

Chapter 7
CO-PERMITTING PROVISIONS IN THE PROPOSED REVISIONS TO THE
NPDES PERMIT REGULATION AND EFFLUENT GUIDELINES AND
STANDARDS FOR CAFOs

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7.2 EXECUTIVE SUMMARY

Co-permitting is a regulatory tool currently applied to discharging facilities under the Clean Water Act. With co-permitting, the EPA and associated permitting authorities would require both owners and operators of concentrated animal feeding operations (CAFOs) to hold NPDES permits.

Three environmental objectives of co-permitting are:

- to improve manure management by contractors/growers via regulatory pressure on the integrators;
- to create a nutrient management system for manure that cannot be utilized on site by the CAFO owners; and
- to create an incentive for the integrator to minimize source loading of nutrients and compounds (e.g. in feed) that directly or indirectly impact the composition of the manure residual.

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The apparent environmental policy objective of co-permitting and the EPA proposed alternatives is to increase environmental oversight of excess manure transferred offsite from CAFOs and applied to land not covered by a CAFO's Permit Nutrient Plan.

Co-permitting would impact several business organizations operating in Missouri. Entities that own animals housed in a CAFO or have significant control over how the animals are raised may be required to have a NPDES permit (and associated environmental liability) along with the owner of the CAFO. Co-permitting would definitely affect integrated poultry production and large-scale integrated hog production. It would likely affect cattle feeding, locally owned sow coops and heifer replacement arrangements in dairy production where these enterprises fall under the definition of a CAFO.

Potential positive aspects of co-permitting include:

- better feed management to reduce excreted nutrients;
- integrator fostering better environmental compliance of growers; and
- additional compliance resources from corporate entities.

Potential negative aspects of co-permitting include:

- decrease the operator's leverage in contract negotiations with the corporate entity;
- increase corporate pressure on operators to indemnify corporate entities against potential liability for non-compliance on the part of the operator;
- encourage corporate entities to interfere in the management of the CAFO;
- provide pretext for corporate entities to terminate contracts;
- restrict the freedom of operators to change integrators; and
- add costs that would be passed from corporate entities to small operators.

Co-permitting will result in an increase in administrative and manure management costs as well as regulatory monitoring and enforcement costs related to excess manure that had previously been transferred from CAFOs. Co-permitting will likely have a negative impact on market transactions for excess manure. The environmental objectives of co-permitting may be obtained with market mechanisms or other regulatory rules.

The EPA is soliciting comments on who should be covered by the proposed co-permitting regulations and how the rules should be implemented, but the EPA is not soliciting comment as to the authority of the agency to require co-permitting. The EPA is also considering alternatives to the co-permitting requirement.

7.3 INTRODUCTION

The objective of this paper is to provide background information on an environmental policy mechanism typically referred to as co-permitting. While not a new regulatory concept, co-permitting in relation to concentrated animal feeding operations is a recent development. The primary focus is to state the objectives of entities proposing co-permitting, consider who would be affected in Missouri by a co-permitting rule, present

the questions, issues and concerns surrounding the implementation of co-permitting regulations and offer alternatives to co-permitting.

7.4 BACKGROUND

Under the Clean Water Act (CWA), the Environmental Protection Agency (EPA) or a National Pollution Discharge Elimination System (NPDES) permitting authority can require either the owner or operator, or both the owner and operator, of a discharging facility to hold an NPDES permit.

To understand co-permitting, consider the situation where a municipality owns a wastewater treatment facility but contracts with an independent firm to operate the facility. Co-permitting would require that both the owner (municipality) and operator (private firm) of the wastewater treatment facility have NPDES permits. The operator is required to have a permit because it controls what happens at the “end of the pipe” with treatment practices and technology. The municipality is required to have a permit because it can influence what goes into the “beginning of the pipe” with zoning and discharge ordinances. The EPA points out that in certain cases under the CWA, it is appropriate for only the operator of a facility to be permitted and likens the CAFO owner to an investor that builds a factory and leases it to a manufacturing entity. The owner of the factory may not need a NPDES permit to discharge, as the investor does not control the industrial process.

