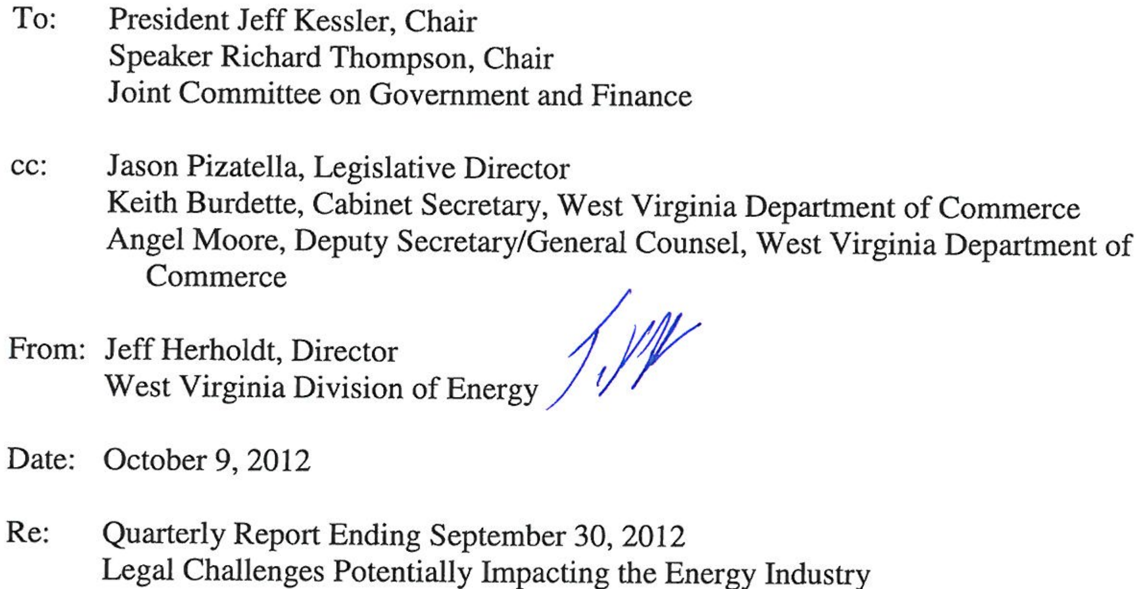
Earl Ray Tomblin
Governor

WEST VIRGINIA DIVISION OF
ENERGY

Jeff Herholdt
Director

MEMORANDUM



To: President Jeff Kessler, Chair
Speaker Richard Thompson, Chair
Joint Committee on Government and Finance

cc: Jason Pizatella, Legislative Director
Keith Burdette, Cabinet Secretary, West Virginia Department of Commerce
Angel Moore, Deputy Secretary/General Counsel, West Virginia Department of Commerce

From: Jeff Herholdt, Director
West Virginia Division of Energy

Date: October 9, 2012

Re: Quarterly Report Ending September 30, 2012
Legal Challenges Potentially Impacting the Energy Industry

As mandated by West Virginia Code §5B-2F-2(s), the following information presents legal challenges with the potential to impact the state's energy industry. This submission has been summarized by the West Virginia Chamber of Commerce's Energy Committee. Future reports will be submitted on a quarterly basis.

Capitol Complex • Building 6, Room 645 • Charleston, West Virginia 25305-0311
Toll Free: (800) 982-3386 • (304) 558-2234 • Fax: (304) 558-0362 • **www.energywv.org**

REPORT ON LITIGATION RELATED TO

ENERGY AND NATURAL RESOURCES IN WEST VIRGINIA

THIRD QUARTER 2012

(Ending September 30, 2012)

1. D.C. District Court Strikes Down EPA's Appalachian Surface Mining Guidance

On July 31, 2012, the U.S. District Court for the District of Columbia set aside as unlawful an EPA Guidance document that had been used to stop surface coal mining permits due to concerns about conductivity. The Court ruled that EPA "overstepped its statutory authority" under the Clean Water Act ("CWA") and Surface Mining Control and Reclamation Act ("SMCRA") through its Guidance Document titled *Improving EPA Review of Appalachian Surface Coal Mining Operations Under the Clean Water, National Environmental Policy Act, and the Environmental Justice Executive Order.*

As a threshold matter, the Court evaluated whether the Guidance was merely a non-binding "policy statement" as EPA claimed, or was a final agency action "from which legal consequences flow" and therefore capable of judicial review. The Court determined that disclaimers in the Guidance stating "[t]his memorandum does not impose legally binding requirements" were mere "boiler-plate" language and instead looked to the "practical effect" of the Guidance. The Court found that EPA regional field offices and State permitting agencies had been denying mining permits if the Guidance's non-binding suggestions and recommendations were not satisfied. Therefore, the Court reasoned that the Guidance was a final agency action reviewable under the Administrative Procedures Act.

