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Will EPA 'ACE' Its Attempt to Replace the Clean Power Plan? A Deeper Dive into EPA's Proposed Affordable Clean Energy Rule

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Introduction

As we have previously reported, on August 21, 2018, the U.S. Environmental Protection Agency ("EPA") proposed to replace the Obama Administration's Clean Power Plan ("CPP") with the Affordable Clean Energy Rule (the "ACE Rule"). Comments on the proposed ACE Rule are due by October 30, 2018.

EPA's proposal is the latest development in the complex series of regulatory and judicial actions initially triggered by EPA's proposal of the CPP on June 3, 2014. In the ACE Rule, EPA has significantly shifted its interpretation of its regulatory authority under Clean Air Act ("CAA") Section 111(d) and also established a number of significant new legal and policy positions. These new positions include: (i) changes to the New Source Review ("NSR") program for power plants, (ii) alterations to how EPA views averaging and trading of emissions under the CAA, and (iii) shifts in EPA's treatment of biomass and biofuels. The ACE Rule represents a significant policy shift in many areas. These legal and policy changes may not have the opportunity to impact real-world operations, however, because the rule's future is far from certain: numerous states and NGOs have promised to sue to block the rule, and EPA's significant shift in approach may present challenges for the agency during the inevitable lawsuits that will follow any final ACE Rule.

Background: How Did We Get Here?

The CPP was prompted by President Obama's ambitious "Climate Action Plan" to address climate change. EPA issued the CPP pursuant to CAA Section 111(d), which addresses standards of performance for existing stationary sources of air pollution. As proposed, the CPP set emission guidelines for states to follow in developing plans to reduce greenhouse gas ("GHG") emissions from existing fossil fuel-fired electric generating units ("EGUs"), as well as a backup Federal Implementation Plan ("FIP") that EPA promised to deploy in recalcitrant states. The proposed CPP required each state to develop a carbon-cutting plan tailored to its specific needs using four "building blocks" approved by EPA. The proposed building blocks included:

- Reducing GHG emissions at individual EGUs through heat rate improvements,

- Reducing GHG emissions by substituting generation at affected EGUs with generation from lesser-emitting EGUs (i.e., load shifting),
- Reducing GHG emissions by substituting generation at affected EGUs with renewable energy generation, and
- Reducing GHG emissions by utilizing demand-side energy efficiency that reduces the amount of generation required.

The CPP's building blocks included "beyond the fence line" methods to meet its carbon reduction goals, meaning that state plans were not confined to measures implemented only "within the fence line" of affected EGUs. When proposed on June 2, 2014, the CPP sought to reduce GHG emissions from affected EGUs by 30% by 2030, based on a 2005 emissions baseline.

EPA finalized the CPP on August 3, 2015. As we previously reported, the final CPP established interim and final carbon dioxide ("CO_2") emission performance rates for two subcategories of EGUs: (i) fossil fuel-fired electric steam generating units (generally, coal- and oil-fired power plants); and (ii) natural gas-fired combined cycle generating units. The final rule included three of the above "building blocks," but omitted the fourth, demand side management. The final CPP allowed states to comply by using an emission standards plan, with source-specific requirements, or a state measures plan, with a mix of state measures such as renewable energy standards and programs to improve residential energy efficiency. EPA also actively encouraged states to establish or participate in market-based emissions trading programs. In EPA's then-prevailing view, these trading programs (including the Regional Greenhouse Gas Initiative in the Northeast and Mid-Atlantic ("RGGI") and California's cap-and-trade program) "maximize compliance flexibility for affected (facilities) and enable the state to meet its mass goal in the most economically efficient manner possible." 80 Fed. Reg. at 64,834, 64,839.

