

## SIXTH CIRCUIT PUSHES BACK ON EPA OIL AND GAS SOURCE AGGREGATION UNDER THE CLEAN AIR ACT

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On August 7, 2012, the United States Court of Appeals for the Sixth Circuit (Sixth Circuit) issued an opinion that has significant Clean Air Act (CAA) regulatory implications for oil and gas development projects. In *Summit Petroleum Corp. v. EPA*, the court vacated an Environmental Protection Agency (EPA) determination that Summit Petroleum Corporation's natural gas sweetening plant and sour gas production wells spread over forty-three square miles constituted a single stationary source for CAA permitting purposes.<sup>1</sup> The permitting requirements for projects like compressor stations and sweetening plants often determine whether such projects are feasible because of the timing and cost associated with such requirements. Whether New Source Review (NSR) air permitting requirements apply to a particular project sometimes depends on whether multiple emissions sources must be combined or "aggregated" and treated as a single source. The *Summit Petroleum* case is encouraging for oil and gas developers whose operations are often spread over substantial areas, though EPA indicates it does not intend to extend the decision's reach beyond the Sixth Circuit at this time.<sup>2</sup>

### A. Air Permitting Overview

The NSR air permitting program under the CAA requires any major source or major modification<sup>3</sup> to obtain a permit prior to beginning construction.<sup>4</sup> Obtaining a

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<sup>1</sup> 690 F.3d 733 (6th Cir. 2012).

<sup>2</sup> Memorandum from Stephen D. Page, Dir., Office of Air Quality Planning and Standards, U.S. Evtl. Prot. Agency, to Regional Air Div. Dirs., Regions I-X, Applicability of the Summit Decision to EPA Title V and NSR Source Determination (Dec. 21, 2012), <http://www.epa.gov/nsr/documents/SummitDecision.pdf>.

<sup>3</sup> Major sources are those that have the potential to emit 100 tons per year (tpy) or 250 tpy of any air pollutant depending on the type of stationary source. See 42 U.S.C. § 7479(1) (2006). Major

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permit can be expensive and the process from application submittal to permit issuance often takes years. Stringent controls may be required and, if the project is located in a “non-attainment area”<sup>5</sup> for a relevant pollutant, project emissions may have to be offset by emission reductions elsewhere.<sup>6</sup> Further, the 1990 CAA Amendments created a national permit system that requires “major sources”<sup>7</sup> of air pollution to obtain Title V operating permits that identify all of the air quality-related “applicable requirements” that govern the source.<sup>8</sup> Title V permit holders must self-report all deviations from the permit’s applicable requirements and, on an annual basis, certify continuous compliance with those requirements for which the permit holder has not reported a deviation.<sup>9</sup>

In contrast, if aggregation is not required, the air emissions associated with the construction of oil and gas wells and their related compressor stations and other ancillary facilities often could be authorized using a simple permit requiring the operator to notify the regulatory authority prior to commencing construction.<sup>10</sup> Because the consequences of major source status under both the NSR and Title V programs can be so burdensome, determining whether a given project will constitute a major source is critical to project development.<sup>11</sup>

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modifications are modifications at existing sources that cause a significant increase in net emissions of the same pollutants. *See* 40 C.F.R. § 51.165(a)(1)(v)(A) (2012).

<sup>4</sup> *See* EPA, *Basic Information*, U.S. ENVTL. PROT. AGENCY, <http://www.epa.gov/nsr/info.html> (last updated July 22, 2011).

<sup>5</sup> A “nonattainment area” is a locality where air pollution levels persistently exceed National Ambient Air Quality Standards, or that contributes to ambient air quality in a nearby area that fails to meet standards. *See* 42 U.S.C. § 7407 (2006). Prevention of Significant Deterioration (PSD) permitting applies in attainment areas. *See id.* §§ 7470–7479. Nonattainment NSR occurs in nonattainment areas. *See id.* §§ 7501–7514.

<sup>6</sup> 42 U.S.C. § 7503(a)(1)(A) (2006).

