Section of Environment, Energy, and Resources
AMERICAN BAR ASSOCIATION

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MESSAGE FROM THE COMMITTEE NEWSLETTER VICE CHAIR

Brittany Tofinchio

ENRL's third and final newsletter of the 2012–2013 ABA year covers general topics in the energy and natural resources litigation field. The article titles include: Lease Contests in the West Virginia Shale Plays, How and When an Operator Can Avoid Fiduciary Duties to Working Interest Holders, State Appeals Court Upholds New York Town's Oil and Gas Activity Ban, and EPA's Illegal Rules Prohibiting Blending and Bacteria Mixing Zones Vacated.

I have enjoyed working with the many great authors of ENRL's Newsletter articles this year and look forward to working with more this coming ABA 2013–2014 year as your Vice Chair of Committee Newsletters. If you have any ideas or suggestions for the ENRL Newsletter, I would be happy to speak with you.

ENRL's first newsletter submission deadline for the 2013–2014 year will be in early fall, so please be on the lookout for an e-mail with guidelines. If you already have an article, please feel free to submit it at any time. I can be reached at bktofinchio@aol.com.

Brittany Tofinchio is an attorney-advisor at the Federal Mine Safety and Health Review Commission. The views presented above are solely those of the author and not necessarily the United States government.

LEASE CONTESTS IN THE WEST VIRGINIA SHALE PLAYS

Joseph V. Schaeffer

Over the past eighteen months, landowners have filed independent actions in West Virginia state courts to invalidate oil and gas leases, some, if not all, of which have been removed to the federal court for the Northern District of West Virginia. *See Heller v. TriEnergy, Inc.*, 877 F.Supp.2d 414 (N.D.W.Va. 2012) (removed from Marshall County); *Holmes v. Chesapeake Appalachia,* No. 5:11-CV-123, 2012 WL 3647674 (N.D.W.Va. Aug. 23, 2012) (removed from Ohio County); *Davis v. EQT Prod. Co.*, No. 5:12-CV-051, 2012 WL 6111694 (N.D.W.Va. Dec. 10, 2012) (Hancock County). The facts and causes of actions in the plaintiffs' complaints are substantially similar. In each case, plaintiffs signed leases between 2006 and 2008 on unfavorable or below-market terms and now wish to void those leases on various theories, including improper acknowledgment and recordation, fraud, and unconscionability.

Until recently, all of these lease contest cases had been referred to arbitration or voluntarily dismissed, leaving these questions largely unsettled. However, *Barber v. Magnum Land Services, LLC*, a recent case filed in Preston County, West Virginia, and removed to the Northern District, has the potential to settle many of these outstanding questions. *See* Complaint, No. 13-cv-00033 [dkt. 1-1] (N.D.W.Va. Feb. 28, 2013).

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Brittany Tofinchio, Editor

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Improper Acknowledgment

The plaintiffs in *Barber* allege that their leases should be expunged and voided because they were improperly acknowledged. *See* Complaint at 11-16. In West Virginia a deed, contract, or other writing must be acknowledged before it can be recorded, and the acknowledgment must be made in the presence of a notary or commissioner. W.Va. Code §§ 39-1-2 and 39-1-4. Plaintiffs admit they entered into oil and gas leases, and those leases bear their signatures, but they allege those signatures were notarized outside of their presence, and accordingly their leases should be expunged from the records. Complaint at 11-14. Further, the plaintiffs argue that, because the signatures were notarized by defendants' employee, the leases should be voided for the disqualifying interest of the acknowledging party. *Id.* at 14-16.

