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Judith E. McKee
Editor, National Environmental Enforcement Journal
National Association of Attorneys General
750 First Street, N.E., Suite 1100, Washington, DC 20002
Phone: (202) 326-6044 Fax: (202) 408-6982

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Chief Counsel for Environment

Dominique Alexander
Environment Project Assistant

MAKING GOOD USE OF ENVIRONMENTAL DISCLOSURES IN BANKRUPTCY

By

Andrea Madigan*

At some point in their careers, most attorneys have awakened from a dead sleep, in a cold sweat, with an unshakable fear that they may have missed an important deadline that will seriously disadvantage their client. Those of us that represent the government in environmental bankruptcy cases are particularly susceptible to such disturbances due to the volume and ambiguity of bankruptcy notices with which our client agencies are served. However, since the Standing Committee on Bankruptcy Rules approved amendments to the Official Bankruptcy Forms to include, among other things, certain environmental disclosures, the task of identifying bankruptcy cases that involve environmental issues of concern to the government has been greatly streamlined — much to the relief of the sleep deprived.

Many debtors routinely include environmental agencies on their bankruptcy mailing matrices regardless of whether they have any reason to believe that the agency has or may have a claim or interest in their bankruptcy case. As a result, environmental agencies are served with thousands of bankruptcy notices that do not involve any environmental claims or matters of concern. One of the reasons for this practice appears to result from the uncertainty associated with when an environmental claim for clean-up costs arises

* Ms. Madigan is a senior enforcement attorney with the United States Environmental Protection Agency Region 8 in Denver Colorado and serves as chairperson of EPA's National Bankruptcy Work Group. Ms. Madigan may be reached at madigan.andrea@epa.gov. The views expressed in this article are those of Ms. Madigan and do not necessarily represent those of EPA nor of the United States.

under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §9601 *et seq.*, (CERCLA) and similar state statutes.¹

In order to be discharged in bankruptcy, a claim must have arisen or exist prior to confirmation of the plan of reorganization in a Chapter 11 case, or as of the date of the order for relief in a Chapter 7 case. If a claim arises after confirmation, the claim is not discharged in Chapter 11 and the reorganized debtor is fully liable for such claim. Accordingly, when the governments' claims for cleanup costs arise is of paramount importance.

In a case of first impression, the Second Circuit held that EPA's claim for reimbursement of response costs under CERCLA arises at the time of the release or threatened release of hazardous substances and may be discharged in bankruptcy, even though such response costs have not yet been incurred and even if the government had no knowledge of the environmental problem. *United States v. LTV Corporation (In re Chateaugay)*, 944 F.2d 997 (2nd Cir. 1991).

Subsequent cases have not followed *Chateaugay*. Most courts have adopted a "fair contemplation of the parties" test for determining when government claims under environmental cleanup statutes arise. In *In re National Gypsum Company*, 139 Bankr. 397 (D.C. Texas 1992), the court held that only those costs associated with pre-petition conduct resulting in a release or threat of release that "could have been fairly contemplated by the parties" are claims in bankruptcy and subject to discharge. The court went on to list a number of factors to be considered in determining whether costs associated with pre-petition conduct resulting in a release or threatened release of a hazardous substance were within the fair contemplation of the parties. The factors identified by the court included knowledge by the parties of a site; NPL listing; notification by EPA of liability; commencement of investigation, and clean-up activities; and incurring of response costs.

In *In re Jensen*, 995 F. 2d. 925 (9th Cir. 1993), the Ninth Circuit applied *National Gypsum's* "fair con-

templation” standard in determining that a claim under the California Hazardous Substance Account Act had arisen pre-bankruptcy because the state had sufficient knowledge of the debtor’s potential liability based upon an earlier state inspection of the site.

The Seventh Circuit appears to favor a similar rule. Although it did not cite *National Gypsum* and emphasized that it was not establishing a rule on the accrual of a CERCLA claim, the court in *In re Chicago, Milwaukee, St. Paul & Pacific Railroad*, 974 F.2d 775, 776 (7th Cir. 1992), stated:

[R]ather than adopting . . . any rule, we explain below that when a potential CERCLA claimant can tie the bankruptcy debtor to a known release of a hazardous substance which this potential claimant knows will lead to CERCLA response costs, and when this potential claimant has, in fact, conducted tests with regard to this contamination problem, then this potential claimant has, at least a contingent CERCLA claim. . . .

The Fifth Circuit adopted the *Chicago Milwaukee* approach in *In re Crystal Oil Co.*, 158 F.3d 291 (5th Cir. 1998), and found that, since the State of Louisiana could have tied the debtor to a known release of a hazardous substance through the exercise of reasonable diligence from matters of public record, the claim had arisen prior to confirmation and was therefore discharged. The Third Circuit appears to have taken a similar approach. In *In re Reading Co.*, 115 F.3d 1111 (3rd Cir. 1997), the court held that the United States’ claim under CERCLA had accrued prior to the bankruptcy reorganization because all the elements of the CERCLA cause of action were present. The court went on to state that, in order for contingent claims to be subject to discharge, there must be a legal relationship between the debtor and the claimant.

Because there is no bright line that establishes precisely when a government claim for clean-up costs arises, debtors have taken to notifying the environ-

mental agencies of their bankruptcy filings even though they have no reason to believe that such a claim exists as a precaution, “just in case.” By giving the government such notice, debtors hope to preserve their ability to fashion an argument in the future that a clean-up claim was discharged by an earlier bankruptcy.²

Prior to 2001, it was often very time consuming and sometimes impracticable to determine why a particular debtor had notified an environmental agency of its bankruptcy filing and whether such notice was merely precautionary or whether the agency had any interests at stake. While debtors are required to list all of their creditors in Schedules D, E, and F of Official Bankruptcy Form 6 and to state the date upon which such debts were incurred and consideration involved, these forms rarely provide sufficient information as to why an environmental creditor was listed. Usually, only the name and address of the creditor and the amount of the claim, if known, are stated. Further, debtors often include environmental agencies on their mailing matrices but do not schedule them as creditors. In addition, many environmental agencies maintain their records based upon the names of sites and facilities, which often do not correspond with those of a debtor. It is not uncommon for a search of agency records to turn up nothing with regard to a particular debtor. The challenge, then, is to determine whether the notice is simply precautionary or whether the debtor is indeed associated with a site or facility for which the government may have a claim but about which it has been unable to locate information in any of the tracking databases. In order to obtain more information, the government attorney would have to issue an information request letter, schedule a Bankruptcy Rule 2004 Examination, or hope that the debtor’s attorney would provide information on an informal basis. Given the volume of bankruptcy notices served upon the agency, this level of research is often not feasible.

In 2001, Official Bankruptcy Form 1, the Voluntary Petition, was amended to add Exhibit C. This exhibit requires debtors to identify and describe all real or personal property owned or possessed by the debtor that poses or is alleged to pose a threat of imminent and identifiable harm to the public health or safety

and the nature and location of the dangerous condition. These disclosures could lead environmental agencies to sites that may require clean-up actions to protect human health and the environment.

Official Bankruptcy Form 7, the Statement of Financial Affairs, was also amended to add a new Question 17. Debtors are now required to disclose at the commencement of their bankruptcy cases the names and address of every site for which the debtor received a notice of liability or notice of violation from a government unit, the names and address of every site for which the debtor reported a release of a hazardous material, and all judicial or administrative proceedings under any environmental laws to which the debtor was or is a party. While these disclosures are not comprehensive, they allow the environmental agencies to focus their investigation and dramatically reduce the time and resources needed to evaluate the government's interest in a bankruptcy case.

The Voluntary Petition and Statement of Financial Affairs are filed with the Bankruptcy Court at the time the bankruptcy case is commenced.³ While these documents are not served upon the environmental agencies, they are generally available on-line through PACER. If an agency is served with a bankruptcy notice for which no claims can be identified, a review of debtor's petition and response to Question 17 can help focus the investigation and identify sites or facilities that merit further evaluation.