<sup>7</sup> Under Title V, a major source is defined as any stationary facility or source of air pollutants that directly emits, or has the potential to emit, 100 tpy of any air pollutant. *Id.* § 7602(j).

<sup>8</sup> *See id.* §§ 7661–7670.

<sup>9</sup> *See id.* § 7661b.

<sup>10</sup> *See e.g.*, 30 Tex. Admin. Code § 116.620 (2012) (Texas standard permit for certain oil and gas facilities); Ark. Dep’t of Env’tl. Quality, *General Air Permit for Minor Source Natural Gas Compressor Stations Permit No. 1868-AGP-000* (Dec. 14, 2010), available at [http://www.adeq.state.ar.us/air/branch\\_permits/pdfs/1868-AGP-000.pdf](http://www.adeq.state.ar.us/air/branch_permits/pdfs/1868-AGP-000.pdf) (Arkansas standard permit); Pa. Dep’t of Env’tl. Prot., *General Plan Approval and/or General Operating Permit (BAQ-GPA/GP – 5)* (Revised Mar. 17, 2011), available at [http://www.dep.state.pa.us/dep/deputate/airwaste/aq/permits/gp/Final\\_GP-5\\_Amendments\\_Approved.pdf](http://www.dep.state.pa.us/dep/deputate/airwaste/aq/permits/gp/Final_GP-5_Amendments_Approved.pdf) (Pennsylvania standard permit).

<sup>11</sup> Conversely, there are instances in which industrial sources might seek single source status in order to “net” emissions, which is another calculation related to triggering NSR permitting. *See* 40 C.F.R. § 52.21(b)(3) (2012) (definition of net emissions increase applies to decreases or increases of emissions at the same stationary source within a five year period).

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## B. Regulatory Framework

Federal NSR regulations define a major stationary source as any building, structure, facility or installation that emits or may emit a regulated NSR pollutant.<sup>12</sup> The regulations further define a “building, structure, facility or installation” for source and emissions accounting purposes.<sup>13</sup> EPA focuses on three factors found in the definition: (1) whether the activities belong to the same industrial grouping; (2) whether the activities are located on one or more contiguous or adjacent properties; and (3) whether the activities are under common control.<sup>14</sup> In applying these criteria, EPA, state, and local permitting authorities are guided by the directive in *Alabama Power Co. v. Costle*<sup>15</sup> to apply the “common sense notion of a plant.”<sup>16</sup>

While the issues of “industrial grouping”<sup>17</sup> and “common control”<sup>18</sup> are replete with nuance, it is the concept of “adjacent” properties that has been the focus in the oil and gas industry and the subject of substantial controversy.<sup>19</sup>

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<sup>12</sup> *Id.* § 51.165(a)(1)(i).

<sup>13</sup> *Id.* § 51.165(a)(1)(ii).

<sup>14</sup> *Id.* The definition of a major source for purposes of Title V permitting includes the same basic criteria. *See id.* § 70.2.

<sup>15</sup> 636 F.2d 323, 397 (D.C. Cir. 1979).

<sup>16</sup> *See* 45 Fed. Reg. 52,676, 52,695 (Aug. 7, 1980) (codified at 40 C.F.R. pts. 51, 52, and 124).

<sup>17</sup> Each source is classified according to its primary activity, which is in turn determined by its principal product. *Id.*

<sup>18</sup> *See* Letter from Richard R. Long, Dir., Air Program, EPA Region VIII, to Julie Wrend, Legal Adm’r, Air Pollution & Control Div., Colo. Dep’t of Pub. Health and Env’t (Nov. 12, 1998), <http://www.epa.gov/region7/air/nsr/nsrmemos/coorstri.pdf>. This letter explains that EPA has identified three methods of establishing common control for purposes of source aggregation under NSR and Title V permitting rules: (1) common ownership; (2) operations control; and (3) control relationship. *Id.* First, common control exists where the same parent corporation owns multiple sources, or a parent and a subsidiary of the parent own multiple sources. *Id.* Common control can be established in the absence of common ownership if an entity has the power to direct the management and policies of a second entity through contractual agreement or a voting interest. *Id.* Finally, common control may also exist in the absence of common ownership if there is a contract for service relationship or a “support/dependency relationship” between the two. *Id.*

