

## President Obama Directs EPA to Regulate Carbon Emissions Under Clean Air Act

### ***Broad plan uses President's executive authority to address climate change with an initial focus on power plants.***

On June 25, 2013, President Obama outlined his much anticipated climate change plan. The centerpiece of this plan mandates that the US Environmental Protection Agency (EPA) regulate carbon emissions under the Clean Air Act, initially focusing on standards for power plants under section 111 of the Act.<sup>1</sup> Prior to this announcement, Obama Administration officials consistently stated that the Administration had no current plans to regulate existing power plants. However, despite this new stance, the announcement surprised few who have been following climate policy. In his State of the Union address this past February, President Obama challenged Congress to act on climate change, but warned that if Congress did not act, the Administration would use its executive authority as a backstop.

Absent any indication that Congress would act on climate change in the near term, the President has chosen to proceed under the Clean Air Act (the Act). EPA believes that the US Supreme Court's decision in *Massachusetts v. Environmental Protection Agency*<sup>2</sup> coupled with EPA's subsequent endangerment finding regarding greenhouse gases<sup>3</sup> establishes a legal basis for EPA to regulate greenhouse gas emissions from stationary sources under the Act.<sup>4</sup>

Many observers view this announcement as President Obama's effort to bolster his environmental legacy. Although he has clearly calculated that starting with power plants will help to achieve his greenhouse gas emission reduction goals, the Administration must also grapple with competing national priorities, including economic growth as well as energy reliability and independence. Balancing these priorities with achievable emissions reductions will require close coordination with the states and with industry — a fact the Administration acknowledged in its memorandum to EPA, which emphasized engaging the states and other stakeholders, including "leaders in the power sector."<sup>5</sup>

This Client Alert highlights implications of EPA regulation of existing power plants under section 111(d), identifies various stakeholder proposals for how such a regulatory program could be structured, and evaluates outstanding questions key to EPA's path forward. Finally, the Client Alert highlights the potential implications for the refining sector, the next likely focus of EPA's section 111 rulemaking.

### **Obama's Plan**

In conjunction with the President's announcement, the White House released a 21-page Climate Action Plan, which describes numerous actions, under the Administration's existing authority, to address climate change. The plan outlines three key pillars: (1) "Cut Carbon Pollution in America"; (2) "Prepare the United

States for the Impacts of Climate Change”; and (3) “Lead International Efforts to Combat Global Climate Change and Prepare for its Impacts.” Actions include:

- Accelerating federal approvals of renewable energy and transmission projects
- Investing in clean energy innovation, increasing fuel economy standards for heavy-duty vehicles
- Developing and deploying advanced transportation technologies
- Energy efficiency standards for appliances and federal buildings
- Increasing investment in energy efficiency and expanding the Better Buildings Challenge
- Taking steps to reduce hydrofluorocarbon emissions
- Developing an interagency methane strategy and working with states and industry to reduce methane emissions across multiple sectors
- Taking multiple programmatic and planning steps and making investments in infrastructure as part of coordinated adaptation strategies
- Leading on a multi-front international engagement and trade strategy to promote climate change actions and clean energy and technologies

## **Power Sector**

### **CAA Sections 111(b) and 111(d)**

President Obama offered even more detail on his plan for the power sector in a memorandum he issued to EPA on June 25, 2013, entitled “Power Sector Carbon Pollution Standards.” In this memorandum, EPA is directed to use its authority under Clean Air Act sections 111(b) and 111(d) to issue standards, regulations or guidelines for modified, reconstructed and existing power plants.<sup>6</sup>

Observers have long anticipated that, if the Administration took action to regulate carbon emissions from existing power plants, it would do so under section 111(d).<sup>7</sup> This rarely-used provision of the Clean Air Act directs EPA to provide guidelines to enable states to establish plans for implementing and enforcing performance standards for existing sources of an air pollutant, once EPA has established a standard of performance for new sources of that pollutant. Therefore, once EPA finalizes standards for new power plants under section 111(b), these standards will pave the way for regulating existing sources.

### **Timing**

President Obama’s memorandum to EPA sets an aggressive timeline for the existing source rule, calling for an EPA proposal by June 1, 2014, a final rule no later than June 1, 2015, and state submissions of their implementation plans under 111(d) to EPA by June 30, 2016.<sup>8</sup> Importantly, under this ambitious plan the EPA will also require time to review and approve all of the state plans, which will further defer any program implementation.

