Nos. 12-1182, 12-1183

IN THE

Supreme Court of the United States

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY, *et al.*,

Petitioners,

AMERICAN LUNG ASSOCIATION, *et al.*,

Petitioners,

v.

EME HOMER CITY GENERATION, L.P., *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF OF RESPONDENTS CALPINE CORPORATION AND EXELON CORPORATION IN SUPPORT OF PETITIONERS

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RULE 29.6 DISCLOSURE STATEMENT

The corporate disclosure statement for Calpine Corporation and Excelon Corporation was set forth at page (ii) of their opening brief and there are no changes to that statement.

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Respondents Calpine Corporation and Exelon Corporation respectfully submit this reply brief in support of Petitioners United States Environmental Protection Agency, *et al.* ("EPA"), and American Lung Association, *et al*. ("ALA").

INTRODUCTION

Mischaracterizing the nature of the Good Neighbor Provision of the Clean Air Act ("Act"), 42 U.S.C § 7410(a)(2)(D), respondents in opposition ("Respondents") analyze the Good Neighbor Provision as if it were a narrow grant of authority to EPA. However, Congress addressed the Good Neighbor Provision to a different audience – the States – and the obligations imposed by it are but of few of the many obligations that States must address in their State Implementation Plans ("SIPs") under Section 110(a)(2) of the Act, 42 U.S.C § 7410(a)(2). Congress assigned to EPA the task of determining whether implementation plans meet the minimum requirements of the Act, and EPA's determinations are entitled to deference, including its determination that the Transport Rule (76 Fed. Reg. 48,208 (Aug. 8, 2011) (App. 117a-1458a)) would have failed to meet those requirements had EPA required less of the States subject to the Rule.

Congress expressly authorized States to fulfill their SIP obligations by creating "economic incentives" which necessarily rely on cost, and the Act is replete with other authorizations to consider cost. When implementing the Good Neighbor Provision on behalf of defaulting States, EPA is certainly authorized to employ the same means available to the States. Respondents do not identify any statutory text that prohibits the use of cost to define

emission reduction obligations under the Good Neighbor Provision. Likewise, neither Respondents nor the majority below offer textual support for the proposition that EPA may consider cost only to relax the obligations of States.

The Transport Rule reflects a measured and thoughtful approach that recognizes the unique nature of the electric generation industry. The Rule imposes on States only the minimum requirements necessary to satisfy the Good Neighbor Provision, while implementing a system that will satisfy the explicit mandate of the Good Neighbor Provision to reduce interstate pollution. Neither the law nor the facts support Respondents' complaints of "overcontrol." EPA was required to make the economic incentives at work in the Transport Rule sufficient to motivate actual emission reductions. Emission reductions come at a predictable cost, and until the value of the incentive to reduce pollution exceeds that cost, there will be no actual reductions in pollution. While Respondents clamor that EPA should have required less of some States and more of others, the reality is that each additional cost distinction between States would create market barriers that would reduce the overall effectiveness of the program and raise costs for all participants. EPA was well within its rulemaking authority to disregard trivial, even hypothetical, cost distinctions among States in order to create an effective, efficient market that works within the context of the electric generation industry to produce the emission reductions demanded by the Good Neighbor Provision.

The Court should reverse the decision of the court of appeals and reinstate the Transport Rule.

ARGUMENT

I. RESPONDENTS' INTERPRETATION OF THE GOOD NEIGHBOR PROVISION IGNORES ITS CONTEXT WITHIN THE ACT.

The central theme struck by Respondents and the majority below regarding the substance of the Transport Rule is that EPA went too far, imposing requirements on States that exceed the authority conferred on EPA by Congress. These arguments, though, are based on grandiose extrapolations from statutory text that Congress neither addressed to EPA in the first instance, nor wrote in a way that is amenable to interpretation as an upper bound on the authority of EPA to regulate air pollution when States fail to meet their obligations under the Act.