On May 10, 2005, the Environmental Protection Agency's Office of Site Remediation Enforcement issued bankruptcy protocols establishing standard operating procedures for, among other things, evaluating bankruptcy notices that are served upon the Agency. In addition to searching EPA databases, EPA will now, to the extent possible, regularly review Exhibit C of the Petition and Question 17 of the Statement of Affairs in an effort to distinguish cases of interest from those involving precautionary notice. Use of these new environmental disclosures will streamline EPA's review process. Further, they may also serve as an antidote to precautionary notices; it should be difficult for a reorganized debtor to argue that an

environmental claim was within the fair contemplation of the parties and, therefore, discharged when the environmental disclosures made at the time of the bankruptcy filing provide no inkling about the claim.

ENDNOTES

1. Claims are broadly defined under the Bankruptcy Code. The term "debt" is defined under Section 101(12) of the Bankruptcy Code as "liability on a claim". The term "claim" is defined under Section 101(5) of the Bankruptcy Code as:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

2. The failure to provide notice to a known creditor may except such creditor's claim from discharge. *See In re Spring Valley Farms, Inc.*, 863 F. 2d 832 (11th Cir. 1989); *In re Maya Construction Co.*, 78 F3d. 1395 (9th Cir. 1996).

3. If the debtor files a list of creditors with its Petition, the Statement of Affairs may be filed up to fifteen days later. In addition, the bankruptcy court may extend the time period for filing of the Schedules and Statement of Affairs for cause. Bankruptcy Rule 1007(c).

DECISIONS

Air

Court Rejects Portion of EPA's 2002 NSR Rule: *New York et al. v. U.S. Environmental Protection Agency*, No. 02-1387 (D.C. Cir. June 24, 2005)**Background**

The 1977 amendments to the Clean Air Act (CAA) required new or modified sources to conform to certain emissions limits known as New Source Performance Standards (NSPS), set at levels more stringent than those needed to meet National Ambient Air Quality Standards (NAAQS). If an existing source made a "modification," it had to conform to meet NSPS, whereas existing, unmodified sources needed to meet only the state implementation plan level for attaining NAAQS. Modification was defined as:

[A]ny physical change in, or change in the method of operation of, a stationary source which increases the amount of any air pollutant emitted by such source or which results in the emission of any air pollutant not previously emitted.

42 U.S.C. § 7411(a)(4).

Prior to the 1977 CAA amendments, EPA had promulgated a regulation that provided that "[m]odification means any physical change in, or change in the method of operation of, an existing facility which increases the amount of any air pollutant (to which a standard applies) emitted into the atmosphere by that facility." 40 Fed. Reg. 58,416, 58,418 (Dec. 16, 1975). Another part of the same regulation stated that "any physical or operational change to an existing facility which results in an increase in the emission rate to the atmosphere of any pollutant to which a standard applies shall be considered a modification within the meaning . . . of the Act," with "[e]mission rate . . . expressed as kg/hr of any pollutant discharged into the atmo-

sphere." 40 Fed. Reg. at 58, 419. EPA defined "modification" in a 1974 regulation implementing the Prevention of Significant Deterioration (PSD) program somewhat differently: "'modification' or 'modified source' mean any physical change in, or change in the method of operation of, a stationary source which increases the emission rate of any pollutant for which a national standard has been promulgated." 30 Fed. Reg. 42,510, 42,514 (Dec. 5, 1974).

The 1974 PSD and the 1971 NSPS regulations provided for exceptions to what constituted a "modification"; the 1975 NSPS exception regulation phrased the exceptions differently and added a few.

The 1977 amendments created a preconstruction review process for new or modified major sources located in nonattainment areas and provided a parallel preconstruction review process in PSD areas. In this lawsuit the parties referred to the first as Nonattainment New Source Review (NNSR), the second as Prevention of Significant Deterioration (PSD), and to both together as New Source Review (NSR). The court followed that terminology in its opinion.

EPA promulgated NSR regulations in 1978 that were challenged by various parties. In new regulations issued in 1980, EPA changed its definition of modification, defining a major modification as "any physical change in or change in the method of operation of a major stationary source that would result in a significant net emissions increase of any pollutant subject to regulation under the Act." 45 Fed. Reg. 52,676, 52,735 (Aug. 7, 1980). "Net emissions increase" was defined as "any increase in actual emissions from a particular physical change or change in method of operation" that occurred after taking into account through "netting" "any other increases and decreases in actual emissions at the source that are contemporaneous with the particular change and are otherwise creditable." *Id.* at 52,736. This regulation emphasized actual emissions and was based on the court's opinion in *Alabama Power Company v. Costle*, 636 F.2d 323 (D.C. Cir. 1979).

The 1980 regulation was again challenged. EPA and the petitioners agreed that the agency would undertake new rulemaking. In the current lawsuit, the industry petitioners and EPA disputed what the 1980 rule meant. They disagreed on how to measure an “increase” in emitted pollutants once a change has occurred. The industry petitioners argued that an increase occurs only if the maximum hourly emissions rate goes up as a result of the change. EPA argued, however, that an increase occurs if, after netting, a source’s past annual emissions are less than future annual emissions, measured by calculating the source’s potential to emit after the change. This became known as the “actual-to-potential” test.

In *Wisconsin Electric Power Company v. Reilly*, 893 F.2d 901 (7th Cir. 1990) (WEPCo), the court agreed with the petitioner that EPA should measure future emissions by projecting future actual emissions rather than assuming that the source would operate at full capacity in the future. Congress, in its 1990 amendment to the CAA, did not address the WEPCo decision, leaving it to EPA to do so. EPA responded by issuing a new rule in 1992 that changed the test that utilities use for measuring emissions increases. The new test, known as the “actual-to-projected-actual test,” required utilities to determine whether they had post-change increases in emissions (and, thus, needed NSR permits) by comparing actual emissions before the change to their projections of actual post-change emissions. Projected emissions would exclude increases stemming from unrelated growth from increased demand by consumers.

Again, various petitioners challenged the rule. The court stayed the proceedings as EPA began a new rulemaking process. In the meantime, EPA began investigating numerous sources for noncompliance with the NSR program and eventually brought complaints against thirty-two utilities in ten states. EPA’s 2002 rule being challenged in this proceeding departed from prior rules in several respects. First, it adopted the actual-to-projected-actual test for *all* existing sources, not just utilities, as an alternative method for calculating the requirement for a permit. The rule also altered the method for measuring past actual emissions.

Under the 1980 rule, the preferred methodology involved averaging annual emissions during the two years immediately prior to the change. There were alternatives also available, but the source had to convince the permitting authorities that the alternative was preferable. Under the 2002 rule, sources other than electric utilities average annual emissions of any two consecutive years during the ten years prior to the change. 40 C.F.R. § 52.21(b)(48)(ii). Because of this change, EPA determined that there was no need for site-specific alternatives that were part of the 1980 rule. For electric utilities, the rule set a five-year lookback period. The 2002 rule also expanded the demand growth exclusion to all sources, not just utilities. The fourth change was that, if a source saw no reasonable possibility of higher post-change emissions, it need not keep records of any actual post-change emissions. The rule also set forth three situations in which sources, without undergoing the permit procedure, could make changes that might otherwise constitute modifications: The Plantwide Applicability Limitations (PAL) program; the Clean Unit option, and the Pollution Control Project (PCP) exception. 40 C.F.R. §§ 52.21 (b), (x)–(z), & (aa).

The PAL program allows sources to make whatever changes they want in the next ten years without triggering permit requirements, provided that each year those sources remain below a certain level of emissions. Under the Clean Unit option, a source that installs technology comparable to Best Available Control Technology (BACT) in PSD regions or Lowest Achievable Emission Rate (LAER) in NNSR regions may make whatever changes they want over the next ten years provided that the changes do not cause the source to exceed the emission limitations set by the comparable technology. Numerous petitioners — states, environmental groups, and industry groups — have now challenged various portions of the rule.