The apparent rationale for permitting both the owner and the operator is at least threefold: 1) requiring the operator to have a permit and associated liability should ensure proper operation of the plant; 2) requiring the municipality to be permitted and liable for the performance of the facility provides additional environmental oversight and; 3) liability faced by both entities theoretically provides an incentive for the municipality to work with the operating contractor to minimize the chance of noncompliance.

Significant environmental regulation of livestock has been proposed and enacted at almost every level of government, from local to federal levels. The impetus to this regulatory activity is related to the increase in the density of livestock production in many areas.

Changes in the structure of ownership of livestock feeding operations have also caused some to call for increased regulations. Poultry production has been a contract production industry for many years. There has recently been a substantial increase in contract hog production as well. Increased contract production has resulted in: 1) partitioning of decision making (e.g. the grower feeds the animals but does not decide what feed ingredients are used) and control rights (e.g. the integrator decides how the birds are to be raised while the grower decides how the manure from the birds is to be land applied), and 2) divergence in the ownership of livestock and ownership of the facilities in which they are raised. These differences in ownership and control with

respect to permitted facilities gives the impression that co-permitting of CAFOs may be similar to other historically regulated entities under the Clean Water Act.

Recently the state of Kentucky proposed the co-permitting of owners and operators of CAFOs using language similar to that proposed by the EPA regulation (Federal Register-1/12/01, vol. 66, no.9). This co-permitting regulation was vacated (set aside) in late May 2001 by a Franklin County, KY circuit court, primarily due to questions regarding the method utilized by the governor to establish the regulation, not because of the regulation itself. The recently vacated co-permitting regulation can be found in the Kentucky Statement of Emergency 401 KAR 5:074E, contained in Appendix A.

7.5 ENTITIES SUBJECT TO CO-PERMITTING

Co-permitting for CAFOs is a regulatory mechanism proposed by the EPA that could require both the owner of a CAFO (grower) **and** entities that exercise substantial operational control over the CAFO (integrator) to obtain a permit under National Pollutant Discharge Elimination System (NPDES) permit regulations. From page 3136 of the Federal Register-1/12/01, vol. 66, no.9:

“(3) *Co-permitting*. Any person who is an “operator” of a CAFO on the basis that the person exercises substantial operational control of a CAFO (see § 122.23(a)(5)(ii)) must apply for a permit. Such operators may apply for an NPDES permit either alone or together as co-permittees with other owners or operators of the CAFO.”

The EPA defines “substantial operational control” on page 3024 of the Federal Register-
:

“The proposed regulation lists factors relevant to “substantial operational control,” which would include (but not be limited to) whether the entity: (1) Directs the activity of persons working at the CAFO either through a contract or direct supervision of, or on-site participation in, activities at the facility; (2) owns the animals; or (3) specifies how the animals are grown, fed, or medicated. EPA is aware that many integrator contracts may not provide for direct integrator responsibility for manure management and disposal. EPA believes, however, that the proposed factors will identify integrators who exercise such pervasive control over a facility that they are, for CWA purposes, co-operators of the CAFO.”

Under the proposed regulations, two key factors will trigger co-permitting on a given animal feeding operation: 1) designation as a concentrated animal feeding operation, and 2) existence of multiple “Operators” under the substantial operational control definition above. It is likely the EPA will change the CAFO definition to 500 or perhaps 300 animal units, down from 1000, thus increasing the number of integrated animal feeding operations classified as CAFOs. It would also seem clear that most integrated poultry and integrated pork production in Missouri would meet the definition of “substantial operational control.” Consequently, it appears that most of the state’s integrated swine and poultry operations would be in a co-permitting situation under the

proposed rules. Other production arrangements that may or may not require co-permitting include: 1) cattle feeding, where livestock are owned by one person who has very little other control over the raising of the animals; 2) sow cooperatives where several farmers combine to hire someone to manage sows they own to provide them with weaner or feeder pigs; and 3) dairy herd replacement operations, where a dairy hires another to feed its replacement females.

