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U.S. v. Ohio Edison and *U.S. v. Duke Energy*: Conflicting Interpretations of "Routine Repair" Defense

By: David M. Friedland
Laura K. McAfee[1]

The month of August, 2003 produced two critical, yet diametrically opposed, decisions in EPA's electric utility enforcement initiative. On August 7, the U.S. District Court for the Southern District of Ohio resoundingly affirmed both EPA's limited interpretation of the "routine maintenance, repair, and replacement" (RMRR) exclusion and the Agency's method of calculating whether a "significant net emissions increase" occurred. *See U.S. v. Ohio Edison*, No. 2:99-CV-1181 (S. D. Ohio Aug. 7, 2003). A mere three weeks later, however, the U.S. District Court for the Middle District of North Carolina rejected these very arguments and reached precisely the opposite conclusion on both issues. *See U.S. v. Duke Energy*, Civ. No. 1:00CV01262 (M.D.N.C. Aug. 26, 2003).

Below, we address both cases. We begin with a brief summary of the major points of interest under each case. Next, we more fully discuss each court's holding on the major issues, identifying issues of interest to practitioners and setting forth practical lessons that can be learned from the decisions. Finally, we conclude with a broader overview of the underlying concerns that appear to have led the court to such opposing interpretations of the same law, and consider the possible impacts of EPA's recently-finalized RMRR rule. For more information, please contact David Friedland at (202) 789-6047 or dfriedland@bdlaw.com, or Laura McAfee at (505) 797-0810 or lmcafee@bdlaw.com.

SUMMARY

I. Ohio Edison

On August 7, the Southern District of Ohio issued what promises to be a seminal opinion on the scope of the RMRR exclusion under the Clean Air Act's (CAA's) New Source Review (NSR) program. The case is one of many recent enforcement actions brought by EPA against the electric utility industry, but only the third to make it to court (following *U.S. v. SIGECO*, 245 F. Supp. 2d 994 (S.D. Ind. 2003), and the recent *TVA* decision, *TVA v. Whitman*, No. 00-16234 (11th Cir. June 24, 2003)), and the first to reach the liability stage.

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[1] David Friedland is a Director in Beveridge & Diamond, P.C.'s Washington, D.C. Office, and the Chair of the firm's Air Practice Group. Laura McAfee is Of Counsel to Beveridge & Diamond, P.C., in Albuquerque, New Mexico.

Ohio Edison involved eleven projects between 1984 and 1998 that EPA claimed were "major modifications" triggering NSR permitting requirements. Ohio Edison claimed that each of the projects was excluded as RMRR, and that even if the RMRR exclusion did not apply, the projects did not trigger NSR because they did not cause a "significant net emissions increase."

The court accepted EPA's arguments in their entirety, flatly rejecting all of Ohio Edison's defenses. The more notable holdings include:

- EPA's "narrow" interpretation of the RMRR exclusion – based on the frequency of the types of changes at the unit, not throughout the industry – was not merely supportable, but clear and unambiguous from the plain language of the CAA itself. The court did not address EPA's apparent reversal of this narrow approach in the recent NSR Reform package (which was finalized after the decision was issued).

- Projects designed to prevent future downtime are not necessarily RMRR. All of the projects in question were designed to prevent future catastrophic failures; none of the projects attempted to increase the facility's maximum capacity in any way, and the only emissions increases resulted from the decrease in downtime the projects allowed. These are the types of maintenance-related projects that industry has typically viewed as RMRR; the court nevertheless rejected the RMRR claim, based at least in part on the alleged "life extension" purpose of the projects.

- The accounting treatment of projects can weigh very heavily in determining whether the RMRR exclusion applies. The court strongly indicated that charging a project to the capital budget may be enough to disqualify it from the RMRR exclusion.

- The "actual to future actual" approach is the proper manner of calculating emissions increases, but cannot consider available post-change data. The court indicated that the "actual to potential" test would not be legally supportable, which may pose one more obstacle to EPA's efforts to use that approach in other enforcement actions. However, the court rejected Ohio Edison's efforts to prove that no significant net emissions increase occurred under the "actual to future actual" test by relying on actual emissions data. Instead, the court insisted that the only relevant question was what Ohio Edison could have predicted at the time of the projects in question. The court nevertheless admitted similar EPA evidence attempting to show that preventing shutdowns did, in fact, increase emissions.

- The court was clearly hostile to Ohio Edison's fair notice defense, based in large part on the company's involvement in trade associations that actively tracked and interpreted the *WEPCO* decision and its progeny.

While the opinion is lengthy and complex, the decision seems to have come down to two basic facts: that "thirty-three years after passage of the Act, the plant to this day emits on an annual basis 145,000 tons of sulphur [*sic*] dioxide, a pollutant injurious to the public health"; and that the company had spent over $130 million in significant projects that increased its actual

emissions of regulated pollutants without ever undergoing major source permitting. *Ohio Edison* at 2, 5-6.[2]

At the same time, however, the court saved a few choice words for EPA, which in the court's view had not consistently interpreted the law as Congress intended. The court implied that the Agency's own failures, while not absolving Ohio Edison of liability, may be taken into consideration during the remedy phase (scheduled for early 2004).