### **Cost, Feasibility and Energy Impact Considerations**

Ultimately, the states will play an important role, as the Act vests them with primary responsibility for developing plans to implement the carbon emission standards for existing sources. First, however, EPA must make initial determinations to facilitate the state efforts. For instance, EPA must evaluate what emission reduction opportunities are currently available at the sources, because the Act requires states to adopt a system of reduction which EPA has already determined to have been “adequately demonstrated.”<sup>9</sup> EPA also must evaluate, among other matters, both the cost of emission reduction opportunities and their potential positive and negative impacts on the overall energy system.<sup>10</sup> EPA’s section 111(d) implementing regulations contemplate that EPA would establish subcategories for existing sources.<sup>11</sup> Such subcategorization will play a key role as EPA develops guidelines because common

source characteristics, such as the fuel type or technology used, will determine the available emission reduction opportunities.

### **Various Stakeholders' Current Proposals**

Even prior to President Obama's announcement, various stakeholders had floated a number of proposals intended to start a dialogue on potential designs for EPA's carbon emission standard guidelines.

The Natural Resources Defense Council (NRDC)<sup>12</sup> has promoted a performance standard that would vary from state to state and would be calculated, based on the fossil-fuel generation mix within that state, using a nationwide benchmark of 1,500 lbs/MWh for coal-fired units and 1,000 lbs/MWh for oil- and gas-fired units.<sup>13</sup> However, the levels in this proposal are justified not solely from controlling an existing source's emissions directly, but also from indirect means — such as reducing the overall end use of electricity in homes and businesses.<sup>14</sup> This approach would effectively make the owners of carbon emitting resources responsible for reducing the electricity consumption of completely independent customers.

Obligating sources to reduce emissions based on conduct outside of their control, as suggested by the NRDC proposal, would almost certainly exceed the authority granted to EPA and the states under the Clean Air Act and require EPA to deviate materially from past agency regulation of stationary sources. Without strong advance assurances by States that their other programs (*e.g.*, demand-side management) will reduce consumption sufficiently to allow generating units to meet such stringent performance standards, this proposal would risk the continued viability of most, if not all, coal-fired plants and even of many gas-fired plants — such units would be unable to achieve the required reductions by applying demonstrated and cost-effective controls on site. Accordingly, the NRDC proposal faces substantial legal, practical and political obstacles.

Other stakeholder groups, such as the Clean Air Task Force, are evaluating dispatch strategies to use underutilized natural gas combined cycle plants to displace high heat rate coal-fired units. This group's proposal would set state-specific performance standards that differ based on fuel type.

Finally, the National Climate Coalition (NCC)<sup>15</sup> a Latham-facilitated, multi-industry coalition, has developed a proposal to balance meaningful carbon emission reductions with other national priorities, such as economic strength, electricity reliability and energy independence. The main elements of the NCC proposal are as follows:

- EPA's guidelines should express performance as an emissions rate (*i.e.*, carbon intensity).<sup>16</sup>
- EPA's guidelines should sub-categorize sources according to fuel and technology type.
- EPA's guidelines should only mandate reductions based on emission reduction opportunities at the stationary source.
- EPA's guidelines should allow inter-source and inter-state emissions averaging, banking and trading.
- EPA should establish uniform credit-generation protocols for state crediting of qualified voluntary activities (*e.g.*, demand-side efficiency, renewable power, energy storage, carbon capture and sequestration (CCS)).
- EPA should establish a Model Rule, with building block components, that provides states the option of participating in a broad interstate trading program.

- EPA should identify alternative (*i.e.*, equivalency) paths states may use to demonstrate that existing or proposed state programs meet EPA guidelines.
- EPA should determine an appropriate mechanism for rewarding fuel switching and unit retirements and include it in the Model Rule.
- EPA's Model Rule should include a ceiling-price alternative compliance payment to fund state-directed cleantech investment as a safety valve if compliance costs are higher than anticipated.<sup>17</sup>

The full text of the NCC proposal is available from any of the authors of this alert.