The West Virginia Supreme Court of Appeals has yet to rule on these narrow issues—whether a failure to acknowledge a lease in the presence of the lessors requires its expungement, and whether a notary is *per se* disqualified when he is compensated by an interested party. Nevertheless, the Northern District has considered the issue of improper acknowledgement and held that the plaintiffs failed to state a claim where they freely admitted to having signed the lease. *See Heller v. TriEnergy, Inc.*, 877 F.Supp.2d 414, 426 (N.D.W.Va. 2012). Moreover, West Virginia has a longstanding rule against invalidating records on "narrow and technical" grounds, and it has also abandoned a *per se* rule of invalidating instruments acknowledged by a notary with a disqualifying interest. Syl. Pt. 3, *Janesville Hay Tool Co. v. Boyd*, 35 W.Va. 240, 13 S.E. 381 (1891); *Galloway v. Cinello*, 188 W.Va. 266, 423 S.E.2d 875 (1992). Indeed, the purpose of an acknowledgment is to (1) authenticate an instrument, (2) permit its admission into evidence, and (3) entitle it to be recorded. *Galloway*, 188 W.Va. 266, 423 S.E.2d 875. Notably, West Virginia does not require an acknowledgment for a lease to be enforceable under its statute of frauds. W.Va. Code § 36-1-3.

Fraud

The plaintiffs in *Barber* have alleged fraud, fraudulent inducement, and fraudulent concealment. *See* Complaint at 16-19. In support of their fraud claim, plaintiffs allege that landmen told them gas could be removed from underneath their properties with or without their consent, and signing a lease was the sole means of ensuring they would receive compensation. Likely, the landmen were referring to the rule of capture, by which a landowner's free-flowing oil or gas may be drained by a well on adjacent property, and which has a long history in West Virginia. *See Powers v. Union Drilling, Inc.*, 194 W.Va. 782, 787, 461 S.E.2d 844, 849 (1995). Less clear is the extent to which the rule of capture, as a practical matter, applies to the Marcellus and Utica Shales, where gas is trapped within tight rock formations, rather than free-flowing. Although this question remains unsettled, it should be noted that Judge Bailey recently held that "hydraulic fracturing under the land of a neighboring property without that party's consent" is not protected by the rule of capture, but is rather an actionable trespass. *Stone v. Chesapeake Appalachia*, No. 5:12-cv-102 *16 (N.D.W.Va. filed Apr. 10, 2013).

Of the plaintiffs' fraud claims, their claim for fraudulent concealment has the greatest potential to impact lease negotiations in West Virginia. At the heart of the plaintiffs' claim is that landmen knew the market for oil and gas leases was more favorable than the offers tendered to the plaintiffs; that landmen had a duty to inform the plaintiffs of the more favorable terms; that landmen nevertheless did not inform the plaintiffs of the more favorable terms; and that the plaintiffs signed leases with unfavorable terms as a result. West Virginia has long recognized a cause of action for fraudulent concealment, but an essential element of any such action is the duty to disclose. Such a duty exists where there is a fiduciary or confidential relationship between the parties or there is a relative inequality in the parties' knowledge or circumstances. *Pocahontas Mining Co. LP v. Oxy USA, Inc.*, 2012 W.Va. 169, 175, 503 S.E.2d 258, 265 (1998). However, as a general rule, there is no duty of disclosure as between parties to an arm's length business transaction.

Unconscionability

Finally, the plaintiffs in *Barber* seek to avoid their leases on the basis of unconscionability. *See* Complaint at 19-21. Traditionally, unconscionability was defined as a bargain that would be made neither by a man in his senses and without delusion nor accepted by a fair man. The modern rule, as applied in West Virginia, defines unconscionability by both its procedural and substantive elements. *Brown v. Genesis Healthcare Corp.*, 229 W.Va. 382, 729 S.E.2d 217 (2012). Procedural unconscionability may exist where the lessor and lessee have unequal bargaining power or the party claiming unconscionability lacks meaningful alternatives. Substantive unconscionability considers whether the terms of the lease are fair. For a lease agreement to be unconscionable, both the procedural and substantive elements must be met. However, a court will apply a sliding scale, whereby greater evidence of procedural unconscionability will require less evidence of substantive unconscionability and vice versa.

The plaintiffs in *Barber* have claimed that their leases are procedurally unconscionable because they were not represented by counsel and the terms were not negotiated. *See* Complaint 16 ¶ 112, 20 ¶ 132. As evidence of substantive unconscionability, plaintiffs cite to $50/acre bonus payments and 12.5 percent royalty rates, both of which they allege were below-market. *Id.* at 20 ¶¶ 132–33.