II. Duke Energy

Just weeks after the *Ohio Edison* opinion was issued, however, the Middle District of North Carolina rejected that court's analysis, and reached precisely the opposite conclusions. The factual and legal claims in *Duke Energy* were practically identical to those in *Ohio Edison*: EPA alleged that 29 projects between 1988 and 2000 triggered NSR, while the company claimed the projects were excluded as RMRR and did not cause a significant net emissions increase. The court's analysis and conclusions, however, could not have been more different. Whereas the *Ohio Edison* court accepted EPA's claims in their entirety, the *Duke Energy* court flatly rejected both EPA's arguments and the *Ohio Edison* court's analysis. The most notable holdings include:

- RMRR must be determined based on whether the project is routine within the industry, not based on how frequently the project is performed at a particular unit or source. The court nevertheless rejected Duke Energy's claim that whether a project has been performed routinely within the industry should be the sole determining factor; rather, the court concluded that each of the four *WEPCO* factors must be independently evaluated, but that the evaluation must compare the project to other projects throughout the industry, not (as EPA urged) by evaluating each project in a vacuum.

- EPA bears the burden of proving that a project is *not* RMRR.

- Emissions increases must be calculated by holding the hours and conditions of operations constant after the change. Thus, the court found that projects that do not increase a facility's maximum hourly emissions rate – such as, for example, the reliability projects at issue in *Ohio Edison* – could not trigger NSR.[3]

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[2] The court also noted that Ohio Edison (and other companies) had chosen to comply with CAA requirements by importing out-of-state, low-sulfur coal, at the cost of 12,000 mining jobs within the state. *Id.* at 2, n.2. While this fact is legally irrelevant, it certainly seems to have colored the court's view of the matter.

[3] The court also rejected Duke Energy's statute of limitations defense, holding that the failure to obtain a PSD permit was a continuing violation that tolled the running of the statute. *Duke Energy* at 74-80. This holding contradicts the holdings of the majority of courts that have addressed this issue. *See*, *e.g.*, *U.S. v. Westvaco Corp.*, 144 F. Supp. 2d 439 (D. Md. 2001); *U.S. v. Murphy Oil USA, Inc.*, 143 F. Supp. 2d 1054 (W.D. Wis. 2001); *U.S. v. Louisiana-Pacific Corp*., 682 F. Supp. 1122 (D. Colo. 1987); *U.S. v. Brotech Corp.*, 2000 U.S. Dist. LEXIS 13859 (E.D. Pa. 2000). The *Ohio Edison* court reserved this issue for later determination.

DISCUSSION

Both *Ohio Edison* and *Duke Energy* address the same four basic questions that so frequently arise in NSR enforcement actions: (1) whether the projects were "physical changes" under the CAA; (2) if so, whether they were excluded as RMRR; (3) if the projects were not excluded, whether they resulted in a "significant net emissions increase"; and (4) even if the projects triggered NSR, whether the defendants could avoid liability because they had not received fair notice of EPA's interpretation. We discuss below each court's holding on each of these issues, and point out issues of interest and practical considerations that arise from these holdings.

I. Physical Change.

The Ohio Edison analysis. The *Ohio Edison* court swiftly determined that the projects in question were "physical changes" that could trigger NSR requirements. As the court noted, the CAA itself defines a "modification" to include "any" physical change – language that the court held must be given its "plain meaning." *Ohio Edison* at 42. Because the projects at issue all physically altered the equipment at the facility, the court determined that the projects were all "physical changes" and therefore were potentially subject to NSR requirements. *Id.* at 42-43.

The Duke Energy analysis. The *Duke Energy* court similarly agreed that the "physical change" test is broad and could encompass practically any change to a facility. *Duke Energy* at 45.

Issues of interest. Both decisions followed the reasoning set forth in *WEPCO v. Reilly* ("*WEPCO*"),[4] the seminal case on point, and so simply reaffirmed existing law.

II. Routine Maintenance, Repair, and Replacement.

The Ohio Edison analysis. The *Ohio Edison* court's discussion of the RMRR exclusion significantly expanded on prior caselaw. The court first addressed whether it should interpret the RMRR exclusion broadly, based on whether similar projects had been performed routinely throughout the industry (as urged by Ohio Edison), or narrowly, by focusing on whether the particular project was frequently performed on the unit in question (as urged by EPA). Against the background of the CAA's reference to "any" physical change, and the facility's three-decades-long "grandfathered" status, the court firmly upheld EPA's interpretation. The court based its holding on the language of the CAA and regulations, the deference due an agency's interpretation of its own regulations, and the prior *WEPCO* and *SIGECO* decisions (both of which the court characterized as upholding EPA's narrow interpretation of RMRR). *Ohio Edison* at 43-44.

Having affirmed EPA's narrow interpretation, the court then applied each of the four *WEPCO* factors (nature and extent, purpose, frequency, and cost) to the eleven projects at issue. While the court described the eleven activities in great detail, *see id.* at 15-33, its legal analysis

[4] *WEPCO v. Reilly*, 893 F.2d 901 (7th Cir. 1990).

was far more cursory. The court evaluated each of the factors, but generally addressed all of the projects as a whole; individual projects (typically, the largest and most extensive ones) were mentioned merely as examples, and the court did not distinguish between a $30MM "first of its kind" equipment upgrade and a $1MM replacement of damaged and corroded panels. *Compare* Activity 5, *id.* at 22-23, 48, *with* Activity 11, *id.* at 32-33, 49. The court concluded that the projects were not exempt RMRR under each of the four factors.