<sup>19</sup> *See* *Citizens for Pa.’s Future v. Ultra Res., Inc.*, No. 4:11-CV-1360, 2012 WL 4434465 (M.D. Pa. Sept. 24, 2012) (CAA citizen suit in federal court is directly targeting Ultra Resources for alleged violations of the Act associated with the company’s shale gas operations spanning 558 square miles); *William J. Hughes v. West Virginia Dep’t of Env’tl. Prot.*, Appeal No. 10-03-AQB, (WV Air Quality Board Aug. 6, 2011) (Board denied petition by private parties alleging failure to aggregate two compressor stations 3 miles apart); *WildEarth Guardians v. EPA*, No. 11-CV-00001-CMA-MEH, 2011 WL 4485964 (D. Colo. Sept. 27, 2011) (EPA denied two petitions by WildEarth Guardians requesting that EPA object to Title V permits issued by the Colorado Department of Public Health and Environment, alleging should have aggregated the permitted oil and gas facilities. Appeal to 10th Circuit was settled after EPA Region VIII agreed to undertake a pilot program to study source determinations in the oil and gas industry).

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### C. Regulatory History

When EPA initially promulgated rules implementing the PSD program, it did not specify the distance between facilities that would qualify those facilities for separate permitting consideration.<sup>20</sup> Specifically, the preamble to the 1980 PSD rules provides:

EPA has stated in the past and now confirms that it does not intend “source” to encompass activities that would be many miles apart along a long-line operation. For instance, EPA would not treat all of the pumping stations along a multistate pipeline as one “source.” EPA is unable to say precisely at this point how far apart activities must be in order to be treated separately. The Agency can answer that question only through case-by-case determinations.<sup>21</sup>

Although EPA was unwilling at the time to specify a distance within which sources would be aggregated, it noted that activities separated by twenty miles are likely too far apart to be considered a single source.<sup>22</sup>

In this early guidance and in the 1980 preamble, EPA rejected the idea of looking beyond geographic proximity to factors like functional interrelatedness or interdependence. Nevertheless, EPA determinations over the years have held that interconnected operations separated by distances of 3.7 miles, 6 miles, and, in one extreme case, 21.5 miles, should be combined as a single source for permitting purposes.<sup>23</sup> By the mid- to late-1990s, EPA commonly gave more weight to the functional interrelatedness or interdependence of operations than the physical separation between facilities in making source determinations.<sup>24</sup>

Little of this evolving EPA guidance on adjacency in source determinations involved the upstream oil and gas sector. However, in the mid-2000s, states and environmental non-governmental organizations (NGOs) began to shift their attention further upstream to emissions from the oil and gas sector.<sup>25</sup> EPA under President George W. Bush released a guidance memorandum on source determinations directed

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<sup>20</sup> See 45 Fed. Reg. at 52,695.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> See Letter from Richard R. Long, Dir., Air Program, EPA Region VIII, to Lynn Menlove, Manager, New Source Review Section, Utah Div. of Air Quality (May 21, 1998), <http://www.epa.gov/region07/air/title5/t5memos/util-trl.pdf> (describing Acme Steel Company, Anheuser-Busch, and Great Salt Lake Minerals Determinations).

<sup>24</sup> See *id.* (responding to a request for guidance in defining “adjacent” for Title V and NSR source aggregation purposes).

<sup>25</sup> See *e.g.*, Petition for Objection to Issuance of Operating Permit for Kerr-McGee Frederick Compressor Station, *United States v. Kerr-McGee Corp.*, 2007 WL 2687992 (Jan. 3, 2007) (Petition by Rocky Mountain Clean Air Action, now WildEarth Guardians, objecting to the issuance of an operating permit to Kerr-McGee, a subsidiary of Anadarko Petroleum Corporation).

