

EPA's New Greenhouse Gas Emissions Rule for U.S. Power Sector – Legal Considerations and Business Impacts

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On August 21, 2018, the United States Environmental Protection Agency (“EPA”) proposed the Affordable Clean Energy Rule¹ (the “ACE Rule”) which would replace its 2015 Clean Power Plan² (the “CPP”) in its entirety, both of which were designed to regulate the greenhouse gas (“GHG”) emissions of fossil fuel-fired power plants pursuant to EPA’s authority under Section 111(d) of the Clean Air Act³ (“CAA”). The ACE Rule dramatically scales back the ambitious sweep of the Obama administration’s CPP. Whereas the CPP proposed to limit GHG emissions by shifting the nation’s electricity generation away from fossil fuel-fired sources towards natural gas and renewables, the ACE Rule is limited to measures aimed at improving the efficiency and prolonging the lifespan of coal-fired power plants. The draft rule, which is subject to a 60-day comment period beginning from the date of publication in the Federal Register, solicits comment on a number of issues, including the categories of power plants subject to the ACE Rule and the impact of recent decreases in GHG emissions from the power sector, that will presumably be addressed in a final rule.

The ACE Rule and the CPP Compared

In contrast to the CPP, the ACE Rule brings GHG emissions regulation firmly “within the fenceline” of individual power plants by establishing a best system of emissions reduction (“BSE”) – the standard established under Section 111(d) of the CAA – based on source-specific heat rate improvements (“HRIs”) focused on coal-fired power plants. The ACE Rule recommends a number of “candidate technologies,” including various smart technologies and improved maintenance practices, which EPA believes are the most effective HRI measures, meaning they are most likely to reduce the energy used to generate electricity. Beyond recommending technologies, the ACE Rule does not establish actual concrete reduction targets or guidelines.

Instead, responsibility for establishing targets is delegated to states. States will be required to submit “standards of performance” (expressed as a pound of CO₂ per MWh rate), which will be evaluated by EPA. However, the criteria for evaluation are not tied to specific benchmarks or targets, and the ACE Rule is explicit in noting that states will be granted considerable flexibility in both establishing and implementing standards. In short, the ACE Rule rejects the approach taken in the CPP, which interpreted BSE as including not only efficiency measures but also the shifting of fuel generation away from coal-fired power plants to efficient natural gas-fired plants in the short term and to renewable sources in the long term. Interpreting BSE to encompass measures “beyond the fenceline” of individual power plants was one of the more controversial legal aspects of the CPP that the ACE Rule avoids.

¹ Currently available at https://www.epa.gov/sites/production/files/2018-08/documents/frn-ace-proposal_8.20.2018.pdf (hyperlink will no longer be available once the rule is published in the Federal Register).

² 80 Fed. Reg. 64662.

³ 42 U.S.C. § 7401 et seq. (1970).

The ACE Rule is narrower in scope than the CPP in other important respects. The ACE Rule is applicable only to fossil fuel-fired electric utility steam generating units, which generally consist of coal-fired power plants, and explicitly carves out, among other emitters, municipal waste combustor units, commercial or industrial solid waste incineration units and integrated gasification combined cycle units. EPA also notes in the ACE Rule that it does not have sufficient information to develop a BSER for natural gas-fired simple-cycle turbines or combined cycle turbines. As a result, those turbines are currently not covered by the ACE Rule, although EPA is soliciting comments as to whether the proposed scope of the ACE Rule is appropriate.

Unlike the CPP, the ACE Rule also proposes changes to the New Source Review program (“NSR”), which imposes preconstruction permitting and pollution control requirements on “major modifications” to power plants. EPA is proposing to replace the existing standard for triggering NSR, a measure of overall emissions increases, with a measure of increases to hourly emissions, meaning that increases to overall emissions would not trigger a potentially expensive NSR review unless they also involve an increase to hourly emissions. As a result, modifications made by power plants to comply with the ACE Rule would be far less likely to engage NSR review. The changes to NSR would also apply more generally beyond the scope of the ACE Rule. This proposal, which has no counterpart in the CPP, is a reflection of the stark difference of philosophy between the two rules: while the CPP envisioned a resulting phase out of coal-fired power plants over time, the ACE Rule seeks to maintain coal-fired power plants while making them more efficient.

Timelines

The proposed timelines under the ACE Rule will mean that regulatory uncertainty with respect to regulation of GHG emissions from power plants will continue at least for the near future. The ACE Rule gives states three years from date of publication of the final rule to submit their standards of performance to EPA. EPA then has a year to evaluate each state’s standards, and if a proposed standard does not meet EPA’s criteria or if a state fails to submit a standard, EPA has an additional two-year period to put into place a federal plan. Additionally, the ACE Rule does not provide any timing requirements for the implementation of the states’ standards of performance. The potential six-year wait for implementation of the ACE Rule, if finalized, may mean, however, that a future administration and Congress could enact alternative GHG legislation or regulations or generally adopt a different approach to emissions and energy policy from the current administration and Congress.