1. Nature and extent.

The court considered a variety of factors in its discussion of the "nature and extent" factor. In addition to the sheer magnitude of the projects (*i.e.*, miles of boiler tubing), the court pointed to the following facts as demonstrating a non-routine nature and extent:

- At least some of the projects involved significant technological upgrades and first-of-its-kind equipment. Interestingly, EPA's recently-finalized RMRR rule indicated that replacement of older parts with newer, upgraded materials could qualify as RMRR. PSD and NSR: Equipment Replacement Provision of the RMRR Exclusion (Final Rule signed Aug. 27, 2003) at 26-27 (to be published in Federal Register). The court, however, without mentioning this rule (which was proposed long before the opinion was issued), found such technological upgrades to be a strong sign that the projects were not RMRR. *Ohio Edison* at 50.

- The work was performed by outside contractors, whereas regular maintenance was performed in-house. *Id.* at 51.[5]

- Significant portions of the projects were charged as capital expenses, not as part of the maintenance O&M budget. *Id.* at 51-53. EPA and the courts have in the past consistently considered accounting characterization as one factor to be considered. *See*, *e.g.*, *WEPCO*, 893 F.2d 901; Memorandum from D. Clay, EPA, to D. Kee, EPA Reg. V, Applicability of PSD and NSPS to WEPCO Port Washington Extension Project (Sept. 9, 1988). The court here, however, went even further, converting the accounting treatment into a *de facto* litmus test. The court explained that the applicable accounting rules (under FERC regulations, Ohio PUC law, and GAAP) allow a project to be capitalized only if it substantially improves an asset; projects that merely maintain an asset in its present condition must be considered an expense. Therefore, the court concluded that a "straightforward and logical construction of the term 'maintenance,' let alone 'routine maintenance,' would exclude from its scope any amounts defined as capital expenditures." *Id.* at 53.

[5] The court had previously found that outside contractors were called whenever needed to weld pressurized equipment, because in-house personnel were not certified to do so (which would seem to imply that the use of such contractors did not necessarily signify that the projects in question were more significant or extensive than other projects, merely that they involved different types of welding). *Id.* at 12-13. Yet the court later found that the use of outside contractors supported a finding that the projects were not RMRR, without even mentioning the company's need for certified pressure welders.

2. Purpose.

EPA has historically viewed the purpose of a project as possibly the most significant of the four factors. Here, the company's documents showed a dual purpose – to extend the life of the units, and to reduce future downtime from unplanned breakdowns – which the court concluded was not RMRR. *Ohio Edison* at 54-55. This determination may reflect a shift in prior interpretation of the RMRR exclusion: while the *WEPCO* decision in 1990 indicated that a "life-extension" purpose may not be RMRR, the desire to minimize or prevent future catastrophic failures has historically epitomized RMRR. Yet the court here did not distinguish between these two purposes, which could imply that the desire to reduce future downtime may not always be accepted as RMRR.

3. Frequency.

In evaluating the "frequency" factor, the court accepted EPA's claim that the review must focus on how frequently the project was performed on the unit in question; it rejected Ohio Edison's attempt to focus the evaluation on how frequently the project had been performed throughout the industry. *Id.* at 55-56. Because the projects in question had been performed only once or twice in the life of the unit, the court determined that they were not RMRR.[6]

4. Cost.

To evaluate the cost of the projects, the court simply listed the costs of the individual projects (from $1MM to $30MM),[7] noted that the total cost was over $136MM and that most of that cost was capitalized, and determined that the projects were therefore not RMRR. Notably, the court reviewed only absolute costs, not relative costs. It did not compare the costs of the eleven projects to the cost of regular maintenance turnarounds – which, if the costs were similar, would seem to undercut EPA's claim that these projects were out of the ordinary. *See*, *e.g.*, Letter from R. Miller, EPA, to S. Dunn., WDNR (Jan 24, 2003) (comparing project costs to routine maintenance costs). Nor did the court compare the costs of the projects in question to the cost of a new unit; while such a comparison may not have been dispositive, a $6MM repair to a $100MM unit certainly seems less significant than a $6MM repair on a $10MM unit. *See*, *e.g.*, Letter from W. Smith, EPA, to J. Johnson, Ga. Envtl. Prot. Div. (Jan. 28, 2002) (assessing percent of replacement value represented by proposed project). Despite EPA's frequent consideration of relative costs in the past, the court did not even consider this approach.

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[6] The court did not consider the apparent inconsistency of its approach with the regulations EPA adopted as a result of the *WEPCO* case (the "*WEPCO* regulations*")*, which explicitly state that the question is "whether that type of equipment has been repaired or replaced *by sources within the relevant industrial category*." *See Ohio Edison* at 103 (emphasis added), *quoting* 57 Fed. Reg. 32,314, 32,326 (July 21, 1992). One could therefore argue that EPA had already accepted Ohio Edison's approach as the appropriate test, and that under *Appalachian Power v. EPA*, 208 F.3d 1015 (D.D.C. 2000), the Agency could not change to a unit-specific approach without first undertaking another rulemaking.

[7] The costs reflected in the court's discussion do not always reflect the costs described in the fact section of the opinion. *Compare Ohio Edison* at 16-33 *with* 46-49, 56-57. No explanation is provided for the discrepancies.

The Duke Energy analysis. The *Duke Energy* court reached precisely the opposite conclusion on RMRR. After explicitly considering and rejecting the *Ohio Edison* court's approach, the court held that whether a project is RMRR must be determined based on whether the project is routinely performed within the industry, not just at a particular unit. *Duke Energy* at 25-26. Based on legislative history, regulatory history, prior EPA interpretations, and post-*WEPCO* statements by the Agency, the court determined that EPA's current enforcement position was a recent reinterpretation that merited no deference. *Duke Energy* at 25-41.

