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## The End of the “Functional Interdependence” Test?

### The U.S. Court of Appeals for the Sixth Circuit Rejects the “Functional Interdependence” Test for Source Aggregation Under the EPA’s Clean Air Act

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#### Introduction

On August 7, 2012, in *Summit Petroleum Corp. v. EPA*,<sup>1</sup> the United States Court of Appeals for the Sixth Circuit, in a 2-1 decision, rejected the U.S. Environmental Protection Agency’s (“EPA”) current position that “functional interdependence” should be a consideration in determining whether to aggregate the air emissions of two or more physically distant facilities for the purpose of regulation under the Clean Air Act (“CAA”).<sup>2</sup> In the past, EPA has evaluated functional interdependence to determine whether separate facilities are “adjacent” to one another, a requirement under EPA regulations. In rejecting EPA’s “functional interdependence” test, the Sixth Circuit directed EPA to limit its evaluation of “adjacency” to whether activities are located on physically proximate properties in accordance with the “ordinary, i.e., physical and geographical, meaning of that requirement.” *Summit* is an important decision for the oil and gas industry because source aggregation of multiple oil and gas wells can trigger the stringent requirements of the Prevention of Significant Deterioration (“PSD”), New Source Review (“NSR”), and Title V permit programs. Industry should closely monitor EPA’s response to the Sixth Circuit decision.

#### Statutory Background

Generally, the CAA subjects only “major sources” of air emissions to the stringent requirements of the PSD, NSR, and Title V programs.<sup>3</sup> Whether a source qualifies as “major” is based upon the quantity of pollutants that a source emits or has the potential to emit (the specific threshold can differ depending on the pollutant, the regulatory program, attainment status of the area, and type of facility at issue). Permitting agencies have often disagreed in their interpretations of what constitutes a single “source” of emissions under the CAA and EPA’s implementing regulations for the purpose of determining if the relevant pollution threshold has been exceeded. This disagreement has been particularly fierce with regard to whether oil and gas well pads should be considered to be part of the same “source” as a central oil or gas processing facility or compressor station.

<sup>1</sup> *Summit Petroleum Corp. v. U.S. Environmental Protection Agency*, Nos. 09-4348; 10-4572, 2012 WL 3181429 (Aug. 7, 2012).

<sup>2</sup> 42 U.S.C. §§ 7401-7671.

<sup>3</sup> See CAA §§ 165(a), 169(1), 42 U.S.C. §§ 7475, 7479(1); CAA § 172(c)(5), 42 U.S.C. § 7502(c)(5); CAA § 502(a), 42 U.S.C. § 7661a(a).

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The answer to this question is critical for oil and gas operators, because processing facilities often emit pollutants in quantities just below the thresholds that could trigger lengthy pre-construction permit review under the PSD program (in attainment areas) and/or the NSR program (in non-attainment areas). If included as part of the “source,” the individually minimal air emissions from multiple well pads can cause the “source” to exceed the thresholds. Facilities that become subject to the PSD program must install Best Available Control Technology (“BACT”) for all regulated pollutants the facility emits,<sup>4</sup> and those subject to the NSR program must install even more stringent Lowest Achievable Emission Rate (“LAER”) technology and obtain emissions offsets.<sup>5</sup> Additionally, any facility subject to either the PSD or NSR program, or that emits more than 100 tons per year of any regulated pollutant, must obtain and maintain a Title V operating permit.<sup>6</sup> Together, these requirements can mean the difference between a profitable project and one that is not worth pursuing.

### Regulatory Background

#### *EPA’s Regulations Defining “Source”*

The question at issue in *Summit Petroleum* – what constitutes a single “source” under the CAA? – has been brewing for several decades, with EPA and authorized permit-issuing states issuing varying and often conflicting decisions and guidance on the topic.

