Legal Backgrounder

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# SOURCE "AGGREGATION": FEDERAL APPEALS COURT REVERSES 30 YEARS OF FAULTY EPA PRECEDENT

by
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On August 7, 2012, the U.S. Court of Appeals for the Sixth Circuit handed down an important decision that reined in the Environmental Protection Agency's (EPA) efforts to aggregate different sources of air emissions and expand New Source Review (NSR) permitting requirements beyond the intent of the original NSR rules. In *Summit Petroleum Corporation v. EPA*, No. 09-4348 (6th Cir. Aug. 7, 2012), the Sixth Circuit held that EPA's decades-long policy of determining whether sources are "adjacent" by looking at whether the sources are functionally related was unreasonable and contrary to the plain meaning of the term "adjacent." The decision's potential impact is significant – it creates a formidable barrier to future attempts by EPA or environmental groups to use aggregation principles to require oil and gas wells and other sources that are not physically located next to each other to obtain Title V and major NSR permits, while also reversing approximately 30 years of EPA's erroneous interpretation and implementation of NSR regulations.

## *Aggregation Law Background*

Whether different facilities are treated as a "major source" depends upon the stationary source's potential to emit certain pollutants. Federal prevention of significant deterioration (PSD) regulations define "stationary source" as "any building, structure, facility, or installation which emits or may emit any regulated air pollutant." 40 C.F.R. § 51.166(b)(5). In 1979, the D.C. Circuit held that "EPA cannot treat contiguous and commonly owned units as a single source unless they fit within the four… statutory terms" that comprise a "stationary source" (*i.e.*, structure, building, facility, or installation). *Alabama Power Co. v. Costle*, 636 F.2d 323, 397 (D.C. Cir. 1979). Accordingly, the *Alabama Power* court directed EPA to promulgate regulatory definitions of the terms "structure," "building," "facility," and "installation" "to provide for the aggregation, where appropriate, of industrial activities according to considerations such as proximity and ownership." *Id*. EPA responded by amending its PSD regulations:

> In EPA's view, … *Alabama Power* sets the following boundaries on the definition for PSD purposes of the component terms of "source": (1) it must carry out reasonably the purposes of PSD; (2) it must approximate a common sense notion of "plant"; and (3) it must avoid aggregating pollutant-emitting activities that as a group would not fit within the ordinary meaning of "building," "structure," "facility," or "installation."

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45 Fed. Reg. 52,676, 52,694-95 (Aug. 7, 1980). In other words, when defining a "stationary source" under the Clean Air Act (CAA), permitting agencies must focus on whether the purported "source" "approximate[s] a common sense notion of plant.'"

Consequently, EPA devised a three-factor test allowing aggregation of emissions only from pollutant-emitting activities that collectively satisfy the "common sense notion of plant." Based on that test, permitting agencies can aggregate emissions from separate oil and natural gas units ***only*** if each of three criteria is established. The separate units must:

1. Belong to the same industrial grouping; ***and***

2. Be under the control of the same person (or persons under common control); ***and***

3. Be located on one or more contiguous or adjacent properties.

40 C.F.R. § 51.166(b)(6).

The first criterion in the three-part test requires that the units belong to the same industrial grouping. The 1980 PSD Regulations established the use of two-digit major Standard Industrial Classification (SIC) codes for analyzing this factor in lieu of analyzing the functional interdependence of separate units. An analysis of SIC Codes enables permitting authorities to determine whether separate activities belong to the same industrial grouping in a manner that adds "objectivity and relative simplicity" to the process. 45 Fed. Reg. at 52,695.

The second criterion is that the units must be under common control. EPA has historically presumed that two companies are under common control when one entity has as much as 50% voting interest in both. "Definition of Source – Arizona Chemical Co.," Memorandum from Edward E. Reich to Region 6 (Mar. 16, 1979). EPA also relies on the Securities and Exchange Commission (SEC) definition of control (*i.e.*, "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person (or organization or association) whether through ownership of voting shares, contract, or otherwise."). *See* 45 Fed. Reg. at 59,878.

Finally, the third criterion is that the units must sit on contiguous or adjacent properties. EPA's recent precedent has been that whether two noncontiguous units are "adjacent" could depend on whether they are (1) proximate ***or*** (2) exclusively interdependent. *See, e.g., Order Denying Petition for Objection to Permit*, Permit No. 95OPWE035, Pet. No. VIII-2010-4, at 11 (Feb. 2, 2011) ("EPA Frederick Order"). EPA lost its way in implementing this third prong.

## *Source Aggregation in the Oil and Natural Gas Industry*

Determining the scope and extent of a "source" for air permitting purposes becomes more complex when regulators try to assess the "interrelationships" between sources in the oil and natural gas industry. In using these "interrelationships," EPA moved away from the common sense notion of a plant and turned a simple case-by-case analysis into a complex analysis that led to a lot of litigation and uncertainty for the regulated community over the past 30 years. Assessing the interrelationships of plants has been problematic because EPA refused to specify a distance in its regulations beyond which plants cannot be considered adjacent. As a result, EPA issued some applicability determinations aggregating sources that were up to 40 miles apart. In 2007, EPA issued guidance on aggregation of oil and natural gas operations which emphasized the importance of proximity, noting that several states used a presumption that units located outside a quarter-mile radius were not adjacent. *See* William L. Wehrum, "Source Determinations for Oil and Gas Industries" (Jan. 12, 2007) ("Wehrum Memo"). But, in 2009, EPA withdrew (without proper public notice and comment) the Wehrum Memo, stating that

proximity was not a "sufficient endpoint" for the analysis and emphasizing that anything other than a case-by-case evaluation was unworkable. *See* Gina McCarthy, "Withdrawal of Source Determinations for Oil and Gas Industries" at 1-2 (Sept. 22, 2009) ("McCarthy Memo"). In fact, as the Sixth Circuit found, EPA's reinstated case-by-case evaluation was unworkable, subjective, and impermissibly deviated from the plain English text of the aggregation test.

