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Client Alert

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Even With Changes To Its Final Clean Power Plan, More Litigation Is On the Horizon for EPA

Responding to over 4 million comments received on its June 2014 proposed rule, the United States Environmental Protection Agency (EPA) has made changes to its controversial plan to regulate carbon dioxide (CO_2) emissions from existing fossil fuel-fired power plants—the Agency's "**Clean Power Plan**," which it released August 3, 2015. While some changes may ease implementation for the 49 states subject to the rule, the final rule arguably retains certain vulnerabilities and legal challenges are expected. Even as it moves forward with this rulemaking, EPA's enforcement arm continues to pursue the Administration's carbon strategy through its **national enforcement initiative** aimed at the power sector, securing commitments to reduce CO_2 emissions by shutting down coal-fired boilers or repowering them to combust natural gas, as well as investments in renewable energy.

Overview of the Final Rule

Pursuant to Section 111(d) of the Clean Air Act, EPA's Clean Power Plan establishes final statewide CO_2 emission standards for existing fossil fuel-fired electric generating units that will reduce CO_2 emissions by 32% as measured from a 2005 baseline. The rule specifies state goals in three forms: a rate-based goal measured in lbs/MWh, and two mass-based goals measured in total short tons of CO_2. The rule also specifies interim performance rates, which are to be achieved from 2022 through 2029, with the final rate effective in 2030.

The rule allows states to choose between two types of plans for EPA approval. The first type—an "emission standards plan"—must include source-specific requirements for all affected sources sufficient to enable the state to meet its 2030 goal. The other type is a "state measures plan," which can include a mixture of measures (including renewable energy and demand-side efficiency). In his August 3, 2015 remarks announcing the Clean Power Plan, the President indicated that this optionality allows each state to develop a plan that reflects its state-specific energy mix.

EPA's final rule also gives states the option to work together on multi-state approaches, including emissions trading. This would enable sources to meet the prescribed emissions standards through either emission rate credits (for rate-based plans) or emission allowances (for mass-based plans), similar to other Clean Air Act programs that utilize market-based emission trading programs, such as the Acid Rain cap and trade program for sulfur dioxide (SO_2) and nitrogen oxides (NO_x).

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The Clean Power Plan incorporates various features intended to ensure that it does not interfere with energy reliability. These include a longer compliance period compared to the initial proposal, flexibility to include a variety of different approaches to achieve the state-specific CO_2 goal, a mechanism for states to revise their plans in the event of unanticipated or significant reliability challenges, and a "reliability safety valve" that would address situations where a power plant had to provide "reliability-critical generation" due to unanticipated or extraordinary circumstances despite the CO_2 constraint that would otherwise apply.

EPA is proposing a model rule that states can adopt, as well as a federal plan that EPA will implement if a state fails to submit an adequate plan. Both the proposed model rule and the federal plan focus on emissions trading mechanisms. States are required to submit plans to EPA for approval within 13 months from promulgation of the rule (or by September 6, 2016, according to EPA). States may request an extension, with final plans due no later than September 6, 2018. The plan must include provisions demonstrating that the state is making progress toward meeting the final 2030 goal – *e.g.*, interim goals. The rule offers three multi-year step-down goals and allows states to develop a "glide path" that is both cost-effective and feasible. States are required to compare actual emissions from their sources to projected emissions enumerated in the state plan and to report this information to EPA.

EPA Eliminated Demand-Side Energy Efficiency as a Building Block

One controversial aspect of the proposed rule, what EPA called building block 4, was an attempt to include outside the fence line reductions (*i.e.*, demand-side energy efficiency) as a building block of the state plans. EPA is not requiring demand-side energy efficiency as a building block for meeting state goals, though the rule allows states to include energy efficiency as part of their strategy to achieve their CO_2 targets. Further, EPA is providing an optional **Clean Energy Incentive Program** to reward early investments in demand-side energy efficiency and renewable energy. EPA describes the program as a "matching fund" program that states can use to incentivize early investments in programs that will reduce CO_2 emissions. EPA will make emission credits available to states to incentivize the early reductions.

Changes Related to Nuclear Energy

States hoping to rely on nuclear energy as part of their strategy will likely applaud certain changes that EPA made in the final rule. In the proposed rule, EPA included nuclear generation under construction as a component of a state's emission performance standards. However, in the final rule, generation from those sources will not count until the units come on line, meaning that states can rely on nuclear generation currently under construction to meet their CO_2 goals. EPA also made a change related to nuclear capacity at existing plants. Specifically, if an existing nuclear plant increases its capacity, that increase will also count as a zero-carbon source, which may make projects to increase capacity at existing plants more attractive.