Respondents minutely parse a single clause of the Good Neighbor Provision, 42 U.S.C. § 7410(a)(2)(D)(i)(I), to extract what they contend are clear Congressionally-designed limits on EPA's authority to impose measures to enforce that provision when States do not. Their analysis, however, ignores the context of the Good Neighbor Provision, and indeed all of Section 110, and its place in the statutory scheme of the Act. Section 110(a)(2), which includes the Good Neighbor Provision, establishes a floor for States – a litany of minimum requirements that States must impose in their implementation plans in order to comply with the Act. Yet, Respondents ask this Court to construe the Good Neighbor Provision not as a floor for State obligations, but as a ceiling on EPA's authority. *See, e.g.*, Brief of Industry and Labor Respondents (ILR Br.) 23. The statute was simply not written this way. Section

110(a)(2) describes the types of measures that must, *at least,* be included in SIPs using open-ended language requiring subjective interpretation. There is not a single clause *limiting* the authority of States or EPA to regulate air emissions.

While Congress did not address Section 110(a)(2) to EPA as the primary audience, it did establish a mandatory role for EPA that this Court must heed. Congress defined State obligations in Section 110(a)(2) in terms clearly demanding interpretation, requiring control measures "as may be necessary or appropriate" to comply with the Act (42 U.S.C. § 7410(a)(2)(A)), enforcement programs "as necessary to assure" compliance with air quality standards (*id.* § 7410(a)(2)(C)) and, in the case of the Good Neighbor Provision, "adequate provisions" to prohibit the interstate air pollution that is the subject of the Transport Rule (*id.* § 7410(a)(2)(D)). *See also, id.* §§ 7410(a)(2)(B) (requiring "appropriate" and "necessary" monitoring devices); 7410(a)(2)(E) ("necessary" assurances of "adequate" State authority and resources); 7410(a)(2)(G) ("adequate" contingency plans to implement emergency authority). Congress enshrined EPA as the expert agency with the duty and authority to interpret these terms and so to decide whether the measures proposed by a State are indeed "necessary," "appropriate" and "adequate" to meet the minimum requirements of Section 110(a)(2). *Id.* § 7410(k); *Train v. NRDC, Inc.,* 421 U.S. 60, 79 (1975). This Court and others have long recognized that EPA is the proper arbiter of the adequacy of SIPs, and is entitled to deference when it determines that a plan meets the minimum standards of the Act, or that it does not. *Train*, 421 U.S. at 79; *Oklahoma, et al. v. EPA*, 723 F.3d 1201, 1204, 1207 (10th Cir. 2013); *Luminant Generation Co.*

LLC, et al. v. EPA, 714 F.3d 841, 856-58 (5th Cir. 2013); *Michigan Dept. of Envtl. Quality, et al. v. EPA*, 230 F.3d 181, 185 (6th Cir. 2000).

When EPA is compelled to step into the shoes of a State and to promulgate a federal implementation plan under Section 110(c)(1), 42 U.S.C. §7410(c)(1), EPA remains the agency charged by Congress with determining what is minimally necessary to fulfill the requirements of Section 110(a)(2), including the amounts of pollution from upwind States that "contribute significantly" to or "interfere with" downwind States' inability to achieve or maintain air quality standards. Likewise, EPA remains entitled to the same deference with respect to its federal plan that courts afford the Agency when it determines that State submissions are adequate or inadequate. EPA determined that its plan reflected by the Transport Rule is "adequate" as required by Section 110(a)(2)(D), and rejected less restrictive measures as "inadequate." App. 189a, 354a-356a, 384a; Brief of Calpine Corporation and Exelon Corporation (Calpine/Exelon Br.) 24. This determination is squarely within the authority conferred on EPA by Congress, and the Court should afford the highest degree of deference to EPA's assessment of the nature and extent of the program necessary to satisfy the Good Neighbor Provision across the 27 States affected by the Rule, just as it would to EPA's determination of the adequacy of a State plan. *Oklahoma*, 723 F.3d at 1216-17 (deference owed "especially strong where the challenged decisions involve technical or scientific matters within the agency's area of expertise"). The Court should reject Respondents' invitation to overlook the role Congress conferred on EPA by narrowly focusing on a single clause in the Act, and reading the Good Neighbor Provision far out of context.