When trying to apply the interdependency test to sources in the oil and gas industry, the results have been understandably inconsistent. The problem with applying the interdependency test to this industry is that the presence of pipelines connecting separate oil and natural gas operations is not particularly useful to a source aggregation determination. Essentially, the entire natural gas production, gathering, processing, and transportation system is interconnected through an elaborate network of pipes extending from the wellhead to the ultimate end-users. Supporting this interstate system is an untold number of local gathering and processing facilities. Therefore, "[t]he simple fact that a pipe connects two physically separate oil and gas facilities or emission units does not, by itself, imply that these two facilities or units should be considered to be a part of the same emission source." *In re Anadarko Petroleum Corp., Frederick Compressor Station*, Pet. No. VIII-2010-4 (Resp. of Colo. Dep't of Pub. Health and Env't, Air Pollution Control Div., to Order Granting Pet. for Objection to Permit) at 5 (July 14, 2010).

## *EPA's Summit Aggregation Determination*

Summit Petroleum Corporation owns and operates a natural gas sweetening plant located in Rosebush, Michigan. The Rosebush plant receives natural gas from over 100 production wells located across a 43-square-mile area with some wells as close as 500 feet from the plant, while others are located up to eight miles away. The Rosebush plant emits slightly less than 100 tons per year of sulfur dioxides ($SO_2$) and nitrous oxides ($NO_x$). Because the Rosebush plant's emissions are under the 100 tons per year threshold, the facility would not need to obtain a Title V operating permit unless the emissions from some or all of the wells were aggregated with the emissions from the plant. *See* 42 U.S.C. § 7602(j).

In January 2005, Summit submitted a request to EPA to determine whether the Rosebush plant was a major source that required a Title V operating permit. After providing information to EPA over the course of several years, Summit finally received EPA's source determination in September 2009 that concluded that the Rosebush plant and the associated production wells were a single stationary source; therefore, according to EPA, Summit needed a Title V operating permit for this major source. EPA argued that its finding was correct because the Rosebush plant and the associated production wells were interdependent and thus adjacent under the 3-part aggregation test.

## *Errors in the EPA Aggregation Determination*

Summit challenged this determination, but agreed with EPA that the Rosebush plant and its production wells were under common control and belonged to the same major industrial grouping. Therefore, the parties only disagreed about whether the Rosebush plant and the production wells were contiguous or adjacent. In particular, EPA argued that the term "adjacent" is ambiguous and the agency's determination of physical distance should be replaced by an interdependency analysis, especially in light of the agency's longstanding policy of assessing the functional relationship between multiple emissions activities. Summit argued that the term "adjacent" is exactly what it says and means to common people – adjacent means adjacent.

Citing to *Webster's* dictionary, the Sixth Circuit concluded that the plain meaning of the term "adjacent" is unambiguous. In particular, the court rejected EPA's suggestion that the term "adjacent" requires undertaking an analysis of the functional relationship between the two plants. The court

determined that asking the purpose of an activity's existence at each plant was an "impermissible and illogical stretch."

The Sixth Circuit was not persuaded that EPA's interpretation should be entitled to deference merely because the agency had a longstanding policy – documented throughout the years in formal applicability determinations – of requiring an assessment of the interrelatedness of the activities. Instead, the court chastised EPA by saying that "[a]n agency may not insulate itself from correction merely because it has not been corrected soon enough, for a longstanding error is still an error."

## *Conclusion*

The Sixth Circuit's decision greatly clarifies – at least in the Sixth Circuit states of Ohio, Michigan, Kentucky, and Tennessee – what has become an unnecessarily complicated and unpredictable issue for industry over the last several years. Although this case is not binding precedent in other jurisdictions, its impact should not be limited to the four states in the Sixth Circuit. The *Summit* case will undoubtedly act as guidance to state permitting authorities across the country and will be a persuasive defense to attempts to aggregate oil and gas fields and other industrial sites. In fact, mere days after the *Summit* decision was issued, Pennsylvania's Environmental Hearing Board cited the *Summit* decision when issuing an order on a motion for summary judgment in a permit challenge regarding whether a compressor station must be aggregated with the 21 gas wells it serves. *Group Against Smog Pollution v. Commonwealth of Pennsylvania*, EHB Docket No. 2011-065-R (Opinion and Order on Permittee's Motion for Summary Judgment and Appellant's Motion for Partial Summary Judgment, Aug. 14, 2012)

The *Summit* court concluded that EPA applicability determinations should not be given deference when they are based on policies or interpretations that are contrary to the plain language provided in the CAA and its implementing regulations. While the court's refusal to give deference to the agency may seem shocking, the truth is that no prior source determination – state or federal – binds a permitting agency – nor does it establish precedent for future permitting or compliance decisions. Until *Summit*, EPA's Office of Enforcement and Compliance Assurance regularly relied on applicability determinations as if they were authoritative rules with precedential value when alleging compliance violations. The *Summit* court appears to have put the brakes on that practice.

The *Summit* case puts EPA on notice that if a policy is contrary to the plain meaning of a regulation, courts will strike down that policy – regardless of that policy's duration. The *Summit* case will undoubtedly influence future NSR permitting decisions and enforcement action and should change EPA's strong reliance on unreasonable applicability determinations and policy statements that expand the agency's regulatory reach beyond the plain language of the CAA and its properly promulgated regulations.

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