### Major Unresolved Questions on EPA's Approach to 111(d)

Even with the detail provided in the President's memorandum to EPA, the President's proposal leaves a number of questions open, providing an opportunity for industry to engage in the dialogue that will shape future EPA actions. The following is just a subset of the significant unresolved questions that will be of great interest to stakeholders.

UNRESOLVED QUESTIONS	PRELIMINARY INDICATIONS
Will EPA set detailed, uniform national guidelines for the states or take a more passive role and merely respond to state proposals?	While EPA has committed to work very closely with the states and to consider state recommendations, EPA's section 111(d) implementing regulations require EPA to provide very detailed information to the states to support their implementation plans, <sup>18</sup> and great benefits will flow from some level of uniformity in programs.
If EPA does set uniform national guidelines, will EPA set up a trading framework for state election? What form might it take?	President Obama's memorandum specifically directed EPA to develop approaches that "allow the use of market-based instruments...and other regulatory flexibilities." <sup>19</sup> Given that EPA's previous rate-based programs have included averaging, banking and trading components, EPA likely would adopt such a framework.
Would EPA's guidelines be fuel-specific or fuel-neutral?	EPA faced very strong and coordinated opposition to its fuel-neutral proposal to regulate carbon emissions from new power plants under section 111(b). Given President Obama's stated desire to work in a bipartisan manner, EPA is likely to propose fuel- and technology-specific guidelines. EPA's section 111(d) implementing regulations also support such an approach because they direct EPA to "specify different emission guidelines or compliance times or both for different sizes, types, and classes of designated facilities when costs of control, physical limitations, geographical location, or similar factors make sub-categorization appropriate." <sup>20</sup>
How will EPA treat existing State programs? Will California's cap-and-trade system or the Regional	Likely any guidelines EPA adopts will allow existing programs, such as in California and the Regional Greenhouse Gas Initiative states, to be deemed equivalent. In his remarks,

<p>Greenhouse Gas Initiative be deemed equivalent under EPA's guidelines?</p>	<p>President Obama acknowledged that a number of states have implemented or are implementing market-based programs to reduce carbon emissions and that he is directing EPA to "provide flexibility to different states with different needs." His memorandum to EPA further stated his intention for the rulemaking regarding existing power plants to "build on State efforts to move toward a cleaner power sector."<sup>21</sup></p>
<p>Will EPA set a tonnage emissions budget for each State?</p>	<p>Such an approach raises significant issues. Unlike the criteria pollutant context, EPA lacks any air quality basis to set state budgets. Moreover, because energy markets tend to be regional, or national or international in the case of other energy sources (e.g., refining, cement), setting State budgets risks serious dislocation of energy markets and unintended consequences. How EPA could overcome the legal, economic and political challenges that it would face in allocating budgets to individual states remains difficult to foresee.</p>
<p>What, if any, implications will other EPA rules have on EPA's approach here?</p>	<p>EPA likely will consider other EPA rules applicable to power plants — particularly in considering the costs, feasibility and impacts on energy requirements when evaluating any emission reduction opportunities. From both a legal and political perspective, EPA will face the important task of harmonizing this 111(d) rulemaking with other rules. For instance, power plants are already facing upgrades related to EPA's Mercury and Air Toxics Rule, so that regulatory requirement should be factored into EPA's evaluation. Furthermore, EPA must address the interaction of its guidelines with the New Source Review program. There is a material risk that efficiency upgrades required to reduce carbon emission would trigger New Source Review (NSR). EPA should consider a streamlined NSR approach that avoids unduly triggering criteria pollutant NSR and that recognizes compliance with the 111(d) program as best available control technology (BACT) for modified GHG sources.</p>
<p>Must EPA promulgate a separate "modified unit" rule under section 111(b) or can it address modifications under section 111(d)?</p>	<p>EPA can avoid duplicative programs by covering unit modifications through its existing source program under 111(d).<sup>22</sup></p>

## Refining Sector

While EPA will be tied up over the next several years in its rulemaking for existing power plants, every indication suggests EPA will then move on to the refining sector. EPA already has committed by consent decree to consider whether and how it should implement emissions performance standards under section 111 for the refining sector. Therefore, those in the refining sector will be watching, very closely, how EPA proceeds with standards for the power sector.

However, the refining sector is significantly more complex than the power sector. Refineries may use a wide variety of feedstocks and intermediate stocks, generate multiple products, and use often highly-individualized processes. These complexities and variety will present difficulties as EPA establishes generally-applicable performance standards even if using multiple categories and subcategories.