Holding

The court proceeded under *Chevron's* two-step process. If Congress has spoken specifically on the matter, then congressional intent decides the issue. If, however, congressional intent is ambiguous, the court determines whether the agency's interpretation is based on a permissible construction of the statute. The court first dealt with the industry challenges.

Industry Challenges

The industry challenges fall into three main groups. First, the petitioners challenged EPA's definition of "modification," arguing that Congress intended to adopt for NSR purposes the NSPS regulatory definition in existence at the time of the 1977 amendments. Second, the petitioners argued that the statements in the preamble to the 2002 rule constitute an unlawful interpretation of the 1980 rule. Third, one petitioner challenged the elimination of the ability of the states to use source-specific emissions limitations as proxies for actual emissions.

The industry argued that "modification" must have the same regulatory meaning for NSR as prevailed for NSPS in 1977 because Congress, by cross-reference, used the same language in both statutory contexts. The petitioners argued that there was abundant evidence of congressional intent that would lead to the inference that Congress intended to incorporate the preexisting regulatory definition into the statute. The court was not convinced. Nowhere in the statute did Congress incorporate the regulatory definition by statute. Furthermore, the regulatory definitions in the NSPS and PSD programs already differed at the time of the 1977 amendments, using two different, and possibly inconsistent, definitions of modification. The court, thus, gave deference to EPA's interpretation.

The court declined to express an opinion as to whether Congress intended to require EPA to use identical regulatory definitions of modification across the NSPS and NSR program (citing *United States v. Duke Energy, infra*) because the petitioners did not make

that argument in their opening brief. Since industry did not attack the reasonableness of EPA's definition of modification for NSR, apart from its divergence from one of the 1974 NSPS definitions, the court rejected that portion of the industry's challenge.

The court held that the claim involving the interpretation of the 1980 rule in the 2002 preamble was unripe. The industry petitioners contended that EPA attempted to interpret the 1980 rule retroactively to require a "universal actual-to-potential test." Ripeness depends on fitness of the issue for judicial review and the hardship of the parties of withholding a judicial decision. Fitness in this case is questionable because, as EPA noted, the statement challenged was just a shorthand reference to the 1980 rule, not a formal interpretation. Nor have the petitioners shown that delay of review would inflict any hardship. Therefore, the court held that this issue was not ripe for review.

One petitioner argued that eliminating the ability of a state to use source-specific allowable emissions violated the CAA's principles of power sharing between the states and the federal government. The court rejected this argument. The CAA gives EPA responsibility for developing the basic rules for the NSR program. It was within EPA's discretion to adopt the new methodology and eliminate source-specific calculations.

State/Environmental Petitioners

The state and environmental petitioners raised two sets of challenges to the ten-year lookback period in the 2002 regulation. First, they argued that it uses an impermissible interpretation of the statutory term "increases" because it allows sources to increase emissions beyond their most recent levels without triggering NSR. Second, they argued that EPA's selection of a ten-year period is arbitrary and capricious because it contravenes the statutory purpose of protecting and enhancing air quality.

The CAA defines "modification" as a physical or operational change that increases emissions, but it does not give instructions as to how to calculate those in-

creases. The government petitioners said that the court should give the term its “ordinary meaning,” which, they maintained, requires the baseline to be measured from a period immediately prior to the change. EPA argued that its regulation is entitled to deference under *Chevron* because the term is ambiguous. The court agreed with the agency that the term is ambiguous. It noted that EPA is entitled to balance environmental concerns with economic and administrative concerns to a certain extent. EPA commissioned a study of the business cycles of nine major emitting industries and found that peak-to-peak cycles ranged from three to six years and trough-to-trough cycles ranged from three to eight years. The study concluded that, in order to capture each industry’s cycle, a minimum of ten years of data was recommended. According to the court, the government and environmental petitioners provided no basis for the court to determine whether a particular time frame would be reasonable under the CAA. Without such an explanation, the court deferred to EPA’s policy choice because it was supported by the study and was not manifestly contrary to the statute.

An additional complaint was that the businesses with shorter business cycles could choose among two or three peaks, not just the most recent one. EPA, however, recognized the difference in business cycles among industries and chose to promote operational flexibility and administrative efficiency. This is a policy choice which reconciles conflicting interests and is entitled to deference under step two of *Chevron*.

The environmental petitioners also challenged the ten-year lookback period on the grounds that it violated the D.C. Circuit’s interpretation of the CAA in *Alabama Power*, 636 F.2d 323. Under that decision, only a change that results in a net increase in emissions is subject to NSR; “contemporaneous” changes that decrease emissions from another unit may be used to “net out” of NSR. EPA has defined changes that are contemporaneous to be those made within five years. Under the new rule, sources can use a ten-year lookback period to calculate baseline emissions to determine whether an offsetting change decreases emissions. According to the petitioners, this ten-year

period combined with the “contemporaneous” period of five years gives sources fifteen years as a baseline. An example would be an emissions increase caused by a change in 2005 could be offset by an emissions decrease that relies on a 1990 baseline. EPA noted, however, that the change that caused the decrease must still occur within five years of the change that causes the increase. This does not violate the requirement of *Alabama Power* that the change be “contemporaneous.”

The petitioners vigorously argued that the ten-year lookback period is arbitrary and capricious. EPA acknowledged that fewer changes will trigger NSR under the 2002 rule than under the 1980 rule. However, EPA also believes that the environment will not be adversely affected and may, in fact, benefit because the rule eliminates a regulatory disincentive for sources to implement changes that improve operating efficiency and reduce emissions rates. EPA rejected the petitioners’ adverse evidence as flawed and the petitioners did not dispute this critique. EPA’s Environmental Impact Analysis (EIA) concluded that the overall consequences of the ten-year lookback period would be negligible because it affected only a small number of facilities. EPA believes that the 2002 rule will actually result in health benefits from reduced concentrations of pollutants.

Where EPA’s predictive judgment is supported by substantial evidence in the record, it is entitled to deference. Despite the fact that the EIA was developed on incomplete data, the court concluded that EPA’s judgment was entitled to deference. However, the court repeated the concern of the Government Accounting Office in reviewing EPA’s EIA and noted its own concern that EPA needs to collect data to confirm that the 2002 rule does not result in increased emissions that harm the environment and public health.

The state government and environmental petitioners also challenged two features of the rule’s projected-actual-emissions methodology: the exclusion from the projection of any emissions due to increased demand and the “reasonable possibility” trigger for recordkeeping and reporting requirements. The peti-

tioners cited EPA's expression in 1998 of dissatisfaction with the demand growth exclusion when it tentatively concluded that it was not appropriate. However, in the 2002 rule, EPA explained in its preamble that both the statute and the regulations indicate there should be a *causal* link between a proposed change and any post-change emissions increase; therefore, the demand growth exception was appropriate. The government petitioners argued that EPA should not have changed its stance from its 1998 notice. In response to the petitioners' argument, the court noted that EPA had accepted comments on the growth demand exclusion, which it considered in promulgating the new rule. According to the court, the petitioners would have EPA ignore the comments on which EPA relied in crafting that part of the rule and accept only comments that insisted that demand growth be included in the calculations. The court found that EPA's approach had ample support in the record.

The recordkeeping and reporting requirements under the 2002 rule exempt sources which believe that there is no reasonable possibility of a significant emissions increase. The petitioners argued that exempting such sources from recordkeeping would render the actual-to-projected-actual methodology unenforceable. How will EPA determine that sources are not escaping NSR if sources may destroy the data crucial to that determination? EPA's response is that the 2002 rule actually increases recordkeeping obligations for non-utilities. The court pointed out, however, the EPA's response ignored major differences between the current and former methods. Under the pre-2002 regulations, non-utilities either accepted the actual-to-potential test, eliminating the need for recordkeeping, or subjected their actual emissions to state monitoring. Furthermore, utilities that projected no significant emission increase, under the pre-2002 regime, had to supply authorities with a minimum of five years' data to support that projection. Under the 2002 rule, so long as the utilities foresee no "reasonably possibility" that changes may cause significant emissions increases, they have no obligation to retain the data on which the projection is based, much less forward that data to authorities. EPA has not explained how, absent recordkeeping, it will be able to determine which

sources have come to accurate conclusions concerning increased emissions. Since EPA has failed to explain how NSR compliance can be ensured without the relevant data, the court remanded on this issue in order for the agency to provide an acceptable explanation or allow it to devise an appropriately supported alternative.