II. THE GOOD NEIGHBOR PROVISION ALLOWS FOR CONSIDERATION OF COST.

During the development of the Transport Rule and even through litigation of the Rule in the D.C. Circuit, no party seriously challenged EPA's authority to consider cost in establishing State emission budgets. At most, those critical of the Transport Rule argued in the litigation that EPA could only consider cost to reduce State emission reduction obligations. For the first time,[1] however, in their opposition brief, Industry and Labor Respondents assert that cost cannot be considered in implementing the Good Neighbor Provision *at all*, a claim so extraordinary that even their co-respondents, including several major electric utilities and trade groups, disagree and distinguish their position. *See* Brief of Utility Air Regulatory Group, *et al.* (UARG Br.) 5-6, 28 n.6 (listing Act provisions which allow cost considerations). Not only is this assertion not borne out by the Act or case law directly on point, but it would impose dangerous and unnecessary limits on both States and EPA when they address interstate pollution. It would also likely result in more costly regulatory burdens for the States and their sources. EPA's use of cost considerations, combined with State air quality impacts, is authorized by the Act, is consistent with prior case law, and allows the Agency to harness the electricity market to achieve the necessary reductions in interstate pollution in the most cost-effective way. *See generally* Calpine/Exelon Br. 32-42. Neither the Good Neighbor Provision nor any other provision of the Act constrains the authority of EPA or the States to consider cost in the manner applied by EPA in the Transport Rule.

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1. For this reason alone, the issue was not properly raised on appeal. *See* 42 U.S.C. § 7607(d)(7)(B), (e).

A. The Act Authorizes Use Of Cost In Implementing The Good Neighbor Provision.

By itself, the Good Neighbor Provision states nothing about the use of cost considerations one way or the other; it certainly does not "unambiguously bar[]" the practice, as Respondents wrongly assert. ILR Br. 29. Despite Respondents' efforts to find bright line limits where there are none, the phrase "contribute significantly" is ambiguous, directing EPA to make a regulatory determination as to what "amounts" of an upwind State's pollution "contribute significantly" to nonattainment of air quality standards or interfere with maintenance of standards in downwind States. *Michigan v. EPA*, 213 F.3d 663, 677-678 (D.C. Cir. 2000).[2] EPA thus has discretion to consider cost if its interpretation of its authority is reasonable under *Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984). Indeed, EPA has interpreted the Good Neighbor Provision and its antecedents to allow for cost considerations for nearly 25 years. *See* Brief of *Amicus Curiae* Institute for Policy Integrity 17-20.[3]

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2. The State and Local respondents in opposition acknowledge the ambiguity of the Good Neighbor Provision, even as their Industry and Labor co-respondents appear to find clear and straightforward textual limits where there are none. State & Local Respondents Br. 39-40, 53.

3. *See* Stephen G. Breyer, Richard B. Stewart, Cass R. Sunstein & Matthew L. Spitzer, *Administrative Law and Regulatory Policy* 65 (4th ed. 1999) (questioning whether agency could determine if risk is "significant" without considering cost of eliminating risk) (cited in *Michigan,* 213 F.3d at 677-678.

As noted above, the Good Neighbor Provision is properly viewed as one part of the overall structure of the SIP process established under Section 110. Section 110 expressly allows use of "economic incentives such as fees, marketable permits, and auctions of emissions rights" in SIPs (and thus in federal implementation plans). *See* 42 U.S.C. §§ 7410(a)(2)(A), 7602(y); Calpine/Exelon Br. 12-15. A State cannot develop such incentive-driven, market-based programs without considering costs. Indeed, additional statutory provisions provide authority for cost consideration in addressing attainment concerns in SIPs, including for pollutants at issue in the Transport Rule. *See* 42 U.S.C. § 7511b(d) (EPA required to provide guidance to States to evaluate cost-effectiveness of various options to control emissions which contribute to nonattainment of ozone standards); *id.* § 7502(c)(6) (nonattainment plans to include economic incentives); *id.* § 7509(d) (States that fail to attain standards must submit revision which considers costs of implementation); *see* UARG Br. 5-6 (citing many of same provisions for the assertion that EPA and States can consider cost); ILR Br. 36 n.17 (citing similar provisions and acknowledging that cost can be considered in implementing but not setting EPA emission budgets). Significantly, none of the provisions listed above purport to *limit* the use of cost in only one direction, *i.e.* only to lower reduction obligations.

