Earl Ray Tomblin
Governor

WEST VIRGINIA DIVISION OF ENERGY

Jeff Herholdt
Director

MEMORANDUM

To: Acting 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: April 18, 2011

Re: Quarterly Report Ending March 31, 2011
Legal Challenges Potentially Impacting the Energy Industry

As mandated by SB 518, the following information presents legal challenges with the potential to impact the state's energy industry. This initial submission has been summarized by the West Virginia Chamber of Commerce's Energy Committee. Future reports will be submitted on a quarterly basis.

Litigation Potentially Impacting the Energy Industry
(1st Quarter 2011 – Ending March 31, 2011)

1. Challenges to EPA action on "fill" permits.

In October 2010, WVDEP sued USEPA in the Southern District of West Virginia, arguing that USEPA had adopted illegal rules in contravention of both the Administrative Procedures Act and of the Clean Water Act for the purpose of reviewing and delaying the issuance of §404 "fill" permits by the Corps of Engineers and §402 NPDES permits by WVDEP. Although there are some differences, the case contains a number of counts which are substantially like those advanced by the National Mining Association in a case filed against EPA in Washington in July 2010. As a consequence, USEPA moved to transfer WVDEP's case to the same court in Washington which the NMA lawsuit is pending.

By order dated January 31, 2011, Judge John T. Copenhaver granted USEPA's motion, finding that there were substantial similarities between the WVDEP and NMA complaints, and that issues of judicial economy and the need for uniform certainty from a single court outweighed competing interests in allowing plaintiffs to choose the court in which they intend to litigate.

The Kentucky Coal Association filed a similar action against USEPA in federal court in Kentucky which has also been transferred to the same court as the WVDEP and NMA cases.

On January 14, 2011, the D.C. District Court issued an opinion in the NMA case (*National Mining Association v. EPA*, No. 10-1220 (D.D.C.)). The opinion denied EPA's motion to dismiss the case on grounds that there was no final agency action, that the case wasn't ripe, and that NMA lacked standing. The Court also denied NMA's motion for a preliminary injunction, but ruled that NMA was likely to prevail on the merits of its claims that EPA's policies are legislative rules adopted in violation of the Administrative Procedure Act's notice and comment requirements. It also determined that EPA's policies are likely outside of its statutory authority. Here, the Court noted that Congress intended to give EPA a limited role under Section 404, and that the ECP process is outside the scope of that role. Most importantly, the Court also stated that "it seems clear that with the implementation of the Guidance Memorandum the EPA has encroached upon the role carved out for the states by setting region-wide conductivity standards."

The case will now likely proceed to the merits.

2. Supreme Court Grants Certiorari in American Electric Power Co. v. Connecticut.

On December 6, 2010 the U.S. Supreme Court granted certiorari review of the Second Circuit Court of Appeals September 21, 2009 decision in Connecticut v. American Electric Power, 582 F.3d 309 (2d Cir. 2009), which will allow the Supreme Court to decide whether states and/or private parties using the federal common law of nuisance can collect damages for injury and ultimately decide upon a remedy that would order emissions caps on greenhouse gases (GHGs). Cert. granted Am. Electric Power Co., et al v. Connecticut, et al.,--- S.Ct. ----, 2010 WL 4922905 (U.S. 2010). Oral argument is scheduled for April 19, 2011.

By way of background, the Plaintiffs, who include eight states (Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, and Wisconsin), New York City, and three land trust groups, sued the Defendants, who include six major electric utilities (American Electric Power Company Inc., American Electric Power Service Corporation, Southern Company, Tennessee Valley Authority, Xcel Energy, Inc., and Cinergy Corporation) under a nuisance claim for the alleged environmental harm and contribution to global warming resulting from their respective greenhouse gas (GHG or GHGs) emissions. Plaintiffs sought monetary damages and a remedy of a cap on Defendants' carbon dioxide emissions and a 3% annual reduction in carbon dioxide emissions for the next ten years.

The Second Circuit reversed the district court's decision that Plaintiffs' claims constituted a political question and is therefore barred, and remanded the case back to the district court. The Second Circuit held, "[f]ederal statutes have not displaced Plaintiffs' federal common law of nuisance claim. The complaints against Defendant-Appellant TVA may not be dismissed on the grounds of the political question doctrine or the discretionary function exception." Id. at 392

3. EPA "Vetoes" Spruce Permit.

On January 13, 2011, EPA issued a final decision prohibiting a subsidiary of Arch Coal from using a "fill" permit issued in January 2007 by the U.S. Army Corps of Engineers for the Spruce No. 1 Surface Mine. EPA's action, commonly called a "veto", comes more than a decade after the mine was originally proposed by Arch. EPA's new action relies heavily on claims that "fills" associated with the mine will have adverse impacts on downstream water quality which will in turn cause unacceptable impacts on aquatic life. However, all discharges of water from the fill area are regulated by an NPDES permit. That permit was issued by WVDEP after EPA withdrew objections to it years ago.

The veto marks the 13th time since 1972 that EPA has used its Clean Water Act veto authority, and the first time EPA has vetoed a previously permitted mine.

