The Legal Intelligencer
THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2012
PHILADELPHIA, FRIDAY, FEBRUARY 24, 2012 VOL 244 • NO. 37 An ALM Publication

ENVIRONMENTAL LAW

Uncertainty Looms Over EPA's Cross-State Air Pollution Rule

BY KATHERINE L. VACCARO AND DIANA A. SILVA
Special to the Legal

In recent years, the Environmental Protection Agency has promulgated a number of regulations affecting the energy sector. Last year was no exception, with the EPA issuing several new rules aimed at curbing air emissions from electric generating units (EGUs). One of the most important — and potentially most costly — of the EPA's recent regulations is the Cross-State Air Pollution Rule (CSAPR), formally titled "Federal Implementation Plans: Interstate Transport of Fine Particulate Matter and Ozone and Correction of SIP Approvals." CSAPR is a direct response to the U.S. Court of Appeals for the D.C. Circuit's 2008 remand of the Clean Air Interstate Rule, or CAIR (*North Carolina v. EPA*). The D.C. Circuit remanded CAIR without vacating it, and directed the EPA to continue to implement the underlying regulatory scheme until the agency could develop a replacement rule to lawfully fulfill the objectives of CAIR.

CSAPR, like CAIR, regulates the interstate transport of air pollution through the use of an emission allowance-based cap-and-trade program applicable to EGUs in 27 states, including Pennsylvania, New Jersey and New York. CSAPR is designed to reduce emissions of nitrogen oxides and sulfur dioxide. The EPA has concluded that nitrogen oxides and sulfur dioxide are "precursors" that react in the atmosphere to form ozone and fine particulate matter. The EPA previously established National Ambient Air Quality Standards (NAAQs) for both ozone and fine particulate matter pursuant to Section 110 of the Clean Air Act (CAA). The EPA estimates the projected annual costs of CSAPR at over $800 million, in addition to the $1.6 billion per year in capital investments that the EPA recognizes are already under way in response to CAIR. Moreover, CSAPR's projected compliance costs, and the uncertainty surrounding the rule's implementation, are likely to have meaningful impacts on the electricity bidding markets in Pennsylvania and other states.

CSAPR was published in the Federal Register on Aug. 8, 2011, and was scheduled to take effect on Jan. 1, 2012. Almost immediately after the final rule was promulgated, interested parties, including many utility companies, filed motions with the D.C. Circuit, asking the court to stay the rule. On Dec. 30, 2011 — less than 48 hours before the rule was to take effect — the court issued an order granting the stay motions. In its per curiam order staying CSAPR, the court ordered the EPA to continue to administer the CAIR program pending the court's resolution of the challenges filed in response to CSAPR.


VACCARO


SILVA

KATHERINE L. VACCARO AND DIANA A. SILVA *are attorneys with the environmental, energy, and land use law and litigation firm of Manko Gold Katcher & Fox. They can be reached at 484-430-5700 or via e-mail at kvaccaro@mgkflaw.com or dsilva@mgkflaw.com.*

In addition to filing motions to stay CSAPR, many parties also filed petitions for review with the court, challenging the validity of the rule. Pennsylvania-based EME Homer City Generation L.P. filed the first petition for review with the D.C. Circuit on Aug. 23, 2011. Nearly 100 additional parties followed suit, challenging one or more aspects of CSAPR. These petitioners include 58 utility and utility-related entities, 16 public agencies, 15 state governments and three city governments. The court has consolidated all the petitions for review into the lead case, *EME Homer City Generation L.P. v. EPA*, and has designated the case as complex.

While numerous parties have objected to the rule, a number of other parties have intervened in support of CSAPR, including several energy companies, as well as several environmental and public health organizations. Some of CSAPR's supporters argue that the health and environmental benefits that will be achieved by the rule outweigh the compliance burdens and associated costs. Several states and major cities have also intervened on behalf of the EPA, citing the ongoing challenges they will continue to face without CSAPR in complying with the NAAQs and the effect of interstate pollution transport on the health of local populations.

Some of CSAPR's unique features provided fodder for the petitioners' legal challenges. First, CSAPR establishes an effective date of Jan. 1, 2012 — less than five months after the promulgation of the final rule. By contrast, the EPA's two prior attempts to regulate nitrogen oxides and sulfur dioxide emissions from EGUs, CAIR and the NOx SIP Call, each provided nearly four years between the promulgation of the final rule and the initial compliance deadline. The EPA itself acknowledges that it would take substantially longer than five months to install the pollution controls necessary to achieve the emission reductions required under CSAPR.

Second, CSAPR relies on Federal Implementation Plans, or FIPs, to establish predetermined source-specific allowance allocations for the rule's initial control period, but does not afford the states an opportunity to allocate allowances among affected EGUs within their boundaries. Conversely, the EPA's prior interstate pollution transport programs established statewide emissions budgets but then allowed each state to determine how best to allocate its budget to individual sources. This approach enabled the states to take into account localized issues, as well as certain operating distinctions among different EGUs of which the states are uniquely aware. Under CSAPR, states do not have any flexibility to allocate allowances on a source-specific basis through their own State Implementation Plans, or SIPs, until 2013, at the earliest, and even then, such flexibility is limited. Accordingly, state government petitioners have argued that, by implementing CSAPR through FIPs, the EPA has usurped the states' authority to regulate interstate pollution transport under CAA Section 110, thereby violating the "cooperative federalism" concepts mandated by the CAA.

