

# Environmental Alert

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## The Clean Air Interstate Rule Lives Again

On July 11, 2008, in the case of *North Carolina v. Environmental Protection Agency*, 531 F.3d 896 (*“North Carolina I”*), the District of Columbia Court of Appeals vacated the federal Clean Air Interstate Rule (“CAIR” or “Rule”) in its entirety, finding that the Rule had “more than several fatal flaws.” Those flaws principally consisted of the following:

- The cap-and-trade program created by CAIR did not necessarily provide for a reduction in nitrogen oxides (NO<sub>x</sub>) and sulfur dioxide (SO<sub>2</sub>) emissions from individual upwind states.
- In promulgating CAIR, EPA ignored the statutory requirement that upwind sources may not interfere with downwind maintenance of National Ambient Air Quality Standards (“NAAQS”) compliance. EPA had focused solely on downwind areas that were in nonattainment, and not the borderline nonattainment areas.
- The 2015 compliance date for implementation of Phase Two reductions in emissions by upwind states was invalid because it was not coordinated with the provision in Title I of the Clean Air Act, which mandates 2010 as the compliance deadline for downwind states.
- The SO<sub>2</sub> budget was unlawful because it took away allowances authorized by the Clean Air Act’s Title IV Acid Rain program.
- Basing the NO<sub>x</sub> budget on a percentage of heat input was an invalid approach.

The decision to vacate the Rule caught all parties to the case by surprise because none of the appellants had sought such relief. In September, the EPA, with the support of a number of intervenors and amici, filed a Petition for Rehearing. In the Petition, the EPA conceded that the Rule needed to address interference with downwind nonattainment, challenged the remaining rulings, and argued that the court should not have vacated the Rule even if the substantive defects were present.

On Dec. 23, in a brief opinion and order (hereinafter *“North Carolina II”*), the court ruled that it would not revisit the merits of *North Carolina I*, but reversed itself on the remedy. Finding that it would “at least temporarily” defeat the environmental values covered by the Rule, the court remanded the Rule to the EPA and reinstated CAIR, which will remain in effect until a replacement rule is drafted. No time limit was imposed for this, but the court noted that if the rulemaking is unreasonably prolonged, it would entertain a mandamus petition.

The immediate consequence of the decision in *North Carolina II* is that entities subject to CAIR—principally electric generating units (“EGUs”)—must comply with its provisions. The provisions of CAIR as it now exists, are to be implemented in two phases. The first phase of the regulations covering emissions of NO<sub>x</sub> begins Jan. 1, 2009, and covers the period of 2009–2014. The first phase of the regulations covering emissions of SO<sub>2</sub> begins Jan. 1, 2010, and covers the period 2010–2014. The second phase of required reductions for both NO<sub>x</sub> and SO<sub>2</sub> begins in 2015. EGUs must obtain and hold sufficient NO<sub>x</sub> allocations to cover their 2009 emissions by March 1, 2010, and must obtain and hold sufficient SO<sub>2</sub> allocations to cover their 2010 emissions by March 1, 2011.

Of immediate concern will be the provisions regarding NO<sub>x</sub> emissions that go into effect Jan. 1. In *North Carolina I*, the court revived the NO<sub>x</sub> trading scheme of the NO<sub>x</sub> State Implementation Plan (“SIP”) call. One of the provisions of CAIR had terminated this program. Since CAIR was reinstated in its entirety, the NO<sub>x</sub> SIP call trading scheme is now defunct, and has been replaced by the CAIR version.

Under the CAIR trading scheme, EGUs are allotted NO<sub>x</sub> and SO<sub>2</sub> emission allowances. Utilities that are unable to comply with these limits can obtain additional allowances through trades, provided their state’s SIP does not prohibit this. In its initial rulemaking, EPA set the annual allocations for each state for both the annual and seasonal NO<sub>x</sub> emissions. EPA published the individual EGU allocations Nov. 7, 2007. Unless a state implements a different allocation procedure in accordance with an approved SIP, the allocations published Nov. 7, 2007 will be the final allocations imposed upon individual EGUs.

In Pennsylvania, the Department of Environmental Protection has determined that the Federal Implementation Plan will be utilized for at least the 2009 enforcement year, and the EGU allocations published by EPA will be utilized. At the time of this Alert, the Department has not issued individual EGU allocations to affected facilities in the form of either modified Title V permits or Plan Approvals. However, Pennsylvania law requires permittees to comply with new standards or regulations promulgated under the Clean Air Act within the time frame required by those standards or regulations, even without a modification of the permittee's operating permit. Thus, EGUs in Pennsylvania will be required to comply with the published allocation, even without action by the Department.

EGUs that cannot comply with either the seasonal or annual NO<sub>x</sub> allocations in 2009 will be required to purchase additional allocations under the CAIR cap-and-trade program. EPA does not buy or sell allowances. It does, however, track allowance holdings and record transactions. According to EPA, it has maintained the tracking database and continues to record transactions under CAIR. Until such time as the EPA modifies CAIR, the emission trading provisions and procedures remain in place.

A particularly thorny issue for the EPA on remand is the 2015 compliance date for Phase Two emission reductions. The court clearly held that this deadline was illegal because, under Title I of the Clean Air Act and its implementing regulations, downwind states are required to meet NAAQS for fine particles no later than 10 years from the date that they were designated to be in nonattainment. For the CAIR states, this target date is 2010. Between 2010 and 2015, therefore, CAIR required downwind compliance without the benefit of the upwind emission reductions of Phase Two. Any prolonged inaction by the EPA on remand will place the downwind states in precisely this position by 2010. On the other hand, while the EPA could carry out the court's mandate by requiring Phase Two emissions reductions by 2010, it would thereby require the regulated community to implement drastic emission reductions with a very short lead time. For many EGUs, the target is likely to be unattainable by 2010. Resolving this dilemma may require action by Congress.

Of course, the court did not contemplate that CAIR would remain unchanged permanently. However, before any new rule is in place, it must be formulated and published, and any comments must be evaluated, so EGUs should make their plans based on the assumption that CAIR will remain in force for an extended period. Legislative solutions to the flaws in CAIR identified in *North Carolina I* were considered by the outgoing Congress, but no action was taken. Whether the incoming Obama administration and Congress will address those issues, and how quickly, is unclear at this time. It is also possible that one or more of the parties to *North Carolina II* will file an appeal with the Supreme Court. Whether the Supreme Court will grant certiorari and hear the appeal is entirely within the scope of the Supreme Court's discretion.

Permittees should expect ongoing issues and problems with the implementation of CAIR. Technical issues related to compliance, the still unresolved legal issues with the regulation set forth in the court's original opinion, and administrative issues associated with the implementation by the states are all of potential concern. In addition, the ongoing litigation and unresolved status of the Clean Air Mercury Rule ("CAMR") are of concern. Many EGUs have developed a compliance strategy based upon compliance with both CAIR and CAMR simultaneously. If CAMR is modified significantly, then the proposed compliance strategy developed by the EGUs possibly may be inadequate to ensure compliance with the final version of both CAIR and CAMR.

Affected parties should closely monitor legislative discussion and Obama administration policy.

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If you have questions involving legislation, policy development, rulemaking, compliance or enforcement, please contact one of the authors, or the Reed Smith attorney with whom you regularly work.

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Client Alert 09-001  
January 2009

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