

Aggregation Spells Trouble For Pa. Oil And Gas Cos.

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Many individual activities in the upstream and midstream oil and gas industry create only small amounts of air emissions, below the thresholds to trigger certain air permit requirements. However, a recent ruling by the Pennsylvania Environmental Hearing Board, *National Fuel Gas Midstream Corp. v. Pennsylvania Department of Environmental Protection* (NFG), incorrectly applied in every respect an accepted test for determining whether multiple sources should be considered a single source under the Clean Air Act, leading to the aggregation of well pad and midstream operations. As a result, oil and gas sources in Pennsylvania may face major source permitting requirements under a great many previously unexpected circumstances.

This decision involves an appeal from a single source determination covering a well pad owned and operated by an exploration and production company and a compressor station owned and operated by a midstream company. The two entities are affiliates, but all of their dealings were administered through contracts, and their dealings were not exclusive. The facilities in question are physically separated by a quarter mile of forest. The Department of Environmental Protection decided to aggregate these well pad and midstream operations into a single “source,” thereby subjecting the entire operation to limits that otherwise applied only to the compressor station. The board upheld that decision.

This ruling has increased the risks of litigation for all oil and gas companies doing business in Pennsylvania for what should be routine air permitting matters. Moreover, the board accepted a highly diluted test for common control that is satisfied by accepted corporate practices like a parent company’s review of a subsidiary’s budgets, the use of interlocking directors, and oversight of decision-making by a subsidiary. This startling ruling suggests that the test for control under the permitting provisions of environmental regulatory statutes is different from the standard for remediation liability set out in another environmental law context, Superfund, by the U.S. Supreme Court.

What is Aggregation?

In order to determine whether a “source” of air pollutants creates enough emissions to trigger the thresholds for various air permit programs governing “major” sources, regulators like the U.S. Environmental Protection Agency and the DEP must first define what the “source” is. Both the EPA and Pennsylvania’s air permitting regulations effectively define a stationary source as “all of the pollutant-emitting activities which belong to the same industrial grouping, are located on one or more contiguous or adjacent properties, and are under the control of the same person (or persons under common control).”

From its inception, the definition was intended to convey the common-sense notion of a “plant.” For large, consolidated facilities like a refinery, this usually is a fairly simple inquiry. In contrast, activities in the upstream and midstream segments of the oil and gas industry tend to be more spread out, making it more difficult for regulators to apply the three-part test dictated by the regulatory definition of a “source.” In the NFG decision, the board gave each of these three requirements an extremely broad reading, which would allow far more oil and gas activities to be aggregated into a single source.

Industrial Grouping

In order to be considered part of the same industrial grouping, the “pollutant-emitting activities” must belong to the same major group — i.e., share the same first two digits in their code — in the Standard Industrial Classification (SIC) Manual. The parties in NFG agreed on the SIC classification for the well pad, but disagreed over the midstream compressor station’s classification. The board determined that the compressor station was part of the same major group as the well pad by looking to the station’s “principal pollutant-emitting activity,” rather than focusing on the core activities conducted at the facility, or how the station owner characterized its own activities.

The board independently chose the applicable SIC code by looking at the sources, which were compressors, and apparently looking for references to compressors in the SIC code. This Boolean approach led the board to choose a “catch-all” SIC code that neither party suggested, and which service firms like Halliburton and Schlumberger use for businesses that are very different from the midstream operations in question. Characterizing a midstream operation as a “services” company providing “contract compression” because it moves the natural gas under a contract with the exploration and production company would be no different than characterizing a refinery as a pipeline company because the crude and refined products move around within the facility through pipelines.

Contiguous or Adjacent Properties

The second part of the test looks to whether the activities are located on one or more contiguous or adjacent properties. Here, the well pad and compressor station were (barely) within a quarter of a mile measured from the edge of the properties, but were physically separated by a state forest and were not visible from each other. The board rejected the idea that two activities could be aggregated simply because they were located on the same leasehold. Instead, it found that the fence-line or developed area of the facility should be the focus. The board nonetheless determined that the properties were adjacent to one another.

Regulators in various states and at the federal level have differed in their approaches to determining when two properties can be considered “adjacent.” The first question in this analysis is how far the

activities can be from one another and still be considered adjacent. For example, states such as Texas, Oklahoma and Louisiana have determined that the activities must be within a quarter-mile of each other to be “adjacent.” Pennsylvania likewise uses a quarter-mile as a “rule of thumb,” and the EPA is proposing to use a similar quarter-mile distance limit in its source definition rule.[1]

The second question is, distance from what? Must the pollution emitting activities themselves be within the distance limit, or only the boundaries of the two properties? In the NFG case, for example, the properties were 0.30 miles apart if measured from the well pad to the compressor station, but the property lines of the two sites were within the quarter-mile “rule of thumb” distance that the DEP uses in its determinations. By contrast, the EPA’s proposed source definitions noted that Louisiana’s source guidance specifies that the geographic center of the site’s emissions is the critical starting point for the quarter-mile distance used to determine the boundary of the single source.