Therefore, there is no clear statutory bar to the use of cost considerations in implementing the Good Neighbor Provision just as there are no such bars – and in fact there is explicit encouragement – for States and EPA to consider cost when addressing nonattainment. EPA's authority to consider cost in the very way utilized by EPA in the Transport Rule has been tested in the courts.

See Michigan, 213 F.3d at 676-680 (rejecting argument that cost cannot be considered under the Good Neighbor Provision and upholding EPA's use of uniform control costs in determining "significant contribution"); *North Carolina v. EPA*, 531 F.3d 896, 917 (D.C. Cir. 2008) (citing *Michigan* and approving of EPA's use of uniform control costs). This Court specifically referenced the *Michigan* ruling on cost consideration without any suggestion it was wrongly decided or that the D.C. Circuit improperly construed the statute. *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 469 n.1 (2001). In *American Trucking*, the Court recognized the distinction in the Act between establishing air quality standards, where cost could not be considered unless clearly so provided in the Act, and implementing those standards, where cost could be considered. *Id.* at 469-470 (citing provisions enabling EPA to consider cost in assisting States to *implement* standards). *See* Calpine/Exelon Br. 34 & n.26. Respondents' argument would require the Court to reverse *Michigan, North Carolina* and other precedents acknowledging the role of cost in developing plans to implement Section 110, including the majority's decision below. App. 27a.[4]

American Trucking does not support Respondents' extraordinary argument. Respondents identify no "unambiguous bar" to cost considerations in the Good Neighbor Provision. *See* ILR Br. 24. Their contention that there are no "textual commitments of authority to EPA to consider costs" overlooks the explicit authority of

4. This Court also acknowledged other leading cases affirming the proposition that costs can be considered under the Act except where specifically prohibited. *See American Trucking*, 531 U.S. at 469 n.1.

Section 110(a)(2)(A) and other relevant provisions of the Act. *Id*. The provisions cited above provide numerous examples of Congress authorizing the States and EPA to consider economic incentives, including cost-based market mechanisms, when implementing SIPs or otherwise addressing nonattainment in the SIP process. If the Court were to endorse Respondents' view, neither States nor EPA could ever consider cost in implementing SIPs and seeking attainment unless Congress explicitly authorized cost considerations in every relevant provision. This Court, though, has recognized that "[i]t would be impossible to perform that task [developing SIPs] intelligently without considering which abatement technologies are most efficient, and most economically feasible –which is why we have said that 'the most important forum for consideration of claims of economic and technological infeasibility is before the State agency formulating the implementation plan.'" *American Trucking*, 531 U.S. at 470 (quoting *Union Elec. Co. v. EPA*, 427 U.S. 246, 266 (1976)).

Respondents' efforts to distinguish *Entergy Corp. v. Riverkeeper, Inc.*, 556 U.S. 208 (2009), also fail. *See* ILR Br. 25-26. As EPA notes, *Entergy* demonstrates the Court's default view that it is appropriate for EPA to consider costs and benefits of regulations when implementing subjectively phrased statutory mandates, even when the statutory text contains no explicit authorization to do so. EPA Br. 44. This Court concluded that such analysis is reasonable provided the statute in question does not "unambiguously preclude cost-benefit analysis." 556 U.S. at 220. The Court found the subjective term "best technology available" to provide EPA with "discretion to determine the extent of reduction that is warranted under the circumstances." *Id.* at 219. There is no reason for the

Court to withhold similar discretion from EPA when it determines the emission reductions required to comply with the Good Neighbor Provision.

The implications of Respondents' argument are profound, and contrary to the interests of both industry and States. States have the primary and initial responsibility to implement the Good Neighbor Provision and other SIP requirements. If the text of the Good Neighbor Provision precludes EPA from implementing that provision through a cost-based program of economic incentives, the text must necessarily preclude States from doing so. In fact, contrary to this Court's understanding of the SIP implementation process, *see American Trucking,* 531 U.S. at 470, States would be precluded from considering cost unless Congress explicitly authorized such an inquiry. If cost cannot be considered, neither States nor EPA will be able to develop an effective market trading program. Calpine/Exelon Br. 3-4, 55-57.