Although the absence of counsel during lease negotiations may be evidence of unconscionability, it does not render an agreement *per se* unconscionable. Likewise, contracts of adhesion are not *per se* unconscionable. It is also unlikely that a court will find unequal bargaining power or lack of meaningful alternatives in the vast majority of lease contest cases. Landmen and industry are more experienced in negotiating leases, but a lessor will have sufficient time in almost every instance to inform himself about oil and gas leases or obtain counsel prior to signing a lease. Most importantly, lessors ultimately possess rights to the natural gas beneath their properties, and this provides the lessor with leverage over landmen, particularly in a state like West Virginia without forced pooling. *But see* J. Zach Burt, Comment, *Playing the "Wild Card" in the High-Stakes Game of Urban Drilling: Unconscionability in the Early Barnett Shale Gas Leases*, 15 TEX. WESLEYAN L. REV. 1 (2008).

As to substantive unconscionability, the general rule is that a court will not test the adequacy of consideration, and a party will be bound to his bargain, even if he later regrets its terms. But, a court may void or reform a contractual provision if it shocks the conscience. Nevertheless, this is a difficult burden for plaintiffs to meet, and substantive unconscionability generally is determined in light of circumstances as they existed when the lease was made. *But see Kansas Baptist Conv. v. Mesa Operating Ltd. P'ship*, 253 Kan. 717, 864 P.2d 204 (1993) (considering changed circumstances).

Plaintiffs face a significant burden, perhaps even an impossible burden, in arguing that a 12.5 percent royalty is unconscionable, because 12.5 percent is the state minimum royalty in West Virginia. Additionally, plaintiffs' argument for unconscionability is, at least in part, premised on the higher bonuses and royalty rates obtained by other landowners, but there is no indication that plaintiffs' properties are comparable to those other properties. For instance, bonus payments and royalties often increase proportionate to the acreage and potential of the tract being leased.

Nevertheless, a fact-finder might determine that either a low bonus payment or a low royalty would be permissible alone, but that together they are unconscionable. A property that is high-risk for an oil and gas company might justify a low bonus payment, but a higher royalty if the well is productive. On the other hand, at least one court has reflected on the inherently speculative nature of the oil and gas industry to hold that a bonus payment was not unconscionable. *Thompson v. Kiddings*, 276 P.2d 229 (Okla. 1954); *see also Heyward v. Bradley*, 179 F. 325 (4th Cir. 1910) (ordering specific conveyance of property containing phosphate rock despite contention by seller that increase in value of property justified rescission); *Moore v. Sawyer*, 167 F. 826 (C.C.E.D. Okla. 1909) (refusing to find 10 percent royalty and bonus payment unconscionable where there was no fraud and royalty rate was usual).

Conclusion

Landmen and operators should follow *Barber* closely because of its potential to create precedent in West Virginia regarding duties of disclosure in lease negotiations and unconscionability of terms. Landmen and operators may also choose to take the following steps to limit their potential liability. First, advise landowners of their right to review the lease before signing. At the same time, inform landowners that an offer is of limited duration and may be withdrawn as circumstances require. Second, avoid potentially misleading references to the rule of capture or, at a minimum, accurately define the rule. Third, ensure that the landowner is aware that the landmen or operator is not his or her representative, but rather represents the lessee. Fourth, avoid absolute statements regarding bonus payments and royalties, as these may be difficult to verify. Instead, counsel landowners that bonus payments and royalties may vary according to the market and the acreage and prospects of the tract to be leased. Fifth, have an attorney review oil and gas leases for potentially troublesome terms. Finally, ensure that any signed lease is properly acknowledged. Although an improperly acknowledged lease should be enforceable against the lessor and lessee, it will not provide constructive notice to subsequent bona fide purchasers. By taking the foregoing steps, landmen and operators will be in a position to avoid lease contests or at least establish a strong defense.