In 1980, EPA promulgated regulations for determining what constitutes a single “source” under the PSD program.<sup>7</sup> These regulations remain essentially unchanged today, and additional, substantively identical regulations now apply to single source determinations under the NSR and Title V programs as well.<sup>8</sup>

First, EPA has provided that “stationary source” means any “any *building, structure, facility, or installation* which emits or may emit any air pollutant subject to regulation under the Act.”<sup>9</sup> This definition is uncontroversial, mirroring the pertinent language of the statute itself.<sup>10</sup>

Second, EPA’s regulations provide three criteria that must be satisfied for multiple pollutant emitting activities to be considered part of the same “building, structure, facility, or installation”:

1. The sources must belong to the same industrial grouping, which is determined with reference to whether they have the *same primary SIC code*;
2. The sources must be located on one or more *contiguous or adjacent properties*, and;
3. The sources must be under *common control* of the same person or corporate entity.<sup>11</sup>

<sup>4</sup> CAA §§ 165(a)(4), 169(3), 42 U.S.C. §§ 7475(a)(4), 7479(3).

<sup>5</sup> CAA §§ 171(3), 173(a), 42 U.S.C. §§ 7501(3), 7503(a).

<sup>6</sup> CAA §§ 501(2), 502(a), 42 U.S.C. §§ 7661(2), 7661a(a); CAA § 302(j), 42 U.S.C. § 7602(j).

<sup>7</sup> See 45 Fed. Reg. 52676 (Aug. 7, 1980).

<sup>8</sup> See 40 C.F.R. §§ 51.165(a)(1)(ii), 51.166(b)(6), 52.21(b)(6), 70.2, 71.2.

<sup>9</sup> See, e.g., 40 C.F.R. § 51.166(b)(5).

<sup>10</sup> See CAA § 111(a)(3), 42 U.S.C. § 7411 (emphasis added) (defining “stationary source” for the purpose of EPA’s New Source Performance Standard (NSPS) program). In prior court decisions, this definition has been used as a guide to decipher the meaning of the term “source” for the purposes of the PSD and NANSR programs. See *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 860, 104 S.Ct. 2778, 2790 (1984); *Alabama Power Co. v. Costle*, 636 F.2d 323, 395 (D.C. Cir. 1979). The Title V program has a different starting point, defining “major source” as “any stationary source (or any group of stationary sources located within a contiguous area under common control)” that meets emissions thresholds established elsewhere in the CAA. CAA § 501(2), 42 U.S.C. § 7661(2).

<sup>11</sup> See, e.g., § 51.166(b)(6).

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The preamble to EPA’s 1980 regulations provides additional texture to the analysis. The preamble establishes that this three-part definition must be interpreted to (1) carry out reasonably the purposes of the PSD program, (2) approximate a common sense notion of a “plant,” and (3) avoid the aggregation of pollutant-emitting activities that as a group would not fit within the ordinary meaning of “building,” “structure,” “facility,” or “installation.”<sup>12</sup> These additional interpretive guidelines were necessitated by the D.C. Circuit’s interpretation of CAA in *Alabama Power Co. v. Costle*,<sup>13</sup> the court decision that spurred EPA’s 1980 regulatory revision.<sup>14</sup>

The 1980 preamble is also notable for its explicit rejection of a standalone factor that would have required EPA to consider “functional interrelationships” in single source determinations. EPA noted that consideration of functional interrelationships would have reduced predictability, lead to “highly subjective” determinations, and “embroiled the Agency in numerous, fine-grained analyses.”<sup>15</sup> Instead, EPA adopted the “same industrial grouping” factor, with its reliance on easily identifiable SIC codes, as a surrogate for function because of its “objectivity and relative simplicity.”<sup>16</sup> Importantly, this additional factor was meant to *limit* the universe of facilities that would be grouped together as a single major source. EPA was concerned that a definition that excluded any consideration of function “would group activities that ordinarily would be considered as separate,” contrary to the common sense notion of a plant.<sup>17</sup>

### *Functional Interdependence and the Meaning of “Adjacent”*

In the decades that followed, EPA allowed “functional interdependence” to creep back into single source determinations through evaluation of the “contiguous or adjacent” factor, expanding the number of sources subject to PSD, NSR, and Title V. EPA has issued many case-by-case decisions aggregating or recommending aggregation of physically distant sources, often separated by many miles, on the basis that functional connections were sufficient to establish adjacency, contrary to the plain meaning of that term.<sup>18</sup>

But in 2007, the Bush Administration EPA rejected this practice in the context of the oil and gas industry in a non-binding policy statement referred to as the “Wehrum Memorandum.”<sup>19</sup> The Wehrum Memorandum instructed EPA’s permit-issuing regional offices that physical proximity, rather than “operational dependence,” should drive the determination as to whether oil and gas activities are contiguous or adjacent: “Given the diverse nature of the oil and gas activities, we believe that proximity is the most informative factor in making source determinations for these industries. We do not believe that it is reasonable to aggregate well sit activities, and other production field activities that occur over large geographic distances, with the downstream processing plant into a single major stationary source.”<sup>20</sup>

<sup>12</sup> See 45 Fed. Reg. 52676, 52694-95 (Aug. 7, 1980).