The position advanced by Industry and Labor respondents directly undermines the authority and flexibility of the State and Local respondents, who understandably have not adopted this position in their own opposition brief. If market-based approaches are unavailable, direct command-and-control approaches would be the only means of mandating necessary emission reductions. Were such regulation to be based entirely on air quality and health impacts, with no means of assuring that emission reductions are made cost-effectively, those regulations would necessarily be more costly. Brief of *Amici Curiae* Hobbs, *et al.* (Hobbs Br.) 26-31. That is precisely why the electric generation industry generally favors such a market-based approach. *See* Calpine/Exelon

Br. 18. In fact, no party who commented on the proposed Transport Rule argued that the Act requires an "air quality only" approach. ALA Br. 30.

B. There Is No Directional Limit On States' And EPA's Consideration Of Cost.

UARG and its co-respondents take the position that cost can be considered in implementing the Good Neighbor Provision but only to "ameliorate regulatory burdens" and not to allow stronger obligations that might be required to assure necessary emission reductions, and Industry and Labor respondents adopt this as a fall-back position. *See* UARG Br. 5-6, 28; ILR Br. 36 n.17, 37. Yet, Respondents do not identify any place in which Congress unambiguously limited EPA's authority to consider cost to justifying the relaxation of a State's obligations under the Good Neighbor Provision.

None of the provisions cited by Respondents actually state that EPA can use cost only to reduce State emission reduction obligations, nor do Respondents point to any other Congressional language making such a clear distinction. UARG Br. 5-6; ILR Br. 36 n.17. Significantly, none of these references appear in Section 110 itself. Rather, they relate to consideration of cost in determining what are "reasonably available" control measures or technology for certain programs. Such usage does not inherently mean that those cost considerations may only be used to *reduce* obligations, nor do statutory references to cost-effectiveness. Reasonableness and cost-effectiveness can cut in two directions. A lower cost is neither reasonable nor cost-effective if it does not produce the necessary reductions; consideration of

cost does not mean consideration of only the lowest cost, without reference to air quality impact. EPA could just as properly conclude that a higher cost is reasonable if it achieves the necessary reduction more cost-effectively than a lower cost option, or that a State should eliminate a greater amount of emissions if it can do so more cost-effectively than another.[5]

The only support for Respondents' claim as to one-way cost consideration comes from the unsupported lower court holding under review here. *See* App. 27a. The majority cites no statutory reference for this summary holding, citing instead to *Michigan* and *North Carolina* with no discussion or even parenthetical explanation of how those decisions support such a holding. A more careful analysis of those cases reveals that neither makes any distinction between the use of cost to establish obligations and the use of cost to reduce obligations. The *Michigan* court allowed EPA to consider "highly cost-effective controls" in determining whether a given contribution by a State was "significant" under the Good Neighbor Provision. *Michigan,* 213 F.3d at 675. In doing so, it recognized EPA's ability to use cost to determine the point where a contribution would no longer be "significant" within the meaning of the Good Neighbor Provision, and thus to establish the emission reduction obligation. Presumably, EPA could make that determination at any level of cost it found applicable, which could be relatively high (EPA in

5. In fact, one provision cited by Respondents, 42 U.S.C. § 7509(d)(2), UARG Br. 5-6, ILR Br. 36 n.17, requires EPA to impose for nonattainment areas "all measures that may feasibly be implemented," based on a balancing of costs with health and environmental impacts. EPA could logically conclude that a given reduction is necessary, even if it comes at a higher cost.

that rule used $2,000 per ton of NO_x reductions), and could find that costs both below and above that figure would not be appropriate. The *Michigan* court most assuredly did not establish a principle that EPA could only use cost to relax emission reduction obligations. The *North Carolina* court merely upheld *Michigan's* holding on the use of "highly cost effective" reductions and made no distinction as to which direction cost could be considered. 531 F.3d at 918. Significantly, however, the court there found that EPA's use of cost *insufficiently protective* of downwind States. The court vacated the Clean Air Interstate Rule not because it imposed unreasonable cost on States and sources but because it failed to assure those States would make the necessary reductions in time to allow downwind States to achieve and maintain air quality standards. *Id.* at 906-908.