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HOW AND WHEN AN OPERATOR CAN AVOID OWING FIDUCIARY DUTIES TO WORKING INTEREST HOLDERS

Ben Allen

Operators of oil and gas exploration and development projects have many incentives to avoid owing fiduciary duties to working interest holders. From a legal standpoint, fiduciary duties require the operator to act with the utmost loyalty and good faith and to subordinate its interests to working interest owners when those interests conflict. From a practical standpoint, fiduciary duties can force operators to perform an accounting of finances for their projects to working interest holders on demand. They also lower the threshold for working interest holders to second guess and challenge operators' economic decisions, such as whether to explore or drill, whether to obtain financing, and when to plug and abandon. In an industry where information is uncertain and hindsight is 20/20, fiduciary duties can create a basis for liability to the disgruntled working interest holder. An operator knowledgeable of when and how these fiduciary duties can be waived can better manage this risk, or at least know where the risk is unavoidable.

A joint operating agreement (JOA) defines the operator and working interest owners' relationship, but whether the JOA creates a "special relationship" is the ultimate question courts ask to determine whether operators owe a fiduciary duty to working interest holders.

The American Association of Professional Landmen (AAPL) has promulgated four Joint Operating Agreement forms over the years—in 1956, 1977, 1982, and 1989. The most recent form contains the following clause relating to operator liability to working interest owners:

> Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and compliance with applicable law and regulations, but in no event shall it have any liability

as Operator to other parties for losses sustained or liabilities incurred except as may result from gross negligence or willful misconduct.

AAPL Form JOA, Art. (V)(A) (1989).

Jurisdictions construing this language, and language like it, to determine the operator's responsibilities to working interest holders fall into roughly four categories: (1) those that never recognize fiduciary duties; (2) those that recognize fiduciary duties in some circumstances but also give the parties the right to disclaim them in the JOA; (3) those that determine the existence of a fiduciary relationship on a case-by-case basis; and (4) those that construe JOAs as joint ventures and, therefore, always recognize a fiduciary relationship.

No Fiduciary Duty

First, Oklahoma, Arkansas, and Louisiana recognize no fiduciary duty is implied between operators and working interest holders. 52 Okl. St. § 902 (passed in 2012 and overturning prior case law recognizing fiduciary duties); Ark. St. Ann. § 15-72-207(a) (mineral lessee does not owe fiduciary duty to mineral interest owners); *Clovelly Oil. Co., LLC v. Midstates Pet. Co., LLC*, No 2012-C-2055, 2013 WL 1115296, *9 (La. 2013) (recognizing no fiduciary duty because the JOA does not create a partnership unless the contract expressly so provides).

Freedom to Contract Jurisdictions

The second type of jurisdiction favors freedom of the parties to contract their agreement and will allow operators to disclaim fiduciary liability with clear contract language, such as the language appearing in the 1989 AAPL Form JOA.

For example, North Dakota law provides that "[i]n the case of joint ventures to develop oil and gas properties, the law is well established that the determination of the existence and extent of such [fiduciary] duties is controlled by the terms of the agreement between the parties." *Grynberg v. Dome Petrol. Corp.*, 599 N.W.2d 261, 268 (N.D. 1999). In Texas, an exculpatory clause relieved the operator from liability for any act taken in its capacity '"as Operator' under the JOA (except for gross negligence or willful misconduct") (citing *Caddo Oil Co. v. O'Brien*, 908 F.2d 13, 17 (5th Cir. 1990) (expressly holding that a disclaimer of liability except for cases of willful conduct precludes a claim for breach of fiduciary duty under Louisiana law)). It also appears that Texas may not recognize even implied fiduciary duties between operators and working interest holders. "[U]nder Texas law, 'evidence of a joint operating arrangement to develop a particular lease [in and of itself] will not support a finding of a broader relationship,' such as a partnership or joint venture." *Norman v. Apache Corp.*, 19 F.3d 1017, 1024 (5th Cir. 1994) (quoting *Rankin v. Naftalis*, 557 S.W.2d 940, 946 (Tex. 1977)).