The Court ruled that EPA exceeded its statutory authority in several areas:

a. <u>SMCRA Best Management Practices</u>: EPA's Guidance declared that state agencies issuing SMCRA permits should "fully evaluate and, where appropriate and practicable, incorporate" certain Best Management Practices ("BMPs") favored by EPA. Since SMCRA neither explicitly nor implicitly grants any authority to EPA to dictate what practices should be followed under SMCRA, the Court held that "EPA has impermissibly injected itself into the SMCRA permitting process with the issuance of the Final Guidance."

b. Conductivity Water Quality Standard: EPA's Guidance recommended that state agencies consider EPA studies purporting to show that impacts to aquatic life occur as conductivity increases beyond EPA's conductivity benchmark standard of 300-500 µS/cm. EPA claimed that this was merely a non-binding recommendation, but the Court found that EPA's regional offices were relying on EPA's conductivity benchmark like a water quality standard. Accordingly, the Court concluded that EPA "impermissibly set a conductivity criterion for water quality" and "overstepped the authority afforded it by Section 303 of the CWA."

c. Pre-Permit Reasonable Potential Analyses: While states have the primary authority to issue water discharge permits under Section 402 of the CWA, EPA can object to draft permits and assume responsibility of the permit if the state does not respond to EPA's objection. In its Guidance, however, EPA insisted that States must perform a reasonable potential analysis to evaluate the likelihood that a surface coal mine discharge would violate a water quality standard before it could issue the discharge permit. EPA claimed it required pre-permit reasonable potential analyses because the science behind its conductivity benchmark would be relevant to those analyses.

The court evaluated the language of 40 C.F.R.§122.44(d)(1), which requires States to place limits on pollutants that "are or may be discharged at a level which will cause, have the reasonable potential to cause, or contribute to an excursion above any State water quality standard, including State narrative criteria for water quality." Noting that the regulation suggests that a reasonable potential analysis can be done on both existing discharges or future discharges, the Court determined that the regulation "does not impose or mandate the timing" of the reasonable potential analysis. Accordingly, the Court found that EPA's Guidance improperly infringed upon the authority of State regulators to determine when to conduct reasonable potential analyses.

This opinion follows a similar decision in October of 2011 in which the same Judge set aside EPA's 2009 Enhanced Coordination Process Memo to the Army Corps of Engineers that regulated the CWA §404 permitting process on the grounds that EPA exceeded its statutory authority under the Clean Water Act. Viewed together, these decisions offer a strong rebuke of EPA efforts over the past few years to more stringently regulate surface mining activities in Appalachia.

2. Court Rejects Challenge to Valley Fill Permit

On August 10, 2012, the United States District Court for the Southern District of West Virginia issued an order affirming the issuance of a "fill" permit to Highland Mining, a subsidiary of Alpha Natural Resources, for its Reylas Surface Mine in southern West Virginia. The permit had been challenged by the Sierra Club and others, which argued that: 1) a mitigation plan submitted by Highland Mining to offset impacts of the fill was inadequate; and 2) that the Corps erroneously concluded that discharges of selenium and conductivity would not cause significant cumulative adverse effects. The Court ruled

that its review of the Corps' decision-making process is sharply limited by law, and that the Court is required to provide great deference to the Corps.

With respect to the mitigation plan claims, the Court expressed skepticism about the "stream creation" plan proposed by Highland, but ruled that a prior ruling of the Fourth Circuit Court of Appeals in *Ohio Valley Environmental Coalition v. Aracoma Coal Company*, 556 F. 3d 177 (4th Cir. 2009) had both affirmed similar plans and had cautioned trial courts that "in matters involving complex predictions based on special expertise, a reviewing court must be at its most deferential." The Court treated the selenium and conductivity claims slightly differently. Concerning selenium, the Court ruled that a Clean Water Act Section 401 "certification" issued by the State attesting that the project would meet water quality standards was not contested by EPA and was, therefore, binding on the Corps.

With respect to conductivity, the opinion is more complicated. The Court determined that the 401 certification was not "conclusive" with respect to conductivity because EPA had expressed concerns about its impacts in letters to the Corps. Here, the Court expressed its belief that expert witnesses produced by the Sierra Club provided compelling testimony on the correlation between conductivity and impacts to aquatic insects, but ultimately observed that the Corps is not the primary regulator of water quality and that it has provided an adequate explanation why it did not believe the permitted fills would significantly affect water quality. Again, the Court noted that the scope of its permissible review was limited by the deference it is required to afford the Corps under the applicable laws.