The court based its interpretation in large part on the language and history of the CAA. The court noted that the RMRR exclusion under the NSPS program used an industry-wide interpretation. Because the definition of "modification" under NSR was carried over from the NSPS definition, and because legislative history indicated that the term was intended to be interpreted consistently under both programs, the court concluded that the RMRR exclusion under NSR should follow the same industry-wide approach. *Duke Energy* at 24-25.

The court found additional support for this interpretation in EPA's own past actions. *Duke Energy* at 26-41. The court specifically pointed to the language in the *WEPCO* regulations that seemed to require an industry-wide approach (language that the *Ohio Edison* court ignored, *see supra* p. 8 n.6). *Id.* at 26. The court then dissected EPA's own *WEPCO* applicability determinations, and the *WEPCO* decision itself, both of which seemed to have followed the industry-wide approach. *Id.* at 27-37. Finally, the court relied on various EPA proclamations issued shortly after the *WEPCO* decision, which reassured both industry and Congress that the projects at issue in *WEPCO* went far beyond the typical utility "life extension" project, and that the *WEPCO* decision would therefore have little to no impact on other, more routine life extension projects. *Id.* at 37-41. The Agency's prior explicit acceptance of life extension projects as RMRR clearly weakened the Agency's claims that the RMRR exclusion had never applied to these types of projects.

On the other hand, the court refused to give any credence to more recent Agency actions that supported EPA's current narrow, unit-specific approach, such as the *TVA* EAB opinion and the 2001 Detroit Edison determination. Because both of these determinations had taken place after EPA filed its enforcement action against Duke Energy, the court found that their "potentially self-serving" nature undercut any claim that they represented a longstanding Agency interpretation. *Duke Energy* at 22 n.8.

While the court adopted Duke Energy's industry-wide approach, it did not accept the company's argument that any project performed routinely within the industry was by definition RMRR. Rather, the court concluded that the four-factor *WEPCO* test should still apply, but should be interpreted in light of the nature and extent, purpose, frequency, and cost of similar projects throughout the industry. *Duke Energy* at 42. The court then denied both parties' motions for summary judgment on this issue, based on outstanding disputed factual issues.

Finally, to provide guidance for future proceedings, the court clarified that EPA bore the burden of proving that a project was not RMRR. *Duke Energy* at 44-47. Most courts – including *Ohio Edison* – have reached the opposite conclusion. The *Duke Energy* court, however, focused on the difference between an exclusion from a rule (which usually must be proved by the party claiming the exclusion, *i.e.*, Duke Energy) and an exclusion from coverage (which usually must

be proved by the party seeking to establish coverage, *i.e.,* EPA). Here, because the generally applicable rule ("any physical change") was so broad, the court found that placing the burden of proving RMRR on Duke Energy would be to "sanction an almost de facto presumption of a PSD violation whenever a utility performs any type of work." *Duke Energy* at 46. Because Congress did not explicitly create such a presumption of liability, the court placed on EPA the burden of proving that the projects in question were not RMRR.

Practical considerations. These conflicting interpretations of the RMRR exclusion may have significant practical impacts for industry. These include:

- *Litigation strategy.* The *Ohio Edison* court's decision to consider all eleven projects together may encourage EPA to persist in its "laundry list" approach to enforcement actions. EPA's complaints typically list any number of alleged violations, spanning years, or even (as here) decades – increasing the apparent magnitude of the alleged violation(s), and creating an appearance of repeated, routine disregard of the law. In response, defendants attempt to focus attention on each project separately (thereby decreasing the apparent magnitude of the alleged violations) and seek dismissal of projects that, standing alone, qualify as RMRR. The *Ohio Edison* decision indicates that it may prove difficult to obtain a thorough judicial evaluation of individual projects, as most defendants would prefer.

- *Conflict with NSR Reform.* The broad language of the *Ohio Edison* opinion – its repeated reference to "any" change – indicates that this court interprets the RMRR exclusion much more narrowly than industry – and even, perhaps, EPA – has in the past. Interestingly, this more limited approach conflicts with EPA's recent RMRR rule, which specifically authorizes many of the types of changes that the court here seems to object to (*e.g.*, use of technological upgrades). Environmentalists will undoubtedly cite *Ohio Edison* as support for their claims that the RMRR rule is not authorized under the CAA, especially given the court's repeated characterizations of its "narrow" interpretation as clear on the face of the CAA itself. The *Duke Edison* opinion, however, should significantly weaken those claims: it is difficult to argue that any interpretation is unambiguous on the face of the statute where different courts, in contemporaneous, thoughtful opinions, have reached opposite conclusions.

- *The "purpose" factor.* The *Ohio Edison* court's unwillingness to accept the prevention of future catastrophic failures as a legitimate "purpose" is troubling, because industry has long believed that this type of preventive maintenance was precisely what the RMRR exclusion was designed to authorize. Here, of course, this maintenance purpose was intertwined with a "life extension" purpose, and so it is not clear whether the court would have rejected preventative maintenance in the absence of a life extension project. Nevertheless, the court was clearly concerned by the fact that preventing future unplanned outages would allow the company to operate more, thus emitting more pollutants – which may imply that courts will in the future take a harder look even at projects that industry has historically considered "pure" preventive maintenance.

  The *Duke Energy* decision, on the other hand, not only accepted the legitimacy of a maintenance purpose, but even went so far as to indicate that a "life extension" purpose

could itself qualify as RMRR. *Duke Energy* at 37-40. Of course, throughout the utility enforcement initiative, EPA has consistently claimed that the law has always been clear, and that at least since *WEPCO*, everyone has understood that life extension projects cannot qualify as RMRR. The prior EPA proclamations brought to light in *Duke Energy*, which imply that the Agency itself at one time believed that "run of the mill" life extension projects could qualify as RMRR, will certainly undercut this argument in the future.