The final CPP was immediately challenged in 15 separate cases brought by a variety of parties, including 26 states in various coalitions and a number of industry parties. Many state, municipal and industry parties also came to EPA's defense, petitioning to intervene on behalf of EPA. These defenders of the CPP included a coalition of 18 states and several cities, encompassing all of the states that currently maintain GHG emission trading programs and/or have state-imposed GHG emissions reduction mandates. The D.C. Circuit consolidated all of the petitions for review into a single case. The subsequent litigation and regulatory proceedings are too extensive to recount here, but the key actions are as follows:

- February 9, 2016: The U.S. Supreme Court stays the effectiveness of the CPP pending resolution of the lawsuit.
- September 27, 2016: The D.C. Circuit hears oral argument on all challenges to (and defenses of) the CPP.
- March 28, 2017: President Trump signs the Executive Order on Promoting Energy Independence and Economic Growth, which, among other things, directs EPA to review the CPP and "publish . . . proposed rules suspending, revising, or rescinding" the CPP.
- April 8, 2017: Upon request from EPA, the D.C. Circuit suspends litigation and orders EPA to file periodic status reports.
- July 26, 2017: EPA files a supplemental status report indicating that it had submitted a proposed regulatory action to the White House for review.
- October 16, 2017: EPA proposed to repeal the CPP.
- December 28, 2017: EPA issued an Advance Notice of Proposed Rulemaking to solicit comments on potential CPP replacement measures.
- June 26, 2018: The D.C. Circuit grants a further pause of the CPP litigation for 60 days but

indicates it may not do so again.
- August 21, 2018: EPA releases its proposed ACE Rule.

The ACE Rule v. the CPP

The CPP and the ACE Rule both have the same goal: reducing CO_2 emissions from certain EGUs. But the two rules are otherwise extremely different. Unlike the CPP, the proposed ACE Rule would only regulate fossil fuel-fired electric steam generating units and does not contain standards applicable to natural gas or integrated gasification combined cycle ("IGCC") turbines. Apart from this applicability difference, the proposed ACE rule differs significantly from the CPP in several other key ways. As proposed, the ACE Rule would:

Give States More Authority. On a fundamental level, EPA has adjusted how it views the balance of authority between the states and the federal government under CAA Section 111(d). In the CPP rule, EPA set specific federal standards and state budgets that states were required to comply with, more akin to how EPA implements other CAA programs, such as the hazardous air pollutant program under Section 112. In the ACE Rule, EPA is taking a less prescriptive approach and giving states far more flexibility to craft their own plans to comply with the ACE Rule. In EPA's current view, this is more consistent with how Congress intended Section 111(d) to function: EPA issues *guidelines* to states, and then the states determine how to obtain compliance within general parameters.

"Take an "Inside the Fence Line" Approach. In the CPP, EPA established firm state emission budgets based on building blocks, consistent with EPA's interpretation of what constituted the "Best System of Emission Reduction" ("BSER") under CAA Section 111(d). Those building blocks required actions outside the source's fence line, including actions that reduced demand by shifting generation to facilities not in the source category being regulated by the CPP. The proposed ACE Rule reverses EPA's prior position and instead limits BSER's scope to "emission reduction measures that can be applied to or at an individual stationary source." 83 Fed Reg. at 44,752. EPA based this shift on its current belief "that BSER must be based on measures must be based on a physical or operational change to a building, structure, facility or installation at that source rather than measures the source's owner or operator can implement at another location." 83 Fed Reg. at 44,752. Accordingly, EPA proposes to determine that only on-site (within the fence line) efficiency projects known as heat rate improvements ("HRIs") constitute the BSER for existing affected EGUs.

Emissions Limits. Unlike the CPP, which set state-wide GHG emissions limits calculated using numerical standards for sources (based on fuel type), the ACE Rule would allow states to set their own standards of performance for existing EGUs. EPA contends this is more consistent with its prior practice under CAA Section 111(d), in which EPA sets the guideline for what is BSER and then states determine standards of performance. 83 Fed Reg. at 44,748, 44,753.

Remaining Useful Life. The ACE Rule interprets the statutory factors in CAA Section 111(d) differently. The CPP barred states from considering remaining useful life of affected sources, even proposing in another rule to block states from granting facility-specific variances from the federal guidelines or compliance extensions. 80 Fed. Reg. 64,966, 64,983 n.36 (Oct. 23, 2015). The proposed ACE Rule would instead allow states to consider the remaining useful life of EGUs, an approach consistent with EPA's current Section 111(d) regulations and, in EPA's eyes, the text of Section 111(d)(1).

Impact on Emissions Reductions. EPA asserts that the ACE Rule will offer emissions reductions similar to the CPP. Unlike the CPP, the ACE Rule sets no deadlines for states to implement their

plans. Moreover, while the CPP targeted 32% GHG reductions by 2030, EPA models project that the ACE Rule will actually reduce GHG emissions by only 1.5% by 2030. In addition to increases in CO_2 emissions, EPA models predict increases in co-pollutants such as mercury, sulfur dioxide, and nitrogen dioxide.

