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Is The "Functional Interdependence" Test Dead?

D.C. Circuit Rejects EPA's Attempt to Limit *Summit Petroleum* to States in the Sixth Circuit.

By Tad J. Macfarlan, Christopher R. Nestor, David R. Overstreet and Craig P. Wilson

Introduction

On May 30, 2014, the United States Court of Appeals for the D.C. Circuit vacated the Environmental Protection Agency's ("EPA's") attempt to preserve an expansive view of what constitutes a single source of air emissions under the Clean Air Act ("CAA"). Specifically, in *National Environmental Development Association's Clean Air Project v. EPA ("NEDACAP")*,[1] the D.C. Circuit vacated a December 21, 2012 EPA memorandum (referred to by the court as the "*Summit* Directive") by which EPA sought to limit the applicability of the Sixth Circuit's decision in *Summit Petroleum Corp. v. EPA,* 690 F.3d 733 (6th Cir. 2012).[2] In *Summit Petroleum*, the Sixth Circuit rejected EPA's practice of aggregating emissions from physically distant but "functionally interdependent" facilities to determine the applicability of "major source" permit programs under the CAA. The *Summit* Directive announced that, moving forward, EPA would only comply with *Summit Petroleum* within the Sixth Circuit's jurisdiction (Michigan, Ohio, Kentucky, and Tennessee). In *NEDACAP*, the D.C. Circuit concluded that the *Summit* Directive violated EPA's "Regional Consistency" regulations at 40 C.F.R. Part 56 and struck down the directive while observing that "[i]t is 'axiomatic . . . that an agency is bound by its own regulations.'"[3] The effect of the decision is that EPA will be required to comply with *Summit Petroleum* across the country, unless EPA successfully challenges the D.C. Circuit's decision or amends its regulations in a manner that maintains compliance with the language of the CAA.

Background

Generally, the CAA subjects only "major sources" of air emissions to the stringent requirements of the prevention of significant deterioration ("PSD"), non-attainment new source review ("NSR"), and Title V permit programs. The statute itself provides multiple definitions of the terms "stationary source" and "major source" that apply to these and other CAA programs.[4] Whether a source qualifies as "major" is based upon the quantity of pollutants that a source emits or has the potential to emit (the specific threshold can differ

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[1] *National Environmental Development Association's Clean Air Project v. EPA*, No. 13-1035 (May 30, 2014).

[2] In prior alerts, the authors described the *Summit Petroleum* decision and the *Summit* Directive.

[3] *NEDACAP* at 15 (quoting *Panhandle Eastern Pipe Line co. v. FERC*, 613 F.2d 1120, 1135 (D.C. Cir. 1979)).

[4] *See* 42 U.S.C. § 7411(a)(3) (defining "stationary source" for the purpose of EPA's New Source Performance Standard program as "any building, structure, facility, or installation which emits or may emit any air pollutant"). In prior court decisions, this definition has been used as a guide to decipher the meaning of the term "source" for the purposes of the PSD and NSR programs. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 860, 104 S.Ct. 2778, 2790 (1984); *Alabama Power Co. v. Costle*, 636 F.2d 323, 395 (D.C. Cir. 1979). The Title V program defines "major source" as "any stationary source (or any group of stationary sources located within a contiguous area under common control)" that meets emissions thresholds established elsewhere in the CAA. 42 U.S.C. § 7661(2).

depending on the pollutant, the regulatory program, attainment status of the area, and type of facility at issue). If emissions from multiple distant, but related facilities—such as oil and gas well sites, compressor stations, and processing facilities—are aggregated, the combined "source" might trigger the onerous major source requirements.

EPA's regulations provide three criteria that must each be satisfied for the emissions from multiple pollutant emitting activities to be aggregated:

1. The sources must belong to the same industrial grouping, which is determined with reference to whether they have the ***same primary SIC code***;
2. The sources must be located on one or more ***contiguous or adjacent properties***, and;
3. The sources must be under ***common control*** of the same person or corporate entity.

With regard to the second prong, EPA has advanced the interpretative position that "functional interdependence" or "functional interrelatedness" should be considered in determining whether sources are located on "adjacent" properties. This interpretation has allowed EPA regional offices to aggregate the emissions of physically distant sources, effectively reading the "contiguous or adjacent" criteria out of the rulebook.

In *Summit Petroleum*, the Sixth Circuit squarely rejected EPA's position that interrelatedness should be considered in determining adjacency. The court determined that the term "adjacent" is unambiguous and required that EPA apply the "ordinary, i.e., physical and geographical, meaning of that requirement."[5] In coming to this conclusion, the court relied upon (1) the dictionary definition and etymological history of the term "adjacent" and (2) case law interpreting the word "adjacent" in other contexts.[6] Because the court found no ambiguity, it applied no deference to EPA's interpretation.[7]

On December 21, 2012, EPA issued the *Summit* Directive, indicating that it would not adhere to the *Summit Petroleum* decision outside of the Sixth Circuit's jurisdiction.[8] In the *Summit* Directive, EPA indicated that it would no longer consider interrelatedness in determining adjacency in Michigan, Ohio, Kentucky, and Tennessee but that it would **not** "change its longstanding practice of considering interrelatedness in the EPA permitting actions in other jurisdictions."