There were also two earlier rulings of note in the case. The first, issued in January 2012, denied the Sierra Club's motion to supplement the complaint with a health effects claim. The Sierra Club had moved to supplement the complaint with a claim that the Corps should have unilaterally updated its environmental assessment under NEPA to consider recent articles by Michael Hendryx of WVU and others which have correlated health effects to proximity to mining operations. *See* http://eem.jacksonkelly.com/2012/01/court-denies-motion-to-supplement-complaint-with-hendryx-studies.html. Also, the Court had previously granted the Corps and Highland summary judgment on challenges to the mitigation plan, ruling that the Fourth Circuit had previously ruled that the Corps was to be accorded an especially high degree of deference in this area.

3. Oil and Gas Wins in Sixth Circuit on Title V Source Determinations

On August 7, 2012, the Sixth Circuit in a two-to-one decision vacated a determination by the U.S. Environmental Protection Agency (EPA) that a natural gas sweetening plant owned by Summit Petroleum Corporation (Summit) and various flares and sour gas production wells also owned by Summit constitute a single stationary source under EPA's Clean Air Act Title V permitting program and remanded the case to EPA. *Summit*

Petroleum Corporation v. EPA, Nos. 09-4348:10-4572 (6th Cir. Aug. 7, 2012). In vacating EPA's determination, the Sixth Circuit rejected EPA's interpretation of the word "adjacent" in its stationary source regulations as meaning merely "functional relatedness" without regard to physical proximity. On remand, the majority directed EPA to "reassess[ ] Summit's Title V source determination request in light of 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" or "physically approximate, properties." *Id. a*t 16 & 25-26.

The case is significant because it is the first decision by a court of appeals to address EPA's "functional relatedness" test, which if allowed would result in more determinations aggregating oil and gas sources into a single stationary source for purposes of Title V permitting. The decision is also significant for EPA's Prevention of Significant Deterioration (PSD) preconstruction permit program because EPA uses the same test to aggregate pollutant-emitting activities into a single stationary source for purposes PSD permitting. Title V requires affected "major sources" to obtain an operating permit, whereas PSD may require a "major stationary source" to install stringent controls as well as obtain a preconstruction permit.

Whether or not a stationary source is a "major source" under Title V or a "major stationary source" under the PSD provisions of the Clean Air Act is important because Title V requires every "major source" of air pollution to have a Title V permit to operate and PSD requires every "major stationary source" to obtain a preconstruction permit for construction activities. 42 U.S.C. §7475(a) (PSD) & §7661(a) (Title V). A "major source" under Title V is defined as "any stationary facility or source of air pollutants which directly emits, or has the potential to emit, one hundred tons per year of any pollutant," including nitrous oxides and sulfur dioxides which are omitted by Summit's oil and gas activities. 42 U.S.C. §7602(j). A "major stationary source" under PSD is similarly defined although the pollutant emissions thresholds vary depending upon the source category. 42 U.S.C. §7479(1). EPA's regulations define a "stationary source" as "any building, structure, facility, or installation which emits or may emit a regulated [air] pollutant." 40 CFR §52.21(b)(5). EPA's stationary source regulations further provide that multiple pollutant-emitting activities may be aggregated together and considered a single stationary source under Title V and PSD only if they: (1) are under common control; (2) "are located on one or more contiguous or adjacent properties"; and (3) belong to the same major industrial grouping. 40 CFR 52.21(b)(6) (PSD) and 40 CFR 71.2 (Title V).

In *Summit,* approximately 100 sour gas production wells located within an area of approximately 43 square miles supply gas to the sweetening plant. The wells are located from 500 feet to 8 miles from the plant, and the plant and wells are connected via underground pipeline. In between the plant and wells are properties owned by other parties. Flares, which burn off natural gas waste, are located from one half-mile to over one mile from the plant. The plant and some of the wells and flares are located on an

Indian reservation, making EPA the permitting authority, while other wells and flares are located outside the Indian reservation and subject to the jurisdiction of the Michigan Department of Environmental Quality. The plant emits, or has the potential to emit, just under one hundred tons of sulfur dioxide and nitrous oxides per year; however, if the emissions of sulfur dioxide from the plant and any one production well were to be combined, they would exceed one hundred tons of pollutants per year. Slip op. at 2-3. Therefore, the issue was whether Summit's facilities are "adjacent" to one another within the meaning of EPA's stationary source regulation to make them a single stationary source and a major source under Title V, requiring Summit to obtain a Title V permit. EPA determined that the Summit's facilities satisfied the regulatory requirement of being "located on...adjacent properties" because they are "truly interrelated" or "truly interdependent". *Id.* at 1 & 7-9.

