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CAIR Court Throws Eastern Utility Markets into Financial Tail-Spin

July 28, 2008

A panel of the U.S. Court of Appeals for the DC Circuit in a July 11 order threw eastern power markets into financial chaos by vacating the Environmental Protection Agency's (EPA) Clean Air Interstate Rule (CAIR). (***North Carolina v. EPA*, No. 05-1244**.) The purpose of the CAIR Rule was to reduce the interstate transport of ozone and particulate matter (PM) from power plants and to help states downwind of emissions attain EPA air quality standards for ozone and PM. The rule called for 28 states and the District of Columbia to institute into their State Implementation Plans a trading scheme for the predominant pollutants from coal-fired power generation "" sulfur dioxide (SO2) and oxides of nitrogen (NOx), which are precursors to PM and ozone. In reliance on the CAIR Rule, a number of coal-fired utilities in the western and southern Mid-Atlantic had expended hundreds of millions of dollars on credits that, in light of the court's ruling, may be worthless. After striking down EPA's method for allocating emissions allowances to upwind states and its interpretation of protections for downwind states, and finding that EPA improperly relied upon provisions in the Clean Air Act's (CAA) market-based program that were meant to deal with acid rain, the panel proceeded to vacate completely the EPA's method for allocating emissions allowances to upwind states. This ruling already has had a significant impact on the emissions trading market. Following the decision, the valuation of NOx and SO2 emission credits free fell. Several utilities have already disclosed financial hits in filings with the Securities and Exchange Commission. Notably, the court's decision raises questions about EPA's ability to remedy what the court found to be "fundamental flaws" in the CAIR Rule by creating a new trading scheme. Specifically, the court emphasized that CAA section 110(a)(2)(D)(i)(I), without qualification "prohibits sources 'within the State' from 'contribut[ing] significantly to non-attainment in . . . any other State. . . .'" *North Carolina v. EPA*, at *16. With this mandate in mind, the court complained that "[i]t is unclear how EPA can assure that the trading programs it has designed in CAIR will achieve section 110(a)(2)(D)(i)(I)'s goals if we do not know what each upwind state's 'significant contribution' is to another state." Therefore, the court determined that "CAIR must include some assurance that it achieves something measurable towards the goal of prohibiting sources 'within the State' from contributing to non-attainment or interfering with maintenance in 'any other State.'" *Id.* Whether EPA or others will seek rehearing is unknown. Beyond possible rehearing, how EPA could to resuscitate CAIR is unclear; however, the D.C. Circuit has predicted that "very little will 'survive[ ] remand in anything approaching recognizable form.'"