JONES DAY

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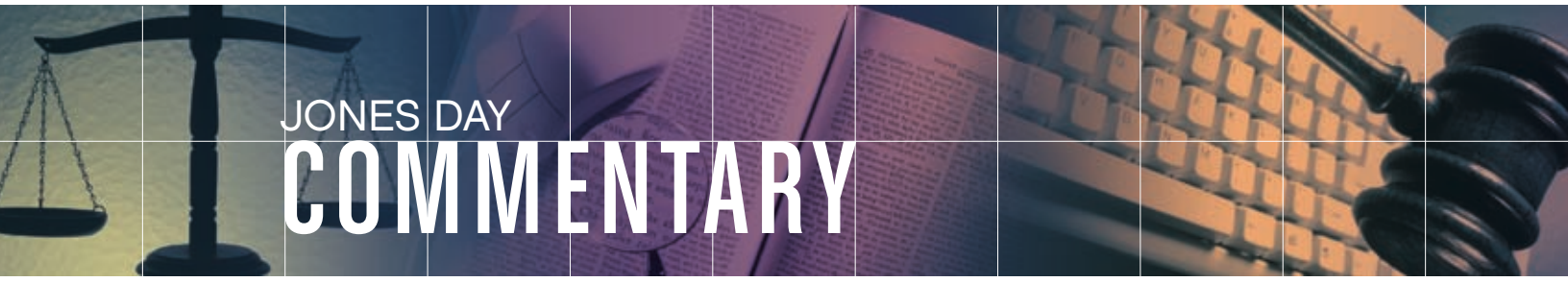

ENVIRONMENTAL DEFENSE V. DUKE ENERGY CORP.: THE NSR ENFORCEMENT CASES MARCH FORWARD

In early April 2007, the United States Supreme Court in *Environmental Defense v. Duke Energy Corp.,* No. 05-848 (U.S. April 2, 2007), thwarted, at least temporarily, industry efforts to halt the federal government's New Source Review ("NSR") enforcement initiative.

In the case, the Supreme Court vacated a decision of the U.S. Court of Appeals for the Fourth Circuit, which had dismissed an NSR enforcement action brought by the federal government against Duke Energy Corporation for alleged violations of the Clean Air Act ("CAA"). After the company undertook certain projects at its plants, the government alleged that the work constituted unlawful "modifications" under the CAA. Rejecting the Fourth Circuit's reading of the CAA, the Court, as explained in more detail below, held that nothing in the text or legislative history of the 1977 CAA Amendments suggests that Congress meant to eliminate customary EPA discretion to define "modification" in the NSR program differently than it had under another program, known as the New Source Performance Standard ("NSPS") program.

Accordingly, the Court concluded that EPA could adopt an hourly test for determining modifications under the NSPS program and an annual test under NSR, despite the use by both programs of the same statutory definition of "modification." The Court, however, expressly declined to decide, among other things, whether EPA had retroactively and unlawfully taken inconsistent positions with respect to what constitutes a "modification," thus leaving that issue to be resolved in the context of the various NSR enforcement actions pending nationwide against electric utilities. With much financially at stake, given the likely size of the government's demand for civil penalties and injunctive relief in these cases, it is unlikely that this decision will halt industry's challenges to the NSR enforcement initiative.

EARLIER PROCEEDINGS

The *Duke Energy* case was initially filed in December 2000 as part of EPA's then-ongoing NSR enforcement initiative against the electric utility industry. In

September 2001, Environmental Defense, the North Carolina Sierra Club, and the North Carolina Public Interest Research Group Citizen Lobby/Education Fund intervened on behalf of EPA. In the case, EPA alleged that between 1988 and 2000, Duke engaged in a plant-modernization program that included 29 projects—such as replacement or redesign of boiler tube assemblies in economizers, waterwalls, superheaters, and reheaters—that enabled the units to operate for more hours each day, thus leading to an increase in actual yearly emissions. After more than two years of intense discovery, the district court ruled upon competing cross-motions for summary judgment, holding that:

1. For there to be an increase in emissions that triggers NSR, a project must increase the unit's maximum achievable hourly emissions rate; and

2. The standard for determining what is routine maintenance, repair, and replacement—a key exemption in the NSR program—is what is routine in the industrial category, not just what is routine at the specific unit in question.