Some jurisdictions however, like Wyoming, clearly recognize a fiduciary duty between operator and working interest holders in certain circumstances but still allow operators to disclaim liability—even where there is a fiduciary relationship—by contractually authorizing particular acts. *Andrau v. Michigan Wisconsin Pipe Line Co.*, 712 P.2d 372, 376 (Wyo. 1986) ("Parties are permitted to limit their fiduciary duties by contract provisions specifically authorizing particular acts."). In *Andrau*, the Court held an operator could not be liable for foreclosing on a non-operator's interest to satisfy debts for drilling costs because the JOA specifically gave the operator the right of foreclosure. *Id.* at 376-377. However, a JOA could just as easily include a term providing that the operator has the absolute discretion to decline or elect to produce, explore, or contract with third parties, which in a jurisdiction like Wyoming, could have the effect of disclaiming many of the commonly litigated potential fiduciary obligations operators face.

Facts-and-Circumstances Jurisdictions

The third type of jurisdiction typically views the existence of a fiduciary relationship between the operator and working interest holders as a factual inquiry based upon the facts and circumstances surrounding the transaction. The Tenth Circuit, construing Colorado law, applies a facts-and-circumstances analysis to determine whether an operator owes fiduciary duties to a working interest owner, with the notable caveat that "an agency relationship may be specifically disavowed in the contract itself." *Dime Box Pet. Corp. v. Louisiana Land and Explor. Co.*, 717 F.Supp. 717, 722, *affirmed*, 938 F.2d 1144 (10th Cir.). Despite the opinion's freedom-of-contract-sounding language, however, the Tenth Circuit only commits to holding that there is no joint venture and, therefore, no fiduciary duties where "experienced and sophisticated parties with equal bargaining power have fully negotiated a contract which specifically disavows a joint undertaking." *Id.* Absent facts and circumstances meeting this high threshold, courts applying Colorado law would likely leave to a jury whether a joint venture existed to create a fiduciary duty. *Id.* at 722 ("Whether a joint venture exists is a question of fact for the fact-finder to determine from the facts and circumstances in evidence"). The Tenth Circuit appears to have extended the facts and circumstances analysis to operator and working interest holders relationships under Utah law as well. *See Cascade Energy and Metals Corp.*, 896 F.2d 1557, 1569 (10th Cir. 1990) (applying Utah law and upholding district court's factual finding of fiduciary duty under joint operating agreement).

Jurisdictions Where Operators Always Owe Fiduciary Duties

Lastly, some jurisdictions hold that JOAs are joint ventures, a particular breed of partnership, and, therefore, all members of the JOA owe each other fiduciary duties. For example, the Supreme Court of Kansas held that a JOA creates a fiduciary relationship between operators and working interest holders even where language in the JOA expressly disclaimed a fiduciary relationship. *See First Nat'l Bank & Trust Co. v. Sidwell Corp.*, 678 P.2d 118, 124 (Kan. 1984). Likewise, in Michigan, all parties to contracts for the development of oil and gas wells are joint venturers and owe a fiduciary duty to one another as a matter of law. *Schmude Oil Co. v. Omar Operating Co.*, 458 N.W.2d 659, 665 (Mich. 1990).

Drafting Considerations

Although this area of the law has yet to be developed in many states, there are a few clear drafting strategies. For facts-and-circumstances jurisdictions, operators will be able to protect themselves by documenting the equality of the parties' bargaining power (where possible), and in jurisdictions like Wyoming, operators will be able to insulate themselves from claims relating to actions they can anticipate and specifically authorize in the JOA. Fortunately, these approaches can be used in tandem to minimize the operator's potential exposure as a fiduciary. The good news is that outside of jurisdictions holding that every JOA creates a fiduciary relationship, operators will usually be able to avoid being fiduciaries to their working interest holders with some careful drafting and planning.

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STATE APPEALS COURT UPHOLDS NEW YORK TOWN'S OIL AND GAS ACTIVITY BAN

Damian Privitera

Just days before the New York State Assembly voted to extend a hydraulic fracturing moratorium in early May, which seeks to prevent drilling of the Marcellus Shale basin through May 2015, a state appeals court ruled in favor of Dryden, New York, to uphold a hydraulic fracturing ban passed into its local zoning ordinances in 2011. Fearful of political gridlock in Albany—rightfully so as the moratorium bill is still pending in the New York State Senate as of August 2013—and impatient to act, this 14,000-resident town in the southern part of the state decided the time had come to ban the activity altogether. After years of litigation, this ban withstood scrutiny at two levels of state court, arming the nearly 175 other towns around the state that have bans and moratoriums in effect, as they prepare to defend their own legislation against potential challenges.