The court next turned to the challenge to the PAL method for assessing increases in emissions. The PAL is calculated by adding a "significant" margin to the baseline actual emissions from any two-year period within the ten-year period immediately preceding permit application. Sources choosing the PAL option must accept various monitoring and recordkeeping responsibilities. The petitioners argued that the PAL provision is arbitrary and capricious because it allows sources to increase their emissions beyond their most recent levels without triggering NSR. The court rejected this challenge on the same grounds as it had rejected the challenge to the ten-year lookback provision. Furthermore, the environmental petitioners failed to refute EPA's assessment of the environmental benefits of PALs. Accordingly, the court deferred to EPA's assessment, which was based on the agency's expert evaluation of technical data from the pilot projects.

Under the Clean Units approach, a change does not increase emissions so long as it does not alter the unit's Clean Unit status, even if the change increases the course's net actual emissions. A unit qualifies automatically for Clean Unit status if it has installed LAER or BACT technology as a result of major NSR within the last ten years. A unit that has not undergone major NSR can qualify for Clean Unit status if it demonstrates that its technology is comparable to LAER or BACT and that its allowable emissions will not violate NAAQS or NSPS. The government and environmental petitioners argued that the Clean Unit provisions contravene the plain meaning of the CAA because those provisions measure increases in terms of Clean Unit status instead of actual emissions. To address this allegation, the court again turned to step one of the *Chevron* analysis.

Examining the statutory language, the court pointed out that in the 1977 amendments to the CAA, Congress defined “major emitting facilit[ies]” as “stationary sources of air pollutants which emit, or have the potential to emit, one hundred tons per year or more of any pollutant.” 42 U.S.C. § 7479(1). According to the court, the juxtaposition of the terms “emit” and “potential to emit” indicates that Congress was conscious of the distinction between actual and potential emissions. Similarly, when Congress defined “best available control technology,” it defined it as “an emission limitation based on the maximum degree of reduction of each pollutant . . . emitted from any major emitting facility.” 42 U.S.C. § 7479(3). The court stated that this juxtaposition indicated Congress was conscious of the distinction between actual and allowable emissions, using the term “emission limitation” to refer to allowable emissions.

The court determined that it was clear that Congress distinguished between actual, potential, and allowable emissions and that, if it wanted to measure increases in emissions in terms of potential or allowable emissions, it would have added a reference to “potential to emit” or “emission limitations.” Because there is no such reference, it was clear to the court that Congress intended to apply NSR to changes that increase actual emissions instead of potential or allowable emissions. Therefore, the court held that EPA lacked authority to promulgate the Clean Unit provision and vacated that portion of the rule.

EPA attempted to remove a “regulatory disincentive that might otherwise prevent industry from undertaking pollution control and prevention measures” by including in the 2002 rule exemptions for “environmentally beneficial” PCPs. These are excluded from the definition of “modification.” The environmental petitioners contended that this exemption violates the language of the CAA because PCPs are plainly “changes” that increase emissions of collateral pollutants. EPA argued that Congress did not intend that the PCPs be considered the kind of change that triggers NSR, but it failed to present evidence of such

intent. Absent such evidence, the court concluded that EPA lacked authority to create the PCP exemption from NSR. Again, the court vacated that part of the 2002 rule.

The government petitioners asserted that the 2002 rule unlawfully precludes states from adopting more stringent criteria. They made this argument based on the preamble which stated that to be “approvable under the SIP, State and local agency programs implementing part C or part D must include today’s changes as minimum program elements.” However, other portions of the preamble suggest a less stringent approach. The court conceded that there are seemingly contradictory statements in the preamble but, at oral argument, EPA stated that it would consider SIPs that do not contain the five elements of the 2002 rule. The court concluded that, until EPA has rejected a newly submitted SIP, the issue was unripe.

Section 193 of the CAA bars EPA from altering any control requirement in effect prior to November 14, 1990, in a nonattainment area for an air pollutant unless the revision “insures equivalent or greater emission reductions of such air pollutant.” 42 U.S.C. § 7515. The government petitioners argued that, since the new rules in some respects reduce the likelihood of NSR, they flunk the “greater or equivalent emission reductions” test. However, the environmental effects of less sweeping NSR are ambiguous: more sweeping NSR will tend to ensure improved controls on qualifying modifications, but may discourage sources from making changes, thereby ensuring the use of older, dirtier technologies. The court could not make a judgment as to what might happen, especially since it was invalidating portions of the new rule that might affect the overall environmental impact.

The court also rejected the government petitioners’ inadequacy of notice argument regarding the rejection of the “menu of alternatives” approach. Accordingly, the court vacated the provisions of the 2002 rule regarding the Clean Unit applicability test and PCPs, remanded the recordkeeping provisions to EPA, and dismissed a portion of the petitions as unripe.

Court Affirms District Court in Duke Energy Lawsuit: *United States et al. v. Duke Energy Corporation*, No. 04-1763 (4th Cir. June 15, 2005)

Background

The federal government brought a lawsuit against Duke Energy Corporation, alleging that it violated the Clean Air Act's (CAA's) Prevention of Significant Deterioration (PSD) regulations when it engaged in various projects at its coal-fired generating units in the Carolinas. The modernization projects were designed to both extend the life of the units and allow them to increase their daily hours of operation. Duke Energy did not apply nor obtain permits for these projects.

According to the government, the projects constituted "major modifications" of the furnaces as defined in the PSD statutory and regulatory provisions, *i.e.*, physical changes leading to a significant net emissions increase, and, therefore, the company was required to obtain permits for them. EPA's position is that the PSD regulations require measurement of the net emissions increase by using an "actual-to-projected-actual test" which compares the actual pre-project emissions from a unit to the projected post-project emissions. Therefore even if, as in Duke Energy's case, there is no increase in the hourly rate of emissions but there is an increase in the hours a unit operates, a permit is required. Duke Energy countered that the PSD program requires a permit only if there is an increase in the hourly rate of emissions.

The district court agreed with Duke Energy's interpretation of the regulation and granted it summary judgment. This appeal followed.

Holding

Under a *Chevron* analysis, the court first asks whether Congress has "directly spoken to the precise question at issue." *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). EPA conceded that the critical question in this case is whether it could interpret the statutory term "modifi-

cation" under PSD, 42 U.S.C. § 7411, differently from how the EPA interpreted the term in the New Source Performance Standards (NSPS) provision, 42 U.S.C. §§ 7470-92. Congress defined "modification" in the NSPS provisions of the CAA and directed that the PSD provisions employ the same definition. *See* 42 U.S.C. § 7479(2)(c) ("construction" includes "modification . . . as defined in section 7411(a).") Since Congress required that the PSD definition of "modification" be identical to the NSPS definition of "modification," EPA cannot interpret it differently.

Supreme Court precedent confirms that, when Congress provides "substantially identical" definitions of a term in different statutes, the agency with the responsibility for enforcing the statutes may not interpret those definitions differently. In *Rowan Companies v. United States*, 452 U.S. 247 (1981), the issue was whether the Commissioner of the Internal Revenue Service could interpret the term "wages" differently for withholding purposes than it was interpreted under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). The commissioner issued regulations interpreting "wages" under FICA and FUTA to include the value of meals and lodging provided to employees for the employer's convenience, but "wages" under the income-tax withholding statute to exclude those items.