While most references to co-permitting are made in respect to large integrators, it is not clear whether or not it will have an impact on small scale business organizations.

7.6 THE ENVIRONMENTAL OBJECTIVES OF CO-PERMITTING

There are two explicit objectives of the proposed co-permitting rules. The first objective is to improve manure management by contractors/growers via regulatory pressure on the integrators.

“Today’s proposal would specify that the disposition of excess manure would remain the joint responsibility of all permit holders. See proposed § 122.23(i)(9). Integrators would thereby be encouraged to ensure compliance with NPDES permits in a number of ways, including: (a) establishing a corporate environmental program that ensures that contracts have sound environmental requirements for the CAFOs; (b) ensuring that contractors have the necessary infrastructure in place to properly manage manure; and (c) developing and implementing a program that ensures proper management and/or disposal of excess manure. The proposed requirement will give integrators a strong incentive to ensure that their contract producers comply with permit requirements and subject them to potential liability if they do not. Integrators could also establish facilities to which CAFOs in the area could transfer their excess manure (Federal Register-1/12/01, vol. 66, no.9, page 3025).”

The second stated objective is to create a nutrient management system for manure that cannot be utilized on site by the CAFO owners:

“All permittees would be held jointly responsible for ensuring that manure production in excess of what can be properly managed on-site is handled in an environmentally appropriate manner (Federal Register-1/12/01, vol. 66, no.9, page 3025).”

There may be an implicit goal of creating an incentive for the integrator to minimize source loading of nutrients and compounds that directly or indirectly impact the composition of the manure residual. The typical structure of production contracts is that feed and live animals are the property of the integrator while manure and dead animals are the property and responsibility of the contractor/grower. Thus, economic considerations on the part of the integrator in feed formulation or input compound choices are likely to be solely based on the economic value or return per hog/bird. For example, the integrator chooses the level of supplemental phosphorus added to the feed, which in turn affects the phosphorus level in manure. Under the proposed rules, increased levels of phosphorus in the manure will likely result in increased manure management costs. With co-permitting, the integrator may also incur new and/or

increased manure management costs. Without co-permitting, the integrator would not experience the increased manure management costs associated with excess phosphorus in the manure and would likely choose a supplemental phosphorus level greater than would be the case if co-permitted.

7.7 APPARENT POLICY OBJECTIVES OF CO-PERMITTING

While not explicitly stated by the EPA, the apparent policy objective of co-permitting as well as the co-permitting alternatives presented in the Federal Register (and below) is to increase the level of environmental regulation of manure that is applied outside of Permit Nutrient Plans (PNP) on land not owned or controlled by CAFO owner/operators (See Appendix B for a brief explanation of the PNP). Currently, CAFO owners must follow a PNP for all manure that is applied to land owned or controlled by the CAFO. However, the CAFO owner may transfer (sell or give away) manure in excess of what can be applied on-site. Currently, the CAFO owner is not responsible or liable for the excess manure transferred to a third party. The third party recipient of the manure does not have to apply the manure under a PNP. As detailed in the above Federal Register excerpt, the EPA clearly intends that “the disposition of excess manure would remain the joint responsibility of all permit holders” and would create new liability and expense for integrators and growers/contractors who were previously transferring excess manure.

Co-permitting appears to be a means of creating a consistent level of environmental oversight on all land applied manure, i.e. all land receiving manure would be subject to a PNP. The liability created by the co-permit is apparently intended to provide the incentive to integrators to enforce NPDES requirements, but also assure that all manure generated on the CAFO is applied under the same standard as manure applied by the CAFO owner. The increased scrutiny of manure exported from CAFOs has the benefit of insuring better environmental oversight than under current rules. However, a policy objective that has the unintended consequence of making manure a very undesirable substitute for unregulated commercial mineral fertilizer will only increase the degree of infrastructure and institutional development requirements needed to achieve the policy objective. Specific issues related to this last point are contained in the last section of the paper.

