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# Aggregation Consternation: Clean Air Act Source Determination Issues in the Oil & Gas Patch

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ARTICLE

**Aggregation Consternation:  
Clean Air Act Source Determination Issues in  
the Oil & Gas Patch**

STEVEN H. LORD, JR.\*

**I. INTRODUCTION**

As a result of the recent development of vast shale gas formations across the United States, natural gas has been heralded as the “bridge fuel” that will satisfy our nation’s energy demand as we transition from dependence on “dirty” fossil fuels to a cleaner energy future. However, as drilling and production activities have become increasingly prominent across the country, particularly in areas not accustomed to prolonged surface operations, significant environmental issues regarding exploration and production activities have been grabbing headlines. While environmental issues regarding hydraulic fracturing have been getting most of the public’s attention recently, a battle concerning the aggregation of oil and gas facilities into a single source for air permitting purposes is quietly being fought between operators, state permitting authorities, and the U.S. Environmental Protection Agency (EPA).

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In 1980, EPA promulgated a definition for “stationary sources” that were to be regulated under the Clean Air Act’s Prevention of Significant Deterioration program.<sup>1</sup> The definition essentially set out a three-factor test to determine if separate facilities could be aggregated into a single source for permitting purposes.<sup>2</sup> However, for three decades, the definition was inconsistently applied to oil and gas facilities. In 2007, EPA issued a guidance document clarifying the issue.<sup>3</sup> Nevertheless, EPA revoked that guidance document in 2009, and the issue of how EPA’s definition of “stationary source” should be applied to oil and gas exploration and production facilities has never been more uncertain.

This article examines the issues concerning source determinations for oil and gas exploration and production facilities. Part II outlines relevant Clean Air Act programs. Part III discusses the regulatory history of EPA’s definition of “stationary source” and the development of the Agency’s aggregation policy, followed by application of that policy in recent source determinations. Part IV gives an overview of the aggregation regulations and policies from various oil and gas producing states. Part V provides criticism of EPA’s aggregation policy and its interpretation of the “contiguous or adjacent” factor in the definition of source. Additionally, this section provides the basis for a court challenge of EPA’s interpretation of “contiguous or adjacent.” Finally, Part VI briefly discusses EPA’s New Source Review circumvention policy and how it affects oil and gas facilities.

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1. *See* Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, and 124).

2. 40 C.F.R. § 52.21(b)(6) (2012).

3. *See* Memorandum from William L. Wehrum, NOAA Office of Oceanic and Atmospheric Research, to EPA Regional Admin. I-X, Source Determinations for Oil and Gas Industries (Jan. 12, 2007) (on file with author) [hereinafter Wehrum Memo].

## II. OVERVIEW OF RELEVANT CLEAN AIR ACT PROVISIONS

In response to the growing national perception that air pollution was a serious national problem, Congress enacted the Clean Air Act (CAA) in 1970.<sup>4</sup> At the heart of the ambitious program were federally promulgated National Ambient Air Quality Standards (NAAQS) and state-adopted plans to implement those standards. The CAA requires the EPA to promulgate National Ambient Air Quality Standards (NAAQS) for “criteria” pollutants.<sup>5</sup>

The primary means of achieving the NAAQS is a system of preconstruction review and permitting requirements for new emissions sources and modifications to existing emissions sources. This system is known as the New Source Review (NSR) program, which has three subparts. The first two apply to large or “major” sources of air pollution: the Prevention of Significant Deterioration (PSD) program under Part C of Title I,<sup>6</sup> and the Nonattainment Area (NAA) program under CAA Section 173 and other provisions in Part D of Title I.<sup>7</sup> The third subpart of the NSR program consists of state programs that apply to smaller or “minor” sources of air pollution, and these vary from state to state.<sup>8</sup> The CAA requires NSR analysis before the construction of any new major stationary source or the major modification of an existing major stationary source.<sup>9</sup>

In the 1990 Clean Air Act Amendments, Congress enacted Title V of the CAA, creating a federally mandated operating permit program to be implemented by the states.<sup>10</sup> A Title V permit contains every federally enforceable air pollution

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4. Clean Air Act (CAA), Pub. L. No. 91-604, 84 Stat. 1676 (1970).

5. CAA, 42 U.S.C. § 7408(a) (2012).

6. *See* 42 U.S.C. §§ 7470–7492 (2012); 40 C.F.R. § 51.160 (2002); 40 C.F.R. § 52.21 (2002)

7. *See* 42 U.S.C. §§ 7501–7515.

8. *See* 42 U.S.C. § 7410(a)(2)(C) (Requiring states to implement preconstruction state permit programs that apply to sources that do not meet or exceed “major source” thresholds in order to assure that the NAAQS are met. Note that there is substantial variation among state permit programs.).

9. 40 C.F.R. § 52.21(b)(1)(i); *see* 42 U.S.C. §§ 7475, 7503.

10. 42 U.S.C. §§ 7475, 7503.

requirement that applies to a particular source.<sup>11</sup> A Title V operating permit generally does not impose new substantive air quality control requirements to a stationary source; rather, it is primarily a procedural requirement. By consolidating the various permit requirements applicable to a stationary source in one document, the Title V program enables EPA, states, and citizens to better understand the requirements applicable to a source and whether the source is meeting those requirements.

### III. SOURCE AGGREGATION

#### A. Origins

The CAA's PSD program applies to certain types of "stationary sources" that emit or could emit 100 tons per year (tpy), or "any other source" that emits or could emit 250 tpy, of any regulated air pollutant.<sup>12</sup> It should also be noted that, as of July 1, 2011, Step 2 of EPA's "Tailoring Rule" went into effect, and PSD and Title V permitting requirements now apply to new stationary sources that emit at least 100,000 tpy of greenhouse gases, even if they do not exceed permitting thresholds for any other pollutant.<sup>13</sup> Significantly, the CAA does not specifically define the terms "stationary source" and "any other source" in the PSD provisions of the Act. To fill the statutory gap, EPA defined these terms when it promulgated its comprehensive CAA regulations in 1978. Shortly thereafter, several industry groups and intervenors challenged EPA's definition of "source" in *Alabama Power v. Costle*.<sup>14</sup> Siding with the petitioners, the D.C. Circuit in *Alabama Power* held that the definition of "source" is limited to the four terms defining stationary source in Section 111(a)(3) of the CAA for the New Source Performance Standards (NSPS) program: building, installation, structure, or facility.<sup>15</sup> The Court of Appeals went on to state, "EPA has discretion to

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11. See 42 U.S.C. §§ 7661a(a), 7661c(a).

12. 42 U.S.C. § 7475(a). See also 42 U.S.C. § 7479(a) (defining "major emitting facility").

13. See Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule, 74 Fed. Reg. 55,292 (Oct. 27, 2009).

14. See *Ala. Power Co. v. Costle*, 636 F.2d 323 (D.C. Cir. 1979).

15. *Id.* at 395.

define statutory terms reasonably so as to carry out the expressed purpose of the (CAA),” and that EPA could reasonably interpret the terms “facility” and “installation” broad enough to cover an entire plant.<sup>16</sup> However, when the Court of Appeals addressed the issue of whether the definition of “source” included industrial units joined by contiguity and common ownership, it ruled that EPA could not aggregate units as a single source “unless they fit within the four permissible statutory terms.”<sup>17</sup> Thus, the Court of Appeals in *Alabama Power* limited EPA’s discretion to interpret the definition of “stationary source.”

EPA responded to the D.C. Circuit’s decision in *Alabama Power* by promulgating a new definition of stationary source in the preamble to the 1980 PSD Regulations.<sup>18</sup> EPA defined stationary source as “any building, structure, facility, or installation which emits or may emit a regulated NSR pollutant.”<sup>19</sup> EPA defined building, structure, facility, or installation as “all of the pollutant-emitting activities which [1] belong to the same industrial grouping, [2] are located on one or more contiguous or adjacent properties, and [3] are [under common ownership or control].”<sup>20</sup> Thus, EPA created a three-factor test to determine if different pollutant-emitting activities at a particular site may be aggregated for major source determination. It is important to note that if any one of these criteria is not met, the pollutant-emitting activities cannot be aggregated.

As in the first factor described above, all pollutant-emitting activities, or emissions units, must belong to the same industrial grouping in order to be aggregated. “Same industrial grouping” means the industrial groups identified by the same two-digit codes in the *Standard Industrial Classification (SIC) Manual* published by the Office of Management and Budget.<sup>21</sup> However,

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16. *Id.* at 396.

17. *Id.* at 396-97.

18. *See* Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, and 124).

19. 40 C.F.R. § 51.165(b)(5) (2011).

20. 40 C.F.R. § 52.21(b)(6).

21. *See* 40 C.F.R. § 52.21(b)(6).

a frequent problem in source determination arises when there are multiple emissions sources at a large industrial complex that do not fall under the same two-digit SIC Code. In this situation, the 1980 PSD Preamble provides that each emissions unit is classified according to the primary activity at the site, which is determined by the site's principle product or services that it renders.<sup>22</sup> Facilities that convey, store, or otherwise assist in production of the principle product are called "support facilities."<sup>23</sup> Although support facilities might not share the same SIC Code with the primary facility, they are considered part of the "same industrial grouping" for the purpose of source determination.

The EPA has provided guidance on when it considers emissions units that are not part of a site's primary activity to be a support facility.<sup>24</sup> EPA presumes a support facility relationship to exist "where more than fifty percent of the output services provided by one facility is dedicated to another facility that it supports."<sup>25</sup> However, a number of financial, functional, contractual, or other factors may allow a permitting authority to make a support facility determination when the fifty percent test is not met. These factors include:

- (1) the degree to which the supporting activity receives materials or services from the primary activity (which indicates a mutually beneficial arrangement between the primary and secondary activities);
- (2) the degree to which the primary activity exerts control over the support activity's operations;
- (3) the nature of any contractual arrangements between the facilities; and
- (4) the reasons for the presence of the support activity on the same site as the primary activity (e.g., whether the support activity would exist at that site but for the primary activity).<sup>26</sup>

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22. Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. at 52,695.

23. *Id.*

24. Letter from JoAnn Heiman, EPA Region 7, to James Pray, at 4 (Dec. 6, 2004) (on file with author).

25. *Id.*

26. *Id.*

Thus, a support facility analysis involves an in-depth review of the primary activity's operational or functional dependence on the secondary activity. However, it is important to note that the above-described support facility analysis only applies when the facilities at issue have different SIC codes. The other parts of the three-factor aggregation test – contiguous or adjacent and common control – must also be met in a support facility analysis to combine emissions units into a single major source.

When defining a source, there are three overarching principles that guide a permitting authority when conducting an aggregation analysis. Significantly, EPA stated in the 1980 PSD Preamble that the *Alabama Power* decision set the following boundaries on the definition of the four component terms of “source” (i.e., building, facility, structure, and installation): “(1) it must carry out reasonably the purposes of PSD; (2) it must approximate a common sense notion of a ‘plant;’ and (3) it must avoid aggregating pollutant-emitting activities that as a group would not fit within the ordinary meaning of ‘building,’ ‘structure,’ ‘facility, or ‘installation.’”<sup>27</sup> Accordingly, as in *Alabama Power* and the 1980 PSD Preamble, the above-described boundaries serve as guiding principles that EPA must use when applying its three-factor test for major source determinations.

### **B. The Rise of “Functional Interdependence”**

An ongoing issue in NSR is how to define “stationary source” in an oil or gas field. Pipelines physically interconnect oil and gas production and gathering facilities, and there is a common product. Although individual emission units in an oil or gas field generally do not exceed major source emissions thresholds, the aggregate total of an entire oil or gas field generally does. Moreover, there are numerous pieces of equipment that can be located miles apart and operate independently. Thus, a source of consternation for much of the oil and gas industry is how to

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27. Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676, 52,694-95 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, and 124).



determine if separate emissions sources in a field can be aggregated under the three-part test for source determination.

When applying the three-part test, the most contentious factor has been whether two or more facilities in an oil or gas field are “contiguous or adjacent.” Black’s Law Dictionary defines “contiguous” as “[t]ouching at a point or along a boundary; adjoining;”<sup>28</sup> and “adjacent” as “[l]ying near or close to, but not necessarily touching.”<sup>29</sup> The 1980 PSD Preamble states, “EPA is unable to say precisely at this point how far apart activities must be in order to be treated separately,” and that it “can answer that question only through case-by-case determinations.”<sup>30</sup> However, the Preamble provides that EPA does not “intend ‘source’ to encompass activities that would be many miles apart along a long-line operation.”<sup>31</sup> Thus, EPA never established any clear guidelines for what constitutes “contiguous or adjacent” in the 1980 PSD Preamble, but indicated that facilities separated by considerable distances should not be aggregated.

Beginning in the early 1980s, EPA began to de-emphasize the plain meaning of “contiguous or adjacent” in its guidance documents and interpretation letters, and developed a functional interdependence test instead. Specifically, using the overarching principle of a common sense notion of a plant as guidance, EPA Regional Offices evaluated the relationship between facilities to determine whether the distance between them was short enough to allow the facilities to operate as a single source.<sup>32</sup> For example, EPA stated in an interpretation letter:

EPA has noted that whether or not two facilities are adjacent depends on the “common sense” notion of a source and the functional inter-relationship of the facilities and is not simply a matter of the physical distance between the two facilities. However, the physical distance between two facilities is obviously

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28. BLACK’S LAW DICTIONARY 362 (9th ed. 2009).