- *Internal consistency.* The *Ohio Edison* decision emphasizes the importance of consistent internal documentation and accounting. In some respects, Ohio Edison was hoist by its own petard: the court frequently and repeatedly used the company's own documents to prove that the projects were not RMRR. The opinion's almost single-minded focus on project accounting is especially significant, as it reflects a significant departure from prior law. Companies must ensure that any project claimed as RMRR is treated as such in all respects.

- *Trade group actions. Ohio Edison* also makes it clear that the courts will not necessarily distinguish between actions taken as part of a trade group and actions taken by the company itself. The court repeatedly used Ohio Edison's participation in trade groups against it: because the company had participated in a trade group that investigated and developed the "life extension" concept in the mid-1980s, the court found it easy to hold that all of the company's projects were designed with life extension in mind. Companies should remain up-to-date on the activities of any industry groups they belong to.

- *Prior EPA statements.* On the other hand, the *Duke Energy* decision makes it clear that EPA also cannot easily separate itself from its own prior statements and actions. The court repeatedly rejected EPA's claims based on the Agency's own prior statements and actions. The decision proves the benefit of thorough knowledge of, and research into, past Agency documents and practices.

- *Turnarounds.* Both decisions may prove especially important to industries that rely on turnarounds to perform maintenance. One the one hand, the *Ohio Edison* court initially implied that some normal maintenance turnarounds would qualify as RMRR. *See Ohio Edison* at 12-13. However, that court's focus on absolute costs, rather than relative costs, is certainly unfavorable to industries that rely on turnarounds, which incur several years' worth of maintenance costs all at once. Moreover, the opinion provides little guidance as to where the line would be drawn between acceptable and unacceptable turnarounds, stating only that RMRR "occurs regularly, involves no permanent improvements, is typically limited in expense, is usually performed in large plants by in-house employees, and is treated for accounting purposes as an expense." *Id.* at 5. On the other hand, the industry-wide focus of the *Duke Energy* decision is very important for such industries: turnaround projects may appear significant in the absolute, but comparing a turnaround to other similar actions within the same industry puts the project in a fundamentally different perspective.

III. Significant Net Emissions Increase.

The Ohio Edison analysis. After rejecting Ohio Edison's RMRR defense, the court went on to analyze whether the projects in question resulted in a significant net emission increase, and so triggered NSR. Once again, the court was faced with conflicting views of how to perform this analysis, and once again, the court sided with EPA across the board. Using the "actual to representative future actual" test as set forth in the NSR regulations (as amended by the 1992 *WEPCO* regulations for utilities), the court found that each of the projects resulted in a significant net emissions increase.

The court first found that emissions estimates must be based on projections at the time of the project, and that subsequent emissions data cannot be used to disprove a violation. *Ohio Edison* at 62-64. The court noted that NSR requires a preconstruction review to determine if permitting is required, and thus concluded that an "after-the-fact" analysis would not be permissible. *Id.* at 64. The court nevertheless allowed testimony from an EPA expert witness as to the actual reduction in downtime that resulted from the projects, and the emission impacts from these improved operations – evidence that would seem to qualify as an "after-the-fact" analysis. *See id.* at 86-87.

To determine pre-change baseline emissions, the court used two different approaches. For projects that predated the 1992 *WEPCO* regulations, the court used the definition in effect at the time, *i.e.*, the two years preceding the change. For projects that occurred after that date, the court used the highest-emitting two years out of the past five. Ohio Edison argued that the latter, more favorable approach should apply to all of the projects, because the earlier regulations allowed use of an alternate period if EPA determined that period to be more representative of normal source operation. The court, however, noted that EPA had not approved any such alternate time period here, and so rejected Ohio Edison's claim.

For the actual calculations themselves, the court accepted as a whole the government's methodology, overriding Ohio Edison's many technical challenges. The court seemed to view these challenges as largely irrelevant, because the increases in question were undoubtedly "substantial." As the court phrased it, "[a]s long as Ohio Edison could have predicted that the eleven projects would result in a substantial increase in emissions, . . . the precise computation of such increase is not at issue." *Ohio Edison* at 90.

The court's characterization of the test is problematic. As a practical matter, this broad phrasing – the court's focus on whether there has been a "substantial" increase in emissions – may not have affected the outcome of the case, as the calculated emissions increases for many of the projects were 100 or more times the significance level. At the same time, however, some of the violations that the court found involved increases of only two to three times the significance level – a level at which even relatively minor changes in calculation methodology could prove that no violation occurred. *See*, *e.g.*, *id.* at 74 (129 tpy increase in SO_2 and 84 tpy increase in NO_x, vs. 40 tpy "significance" threshold). Thus, while the court did in fact consider all of Ohio Edison's objections to the government's calculations, its apparent hostility to what it seemed to consider irrelevant technical challenges raises a question as to whether that review was as thorough and unbiased as it should have been.

The court also did not appear to consider emissions increases that resulted from increased demand. The *WEPCO* regulations specifically allow utilities to exclude any emissions increases resulting from increases in demand that the facility was capable of accommodating prior to the change in question. *See* 40 C.F.R. § 52.21(b)(33)(ii). Yet the court did not consider this; in fact, when Ohio Edison's expert attempted to discuss demand, the court dismissed his concerns. *See Ohio Edison* at 87-88.