The limits to consideration of cost asserted by Respondents are entirely of their own invention. Like the other limits they seek to graft into the Good Neighbor Provision, these hypothetical limits "rest[] on reasoning divorced from the statutory text," *Massachusetts, et al. v. EPA,* 549 U.S. 497, 532 (2007), and lack any basis in the statute or case law construing the statute, except the opinion under review. This Court should reject the argument that the Good Neighbor Provision establishes such clear textual limits and rather should hold that EPA offered a reasonable interpretation of a statutory provision giving States and EPA the authority to determine when an upwind contribution "significantly" impacts or interferes with downwind attainment of air quality standards.

III. FAR FROM OVERREACHING, EPA'S APPROACH RECOGNIZES THE PRACTICAL CHARACTERISTICS OF THE ELECTRIC GENERATION SYSTEM.

There is nothing fundamentally illicit about EPA's choice of a market-based program to implement the Good Neighbor Provision, and much to support it. Respondents primarily claim that EPA took a legitimate, statutorily authorized approach too far, that is, that EPA required sources in some States to spend more on reducing emissions than necessary to satisfy those States' minimum obligations under the Good Neighbor Provision. This argument fails for two reasons. First, Respondents' argument is entirely hypothetical, and turns on an unspoken and factually incorrect assumption that if emissions can be reduced for a cost of $500 per ton, they can be reduced a little less for $400 or $300 or $200 per ton. Second, EPA reasonably chose to maximize the efficiency of the system by limiting the number of trading markets, allowing all States subject to the Rule to have access to the broadest and most efficient allowance markets consistent with the statutory objective of reducing interstate air pollution.

A. The Transport Rule Does Not Require Greater Reductions Than Necessary To Implement The Good Neighbor Provision.

Respondents make a number of arguments that EPA required too much of certain States and thus exceeded its statutory authority. ILR Br. 12-22; UARG Br. 18-19, 26-34. Subtle distinctions aside, all of these arguments hinge on a single claim: that the Rule exceeds EPA's authority

because it would improve air quality in some areas to such a degree that pollution levels would fall materially below air quality standards. As a threshold matter, even taken at face value this claim is no indictment of EPA. There is no prohibition in the Act against measures to make air quality *cleaner* than air quality standards.

The *whole* Good Neighbor Provision, Section 110(a)(2)(D), including clauses (i)(I) *and* (II), provides that States must prohibit emissions that would significantly degrade air quality in downwind States *in areas that are well below air quality standards, and have no history of nonattainment.* 42 U.S.C. § 7410(a)(2)(D). Respondents myopically focus only on the first clause of the Good Neighbor Provision relating to attainment and maintenance of standards, but the second clause also requires States to prohibit emissions that would interfere with any other State's programs "to prevent significant deterioration of air quality or to protect visibility." *Id.* § 7410(a)(2)(D)(i)(II) (referring to the requirements of "part C of this subchapter," §§ 7470-7492). These part C programs are required by the Act "to protect health and welfare from any actual or potential adverse effect which . . . may reasonably be anticipated to occur from air pollution . . . *notwithstanding attainment and maintenance of all national ambient air quality standards*." 42 U.S.C. § 7470(1) (emphasis added). Thus, Congress specifically required that upwind States eliminate their downwind impacts not only when attainment of air quality standards is in doubt, but when good air quality might be degraded or visibility compromised, "notwithstanding attainment" of the standards. While EPA did not rely on part C compliance for the Rule, Respondents' premise that the Act prohibits EPA from requiring emission reductions that

would yield air quality better than air quality standards is wrong. *See* Calpine/Exelon Br. 54 n.35.

Even assuming that Respondents' premise were correct, it does not follow that EPA exceeded its authority in adopting the Transport Rule. Without citation to the administrative record, Respondents hypothesize that EPA could have relaxed the budgets of some States by assuming a lower pollution control cost, and nonetheless eliminated the contribution of those States to downwind impacts. This supposition ignores the practical realities of applying economic incentives to the electric generation sector in a way that *actually reduces interstate pollution*, which is the mandate of the Good Neighbor Provision. EPA entertained and rejected this supposition for reasons well within its rulemaking discretion.