29. *Id.* at 46.

30. Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. at 52,695.

31. *Id.*

32. See Letter from Richard R. Long, EPA Region 8, to Lynn Menlove, Utah Division of Air Quality, at 1-2 (May 21, 1998) (on file with author).

a factor to be considered in deciding whether the two are close enough to be considered one source in a given situation.<sup>33</sup>

Moreover, in a guidance letter, EPA Region 8 listed several factors that EPA considers when determining whether facilities are contiguous or adjacent. The contiguous or adjacent factors strikingly resemble the factors listed for a support facility analysis to determine whether facilities are part of the same industrial grouping:

[1] Was the location of the new facility chosen primarily because of its proximity to the existing facility, to enable the operations to be integrated? . . . [2] Will materials be routinely transferred between the facilities? Supporting evidence for this could include a physical link or transportation link . . . , such as a pipeline, railway, special-purpose or public road, channel or conduit. [3] Will managers or other workers frequently shuttle back and forth to be involved actively in both facilities? [4] Will the production process itself be split in any way between facilities, i.e., will one facility produce an intermediate product that requires further processing at the other facility, with associated air pollutant emissions?<sup>34</sup>

These factors are prevalent throughout numerous other EPA guidance documents and source determinations, although not applied consistently.<sup>35</sup> Accordingly, as the EPA guidance documents suggest, physical distance alone does not determine

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33. Letter from EPA to John T. Higgins (Oct. 11, 2000) (on file with author).

34. Letter from Richard R. Long, EPA Region 8, to Lynn Menlove, Utah Div. of Air Quality, *supra* note 32, at 2.

35. See Memorandum from Robert G. Kellam, EPA, to Richard R. Long (Aug. 27, 1996) (“Whether facilities are contiguous or adjacent is determined on a case-by-case basis, based on the relationship between the facilities.”) (on file with author); See also Letter from Pamela Blakely, EPA, to Don Sutton, EPA (Mar. 14, 2006) (using the “common sense notion of a plant” as the guiding principle in determining that four facilities operated by one company but located up to eight miles apart were a single Title V source because “the activities occurring at these sites all assist in supporting” the main manufacturing operation of the company) (on file with author); Letter from Kathleen Henry, EPA, to John Slade, Pa. Dep’t of Env’tl. Prot. (Jan. 15, 1999) (“determining whether facilities are contiguous or adjacent depends not only on the physical distance between them but [also] on the type of nexus (relationship) between facilities.”) (on file with author).

whether facilities are contiguous or adjacent. Rather, if facilities are close enough to be functionally interdependent, they will be considered a single source, so long as they are also under common control and in the same industrial grouping. Thus, according to prior EPA guidance documents and interpretation letters, in determining whether facilities are contiguous or adjacent, physical distance and proximity are merely one factor within a much broader functional interdependence analysis.

For non-oil and gas facilities, EPA Regional Offices have concluded that facilities were contiguous or adjacent under the following circumstances, among many others: a mine and a processing plant connected by a forty-four mile-long pipeline;<sup>36</sup> a plant and a pump station 21.5 miles apart connected by a dedicated channel;<sup>37</sup> a brewery and a land farm six miles apart connected by a pipeline.<sup>38</sup> Although the facilities in these cases were separated by a number of miles, the operations were connected by a pipeline or dedicated conveyance. In each of these cases, EPA believed that such a physical connection was a salient factor that demonstrated an integral relationship between the facilities, allowing EPA to conclude they were contiguous or adjacent.

### C. The Wehrum and McCarthy Memos

#### 1. The Wehrum Memo

On January 12, 2007, William Wehrum, Acting Assistant Administrator for the EPA Office of Air and Radiation (OAR), issued a memorandum (the “Wehrum Memo”)<sup>39</sup> to provide guidance to permitting authorities in making major source determinations for the oil and gas industry. Recognizing the complexity of oil and gas production operations, the Wehrum

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36. See Letter from Richard R. Long, EPA Region 8, to Dennis Myers, Colorado Dep’t of Public Health & Env’t (Apr. 20, 1999) (on file with author).

37. See Letter from Richard R. Long, EPA Region 8, to Lynn R. Menlove, Utah Dep’t of Env’tl. Quality (Aug. 8, 1997) (on file with author).

38. See Letter from Robert Kellam, EPA Office of Air Quality Planning Standards, to Richard R. Long, EPA Region 8 (Aug. 27, 1996) (on file with author).

39. Wehrum Memo, *supra* note 3.

Memo attempted to simplify source aggregation decisions for oil and gas operations by creating more certainty in how the “contiguous or adjacent” factor is applied.

To simplify source determination, the Wehrum Memo recommended that permitting authorities begin an aggregation analysis by determining whether each individual surface site constitutes a separate source.<sup>40</sup> The memorandum defined “surface site” generally as a single area of development, which “includes any combination of one or more graded pad sites, foundations, platforms, or the immediate physical location upon which equipment is physically affixed.”<sup>41</sup> If the permitting authority has determined that the surface sites at issue are under common control and in the same industrial grouping, it should consider aggregating pollutant-emitting activities at multiple surface sites if they are in close proximity to one another.<sup>42</sup> Surface sites are in close proximity if they are physically adjacent or separated by no more than a short distance (e.g., across a highway, separated by a city block, or some similar distance).<sup>43</sup> Finally, once the stationary source is identified (the aggregated surface sites), the permitting authority should consider all the equipment located on the surface sites collectively to determine whether they qualify as a major stationary source for the purposes of NSR and Title V permitting.<sup>44</sup>

The Wehrum Memo acknowledged that the three overarching principles set out by the court in *Alabama Power*, and expressed in the 1980 PSD Preamble, should guide permitting authorities when interpreting the regulatory criteria for source determination. “Specifically, [the permitting authority] must: (1) reasonably carry out the purposes of. . . (PSD); (2) approximate a common sense notion of a ‘plant;’ and (3) avoid aggregating pollutant-emitting activities that as a group would not fit within the ordinary meaning of ‘building,’ ‘structure,’ ‘facility,’ or

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40. *Id.*

41. *Id.* at 1.

42. *Id.*

43. *Id.*

44. *Id.* at 2.

‘installation.’”<sup>45</sup> The Wehrum Memo expressed that the “common sense” notion of a plant should be the foremost guiding principle.<sup>46</sup>

Guided by the above-mentioned overarching principles, the Wehrum Memo rejected the use of functional interdependence to determine whether facilities are “contiguous or adjacent.” The memo noted that in the 1980 PSD Preamble, EPA explicitly declined to add a “functionality” criteria to the definition of source because EPA believed that “assessments of functional interrelationships would be “highly subjective” and “embroil . . . the Agency in fine-grained analysis” that would potentially lead to results that do not conform to the common sense notion of a plant.<sup>47</sup> Aggregating oil and gas field activities that occur over large geographic distances defied the concept of contiguous or adjacent.<sup>48</sup> Given the complex nature of oil and gas activities, the Wehrum Memo concluded that physical proximity is the most informative factor in a contiguous or adjacent analysis.<sup>49</sup>

Further justifying its de-emphasis of functional interdependence, the Wehrum Memo noted that Congress recognized the unique geographic attributes of the oil and gas industry when it provided direction on how oil and gas exploration and production operations should be aggregated under the CAA section 112 hazardous air pollutants (HAPs) program.<sup>50</sup> Specifically, section 112(n)(4) of the CAA provides:

emissions from any pipeline compressor or pump station shall not be aggregated with emissions from other similar units, whether or not such units are in a contiguous area or under common control, to determine whether such units or stations are major sources, and in the case of any oil or gas exploration or

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45. Wehrum Memo, *supra* note 3 (citing Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676, 52,694-95 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, and 124)).

46. *Id.*

47. *Id.* at 2-3.

48. *Id.* at 4.

49. *Id.*

50. *Id.*

production well (with its associated equipment), such emissions shall not be aggregated for any purpose under this section.<sup>51</sup>

Under this congressional mandate, EPA defined major source under section 112, regarding the oil and gas industry, in reference to individual surface sites.<sup>52</sup> The Wehrum Memo recognized that permitting authorities should not strictly apply the section 112 major source definition to NSR and Title V permitting, but that EPA “does believe that the ‘surface site’ is a reasonable place to begin the source determination analysis.”<sup>53</sup>

The Wehrum Memo concluded that:

[In] a great majority of cases, we expect that permitting authorities will find a single surface is the most suitable industrial grouping because it correlates best with the definition of a stationary source. Accordingly, permitting authorities could treat each surface site as a separate stationary source and generally would not need to aggregate activities located on different oil and gas properties (oil and gas lease, mineral fee tract, subsurface unit area, surface fee tract, or surface lease tract) or located on the same lease, when the sites are not located in close proximity to each other.<sup>54</sup>

## 2. The McCarthy Memo

On September 22, 2009, Gina McCarthy, Assistant Administrator for the OAR, issued a memorandum (the “McCarthy Memo”), withdrawing the Wehrum Memo.<sup>55</sup> Rather than continue the simplified source determination process expounded by the Wehrum Memo, the McCarthy Memo reverted EPA policy to the in-depth case-by-case analysis that was in place before the Wehrum Memo. Essentially, the reasoning for the

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51. 42 U.S.C. § 7412(n)(4)(A) (2012).

52. Wehrum Memo, *supra* note 3.

53. *Id.*

54. *Id.*

55. Memorandum from Gina McCarthy, OAR, to EPA Regional Administrators, Regions I-X, Withdrawal of Source Determinations for Oil and Gas Industries (Sept. 22, 2009), *available at* <http://www.epa.gov/region07/air/nsr/nsrmemos/oilgaswithdrawal.pdf> [hereinafter McCarthy Memo].

policy shift was that the Wehrum Memo process simplified source determinations too much:

The [Wehrum Memo] attempted to simplify this analysis by focusing on one of the three regulatory criteria for source determinations – whether activities are “adjacent or contiguous.” It emphasized proximity in addressing this criterion. In practice, however, I find individual facts warrant a closer examination of all three criteria identified in those regulations to arrive at a reasoned decision, and therefore, the simplified approach provided in the [Wehrum Memo] should not be relied on by permitting authorities as a sufficient endpoint in the decision-making process.<sup>56</sup>

The McCarthy Memo went on to state that permitting authorities should rely foremost on all three regulatory criteria for source determinations: (1) common control, (2) contiguous or adjacent, and (3) same industrial grouping; and that permitting authorities should apply these criteria with respect to the explanation provided in the 1980 PSD Preamble.<sup>57</sup> Moreover, the McCarthy Memo concluded that source determinations for oil and gas facilities “will continue to be complex” and may involve “in-depth analyses of ownership and operational issues.”<sup>58</sup> Thus, instead of beginning the source determination analysis at the surface site, as in the Wehrum Memo, the McCarthy Memo prescribed the equivocal fine-grained case-by-case analysis used by EPA for source determinations prior to the Wehrum Memo.

Unfortunately, the McCarthy Memo incorrectly interpreted the Wehrum Memo. The McCarthy Memo interpreted the Wehrum Memo as focusing on the contiguous or adjacent criteria at the expense of the other two factors. This is not the case. Only after assuming that the first two criteria are met did the Wehrum Memo proceed to analyze the contiguous or adjacent factor. Although determining whether two or more facilities share common control and the same industrial grouping can sometimes entail a complicated analysis, the process of evaluating these factors is not nearly as contentious an issue as whether oil and

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56. *Id.*

57. *Id.*

58. *Id.*

gas facilities are contiguous or adjacent. As stated in the Wehrum Memo, “[e]ven when two or more pollutant-emitting activities are clearly under common control and belong to the same [industrial grouping], the unique geographical attributes of the oil and gas industry necessitate a detailed evaluation of whether the activities are contiguous or adjacent.”<sup>59</sup> The contiguous or adjacent factor is not more important than the other two, as the McCarthy Memo interpreted the Wehrum Memo as stating. The Wehrum Memo recognized that all three factors must be met to aggregate sources, and merely attempted to provide some clarity to an ambiguous term as it is applied to a diverse and complex industry. Nevertheless, the McCarthy Memo represents EPA’s current interpretation of the three-factor definition of source.

#### D. Recent EPA Case-by-Case Determinations

##### 1. MacClarence v. EPA

*MacClarence v. EPA* involved the aggregation of BP’s crude oil production well pads and processing facilities in the Prudhoe Bay Unit (PBU) on Alaska’s North Slope.<sup>60</sup> Initially, a BP affiliate in the PBU filed a draft Title V operating permit with the Alaska Department of Environmental Conservation (ADEC), but the permit did not aggregate the production facility at issue, Gathering Center #1 (GC1), with any other stationary sources in the PBU.<sup>61</sup> At the time, crude oil was produced from thirty-eight individual drill sites and pumped to one of six dedicated production centers within the PBU where it was processed and distributed to the Trans-Alaska Pipeline for sale.<sup>62</sup> After the draft permit was submitted to ADEC, a private citizen submitted comments arguing that *all* of BP’s stationary sources in the PBU should be aggregated.<sup>63</sup> In spite of the citizen’s comments, ADEC

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59. Wehrum Memo, *supra* note 3.