Dryden, New York amended its zoning ordinance in August 2011 after its residents convinced the town board to clarify that oil and gas activities were prohibited, which includes hydraulic fracturing and its associated activities. Dryden was promptly sued by Anschutz Exploration Corporation, who challenged the locality's right to ban industrial activity, arguing that New York State's Oil, Gas and Solution Mining Law (OGSML) preempted Dryden's zoning ordinance. *See Anschutz Exploration Corp. v. Town of Dryden*, 2012 N.Y. Slip Op. 22037 (Sup. Ct. Tompkins Co. Feb. 21, 2012*)*. But a state trial judge agreed with Dryden that the New York State Constitution's home rule provision granted it the right to make local land use decisions. *Id.* As a matter of first impression, the decision hinged on the statutory interpretation of the preemption provision in the statute, which provides that the OGSML "shall supersede all local laws or ordinances relating to the regulation of the oil, gas and solution mining industries…." *See* N.Y. Env. Cons. Law § 23-0303(2) (2011). Judge Philip Rumsey found analogous precedent to conclude that Dryden's zoning ordinance did not itself relate to the oil, gas, and solution mining industries, but rather to the regulation of land use. *Anschutz*, 2012 N.Y Slip Op. 22037 at 13.

Norse Energy appealed Anschutz's loss in a case that ended up in the Appellate Division, Third Department. In its decision, the appeals court unanimously upheld the state trial court opinion that the OGSML did not expressly preempt land use zoning ordinances, and delved further into an examination of whether the OGSML may impliedly preempt these same land use ordinances. *See Norse Energy Corp. v. Town of Dryden et al.*, No. 515227 (N.Y. App. Div. May 2, 2013). Not persuaded by Norse's arguments that the OGSML impliedly preempted Dryden's zoning ordinances for consistent policy and regulation purposes, the court once again ruled in favor of Dryden and upheld its hydraulic fracturing ban. *Id.* at 14-15. Though Norse has indicated it wishes to appeal this decision to the Court of Appeals, an appeal would require special dispensation from the Third Department.

This is an important decision, and not only for the people of Dryden. As of May 2013, nearly 175 New York State municipalities have passed bans or moratoriums on hydraulic fracturing, and this decision gives them an arrow in their quivers, at least to fend off attacks based on the legal theory of preemption. In addition, the decision demonstrates the grassroots efforts poised to lobby town boards and councils while those in Albany continue their cost-benefit analysis of allowing and regulating gas exploration, drilling, and production. A de-facto moratorium on hydraulic fracturing remains in effect, as no permits for the activity are being granted by the state during the time that the scientific and economic studies are pending. Dryden's win may further empower towns and municipalities to pursue land use ordinances banning hydraulic fracturing, secure in the knowledge that an outright ban enacted per land use powers cannot be preempted by the OGSML, especially those who fear the larger lobbying efforts underway in the capital.

Damian Privitera is a rising 3L at Georgetown University Law Center, where he is a Global Law Scholar focusing on the environment, energy, and land use and their intersection with international law and policy. He has worked as a research assistant to a professor of international water law, clerked at the Environmental Protection Agency, and recently concluded an internship, in-house, at a French power company. He can be reached at djp59@law.georgetown.edu.

EPA'S ILLEGAL RULES PROHIBITING BLENDING AND BACTERIA MIXING ZONES VACATED

John C. Hall and Keisha M. Sedlacek

In a forty-two-page unanimous opinion released on March 25, 2013, the Eighth Circuit Court of Appeals firmly renounced the Environmental Protection Agency's (EPA's) attempts to revise, without rulemaking, National Pollution Discharge Elimination System (NPDES) rules limiting facility design options for processing peak flows (commonly referred to as "blending") and preventing the use of bacteria mixing zones for NPDES discharges. *Iowa League of Cities (Iowa League) v. EPA*, 711 F.3d 844 (8th Cir. 2013). Additionally, the court concluded that a blending prohibition was beyond EPA's statutory authority (*i.e.*, was *"ultra vires"). Id.* at 876-79.

