The DC Circuit Doesn't Care for CAIR: Another Setback for EPA

2008-07-15

On July 11, 2008, the United States Court of Appeals for the District of Columbia Circuit issued its decision in State of North Carolina v. Environmental Protection Agency, No. 05-1244 (D.C. Cir.) vacating in its entirety the Clean Air Interstate Rule ("CAIR") promulgated in 2005 by the US Environmental Protection Agency's ("EPA" or the "Agency"). The decision is the latest in a series of setbacks for EPA in its efforts to promulgate far-reaching regulations implementing the Clean Air Act.

The court did leave the door slightly ajar regarding the ability of the Agency to issue CAIR-like regulations under existing CAA authority. Given the uncertainties posed by the upcoming election and the many other significant issues faced by EPA, however, it is not clear that such an effort will be forthcoming. In the absence of such a regulatory program, the burden may fall to Congress to develop legislation that comprehensively addresses these and other CAA pollutants. At the same time, individual states must address their looming CAA attainment deadlines without the aid of this federal program, which was designed to mitigate the impact of upwind emission sources on downwind states' air quality. Finally, companies that have undertaken comprehensive, long term planning based at least in part on their compliance obligations under CAIR and other EPA CAA regulations may find themselves with compliance strategies that are not bound by any regulatory requirements and that may not make sense in the current CAA regulatory climate.

CAIR

EPA promulgated CAIR in response to its regulatory finding that emissions of sulfur dioxide (SO2) and nitrogen oxides (NOx) from 28 states and the District of Columbia significantly contributed to downwind states' inability to meet health-based national ambient air quality standards for fine particulates (PM2.5) and ozone. To mitigate the affect of emissions from sources in these upwind states, CAIR called for a cap on emissions of SO2 (as a precursor to PM2.5) and NOx (as a precursor to PM2.5 and ozone), to be implemented in two stages, and provided a model interstate trading program to facilitate compliance with the new emission reduction targets.

Numerous parties filed petitions with the D.C. Circuit seeking judicial review of CAIR, some supporting CAIR but alleging that it needed to go further in protecting downwind states (North Carolina), some alleging EPA exceeded its CAA authority in promulgating CAIR (Utility Air Regulatory Group and others), and some alleging that EPA had improperly included certain states as "upwind contributors" (utilities in Texas, Florida and Minnesota).

The Analysis and Decision

The court's analysis includes a review of the statutory framework of the CAA and how EPA believed CAIR fit within that framework. The linchpin of the decision was whether the Agency had adequately addressed, in its analysis and rulemaking record, the specific issue of upwind states' "contribution" to downwind states' nonattainment status (or maintenance of attainment status) pursuant to statutory language in Section 110(a)(2)(D)(i)(I), 42 U.S.C. §7410(a)(2)(D)(i)(I).

The court found "more than several fatal flaws in the rule" and accordingly vacated the rule in its entirety. Although each of the issues raised by petitioners was addressed in separate sections of the opinion, the main common thread throughout the opinion was the Agency's inability or unwillingness to explain how the main elements of the regulation were authorized by, or related to, the statutory language in Section 110(a)(2)(D)(i)(I). For example, the court ruled in favor of North Carolina on the issue of whether the Agency's analysis included sufficient evaluation of upwind states' "significant contribution" to downwind states, holding that EPA's failure to measure the "significant contribution" from sources in upwind states renders the regulation invalid under Section 110(a)(2)(D)(i)(I).

The court went even further, holding that CAIR "must actually require elimination of emissions that contribute significantly and interfere with maintenance" in downwind states. The court also found that the EPA "ignored" a requirement that CAIR be "consistent" with other provisions in the Title I of the CAA by establishing compliance deadlines (2015) that were inconsistent with the attainment deadlines that have been established under Title I for PM2.5 and ozone (2010).

