by Congress, and thus there is little risk that total expenditures, including SEPs, will exceed the authorized amount.