In finding the IRS interpretation impermissible, the Court looked at the plain language of the statutes and their legislative history. In the case of the CAA, the court found that there was even stronger evidence than there was in *Rowan* that Congress intended "modification" to be interpreted identically in the PSD and NSPS provisions. While the *Rowan* Court found only "substantially the same language," here Congress provided that the definition of "modification" in the PSD provisions be exactly the same as the definition of "modification" as the NSPS definition by incorporating the NSPS definition into the PSD provisions. Furthermore, as in *Rowan*, the legislative history of the statutes here shows no evidence that Congress intended the definitions to be interpreted differently. In fact, in the congressional summary, the expressed intent of the legislative amendments was to "conform"

the definition of modification in the PSD provisions “to usage in other parts of the Act.” 123 Cong. Rec. 36,253 (Nov. 1, 1977).

EPA and the intervenors in this action emphasized the “vital differences” between PSD and NSPS. It is true that these two programs address different problems. This fact has led courts to interpret identical words used in both programs differently; however, when this has been done, it is because the word used was not defined in the statutory provisions setting up one of these programs. See *Potomac Electric Power Company v. EPA*, 650 F.2d 509 (4th Cir. 1981), and *Northern Plains Resource Council v. EPA*, 645 F.2d 1349 (9th Cir. 1981). According to the court, these cases illustrate the principle that generally the same word or phrase will be presumed to have the same meaning when used in different parts of a statute, but the presumption will be overcome by a showing that there is a variation in the way the words are used as to reasonably warrant the conclusion they were used in different parts of the statute with different intent.

In this case, however, the presumption of uniform usage is irrebutable because Congress itself defined the words in the exactly same way. Thus, EPA must interpret its PSD regulations defining “modification” congruently with the NSPS definition. The court therefore affirmed the judgment of the district court.

[Editor’s note: Duke’s alternative position — that its projects constituted maintenance, repair, and replacement that are routine in the industry — was not addressed by the court.

In another recent decision, *United States v. Alabama Power Company*, No. 01-152 (N.D. Ala. June 3, 2005), the court refused to give EPA deference in regard to its interpretation of the NSR program because of the conflicting interpretations offered by the agency in the past thirty years. The court agreed that the routine maintenance exception applied to projects commonly performed within the industry and that emissions increases should be calculated only on the basis of maximum hourly emission rates.]

EPCRA

Only Toxic Chemicals May Be Listed on Toxic Release Inventory List: *American Chemistry Council v. Steven L. Johnson and U.S. Environmental Protection Agency*, No. 04-5189 (D.C. Cir. May 10, 2005)

Background

The Emergency Planning and Community Right-To-Know Act (EPCRA) requires the creation of a Toxic Release Inventory (TRI) list. Facilities that manufacture, process, or use chemicals on the TRI must provide an estimate of the amount of chemical present and the annual quantity of that chemical entering the environment. EPCRA was intended to provide communities and their safety officers with information on the potential for chemical hazards in their neighborhoods. One of the chemicals U.S. EPA listed on the TRI was methyl ethyl ketone (MEK).

In 1996, the American Chemistry Council petitioned EPA to delete MEK from the TRI. It argued that MEK was not a toxic chemical as the term is used in EPCRA. MEK is a clear, colorless, low-boiling, but highly volatile and highly flammable liquid. It is used as a solvent and is released into the environment in substantial quantities with nearly 80 million pounds released into the air, 100,000 pounds into the water, and 50,000 pounds onto the land in 1994. MEK can cause, at high doses, chronic developmental toxicity.

EPA denied the American Chemistry Council’s petition and the district court granted summary judgment for the agency. This appeal followed.

Holding

EPCRA provides for listing of a chemical if the EPA administrator determines there is evidence to establish any one of the following:

- (A) The chemical is known to cause or can reasonably be anticipated to

cause significant adverse acute human health effects at concentration levels that are reasonably likely to exist beyond facility site boundaries as a result of continuous, or frequently recurring, releases.

(B) The chemical is known to cause or can reasonably be anticipated to cause in humans—

- (i) cancer or teratogenic effects, or
- (ii) serious or irreversible—
 - (I) reproductive dysfunctions,
 - (II) neurological disorders,
 - (III) heritable genetic mutations, or
 - (IV) other chronic health effects.

(C) The chemical is known to cause or can reasonably be anticipated to cause, because of—

- (i) its toxicity,
- (ii) its toxicity and persistence in the environment, or
- (iii) its toxicity and tendency to bioaccumulate in the environment,

a significant adverse effect on the environment of sufficient seriousness, in the judgment of the Administrator, to warrant reporting under this section.

42 U.S.C. § 11023(d)(2).

In responding to the American Chemistry Council's petition, EPA agreed that MEK did not fit the "acute human health effects" criterion, but argued that it did meet the "chronic health effects" and the "significant adverse effect on the environment" requirements. EPA's opinion was based on the proposition that

MEK, as a volatile organic chemical, is a precursor to ozone, which has significant adverse effects to human health and the environment.

The court noted that there is no dispute that ozone itself is a chemical that meets the listing criteria or that MEK does, to some degree, contribute to the creation of ozone. The question is whether the Council is correct that only chemicals that are toxic in themselves must be listed or whether EPA is correct that chemicals that foster toxic chemicals should be listed. EPA interprets the phrase "known to cause or can reasonably be anticipated to cause" serious chronic health effects as incorporating indirect effects. The court noted that the first inquiry is whether the overall text, structure, and purpose of EPCRA allow EPA to list non-toxic chemicals.

The court noted that the term toxicity or toxic chemical is used thirty-eight times in the statute. This suggests, according to the court, that the TRI is intended to include chemicals that are, in fact, toxic. Even EPA, in this case, observed that Congress intended that only toxic chemicals be included in the TRI. The structure of section 313(d)(2) also conveys this impression. Subsection (A) regards acute toxicity; subsection (B) deals with chemicals that pose serious chronic health risks. Subsection (C) clearly involves only toxic chemicals.

Nonetheless, EPA argued that the term "toxicity" should be understood differently from how it is used in ordinary speech. EPA's understanding is that toxicity should be defined as the *potential* to cause harm. The Council argued that a chemical is toxic if "it causes illness or injury when ingested, inhaled, or otherwise absorbed into the body." The court noted that virtually all definitions, other than EPA's litigation definition, approximate the Council's definition. Even EPA's *Toxicology Handbook* defines "toxicant" as a "harmful substance or agent that may injure an exposed organism."

The court also noted that EPA's current definition would qualify materials that "no scientist or educated lay person would term toxic." The release of large

volumes of *any* liquid has the *potential* to cause harm to living systems by drowning or by flooding. Furthermore, under the view that EPA espoused here, any and all VOCs — and even water — could be listed because they contribute to the formation of ozone.

The court stated that Congress intended that EPCRA facilitate community information, awareness, and planning for the release of hazardous chemicals. As the court noted:

[T]he sort of community response seemingly anticipated — precautions against relatively local toxic releases — is hardly advanced by including a chemical that, when mixed with other chemicals thousands of feet above the point of release, tends to generate a third chemical, which in turn may result in adverse effects on humans and the environment in regions hundreds of miles from the initial time and place of the release.

Slip op. at 7.

The court held EPCRA allows only for the listing of toxic chemicals as that term is used in ordinary parlance. At a minimum, the chemical must cause harm via exposure. MEK fails this test. The court thus vacated the decision of the district court and remanded so that the court can direct EPA to delete MEK from the TRI.

Privilege

No Settlement Privilege in Federal Courts: *In re Subpoena Issued to Commodity Futures Trading Commission*, No. 04-564 (JDB) (D.D.C. Apr. 28, 2005)

Background

The underlying lawsuit involves an action by Gallo, a California wine producer, against two energy companies seeking damages for the alleged manipulation of natural gas prices in California. It was brought in the Eastern District of California. Gallo is one of the largest consumers of natural gas in the state. Some of the documents that Gallo sought in discovery were those created for the purposes of settling an action brought against WD Energy, the successor company to one of the defendants, by the Commodity Futures Trading Commission (CFTC). The magistrate judge issued an order holding that the documents were protected from disclosure by a settlement privilege. Gallo did not file an objection to the magistrate judge's order.