60. *See MacClarence v. EPA*, 596 F.3d 1123 (9th Cir. 2010).

61. *Id.* at 1127-28.

62. BP Exploration (Alaska), Inc. Gathering Center #1, 50 Fed. Reg. 26,813 (EPA, Apr. 20, 2007) (order denying petition for objection to permit).

63. *MacClarence*, 596 F.3d at 1128.



issued a proposed permit that did not aggregate GC1 with any other sources.<sup>64</sup> However, after the proposed permit was issued, EPA raised concerns about the lack of a discussion regarding the private citizen's aggregation comments.<sup>65</sup> Consequently, EPA, ADEC, and BP collaborated to resolve the aggregation issue.<sup>66</sup> After these discussions concluded, ADEC reissued a draft permit, employing a "hub-and-spoke" aggregation model that collocated GC1 with the seven well pads that supplied it with crude oil.<sup>67</sup> However, the permit did not aggregate GC1 with the rest of the PBU facilities, as requested by the citizen, and he filed a petition with the EPA requesting that the Administrator object to the permit.<sup>68</sup> The Administrator denied the petition, stating that the citizen failed to provide adequate information or legal support in his petition.<sup>69</sup>

The Administrator cited an ADEC Statement of Basis regarding the draft permit in the reasoning for her decision, which the Ninth Circuit affirmed on appeal.<sup>70</sup> In the Statement of Basis, ADEC explained that it rejected aggregation of all PBU facilities because, among other reasons:

- (1) the PBU covers roughly 300 square miles and therefore aggregation "stretches the concept of proximity" that underlies aggregation determinations;
- (2) "[t]he complexity of administering . . . and operating . . . a stationary source as large as the PBU without clear corresponding environmental benefit argues against" aggregation of the entire PBU; and
- (3) "there

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64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 1129.

69. MacClarence, 596 F.3d at 1129.

70. BP Exploration (Alaska), Inc. Gathering Center #1, 50 Fed. Reg. at 26,814 ("ADEC discussed in great detail why it decided, based on the applicable statutes, regulation, and EPA guidance and specific facts before ADEC, that it was not appropriate to aggregate all facilities within the entire PBU.").

[was] no precedent for defining such a large stationary source . . .  
.”<sup>71</sup>

Additionally, pipeline connections were not a deciding factor in an aggregation analysis because “pipelines connect everything” in the oil and gas industry.<sup>72</sup> ADEC explained that source determination based on pipeline connectivity, without regard to the concept of a common sense notion of a plant, “would result in one stationary source extending from the North Slope oil fields all the way to the Valdez Marine Terminal.”<sup>73</sup>

Physical proximity was not a determinative factor in ADEC’s final contiguous or adjacent analysis. The longest distance between a well pad and a production facility that were aggregated in the PBU was nine miles. Rather than consider distance, ADEC applied a case-by-case analysis with the common sense notion of a plant being the guiding principle – the functional interdependence test.<sup>74</sup>

To determine if the facilities that were aggregated with GC1 were contiguous or adjacent, ADEC developed a “wagon wheel” model based on the production centers (hubs) and well pads (spokes).<sup>75</sup> Consistent with the McCarthy Memo, ADEC reasoned that this model was appropriate because it fit the concept of a common sense notion of a plant. The well pads delivered crude oil (raw materials) to the production center for processing into sales oil (finished product) for delivery and custody transfer at a Trans-Alaska Pipeline pump station.<sup>76</sup> Thus, each production center and its associated well pads constituted a single stationary source because of their functional interdependence.

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71. MacClarence, 596 F.3d at 1128-29, (citing Alaska Dep’t of Env’t Conservation Air Quality Operating/Construction Permit, Permit No. 182TVP01 5 (Feb. 17, 2004).

72. Alaska Dep’t of Env’t Conservation Air Quality Operating/Construction Permit (draft), Permit No. 182TVP01 6 (Feb. 17, 2004).

73. *Id.*

74. *Id.* at 4.

75. *Id.*

76. *Id.*

## 2. Summit Petroleum v. EPA

Summit Petroleum Corporation operates a natural gas sweetening plant in Michigan that is connected to approximately 100 sour natural gas wells via pipeline. These wells supply gas exclusively to the sweetening plant. The closest gas well is 500 feet from the sweetening plant and the furthest gas well is over eight miles away. Overall, the wells are located across three separate field units that are not contiguous, covering a forty-three square-mile area.<sup>77</sup>

In January 2005, Summit submitted a written request to EPA Region 5 requesting a determination of major source status for the above-described facilities.<sup>78</sup> On April 26, 2007, EPA Region 5 responded to Summit's request.<sup>79</sup> Although Region 5 indicated that it believed Summit's facilities fit the common sense notion of a plant because the wells supplied gas to the plant, Region 5 acknowledged that, under the Wehrum Memo, proximity was the most determinative factor in a contiguous or adjacent analysis.<sup>80</sup> Region 5 stated it was unable to make a decision and requested more information from Summit to evaluate the proximity of the wells and the plant.<sup>81</sup> After a series of correspondence between Summit and Region 5, the Regional Office issued a final decision on Summit's source determination request on September 8, 2009, two weeks prior to the release of the McCarthy Memo.<sup>82</sup> After four years of working to make a determination, Region 5 concluded that the wells and plant were adjacent and constituted a single source for the purpose of Summit's Title V permit. In current litigation, Summit alleges that Region 5 did not provide a basis for its decision other than to cite previous correspondence between Region 5 and Summit, which relied on the Wehrum Memo.<sup>83</sup>

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77. Brief of Petitioner-Appellant at 27, *Summit Petroleum Corp. v. U.S. EPA*, Nos. 09-4348, 10-4572 (6th Cir. Apr. 1, 2011).

78. *Id.* at 6.

79. *Id.* at 7.

80. *Id.* at 17.

81. *Id.*

82. *Id.* at 10.

83. Brief of Petitioner-Appellant at 10-11, *Summit Petroleum Corp. v. EPA*, Nos. 09-4348, 10-4572.

Summit filed a petition in the Sixth Circuit appealing EPA Region 5's decision. However, the case was held in abeyance to allow Region 5 to reconsider its determination and obtain additional information from Summit.<sup>84</sup> Summit continued to argue to Region 5 that because the gas wells were separated from the sweetening plant by a considerable distance and intervening properties, they were not contiguous or adjacent and did not fit the common sense notion of a plant.<sup>85</sup> On October 18, 2010, EPA Region 5 issued a letter to Summit summarizing its review and reissued a final determination.<sup>86</sup> However, physical proximity was not relevant to Region 5's decision.<sup>87</sup> Citing the McCarthy Memo as guidance this time, Region 5 applied the functional interdependence test: "the sour gas wells are truly interdependent on the sweetening plant – the wells provide all their sour gas to the sweetening plant, the sour gas cannot flow anywhere else, and Summit owns and operates the sweetening plant and well sites."<sup>88</sup> Consequently, Summit has resumed its appeal, which is currently pending in the Sixth Circuit.

### 3. In re Anadarko Petroleum Corporation, Frederick Compressor Station

On January 1, 2007, the Colorado Department of Public Health and Environment (CDPHE) renewed the Title V operating permit for the Frederick Compressor Station, which collects natural gas and liquid condensate products from wells in the Wattenberg field. Numerous oil and gas companies own and operate approximately 24,000 wells scattered over 2,000 square miles in the field.<sup>89</sup> Anadarko Petroleum Corporation (Anadarko)

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84. *Id.* at 12.

85. Brief of Petitioner-Appellant at 37-44, Summit Petroleum Corp. v. EPA, Nos. 09-4348, 10-4572.

86. Letter from Cheryl L. Norton, Director, Air & Radiation Div., EPA Region 5, to Scott Huber, Summit Petroleum Corporation Corp. (Oct. 18, 2010), available at <http://www.epa.gov/region07/air/title5/t5memos/singler5.pdf> (on file with author) [(hereinafter Letter from Cheryl L. Norton to Scott Huber)].

87. Brief of Petitioner-Appellant at 7, Summit Petroleum Corp. v. EPA, Nos. 09-4348, 10-4572.

88. Letter from Cheryl L. Norton to Scott Huber, *supra* note 86, at 3.

89. Order Granting Petition for Objection to Anadarko Petroleum Corp.'s Frederick Compressor Station Title V Permit, 74 Fed. Reg. 56,610 (Oct. 10,

operates over 4,000 wells in the Wattenberg field, and the Frederick Compressor Station is one of seven natural gas compressor stations that Anadarko owns and operates in the field.<sup>90</sup> The facility consists of three large natural-gas-fired reciprocating internal combustion engines that emit NO<sub>x</sub> and VOCs in “major” amounts.<sup>91</sup>

On January 3, 2007, an environmental advocacy group<sup>92</sup> filed a petition with the EPA Administrator requesting that the Agency object to CDPHE’s issuance of the renewal Title V permit for the Frederick Compressor Station.<sup>93</sup> On February 7, 2008, the Administrator granted the petition on the grounds that CDPHE failed to adequately respond to the petitioner’s comments regarding the source aggregation issues and ordered CPDHE to respond to petitioner’s comments.<sup>94</sup> On April 29, 2008, CDPHE supplemented the Title V permit application, but concluded no changes to the [Title V] permit were warranted.<sup>95</sup> Relying extensively on the Wehrum Memo, which was in effect at the time, CPDHE focused its “adjacent” analysis on proximity and ownership of wells that were within one city block of the compressor station.<sup>96</sup> However, the petitioners were not satisfied with the response and, on October 14, 2008, filed a second

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2009), *available at* <http://www.cdphe.state.co.us/ap/Frederick/A-1EPAOrderAnadarkoFrederickStation10.08.09.pdf>.

90. Order Denying Petition for Objection to Anadarko Petroleum Corp.’s Frederick Compressor Station Title V Permit, 76 Fed. Reg. 10,361 (Feb. 16, 2011). At the time of its Title V permit renewal on January 1, 2007, the Frederick Compressor Station was owned by Kerr-McGee Gathering, LLC, which is now a wholly-owned subsidiary of Anadarko.

91. *Id.* at 10,362.

92. Rocky Mountain Clean Air merged with WildEarth Guardians on September 16, 2008. *See Merger Gives Might to WildEarth Guardians’ Climate and Energy Program*, WILDEARTH GUARDIANS, <http://www.wildearthguardians.org/site/News2?page=NewsArticle&id=5516> (last visited Apr. 20, 2011).

93. *See* Petition for Objection to Issuance of Operating Permit for Anadarko Petroleum Corporation’s Frederick Compressor Station (EPA Jan. 3, 2007).

94. *See* Order Responding to Petitioners’ Request that Admin. Object to Issuance of State Operating Permit, VIII-2007-[sic] (EPA Feb. 7, 2008) (Administrator review).

95. *See* Addendum to the January 1, 2007 Technical Review Document for Renewable Operating Permit 950PWE035 (EPA April 29, 2008) (Administrator response).

96. *Id.*

petition requesting that the EPA Administrator object to the operating permit.<sup>97</sup>

On October 9, 2009, two weeks after the McCarthy Memo withdrew the Wehrum Memo, the EPA Administrator granted the environmental group's petition.<sup>98</sup> Curiously, the Administrator admonished CDPHE for using "one city block" to measure proximity, even though it was one of the examples the Wehrum Memo provided:

In relying primarily on proximity and only evaluating ownership within one city block without any explanation as to why that distance was appropriate under the circumstances and without an examination of other criteria relevant to source determination, CDPHE failed to adequately support or explain its aggregation decision.<sup>99</sup>

Nevertheless, the Administrator ordered CDPHE to "do a thorough analysis" of the aggregation issue by applying all three regulatory criteria for identifying emissions sources that belong to the same building, structure, facility, or installation, as emphasized in the McCarthy Memo.<sup>100</sup>

On July 14, 2010, CDPHE issued a detailed forty-two page response, and again decided not to aggregate the Frederick Compressor Station with other wells in the Wattenberg Field.<sup>101</sup> In defiance of the McCarthy Memo and EPA's reliance on functional interdependence, CDPHE noted that "the concept of "interdependency" . . . is not discussed in the 1980 PSD Preamble, or mentioned in the federal PSD or Title V regulations defining 'source.'"<sup>102</sup> Rather, CDPHE pointed out that it was a concept developed over time through EPA guidance documents and case-by-case determinations.<sup>103</sup> CDPHE concluded, "while the

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97. See Petition for Objection to Issuance of Operating Permit for Anadarko Petroleum Corp.'s Frederick Compressor Station (EPA Oct. 14, 2008).

98. See Order Granting Petition for Objection to Permit (EPA Oct. 9, 2009).

99. See *id.*

100. See *id.*

101. See Response of CDPHE, Air Pollution Control Division, To Order Granting Petition for Objection to Permit, VIII-2008-02 (EPA Jul. 14, 2010) (Administrator response) [hereinafter Response of CDPHE].

102. *Id.* at 14.

