Aluminum Manufacturers Not Entitled To Emission Allowances

The U.S. Court of Appeals for the Fourth Circuit recently held that an aluminum manufacturer is not entitled to a proportionate share of pollution emissions allowances allocated to an electric power plant under the Clean Air Act (CAA).

Ormet Corporation (Ormet) manufactures primary aluminum at its plant near Hannibal, Ohio. Electricity is the greatest raw material cost in the production of aluminum, as the Ormet facility consumes as much electricity per day as does the entire city of Pittsburgh.

In order to obtain electrical power for its Hannibal facility, Ormet entered into a series of agreements with Ohio Power in 1957. Under those agreements, three power-generating units were constructed at the Kammer Generating Station (Kammer Plant) near Moundsville, West Virginia, with Ormet becoming the owner of two of the units and Ohio Power becoming the owner of the third unit. The parties agreed to an undivided ownership of the plant's common areas in proportion to their ownership of the units.

Ormet's power needs kept growing, and it sought assurance from Ohio Power that Ormet would be supplied with power even beyond the capacity of the Kammer Plant. Consequently, in 1966, Ormet and Ohio Power revised their arrangement and implemented a new contract, which they called a "Power Agreement." Under the Power Agreement, Ohio Power acquired all of Ormet's ownership interest in the Kammer Plant and agreed to supply Ormet's power needs at contractually specified prices. The Power Agreement had a 25 year term, with an option for a 5-year extension, which Ormet exercised in 1991.

In 1990, Title IV of the CAA was enacted, creating the Acid Rain Program. This program created pollution emissions rights associated with specific fossil fuel-fired combustion plants in the United States, including the Kammer Plant. In 1994, Ormet filed suit under the CAA against Ohio Power in federal district court, seeking a declaratory judgment that, in light of its contractual relationship with Ohio Power, it was a joint owner of the Kammer Plant and therefore was entitled to 89% of the pollution emissions rights allocated to the Kammer Plant. Ormet also claimed that these rights were worth over $40 million.

The district court held that, under the CAA, the contractual agreement between Ormet and Ohio Power did not make Ormet a joint owner of the Kammer Plant, and that Ormet was, therefore, not entitled to any proportionate share of the pollution rights allocated to the plant. Accordingly, the district court entered a judgment before trial against Ormet. Ormet appealed.

Under Title IV of the CAA, limits are prescribed for emissions of sulfur dioxide and nitrogen oxides from specified electric utility plants in the contiguous 48 states. It requires that owners or operators of fossil fuel-fired electric generation devices, referred to as "units," obtain emissions permits from the U.S. Environmental Protection Agency (EPA) for each location or "source" where units exist. Each permit allocates to each unit a number of emissions "allowances" authorized for each location, and each allowance authorizes the holder to emit one ton of sulfur dioxide. Title IV also provides that that these emissions allowances may be bought and sold as any other commodity. This system established under Title IV is intended to harness

the power of market forces so that emissions reductions may be attained efficiently. For example, the holder of allowances that reduces sulfur dioxide emissions below the level authorized at its unit may sell the excess allowances to the owner of some other unit which has a need for greater emissions authority.

In order to address the problem of joint ownership of a plant, Title IV provides that allowances allocated to a jointly-owned unit "will be deemed to be held or distributed in proportion to" each owner's share of the unit. Joint ownership is defined under Section 7651g(i) of the CAA to include several types of relationships, including situations where "a utility or industrial customer purchases power from an affected unit (or units) under life-of-the-unit, firm power contractual arrangements." Section 7651a(27) of the CAA defines the term "life-of-the-unit, firm power contractual arrangement."

On appeal, Ormet claimed that under the Power Agreement, it was a joint owner of the Kammer units because it purchased power from the Kammer Plant under a "life-of-the-unit, firm power contractual arrangement." Therefore, Ormet argued that it was entitled to the pollution allowances in proportion to its ownership interest under the multiple ownership provisions of Section 7651g(i) and the life-of-the-unit provisions of Section 7651a(27).

The Court of Appeals held that in order for Ormet to be a joint owner of the Kammer Plant, the Power Agreement must satisfy the following four elements in order to constitute a "life-of-the-unit, firm power contractual arrangement": (1) Ormet must have reserved or been entitled to receive a specified amount or percentage of capacity and associated energy; (2) the energy must be generated by a specified generating unit or units; (3) the agreement must require Ormet to pay "its proportional amount" of the total costs of the specified unit or units; and (4) the arrangement must be for a substantial length of time relative to the life of the unit, as specified in Title IV. Thus, the court stated that the Act recognizes joint ownership only where a power sales agreement provides for both a firm reservation of electrical power from a specific unit and a proportionate division of the operating costs of that unit. The court further observed that joint ownership was not indicated when the agreement guarantees a customer's power needs from any source and does not impose upon the customer the risk of the loss of power from a particular unit.

Applying the four elements to the Power Agreement, the Court of Appeals found that Ormet was indeed entitled to receive a specified amount of capacity and associated energy, even though the specific amount of power reserved to Ormet under the Power Agreement ranged between 465,000 and 575,000 kilowatts. The Power Agreement, however, did not bind Ohio Powers' supply obligations to any specific generating unit. In fact, the Power Agreement clearly contemplated that the power delivered to Ormet could be generated anywhere in Ohio Power's system and, further, Ohio Power was obligated to seek power from other electric companies if it was unable to meet Ormet's needs.

Additionally, the Court of Appeals found that the Power Agreement did not require Ormet to pay its proportional amount of the Kammer Plant's total costs. Ormet's share of the costs of operating the units at the plant did not fluctuate in proportion to its reservation of energy,

and did not show a consistent relation to the total costs incurred by Ohio Power in operating the Kammer Plant units.

Therefore, the Court of Appeals found that the Power Agreement was not a "life-of-the-unit, firm power contractual agreement," and affirmed the judgment of the district court - that Ormet was not entitled to a proportionate share of the pollution emissions allowances allocated to the Kammer Plant.

***Ormet Primary Aluminum Corp. v. Ohio Power Co.*, ___ F.3d ___ (4th Cir. 2000).**

This article was prepared by Brian J. Negele, a partner in our Environmental Department, and previously appeared in the July, 2000 edition of the Michigan Environmental Compliance Update, a monthly newsletter prepared by the Environmental Department and published by M. Lee Smith Publishers.