Other changes include the New Source Review ("NSR") reforms detailed below and changes to CAA Section 111(d) regulations governing development and submission of state plans.

Key Policy Shifts by EPA

In addition to the BSER, general applicability, and emissions limitation changes outlined above, EPA has proposed significant policy changes. Among the more interesting—and impactful—policy shifts are those related to the NSR program, interstate trading, and treatment of co-firing and biomass.

1. Significant Change to New Source Review

The ACE Rule proposes a significant change to the NSR program, which is a portion of the CAA that requires preconstruction permits for new sources and "major modifications" to existing sources, including affected EGUs. Currently, NSR permitting is required when there is an *annual* emissions increase above a relevant threshold. The proposed ACE Rule would change the triggering criteria to an *hourly* emissions increase for affected EGUs. This means that modifications resulting in overall, annual emissions increases will not trigger costly NSR permitting requirements unless they *also* increase the hourly emissions rate. This proposed modification to the NSR regulations would apply to all EGUs subject to the NSR regulations, not just coal-fired EGUs, and would apply to all regulated pollutants, not just GHGs.

EPA believes this change to NSR is required because HRI projects at EGUs could lead to increased operation of the EGU and thus an increase in annual emissions. Under EPA's current regulations, this could potentially trigger NSR. As EPA puts it, "state agencies should not be burdened with having to determine a 'work around' for the NSR program requirements in developing their plans to implement the [ACE Rule's] emission guidelines." 83 Fed Reg. at 44,777.

The idea of basing NSR on emission rates is not entirely new. EPA previously proposed applying an hourly emissions test for NSR applicability in 2005 and 2007 under the George W. Bush administration. The 2005 proposed rule relied in part on a Fourth Circuit decision that held that EGUs were not required to undergo NSR when proposed modifications did not increase the maximum hourly emissions rate. *See U.S. v. Duke Energy Corp.*, 411 F.3d 539, 548–50 (4th Cir. 2005). Although the Supreme Court reversed the Fourth Circuit, EPA has argued previously that the Supreme Court left the door open for EPA to utilize an hourly emissions test. 83 Fed. Reg. at 44,779.

While EPA and proponents of the ACE Rule argue that these updates to NSR are needed to make HRI projects possible and attractive for EGUs, opponents argue that the proposed reforms create a loophole to extend the life of and increase the usage of aging fossil fuel-fired plants, which would increase emissions of GHGs and other pollutants. Opponents will likely rely heavily on the D.C. Circuit's prior rejections of other EPA attempts to narrow NSR applicability. In 2005, the D.C. Circuit in *New York v. EPA*, 413 F.3d 3, rejected an EPA interpretation of the term "modification" that excluded a greater number of sources. In 2006, the D.C. Circuit again rejected EPA's effort to narrow NSR applicability by reinterpreting the CAA's requirement of NSR for "any" physical change in a stationary unit. *New York v. EPA*, 443 F.3d 880, 889 (D.C. Cir. 2006). The D.C. Circuit wrote that "[o]nly in a Humpty Dumpty world would Congress be required to use superfluous words while

an agency could ignore an expansive word that Congress did use." *Id.* at 887. However, the proposed ACE Rule states that the D.C. Circuit's 2006 decision "affirmed that EPA has wide discretion to interpret the definition of 'modification.'" 83 Fed. Reg. at 44,780. The proposed rule goes on to quote the D.C. Circuit's opinion:

> Because the CAA is "silent on how to calculate . . . 'increases' in emissions" for purposes of determining "modification," the [D.C. Circuit] said, *id.* at 22, EPA has discretion to give meaning to that term by adopting a baseline period that "'represents a reasonable accommodation of'" the Agency's environmental, economic, and administrative concerns. *Id.* at 23 (*quoting Chevron*, 467 U.S. at 845). The D.C. Circuit went on to say that "[d]ifferent interpretations of the term 'increases' may have different environmental and economic consequences," and in "administering the NSR program and filling in the gaps left by Congress, EPA has the authority to choose an interpretation that balances those consequences." *Id.* at 23–24. The court added that this choice may be informed by both EPA's "extensive experience and expertise" in this technical and complex regulatory program and by the "incumbent administration's view of wise policy." *Id.* at 24.