The majority held that "EPA's conclusion that Summit's activities are 'adjacent' because they are 'truly interrelated' is unreasonable." *Id.* at 11.

4. Fifth Circuit Reverses EPA's Disapproval of State Clean Air Act SIP

August 13, 2012 the Fifth Circuit Court of Appeals in State of Texas v. EPA (Case: 10-60614) affirmed Texas' State Implementation Plan (SIP) minor source permit program allowing for "flexible permits" i.e., a facility may make modifications without review so long as aggregate emissions do not exceed an emissions cap ("Texas Flexible Permit Program"). EPA did not like the Texas Flexible Permit Program because it did not track EPA's "flexible permit program" for major new source permitting. The case is important nationwide for the Court's determination that if a SIP meets the statutory criteria of the Clean Air Act (CAA), then the EPA must approve the SIP. EPA cannot disapprove a State's air program based on its "policies" reflecting its preferences and prejudices and not a CAA standard.

Despite the CAA's mandate that the EPA approve or disapprove a SIP revision within eighteen months of its submission, after a 16-year delay EPA disapproved the Texas Flexible Permit Program originally submitted by Governor Ann Richards in 1994. EPA's action unraveled approximately 140 permits issued under the Texas Flexible Permit Program, and exposed every facility with a flexible permit to federal fines or other enforcement action irrespective of emissions levels or risk. The State of Texas, U.S. Chamber of Commerce and numerous industry groups—American Chemistry Council, American Petroleum Institute, Texas Oil & Gas Association, and others-- filed a petition for review of EPA's action under the Administrative Procedure Act.

The Fifth Circuit Court emphasized its deference to both EPA's fact findings and interpretation of the CAA. EPA cited three grounds for disapproving Texas's Flexible Permit Program: (1) it might allow major sources to evade Major New Source Review

("NSR", i.e., PSD and Nonattainment NSR—"Major NSR"); (2) the provisions for monitoring, recordkeeping and reporting ("MRR") are inadequate; (3) and the methodology for calculating flexible permit emissions caps lacked "clarity and replicability".

EPA's first claim of evasion of Major NSR was based on dislike for the Texas language affirmatively requiring compliance with Major NSR, rather than "thou shall not" language. The Court found EPA could not disapprove the Texas SIP because it disagreed with Texas grammar:

> *Because the administrative record reflects that the EPA's rejection is based, in essence, on the Agency's preference for a different drafting style, instead of the standards Congress provided in the CAA, the EPA's decision disturbs the cooperative federalism that the CAA envisions. A state's "broad responsibility regarding the means" to achieve better air quality" would be hollow indeed if the state were not even responsible for its own sentence structure.*

In regard to MRR, the Texas requirements are tailored to each source permit based on size, needs and type of facility, rather than a one-size-fits-all program (i.e., the "flexibility"). EPA's objected that the director of the Texas air program had too much discretion, citing its "policy" against "director discretion". The Court found EPA's "director discretion" policy not only lacking any CAA basis but fabricated by EPA to disapprove the Texas Flexible Permits Program:

> *Instead, the EPA has invoked the term "director discretion" as if that term were an independent and authoritative standard, and has not linked the term to the language of the CAA. The EPA's use of a particular term does not constitute a "satisfactory explanation for its action" or a "consideration of the relevant factors" for its decision. . . the EPA's insistence on some undefined limit on a director's discretion is, like the Agency's insistence on a particular drafting style, based on a standard that the CAA does not empower the EPA to enforce.. . . Other recent EPA action tends not only to undercut the assertion of a policy against director discretion, but also to give the appearance that the EPA invented this policy for the sole purpose of disapproving Texas's proposal . . . Although the EPA may certainly change its policies, it cannot reject the very concept of director discretion in one case months after approving extensive director discretion in another, and then hold out its rejection here as an example of reasoned decision making*

Similarly the Court found not only that the Texas program for emission caps was both clear and replicable, but that EPA's disapproval on the basis of "clarity and replicability" was founded on terms the EPA invented rather than a CAA standard:

Premising disapproval on the ground that the Flexible Permit Programlacks clarity and replicability in the method for calculating emissions caps fails for the same reason that premising disapproval on inadequate MRR provisions fails. The CAA does not make the replicability the EPA desires a standard for disapproving a SIP revision, and the EPA has not explained how the method for calculating emissions caps otherwise relates to a CAA standard.