7.8 COMMENTS RECEIVED BY THE EPA

In the normal regulatory process, the EPA seeks comments from interested parties and is required to solicit input from entities affected by proposed regulation. A portion of the input that the EPA has already received is presented here. In the following section, issues and concerns beyond these EPA comments are presented.

(For the readers of this paper who may go to the Federal Register in follow-up, it useful to understand that the following comments were made to/obtained by the EPA upon announcement of the new CAFO regulations as required by the Regulatory Flexibility

Act (RFA) and the Small Business Regulatory Enforcement Fairness Act (SBREFA). The RFA and SBREFA require the EPA to carefully consider the economic impacts rules will have on small entities. The SBREFA amended the RFA to require the EPA to convene a small business advocacy review panel prior to proposing any rule that will have a significant economic impact on a substantial number of small entities. Thus, the following comments were solicited upon announcement (prior to the current proposal) of the CAFO regulations per RFA/SBREFA.)

Some of these comments and concerns have been reported on pages 3025 and 3026 of the Federal Register-1/12/01, vol. 66, no.9 and the following are paraphrased or verbatim highlights from those pages:

- A majority of the SERs (Small Entity Representatives) were opposed to co-permitting, expressing concern that co-permitting could:
 - decrease the operator's leverage in contract negotiations with the corporate entity,
 - increase corporate pressure on operators to indemnify corporate entities against potential liability for non-compliance on the part of the operator,
 - encourage corporate entities to interfere in the operation management,
 - provide pretext for corporate entities to terminate contracts,
 - restrict the freedom of operators to change integrators
- A few SERs, who were not themselves involved in a contractual relationship with a larger corporate entity, favored co-permitting as a way of either leveling the playing field between contract and independent operators, or extracting additional compliance resources from corporate entities.
- SERs were not convinced that co-permitting would result in additional corporate resources being directed toward environmental compliance.
- SERs were not convinced that co-permitting would result in any benefit to the environment, given that the operator generally controls those aspects of a feedlot's operations related to discharge.
- Despite general concern over co-permitting due to the economic implications for the contractor, several SERs voiced their support for placing shared responsibility for the manure on the integrators, especially in the swine sector.
- The SBAR (Small Business Advocacy Review) Panel also expressed concern that any co-permitting requirements may entail additional costs, and that co-permitting cannot prevent these costs from being passed on to small operators, to the extent that corporate entities enjoy a bargaining advantage during contract negotiations. The Panel thus recommended that the EPA carefully consider whether the potential benefits from co-permitting warrant the costs, particularly in light of the potential shifting of these costs from corporate entities to contract growers.

- Commenters have noted that integrators have a bargaining advantage in negotiating contracts, which may ultimately allow them to force producers to incur all compliance costs as well as allow them to pass any additional costs down to growers that may be incurred by the processing firm.

The EPA also entered the following in the Federal Register on page 3026:

“The Panel did not reach consensus on the issue of co-permitting. On the one hand, the Panel shared the SER’s concern that co-permitting not serve as a vehicle through which the bargaining power and profits of small contract growers are further constrained with little environmental benefit. On the other, the Panel believed that there is a potential for environmental benefits from co-permitting. For example, the Panel noted (as discussed above), that co-permitted integrators may be able to coordinate manure management for growers in a given geographic area by providing centralized treatment, storage, and distribution facilities, though the Panel also pointed out that this could happen anyway through market mechanisms without co-permitting if it resulted in overall cost savings. In fact, the Agency is aware of situations where integrators do currently provide such services through their production contracts. The Panel also noted that co-permitting could motivate corporate entities to oversee environmental compliance of their contract growers, in order to protect themselves from potential liability, thus providing an additional layer of environmental oversight.”