Arch Coal has appealed this decision to US District Court for the District of Columbia.

4. Conductivity.

The Environmental Quality Board issued a final order in Sierra Club v. DEP, 10-34-EQB, on March 25, 2011. As a reminder, in this appeal Sierra Club challenged a modification to an NPDES permit that expanded a surface mine in Monongahela County. Sierra Club claimed DEP should have imposed limits on conductivity, sulfate, total dissolved solids (TDS), and whole effluent toxicity (WET), because there was a reasonable potential in the absence of such limits that the discharges would violate West Virginia's "narrative" water quality standard. While there are currently no numeric standards in West Virginia for these parameters, Sierra Club requested that the EQB impose limits on conductivity (300 uS/cm), sulfate (50 mg/l), and TDS (500 mg/l), levels considered unachievable by any Appalachian surface mine without the use of highly expensive reverse osmosis technology. This was seen by the coal industry as a programmatic challenge because all mining activities will result in discharges of these substances—almost always at levels above those the Sierra Club sought to impose.

The EQB primarily sided with Sierra Club. EQB's Order states that DEP erred by issuing the NPDES permit without conducting a reasonable potential analysis and by not placing limits on conductivity, sulfate, TDS and WET. The Board has remanded the NPDES permit back to DEP with orders that the agency conduct a "reasonable potential" analysis and establish appropriate limits for conductivity, sulfate, TDS, and WET.

EQB's order, which Patriot Mining Company will likely appeal to the Kanawha County Circuit Court, ultimately leaves many questions unanswered. While the Board concluded that high levels of conductivity and sulfate can cause violations of the narrative water quality standard, it did not determine at what concentrations such harm occurs or provide an intelligible standard for measuring compliance with the narrative water quality standard. The Board did reject Sierra Club's assertion, lifted from EPA's Draft Conductivity Benchmark publication, that levels of conductivity above 300 uS/cm cause harm to aquatic life, concluding instead that "[the Board] does not agree that 300 uS/cm is necessarily an appropriate limit for this permit". The EQB Order also refused to define what types of harm to aquatic life constitute a violation of the narrative water quality standard.

5. Selenium.

A matter of significant concern to the coal industry as a whole involves appeals of selenium limits that were set to take effect in April of 2010. The Environmental Quality Board ("EQB") previously allowed the West Virginia Department of Environmental Protection ("WVDEP") to issue Amended Orders extending the date for compliance with final selenium limits by three years until April 5, 2010, at which point surface mine operators would have been required to meet final effluent limits for selenium of 4.7 ppb. Recognizing that no coal mining operation has yet been capable of consistently meeting final effluent limit of 4.7 ppb, many operators submitted modification applications to WVDEP prior to the April 5, 2010 deadline. Through these modification requests, the industry sought to extend the schedule for achieving compliance with final effluent limits until the July 1, 2012 deadline established by the West Virginia Legislature in W.Va. Code § 22-11-6 (2009).

WVDEP denied the requests of those operators it did not feel had taken adequate steps towards achieving compliance and proposed to grant the requests of those operators whose compliance efforts it deemed worthy of an extension. When WVDEP issued draft permit modifications, however, EPA issued a general objection and followed that with a specific objection to the permits. WVDEP may not issue an NPDES permit or modification over an EPA objection. Ultimately, WVDEP denied most, if not all, extension requests.

Upon receiving the denials of the extension requests many operators filed appeals with the EQB and were granted stays of the final limits until the EQB had an opportunity to decide the appeals on the merits. Many of those appeals are being resolved by WVDEP enforcement actions in Circuit Court. In February, the EQB placed the remaining appeals on the EQB's inactive docket.

Despite the ongoing state administrative proceedings, environmental groups are currently pursuing citizen suits in federal court before Judge Chambers. *See OVEC v. Independence Coal Co., LLC,* WVSD # 3:10-cv-00836; *see also OVEC v. Coal-Mac, Inc.*, WVSD # 3:10-cv-0833. In March, 2011, Judge Chambers ruled in favor of the environmental groups and rejected the claim that the EQB stayed the effective date of new standards for selenium. He wrote that the board exceeded its statutory authority. Additionally, he wrote that when EPA objects to a state permit, a public hearing process governs relations between the state and EPA. Having found the stays to be invalid, Judge Chambers found the selenium limits of the underlying permits to be effective. Accordingly, he has directed the parties to propose schedules for hearings on penalties and relief by April 15, 2011.

The cases pending before Judge Chambers against Apogee Coal Company, LLC and Hobet Mining, LLC were discussed in detail in the report for the third and fourth quarter. In October, Judge Chambers held Apogee and Hobet in contempt of their consent

decree for failing to bring their discharges into compliance with the water quality standards and ordered them to post a $45 million letter of credit to ensure that the fluidized bed reactor treatment systems (a system that essentially uses bugs to eat the selenium) are installed at their operations. *See OVEC v. Apogee*, --F. Supp. 2d--, 2010 WL 3955828 (S.D.W.Va. Oct. 8, 2010). The selenium issue has the potential to be highly costly to the industry as a whole.