5. **Oral Argument Held By The West Virginia Supreme Court Of Appeals About Surface Owner Rights Of Appeal In Regard To Drilling Permits**

On September 25, 2012, the Supreme Court of Appeals of West Virginia held oral argument in *Martin v. Hamblet* on an issue of great importance to the oil and gas industry. At issue is whether surface owners have a right of appeal from the issuance of drilling permits by the state Department of Environmental Protection's Office of Oil and Gas.

Martin centers on a question certified from the Circuit Court of Doddridge County:

Does the West Virginia Supreme Court of Appeals' opinion in *State ex. rel. Lovejoy v. Callaghan*, 576 S.E.2d 246, 213 W.Va. 1 (2002), interpret the relevant statutes, when read *in para materia*, to permit a surface owner to seek judicial review of the issuance of a well work permit for a horizontal Marcellus well by the West Virginia Department of Environmental Protection's Office of Oil and Gas? The Circuit Court answered "yes."

While the statute allows surface owners to comment on permits, they are not considered parties and therefore, unlike the mineral rights holders, do not have a right to appeal the issuance of permits.

During oral argument the justices discussed the court's prior per curiam opinion in *Lovejoy*, which recognized, in dicta, a right of appeal, and questioned its precedential value. One justice questioned the reliance of the circuit court upon the opinion. One justice also questioned the surface owners' position that there was a constitutional right of appeal, stating that the remedy was not to create the right, but to strike down the statute as unconstitutional and leave it to the legislature to deal with the issue. Counsel for the Surface Owners' Rights Organization argued that absent a right of appeal, the surface owners had no reasonable protection against permits wrongfully issued. There was discussion of the protection afforded surface owners under oyster statutes and common law.

The Supreme Court should issue its opinion by the end of the term, in early December.

6. **NHPA No Barrier to Prevent Surface Mining on Blair Mountain**

An assortment of anti-mining interests have failed in their attempted use of the National Historic Preservation Act ("NHPA") to prohibit the consideration of surface coal mining permits for future mining on Blair Mountain. On October 2, 2012, the U.S. District Court for the District of Columbia issued an order and opinion denying the mining opponents summary judgment on their claims on the basis that they failed to demonstrate standing to bring their action. The U.S. Department of the Interior, acting on behalf of the National Park Service, was granted summary judgment on its cross motion.

The case involves a now decade long dispute over the ability of companies to secure permits for potential surface mining in an area of Logan County generally identified as Blair Mountain. The area was the scene of a historic and armed confrontation between miners and civil authorities over five days in August and September 1921. Individuals and groups have filed multiple petitions with the West Virginia Department of Culture and History to declare approximately 1600 acres stretched across ten miles of the ridge of the property to be eligible for listing on the National Register of Historic Places.

In March, 2009, the West Virginia agency submitted the most recent petition to the National Park Service, which administers the NHPA, with the recommendation that the property be placed on the National Register. The following month, the West Virginia agency rescinded its recommendation when confronted by property owners who objected to the listing. Under the NHPA, a property cannot be listed if a majority of owners object to its inclusion.

The Park Service offered the state agency the opportunity to submit additional information in support of the listing. When the state agency provided no further information in support of its initial recommendation, the Park Service removed the property from the National Register on December 30, 2009. It is the decision of the Park Service that was challenged in a suit filed in mid-2010.

The District Court never reached the merits of the plaintiffs' claims, and found simply that they lacked standing to bring their claims. In fact, the Court found that the plaintiffs failed to demonstrate any of the three so-called "three prongs" of standing –imminent harm, causation, and redressability. The plaintiffs failed to provide any evidence that "the potential harm from surface mining is 'actual or imminent,' rather than 'conjectural or hypothetical.'" The Court found particularly persuasive the fact that companies had mining permits for much of the property, but had failed to mine under those permits for many years due to economic conditions. This made any alleged injury merely hypothetical and not a basis for standing.

The Court next found that the plaintiffs failed to meet the "causation" element of standing. In the Court's view, the Park Service's decision could not have caused any alleged harm to the plaintiffs. Only mining under existing mining permits could possibly have caused harm. Therefore, plaintiffs failed to prove causation.

Finally, the Court found the plaintiffs failed to meet the "redressability" element of standing.

The Court's final paragraph sums up its decision best: "The plaintiffs have failed to meet their burden as to each prong of the standing inquiry. In the absence of a plaintiff that has standing to bring this suit, this Court is not permitted under Article III of the Constitution to exercise jurisdiction over the plaintiffs' claims. Accordingly, the defendants' motion for summary judgment must be granted, and the plaintiffs' claims must be dismissed."