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specifically at the upstream oil and gas sector.<sup>26</sup> Issued in 2007 and titled “Source Determinations for Oil and Gas Industries,” this document became known as the “Wehrum Memo” after its author, William Wehrum, then Acting Assistant Administrator in EPA’s Office of Air and Radiation.<sup>27</sup>

According to the Wehrum Memo, interconnected sources could be counted as separate minor sources for NSR and Title V purposes if the sites were under common control, but located more than a quarter-mile from each other.<sup>28</sup> Because it made proximity the determining factor and established, for the first time, a precise distance (a quarter-mile) above which sources would be considered separate, the Wehrum Memo was assailed by environmental NGOs and certain states.<sup>29</sup>

In 2009, after President Obama’s inauguration, Gina McCarthy, the new Assistant Administrator for EPA’s Office of Air and Radiation, issued a memorandum that officially withdrew the Wehrum Memo.<sup>30</sup> The “McCarthy Memo,” as it came to be known, expressly rescinded the Wehrum Memo because of its emphasis on geographic proximity in oil and gas sector source determinations.<sup>31</sup> The McCarthy Memo noted that source aggregation determinations for the oil and gas industry must be made on a case-by-case basis based on an analysis of the three fundamental criteria: common control, industrial grouping, and whether the sources are “contiguous or adjacent.”<sup>32</sup> In withdrawing the Wehrum Memo, the McCarthy Memo made clear that EPA considered it possible, as it had prior to 2007, for activities located more than a short distance away to be aggregated based on an evaluation of the three factors.<sup>33</sup>

The withdrawal of the Wehrum Memo caused as much controversy in oil and gas circles as its issuance did among environmental NGOs.<sup>34</sup> The issue of functional

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<sup>26</sup> Memorandum from William L. Wehrum, Acting Assistant Adm’r, Office of Air and Radiation, EPA, to Regional Adm’rs I-X, Source Determinations for Oil and Gas Industries (Jan. 12, 2007), <http://www.epa.gov/region7/air/nsr/nsrmemos/oilgas.pdf>.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 4–5.

<sup>29</sup> *See, e.g.,* Robin Bravender, *EPA Tosses Bush-Era ‘Aggregation’ Policy for Oil and Gas Industry*, N.Y. TIMES, Oct. 14, 2009, available at <http://www.nytimes.com/gwire/2009/10/14/14greenwire-epa-tosses-bush-era-aggregation-policy-for-oil-70149.html> (illustrating previous opposition to Wehrum Memo).

<sup>30</sup> Memorandum from Gina McCarthy, Assistant Adm’r, Office of Air and Radiation, EPA, to Regional Adm’rs Regions I-X, Withdrawal of Source Determinations for Oil and Gas Industries (Sept. 22, 2009), <http://www.epa.gov/region07/air/title5/t5memos/oilgaswithdrawal.pdf>.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *See id.*

<sup>34</sup> *See, e.g.,* Gary McCutchen, Gurinder (Gary) Saini, Colin Campbell, *Source Determinations for Oil and Gas Industries: EPA’s Changing Policy and One State’s Recent Experience*, 20 AIR POLLUTION CONSULTANT, no. 6, 2010, at 5.3 (voicing opposition to McCarthy Memo and describing its effects as throwing “state and local agencies back into a complex, case-by-case decision-making mode with little real guidance, a disservice to both air permitting agencies and the oil and gas industry”).

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interrelatedness and interdependence as a means of determining adjacency has been a key issue in challenges to upstream source aggregation decisions by both industry and environmental NGOs. Until recently, the collective results of these challenges were mixed.<sup>35</sup> This has spurred challenges in state and federal court and, in at least one example, inspired an environmental NGO to side-step the Title V objection process and file suit directly against an operator under the CAA's citizen suit provisions.<sup>36</sup>