The EPA requested comment on whether the center or some other feature, such as the boundary of the surface site, is more appropriate to use as the starting point of the measurement radius when determining the source. An approach like the one used by the board that focuses on property lines, rather than the location of the emitting activities, loses sight of the fundamental question of whether the operations in question function as a single unit so that their permitting can be done on that basis. The property line perspective allows additional activities to become caught in the source net and aggregated in the permitting analysis.

Common Control

Finally, the source test requires that the emitting activities be under common control, a term that neither EPA nor DEP regulations define. Rather than looking to relevant definitions of control, the board instead declared that “the terms ‘control’ and ‘common control’ are sufficiently clear and unambiguous so as to be given their plain meaning.” The board found that such common control existed not by looking at the operations of the facilities themselves but instead by focusing on the role of the ultimate parent company on material business issues that rise to the level of the board of directors. The board explained that while the two subsidiaries implemented their own budgets, the mere fact that those budgets were subject to review by the parent’s CEO at annual meetings gave the parent “control” over the subsidiaries and “could play a more active role” in the operations of the subsidiaries if it chose to. Rather than actual control, the board was plainly applying an “authority to control” concept.

This expansive understanding of “control” ignores the usual respect given to separate corporate entities, and stands in stark contrast to the analysis that the Supreme Court has directed courts to use when determining whether a parent entity can be held liable for the activities of its subsidiaries under the Comprehensive Environmental Response, Compensation and Liability Act of 1980. Under *United States v. Bestfoods*, a parent company must either actually control the facility in question, or must be exercising such extensive control over the subsidiary that it is appropriate to pierce the corporate veil.

As the Supreme Court emphasized, “it is hornbook law that the exercise of the ‘control’ which stock ownership gives to the stockholders ... will not create liability beyond the assets of the subsidiary. That ‘control’ includes the election of directors, the making of by-laws ... and the doing of all other acts incident to the legal status of stockholders.” Other courts, including the United States Court of Appeals for the Third Circuit, applied *Bestfoods* in analyzing control issues under the Clean Air Act.[2] Because every parent company likely has the “authority” to control its subsidiary’s decision-making on material issues, the control test enunciated by the board will find “common control” in almost every situation where the sources are owned by affiliates.

Had the board applied the correct legal test to the germane facts before it, the outcome of the common control analysis should have been very different. Indeed, the board found that well pad and compressor station do not share purchasing functions, personnel services, benefit plans, maintenance responsibilities, environmental compliance, or remediation responsibilities, and the employees of each do not have permission to enter the facilities of the other subsidiary. It is hard to imagine a factual context less conducive to a finding of common control at the facility level. The board's finding of common control using an authority to control test strains all notions of common sense, particularly where the employees of one affiliate do not have a legal right to be on the property of the source whose emissions are being aggregated with theirs.

The board's control analysis is also noteworthy for its lack of any consideration of the myriad implications from its new, broad test for "control" between a parent and its subsidiaries in the air permitting context. Is this "control test" the correct legal standard for other questions such as responsibility for fines and penalties? Can a determination that the parent controls the operations at a particular facility have any collateral impacts in the event of accidents or other industrial incidents at aggregated facilities? The decision leaves these questions unanswered.

Not only does this ruling depart markedly from how the individual factors of the test are to be applied, its outcome actually mocks any common-sense notion of a single plant. In NFG, there are two physically separated facilities with separate workforces that are engaged in distinct operations. Their environmental compliance functions are administered entirely separately, and the employees from one operation do not even have the right to be on the other's property. There was not a single fact suggesting that the day-to-day operations of either facility are run by a single management group. Not only can one operation not be seen from the other, the facilities are in fact separated by a state forest. A ruling that takes the reality of what happens in the operations on the ground out of the analysis of whether the two businesses should be considered a single plant flouts common sense.

Conclusion

The board's ruling is potentially very problematic in several important respects, not the least of which is creating the kind of uncertainty on key permitting points that citizens' groups like to exploit in opposing projects. The board's superficial conclusion regarding common control is perhaps the most notable of these errors as it makes a gigantic leap on the law and the facts to conclude that control of a subsidiary's board room equates to control over the operations at a particular facility without regard to an actual lack of control at the facility level. The decision is currently being appealed. Unless and until reversed, it should be a concern for all oil and gas businesses operating in the state, where the Marcellus Shale has accounted for a significant portion of increased shale gas production in recent years.

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[1] See Environmental Protection Agency, Source Determination for Certain Emission Units in the Oil and Natural Gas Sector, 80 Fed. Reg. 56,579 (Sept. 18, 2015).

[2] United States v. Dell'Aquila, 150 F. 3d 329 (3d Cir. 1998).

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