103. *Id.*

[CDPHE] has thoughtfully considered ‘interdependency’ as part of its contiguous or adjacent analysis, given the unique engineering and commercial complexities in the oil and gas production midstream sector, the [CDPHE] will not necessarily look to interdependency as a determining factor in this or other similar cases.”<sup>104</sup>

CDPHE then went on to discuss proximity factors in the Wattenberg field that led to its conclusion not to aggregate.<sup>105</sup> However, in an apparent attempt to satisfy EPA, CDPHE discussed a detailed set of facts that would apply to a functional interdependence analysis. For instance, the Frederick Compressor Station has no operational control over the wells and associated pollutant-emitting activities that it services.<sup>106</sup> There are numerous compressor stations in the Wattenberg Field and gas gathering agreements do not specify which gas will move through the Frederick Compressor Station.<sup>107</sup> Information gathered by CDPHE indicates that in a mature field, such as Wattenberg, the production and gathering system results in a spider web of gathering and distribution lines, compressor stations, and wells, which overlap, run parallel, and cross at different depths.<sup>108</sup> Moreover, once gas flows into the gathering system, it becomes co-mingled and is indistinguishable from gas from wells not owned or operated by Anadarko.<sup>109</sup> Furthermore, if the Frederick Compressor shuts down, gas would flow through other compressor stations.<sup>110</sup> Thus, CDPHE reached the conclusion that gas wells and associated equipment owned or operated by Anadarko are not solely dependent on the Frederick Compressor Station, and vice-versa.

Nevertheless, the environmental group challenged CDPHE’s response.<sup>111</sup> But on February 2, 2011, the EPA Administrator

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104. *Id.* at 15.

105. *See id.* at 16.

106. *See* Response of CDPHE, *supra* note 101, at 25.

107. *See id.* at 24-25.

108. *Id.* at 25.

109. *Id.* at 26.

110. *Id.*

111. *See* WildEarth Guardians Petition for Objection (EPA Nov. 3, 2010).

finally sided with CDPHE's exhaustive response memo.<sup>112</sup> The Administrator conducted a thorough analysis of prior EPA guidance documents and determinations regarding aggregation and concluded that CDPHE had properly determined that the Frederick Compressor Station, alone, was a single source for PSD and Title V purposes.

Thus, even though CDPHE rejected the use of functional interdependence, its analysis included enough facts for the EPA Administrator to conclude that the Frederick Compressor Station and wells in the Wattenberg Field were not interdependent, and therefore not contiguous or adjacent.<sup>113</sup>

#### IV. STATE REGULATIONS

Several states have developed guidance on aggregation of oil and gas exploration, production, and distribution activities. These guidance documents focus on the contiguous or adjacent prong of the three-part aggregation analysis, which, as previously discussed, has proven to be the most contentious issue in the aggregation analysis for the oil and gas industry. Each of the following state guidance documents advocates a general quarter mile rule of thumb to consider facilities adjacent, and discuss proximity in great detail. Although each of the states acknowledge that functional interdependence plays some kind of role in a source determination, the state guidance documents do not describe how functional interdependence is to be applied in great detail. The guidance documents are written as if to merely give a nod to the McCarthy Memo. Thus, it appears that the following states only reticently acknowledge functional interdependence because their regulations must be at least as stringent as the federal requirements.

##### A. Wyoming

On February 23, 2010, the Wyoming Department of Environmental Quality (WDEQ) made a presentation to EPA

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<sup>112</sup>. See EPA Order Denying Petition for Objection to Permit (EPA Feb. 2, 2011) (admin. review).

<sup>113</sup>. *Id.*



regarding its position on aggregation of oil and gas activities.<sup>114</sup> WDEQ began by stating, “[w]e use EPA’s definition of ‘source,’” and outlined the four-part statutory definition (i.e., building, structure, facility, or installation) and the three-prong regulatory definition (i.e., common control, same industrial grouping, and contiguous or adjacent).<sup>115</sup> WDEQ noted that a pipeline, on its own, does not constitute contiguous or adjacent.<sup>116</sup> However, “nothing escapes permitting consideration.”<sup>117</sup>

WDEQ then proffered a criticism of EPA’s reliance on policy memos, contending that functional interdependence is not an expressed element of the three-part aggregation test, and was only developed through a series of EPA guidance documents.<sup>118</sup> WDEQ warned that aggregating oil and gas sources would result in additional permitting timelines and burdens with little or no environmental benefit.<sup>119</sup> The potential permitting workload would increase for every new well drilled, and there would be an increase in litigation.<sup>120</sup> WDEQ also argued that its source determinations were consistent with the CAA and EPA regulations, but that EPA efforts “could erode [the] predictability we currently have.”<sup>121</sup>

WDEQ concluded the presentation with recommendations on how to define “source.” According to WDEQ, a permitting authority should “[a]dhere to the statutory and regulatory definitions of ‘stationary source,’ as informed by EPA’s PSD rule preamble discussion, and the guidance provided by *Alabama Power*.”<sup>122</sup> However, it should not “rely upon past EPA regional office decisions which substituted a ‘functional relationship’ or ‘proximity’ test for the statutory definition.”<sup>123</sup>

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114. See *Aggregation in Wyoming*, WYO. DEP’T OF ENVTL. QUALITY (Feb. 23, 2010), available at [http://www.cdphe.state.co.us/ap/Frederick/A-7WyomingPowerPointPresentation2\\_23\\_2010.pdf](http://www.cdphe.state.co.us/ap/Frederick/A-7WyomingPowerPointPresentation2_23_2010.pdf).

115. *Id.* at 2.

116. *Id.*

117. *Id.*

118. *Id.* at 4.

119. *Id.* at 6.

120. See *Aggregation in Wyoming*, *supra* note 114, at 6.

121. See *id.*

122. *Id.*

123. See *id.*

## B. Oklahoma

Oklahoma state regulations essentially adopt the EPA three-part definition of source, i.e., common control, contiguous or adjacent, and same industrial grouping.<sup>124</sup> Similar to EPA guidance, the Oklahoma Department of Environmental Quality (ODEQ), Air Quality Division, employs a case-by-case analysis to determine whether to aggregate sources. However, ODEQ prescribes a hybrid approach to source determination that includes distance and interdependence factors.<sup>125</sup> In a guidance document, ODEQ considers facilities located within a quarter mile of one another to be “within a contiguous area.”<sup>126</sup> However, the Agency notes that distance “may not adequately deal with situations with more extenuating circumstances; such as when sources are not within [a quarter] mile of each other, but operationally support each other and are ‘connected’ by some means of transportation (for example; pipeline, road, or railroad).”<sup>127</sup> Accordingly, these facilities must be analyzed on a case-by-case basis.<sup>128</sup> For example, ODEQ provides that if two facilities are located in different counties and the property boundaries are more than five miles apart, they will likely be considered “adjacent” if they operationally support each other and are physically joined in any manner.<sup>129</sup> However, if the facilities do not operationally support each other and are not connected then they are not considered adjacent due to geographical distance and logistics.<sup>130</sup>

## C. Louisiana

The Louisiana Department of Environmental Quality (LDEQ) also provides guidance regarding the aggregation of oil

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124. See OKLA. ADMIN. CODE § 252:100-7-1.1 (2011) (defining “facility”).

125. See OKLA. DEP’T OF ENVTL. QUALITY, AIR PERMITTING COLLOCATED FACILITIES (2011), available at <http://www.crossroads.odl.state.ok.us/cdm4/document.php?CISOROOT=/stgovpub&CISOPTR=47512&REC=7>.

126. *Id.* at 3.

127. *Id.*

128. See *id.*

129. See *id.*

130. See *id.*

and gas production facilities. LDEQ states, “sites separated by [a quarter] mile or less shall be considered contiguous.”<sup>131</sup> Permit applications should provide a map of all facilities under common control that are located within a quarter mile of the “target facility,” which establishes a boundary for contiguous facilities.<sup>132</sup> Facilities should not be “daisy-chained” together to establish a continuous grouping.<sup>133</sup> Although LDEQ primarily relies on a proximity analysis, the Agency will also consider factors such as interdependency for facilities separated by more than a quarter mile, “given the particular circumstances for a given case.”<sup>134</sup>

#### D. Texas

Similar to Oklahoma and Louisiana, the Texas Commission on Environmental Quality (TCEQ) considers proximity and interdependence when determining whether to aggregate facilities for NSR and Title V purposes. In a guidance document, TCEQ states, “properties located less than a [quarter] mile apart are considered contiguous.”<sup>135</sup> However, TCEQ acknowledges the McCarthy Memo and provides, “[w]hile proximity of sources to one another should be considered when determining whether contiguous and adjacent, a case-by-case analysis of all criteria must be conducted.”<sup>136</sup> As such, TCEQ also provides that interdependent properties located more than a quarter mile apart might also be contiguous.<sup>137</sup> TCEQ defines interdependent properties as those that are mutually dependent, meaning one property supports or is supported by another and cannot function independently.<sup>138</sup>

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131. LA. DEP’T OF ENVTL. QUALITY, INTERPRETATION OF CONTIGUOUS FOR OIL & GAS PRODUCTION FACILITIES 1 (2011), *available at* [www.deq.louisiana.gov/portal/tabid/2347/Default.aspx](http://www.deq.louisiana.gov/portal/tabid/2347/Default.aspx).

132. *Id.*

133. *Id.*

134. *Id.*

135. TEX. COMM’N ON ENVTL. QUALITY, DEFINITION OF SITE GUIDANCE DOCUMENT 1 (Aug. 2010), *available at* [http://www.tceq.texas.gov/assets/public/permitting/air/Guidance/Title\\_V/site.pdf](http://www.tceq.texas.gov/assets/public/permitting/air/Guidance/Title_V/site.pdf) (last visited Apr. 29, 2011).

136. *Id.* at 2

137. *Id.* at 1.

138. *Id.*

However, beginning April 1, 2011, TCEQ plans to implement regulations to replace a type of minor source permit for oil and gas sites in the Barnett Shale area, and for oil and gas sites statewide in 2012. Under the new minor source permit, all oil and gas facilities that are operationally dependent and located *no more* than a quarter mile apart must be aggregated in the same permit.<sup>139</sup> If piping is the only connection between facilities and the distance between them exceeds a quarter mile, then the facilities are considered separate.<sup>140</sup> To ensure there is no daisy-chaining of facilities, the quarter mile boundary of the site becomes fixed when the permit is registered and no facility within the boundary may be authorized under more than one registration.<sup>141</sup>

In comments to the proposed rule, EPA contended that the quarter mile limitation should not be included as part of the definition of oil and gas sites, and reminded TCEQ of the requirements stated in the McCarthy Memo.<sup>142</sup> TCEQ responded in the following manner:

Determinations for federal new source review and federal operating permits beyond the [quarter] mile and relying on other relevant factors must continue to occur on a case-by-case basis. If these federal review requirements apply, a PBR or standard permit will not be the appropriate mechanism for authorization.<sup>143</sup>

Accordingly, owners and operators of oil and gas facilities must determine if federal requirements apply to their facilities, and if so, they will not be eligible for the minor source permit. Thus, under TCEQ's new minor source permit regime, owners and

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139. *Air Quality Standard Permit for Oil and Gas Handling and Production Facilities*, TEX. COMM'N ON ENVTL. QUALITY, at (b)(6)(A)-(B), available at <http://www.tceq.texas.gov/assets/public/permitting/air/Announcements/oilgas-sp.pdf> (last visited on Apr. 28, 2012).

140. *Id.* at (b)(6)(C).

141. *Id.* at (b)(6)(D).

142. *Response to Comments*, at 65, available at [http://www.tceq.texas.gov/permitting/air/newsourcereview/chemical/oil\\_and\\_gas\\_sp.html](http://www.tceq.texas.gov/permitting/air/newsourcereview/chemical/oil_and_gas_sp.html) (Under the heading "Background Information on Recent Changes," click on the hyperlink "Response to Comments") (last visited Apr. 28, 2012).

143. *Id.* at 66.

operators of oil and gas sites should conduct separate aggregation analyses for the Texas permit and federal NSR and Title V permits.

**V.      FUNCTIONAL INTERDEPENDENCE IS  
         VULNERABLE TO A COURT CHALLENGE**

The United States Constitution provides rules guiding the creation of administrative agencies, such as the EPA, and the exercise of administrative power. However, the Framers, to a considerable degree, left the extent of administrative powers open for debate in the political process they set in motion.<sup>144</sup> Additionally, the amended Constitution provides significant, but limited, protection for individual rights that administrative agencies may put at risk.<sup>145</sup> In passing the Administrative Procedure Act [APA], Congress implemented a sub-constitution for administrative agencies that provides a flexible framework for federal agencies taking actions that affect individual rights.<sup>146</sup>

Section 553 of the APA provides a uniform, baseline procedure for the most widespread form of agency action that creates rules with the force of law – informal or “notice and comment” rulemaking. As stated by one commentator, “The heart of the informal rulemaking process of section 553 is a written exchange between the agency and interested members of the public.”<sup>147</sup> To create a rule that has the force of law under section 553, an agency begins by publishing a “notice of proposed rulemaking” [NOPR] and invites written comments from the public.<sup>148</sup> The notice is typically published in the *Federal Register*.

The NOPR is significant for three reasons. First, the NOPR subjects the findings and assumptions of administrative officials to “public scrutiny” that will foster “rational” and “informed”

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144. KEITH WERHAN, *PRINCIPLES OF ADMINISTRATIVE LAW* 158 (2008).

145. *Id.*

146. *Id.*

147. *Id.* at 219.