The *Iowa League* decision represents a major victory for municipal interests across the country. By EPA's own estimate, the blending ban alone imposed over $150 billion in costs nationwide. *See* Draft National Cost Impact Analyses by Limno-Tech, Inc. (an EPA consultant). The costs associated with a bacteria mixing zone ban were never estimated. However, one Midwest state official stated to League Counsel that a federal bacteria mixing zone prohibition would have put every stormwater discharger in their state in non-compliance with no reasonable way to ever meet the permit limitations.

Background on the Case

The *Iowa League* decision was the culmination of a decade-long battle to obtain judicial review of various EPA blending prohibition policies and to confirm that the use of peak flow "blending" was allowable under the Clean Water Act (CWA). Blending is a type of facility design used to manage peak wet weather flows by routing such flows around sensitive treatment units and recombining it before being discharged. This allows greater flows to be treated while still meeting all permit requirements. In 2005, EPA Headquarters issued a "draft" peak flows policy, which classified blending as an "illegal bypass" and required a "no feasible alternatives" demonstration before blending could be used. 70 Fed. Reg. 76,013 (Dec. 22, 2005).

The second issue addressed by the *Iowa League* case, was EPA's prohibition regarding bacteria mixing zones. A bacteria mixing zone is a designated area where the treated water is discharged and mixes with the receiving water. Typically, states allow such mixing zones if they are not near a bathing beach or high-use area. However, in late 2008, EPA issued the "King Memorandum," which stated that bacteria mixing zones "should not be permitted" in primary contact recreation waters. Memorandum from Ephraim S. King, EPA Director of Science and Technology to Water Management Division Directors, EPA Regions 1-10 (Aug. 10, 2005), *available at* http://water.epa.gov/scitech/swguidance/standards/criteria/nutrients/upload/tier2.pdf. This memorandum essentially modified the mixing zone provisions contained within every state's water quality standards. EPA required approved NPDES state agencies to enforce these controversial policies at the time of permitting, or face an EPA objection letter.

In 2011, the League filed for review of these policies after EPA issued two letters in response to inquiries by Senator Charles Grassley and the Iowa Water Environment Association, which confirmed these permit prohibitions were being actively enforced. The League argued that these new, nationwide permitting prohibitions were inconsistent with the Agency's adopted rules and exceeded CWA authority by attempting to dictate treatment plant design. EPA claimed that the positions set forth in these letters simply reflected existing, longstanding regulatory requirements and, therefore, did not require EPA to follow formal rulemaking procedures under the federal Administrative Procedures Act (APA). *Iowa League*, 711 F.3d at 854.

The Court Finds Jurisdiction to Review EPA's Actions

The court concluded it had jurisdiction to review the regulatory interpretations contained in the letters as they were "functionally similar" to a formal rule promulgation that had a "binding effect" on the

League's members who have "reasonably [been] led to believe that failure to conform will bring adverse consequences." *Id.* at 864. The court also found the case was ripe for review because, given these EPA pronouncements, "[l]eague members must either immediately alter their behavior or play an extensive game of Russian roulette with taxpayer money" should the designs be subsequently rejected at the time of permitting. *Id.* at 868. EPA argued that the court should forego review as the Agency was considering changes to the prohibitions. The court rejected this request, concluding that the possible amendment of a position "does not insulate regulated entities from the binding nature of the obligations and similarly cannot serve to inoculate the agency from judicial review." *Id.* at 865. The court determined that the letters plainly established new "prohibitions" that did not rely on site-specific facts and Agency claims to the contrary were "Orwellian Newspeak." *Id.* Thus, the court held that the positions claimed to be "existing regulatory requirements" were now ripe for review. *Id.* at 868.