Finally, the court rejected Ohio Edison's claim that any increases were the result of increases in the hours of operation, which are exempt from permitting under 40 C.F.R. § 52.21(b)(2)(iii)(f). The court held that this exclusion applied only when the increased hours of operation did not result from a physical change; here, the facility was able to increase its operations only because of the modifications, and so the hours of operation exclusion did not apply. *Ohio Edison* at 82-83.

The Duke Energy analysis. As with RMRR, the *Duke Energy* court one again explicitly considered and rejected the *Ohio Edison* analysis, instead adopting the very arguments the earlier case had rejected. The court rejected in its entirety EPA's "actual to representative future actual" test, instead holding that emissions increases must be calculated on an annual basis, but holding hours and conditions of operation constant. *Duke Energy* at 48**.** As a result, the court found a project could result in a "significant net emissions increase" (and thus trigger NSR) only if it increased a unit's hourly emissions rate. *Id.*

The court focused its analysis on the 1980 regulations, not on the 1992 amendments adopted after the *WEPCO* decision. Although those amendments on their face establish an "actual to representative future actual" test for the utility industry, the court found that the amendments did not apply here, because the alleged violations for the most part occurred before the changes were adopted into the North and South Carolina State Implementation Plans (SIPs).[8] Thus, the court did not decide whether EPA's interpretation would be supportable under the 1992 amendments, which set forth the "actual to representative future actual" test far more explicitly.

The court began its analysis with the language of the 1980 regulations themselves, noting that the definition of "physical change or change in the method of operation" on its face excluded increases in hours of operation. Thus, the court concluded that any estimate of post-change emissions could not consider any increases in hours of operations, and so must assume the same "representative" operating conditions that were used in the pre-change emissions calculations. *Duke Energy* at 48-49.

[8] The court noted that some of the alleged violations post-dated the adoption of the *WEPCO* regulations. Even here, however, the court found that the amended regulations did not apply, because Duke Energy "opted out" by not submitting the required five years' of post-change emissions data. *Duke Energy* at 64-65 & n.25. This holding effectively allows utilities to take advantage of the court's more liberal approach to calculating emissions increases under the 1980 regulations, simply by refusing to comply with the provisions of the 1992 amendments.

EPA, as it had in *Ohio Edison*, argued that the exclusion for increases in hours of operation may not be used in conjunction with a construction project – that is, that the hours of operation exclusion applies only where no physical changes occur that may enable or encourage increased operation. *Duke Energy* at 50. The court, however, refused to defer to EPA's interpretation, because the additional restriction was not apparent on the face of the regulations themselves (which require only that the increase in operating hours not be prohibited by a federally-enforceable permit limit). *Id.* The court further pointed to early EPA guidance, which indicated that the hours of operation exclusion *could* be used in conjunction with a construction project. The court found these contemporaneous interpretations – the very same documents dismissed by the *Ohio Edison* court – to be "compelling evidence" of the rules' original meaning. *Id.* at 51-52.

The court then looked to congressional intent, noting once again that the NSPS definition of "modification" had been incorporated into the NSR program. *Duke Energy* at 53-54. EPA argued that "critical differences" between the NSPS and NSR programs required a different definition of "modification," and that adopting the NSPS definition (which is based on hourly emissions rates) into the NSR program (which is based on annual emissions increases) would ignore the different needs and purposes of each program. *Id.* at 55. The court, however, found that applying the NSPS hourly approach to the NSR program was not inconsistent with the purposes of each program, because the NSR requirement for an annual emissions increase was *in addition to*, not *instead of*, the NSPS hourly emissions rate increase. *Id.* at 55-56. In other words, the court appeared to view the NSR program as having a more limited reach than NSPS, because NSR allows facilities to "net" out of review by using past emissions decreases to offset increases from a particular project, or to offset increases at one unit with decreases at another. *Id.* Thus, the court interpreted the requirement for a significant annual emissions increase as further limiting the types of emissions increases for which NSR is triggered. *Id.* at 58-59.

Finally, the court rejected EPA's claims that its interpretation contradicted the *WEPCO* opinion. As the court pointed out, the *WEPCO* court instructed EPA to determine whether a significant net emissions increase would occur if the facility was operated "under present hours and conditions." *Duke Energy* at 60, *quoting WEPCO*, 893 F.2d at 918 n.14. Thus, the court found that *WEPCO* had itself advocated the hourly emissions rate approach – a fact that EPA had noted at the time and dismissed as "incorrect" and "absurd." *Id.* at 62. Moreover, EPA had been aware of this holding at the time and simply chosen to disregard it. This again clearly undercut the Agency's claims that *WEPCO* supported the "actual to future actual" test advocated by EPA.[9]

After establishing the test for determining whether a significant net emissions increase occurred, the court also evaluated, but did not decide, whether reactivation of a mothballed plant would cause an increase in the emissions rate that could trigger NSR. EPA argued that under the

[9] Unable to avoid the language of the *WEPCO* opinion itself, EPA sought deference for its interpretation of that opinion as "incorrect" and "absurd." *Id.* at 63. The court rejected this request, finding that the interpretation of judicial opinions was "a task the court is equally able to perform." *Id.*

1980 regulations, the pre-change emissions baseline must be based on the two years immediately prior to the change; here, because the unit was shut down during that time, it had no emissions, so reactivating the unit would necessarily cause an emissions increase that would trigger NSR. Duke Energy, on the other hand, claimed that North Carolina's SIP had been approved by EPA, making the State, not EPA, the arbiter of the baseline; it introduced evidence that North Carolina would use the last two years prior to the shutdown for the baseline.