148. 5 U.S.C. § 553(b)-(c) (2006).

rulemaking.<sup>149</sup> Second, by providing interested members of the public an opportunity to shape regulations that will govern their conduct, the NOPR furthers the values of fairness and democratic participation.<sup>150</sup> Third, the NOPR aids judicial review of a regulation by allowing the public to submit evidence supporting their positions for the administrative record.<sup>151</sup> A NOPR is typically divided into two parts: a preamble, which discusses the legal, factual, and policy basis for the proposed rule; followed by the text of the proposed rule.<sup>152</sup>

After reviewing the comments, an agency re-evaluates its proposed rule and makes changes as necessary to address concerns raised in the comments.<sup>153</sup> The agency then publishes the final rule, along with a “statement of [its] basis and purpose,” and a regulation that has the force of law is created.<sup>154</sup> Reviewing courts expect the statement of basis and purpose to “indicate the major issues of policy that were raised in the proceedings and [to] explain why the agency decided to respond to these issues as it did, particularly in light of the statutory objectives that the rule must serve.”<sup>155</sup> Accordingly, agencies must respond reasonably to those public comments that, if true, would have required the agency to change the rule.<sup>156</sup>

Within the framework Congress established in Section 553 of the APA, EPA’s application of functional interdependence to source determinations and the McCarthy Memo’s prescription of its use raises serious concerns. Rather than being tested under section 553’s notice and comment procedures, functional interdependence was developed over time through EPA guidance

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149. WERHAN, *supra* note 144, at 228 (citing *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1031 (D.C. Cir. 1978)); *see also* *Chocolate Mfrs. Ass’n v. Block*, 755 F.2d 1098, 1103 (4th Cir. 1985).

150. WERHAN, *supra* note 144, at 228-29; *see, e.g.*, *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 547 (D.C. Cir. 1983).

151. WERHAN, *supra* note 144, at 228-29; *see also* *Small Refiners*, 705 F.2d at 547; *Marathon Oil Co. v. EPA*, 564 F.2d 1253, 1271 n. 54 (9th Cir. 1977).

152. WERHAN, *supra* note 144, at 228-29.

153. 5 U.S.C. §§ 553(c), (d) (2012).

154. *Id.*

155. *Independent U.S. Tanker Owners Comm. v. Dole*, 809 F.2d 847, 852 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 819 (1987).

156. *Reytblatt v. NRC*, 105 F.3d 715, 722 (D.C. Cir. 1997); *Am. Mining Cong. v. EPA*, 907 F.2d 1179, 1188 (D.C. Cir. 1990).

documents and case-by-case determinations. Yet, the regulatory history of EPA's definition of "source" rejects the concept of functional interdependence as applied to the contiguous or adjacent factor. Thus, EPA has unreasonably interpreted the term "adjacent" to mean "interdependent," and the Agency's interpretation requires formal rulemaking including public notice and comment. Moreover, if the validity of the McCarthy Memo is challenged in court, a reviewing court could set it aside.

**A. EPA Unreasonably Interprets "Contiguous or Adjacent" to mean "Interdependent"**

The McCarthy Memo and numerous other EPA guidance documents interpret "contiguous or adjacent" to mean "interdependent." As in the previously discussed EPA source determinations, interdependence is the primary factor EPA uses in its contiguous or adjacent analysis. The U.S. Supreme Court has held that an agency's interpretation of its regulation is entitled to deference.<sup>157</sup> Some courts of appeal describe this deference as being even greater than that granted to an agency interpretation of a statute it is entrusted to administer.<sup>158</sup> However, the D.C. Circuit expounds an outer limit to agency deference:

A substantive regulation must have sufficient content and definitiveness as to the meaningful exercise in agency lawmaking. It is certainly not open to an agency to promulgate mush and then give it concrete form only through subsequent less formal "interpretations." That technique would circumvent section 553, the notice and comment procedures of the APA.<sup>159</sup>

Accordingly, a reviewing court will not defer to an agency's interpretation of its regulations unless: (1) the regulation is

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157. See *Auer v. Robbins*, 519 U.S. 452, 461-62 (1997); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945) (ruling that an agency's interpretation of its regulations has "controlling weight unless it is plainly erroneous or inconsistent with the regulation").

158. See, e.g., *Capital Network Sys. v. FCC*, 28 F.3d 201, 206 (D.C. Cir. 1994); *Paradissiotics v. Rubin*, 171 F.3d 983, 987 (5th Cir. 1999).

159. *Paralyzed Veterans of Am. v. D.C. Arena*, 117 F.3d 579, 584 (D.C. Cir. 1997).

ambiguous;<sup>160</sup> and (2) the agency's interpretation is reasonable.<sup>161</sup> If a regulation is unambiguous, then a reviewing court will not defer to an agency interpretation that contradicts the regulation's plain language.<sup>162</sup>

First, the term "contiguous or adjacent" unambiguously refers to physical distance and proximity, not "interdependence." The U.S. Supreme Court has ruled that a term is ambiguous if it is "susceptible to more precise definition and open to varying constructions."<sup>163</sup> As previously mentioned, *Black's Law Dictionary* defines "contiguous" as "Touching at a point or along a boundary; adjoining;" and "adjacent" as "Lying near or close to, but not necessarily touching."<sup>164</sup> Thus, the plain meaning of "contiguous or adjacent" emphasizes proximity and physical distance. Application of the plain meaning of "contiguous or adjacent" to the regulation is bolstered by the decision in *Alabama Power*, where the D.C. Circuit commanded EPA to create a regulatory definition of source, "according to considerations such as proximity and ownership." It warned that EPA must avoid aggregating pollutant-emitting activities that as a group would not fit within the ordinary meaning of "building," "structure," "facility," or "installation."<sup>165</sup> Therefore, the word "contiguous" unequivocally refers to a fixed physical distance, i.e., touching or adjoining. Although the word "adjacent" does not describe a specific distance, it unambiguously refers to some kind of physical distance. Because the EPA regulations do not define "adjacent," the physical distance necessary to determine whether two or more facilities are adjacent remains unclear. Thus, a court might consider the term "contiguous or adjacent" ambiguous in

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160. See *Christensen v. Harris Cnty.*, 529 U.S. 576, 588 (2000); *Martin v. Occupational Safety & Health Review Comm'n*, 499 U.S. 144, 151-53 (1991).

161. See, e.g., *Martin*, 499 U.S. at 158 ("The reviewing court should defer to the Secretary only if the Secretary's [rule] interpretation *is* reasonable."); *Ehlert v. United States*, 402 U.S. 99, 105 (1971) (reviewing courts are "obligated to regard as controlling a reasonable, consistently applied administration" of an ambiguous agency rule).

162. See *Christensen*, 529 U.S. at 588 ("But *Auer* deference is only warranted when the language of the regulation is ambiguous. The regulation in the case, however, is not ambiguous – it is plainly permissive.").

163. *Gonzalez v. Oregon*, 546 U.S. 243, 258 (2006).

164. BLACK'S LAW DICTIONARY 362 (9th ed. 2010).

165. *Ala. Power Co. v. Costle*, 636 F.2d 323, 397 (D.C. Cir. 1979).



the regulatory context because it does not specify a precise distance, leaving the term open to various constructions. If the term adjacent is ambiguous, a reviewing court will defer to the EPA's interpretation if it is reasonable.<sup>166</sup>

However, EPA unreasonably interprets "contiguous or adjacent" to mean "interdependent." The U.S. Supreme Court has ruled that an agency's interpretation of an ambiguous regulation is "subject to the same standard of substantive review as any other exercise of delegated lawmaking power."<sup>167</sup> Accordingly, to determine if an agency's interpretation of its regulation is reasonable, a reviewing court will analyze the "ordinary" and "dictionary" meanings of the regulation, the "statutory context" of the provision, and the "broad purpose" and "legislative history" of the statute.<sup>168</sup> As explained by the D.C. Circuit, "contemporary indications as to what the agency meant by the language used, such as the comments received, could play the same role as legislative history does in both steps of a *Chevron* analysis."<sup>169</sup> A court will also evaluate whether the regulation provides adequate notice that it could be interpreted in the manner that the agency interprets it.<sup>170</sup>

As discussed above, the plain meaning of contiguous or adjacent unambiguously connotes proximity and physical distance. However, the court in *Alabama Power* ruled that "EPA

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166. See *Christensen*, 529 U.S. at 588; *Martin*, 499 U.S. at 158; *Ehlert*, 402 U.S. at 105.

167. *Martin*, 499 U.S. at 158.

168. See *Babbitt v. Sweet Home Chapter of Cmty. for a Great Or.*, 515 U.S. 687, 696-708 (1995) (to evaluate the reasonableness of an agency's interpretation of a statute Congress has entrusted it to administer, reviewing courts "ask whether the [agency's] interpretation . . . is reasonable in light of the language, legislative history, and policies of the statute.").

169. *Paralyzed Veterans of Am. v. D.C. Arena.*, 117 F.3d 579, 585 (D.C. Cir. 1997) (citing *King Broadcasting Co. v. FCC*, 860 F.2d 465, 469 (D.C. Cir. 1988)); *City of Cleveland v. NRC*, 68 F.3d 1361, 1366 (D.C. Cir. 1995); *Chevron U.S.A., Inc., v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 840-45 (1984) (The two-step *Chevron* analysis defines the scope of judicial review of an agency's construction of the statute which it administers. First, a court must determine whether "Congress has spoken to the precise question at issue." If so, "that is the end of the matter." But if the statute is silent or ambiguous regarding the specific issue, a court must determine if the agency's interpretation "is based on a permissible construction of the statute.").

170. *Paralyzed Veterans of Am.*, 117 F.3d at 585.

has discretion to define statutory terms reasonably so as to carry out the expressed purpose of the [CAA],” and that EPA could reasonably interpret the statutory terms “facility” and “installation” broad enough to cover an entire plant.<sup>171</sup> To this end, EPA promulgated the three-part definition of “stationary source” (i.e., common control, contiguous or adjacent, and same industrial grouping) so that the definition of “source” would fit within the concept of a “common sense notion of a plant.”<sup>172</sup> But in doing so, EPA expressly rejected the use of functional interdependence in the 1980 PSD Preamble:

[Commentators] urged that EPA formulate a definition that looked only to proximity and *function*. But such a definition . . . would unnecessarily increase uncertainty . . . and drain the Agency’s resources. In addition, such a definition would present groupings . . . that would severely strain the boundaries of even the most elastic of the four terms, “building,” “structure,” “facility,” and “installation.”<sup>173</sup>

EPA excluded the functionality requirement in favor of proximity because the Agency did not want to get bogged down in “highly subjective” assessments that would “embroil[] the Agency in numerous, fine-grained analyses.”<sup>174</sup> Moreover, EPA explicitly referred to the term “contiguous or adjacent” in the context of proximity and physical distance:

[S]ome urged EPA to add to the definition the provision that the properties for [long-line] operations are neither contiguous nor adjacent. To add such a provision is unnecessary. 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.<sup>175</sup>

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171. *Ala. Power Co.*, 636 F.2d at 396.

172. Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676, 52,694-95 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, & 124).

173. *Id.* at 52,695.

174. *Id.*

175. *Id.*

Moreover, “one commentator asked . . . whether EPA would [consider] a surface coal mine and an electrical generator separated by twenty miles, [but] linked by a railroad, [as a single] ‘source.’”<sup>176</sup> EPA responded that “it would not” because, “the mine and the generator would be too far apart.”<sup>177</sup> EPA’s response does not mention the functional relationship between the facilities. It blankly states that the facilities are too far apart. Therefore, as discussed in the 1980 PSD Preamble, EPA unmistakably intended the contiguous or adjacent factor to refer only to the physical distance or proximity between facilities, not their functional relationship.

The problem with the 1980 PSD Preamble is that it does not provide clear guidance regarding the degree of proximity necessary to determine whether facilities are contiguous or adjacent. The 1980 PSD Preamble states, “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>178</sup> Referring to prior EPA guidance documents and source determinations that applied functional interdependence to aggregate sources, the McCarthy Memo notes, “these numerous case-by-case determinations illustrate the kind of reasoned decision-making that is necessary to justify adequately a permitting authority’s source determination decision.”<sup>179</sup> However, as previously discussed, these “highly fact-specific” case-by-case determinations have resulted precisely in the kind of “highly subjective” assessments that EPA expressly intended to avoid in the 1980 PSD Preamble.<sup>180</sup>

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176. *Id.*

177. *Id.*

178. Requirements for Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676, 52,695 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, & 124).

179. McCarthy Memo, *supra* note 55, at 2.

180. *Id.* at 2; *cf.* Requirements for Preparation, Adoption, and Submittal of Implementation Plans: Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676, 52,695 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, & 124).

By prescribing “highly fact-specific case-by-case determinations,” the McCarthy Memo and other EPA guidance that rely on functional interdependence appear to confuse the contiguous or adjacent factor with a support facility analysis. In the 1980 PSD Preamble, the concept of functional interdependence is implied from EPA’s discussion of support facilities. As previously discussed, facilities must be part of the “same industrial grouping,” in addition to satisfying the other two regulatory criteria, to be aggregated. EPA considers facilities to be in the same industrial grouping if they share the same SIC code. However, EPA explicitly rejected classifying industrial grouping based solely on “functional interrelationships” because, “to have merely added function to the proposed definition as another abstract factor would have reduced the predictability of aggregating activities under that definition dramatically, since any assessment of functional interrelationships would be highly subjective.”<sup>181</sup> Accordingly, to promote predictability and consistency, EPA utilizes SIC codes to objectively determine if facilities are part of the same industrial grouping.