In an incentive-driven system, participants will reduce their emissions only when the cost of doing so is less than the value of the incentive offered. If an allowance can be purchased for less than the cost of eliminating one ton of pollution, a rational market participant will purchase the allowance rather than eliminate the pollution. While this purchase represents "compliance," it does not reduce pollution or improve air quality in any downwind State, and thus does not fulfill the mandate of the Good Neighbor Provision. Therefore, in developing an effective market system, EPA had to ensure that the price of allowances would be high enough to incentivize the operation of existing emission controls and the installation of sufficient new controls in upwind States in order to reduce downwind pollution. *See* Stephen G. Breyer, *Regulation and Its Reform* 273 (Harvard University Press 1982) (noting that pollution tax will not yield adequate emission reductions if set too low).

Given the means available to reduce NO_x and SO_2 emissions, there is a minimum cost that power plants must incur to eliminate each incremental ton of pollution. This minimum cost reflects the price of emission control chemicals, lost electric generation, substitute fuels and other costs depending on the pollutant and the particular means chosen by the power plant owner to reduce emissions. Exercising its core rulemaking authority, EPA determined this minimum cost to be approximately $500 per ton for NO_X, and for SO_2 in most States. This conclusion is amply supported by the administrative record. *See, e.g.*, App. 350a-351a, 354a-356a; *Proposed Transport Rule*, 75 Fed. Reg. 45,210, 45,276 (Aug. 2, 2010). Certainly, the precise cost varies among the more than 1,000 generation units covered by the Rule. Some may have a minimum cost slightly below $500/ton. However, such data-driven judgments are consigned to the expert agency, and there is no indication in the record that EPA's estimate was unreasonable. Having determined this minimum cost, EPA was equally justified in concluding that hypothetical allowance costs below $500 per ton would produce *insufficient actual emission reductions.*[6] *See* App. 350a-351a, 354a-356. No rational market participant would spend $500 to eliminate a ton of pollution if it could comply with the law by purchasing a $200 or $300 or $400 allowance instead.

6. Respondents suggest that it was inappropriate for EPA to reject sub-$500 allowance prices because lower prices would cause generators to cease to operate pollution controls. ILR Br. 16. Of course, the consequence of *not operating controls* is increased pollution, which is fundamentally inconsistent with a program required to decrease pollution.

Using economic models specific to the electric generation industry, EPA then evaluated potential State emission budgets by assessing the amount of pollution that power plants in each upwind State would emit if required to expend an additional $500 per ton of pollution. *See* Calpine/Exelon Br. 11, 23. EPA modeled these projected emissions and their impact on downwind air quality, and concluded that, in most cases, downwind nonattainment and maintenance problems would be eliminated at this minimum cost level.[7] EPA established State-specific emission budgets (*i.e.*, the number of allowances) based on these projected emissions.[8] *See* EPA Br. 10-12.

Respondents' argument that EPA was legally required to adopt lower budgets in order to avoid "overcontrol" ignores the practical reality that the budgets adopted by EPA were based on the *minimum* cost to eliminate a ton of pollution. EPA need not engage in extensive investigations to predict what would happen if allowance prices were lower than the real cost of pollution reductions: pollution would not be reduced. The Good Neighbor Provision requires real emission reductions, not fruitless hypothetical exercises incapable of application in the real world. *See North Carolina*, 531 F.3d at 907-908 (Good

7. The noteworthy exception relates to States whose contributions of SO_2 could only be eliminated at much higher cost levels (the Group 1 SO_2 States), and some downwind impacts would remain at even these higher cost levels. *See* Calpine/Exelon Br. 52 n.34.

8. By employing state-of-the-art modeling tools that predict both the response of power plant operators and the dispersion patterns of air pollution, EPA was able to resolve two potential problems with systems of "marketable rights" – uncertainty as to the cost of allowances and predictability of the location of reductions. *See* Breyer, *Regulation and Its Reform* 273-76.

Neighbor regulations must result in reductions that actually "achieve something measurable").

B. EPA Reasonably Chose To Use A Uniform Control Cost To Minimize Trading Markets And To Maximize Efficiency.

The effectiveness of a market-based system begins with the requirement that economic incentives exceed minimum control costs, but does not end there. EPA properly considered a variety of other appropriate factors in developing the Rule. Among these considerations were impacts on the electric generation system, ease of implementation and cost-effectiveness. When they claim that EPA should have established less restrictive budgets, Respondents argue, in effect, that rather than establishing a single market for NO_x allowances based on a $500/ton control cost and including power plants in 27 States (and two markets for SO_2 allowances), EPA should have established multiple markets based on marginally different control costs, each consisting of fewer, or even single, States.[9] Even if EPA could have made subtle distinctions between the control costs (*i.e.*, hypothetical allowance prices) used to develop different State budgets, EPA reasonably chose to minimize the number of cost distinctions in pursuit of its primary objective of enforcing the substantive reductions mandated by the Good Neighbor Provision.