83 Fed. Reg. at 44,780.

As history demonstrates, the NSR provisions of the proposed ACE Rule will inevitably be challenged upon finalization of the rule. Perhaps for that reason, EPA proposes to make the "hourly" NSR criteria severable from the rest of the ACE rule.

2. EPA May Reverse Course on Averaging and Trading

EPA is soliciting comment on whether CAA Section 111(d) authorizes states to include averaging and trading between affected sources in their state plans. EPA proposes to allow states to average among coal-fired EGUs at a single facility. However, EPA "believes that there are both legal and practical concerns [sic] may weigh against the inclusion of averaging and trading between existing sources in state plans at any level more broad than averaging between sources across a particular facility." 83 Fed. Reg. at 44,767.

EPA provides several reasons for its tentative opposition to averaging and trading between facilities. First, EPA believes that averaging and trading across affected sources might be inconsistent with EPA's "inside the fence line" definition of BSER. Second, "if section 111(d) authorized states to include trading and averaging between sources in their plans, the express provision under 111(d)(1) authorizing states to consider existing sources' remaining useful life and other factors when establishing and applying standards of performance could be viewed as superfluous." 83 Fed. Reg. at 44,767. Third, EPA is concerned about the relative complexity of developing and implementing state plans incorporating averaging and trading systems.

As in other parts of the proposed rule, EPA acknowledges it is grappling with the delicate balance between narrowly construing BSER and allowing states and EGUs maximum flexibility. EPA appears open to possible trading and other flexibility options, stating that: "EPA recognizes that there are significant benefits of averaging and trading across affected sources and is interested in whether emissions averaging could be a way to provide flexibility while still focusing on a core tenet of the BSER for this rule: Reducing emissions per MWH of coal-fired generation." 83 Fed. Reg. at 44,768.

3. Mixed Signals on Co-firing and Biomass

EPA proposes *not* to include co-firing of natural gas or biomass as components of BSER. EPA contends that "regional considerations and characteristics (e.g., access to biomass, or natural gas pipeline infrastructure limitations)" prevent co-firing from being a national-level solution. For example, natural gas "cannot be stored in quantities sufficient for sustained utilization on site," and biomass is subject to "regional supply and demand dynamics." 83 Fed. Reg. at 44,762. Moreover, co-firing methods "have been shown to be costly." 83 Fed. Reg. at 44,762. EPA proposes to include co-firing as a compliance option that states may consider and solicits comment on whether to include co-firing among the list of BSER candidate technologies.

At the same time, the proposed ACE Rule notably references EPA's April 23, 2018 announcement stating that EPA will "treat biogenic CO_2 emissions resulting from the combustion of biomass from managed forests at stationary sources for energy production as carbon neutral." 83 Fed. Reg. at 44,766. Based on this statement and the inclusion of co-firing in the CPP, many groups are likely to argue during comments and litigation that co-firing is an "inside the fence line" measure that is adequately demonstrated and more widely deployed than several of the HRI "candidate technologies" EPA's proposal would recognize as BSER.

Outlook: Uncertain

The future of the ACE Rule remains highly uncertain. Litigation is a certainty: several environmental groups and state attorneys general have already threatened to challenge any final ACE Rule. Congressional action, while threatened, is likely to be ineffective. Even if there are sufficient numbers to overturn the ACE rule using the Congressional Review Act, President Trump will almost certainly veto such action.

EPA was wise not to characterize its approach in the ACE Rule as the only legally permissible interpretation of unambiguous statutory terms (an approach much more likely to be rejected by a reviewing court). Instead, EPA generally characterizes its interpretations as "reasonable" interpretations of Section 111(d). This could help bolster EPA's case in court, although *Chevron*-style deference is increasingly subject to scrutiny. One significant downside to EPA's approach—a wholesale re-interpretation of Section 111(d)—is that the proposed ACE Rule leaves open the possibility for a future administration to re-interpret 111(d) yet again. And with the regulatory and litigation processes likely to extend into the next administration, it's anyone's guess as to whether the ACE Rule will survive or serve merely as the next iteration in EPA's ongoing saga to establish GHG standards for existing power plants.

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