EPA only alludes to an analysis of the relationship between facilities when it must determine if the facilities are part of the same industrial grouping but have different SIC codes. The 1980 PSD Preamble states, “[w]here a single unit is used to support two otherwise distinct sets of activities, the unit is to be included within the source which relies most heavily on its support.”<sup>182</sup> This necessarily entails an analysis of the relationship between the support facility and the primary pollutant-emitting activity. However, a support facility analysis is only relevant when determining whether facilities are part of the same industrial grouping and do not share the same SIC code. The support facility must also meet the two other regulatory criteria, i.e., (contiguous or adjacent and common control) to be aggregated with the primary facility. In fact, the EPA Administrator acknowledges this in her Order Denying Petition for Objection to

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181. Requirements for Preparation, Adoption, and Submittal of Implementation Plans: Approval and Promulgation of Implementation Plans, 45 Fed. Reg. at 52,695.

182. *Id.*

Permit the Frederick Compressor Station operating permit.<sup>183</sup> Nowhere in the 1980 PSD Preamble did EPA prescribe the use of functional interdependence, except to imply that it could be used in a support facility analysis. The 1980 PSD Preamble expressly rejected it otherwise.

Furthermore, Congress specifically prohibited oil and gas exploration and production facilities from being aggregated for the purpose of defining a major source under the section 112 program for hazardous air pollutants (HAPs).<sup>184</sup> Consistent with this statutory mandate, EPA has expressly determined that oil and gas field production facilities do not fit within the profile of a typical industrial facility.<sup>185</sup> Because of the unique geographical and operational complexities inherent to the oil and oil gas industry, EPA looks to the surface site when determining whether to aggregate exploration and production facilities for section 112 purposes. In its proposed rule for Oil and Gas MACT Standards, EPA stated, “[b]ecause the term surface site is well understood within the industry and easily recognizable by enforcement authorities, a facility definition on this basis should be easily implementable. For these reasons, the EPA is proposing a facility definition based on surface site.”<sup>186</sup> Accordingly, for section 112 major source determinations, EPA promulgated the definition of “facility,” which provides, “[p]ieces of production equipment or groupings of equipment located on different oil and gas leases, mineral fee tracts, lease tracts . . . [or separate surface sites, whether or not connected by a road, waterway, power line or pipeline], shall not be considered part of the . . . facility.”<sup>187</sup> EPA’s statement closely resembles the 1980 PSD Preamble’s rejection of functional interdependence in order to avoid

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183. *See in re Anadarko Petroleum Corp.*, No. VIII-2010-4, 2011 WL 3533365, at \*16-17 (EPA 2011).

184. *See* 42 U.S.C. § 7412 (2006).

185. *See* National Emission Standards for Hazardous Air Pollutants: Oil and Natural Gas Production and Natural Gas Transmission and Storage, 63 Fed. Reg. 6288, 6303 (Feb. 6, 1998) (to be codified at 40 C.F.R. pt. 63).

186. *Id.*

187. National Emission Standards for Hazardous Air Pollutants: Oil and Natural Gas Production and National Emission Standards for Hazardous Air Pollutants: Natural Gas Transmission and Storage, 64 Fed. Reg. 32,610, 32,630 (June 17, 1999) (to be codified at 40 C.F.R. pt. 63).

embroiling the Agency in “highly subjective” “fine-grained” analyses that would drain its resources.<sup>188</sup>

Moreover, in section 112(a)(3), Congress defined “stationary source” as having the same meaning the definition has under Section 111(a) for the NSPS program.<sup>189</sup> Similarly, the D.C. Circuit in *Alabama Power* held that the “applicable definition” for “source” under the PSD program “is provided in section 111.”<sup>190</sup> Accordingly, the definitions for “stationary source” under the NSR, NSPS and HAPs programs include the four component terms “any building, structure, facility, or installation.” This does not necessarily mean that EPA’s regulatory definitions of the four statutory terms for “source” must be identical for separate and distinct regulatory programs under the CAA. EPA has discretion to define statutory terms to carry out the purposes of the CAA.<sup>191</sup> However, EPA must define terms reasonably and it is significant that EPA defines oil and gas sources differently for HAPs than PSD review.

As expressed in the 1980 PSD Preamble and the Oil and Gas MACT Standards, EPA defined “source” in a manner that would simplify application of the definition for industry and permitting authorities and avoid a highly subjective fine-grained analysis. In contrast to EPA’s regulatory definitions, which underwent public notice and comment, the concept of functional interdependence arose over time through various EPA office’s case-by-case determinations and guidance documents. The text of EPA’s regulatory definition of source for PSD and the associated 1980 PSD Preamble provides no notice to industry that facilities will be considered contiguous or adjacent if they are functionally interdependent. Moreover, EPA looks solely to the physical distance and proximity of surface sites when determining whether oil and gas exploration and production facilities are

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188. Requirements for Preparation, Adoption, and Submittal of Implementation Plans: Approval and Promulgation of Implementation Plans, 45 Fed. Reg. 52,676, 52,695 (Aug. 7, 1980) (to be codified at 40 C.F.R. pts. 51, 52, & 124).

189. 42 U.S.C. § 7412.

190. *See* *Ala. Power Co. v. Costle*, 636 F.2d 323, 396 (D.C. Cir. 1979).

191. *Id.* (“EPA has discretion to define the terms reasonably to carry out the intent of the Act, but not go clear beyond the scope of the Act, as it has done so here.”).

contiguous or adjacent under the HAPs program. Similarly, the HAPs program contains the same four component terms for “stationary source” as the PSD program.<sup>192</sup> Therefore, it should be reasonable to infer that EPA will treat oil and gas exploration and production facilities similarly under the PSD program.

As mentioned above, previous EPA guidance documents indicate that proximity is a factor in a contiguous or adjacent analysis. However, the issue of proximity is framed as being only one factor in a broader functional interdependence analysis. That is, EPA evaluates proximity to determine whether facilities are close enough to be functionally interdependent. However, if this was EPA’s intention when it promulgated the three-part definition of source, it would have either listed functional interdependence as a factor or explained that proximity was one factor that should be used in a functional interdependence analysis to determine whether facilities are contiguous or adjacent. But this is not the case. EPA expressly rejected functional interdependence in the 1980 PSD Preamble and did not define “contiguous or adjacent” in terms other than the plain meaning.

Therefore, EPA’s practice of analyzing functional interdependence to determine if oil and gas facilities are contiguous or adjacent for NSR and Title V purposes is unreasonable. The plain meaning of “contiguous or adjacent” unambiguously connotes physical distance and proximity, and the 1980 PSD Preamble and subsequent regulations do not indicate otherwise. Conversely, the concept of functional interdependence arose through EPA case-by-case determinations and guidance documents that were not scrutinized under the public notice and comment requirements for agency regulations under the APA. Although the regulatory term “adjacent” is slightly ambiguous because it does not provide for a specific distance, EPA may not read a plainly inconsistent meaning, such as “interdependence,” into a term that is not otherwise defined. Accordingly, a reviewing court might not give deference to an EPA source determination that relies on functional interdependence to

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192. *C.f.* 42 U.S.C. § 7412 (a)(3) and *Ala. Power Co. v. Costle*, 636 F.2d 323, 396 (D.C. Cir. 1979) (holding that the “applicable definition” for “source” under the PSD program “is provided in section 111”).

determine whether oil and gas exploration and production facilities are contiguous or adjacent.

### **B. EPA's Interpretation Requires Notice and Comment Rulemaking**

Section 553 of the APA establishes a general default rule that requires administrative rulemaking to “observe the notice-and-comment process.”<sup>193</sup> However, the act expressly allows agencies to issue certain types of rules without providing for any form of public participation including “general statements of policy” and “interpretive rules.”<sup>194</sup> “[P]olicy statements . . . [and interpretive rules] assume a variety of forms and . . . [are issued] under . . . [different] titles, such as ‘guidance,’ ‘memoranda,’ ‘manuals,’ ‘policy letters,’ ‘press releases,’ ‘staff instructions,’ ‘bulletins’ and the like.”<sup>195</sup> These types of documents “serve two basic functions.”<sup>196</sup> First, they promote administrative consistency by providing guidance to agency personnel on how to apply an ambiguous regulation.<sup>197</sup> Second, the documents are a tool “agencies [can use] to inform . . . the public of administrative policies and legal interpretations before the agency acts on them.”<sup>198</sup>

Policy statements and interpretive rules differ characteristically from the legislative, or “substantive” rules for which the APA requires notice and comment rulemaking.<sup>199</sup> The distinguishing characteristic is that “like a statute, [legislative rules] regulate[] private conduct with ‘the force and effect of law.’”<sup>200</sup> “If valid . . . [legislative rules] create legally enforceable rights for or impose legal obligations on members of the public,

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193. WERHAN, *supra* note 144, at 249.

194. 5 U.S.C. § 553(b)(A)(2006).

195. WERHAN, *supra* note 144, at 250.

196. *Id.* at 253.

197. *Id.*

198. *Id.*

199. *Id.* at 250. The APA uses the term “substantive rule” in section 553(d), but the Act does not use the term “legislative rule.” However, the two terms are often used interchangeably in administrative law. *Id.* at 250 n.3.

200. *Id.* (citing TOM C. CLARK, ATTORNEY GENERAL, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT, at 30 n.3 (1947)).



[as well as] . . . bind the agency and . . . courts . . . .”<sup>201</sup> Because of the legislative nature of these rules, Congress requires public participation before they are adopted by an agency.<sup>202</sup> In contrast, “[s]ubstantive rights are not at stake’ in the same way [as] when [an] agenc[y] issue[s] [an] . . . [i]nterpretive rule[] [or a] . . . policy statement[] . . . because [these types of documents] . . . ‘lack the force of law’.”<sup>203</sup> Thus, the APA does not require public notice and comment procedures for policy statements and interpretive rules. Accordingly, “[r]eviewing courts distinguish legislative rules . . . from [policy statements or interpretive rules by utilizing variations of a ‘legal effects’ test,] “depending on whether the agency claims . . . [the document at issue] is a policy statement or an interpretive rule.”<sup>204</sup>

Rather than the guidance document that it purports to be, the McCarthy Memo is a legislative rule that requires notice and comment rulemaking. Functional interdependence is not an expressed element in EPA’s three-part definition of “source.” Furthermore, as discussed in the previous section, the concept cannot reasonably be inferred from the meaning of “contiguous or adjacent,” as set out in the 1980 PSD Preamble and subsequent regulations. However, the McCarthy Memo adds functional interdependence as requirement to the definition of stationary source. In doing so, the McCarthy Memo constitutes final agency action that is subject to judicial review. Accordingly, notwithstanding whether EPA considers the McCarthy Memo to be a non-binding policy statement or an interpretive rule, the Memo could be challenged in court because adding functional interdependence to a contiguous or adjacent analysis requires notice and comment rulemaking.

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201. WERHAN, *supra* note 144, at 251.

202. *Id.*

203. *Id.* at 250 (*citing* TOM C. CLARK, ATTORNEY GENERAL, ATTORNEY GENERAL’S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT, 30 n.3 (1947)).

204. *Id.* at 251.

### 1. The McCarthy Memo Constitutes Final Agency Action

Before reaching the issue of whether the McCarthy Memo is a non-binding guidance document or a legislative rule requiring notice and comment rulemaking, a reviewing court must determine whether the document constitutes “final agency action.” The APA only authorizes lawsuits challenging “final agency action.”<sup>205</sup> Consequently, the U.S. Supreme Court has devised a two-part test to determine whether an agency action is final, and thus subject to judicial review. First, the agency action must be “the consummation of the agency’s decisionmaking process.”<sup>206</sup> If the agency’s action “is tentative or interlocutory,” it is not final.<sup>207</sup> Second, if the administrative process is complete, the agency action must determine “rights or obligations” or have some other kind of “legal consequences” to be final.<sup>208</sup>

The McCarthy Memo is not tentative or interlocutory. The Memo provides explicit instructions to state permitting authorities and EPA Regional Offices on how they should apply the three regulatory criteria for the definition of “source.”<sup>209</sup> Even though the Memo could be subject to change (after all, it revoked the Wehrum Memo), a reviewing court could still consider it to be the completion of the administrative process.<sup>210</sup> As stated by the D.C. Circuit when holding a guidance document to be a final agency action, “the fact that a law may be altered in

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205. 5 U.S.C. § 704 (2006).

206. *See* *Bennet v. Spear*, 520 U.S. 154, 178 (1997).

207. *Id.*

208. *Id.*

209. *See* McCarthy Memo, *supra* note 55, at 2. *See also id.* (“I withdraw the [Wehrum Memo], and direct permitting authorities to the three criteria for making source determinations specified in the existing NSR regulations. Regional Offices should continue to review and comment on source determinations to assure that permitting authorities conduct fully-reasoned source determinations that remain consistent with existing regulatory requirements and historical permitting practice.”).