9. Respondents who assert that EPA could not consider cost at all would logically be required to maintain that EPA could not establish any program deploying a system of economic incentives based on cost to implement the Good Neighbor Provision.

The electric generation market is not cabined by State boundaries. When a need for more power arises, it will be met by the plant that can generate that power cheapest, whether that plant is next door or three States away. *See* Calpine/Exelon Br. 7-10, 19; App. 348a. This fluidity has two implications for the Rule, both of which support EPA's use of the fewest control cost distinctions in developing the Transport Rule system.

First, the Rule operates by creating incentives that change the geographic distribution of electric generation, and thus the distribution of the pollution from that activity. When an additional control cost is introduced into the generation system, generation shifts to power plants that have the lowest generation cost, taking into account that new control cost. *See* Calpine/Exelon Br. 1-10. The Transport Rule uses this market structure to shift generation to plants that produce less pollution. Had EPA used different control costs for each State, the Rule would instead shift generation to plants in the lower cost States, regardless of whether those plants would in fact produce less pollution, or would create new downwind air quality problems. *See* App. 384a (describing "emissions leakage").

Second, if EPA based different State budgets on different control costs, the only way for EPA to ensure that the emission reductions needed to satisfy the Good Neighbor Provision would actually occur would be to prohibit trading between States. *See* Calpine/Exelon Br. 55-57. Respondents' claim that EPA never considered a more vigorously tiered approach to cost is untrue. EPA thoughtfully considered the implications of such distinctions in several ways. Most obviously, when EPA determined that the Group 1 SO_2 States required costlier

reductions, EPA concluded that it could not permit trading of allowances between Group 1 States (with a control cost of $2,300/ton) and Group 2 States (with a control cost of $500/ton). Calpine/Exelon Br. 37; App. 386a-387a, 425a. Rather than having one trading market for NO_X allowances and two for SO_2 allowances, EPA would have had to create a separate trading market for each control cost it used for each type of allowance, and to prohibit trading between markets.

The Balkanization of the allowance markets into areas of like cost assumptions would not be merely inconvenient or administratively cumbersome. Calpine/Exelon Br. 38-41. Such cost distinctions, and the fallout from them, would undermine the effectiveness of the Rule. *Id.* The logical extension of Respondents' argument is that each State would have its own allowance markets based on its own unique minimum control costs (or such higher costs as EPA determined was necessary to eliminate downwind impacts). EPA considered and rejected an alternative program that would have prohibited interstate trading. EPA found that such a system would be administratively unworkable, but perhaps more importantly, found that such a system would be more costly and less efficient than the system ultimately adopted. App. 428a-429a.

The larger the market across which a scheme of economic incentives may be applied, the more effective and efficient those incentives will be. *See* Hobbs Br. 26-31. EPA reasonably concluded that the effectiveness and efficiency of the Transport Rule would be compromised if too many sub-markets were created, App. 428a-429a, and how many is "too many" is precisely the sort of task that Congress consigned to EPA's expert decision-making.

Respondents focus so narrowly on cost that they do not credit the need for EPA to address critical rulemaking considerations such as efficiency, reliability, regulatory certainty and above all, efficacy in assuring the emission reductions required by the Act. Respondents' criticisms of EPA's regulatory choices are inconsistent with the text and purpose of the Act, and the role that Congress assigned to EPA. There is nothing in the language of the Good Neighbor Provision or elsewhere in the Act that, construed in context, would prohibit EPA from overlooking marginal (if not entirely hypothetical) cost distinctions among States in order to establish an effective and efficient system of economic incentives that will produce the actual emission reductions necessary to fulfill the obligations of defaulting States under the Good Neighbor Provision.

CONCLUSION

Respondents Calpine Corporation and Exelon Corporation respectfully request that the Court reverse the decision of the court of appeals and reinstate the Transport Rule.

Respectfully submitted,

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