Meanwhile, Gallo had issued a subpoena to the CFTC requesting the documents that it had collected from WD Energy and nine other energy companies in the course of the CFTC's investigation into possible misfeasance in natural gas trading activities. Each of the energy companies filed objections to the subpoena in the U.S. District Court for the District of Columbia. Eventually, after Gallo filed a motion to compel, the CFTC submitted a statement explaining that it would not assert any governmental privileges at that time and did not oppose production of the documents that were then in question — documents relating to three energy companies, including WD Energy.

The court resolved most of the open questions relating to the documents of two of the energy companies. One of the remaining issues is whether the documents relating to WD Energy are protected by a federal settlement privilege. The CFTC's position is that the court should not recognize such a privilege.

Holding

The Sixth Circuit recently recognized a settlement privilege in *Goodyear Tire & Rubber Company v. Chiles Power Supply, Inc.*, 332 F.3d 976 (6th Cir. 2003). Quoting from that decision, WD Energy argued that there “exists a strong public interest in favor of secrecy of matters discussed by parties during settlement negotiations” because “the ability to negotiate and settle a case without trial fosters a more efficient, more cost-effective, and significantly less burdened judicial system,” and that “without a privilege, parties would more often forgo negotiations for the relative formality of trial.” *Id.* at 983.

Federal Rule of Evidence 501 authorizes federal courts to adopt new privilege rules by interpreting “the principles of the common law . . . in the light of reason and experience.” However, the Supreme Court has cautioned that testimonial privileges should not be “lightly created nor expansively continued, for they are in derogation of the search for truth.” *United States v. Nixon*, 418 U.S. 683 (1974). More recently, the Court has noted that “[a]lthough Rule 504 manifests a congressional desire not to freeze the law of privilege . . . we are disinclined to exercise this authority expansively.” *University of Pennsylvania v. EEOC*, 493 U.S. 182 (1990). In the case at bar, the court noted that the recognition of various privileges has been denied in recent years. This includes the identity of reporters’ confidential sources, child abuse records, parent-child communications, academic peer-review records, records involving the protective function of the Secret Service, corporate ombudsman records, communications between an insurer and an insured, and records of unemployment hearings.

The Supreme Court has identified several factors courts should consider when determining whether it should adopt a proposed privilege. First, the question should be asked whether there exists a broad consensus in federal and state law in favor of the privilege. Second, the court should determine whether Congress has considered the competing interests and concerns

involved but, nevertheless, has failed to provide the privilege legislatively. Finally, the court should consult the list of evidentiary privileges recommended by the Advisory Committee of the Judicial Conference in its proposed Federal Rules of Evidence. See *Jaffee v. Redmond*, 518 U.S. 1 (1996).

According to the court, WD Energy failed to make a persuasive case for a federal settlement privilege under any of these factors. It did not demonstrate a broad consensus in the federal court for such privilege. In fact, two prior decisions of the D.C. district court rejected the notion of a settlement privilege. WD Energy did not even attempt to show there was a consensus in state law for such a privilege.

Federal Rule of Evidence 408 is instructive when one considers the question of Congress having considered the competing concerns involved. It provides:

Evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

This rule was clearly enacted to promote the settlement of disputes outside the judicial process. However, Congress clearly chose to promote this goal

through limiting the admissibility of settlement material rather than limiting their discoverability. In commenting on Rule 408, a leading treatise on evidence noted that a party is not allowed to use Rule 403 “as a screen for curtailing [an] adversary’s right of discovery.” 2 Weinstein’s Federal Evidence § 408.07 at 426 (2005).

The final consideration also weighs against the proposed privilege. It is not listed among the nine privileges identified by the Advisory Committee of the Judicial Conference.

The court commented that WD Energy made a forceful argument that a settlement privilege is required in order to preserve the strong public interest in the settlement of disputes, but noted that a compelling argument has been made for the contrary position. The court also commented that, even if it were to consider such a privilege, it would be particularly inappropriate in this case where the CFTC does not believe a privilege is necessary to encourage settlement. Accordingly, the court declined WD Energy’s invitation to recognize a federal settlement privilege and ordered the CFTC to produce the documents at issue to Gallo.

Attorney-Client Privilege Applies to In-House Agency Counsel: *State ex rel. Leslie v. Ohio Housing Finance Agency*, No. 2004-0105 (Ohio Apr. 13, 2005)

Background

Mark A. Leslie, an attorney, was employed by the Ohio Department of Development for approximately one and one-half years as its chief of compliance. In March 2002, the department terminated his employment. In the fall of 2002, Leslie filed a complaint naming various individuals and agencies as defendants and alleging that they had violated certain laws. In responding to a motion to dismiss, Leslie’s reply contained two endnotes describing various documents and explaining his discharge. The appellants moved to strike the endnotes, seal those portions protected by attorney-client privilege, and obtain a protective order to prohibit Leslie’s disclosure of privileged records.

The magistrate judge applied an Ohio Court of Appeals’ precedent in *State ex rel. Olander v. French*, 1996 WL 403802, which held that the attorney-client privilege does not exist between a state agency and its in-house counsel unless the attorney is a member of the Attorney General’s office. Thus, the magistrate recommended that the court of appeals deny the appellant’s motion to seal and for a protective order.

The court of appeals adopted the magistrate’s decision although two of the three judges “reluctantly” concurred. They believed that *Olander* had been wrongly decided but noted it remained the law since it had not been overruled.

The appellants appealed and Leslie cross-appealed.

Holding

In Ohio, the attorney-client privilege is addressed in a statute, Ohio Rev. Code Ann. § 2317.01(A). The common law governs those cases not covered by statute. The statute provides that, in general, an attorney shall not testify “concerning a communication made to the attorney by a client in that relation or the attorney’s advice to a client.” The attorney-client privilege is one of the oldest recognized privileges. Its purpose is to promote frank and full communication between attorneys and their clients and, thus, to promote the broader public interest in the observance of law and administration of justice.

Courts have extended the attorney-client privilege to communications between attorneys and their corporate clients. Although jurisprudence on the applicability of the privilege in the government context is not extensive, the weight of authority applies the privilege to confidential communications between government agencies and their counsels. Nonetheless, Leslie challenged this precedent by contending that the Ohio statute does not apply to government clients and argued further that the privilege should be limited to trial preparation materials and that its extension to government entities subverts Ohio’s Public Records Act and Ohio’s whistleblower-protection statute for state employees. The court disagreed. Even assuming that the Ohio

statute doesn't extend attorney-client privilege to government entities, the common-law attorney-client privilege would apply. Although acknowledging that a government attorney-client privilege has received some criticism from commentators, the court concluded that the prevailing rule remains that governmental entities enjoy the same privilege as nongovernmental entities. Furthermore, courts, including Ohio courts, have generally construed open meeting and open files laws to be subject to attorney-client privilege.

Leslie argued that Ohio Rev. Code Ann. § 109.02 limits the attorney-client relationship in Ohio state government to the relationship between the state and attorneys representing it who are from the Attorney General's office. That statute provides that, generally, the Attorney General is the chief law officer for the state and neither state boards nor officers may be represented by other attorneys:

The attorney general is the chief law officer for the state and all its departments [No] state officer or board, or head of a department or institution of the state shall employ, or be represented by, other counsel or attorneys at law. The attorney general shall appear for the state in the trial and argument of all civil and criminal causes in the supreme court in which the state is directly or indirectly interested. When required by the governor or the general assembly, the attorney general shall appear for the state in any court or tribunal in a cause in which the state is a party, or in which the state is directly interested.

