

# KIRKLAND ALERT

June 2014

## EPA's Continued Regulatory Barrage on Fossil Fuel-Fired Electric Generation

EPA has unveiled yet another in a series of actions aimed at regulating electric generating units, and in particular, fossil fuel-fired generation. This latest proposal, EPA's "*Clean Power Plan*," exercises authority under Section 111(d) of the Clean Air Act to reduce greenhouse gas ("GHG") emissions from existing fossil fuel-fired electric generating units. In a related action on the same day, EPA proposed GHG performance standards for modified and reconstructed fossil fuel-fired electric generating units pursuant to Section 111(b) of the Clean Air Act.

EPA has recently promulgated rules (or has committed to promulgate rules) for these sources under not only the Clean Air Act, but also the Resource Conservation and Recovery Act, and the Clean Water Act. Indeed, in the air regulatory space, these sources are subject to EPA's *Clean Air Interstate Rule* (intended by EPA to be replaced by its *Cross-State Air Pollution Rule*, now on remand to the D.C. Circuit following the Supreme Court's April 29, 2014 decision), and the *Mercury and Air Toxics Standards*. EPA is poised to issue a waste rule regulating *coal combustion residuals*. In the water regulatory space, EPA recently promulgated its final *cooling water intake rule* and has committed to promulgate *effluent limitations for wastewater discharges* by September 30, 2015.

### *EPA's Coal-Fired Power Plant Enforcement Initiative*

EPA took major action against coal-fired power plants in November 1999, when the Justice Department, on behalf of EPA, filed lawsuits against seven electric utility companies operating coal-fired power plants in the Midwest and Southeast. At the heart of these lawsuits were allegations that these companies had modified their units in violation of the New Source Review requirements of the Clean Air Act. EPA has continued to pursue such enforcement actions against this sector. Indeed, EPA continues to maintain a "*National Enforcement Initiative*" directed specifically at coal-fired power plants.

Through its National Enforcement Initiative, EPA secures commitments from settling companies to reduce air pollutants, including sulfur dioxide, nitrogen oxides, and particulate matter. In these settlements, EPA has also successfully negotiated provisions that reduce GHG emissions, by way of retirements of coal-fired units or conversion of such units to combust natural gas or biomass. In a landmark settlement in 2011, the *Tennessee Valley Authority* agreed not only to unit retirements and conversions but also to perform energy efficiency projects and to invest in clean and renewable sources of energy as part of a mitigation package. Thus, the Agency's recent proposed GHG rule for existing sources continues the direction EPA's enforcement office has already taken to reduce GHG emissions from this sector.

**EPA's proposed GHG rule for existing sources under Section 111(d) continues the direction EPA's enforcement office has already taken to reduce GHG emissions from this sector.**

A recent trend in environmental litigation, the so-called “sue and settle” phenomenon, gave rise to the Agency’s GHG rulemakings under Section 111. The genesis of these rules was a consent decree EPA entered into with environmental groups resolving litigation at the end of 2010. Through its New Source Review litigation, EPA has imposed limitations on GHG emissions in settlements with power plants. In the Section 111 context, EPA has leveraged itself into regulating GHGs, again in settlement of litigation. And while EPA may have the authority to include retirements, unit conversions, energy efficiency projects, or investment in renewable energy in settlement of an enforcement action, its authority to require fossil fuel-fired units to reduce GHG emissions pursuant to Section 111(d) of the Clean Air Act through such strategies is questionable. In addition to this fundamental question of EPA’s authority under Section 111(d), there are a panoply of other legal issues associated with this proposed rulemaking including: EPA’s determination that best system of emission reduction (“BSER”) includes carbon reductions from sources outside of the facility, the development of emission guidelines that prescribe emission standards as opposed to setting forth plan requirements, and an intrusion into the states’ authority to consider the appropriateness of carbon standards in light of the “cost of control resulting from plant age or basic design.”

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### *Overview of EPA’s Proposed Rule*

On June 2, 2014, EPA proposed state-specific goals to achieve a 30% reduction in the nation’s GHG emissions from 2005 levels by 2030. As proposed, each state’s goal is an emission rate. There is an interim rate applicable from 2020-2029, and a final rate that applies beginning in 2030. EPA left open the option that the states could convert their emission rates into mass-based limits, to provide flexibility to the states in meeting the goals and to facilitate multi-state trading programs. The states will determine how they achieve EPA’s prescribed GHG goals through the preparation of state plans. The plans are to be submitted by June 2016, though EPA acknowledges that extensions are available under certain circumstances, to as late as 2018.

EPA’s proposed emission rates do not apply to specific electric generating units directly. Rather, the rates (or mass limits) must be met on a statewide basis. Instead of giving EPA direct authority to set national standards, Section 111(d) provides that EPA shall establish a procedure for states to issue standards of performance for existing sources in the relevant source category. As defined under Section 111(a), a “standard of performance” reflects the “best system of emission reduction . . . (taking into account the cost of achieving such reduction and . . . energy requirements) the Administrator determines to be adequately demonstrated.” This is referred to as “BSER” — “best system of emission reduction.”