<sup>13</sup> *Alabama Power Co. v. Costle*, 636 F.2d 323 (D.C. Cir. 1979).

<sup>14</sup> 45 Fed. Reg. 52676, 52694-95 (Aug. 7, 1980).

<sup>15</sup> *Id.* at 52695 (Aug. 7, 1980).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> See *Summit* at \*10 (listing EPA decisions broadly interpreting the term “adjacent”).

<sup>19</sup> Memorandum from William L. Wehrum, EPA Acting Assistant Administrator, to Regional Administrators, re: Source Determinations for the Oil and Gas Industries (Jan. 12, 2007).

<sup>20</sup> *Id.* at 3-4.

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The Obama Administration EPA reversed course in 2009, issuing the “McCarthy Memorandum.”<sup>21</sup> The McCarthy Memorandum withdrew the Wehrum Memorandum and its emphasis on proximity, but did not explicitly endorse consideration of functional dependence or any variation thereof. Instead, the McCarthy Memorandum re-emphasized the importance of the three primary criteria found in EPA’s regulations, as explained in the 1980 preamble and demonstrated through EPA’s historical case-by-case determinations. Notably, this change of policy occurred while EPA Region 5 was in the midst of determining whether Summit Petroleum’s facilities qualified as a single source.

EPA’s ambivalence with regard to the meaning of “adjacency” is reflective of the experience in states that are authorized to issue CAA permits on EPA’s behalf. For instance, in Pennsylvania, the Department of Environmental Protection (“PADEP”) issued differing interim guidance documents in quick succession in 2010 and 2011.<sup>22</sup> The currently effective PADEP guidance document emphasizes spatial proximity, rejects consideration of interdependence, and adopts a quarter-mile rule of thumb for deciding adjacency.<sup>23</sup>

The multiple and conflicting interpretations of the term “adjacent” as used in EPA’s regulations highlights the need for a firm judicial resolution of the very issue that was teed up for the Sixth Circuit in *Summit Petroleum*.

### What Happened in Summit

#### *Background*

Summit is the owner and operator of a natural gas sweetening plant that treats sour gas from approximately 100 sour gas wells owned by Summit. The wells are located throughout a 43 square mile area and vary between 500 feet to eight miles from the sweetening plant. Summit does not own the property between the wells and the sweetening plant, but does own the pipelines connecting them. The wells are located primarily within territory of Michigan’s Saginaw Chippewa Indian Tribe’s Isabella Reservation, which is why EPA (rather than the state of Michigan) had the authority to regulate Summit’s operations.

The sweetening plant has the potential to emit just under 100 tons of pollutants that are subject to regulation under the CAA, the threshold that would trigger the requirement to obtain a Title V operating permit.<sup>24</sup> Each well has the potential to emit significantly lower amounts of pollutants. However, the emissions from the sweetening plant and any one well combined would exceed 100 tons of pollutants per year. Thus, the facts of *Summit* present the classic scenario when the relatively minor emissions from distant wells can trigger onerous permitting requirements.

In 2005, Summit submitted a request to EPA to determine whether its sweetening plant and wells met the definition of a major source under Title V of the CAA. In September 2009, after four years of negotiations and EPA’s change of policy from the Wehrum Memorandum to the McCarthy Memorandum, EPA issued its initial determination that Summit’s Sweetening Plant constituted a single stationary source, and therefore, constituted a “major source” under Title V of the CAA. After

<sup>21</sup> Memorandum from Gina McCarthy, EPA Assistant Administrator, to Regional Administrators, re: Withdrawal of Source Determinations for Oil and Gas Industries (Sept. 22, 2009).