EPA appealed the district court decision to the Fourth Circuit for the U.S. Court of Appeals. The Fourth Circuit affirmed the judgment of the district court, granting the complete dismissal of EPA's NSR enforcement case against Duke Energy.[1]

The Fourth Circuit held that because the NSPS and NSR programs used the same statutory definition of "modification," EPA's rules for determining when a modification occurs under either program must also be the same. Heavy reliance was placed on a 1982 Supreme Court case—*Rowan Cos. v. United States*, 452 U.S. 247 (1981)—where the Court held against the government's differing interpretations of the word "wages" in separate Internal Revenue Service regulations. As there was no dispute that NSPS modifications are defined to include only those projects that increase a plant's hourly rate of emissions, the Fourth Circuit concluded that EPA must interpret its NSR regulations "congruently" or consistently. Given this, the Fourth Circuit failed to reach the issue of whether the routine maintenance, repair, and replacement exclusion would apply to the projects at issue.

After that decision, the plaintiff-intervenor environmental groups filed a petition for *certiorari* with the U.S. Supreme Court, to which both Duke Energy and the United States objected. Nevertheless, the Supreme Court granted the petition.

THE SUPREME COURT DECISION

The Supreme Court unanimously reversed the Fourth Circuit, holding that EPA did not have to apply the same emissions increase test in NSR used in the NSPS program to determine the occurrence of a modification. Acknowledging that both programs used the same statutory definition of "modification," the Court disagreed with the Fourth Circuit that an irrebuttable presumption attached, forcing EPA to adopt identical modification regulations in both the NSPS and NSR programs. *Environmental Defense v. Duke Energy Corp*., 549 U.S. ___, slip op. at 9–12. Instead, the Court found that this "natural presumption" had been rebutted and that it was within EPA's discretion to vary its NSR modification regulations from those adopted pursuant to NSPS. *Id*. at 12. Of no small import was the Court's conclusion that a contrary finding—that both programs must use an hourly approach—directly contradicted the 1980 Prevention of Significant Deterioration ("PSD") rules in issue, amounting to an "implicit invalidation of those regulations." *Id*. at 9.

Upon vacating the Fourth Circuit decision and remanding the case, the Court noted that Duke Energy's claim of inconsistent EPA decisions for the past two decades could be considered "to the extent . . . not procedurally foreclosed . . . ." *Id*. at 17.

RAMIFICATIONS OF THE CASE

For Duke Energy, upon remand, consideration will no doubt be given to remaining defenses, such as whether: i) the changes in issue were excluded from NSR as routine maintenance, repair, and replacement; ii) the alleged changes caused any increase in emissions (now clearly on an annual basis); and iii) EPA's inconsistent interpretations are a defense

1. *United States v. Duke Energy Corp.*, 411 F.3d 539 (4th Cir. 2005).

to either liability or relevant to mitigate any penalty. For the rest of the industry, the case extinguishes the argument that the 1980 PSD rules must use an hourly test to evaluate increases in emissions resulting from a change.

Going forward, the decision does not resolve many other issues that remain in the case involving application of the NSR rules. Further, it also does not prevent EPA from proceeding with its proposal to adopt an hourly test under PSD so as to more closely conform with the NSPS modification test. In 2005, EPA proposed a rule that would apply the hourly standard under NSPS to the emissions increase test under NSR, for existing electric generating units, to determine whether a modification from a contemplated change will occur. Shortly after the decision, EPA announced its intention to continue with that rulemaking. Given the Supreme Court's view of EPA's broad discretion in adopting "modification" rules for PSD, further EPA actions to simplify and streamline NSR through reform rules may be likely.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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