The court noted numerous reasons why this statute does not limit the government attorney-client privilege to communications with attorneys employed by the attorney general's office. It noted, first, that the authority to regulate the practice of law is vested in the Ohio Supreme Court. Second, as to the statute itself,

it merely limits *representation* in courts and tribunals to attorneys employed by the attorney general's office. It says nothing about legal advice given by in-house counsel to agencies and officers on a day-to-day basis. Ohio statutes permit departments of the state to employ the "necessary employees," including attorneys. There is nothing in the statutes which prohibit those attorneys so hired from engaging in the practice of law, including giving legal counsel. A September 1999 memorandum of understanding between the Attorney General and the Governor recognized that state agencies needed attorney employees to provide legal advice on a daily basis and that these legal communications are subject to attorney-client privilege. The court noted that Leslie's construction of section 109.2 might lead to the absurd result that his own employment as an attorney by the Department of Development was prohibited.

The court therefore concluded that the communications by attorney-employees of the departments in question were subject to the attorney-client privilege and should have been sealed.

Takings

Court Rejects *Agins*' "Substantially Advances" Test for Regulatory Takings: *Lingle et al. v. Chevron U.S.A., Inc.*, No. 04-163 (U.S. May 23, 2005)

Background

In June 1997, the Hawaii Legislature enacted a statute that imposed some restrictions on the ownership and leasing of service stations by oil companies. The legislature was concerned about the effects of market concentration on retail gasoline prices. The particular provision at issue in this case was the limitation on the amount of rent that an oil company could charge a lessee-dealer. Chevron, which controls sixty percent of the gasoline produced in the state and thirty percent of the wholesale market on Oahu, brought a lawsuit against the Governor and Attorney General of Hawaii claiming, *inter alia*, that the rent cap, on its face, unconstitutionally effected a taking of Chevron's property.

The parties entered into a joint stipulation that stated that, even under the new legislation, Chevron would continue to earn a return on its investment in lessee-dealer stations in Hawaii that satisfied constitutional standards. The district court granted summary judgment to Chevron, holding that Act 257 failed "to substantially advance a legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments." *Chevron U.S.A. Inc. v. Cayetano*, 57 F. Supp. 2d 1003, 1014 (1998). A divided panel of the U.S. Court of Appeals for the Ninth Circuit held that the district court had used the correct legal standard, but vacated the grant of summary judgment, holding that a material fact remained as to whether the statute would benefit consumers.

On remand, after a one-day bench trial where competing expert witnesses testified, the court held that Chevron's witnesses were "more persuasive" than the state's and, once again, concluded that the oil companies would raise gasoline prices to offset any rent reduction required so that consumers would pay in-

creased gasoline prices. It also found that incoming lessees would not obtain any of the benefits of the rent cap because existing lessees would sell at a premium and that the statute would actually decrease the number of lessee-dealer stations because it would discourage oil companies from building such stations. It therefore again held that the statute effected an unconstitutional taking.

The Ninth Circuit upheld the district court. Judge Fletcher dissented, renewing his earlier contention that the statute should not have been reviewed under the "substantially advances" standard. The Supreme Court granted certiorari.

Holding

The Fifth Amendment does not prohibit the taking of private property. Instead, it puts a condition on such taking. As the Court in *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 315 (1987), noted, it "is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." In *Pennsylvania Coal Company v. Mahon*, 260 U.S. 393 (1922), the Court recognized that some government regulation of private property could be tantamount to a direct appropriation and that such "regulatory takings" may, thus, be compensable.

The Court's precedents have established two categories of regulatory action that are considered *per se* takings for Fifth Amendment purposes: where the government has permanently physically invaded property and where the regulation has completely deprived an owner of "all economically beneficial" use of the property. *Loretto v. Teleprompter Manhattan CATV Corporation*, 458 U.S. 419 (1982); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992). Other than in these circumstances, regulatory takings are judged by the factors set forth in *Penn Central Transportation Company v. New York City*, 438 U.S. 104 (1978).

The Court's regulatory takings jurisprudence, taken together, focuses on identifying regulatory actions that are functionally equivalent to the classic taking scenario, where the government directly appropriates private property or ousts the owner. Thus, each of these tests looks at the severity of the burden the government imposes upon private property rights. In *Agins v. City of Tiburon*, 477 U.S. 255 (1980), in a case regarding zoning laws, the Court seemingly announced an additional test for takings—whether an ordinance would “substantially advance legitimate state interests.” This was the formula used by both the district court and the Ninth Circuit to determine that the Hawaiian statute was unconstitutional.

Upon consideration, however, the Court concluded that the “substantially advance legitimate state interests” test was not a takings test but, rather, prescribes an inquiry in the nature of a due process challenge. In fact, in support of the “substantially advance” language in *Agins*, the Court quoted *Nectow v. Cambridge*, 277 U.S. 183 (1928), a Fourteenth Amendment challenge to a city zoning ordinance. In *Nectow*, the Court looked to a due process challenge of a municipal zoning ordinance in *Village of Euclid v. Ambler Realty Company*, 272 U.S. 365 (1926). According to the Court, it was reasonable for the *Agins* Court to look to these earlier zoning regulations cases and the comingling of due process and takings inquiries in *Agins* had some precedence in the Court's decision in *Penn Central*. Also, when *Agins* was decided, there was a history of referring to deprivation of property without due process of law as “takings.”

Nonetheless, the “substantially advances” test suggests a means-ends test, an approach that has some logic in a due process inquiry. Such a test, however, does not have a place in determining whether private property has been “taken” for Fifth Amendment purposes. The test asks nothing about the character or size of the burden a regulation imposes on private prop-

erty nor does it ask how that burden is distributed among property owners. The Court stated:

[T]his test does not help to identify those regulations whose effects are functionally comparable to government appropriation or invasion of private property; it is tethered neither to the text of the Takings Clause nor to the basic justification for allowing regulatory actions to be challenged under the Clause.

Slip op. at 12.

The Court commented that Chevron's challenge to the statute in this case illustrates the flaws in the “substantially advances” test. The thrust of Chevron's argument is not that the statute has singled it out to bear a particularly severe regulatory burden. Instead, Chevron claims that the rent cap will not serve the state's legitimate purpose of protecting consumers against high gasoline prices. Chevron does not seek compensation for a taking but, rather, an injunction against a regulation it considers arbitrary and irrational. Furthermore, the “substantially advances” formula can be read to require courts to review the efficacy of state and federal regulations. This is a task for which courts are not well suited. It would allow, and perhaps require, a court to substitute its judgment for that of an elected legislature or agency.

Thus, the Court concluded that the “substantially advances” formula is not a valid method of identifying regulatory takings for which the Constitution requires just compensation. It reversed the judgment of the Ninth Circuit and remanded the case.

CIVIL PROCEEDINGS

New Filings

Air

Illinois v. American Kitchen Delights, Shahnawaz Hasan, and City of Harvey, No. (Cir. Ct. Cook County June 29, 2005)

The Illinois Attorney General's Office has filed suit against a Harvey, Illinois, company, its president, and the city for alleged violations of state environmental and air pollution laws at the closed Dixie Square Mall. According to the complaint, the presence of asbestos-laden debris both inside and outside the mall's Montgomery Ward building creates a health threat to both work crews renovating the site and to nearby residents.

The property on which the mall is located is owned by the city. American Kitchen Delights had begun gutting the old Ward's building for use as a warehouse although it had no permits to do so.

[For further information, contact Illinois AAG Bridget Carlson at (312) 814-0608.]

Pennsylvania, Connecticut, Maryland, New Jersey, and New York v. Allegheny Energy, No. 2:05CV885 (W.D. Pa. June 28, 2005)

The Pennsylvania Department of Environmental Protection and the Attorneys General of Connecticut, Maryland, New Jersey, and New York have filed a lawsuit against Allegheny Energy, charging that modifications at its coal-fired plants violate U.S. EPA's New Source Review regulations.

According to the complaint, modifications at the company's Hatfield's Ferry plant in Greene County, Pennsylvania, Armstrong plant in Armstrong County, and Mitchell plant in Washington County were accomplished without a required NSR permit and without installation of modern pollution controls.

[For further information, contact Connecticut AAG Kim Massicotte at (860) 808-5250; Maryland AAG Susan Martielli at (410) 537-3704; New Jersey DAG Kevin Auerbacher at (609) 292-2945; or New York AAG Peter Lehner at (212) 416-8450.]