The D.C. Circuit's Decision

The petitioner in *NEDACAP* claimed that the *Summit* Directive gave resource extraction and manufacturing companies operating in the Sixth Circuit a competitive advantage over companies operating outside the Sixth Circuit and that the directive violated the CAA and EPA's implementing regulations. EPA argued, in response, that (1) the petitioner lacked Article III standing because the alleged injury was speculative; (2) the directive was not a final agency action subject to review; and (3) the claim was not ripe for review. EPA also

[5] 690 F.3d at 735.

[6] *Id.* at 741-44.

[7] *Id.* at 744-46.

[8] Memorandum from Stephen D. Page, Director, EPA Office of Air Quality Planning and Standards, to Regional Air Division Directors, re: Applicability of the Summit Decision to EPA Title V and NSR Source Determinations (Dec. 21, 2012).

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maintained that neither the CAA nor its regulations mandate national uniformity in response to a judicial decision.

The D.C. Circuit found that the petitioner had Article III standing to challenge the *Summit* Directive as a final action that was ripe for judicial review and then held that the directive was "plainly contrary" to EPA's own regulations at 40 C.F.R. § 56.3(a) & (b), which provide:

> It is EPA's policy to:
>
> (a) Assure fair and uniform application by all Regional Offices of the criteria, procedures, and policies employed in implementing and enforcing the act; [and]
>
> (b) Provide mechanisms for identifying and correcting inconsistencies by standardizing criteria, procedures, and policies being employed by Regional Office employees in implementing and enforcing the act . . . .

The court, having found that the directive was contrary to EPA's own regulations, did not reach the question of compliance with the CAA.

Finding that petitioners suffered the requisite Article III injury-in-fact, the court focused on the additional permitting requirements, ambiguity, and delay associated with continued application of the functional interdependence test outside of the Sixth Circuit. While the burden on companies operating outside the Sixth Circuit had not changed, the court was persuaded that the *Summit* Directive increased "the *relative* regulatory obligations and costs for companies outside the Sixth Circuit."[9] Petitioner's members were injured, concluded the court, not because they were worse off but because they had shown "that, had the EPA taken the course of action that they claim the law required, they would have been better off."[10]

Regarding finality, the court rejected EPA's assertion that the *Summit* Directive was not a final action because EPA claimed that it was still assessing how to respond to the Sixth Circuit's decision. The court concluded that the *Summit* Directive resulted in a binding change in enforcement policy by "provid[ing] firm guidance to enforcement officials about how to handle permitting decisions."[11] The directive, according to the court, "*compels* agency officials to apply different permitting standards in different regions of the country."[12] Thus, the court concluded that "there can be little doubt there that the *Summit* Directive reflects final agency action that is subject to judicial review."[13]

The court also rejected EPA's claim that the action was not ripe. EPA argued that, rather than entertain a facial challenge, the court should wait for the directive to be applied. The court disagreed, noting that "this case presents a purely legal question of whether EPA's final action adopting a non-uniform enforcement regime violates the strictures of the CAA or EPA regulations."[14]

The court then assessed the *Summit* Directive in light of EPA's Regional Consistency regulations. Discussing the standard of review, the court observed that an agency is not free to ignore or violate its own regulations and that, as a result, agency action may be set aside

[9] *NEDACAP* at 9.
[10] *Id.* at 10.
[11] *Id.* at 11.
[12] *Id.* at 12.
[13] *Id.*
[14] *Id.* at 14.

as arbitrary and capricious if the agency fails to comply with its own regulations. Turning to the merits, the court noted that the Regional Consistency "regulations, taken together, strongly articulate EPA's firm commitment to national uniformity in the application of its permitting rules. And there is no indication that EPA intended to exempt variance created by a judicial decision."[15] EPA, the court concluded, had violated its own regulations when issuing the *Summit* Directive. Moreover, EPA's action was not saved by the "doctrine of intercircuit nonaquiesence," because, even if EPA has authority under the CAA to decline to follow a decision of a particular Circuit Court, it cannot ignore the plain meaning of its own regulations.[16]

What is Next?

The controversy surrounding the functional interdependence test is not yet over. On the judicial front, EPA may seek rehearing or petition the Supreme Court to issue a writ of certiorari. Alternatively, as the D.C. Circuit observed, EPA could amend its CAA implementing regulations to replace the "adjacency" requirement with the functional interdependence test, though it is questionable whether such a rulemaking would survive legal challenge. As EPA has previously acknowledged, courts interpreting the CAA have indicated that the regulatory definition of "source" "must approximate a common sense notion of 'plant'" and "avoid aggregating pollutant-emitting activities that as a group would not fit within the ordinary meaning of 'building,' 'structure,' 'facility,' or 'installation.'"[17] Or, EPA could revise its Regional Consistency regulations to expressly allow for regional variances created by judicial decisions.

Nevertheless, the D.C. Circuit's decision will likely derail, at least temporarily, efforts by EPA to apply the functional interdependence test rather than the common sense, plain meaning approach to "adjacency" sanctioned by the court in *Summit Petroleum*. While state agencies implementing the relevant CAA permit programs are not directly affected by the D.C. Circuit's decision, the decision strikes a significant blow to EPA's ability to compel state compliance with EPA's preferred interpretation.

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[15] *Id.* at 17.
[16] *Id.* at 19.
[17] 45 Fed. Reg. 52676, 52694-95 (Aug. 7, 1980) (discussing *Alabama Power Co. v. Costle*, 636 F.2d 323 (D.C. Cir. 1979)).

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