210. *See* *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1022 (D.C. Cir. 2000) (also providing that “EPA may think that because the Guidance in all its particulars, is subject to change, it is not binding and therefore not final action . . . But all laws are subject to change.”).

the future has nothing to do with whether it is subject to judicial review at the moment.”<sup>211</sup> Thus, the McCarthy Memo marks the consummation of EPA’s decision-making process regarding the three-part regulatory definition of “source.”

Accordingly, the second issue a reviewing court will consider is whether the McCarthy Memo determines or affects individual rights or obligations. As discussed in the previous section, only legislative rules (e.g., regulations) that an agency promulgates in accordance with the procedures set out in the APA have the “force and effect of law.” As such, courts may only review a guidance document if it has an effect similar to a legislative rule, which is legally binding on an agency and the courts.

The D.C. Circuit confronted this precise issue in *Appalachian Power*.<sup>212</sup> In that case, the court of appeals reviewed the validity of an EPA guidance document entitled “Periodic Monitoring Guidance.” Under its authority granted by the CAA, EPA promulgated a regulation requiring certain states to include “periodic monitoring” as a condition in a stationary source’s Title V operating permit.<sup>213</sup> Subsequently, EPA issued the disputed guidance document, which elaborated the “periodic monitoring” requirements.<sup>214</sup> In the document, EPA instructed its personnel to follow the guidance when reviewing permits, and insisted that state and local permitting authorities comply with the guidance document when establishing the terms and conditions of the Title V permit.<sup>215</sup> EPA argued that its guidance document was not final because it was not binding.<sup>216</sup> However, the court of appeals disagreed:

If an agency acts as if a document issued at headquarters is controlling in the field, if it treats the document in the same manner as it treats a legislative rule, if it bases enforcement actions on the policies or interpretations formulated in the document, if it leads private parties or State permitting authorities to believe that it will declare permits invalid unless

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211. *Id.*

212. *Id.*

213. *Id.* at 1017-18.

214. *Id.* at 1019-20.

215. *Id.* at 1022.

216. *Appalachian Power Co.*, 208 F.3d at 1020.

they comply with the terms of the document, then the agency's document is for all practical purposes "binding."<sup>217</sup>

Under these premises, the court of appeals determined that "[the guidance document] . . . reads like a ukase. It commands, it requires, it orders, it dictates. Through the Guidance, EPA has given the States their 'marching orders' and EPA expects the States to fall in line."<sup>218</sup> Accordingly, the D.C. Circuit held the guidance document constituted final agency action because it "reflect[ed] a settled agency position which has legal consequences both for State agencies administering their permit programs and for companies . . . [that] must obtain Title V permits in order to continue operating."<sup>219</sup>

One could argue that the McCarthy Memo is a non-binding guidance document that does not have legal consequences. The memo states that it withdraws the Wehrum Memo, and instead "re-emphasi[z]es the fundamental criteria for making source determinations as specified in [EPA's] existing NSR regulations, explained in the preamble to [EPA's] 1980 promulgation of those regulations and demonstrated through historical practice in making source determinations in these programs."<sup>220</sup> Thus, it would seem that the McCarthy Memo is merely a non-binding guidance document because it purports to do no more than require permitting authorities to apply the criteria set forth in the regulations and Preamble.

However, upon closer examination, the McCarthy Memo implicitly adds the requirement of functional interdependence. The McCarthy Memo points to prior EPA "case-by-case determinations [that] illustrate the kind of reasoned decision-making that is necessary to justify adequately a permitting authority's source determination decision."<sup>221</sup> However, as previously discussed, these prior determinations evaluate the functional interdependence between facilities to determine

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217. *Id.* at 1021 (citing Robert A. Anthony, *Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like- Should Federal Agencies Use them to Bind the Public?*, 41 DUKE L.J. 1311, 1328-29 (1992)).

218. *Id.* at 1023.

219. *Id.*

220. McCarthy Memo, *supra* note 55, at 1.

221. *Id.* at 2.

whether they are contiguous or adjacent. Moreover, the memo explains, “After conducting the necessary analysis, it may be that, in some cases, ‘proximity’ may serve as the overwhelming factor in a permitting authority’s source determination decision. However, such a conclusion can only be justified through reasoned decision making after examining whether *other factors* are relevant to the analysis.”<sup>222</sup> Here, the memo unequivocally states that proximity is not the sole factor used to determine whether facilities are contiguous or adjacent, as the plain meaning and 1980 PSD Preamble would suggest. Instead, the memo implies that proximity is one factor in a broader functional interdependence analysis for the contiguous or adjacent requirement. Therefore, the McCarthy Memo either adds a fourth requirement to the definition of source, or expands the contiguous or adjacent criteria beyond the plain meaning prescribed by the regulation and 1980 PSD Preamble.

Consequently, the McCarthy Memo consummates EPA’s position that functional interdependence is an added requirement for a permitting authority’s source determination. As in *Appalachian Power*, this added requirement has legal consequences for state permitting authorities and companies that must obtain construction and operating permits. The McCarthy memo concludes by stating:

I withdraw the [Wehrum Memo] . . . and direct permitting authorities to the three criteria for making source determinations specified in the existing NSR regulations. Regional Offices should continue to review and comment on source determinations to assure that permitting authorities conduct fully-reasoned source determinations that remain consistent with existing regulatory requirements and historical permitting practice.<sup>223</sup>

This passage is significant for two reasons. First, in the context of the memo, the instruction to make “fully-reasoned source determinations . . . consistent with . . . historical permitting practice”<sup>224</sup> implies that state and local permitting authorities

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222. *Id.* (emphasis added).

223. *Id.*

224. *Id.*

must use the concept of functional interdependence instead of relying solely on proximity to determine if facilities are contiguous or adjacent. Second, the memo essentially directs EPA Regional Offices to reject state or local source determinations that do not use functional interdependence. This is illustrated in the previously discussed source determinations in *MacClarence* and *In re Anadarko*,<sup>225</sup> where EPA did in fact overturn the state permitting authorities' initial decisions because they based their contiguous or adjacent determinations on proximity rather than functional interdependence. Also, as discussed in *Summit*,<sup>226</sup> EPA Region 5 rejected Summit's proximity argument to conclude that its wells and gas sweetening plant were functionally interdependent. Each of the EPA Regional Offices in *MacClarence*, *In re Anadarko*, and *Summit* cite the McCarthy Memo as a basis for their decisions. Moreover, as demonstrated by the Wyoming, Oklahoma, Louisiana, and Texas source definitions, the States prefer to use proximity as the primary factor when determining whether a source is contiguous or adjacent, and appear to only reticently provide for functional interdependence in order to acknowledge the McCarthy Memo. Therefore, as in *Appalachian Power*, the McCarthy Memo commands, requires, orders, and dictates. It gives the States their "marching orders" to fall in line with functional interdependence. Like a legislative rule, it is a binding document from which legal consequences will follow. The McCarthy Memo obligates state and local permitting authorities to follow its guidance, and affects the individual rights of companies seeking a NSR or Title V permit.

Accordingly, by revoking the Wehrum Memo, the McCarthy Memo is a binding document that consummates EPA's position on the definition of "stationary source," which goes beyond the scope of the regulations to require functional interdependence as a factor in source determinations.<sup>227</sup> As a result, the memo determines rights and obligations, constituting final agency action that is subject to judicial review.

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225. See *supra* Parts III-D-1 & 3.

226. See *supra* Part III-D-2.

227. See McCarthy Memo, *supra* note 55

## 2. Functional Interdependence Requires Notice and Comment Rulemaking

The McCarthy Memo interprets the regulatory definition of stationary source to include functional interdependence. However, the memo does not state whether it purports to be a policy statement or an interpretive rule. Policy statements are “issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary function.”<sup>228</sup> On the other hand, interpretive rules are “issued by an agency to advise the public of the agency’s construction of the statutes and rules which it administers.”<sup>229</sup> Because of the distinctions between policy statements and interpretive rules, courts sometimes use slightly different analyses for distinguishing the two types of guidance documents from legislative rules that require public notice and comment.<sup>230</sup> However, the McCarthy memo does not present this issue. As explained by the D.C. Circuit in *Appalachian Power*:

[W]hatever EPA may think of its guidance generally, the elements of the Guidance petitioners challenge consist of the agency’s settled position, a position it plans to follow in reviewing State-issued permits, a position it will insist State and local authorities comply with in setting the terms and conditions of permits issued to petitioners, a position EPA officials in the field are bound to apply.<sup>231</sup>

Accordingly, the court of appeals analyzed the guidance document at issue as if it was an interpretive rule.<sup>232</sup> Similarly, a court challenge of the McCarthy Memo should pertain to EPA’s settled position that functional interdependence is a requirement for source determinations, a position the McCarthy Memo instructs permitting authorities to follow and for EPA Regional Offices to

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228. WERHAN, *supra* note 144, at 253 (quoting *Attorney General’s Manual on the Administrative Procedure Act*, at 30 n.3 (1947), reprinted in WILLIAM F. FUNK, ET AL., *FEDERAL ADMINISTRATIVE PROCEDURE SOURCEBOOK* 33-171 (3d ed. 2000)).

229. *Id.* at 257.

230. *Id.* at 253.

231. *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1022 (D.C. Cir. 2000).

232. *Id.* at 1024.

review in state-issued permits. Thus, the issue is whether the McCarthy Memo's *interpretation* of the regulatory definition of "stationary source" requires the public notice and comment procedures required under the APA.

Whether a particular agency guidance document is legislative rule requiring notice and comment or an interpretive rule exempt from such requirements is a highly fact-specific inquiry.<sup>233</sup> The central inquiry is whether the guidance document itself creates or modifies a legal right or obligation or merely explains or clarifies provisions in a regulation.<sup>234</sup> The guidance document may do no more than "spell[] out a duty fairly encompassed within the regulation that the interpretation purports to construe."<sup>235</sup> In other words, a reviewing court will uphold an agency interpretation if it "supplies crisper and more detailed lines than the authority being interpreted" without creating a new and distinct standard of conduct.<sup>236</sup> Accordingly, a reviewing court should compare the language of the regulation or statute with the agency's interpretation: "The distinction between an interpretive rule and [a legislative] rule more likely turns on how tightly the agency's interpretation is drawn linguistically from the actual language of the statute or rule."<sup>237</sup>

The D.C. Circuit scrutinized an agency's interpretation of a regulation in an influential case, *Paralyzed Veterans of America v. D.C. Arena L.R.* In *Paralyzed Veterans*, the Americans with Disabilities Act contained an ambiguous provision that required certain newly constructed facilities to be "readily accessible to and usable by individuals with disabilities."<sup>238</sup> Under its rulemaking authority granted by the Act, the Justice Department promulgated a regulation requiring newly constructed facilities to include wheelchair seating that provided "lines of sight

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233. *American Hospital Ass'n v. Bowen*, 834 F.2d 1037, 1045 (D.C. Cir. 1987).

234. *Id.* at 1045.

235. *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 588 (D.C. Cir. 1997).

236. *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

237. *Paralyzed Veterans of America*, 117 F.3d at 588.

238. *Id.* at 580 (internal quotations omitted, quoting 42 U.S.C. § 12181(a)(1) (1994)).



comparable to those for members of the general public.”<sup>239</sup> Subsequently, in a manual published without public notice and comment, the Justice Department interpreted “lines of sight comparable” to require sightlines over standing spectators in circumstances such as a sports arena, where spectators can be expected to stand at times.<sup>240</sup> The court of appeals found that the interpretation in the manual had been “driven by the actual meaning [the Justice Department] ascribe[d] to the phrase ‘lines of sight comparable.’”<sup>241</sup> Thus, the legal basis of the Justice Department’s interpretation was the legislative rule it had issued pursuant to public notice and comment. Stated differently, “the government arguably could have relied on the regulation itself, even without the manual interpretation, to seek lines of sight over standing spectators.”<sup>242</sup> Accordingly, the D.C. Circuit held that the Justice Department’s interpretation was “not sufficiently distinct or additive to the regulation to require notice and comment.”<sup>243</sup>

On the other hand, in *Appalachian Power*, the D.C. Circuit set aside EPA’s Periodic Monitoring Guidance because it improperly revised prior EPA regulations without following proper notice and comment rulemaking procedures. In that case, EPA promulgated a regulation providing for monitoring and testing of stationary sources. Specifically, the regulation at issue required “periodic monitoring” as a condition to a source’s Title V operating permit when the applicable state or federal emissions standard for a particular source did not provide for “periodic testing or instrumental or noninstrumental monitoring.”<sup>244</sup> The heart of the issue was the ambiguous definition of “periodic monitoring,” and what the term required. The disputed guidance document interpreted “periodic monitoring” to require states to evaluate the adequacy of all monitoring requirements, and that states must require additional monitoring if the existing monitoring requirements did not provide the “necessary

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239. *Id.* at 581 (quoting 28 C.F.R. § 36 app. A (1996)).

240. *Id.* at 582.

241. *Id.* at 588 (citing *Am. Mining Cong.*, 995 F.2d at 1112).

242. *Paralyzed Veterans of Am.*, 117 F.3d at 588.