Settlements

Air

United States and Delaware v. Formosa Plastics Corporation, No. 05-443 (D. Del. June 28, 2005)

Formosa Plastics Corporation, a Delaware chemical plant, has agreed to pay a \$450,000 fine and spend \$840,000 on plant upgrades to settle a state and federal lawsuit that alleged the company violated the Clean Air Act, Clean Water Act, and various hazardous waste storage and reporting laws.

The settlement also includes a program that requires the company to meet stringent future goals for reductions of vinyl chloride emissions or pay stipulated penalties. The agreement calls for Formosa to immediately reduce its current vinyl chloride permit level from 1,000 parts per million (ppm) to a rolling twelve-month weighted average of 750 ppm. Over the next three years, Formosa is to further reduce the emissions to 550 ppm and incorporate that new level into its permit limit.

Formosa has also agreed to implement a supplemental environmental project that will involve automating certain manufacturing process equipment that will further reduce vinyl chloride emissions.

[For further information, contact Delaware DAG Kevin Maloney at (302) 739-4636.]

United States v. Volkswagen of America, Inc., No. 05-1193 (D.D.C. June 15, 2005)

The federal government has entered into a Clean Air Act settlement with Volkswagen of America, Inc., under which the company will pay \$1.1 million to resolve its failure to promptly notify and correct a defective oxygen sensor. The defect affected at least 326,000 of their 1999, 2000, and 2001 Golfs, Jettas, and New Beetles. This is the largest civil penalty to date for this type of violation.

As a part of the settlement, Volkswagen completed a voluntary recall of the affected vehicles. The defect occurs gradually on engine start ups in cool and damp environments where the oxygen sensor cracks from "thermal shock." The dashboard indicator lights up, alerting the operator to "check engine." Although Volkswagen received numerous warranty claims during the winter of 1999 to 2000, it did not report the defect to EPA until June 2001.

Volkswagen will also improve its emissions defect investigation and reporting system to ensure future compliance.

[For further information, contact Jerry Ellington, DOJ, at (303) 312-7321.]

United States et al. v. Sunoco Oil Company, No. 2:05-cv-2816PBT (E.D. Pa. June 16, 2005)

United States et al. v. Valero and Tesoro, No. 05-0569 (W.D. Tex. June 16, 2005)

A comprehensive Clean Air Act settlement has been entered into with two major petroleum refineries that is expected to reduce harmful air emissions by more than 44,000 tons per year from eighteen refineries in eight states. Colorado, Louisiana, New Jersey, Oklahoma, and Texas joined in the settlement with Valero. Ohio, Oklahoma, Pennsylvania and the City of Philadelphia joined in the settlement with Sunoco.

The settlement with Valero and Tesoro, who purchased the former Valero Golden Eagle Refinery in

Martinez, California, calls for the expenditure of more than \$700 million to install and implement innovative emission control technologies at their refineries. This agreement is expected to reduce annual emissions of nitrogen oxide (NOx) by more than 4,000 tons and sulfur dioxide (SO₂) by more than 16,000 tons per year. Valero will also pay a \$5.5 million civil penalty and expend more than \$5.5 million on other projects to further reduce emissions and to support activities in the communities where it operates.

The Sunoco settlement requires the company to spend approximately \$285 million to install and implement control technologies. This agreement is expected to reduce NOx by more than 4,400 and SO₂ by more than 19,500 tons per year. In addition, Sunoco will pay a \$3 million penalty and spend more than \$3.9 million on supplemental environmental projects.

[For further information on the Valero settlement, contact Diane Shawley, DOJ, at (202) 514-0095. For further information on the Sunoco settlement, contact Michael McNulty, DOJ, at (202) 514-1210.]

CERCLA

United States v. B&B Mines, No. 05-CV-992 (D. Colo. May 31, 2005)

Under a recently-filed consent decree, B&B Mines has agreed to pay \$718,432 to reimburse U.S. EPA for the cost of addressing contamination at the Wellington-Oro site in Summit County, Colorado. The company will also sell the property to the Town of Breckenridge and Summit County for a cost reflecting the contamination.

The Wellington-Oro site was a lead-zinc-silver sulfide and gold ore operation. Under the agreement, the town and county will undertake cleanup at the site under Colorado's Voluntary Cleanup Program. They will also build and operate a water treatment plant to address acid mine drainage from the site.

[For further information, contact Andrea Madigan, Region VIII, U.S. EPA, at (303) 312-6904.]

CRIMINAL PROSECUTIONS**Pleas****Air (Asbestos)*****United States v. Kevin Pilgrim*, No. 05-CR-49
(N.D.N.Y. June 20, 2005)**

Kevin Pilgrim, formerly of Schenectady, New York, and now of Midvale, Utah, pled guilty to committing perjury during the federal criminal trial of Alexander and Raul Salvagno and AAR Contractor, Inc., for widespread conspiracies involving asbestos abatement. Pilgrim was called as the first witness for the defense. He testified that he worked at AAR and Analytical Laboratories of Albany for four years and neither observed nor participated in any illegal asbestos abatement activities. In pleading guilty, Pilgrim admitted that his testimony exonerating the Salvagnos was false. He admitted that Alex Salvagno had contacted him repeatedly by telephone (in violation of the conditions of Salvagno's pretrial order of release) to tell him about the government's evidence and to prep him on what he would need to say in order to rebut that evidence.

Pilgrim faces a maximum term of five years' imprisonment and a \$250,000 fine. His sentencing is scheduled for October 14, 2005.

[For further information, contact AUSA Craig A. Benedict at (315) 448-0672.]

Sentences**Air (Asbestos)*****United States v. Thomas C. Reed and Michael Shanahan*, Nos. 62-CR-051-002 & -007
(N.D.N.Y. June 23, 2005)**

Thomas C. Reed and Michael Shanahan have been sentenced to five and two years' imprisonment, respectively, following their guilty pleas for crimes related to illegal asbestos removal activities throughout New York State. Mr. Reed was also ordered to forfeit \$23 million to crime victims.

Thomas Reed was the general manager of AAR Contractor, Inc., an Albany, New York, asbestos abatement company formerly owned by Alex and Raul Salvagno. Michael Shanahan was an AAR field supervisor. Last year, the Salvagnos were sentenced to serve 25 and 19.8 years in prison, respectively. These terms represented the longest terms of incarceration ever handed down in the United States for environmental crimes.

Prior to the Salvagno trial, Thomas Reed pled guilty to fourteen felonies, include conspiracy to violate the Racketeer Influenced and Corrupt Organization Act (RICO) as well as various Clean Air Act (CAA) violations and tax fraud. Shanahan pled guilty to conspiracy to violate the CAA and to substantive CAA violations. Reed and Shanahan provided substantial assistance to the federal government against the former AAR owners. One dozen other former high level supervisors of AAR and of Analytical Laboratories remain to be sentenced.

[For further information, contact AUSA Craig A.

Benedict at (315) 448-0679.]

UPDATES

***Honeywell International, Inc. v. Interfaith Community Organization, Inc.*, No. 04-1560 (U.S. May 19, 2005):** Honeywell International has asked the U.S. Supreme Court to review a court-ordered cleanup of a site in New Jersey. The U.S. Circuit Court of Appeals for the Third Circuit upheld the ordered cleanup of the site under the Resource Conservation and Recovery Act. Honeywell argued that the court's ruling did not give sufficient deference to prior state agency-ordered remedies. (See the March 2005 issue of the *Journal*.)

***S.D. Warren Company v. Maine DEP*, No. 04-1257 (U.S. May 12, 2005):** A Maine dam owner has asked the U.S. Supreme Court to review a state court decision holding that water passing through a dam constitutes a discharge into waters for Clean Water Act certification purposes. According to the petition, the court's decision violates the U.S. Supreme Court's decision in *South Florida Water Quality Management District v. Miccosukee Tribe of Indians*, 541 U.S. 5 (2004).