<sup>22</sup> See 40 Pa. Bulletin 7323, 7429 (Dec. 25, 2010); 41 Pa. Bulletin 999, 1066 (Feb. 26, 2011); 41 Pa. Bulletin 5611, 5719 (Oct. 22, 2011).

<sup>23</sup> See Pennsylvania Department of Environmental Protection Guidance for Performing Single Stationary Source Determinations for Oil and Gas Industries, Doc. No. 270-0810-006 (Oct. 12, 2011).

<sup>24</sup> See 40 C.F.R. § 71.2 (subsection (2) of the definition of “Major source”).

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supplemental submissions from Summit, EPA sent a final letter to Summit confirming its initial decision. EPA’s final letter provided that in determining whether the wells and the sweetening plant were adjacent, it considered factors such as the “nature of the relationship between the facilities” and the “degree of interdependence between them.” Finding that the wells and the sweetening plant worked together to produce a “single product,” EPA concluded that the wells and sweetening plant are not separate emission sources. Summit appealed the decision to the Sixth Circuit.

### *What did the Sixth Circuit Decide?*

The Sixth Circuit, in a 2-1 decision, rejected the applicability of the “functional interdependence” test.

The Court determined that the term “adjacent” is unambiguous and mandates a focus on physical proximity. In coming to this conclusion, the court relied upon (1) the dictionary definition and etymological history of the term “adjacent” and (2) case law interpreting the word “adjacent” in other contexts.<sup>25</sup> Because the Court found no ambiguity, it applied no deference to EPA’s interpretation.<sup>26</sup>

EPA argued that the term “adjacent” is ambiguous because EPA has never defined a specific physical distance by which the term is defined.<sup>27</sup> After reviewing multiple dictionary definitions, the Sixth Circuit concluded that it was unable to find any authority to support that the term “adjacent” “invokes an assessment of the functional relationship between two parties.”<sup>28</sup> Additionally, the Court found that the etymological root of the term further supports the position that the meaning of the term “adjacent” is limited to considerations of geographical location.<sup>29</sup> The Court found support for its textual interpretation in two U.S. Supreme Court decisions: *United States v. St. Anthony R.R. Co.*<sup>30</sup> and *Rapanos v. United States*.<sup>31</sup> Each of these cases provided narrow, geographically-focused interpretations of the term adjacent.<sup>32</sup>

The Sixth Circuit rejected the argument that some amount of deference was owed simply because EPA had long adhered to the “functional interdependence test, because “an agency may not insulate itself from correction merely because it has not been corrected soon enough, for a longstanding error is still an error.”<sup>33</sup>

Finally, the Court explained that, even if the term “adjacent” was ambiguous, it would have rejected EPA’s interpretation anyway, in light of the regulatory history discussed above.<sup>34</sup>

The Sixth Circuit ultimately vacated the determination of the EPA and remanded to the EPA for a reassessment of Summit’s source determination “in light of the proper, plain-meaning application of the requirement that Summit’s activities be aggregated . . . if they are located on physically contiguous or adjacent properties.”<sup>35</sup>

<sup>25</sup> *Summit* at \*7.

<sup>26</sup> *Id.* at \*10.

<sup>27</sup> *Id.* at \*7.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at \*8.

<sup>30</sup> 192 U.S. 524 (1904).

<sup>31</sup> 547 U.S. 715 (2006).

<sup>32</sup> *Summit* at \*9.

<sup>33</sup> *Id.* at \*11.

<sup>34</sup> *Id.* at \*11-15.

<sup>35</sup> *Id.* at \*16.

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### Conclusion

The Sixth Circuit’s decision is binding within its jurisdiction (including Michigan, Ohio, Kentucky, and Tennessee), but it remains to be seen whether courts in other jurisdictions will take a different position. Interested parties should be mindful that there is another case involving essentially the same issues currently before the Federal District Court for the Middle District of Pennsylvania, situated within the Third Circuit.

The industry should monitor whether EPA decides to seek an *en banc* rehearing or files a petition with the United States Supreme Court for certiorari. If EPA does not appeal the decision, given this guidance from the Sixth Circuit, the oil and gas industry should closely monitor how EPA reassesses this matter on remand. EPA’s next move will provide insight into the way that EPA will likely handle other single source determinations moving forward. The reactions of state regulators should be monitored as well.

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