Bacteria Mixing Zones: Unlawful

The court held that the letter's prohibition of bacteria mixing zones in primary contact recreation waters, regardless of health risks, "eviscerate[d] state discretion" to utilize such mixing zones and, therefore, constituted a revised rule that did not go through proper APA rulemaking procedures. *Id.* at 874. In reaching this conclusion, the court relied on, among other evidence, EPA's published guidance and historical practice of allowing state discretion to approve such mixing zones when no significant public threat exists. The court found the letter created a "new legal norm for bacteria mixing zones based on EPA's authority to promulgate effluent limitations." *Id.* Therefore, the court vacated the bacteria mixing zone rule.

Blending: Unlawful and Beyond EPA's Authority

The court found EPA's blending prohibition both procedurally and substantively improper as it was "irreconcilable with both the secondary treatment rule and the bypass rule" and "exceeds the EPA's statutory authority" under the CWA. *Id.* at 875, 877. The court addressed the letter's declaration that wet weather treatment designs that "blend" or "recombine" flows are illegal unless the diverted flow independently meets secondary treatment requirements or the permittee is able to demonstrate that there are "no feasible alternatives." This prohibition, which was to apply regardless of the facility's ability to comply with its permit limits, deviated from EPA's historical practice of approving and publicly endorsing such treatment plant designs. The court held that EPA's regulatory interpretation presented in the letter "severely restricts the use of . . . systems that do not include a biological component" because EPA does not "consider them to be secondary treatment units." *Id.* at 876. Because EPA effectively created a "new legislative rule mandating certain technologies as part of the secondary treatment phase," without rulemaking, the court vacated the rule. *Id.*

The court also concluded that EPA's blending prohibition "clearly exceeds" EPA's statutory authority because "the blending rule imposes secondary treatment regulations on flows within facilities" rather than on the final effluent quality. *Id.* 878. EPA's statutory authority only permits the Agency to set "effluent limitations based upon secondary treatment" (33 U.S.C. § 1311(b)(1)(B)) for the "addition of any pollutant to navigable waters" from a "point source." 33 U.S.C. §§ 1311(a), 1362(12). This authority does not extend to setting "effluent limitations to the discharge of flows from one internal treatment unit to another." *Id.* at 877. Therefore, the court ruled EPA has no statutory authority to proscribe facility designs utilizing blending under the bypass (40 C.F.R. § 122.41(m)) or secondary treatment rules (40 C.F.R. Part 133). *Id.* at 878.

What the Decision Means for the Regulated Community

This is one in a series of recent cases, where courts have stated that EPA cannot use guidance, letters, and other informal approaches as a means to short-circuit the rulemaking process and to impose new requirements upon the regulated community. *See e.g., Conservation Nw. v. Sherman,* 2013 U.S. App.

LEXIS 8396 (9th Cir. 2013). It is the first CWA case to do so, and it avoids the needless expenditure of hundreds of billions of dollars by the regulated community. The court's action will have widespread impacts on wet weather program compliance regarding sanitary sewer overflows, combined sewer overflows, system bypasses, and stormwater. More cost-effective options now exist to process peaks flows and to permit wet weather discharges. Permits, orders, bacteria total maximum daily loads, long-term control plans, or any other final agency actions based upon these now-vacated policies may be reconsidered to properly reflect applicable regulatory requirements. In particular, those communities forced to construct extensive retention facilities rather than incorporate peak flow blending at the wastewater facility should now be able to reopen those orders to consider this option. No community should be required to prepare a "no feasible alternatives" analysis or report properly operating facilities that blend as unlawful "bypasses." While this decision should be the death knell of future EPA attempts to regulate how a facility is designed and/or to mandate "end of pipe" bacteria limits for all NPDES discharges, only time will tell.

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Thursday, October 10, 2013

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Reacting to Coastal Disasters: Response and Future Preparedness

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Environmental Markets 2.0: The Evolving Use of Market-Based Mechanisms

Friday, October 11, 2013

Plenary Session 2—From the Top: Second Term Priorities and Perspectives from Senior EPA Officials

Renewable Energy Development: Challenges, Opportunities and Pay-Offs

TMDL Regulation: How EPA's Chesapeake Bay Initiative May Spread to Your Watershed

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