The court, however, refused to decide the issue on the available record. The court noted that Duke Energy would have to prove both that it was entitled to request a different baseline after-the-fact, and that this baseline was more representative of normal operations; if the company did so, EPA would then have to prove that the project caused an increase in the hourly emissions rate.

Practical considerations. As with the RMRR exclusion, the courts' evaluation of the emissions increases raises many issues relevant to practitioners. These include:

- *Actual to potential test.* The *Ohio Edison* court specifically noted that the "actual to potential" test generally favored by EPA was "not legally supportable," because the facility was in operation when the modifications took place. *Ohio Edison* at 60. The court's statement was dicta, as EPA did not attempt to apply the "actual to potential" test to this case – indeed, the Agency could not have done so, because the "actual to potential" test has been disallowed for utilities. *See WEPCO*, 893 F.2d at 917-18; 57 Fed. Reg. 32313, 32,317, 32,323, & 32,334 (July 21, 1992).

  The *Duke Energy* decision did not pass on the legality of the "actual to potential" test; the court noted that EPA originally sought to apply that test, but later dropped that claim. Given the court's ultimate holding, however, it appears extremely unlikely that it would have upheld such an approach. Thus, both cases could further undercut EPA's ability to require use of the "actual to potential" test in other contexts – a potentially important point, given EPA's continued insistence on the "actual to potential" test in other enforcement actions.

- *"Substantial" increases.* The *Ohio Edison* court's emphasis on whether the emissions increases were "substantial," rather than "significant," raises an important concern for future enforcement actions. To prove a violation of NSR, EPA must demonstrate that a particular project resulted in a "significant net emissions increase" of each pollutant alleged. Here, however, the court effectively required EPA to prove only that the increases were "big enough" to have raised concerns at the time the projects were commenced; its grudging and cursory review of Ohio Edison's challenges to EPA's calculations then made it very difficult for Ohio Edison to prove that the projected increases would not have been "significant." Companies facing this type of claim in the future would be well-served to perform, document, and fully support their own emissions calculations – something Ohio Edison chose not to do. While EPA will no doubt object to those calculations, and counter with its own, the very presence of an alternate emissions calculation levels the playing field, and helps avoid the inference that the company is attempting to escape on a "technicality."

- *Emissions increases from prevented downtime.* The *Ohio Edison* case is troubling for industry, because all of the calculated "increases" in emissions resulted entirely from prevented downtime, not from increased operating rates. The government calculated post-change emissions by relying on an "availability factor," which allegedly reflected the decreased downtime that resulted from preventing the shutdowns that would have occurred if the project had not been performed. *See Ohio Edison* at 68-69. This approach is likely to find far more violations, as any type of maintenance or reliability project will almost inevitably reduce future downtime – that is the very purpose of such projects.

  The *Duke Energy* approach, however, would reach the opposite result. While the court did not perform the same emissions calculations as the *Ohio Edison* court, its requirement that a change increase the hourly emissions rate would necessarily seem to preclude liability for the types of changes at issue in *Ohio Edison*. The projects at issue in *Ohio Edison* were admittedly limited to reducing downtime, and did not increase operating rates above past levels. Thus, almost by definition, these types of reliability projects could never result in a significant net emissions increase under the *Duke Energy* approach.

- *Contemporaneous calculation.* The *Ohio Edison* case underscores the importance of performing emissions calculations at the time a particular change is considered. Here, Ohio Edison had not done so, which left it effectively at the mercy of government witnesses (who undoubtedly chose unfavorable methodologies, from Ohio Edison's perspective). Again, there is no guarantee that performing such calculations at the time of a change will insulate a company from subsequent attack. However, having this type of information both shows a good-faith attempt to comply with the law and makes it less likely that a subsequent different interpretation by EPA will be accepted, unchallenged, by the court.

- *Interactions with the Credible Evidence Rule.* The *Ohio Edison* court's insistence on a pre-change emission analysis, and its refusal to consider actual documented emissions after the fact, would seem to run counter to the Credible Evidence Rule, which allows both EPA *and* defendants to present "any credible evidence" to prove or disprove a violation. It is interesting to note, however, that EPA's insistence on a pre-change analysis could actually hurt the Agency in the future. EPA has repeatedly argued that "after the fact" data cannot be used to prove that no significant net emissions increase has occurred, and it has consistently won this point. *See, e.g., In re Tennessee Valley Authority*, 9 E.A.D. 357, 435-436 (EAB 2000). Yet EPA itself may well want to use "after the fact" data in some cases. For example, if a company projects no significant net emissions prior to a change, and that projection turns out to be incorrect, EPA would undoubtedly claim that the source has violated NSR, based on the very *post hoc* analysis that the Agency itself has consistently opposed. Given EPA's long history of opposing such an approach, the Agency may well find itself judicially estopped from using "after the fact" information to prove a violation in this type of situation.

IV. Fair Notice.

The Ohio Edison analysis. Ohio Edison claimed that it did not receive fair notice of EPA's narrow interpretation of the RMRR exclusion, and that it therefore could not be liable for violating NSR. Once again, the court disagreed. Based on the language of the CAA and regulations, as well as various regulatory preambles and court decisions, the court held that Ohio Edison must have been on notice that its projects ran afoul of EPA's narrow interpretation of RMRR.

The Duke Energy analysis. The *Duke Energy* court did not directly address the company's fair notice claim, merely dismissing EPA's challenge to this defense without discussion.

Issues of interest.