7.9 ALTERNATIVES TO CO-PERMITTING

The EPA has proposed two alternatives to co-permitting. The following is from the Federal Register-1/12/01, vol. 66, no.9, page 3027:

“EPA also considered alternative approaches under which EPA would waive the co-permitting requirement for States and processors that implement effective programs for managing excess manure and nutrients. One such approach would require the disposition of manure that is transported off-site to remain the joint responsibility of the processor and other permit holders, unless an enforceable state program controls the off-site land application of manure. For example, if the State program addressed the off-site land application of manure with PNP [Permit Nutrient Plans] development and implementation requirements that are equivalent to the requirements in 40 CFR 412.13(b)(b) and 122.23(j)(2) [i.e. the regulations currently imposed on CAFOs], it would not be necessary to permit the processor in order to ensure the implementation of those requirements. Another approach would be based on whether the processor has developed an approved Environmental Management System (EMS) that is implemented by all of its contract producers and regularly audited by an independent third party. EPA anticipates that the alternative program would be designed to achieve superior environmental and public health outcomes by addressing factors beyond those required in this proposed regulation, such as odor, pests, etc.”

There is little discussion in the Register with regard to enforceable state programs addressing the off-site application of excess manure. However, there are a number of issues associated with a Permit Nutrient Plans, (PNP) that are currently required of CAFOs (requirements in 40 CFR 412.13(b)(b) and 122.23(j)(2)), that would increase costs to producers and make third party or off-site applicators reluctant to buy or receive manure. With regard to the second alternative, the EPA only describes some desirable

features an EMS should or would contain and not what would constitute an “acceptable” EMS. While there are a number of positive features of the EMS approach, it is not readily apparent from the EMS discussion of pages 3027 and 3028 of the Federal Register-1/12/01, vol. 66, no.9, that the entity avoiding a co-permitting situation via an EMS approach reduces its compliance costs or environmental liability relative to co-permitting. Furthermore the EPA acknowledges that “... an EMS approach could be more difficult to administer and enforce [than co-permitting].”

7.10 OTHER CONCERNS AND ISSUES

The current disparity in environmental oversight between manure applied under the CAFO owner’s PNP and excess manure transferred to a third party is a serious environmental issue. It is apparent that both the co-permitting proposal and the EPA proposed alternatives are means to bring a greater proportion of land applied manure under a PNP. The co-permitting and EMS alternative would appear to cover excess manure application in contract CAFO situations. The alternative involving enforceable state programs regulating the application of excess manure based on a PNP would appear to bring excess manure from both contract and independent CAFOs under a PNP.

The overriding issue with regard to excess manure is that under the current regulations, no one bears the direct and significant costs that would be associated with the liability, administration/red tape and manure management, as well as the regulatory burden, if the manure were subject to the NPDES CAFO rules. The proposed regulations would monetize these costs via co-permitting, EMS or PNP-based state regulations. Numerous questions and issues arise as the existence and distribution of these new costs are considered.

Clearly the alternative of an enforceable state PNP-based program places the regulatory monitoring and enforcement costs on the state NPDES permit authorities. Under this scenario, the costs of managing the excess manure under a PNP would fall on the CAFO owner and the third party accepting the manure if it chose to do so. The CAFO owner in this situation would incur increased liability to the extent that application of excess manure would now fall under the CAFO’s NPDES permit. The integrator under this arrangement would not be required to contribute any resources to the new compliance burden and would not have any liability for the manure management or composition of the manure.

Under a co-permitting or EMS situation, as mentioned above, the regulatory cost burden would be borne by the integrator. In addition to monitoring and enforcement costs, the integrator would incur: 1) environmental liability and manure management cost of the excess manure and, 2) liability for the manure managed onsite and previously the responsibility of the CAFO owner. The increased costs and risks to the integrator, in reality, are borne by consumers, the growers and investors. The allocation between the

three is difficult to estimate. However, the process by which increased costs and risks are allocated or absorbed in the market is not a friendly one, but one where growers and integrators who are least able to comply face failure.