Section 111(d) further specifies that in applying a standard of performance to any particular source, the state shall take into consideration the useful life of the existing source. EPA’s implementing regulations (codified at *40 C.F.R. Part 60 subpart B*) provide that, on a case-by-case basis, the states are authorized to provide less stringent emission standards than BSER based on: (1) unreasonable cost of control resulting from plant age, location, or basic process design, (2) physical impossibility

of installing necessary control equipment, or (3) other factors specific to the facility (or class of facilities) that make application of a less stringent standard more reasonable. *See* 40 C.F.R. § 60.24(f).

To calculate the GHG emission rates, EPA identified BSER as composed of four building blocks: supply-side efficiency (i.e., improving the heat rate of the unit), using lower-emitting power plants in lieu of coal-fired units (i.e., natural gas), using more renewable and nuclear energy, and reducing fossil fuel generation through increasing demand-side efficiency. EPA prepared each state's numerical emission rate based on a mix of these four building blocks. Specifically, EPA applied the following formula: CO<sub>2</sub> emissions from fossil fuel-fired power plants in pounds (lbs) divided by state electricity generation from fossil-fuel fired power plants and low- or zero-emitting power sources in megawatt hours (MWh). EPA explained that each state's goal is different, because each state has a unique mix of emissions and power sources to plug into each part of the formula.

### *Legal Vulnerability of the Proposed Rule*

As indicated above, EPA's proposed rule raises serious questions about the legality of EPA's proposed action, both in terms of its authority to regulate electric generating units under Section 111(d) and with regard to the substance of the rule itself (including the building blocks used to determine BSER and establishment of numerical emission rates). For instance, when EPA promulgates emission guidelines under Section 111(d), EPA must prescribe procedures for states to consider in developing a plan that is submitted to EPA for approval. By specifying emission rates that must be met by the states, EPA's proposed rule transcends "procedure" and enters the realm of substance, which may run afoul of its authority under Section 111(d). Moreover, EPA may not have the authority to establish BSER on a statewide basis, as opposed to determining BSER for the sources operating in this source category.

A more fundamental question is whether existing electric generating units can be regulated for GHGs under Section 111(d). Congress seemingly carved out of Section 111(d) sources that are already subject to regulation under Section 112. In 2012, EPA subjected electric generating units to regulation under Section 112 by way of the Mercury and Air Toxics Standard. Accordingly, there will be considerable legal debate about proper construction of this limiting language of Section 111(d). As part of the regulatory process leading up to EPA's failed Clean Air Mercury Rule in 2005, EPA enunciated an interpretation that the Section 112 limitation applies to regulated pollutants not sources. Thus, EPA will argue that because GHGs are not regulated under Section 112, it can regulate GHGs under Section 111(d). If a court finds that Section 111(d) applies to sources (as opposed to pollutants) subject to regulation under Section 112, EPA's ability to impose GHG regulations on existing sources will be significantly hampered, short of an act of new legislation from Congress.

EPA may have also stepped outside of its statutory authority in basing BSER on reductions that can only occur beyond the fence-line of a facility. Indeed, three of the

**There is a fundamental legal question as to whether EPA has the statutory authority to regulate fossil fuel-fired units under Section 111(d).**

four building blocks that EPA relied upon in establishing the state emission rates are based on such outside the fence-line reductions. Thus, EPA will likely face legal challenges regarding its authority to set limits based on reductions that are not derived from an evaluation of what can be achieved by the unit itself. EPA, aware of this risk, articulated a rationale in support of its interpretation that beyond the fence-line measures are appropriate in determining BSER. The Agency will advocate for deference to this interpretation in defending legal challenges to the final rule.

**EPA's proposed rule may impermissibly limit state authority granted by Congress under Section 111(d).**

EPA's approach to determining BSER may also impermissibly limit a state's authority (recognized under the Clean Air Act and in EPA's implementing regulations) to apply source-specific considerations in establishing an emission rate for a particular unit. In this regard, EPA's proposed rule may intrude on a state's ability to consider the useful life of sources operating in its state or to set less stringent limitations based on age, location, basic process design, physical impossibility, or other factors relevant to its sources.

Finally, EPA may be legally vulnerable as to whether some of the building block measures it relied on in setting the state emission rates (including, for instance, demand-side efficiency) fall within the meaning of "standard of performance." Again, once challenged, EPA will argue for deference and rely on language in the preamble to support its interpretation that such measures fall within the statutory term.

In light of the foregoing potential legal vulnerabilities, EPA's rule, once promulgated, will likely face legal challenge. In July 2014, EPA will host four public hearings to take comment on the proposed rule. The written comment period is set to close 120 days from the date the proposed rule is published in the federal register. EPA expects to finalize the rule by June 2015.

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If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

Granta Y. Nakayama, P.C.  
Kirkland & Ellis LLP  
455 Fifteenth Street, N.W.  
Washington, D.C. 20005  
[www.kirkland.com/gnakayama](http://www.kirkland.com/gnakayama)  
+1 (202) 879-5074

Jeffrey Bossert Clark  
Kirkland & Ellis LLP  
455 Fifteenth Street, N.W.  
Washington, D.C. 20005  
[www.kirkland.com/jclark](http://www.kirkland.com/jclark)  
+1 (202) 879-5960

Ilana Saltzbart  
Kirkland & Ellis LLP  
455 Fifteenth Street, N.W.  
Washington, D.C. 20005  
[www.kirkland.com/isaltzbart](http://www.kirkland.com/isaltzbart)  
+1 (202) 879-5286

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