Key Legal Considerations

In its issuance of the ACE Rule, EPA seems to be walking a tightrope between the aggressive and novel use of CAA Section 111(d) encompassed in the broad-based ambitions of the CPP and not regulating power plant GHG emissions at all. On the one hand, the ACE Rule’s focus on “within the fenceline” measures would seem to insulate it from the key legal vulnerabilities of the CPP. In fact, during oral arguments over challenges to the CPP,⁴ President Trump’s Supreme Court nominee, Judge Brett Kavanaugh, expressed deep skepticism regarding the consistency of the CPP’s “beyond the fenceline” approach with the text of the CAA. Judge Kavanaugh also questioned whether the CAA gave EPA the authority to enact such an ambitious and broad rule, a view likely shared by conservative members of the U.S. Supreme Court. The more modest approach reflected in the ACE Rule seems calibrated to address these concerns.

⁴ Transcript of Oral Argument, *State of West Virginia et al. v. EPA* (2016) (No. 15-1363).

At the same time, EPA did not choose to forgo regulating power plant GHG emissions altogether by either overturning its 2009 endangerment finding, which serves as the basis for much of EPA's climate change rulemaking activity, or concluding that CAA Section 111(d) does not authorize regulation of GHG emissions from existing power plants. Although some industry groups and policymakers have advocated either or both approaches, such approaches would certainly have been challenged in light of prior U.S. Supreme Court precedent and EPA rulemaking activity. In addition, abandoning GHG regulation altogether could have made the power industry more vulnerable to climate change–based common law lawsuits. In *Connecticut v. AEP*,⁵ the U.S. Supreme Court rejected such a lawsuit on the basis that EPA's authority to regulate power sector GHG emissions displaces the right of parties to bring common law claims, such as nuisance. EPA's decision to continue to regulate power sector GHG emissions would seem to preserve the ability of the power industry to assert that common law claims should be barred.

That said, the ACE Rule is likely to be the subject of substantial litigation and administrative challenges; in fact, environmental advocates and certain states have already announced an intention to challenge it once finalized. Such challenges are likely to assert that the ACE Rule does not meet EPA's obligations under section 111 of the CAA to regulate sources of GHG, because merely identifying various technologies without establishing any concrete numerical or other targets that states are required to meet is likely not BSER as it does not constitute a "system of emissions reduction," and certainly not one that is "best." As part of this argument, opponents of the ACE Rule will no doubt question EPA's modeling regarding the effectiveness of efficiency measures to meaningfully reduce emissions. In doing so, opponents will likely point to the "rebound effect," which is the tendency of efficiency measures alone to backfire in reducing emissions because applying such measures to a pollution source can result in lower costs, which can lead to more use of the source, thereby cancelling out some or all of the emissions reduction that might otherwise be expected. In fact, in issuing the CPP, EPA noted that implementing HRI measures alone were not adequate to sufficiently reduce GHG emissions.

Another potential challenge, which has already received substantial media attention, is the concern that changes to NSR will allow aging fossil fuel–fired plants to continue their operations for longer periods of time. In addition to increases in carbon dioxide emissions, EPA models predict increases to other pollutants harmful to human health, including sulfur dioxide, nitrogen dioxide and mercury. Opponents of the ACE Rule have suggested that, by EPA's own estimates, the ACE Rule would result in more significant public health impacts, including as many as 1,400 more premature deaths per year as compared to the CPP.⁶

The ACE Rule also raises questions relating to the United States' obligations under the Paris Agreement. The CPP was meant to be the main component of the United States' efforts to comply with the Paris Agreement, and should the ACE Rule replace the CPP in its entirety, the United States would likely fall short of meeting its obligations. However, the United States will officially be withdrawn from the Paris Agreement as of November 2020, and so compliance is only an interim problem and unlikely to have any significant impact.

Business Implications

The immediate impact of the ACE Rule on the power sector, if finalized, is likely to be relatively modest. While EPA estimates that the ACE Rule would reduce the compliance burden on the fossil fuel–fired power sector by \$400 million in comparison to the CPP, it is important to bear in mind that industry has

⁵ 564 U.S. 410 (2011).

⁶ Lisa Friedman, *Cost of New E.P.A. Coal Rules: Up to 1,400 More Deaths a Year*. N.Y. TIMES, Aug. 21, 2018 [online] available at <https://www.nytimes.com/2018/08/21/climate/epa-coal-pollution-deaths.html>.

been operating for several years on the assumption that the CPP was never likely to become effective law. In addition, power companies have been shifting their generation portfolios away from coal due to a variety of factors, including market forces and stakeholder demand. According to some analyses, market dynamics have been so pronounced that many states have already made progress towards meeting the CPP's emissions goals. It appears unlikely that the ACE Rule alone will significantly impact this trend in the near term.

The long-term outlook on the power sector (and related commodity pricing), however, is somewhat murkier. The Trump administration has been a strong advocate for coal and has suggested a variety of measures to prop up coal-fired power generation, including price supports and mandates to grid operators to purchase power from identified coal-fired power plants. Should the Trump administration continue beyond 2020 and succeed in putting these measures into place, such measures combined with the ACE Rule (and particularly its NSR reform proposal) may slow the trend away from coal, thereby potentially impacting the prices of fossil fuels. On the other hand, a Democratic administration may send its EPA to the drawing board once again, or, more likely, push for comprehensive climate change legislation from Congress, the impact of which is currently difficult to predict.

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