243. *Id.*

244. *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1017-18 (D.C. Cir. 2000).

assurance of compliance.”<sup>245</sup> However, Petitioners argued that if “periodic monitoring” had its usual meaning, any emission standard requiring monitoring or testing “from time to time – that is yearly, monthly, weekly, daily, or hourly – would be satisfactory,” and that the regulation required no further re-evaluation of the monitoring or testing requirements to ensure compliance with applicable air quality standards.<sup>246</sup> The court of appeals examined the language of the regulation and the guidance document and concluded that the regulation did not require states to revise existing monitoring requirements *in addition to* creating periodic monitoring requirements for emission standards that lacked recurring monitoring requirements.<sup>247</sup>

In support of its conclusion, the D.C. Circuit in *Appalachian Power* found that EPA’s interpretation of the regulation in the guidance document was inconsistent with other statements EPA made at the time the Title V regulations were promulgated.<sup>248</sup> First, the court of appeals observed that in response to comments in the Title V regulations preamble, EPA stated that if there was “any federally promulgated requirement with insufficient monitoring, EPA will issue a rulemaking to revise such requirement.”<sup>249</sup> However, the court of appeals noted that instead of promulgating a new rule as promised, EPA issued the guidance document without public notice and comment.<sup>250</sup> Second, the court of appeals pointed out that the Title V permit regulations state, “Title V does not impose substantive new requirements.”<sup>251</sup> The court of appeals found that:

Test methods and the frequency of testing for compliance with emission limitations are surely “substantive” requirements; they impose duties and obligations on those who are regulated . . . We have recognized before that changing the method of measuring

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245. *Id.* at 1025.

246. *Id.* at 1024.

247. *Id.* at 1028.

248. *Appalachian Power Co.*, 208 F.3d at 1024-27.

249. *Id.* at 1025.

250. *Id.* at 1024.

251. *Id.* at 1026 (quoting 40 C.F.R. § 70.1(b) (2000)).

compliance with an emission limitation can affect the stringency of the limitation itself.<sup>252</sup>

Accordingly, the court of appeals found that regulatory history failed to demonstrate that the rule at issue “initially had the broad scope the Guidance now ascribes to it.”<sup>253</sup> Because the guidance document required states to re-evaluate existing monitoring requirements, it created new substantive requirements contrary to the Title V regulations and associated preamble. Thus, the D.C. Circuit struck down the Periodic Monitoring Guidance in its entirety.<sup>254</sup>

Similar to *Appalachian Power*, the regulatory history of the definition of source, as illustrated by the 1980 PSD Preamble and the text of the regulation itself, conflicts with subsequent EPA applications of functional interdependence to determine if facilities are contiguous or adjacent. By prescribing the use of functional interdependence, the McCarthy Memo either mistakenly concludes that the three criteria for “source” are interchangeable, unreasonably expands the definition of “contiguous or adjacent” beyond the plain meaning denoted in the regulatory history, or erroneously adds a fourth criterion not expressed in the text of the regulation.

Therefore, the McCarthy Memo does not “suppl[y] crisper and more detailed lines” than the regulatory definition of source.<sup>255</sup> It creates a new and distinct standard of conduct. Accordingly, unlike the guidance manual at issue in *Paralyzed Veterans*, the McCarthy Memo’s implicit requirement of functional interdependence for source determinations is “sufficiently distinct or additive to the regulation to require notice and comment.”<sup>256</sup>

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252. *Appalachian Power Co.*, 208 F.3d at 1027 (citing *Portland Cement Ass’n v. Ruckelshaus*, 486 F.2d 375, 396-97 (D.C. Cir. 1973)).

253. *Id.* at 1026.

254. *Appalachian Power Co.*, 208 F.3d at 1028.

255. *See Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

256. *See Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 588 (D.C. Cir. 1997).

## VI. NEW SOURCE REVIEW CIRCUMVENTION

When an operator of an oil and gas facility decides to construct a new facility or modify an existing facility that emits regulated air pollutants, it must determine what type of permit to obtain for said facility. New or modified sources with low emission levels might only require a state minor source permit, while sources with emissions that exceed CAA major source thresholds would require NSR. However, determining which permitting path to follow becomes more complicated when functionally interdependent sources are aggregated.

### A. Modifications to an Existing Major Source

Aggregation of oil and gas exploration and production facilities on a large scale basis can result in unintended consequences. For example, assume a natural gas production field is located in an area designated attainment for all criteria pollutants. A permitting authority decides to aggregate all of the emissions activities for one operator within the entire natural gas field for PSD review and Title V permitting purposes. This means all of the gas wells, compressor stations, combustion equipment, separator tanks, etc. are aggregated into a single source. Individually, the above-described emissions activities do not exceed major source thresholds, but they do collectively.

Under the CAA, PSD review applies, among other circumstances, when a major source proposes to undergo a modification (i.e. a physical change or change in method of operation)<sup>257</sup> that will result in both (1) a defined “significant emissions increase” of a regulated NSR pollutant; and (2) a significant “net emissions increase” of that pollutant from the major source.<sup>258</sup>

Accordingly, the first step in determining if PSD review applies is to determine what emissions increases, without considering decreases, will be associated with the proposed modification. Modifications that do not result in emissions increases above established significance levels generally do not

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257. See 40 C.F.R. § 51.21(b)(2)(iii).

258. See 40 C.F.R. §§ 52.21(b)(2), (b)(3), (b)(23), (b)(40), and (b)(50).

have to undergo PSD review. State regulations typically define significance levels, but some of the federal standards are as follows: Carbon Monoxide – 100 tpy; Nitrous Oxides – 40 tpy; Sulfur dioxide – 40 tpy; Ozone – 40 tpy of VOCs, etc.<sup>259</sup> In the above-described hypothetical facts, many of the emissions activities would not exceed these significance levels. Thus, over time, the operator could add a natural gas well, build a new separator tank, and the like, thereby increasing the overall emissions levels for the aggregated single “major source” without ever triggering PSD review.

Furthermore, under the second step of PSD review, if there is a significant emissions increase, the operator must determine if the proposed modification will result in a “net” emissions increase.<sup>260</sup> The emissions netting analysis is a complex process, but can be summarized as follows. A net emissions increase equals: all emissions increases associated with the modification, minus all source-wide creditable contemporaneous emissions decreases, plus all source-wide creditable contemporaneous increases.<sup>261</sup>

There are many complex nuances for each of the netting requirements, but in the end, if the net emissions increase does not exceed a significance level for one of the listed pollutants, PSD review does not apply. Thus, even if one of the operator’s proposed modifications exceeded a significant emissions level, the operator could still avoid PSD review by netting out emissions decreases from other emissions units within the single aggregated source.

### **B. Circumvention**

Although it seems as if the operator in the above-described hypothetical could increase his overall emissions levels without triggering NSR, the operator may not avoid NSR by breaking a single project into smaller minor projects to avoid significant emissions thresholds for PSD review. In a June 28, 1989 Federal Register notice, EPA stated that it is not only improper, but also

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259. 40 C.F.R. § 52.21(b)(23)(i).

260. *See* 40 C.F.R. § 52.21(b)(3).

261. *See id.*

a violation of the CAA to construct a source or major modification with a minor source permit when there is intent to operate as a major source.<sup>262</sup> EPA went on to state:

It is not possible to set forth, in detail, the circumstances in which EPA considers an owner or operator to have evaded preconstruction review in this way, and thus subjected itself to enforcement sanctions under sections 113 and 167 from the beginning of construction. This is ultimately a question of intent. However, EPA will look to objective indicia to establish that intent.<sup>263</sup>

Thus, EPA considers a deliberate attempt to circumvent the NSR process to be a sham permit application, which can result in civil and criminal penalties.

Although EPA could not define what particular circumstances would lead to a circumvention determination, the Agency expressed that the central inquiry would be intent. Factors establishing intent have been set out in an influential EPA memorandum regarding 3M's Maplewood research and development facility (the "3M Maplewood Memo"). In the memo, EPA explains the criteria it will consider when determining whether a source is circumventing major NSR by obtaining minor source permits for its modifications:

1. Filing of more than one minor source or minor modification application associated with emissions increases at a single plant within a short period of time.
2. Application of [the source's] funding [to the project].
3. Reports of consumer demand and projected production levels.
4. Statements of authorized representatives of the source regarding plans for operation.
5. EPA's own analysis of the economic realities of the projects considered together.<sup>264</sup>

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<sup>262</sup> Requirements for the Preparation, Adoption, and Submittal of Implementation Plans; Approval and Promulgation of Implementation Plans, 54 Fed. Reg. 27,274, 27,281 (June 28, 1989) (codified at C.F.R. pts. 51 and 52).

<sup>263</sup> *Id.*

<sup>264</sup> Memorandum from John B. Rasnic, Director, Office of Air Quality Planning and Standards, to George T. Czerniak, Chief, Air Enforcement Branch, EPA Region 5, *Applicability of New Source Review Circumvention Guidance to*

The 3M Maplewood Memo is referenced in numerous other EPA circumvention determination memos and guidance documents, and currently represents EPA's stance regarding circumvention.<sup>265</sup>

However, similar to the concept of functional interdependence in source determinations, the factors described in the 3M Maplewood Memo evolved over time through case-by-case applicability determinations and guidance documents. In 2006, EPA proposed a circumvention rule in order to clarify and simplify the determination process, and the rule was finalized in 2009.<sup>266</sup> However, in 2010, EPA delayed the effective date of the final rule indefinitely. Thus, EPA will likely continue to use the factors expressed in the 3M Maplewood Memo in the foreseeable future.

### C. Circumvention Applied to Oil and Gas Facilities

EPA's NSR circumvention policy could have significant implications for the oil and gas industry if EPA continues to apply functional interdependence to its aggregation analysis. Once a group of interdependent oil and gas facilities are aggregated, operators of the aggregated facilities would need to be concerned about whether they are circumventing NSR every time they decide to drill a new well, build a tank, or add some other kind of small emissions unit. When the operator decides to build or modify these types of facilities it must decide whether to undergo NSR or merely obtain a minor source permit for said facility.

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*3M – Maplewood, Minnesota* (June 1993), available at <http://www.epa.gov/ttn/nsr/gen/u3-18.txt> [hereinafter "3M Maplewood Memo"].

265. See Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NSR): Aggregation; Reconsideration, 75 Fed. Reg. 19567-01, 19570 (Apr. 15, 2010) (codified at 40 C.F.R. pts. 51 and 52) (citing Memorandum from Darryl Tyler, Director, EPA Office of Air Quality Planning and Standards, to David Kee, Director, Air Management Division, EPA Region 5, *Applicability of PSD to Portions of Plan Constructed in Phases Without Permits* (Oct. 21, 1986); Memorandum from Doug Cole, EPA, to Grant Cooper and Raymond McKay, *PSD Applicability for Frederick Power, L.P.* (Oct. 12, 2001)).

266. See Prevention of Significant Deterioration (PSD) and Nonattainment New Source Review (NSR): Aggregation and Project Netting, 74 Fed. Reg. 2376 (Jan. 15, 2009) (codified at 40 C.F.R. pts. 51 and 52).

Because obtaining a federal construction or operating permit is considered a rulemaking, an operator's facilities will be subject to public notice and comment if it chooses the NSR or Title V permitting path. As demonstrated by *MacClarence*, *Summit*, and *In re Anadarko*, attempting to obtain a federal permit entails a complicated analysis of a facilities' functional interdependence, and obtaining a permit can involve years of negotiations between the operator, state permitting authority, and EPA, not to mention delays from court challenges by environmental activist groups or concerned citizens. In the oil and gas industry, the issue of timing can mean the difference between a well getting drilled or not. Every oil and gas lease has a primary term that will expire at some point. As primary term expiration dates approach, lessees will have to weigh their options between state minor source permit requirements, federal permitting requirements, and the consequences of NSR circumvention.

## VII. CONCLUSION

As a result of EPA's application of functional interdependence to the contiguous or adjacent analysis of oil and gas facilities, operators of such facilities are faced with a difficult choice. As they develop oil and gas fields, operators have two options. They can obtain NSR or Title V permits for their functionally interdependent facilities and subject themselves to the complications and delays involved with the federal permitting requirements. On the other hand, an operator could choose to forego the federal requirements and apply for a straightforward state minor source permit. However, if operators choose the latter option, they should be wary of NSR circumvention. If the permitting authority believes the operator is circumventing the federal permitting requirements, a lengthy court battle will be inevitable and the operator risks severe fines and possible criminal liability.

So far, EPA has declined to apply functional interdependence to entire oil fields, but the broad concept could allow for such an interpretation. Moreover, the risk of NSR circumvention might force more operators to apply for federal construction and operating permits. This would present an obstacle to exploration and development activities as operators wait for permits and



production costs increase. Consequently, the current booming production rate that is one of few bright spots in our struggling economy would slow to a grinding pace with little or no added environmental benefit.

As in the cases discussed above, various courts have held that guidance is not a substitute for rulemaking. Neither the text of the regulatory definition of “stationary source” nor the 1980 PSD Preamble support the concept of functional interdependence as applied to a contiguous or adjacent analysis. Thus, if EPA continues to apply the standards set forth in the McCarthy Memo, oil and gas operators could respond with a court challenge. EPA should either produce a guidance document that articulates reliance on proximity as the primary factor in a contiguous or adjacent analysis, as reflected in the 1980 PSD Preamble, or subject its functional interdependence test to the notice and comment rulemaking procedures required under the APA.