With regard to the trading program, the court found significant problems with the manner in which EPA established budgets for the SO2 and NOx trading programs. EPA's decision to base the SO2 budgets on the allowances that sources receive under the Acid Rain program (Title IV of the CAA) was arbitrary and capricious in the context of Section 110(a)(2)(D)(i)(I), as EPA failed to offer any explanation for how reducing Title IV allowances by 50% and 65% (in 2010 and 2015) would meet statutory objectives relative to upwind states' significant contribution to downwind states' nonattainment. Similarly, EPA's use of the NOx SIP Call and fuel factors to adjust states' NOx budgets was improper because there was no evidence relating these factors to upwind states' significant contribution to downwind states.

Finally, the court found that the Agency did not have authority under Section 110(a)(2)(D)(i)(I) to either terminate or limit Title IV allowances under the existing Acid Rain program. EPA had included a requirement that sources surrender Title IV allowances in ratios greater than 1:1 in an effort to prevent flooding the Title IV SO2 trading market with excess SO2 allowances created as a result of the SO2 reductions required by CAIR. While the court did not object to the Agency's efforts to consider the impact of CAIR on the Title IV market, it held that "no statute confers authority on EPA to terminate or limit Title IV allowances, and EPA thus has none."

In conclusion, the court found that EPA's regulation--which it described as "regionwide caps with no state-specific quantitative contribution determinations or emissions requirements"--was

fundamentally flawed. Although the court looked closely to see if it could remand portions of the regulation back to EPA and retain other portions, it ultimately concluded that "very little" of the rule would survive. The court also noted that EPA has consistently affirmed that CAIR was one, comprehensive program; as a result, the court vacated CAIR in its entirety.

What is Next?

The decision has far reaching implications for regulatory agencies, for regulated entities, and perhaps for Congress, especially when viewed in light of previous decisions invalidating EPA regulations relating to mercury and New Source Review.

If EPA is determined to proceed with a comprehensive regulations under Section 110(a)(2)(D), the decision makes it clear that it must do the appropriate analysis "from the ground up" and in strict adherence to the Section 110(a)(2)(D) statutory process. In other words, EPA must make state by state determinations as to which states have sources that "contribute significantly" to downwind nonattainment or interfere with maintenance, and quantify those contributions. It must give effect to the attainment deadlines set pursuant to other provisions in Title I, and must set a compliance date that is as "expeditious as practicable" for those states to eliminate their downwind contributions. If the program is to include trading provisions, those trading provisions must "actually require" the elimination of emissions from sources that contribute significantly and interfere with maintenance in downwind areas. It is highly unlikely that the Agency could, even if it wanted to, complete a rulemaking along these lines on any timetable that would assist downwind states in meeting applicable attainment deadlines.

With respect to states, they still face Title I attainment deadlines, in many cases coming in 2010 or sooner. As the court noted, downwind states have been counting on SO2 and NOx emission reductions from CAIR to meet the looming attainment deadlines. Those states still have the authority to proceed against sources in upwind states through the Section 126 petition process 42 U.S.C. §7426, although that process is time consuming and will likely provide little, if any, timely relief. In the absence of significant emission reductions from upwind states, those downwind states may be forced to look for additional emission reductions from in-state sources.

The decision could also add more momentum to calls for multi-pollutant legislation at the federal level. Now that legislative efforts relative to climate change have stalled, there may be a movement towards expanding the legislation to include emission reduction programs for mercury, SO2 and NOx in addition to greenhouse gases. Legislation such as Senator Carper's (D-Del.) Clean Air Planning Act, which would require reductions in mercury, SO2 and NOx from power plants by 2015 may get additional traction.

In the meantime, sources that have made decisions based on the mercury and CAIR regulations may find themselves between a rock and a hard place -- they may be in the middle of extremely costly and time consuming pollution control projects, with binding commitments made as part of a broad compliance strategy, designed to meet regulations that are no longer valid. It is important, however, to assess whether the appropriate state agency has state CAIR rules in place that would continue to be effective even in the absence of the federal CAIR rules. Other companies may have made compliance decisions based on certain assumptions regarding the SO2 and NOx trading markets that are no longer valid. One thing is clear--CAIR, which with the Clean Air Mercury Rule formed the basis for many of these decisions and strategies--is no longer operative. And the debate

over what takes its place is likely to be as complex and controversial as CAIR itself.