Potential Legal Vulnerabilities Remain Despite Changes Made In Response to Comments

A fundamental issue underlying the EPA's Clean Power Plan is whether these electric generating units can be regulated for CO_2 under Section 111(d). There is an argument based on the text of the Clean Air Act that "sources" subject to regulation under Section 112 cannot also be regulated under Section 111(d). In 2012, EPA issued the Mercury and Air Toxics Standards ("MATS"), which subjected these electric generating units to regulation under Section 112. On June 29, 2015, the **Supreme Court held** that EPA acted unreasonably when it deemed cost irrelevant to its decision to regulate power plants under Section 112, and remanded the rule to the D.C. Circuit. The intersection of the Supreme Court's MATS decision and promulgation of the Clean Power Plan could be seen as undermining this legal argument. Yet, should the D.C. Circuit vacate the rule, there is nothing to prevent EPA from taking action under Section 112 in the future, provided that, after considering costs, it determines that regulation of power plants is appropriate and necessary. EPA will argue that the limitation under Section 111(d) only applies to "pollutants" (as opposed to "sources"), and thus, even if it regulates power plants under Section 112 for hazardous air pollutants, it may still regulate these sources' CO_2 emissions under Section 111(d). We expect that this argument will be part of the legal challenges to the rule.

Other vulnerabilities likely to be raised by opponents to EPA's Clean Power Plan pertain to both the substance and contours of EPA's authority to promulgate emission rates under Section 111(d). For instance, under Section 111(d), EPA is authorized to establish a "procedure" for states to submit plans to EPA for approval. The states, in turn, are to establish standards of performance for their sources. As defined under Section 111(a), a "standard of performance" reflects the "best system of emission reduction which (taking into account the cost of achieving such reduction and . . . energy requirements) the Administrator determines has been adequately demonstrated." Arguably, by specifying emission rates that must be met by the states, EPA's rule may go beyond its authority under Section 111(d). Further, litigants may challenge EPA's authority to establish the best system of emission reduction on a statewide basis as opposed to a source-specific approach.

Additionally, litigants may argue that the rule impermissibly limits a state's authority to apply source-specific considerations in establishing a source-specific emission rate. Notably, EPA's regulations implementing Section 111(d) allow states to consider the useful life, age, location, basic process design, physical impossibility, and other factors, in establishing the performance standards. *See* **40 C.F.R. § 60.24(f)**. Yet, EPA's approach may deprive a state of its ability to take these source-specific issues into account in developing its plan to meet the statewide CO_2 goal prescribed by EPA in the rule.

EPA's Coal-Fired Power Plant Enforcement Initiative Continues to Push CO_2 Reductions

After 15 years, EPA's coal-fired power plant enforcement initiative remains active, with the most **recent settlement announced on July 15, 2015**, with Iowa electricity producer, Interstate Power and Light Company (IPL). EPA's enforcement initiative targets companies under the Clean Air Act's New Source Review program for allegedly illegal physical or operational changes commenced without first obtaining appropriate permits.

The settlement with IPL covers all seven coal-fired power plants (1,900 megawatts) owned and operated by the company in the state. To resolve its alleged New Source Review liability, IPL agreed to pay a civil penalty of $1.1 million, spend $6 million on environmental mitigation projects, and invest more than $620 million at its facilities. Notably, the company agreed to shutdown 10 coal-fired boilers and to either shutdown or repower/refuel to natural gas another 11 boilers. These commitments run from entry of the consent decree through 2025. Through a menu of environmental mitigation project options, the settlement also promotes renewable energy, allowing IPL to spend $3 million on a long-term power purchase agreement for solar power and $3 million to develop anaerobic digestion systems (*e.g.*, biogas).

In the past, EPA's enforcement program regarded itself as "fuel neutral"—giving companies the option to retrofit existing coal-fired boilers with pollution controls in addition to shutting down or repowering. This most recent settlement with IPL appears to signal a shift away from fuel neutrality, however, in line with the Agency's current agenda to reduce electricity generation from coal. Further, by securing coal-fired boiler retirements, greater use of natural gas, and investments in renewable energy projects, EPA's enforcement program is leveraging CO_2 reductions through a regulatory program intended to reduce traditional criteria pollutants (*e.g.*, SO_2, NO_x, and particulate matter—PM). There is no indication that EPA will curtail these efforts, especially given the Agency's recent judicial setbacks in other programs, most notably before the Supreme Court under the **Mercury and Air Toxics Standards rule** and before the D.C. Circuit under the **Cross-State Air Pollution Rule** (finding that EPA promulgated invalid SO_2 and NO_x budgets for 13 states, including Texas).