EPA has taken the correct first step; gathering data regarding the refining sector and analyzing refining processes before identifying appropriate next steps. An appropriate second step may be for EPA to establish initial energy efficiency and work practice standards. These standards can be developed once EPA has concluded its data gathering and analysis and without the need to set generalized performance standards. Such work practice standards could include facility self-audits and energy-efficiency inventories.

Ultimately, if Congress does not act before EPA is in a position to address the refining sector, EPA can work with stakeholders to establish appropriate complexity-weighted performance standards that would reflect the significant differences among facilities operating in highly-specialized industrial sectors, including differences in feedstocks and intermediate stocks, processes and products. This third-phase program also could implement averaging, banking, and trading and other cost-effective mechanisms.

## Conclusion

In the coming year, stakeholders can expect many opportunities for dialogue on these issues. Engaging in this process will be important, especially for companies and industries whose operations could face increased regulation or cost given the significant and far-reaching impacts of President Obama's plan. EPA should address each of the open questions in a way that balances multiple national priorities and achieves meaningful carbon emission reductions.

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## Endnotes

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- <sup>1</sup> Memorandum from President Obama to Administrator of the Environmental Protection Agency, Power Sector Carbon Pollution Standards (June 25, 2013) (hereinafter "Presidential Memorandum").
- <sup>2</sup> *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497, 127 S.Ct. 1438 (2007).
- <sup>3</sup> Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, 74 Fed. Reg. 66,496 (Dec. 15, 2009).
- <sup>4</sup> In *Coalition for Responsible Regulation, Inc. v. EPA*, the D.C. Circuit upheld EPA's endangerment finding and its stationary source-related statutory interpretations based upon it. 684 F.3d 102 (D.C. Cir. 2012). Numerous petitions for certiorari have been filed seeking US Supreme Court review of this decision. Should the Supreme Court decide to grant one or more of those petitions, it is possible that the resulting opinion could disallow or otherwise impact some of what EPA is being asked to achieve under President Obama's plan.
- <sup>5</sup> Presidential Memorandum § 1(c)(i).
- <sup>6</sup> *Id.* at § 1(b).
- <sup>7</sup> 42 U.S.C. § 7411(d).
- <sup>8</sup> Presidential Memorandum § 1(b).
- <sup>9</sup> See § 7411(a)(1).
- <sup>10</sup> See *id.*
- <sup>11</sup> See 40 C.F.R. § 60.22(b)(5).
- <sup>12</sup> Natural Resources Defense Council Report, "Closing the Power Plant Carbon Pollution Loophole: Smart Ways the Clean Air Act Can Clean Up America's Biggest Climate Polluters" (March 2013).
- <sup>13</sup> See *id.* at 13-14.
- <sup>14</sup> See *id.* at 14 (describing NRDC's Policy Case).
- <sup>15</sup> The National Climate Coalition was formed in 2008 to provide input to EPA regarding greenhouse gas emission regulation under the Clean Air Act, See "Using EPA Clean Air Act Authority to Build a Federal Framework for State Greenhouse Gas Reduction Programs" (NCC Proposal), April 2013.
- <sup>16</sup> EPA has extensive experience with rate-based averaging programs. See, e.g., EPA, Regulation of Fuel and Fuel Additives; Gasoline Lead Content; Final rule, 50 Fed. Reg. 9,386 (Mar. 7, 1985; implementing the final segment of a lead phase-out program that EPA launched in 1973).
- <sup>17</sup> This mechanism could be based on the similar option recommended in a 1997 Presidential Memorandum regarding implementation of revised ozone and fine particulate standards. See Presidential Documents, 62 Fed. Reg. 38421, "Memorandum of July 16, 1997, Implementation of Revised Air Quality Standards for Ozone and Particulate Matter," in particular, page 38429 (discussion of Clean Air Investment Fund as an alternative compliance option).
- <sup>18</sup> See 40 C.F.R. § 60.22(b).
- <sup>19</sup> Presidential Memorandum § 1(c)(iii).
- <sup>20</sup> 40 C.F.R. § 60.22(b)(5).
- <sup>21</sup> Presidential Memorandum § 1(b).
- <sup>22</sup> See NCC Proposal at pages 6-7.