#### D. *Summit Petroleum Corporation v. EPA*

Against this backdrop, on August 7, 2012, the Sixth Circuit ruled in *Summit Petroleum Corporation v. EPA* that EPA could not base adjacency in source determinations on anything but geographical proximity.<sup>37</sup> EPA had determined, pursuant to a request from Summit Petroleum and the Michigan Department of Environmental Quality, that Summit Petroleum's facilities should be aggregated because they were "truly interrelated" and therefore adjacent.<sup>38</sup> EPA relied on the McCarthy Memo to support its determination that adjacency could exist despite lack of physical proximity.<sup>39</sup>

The Sixth Circuit considered that the dictionary definition and plain meaning of "adjacent" requires proximity,<sup>40</sup> that case law supported the idea that adjacency relates only to physical proximity,<sup>41</sup> and that EPA's own regulatory history did not support the use of a relatedness test.<sup>42</sup> The court concluded by remanding the determination to EPA to be made based on "the proper, plain-meaning application of the requirement that Summit's activities be aggregated only if they are located on physically contiguous or adjacent properties."<sup>43</sup> While physical proximity is the touchstone of the analysis, just how proximate is sufficient remains to be seen.

Judge Moore, in dissent, argued that EPA's interpretation of the term "adjacent" was entitled to deference and that examining functional interrelatedness provides context for determining if facilities are sufficiently proximate to be considered adjacent.<sup>44</sup> Judge Moore expressly contended that the remand does not require EPA to reach a particular result, but only to provide a justification for its decision consistent with the majority

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<sup>35</sup> Compare Clean Air Act Operating Permit Program; Petition for Objection to State Operating Permit for Anadarko Petroleum Corporation—Frederick Compressor Station, 76 Fed. Reg. 10,361-01 (Feb. 24, 2011) (denial of petition for objection) with Clean Air Act Operating Permit Program; Petition for Objection to State Operating Permit for Williams Four Corners, LLC, Sims Mesa CDP Compressor Station, 76 Fed. Reg. 52,946-01 (Aug. 24, 2011) (grant of petition for objection).

<sup>36</sup> See *Citizens for Pa.'s Future v. Ultra Res., Inc.*, 2012 WL 4434465, at \*1.

<sup>37</sup> 690 F.3d 733, 741 (6th Cir. 2012).

<sup>38</sup> *Id.* at 735.

<sup>39</sup> *Id.* at 739–40.

<sup>40</sup> *Id.* at 741–744.

<sup>41</sup> *Id.* at 743–744.

<sup>42</sup> *Id.* at 746–749.

<sup>43</sup> *Id.* at 751.

<sup>44</sup> *Id.* at 753–755 (Moore, J., dissenting).

opinion.<sup>45</sup> Elsewhere, Judge Moore also asserted that, although not a fact relied on by EPA, the wells all draw from the same, contiguous gas field.<sup>46</sup>

### E. Similar Aggregation Arguments at the State Level

The debate in *Summit Petroleum* mirrors the clear split between the Pennsylvania state permitting authority and EPA Region III. State agencies conduct most air permitting pursuant to EPA-approved programs, but EPA can comment and, with more teeth, can issue objections to Title V permits.<sup>47</sup> In October 2011, the Pennsylvania Department of Environmental Protection (PADEP) issued guidance on source aggregation titled “Guidance for Performing Single Stationary Source Determination for Oil and Gas Industries” (PADEP Guidance).<sup>48</sup> Whereas the McCarthy Memo was the result of a change from Republican to Democratic control of the EPA, the PADEP Guidance resulted from a gubernatorial race that saw the Republican Party unseat the incumbent Democrat.<sup>49</sup>

Conflict between EPA and PADEP related to the guidance was inevitable. The PADEP Guidance, like EPA’s withdrawn Wehrum Memo, makes proximity the controlling factor in oil and gas source determinations, and even adopts a similar quarter-mile benchmark.<sup>50</sup> In fact, the approach set out in the PADEP guidance is very similar to the Sixth Circuit’s reasoning in *Summit Petroleum*, including its rejection of functional interrelatedness and interdependence as a practical consideration in determining adjacency and adopting the dictionary definitions of “adjacent” and “contiguous.”<sup>51</sup> As expected, EPA Region III provided negative comments on the guidance, going so far as to suggest that the guidance was without legal effect.<sup>52</sup> EPA’s comments on the PADEP Guidance track the agency’s briefing position in *Summit Petroleum*.<sup>53</sup> In general, state permitting authorities have resisted an aggressive approach to aggregation, and the Sixth Circuit’s holding, at a minimum, bolsters that position with respect to oil and gas

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<sup>45</sup> *Id.* at 757 (Moore, J., dissenting).