Petitioners have also attacked the methodology the EPA used to determine the emission budgets for each state, and in turn, the allowance allocations for individual EGUs, citing inaccuracies in the data relied upon by the EPA and the incorporation of such data

into the EPA's emissions projections models. Others have argued that CSAPR effectively compels certain facilities to purchase additional allowances from their competitors as the only realistic compliance demonstration option. CSAPR allocates allowances to these facilities at levels substantially less than historic emission rates for one or more of the regulated pollutants. Given CSAPR's effective date, these facilities cannot feasibly install necessary controls as a means of demonstrating compliance. The concerns implicated by the compelled reliance on allowance trading are compounded when taking into account the uncertainty inherent in CSAPR's allowance trading programs. In particular, the application of CSAPR's "assurance provisions" (which are triggered in a particular state when the collective emissions from EGUs in that state exceed the state's budget established by the EPA) would require certain affected facilities to surrender additional allowances to the EPA as a penalty, on top of those already required to cover the facility's emissions during the relevant control period. It is unclear at this time whether sufficient numbers of emission allowances will be available to ensure that such facilities will be able to fully comply with CSAPR.

Still other petitioners have argued that in order to comply with CSAPR's emission reduction requirements, some EGUs will be forced to reduce their overall electricity generation, at least during the early years of implementation. Petitioners have opined that in some regions, this reduction in generation output may undermine the reliability of the electric grid, potentially causing interruptions in electricity, particularly during the summer months, when demands on the grid are typically the highest. Likewise, many petitioners have stressed that the costs of complying with CSAPR may lead to increases in consumer electricity rates, and potentially force certain utilities to close their doors and eliminate jobs amidst an otherwise struggling economy.

Petitioners have also challenged CSAPR on the basis that it violates the notice and comment requirements of the CAA and the Administrative Procedure Act, arguing that the final rule was not a "logical outgrowth" of the proposed rule. Specifically, the argument asserts that the final version of CSAPR includes substantial revisions that were not included in the proposed version of the rule, and the EPA failed to provide adequate notice of such revisions.

As a matter of law, the court would not grant a stay without concluding, among other things, that movants had demonstrated a probability of success on the merits on their underlying claim. Although the court's Dec. 30, 2011, order staying CSAPR does not provide any explanation of the reasoning behind the court's decision, it is reasonable to assume that the court concluded — at least for purposes of granting the stay — that the petitioners had demonstrated a likelihood of success on the merits.

However, despite granting the stay, the court has imposed an aggressive schedule for reviewing the merits of the case. The parties submitted joint briefing proposals on Jan. 17, and the court issued an order the following day, adopting a more expedited briefing schedule than either the petitioners or the EPA had proposed — a surprising outcome in comparison with schedules established for similar challenges to EPA regulations filed in the past. Per the court's order, the petitioners' joint briefs were filed on Feb. 9. The EPA's response must be filed by March 1. Petitioners will then have 10 days to submit their reply briefs. The court is set to ultimately hear oral argument in the case on April 13. By comparison, in the *North Carolina* decision, which remanded CAIR, the briefing schedule spanned a six-month time frame, rather than the mere six weeks afforded by the court in the instant case. With this schedule, the court could issue a final decision as early as June 2012.

If the D.C. Circuit ultimately determines to uphold CSAPR, even in part, the EPA could, in theory, begin administering CSAPR before the end of 2012.

Adding to the complexity of the CSAPR litigation is the fact that many parties have also filed administrative challenges to the rule, in addition to the judicial challenges currently pending before the court. Approximately 62 petitions for reconsideration were filed directly with the EPA, seeking administrative reconsideration of various aspects of CSAPR. As of the date of this article, the EPA has yet to act on any of these petitions, nor has the agency given any indication of if or when it will act. Petitioners have argued to the court that this situation presents unique ripeness issues, because a number of the petitioners' specific issues may ultimately be resolved at the administrative level, if and when the EPA acts on the pending petitions for reconsideration.

Furthermore, despite continuing to defend the validity of CSAPR, the EPA has already issued certain "technical" revisions to CSAPR. These revisions were proposed in October 2011 and released in final form on Feb. 7. These revisions include increasing certain states' emissions budgets, and postponing (until January 2014) the effectiveness of CSAPR's assurance provisions. Following the publication of the final revisions to CSAPR in the Federal Register on Feb. 21, such revisions will likely give rise to a separate set of legal challenges before the D.C. Circuit. Finally, also at the administrative level, on Dec. 27, 2011, the EPA issued a supplemental rule that extends the application of CSAPR's ozone season nitrogen oxides trading program to five new states, presenting yet another opportunity for parties to challenge CSAPR going forward.

The complexity of the pending *Homer City* litigation, the EPA's supplemental rulemaking efforts to revise CSAPR, and the agency's lack of response to the pending administrative petitions for reconsideration have jointly contributed to an atmosphere of extreme uncertainty for interested parties, including, in particular, power companies attempting to plan for future operations of their facilities. For example, the court's stay decision has already halted the nascent trading markets for CSAPR emission allowances and created uncertainty for CSAPR allowance transactions that have already been executed.

If the D.C. Circuit ultimately determines to uphold CSAPR, even in part, the EPA could, in theory, begin administering CSAPR before the end of 2012. However, such a proposition fails to account for the practical challenges that would necessarily be associated with attempting to begin implementing the rule's trading programs midway into the 2012 control period. Given these, and other practical problems, if CSAPR is upheld, the EPA may continue to administer CAIR throughout 2012. Interested parties will hopefully receive greater clarity on these issues as things continue to unfold both at the judicial level and on the regulatory-development front. •