Under either scenario a difficult issue arises as to the third party that had previously bought or accepted the manure (and may well have applied it in a responsible manner). In any of the co-permitting or alternative scenarios it would appear that the regulations create a disincentive to farmers to accept manure from CAFOs. Under current and proposed regulation, a non-CAFO landowner can purchase and apply commercial fertilizer without a PNP. Thus in the marketplace, nutrient variability and application challenges combined with regulation make manure an increasingly undesirable substitute for commercial fertilizer. Under co-permitting there is the potential that farmers receiving manure from a CAFO will need to supply the CAFO or the integrator managing the manure with data needed to complete a PNP. The new data requirements include extensive soil test results, crop yield histories, tillage practices, 5-year crop rotation, and annual yield data at harvest. The farmer receiving the manure also will be unable to apply additional fertilizer on the field in addition to manure unless it is acceptable based on the EPA recommendations.

Once a PNP is introduced into the excess manure transaction, transaction costs increase, the non-CAFO landowner loses flexibility as to fertility management and may be incurring new liability. At best, these issues would increase the cost to the CAFO owner in terms of inducing the manure transfer transaction but may preclude the transaction completely. Environmental degradation from manure is also likely to be associated with the absence of a market for the manure. Were an efficient market to exist for manure nutrients, managers would participate in it to maximize their profit. An alternative to co-permitting (which adds costs without certain gain in environmental quality) would be to foster markets for manure.

Given co-permitting or an EMS arrangement, it would be unreasonable to assume that the status quo would be maintained with respect to manure managed by the CAFO owner. At the very least it would seem likely that the added liability to the integrator would result in increased expense to the CAFO owner in terms of proving compliance to the integrator. Another significant possibility would be that the integrator would assume all responsibilities for manure management. Under this arrangement, grower compensation would almost certainly decline and the grower would lose control of the nutrient resource. Under this arrangement, the neighbor that previously was willing to accept manure would be faced with dealing with a third party that would dictate compliance with a PNP that may be inconsistent with the environmentally responsible agronomic goals of the neighbor. The possibility of the integrator assuming responsibility for manure management may sound equitable or appealing to some stakeholders, but given a reduction in contract returns, the tradeoff could be an economic burden.

The greatest impact of increased regulation of excess manure would fall on those growers with the least land relative to the manure produced in the CAFO. Under current regulations, for example, poultry growers that often own only small acreages have been able to transfer excess manure to third parties, often at positive prices or in exchange for new litter. Under co-permitting or state PNP-based regulation, this economic arrangement changes dramatically. The likely move from a nitrogen to a phosphorus standard for manure application under PNPs will only exacerbate the situation.

How firms that engage in CAFO level contract production would react to these new costs and liabilities is not clear. It is plausible that packers engaged in contract production would seriously consider abandoning the practice in the face of dramatically increased liability. In the swine industry, the majority of hogs are procured under marketing contracts or cash transactions, which according to the EPA would not typically constitute “significant operational control” and thus would not require co-permitting. Poultry processors on the other hand procure birds almost exclusively under contract production arrangements, so the implications are more severe for that industry. Some pork and poultry integrators may consider owning or leasing production facilities and eliminate the contract growers. In the near term, it is questionable if this latter consideration is a realistic option for most integrators, given the enormous capital requirements of owning or controlling the production facilities with little additional profit from doing so. Furthermore, meatpacking and poultry processing have not been high return industries and thus increased risk and lower returns associated with the proposed regulation would not seem to facilitate debt or equity financing.

Often, contract production is associated with large corporations; however the proposed regulations will likely impact a number of smaller operations as well. There are a number of relatively small operations in the state that regularly or occasionally contract with nearby farmers to finish swine. While these smaller contractors should not be held to a lower environmental standard, these operations will typically not have the resources to absorb an adverse environmental outcome caused by another contracting farmer. Dairy herd replacement operations, if classified as a CAFO, could be threatened as well. Often the dairy operation that contracts for the replacements is hundreds of miles away and may be reluctant to be responsible for the actions of another farmer over such distances. Members of the emerging sow cooperatives around the state may face difficult liability positions as well. In these situations, if the farmer that has a small interest in the co-op must be co-permitted, the liability relative to his/her home farm operation may be dramatically out of proportion. These local co-permitting situations perhaps best illustrate the instance where the cost of what may be a very small marginal and uncertain environmental improvement will likely be greater than these entities are able to bear.