<sup>46</sup> *Id.* at 753, n.2 (Moore, J., dissenting).

<sup>47</sup> See EPA, *Frequently Asked Questions*, U.S. ENVTL. PROT. AGENCY, <http://www.epa.gov/region1/eco/permits/title5/faq.html> (last updated Jan. 2, 2013).

<sup>48</sup> Dep’t of Env’tl. Prot., Bureau of Air Quality, Doc. No. 270-0810-006, Guidance for Performing Single Stationary Source Determination for Oil and Gas Industries, (Oct. 12, 2011), available at <http://www.elibrary.dep.state.pa.us/dsweb/Services/Document-90745> [hereinafter *PADEP Guidance*].

<sup>49</sup> *Tom Corbett Wins Pa. Governor’s Race*, ASSOCIATED PRESS, Nov. 2, 2010, available at [http://www.lehighvalleylive.com/elections/index.ssf/2010/11/abc\\_declares\\_pa\\_governors\\_race.html](http://www.lehighvalleylive.com/elections/index.ssf/2010/11/abc_declares_pa_governors_race.html).

<sup>50</sup> See *PADEP Guidance*, *supra* note 48, at 6–7.

<sup>51</sup> See *id.* at 5.

<sup>52</sup> See Letter from Diana Esher, Dir., Air Prot. Div., EPA Region III, to Krishnan Ramamurthy, Bureau of Air Quality, Pa. Dep’t of Env’tl. Prot. (Nov. 21, 2011), [http://www.cleanair.org/sites/default/files/epa2011\\_2268a.pdf](http://www.cleanair.org/sites/default/files/epa2011_2268a.pdf).

<sup>53</sup> See Enclosure, Letter from Diana Esher, Dir., Air Prot. Div., EPA Region III, to Krishnan Ramamurthy, Bureau of Air Quality, Pa. Dep’t of Env’tl. Prot. 4-5 (Nov. 21, 2011) (on file with authors).

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activities occurring over wide areas.

### Conclusion

The Sixth Circuit's *Summit* decision is certainly not the closing shot in the battle over aggregation in the oil and gas industry. In fact, EPA recently issued a memorandum expressly stating that "EPA does not intend to change its longstanding practice of considering interrelatedness in the EPA permitting actions in other jurisdictions [i.e., beyond the Sixth Circuit]." <sup>54</sup> But the *Summit* decision provides clear reasoning for states as they develop their own regulations and guidance for the industry. As in Pennsylvania, the decision furnishes legal support to state permitting authorities otherwise faced with an aggressive EPA policy stance on aggregation. <sup>55</sup> However, until we gain more clarity through EPA guidance, state determinations and court decisions, functional relatedness will still need to be evaluated for its potential implications on project development. A case-by-case approach is still necessary even where physical proximity is required.

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<sup>54</sup> Memorandum from Stephen D. Page, *supra* note 2.

<sup>55</sup> For example, EPA Region III displayed its aggressive support of the broader approach to aggregation reflected in the McCarthy Memo in a January 10, 2012 letter to the Virginia Department of Environmental Quality (VADEQ), advising VADEQ to aggregate a gas-to-energy co-generation facility and a landfill that were separated by two miles and connected by a pipeline. *See* Letter from Kathleen Cox, Assoc. Dir., Office of Permits & Air Toxics, Air Prot. Div., EPA Region III, to Troy D. Breathwaite, Air Permits Manager, VADEQ (Jan. 10, 2012), <http://www.epa.gov/region7/air/nsr/nsrmemos/gpc2012.pdf>.