- *Ambiguity.* The *Ohio Edison* court repeatedly treated EPA's narrow interpretation of RMRR as unambiguous – a characterization that would undoubtedly come as a surprise to practitioners (as well as the *Duke Energy* court). *See*, *e.g.*, *Ohio Edison* at 104. Focusing once more on the CAA's reference to "any" physical change, the court found that the narrow interpretation advocated by EPA was obvious on the face of the statute, and that finding any of Ohio Edison's projects to be RMRR "would vitiate the very language of the CAA itself." *Id.* The court appears to have confused "narrow" with "clear." Even if the CAA unambiguously supported EPA's narrow interpretation, and even if that "narrow" interpretation must necessarily be the four-factor *WEPCO* test, such a conclusion does not, *a fortiori*, mean that the application of those four factors to a particular project is equally unambiguous. Note that the *Duke Energy* opinion undercuts the persuasiveness of the *Ohio Edison* court's analysis, as that court seemed to find the statute equally unambiguous, but in the opposite direction.

- *Impact of WEPCO.* The *Ohio Edison* court further noted that even if the CAA and regulations were ambiguous, Ohio Edison was on notice of EPA's interpretation at least since 1988-90, when EPA issued its WEPCO determination and that decision was upheld by the 7th Circuit. *Ohio Edison* at 105-06. The court did not distinguish, however, between the five projects that occurred before or during the *WEPCO* decision and the six that occurred after.

  Of course, as the *Duke Energy* court pointed out in some detail, various portions of the *WEPCO* determination and case appear to support the "industry-wide" approach that Ohio Edison advocated. Moreover, EPA's own post-*WEPCO* statements repeatedly reassured both industry and Congress that the *WEPCO* decision would *not* affect other life-extension projects. Thus, the *Duke Energy* opinion seems to indicate that the *WEPCO* decision would strengthen, not weaken, a fair notice claim.

- *Participation in trade groups.* The *Ohio Edison* court appeared to take the company's fair notice claim with a large grain of salt, based on its membership and participation in various industry trade groups, including task forces that specifically investigated the likely impacts of the *WEPCO* opinion. *Ohio Edison* at 106. The court seemed to believe

that these memberships necessarily would have given the company notice of EPA's policy, thus undercutting the fair notice claim. Again, however, the *Duke Energy* opinion supports the argument that understanding *WEPCO* would not necessarily put one on notice of EPA's unit-specific approach.

Practical considerations.

- *Longstanding EPA policies.* The *Ohio Edison* opinion makes it clear that a fair notice defense may be difficult to pursue where a longstanding EPA policy exists, even if that policy does not provide clear answers on how the rule may apply to a given situation – and even where EPA itself may have changed its interpretation of that policy over time. The *Duke Energy* opinion, however, shows that a close scrutiny of such longstanding policies may disclose that the Agency's interpretation was not always as "clear" as EPA would now claim.

- *Hostility towards sophisticated entities.* Large, sophisticated companies that actively participate in industry groups may find a fair notice defense especially difficult. The *Ohio Edison* court was clearly hostile to the concept that a major player in the utility industry could be ignorant of a significant rule that had been the focus of significant court cases and multiple Agency guidance documents. The court effectively created a "constructive notice"-type of doctrine – that, given the company's size, resources, sophistication, and active participation in trade groups, it must have known of EPA's interpretation.

Conclusion

The *Ohio Edison* decision should raise a red flag for all industries, but especially for those who continue to operate major process units under grandfathered status. The court clearly viewed with great distrust the notion that Ohio Edison had not triggered NSR at some point over the past twenty-five years since the program was enacted – especially given the size (in absolute terms) of the eleven projects in question. Underlying the court's analysis was its conclusion that Congress did not intend to allow grandfathered sources to avoid regulation forever. *Id.* at 35. Thus, whether or not this court's interpretation of the CAA is adopted by other courts, the decision stands as a warning to all grandfathered sources: at some point, the courts may simply be unwilling to believe that such a facility could have continued operating for so long a time *without* triggering NSR.

The *Duke Energy* court, on the other hand, focused not on the overarching purpose of the CAA, but on the unfairness of using enforcement actions to establish (or change) agency policies. In a much more detailed review of the law, the court intensely parsed legislative history and prior EPA statements and actions, repeatedly holding the Agency to its prior pronouncements regardless of subsequent statements or events.

Since both of these cases were decided, EPA itself has weighed in on the RMRR issue in its new RMRR rule, coming down clearly on the side of *Duke Energy*, and rejecting the narrow interpretation that the *Ohio Edison* court believed was unambiguously required on the face of the CAA. The new rule explicitly authorizes several of the types of changes rejected in *Ohio*

Edison, such as replacing equipment to take advantage of new technology. It further provides a broad safe harbor for changes that cost no more than 20% of the cost of an entire new process unit – a level that may well exempt the types of changes at issue in both *Ohio Edison* and *Duke Energy*.

The new regulations, however, will not end the debate. Environmentalists will undoubtedly claim that the rule exceeds EPA's authority under the CAA – and cite *Ohio Edison* as support. EPA's own enforcement personnel will undoubtedly be displeased as well, as the regulations clearly authorize some of the very types of actions they are currently prosecuting. While the new rule is not retroactive, it may prove more difficult as a practical matter for the Agency to obtain significant penalties and injunctive relief for actions that would be entirely proper if conducted today. Thus, the new rule, together with *Ohio Edison* and *Duke Energy*, will doubtlessly provide significant ammunition for both sides of the debate for years to come.