**MEMORANDUM**

**March 2, 2016**

**To: Rae Cronmiller, NRECA**

**From: Sharon M. Mattox, Sharon M. Mattox, PLLC**

**Brandon M. Tuck, Vinson & Elkins LLP**

**Re: Preliminary Analysis on the Rural Utilities Service’s New Final Rule on Environmental Policies and Procedures Implementing the National Environmental Policy Act**

In February 2014, U.S. Department of Agriculture Rural Development (Agency) released a proposed rule addressing how the Agency would consolidate and revise its existing environmental policies and procedures governing the Agency’s efforts to comply with the National Environmental Policy Act (NEPA). The National Rural Electric Cooperative Association (NRECA) submitted extensive comments on the proposed rule in May 2014. The Agency released its final rule on March 2, 2016. This memorandum contains our preliminary assessment of the Agency’s final rule, with particular emphasis on those areas addressed in NRECA’s May 2014 comments.

The Agency acknowledged that most of the 500 comments submitted to the Agency were from rural electric cooperatives and associated organizations relating to the application of the NEPA rules to the Rural Utilities Service (RUS) Electric Program. The Agency also noted broad support among commenters for NRECA’s detailed comments. Overall, the Agency appears to have addressed favorably many of the more significant comments included in NRECA’s prior submission. In some cases, the Agency provided a reasoned basis where it did not adopt NRECA’s position; in other cases, the Agency did not address points identified in NRECA’s prior submission.

1. **Loan servicing actions, lien accommodations, and lien releases**

The Agency’s final rule resolves most of the issues NRECA identified in the proposed rule regarding the treatment of loan servicing actions, lien accommodations, consents and approvals, and related issues. Indeed, the Agency peppered the preamble with favorable language and analysis firmly documenting why such actions, accommodations, consents, and approvals are routine, ministerial, and administrative actions that are not “major Federal actions” and therefore do not require NEPA analysis. The Agency explained that these types of actions and approvals are part of the entire “life cycle” of financial assistance, from initial grant to final repayment, and that they fall within the original review of the financial assistance request. The following subsections discuss several of NRECA’s specific comments and how the Agency addressed them in the final rule.

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| * 1. **NRECA’s comment**: Loan servicing actions, consents, and approvals are not “major federal actions” requiring NEPA review. | **New Rule**:  Accepted |

The Agency agreed that these servicing actions are routine, ministerial, and administrative, and were already considered in the Agency’s original decision-making process. The Agency bundled most loan servicing actions, consents, and approvals in the newly defined term “servicing action,” and then excluded these “servicing actions” in a new subsection (e) within the revised § 1970.8 (Actions requiring environmental review). “Servicing actions” encompass all routine, ministerial, or administrative actions that do not involve new financial assistance, including advancing funds; billing; processing payments; transfers; assumptions; refinancing involving only a change in interest rates; accepting prepayment; monitoring collateral; foreclosing; compromising, adjusting, reducing, or charging off debts or claims; modifying or releasing terms of security instruments, leases, contracts, and agreements; and consents or approvals pursuant to loan contracts, agreements, and security instruments.

In the preamble, the Agency clarifies that such servicing actions do not involve new projects, substantive changes to a project, new construction not reviewed under the original request for financial assistance, or a change in use of the property. Therefore, for example, an RUS action to write off a portion of a borrower’s debt would be “compromising, adjusting, reducing, or charging off debts or claims” and not subject to NEPA, but if that debt write-off were part of a concurrent arrangement with RUS to establish new financing for a project expansion, the write-off may be a form of financial assistance requiring NEPA analysis.

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| * 1. **NRECA’s comment**: Lien accommodations are not “major federal actions” requiring NEPA review. | **New Rule**:  Accepted |

The Agency agreed that lien accommodations (what it called “lien sharing”) are ministerial, and it excluded them in a new subsection (d) within the revised § 1970.8 (Actions requiring environmental review). The Agency defined “lien sharing” as “agreement to pro rata payment on shared secured collateral without priority preference.” The Agency explained that historically, RUS provided 100 percent of a system’s financing, but in response to limited RUS funding in more recent times, borrowers have had to supplement their financing with commercial lenders (including through the use of indentures). The Agency explained that it routinely needs to share a first lien with other lenders, and that such sharing was already anticipated and considered in the original NEPA analysis.

The Agency also reiterated that lien sharing has become commonplace and expected as borrowers continue to use non-federal financing for projects. The Agency noted legislation (7 U.S.C. 936e) where Congress directed that the government take actions to allow lien sharing in certain circumstances. The Agency discussed this and other factors as reasons why RUS lacks significant discretion and control or responsibility over lien sharing, and why RUS therefore has no authority or control over future actions to be taken as a result of a private lender’s request for lien sharing. The Agency clearly posits that lien sharing, and future actions that such sharing might facilitate on the borrower’s end, are not federal actions to which NEPA applies.

In response to other commenters, the Agency stated that it considers lien subordination in a different category from lien accommodations. The Agency added a new definition for lien subordination and explained that because it is a form of financial assistance, the Agency will undertake the required NEPA review for subordination actions.

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| * 1. **NRECA’s comment**: Lien releases and all other loan-servicing actions triggered by payment-in-full are not “major federal actions” requiring NEPA review. | **New Rule**:  Accepted |

The Agency agreed that lien releases are ministerial and non-discretionary, and the § 1970.8(e) exclusion for “servicing actions” can be read to encompass lien releases. In the preamble, the Agency says that “lien releases” are included in the definition for “servicing actions,” but that phrase does not appear there. It is likely that it is reflected indirectly through the phrase “modifying or releasing the terms of security instruments, leases, contracts, and agreements.” In the preamble, the Agency also agreed that at the time the financing decision is made, the Agency contemplates the entire suite of servicing actions during the life cycle of the loan through final payment (or prepayment), and that servicing actions through that period are ministerial and non-discretionary. Thus, other actions triggered by payment-in-full appear to be excluded as part of the broader “servicing actions” exclusion.

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| * 1. **NRECA’s comment**: Third-party approvals and consents under indentures are not “major federal actions” requiring NEPA review. | **New Rule**:  Accepted |

The Agency agreed that its decision to use an indenture is not a federal action, and that the trustee’s duties are ministerial and non-discretionary (prior to a default). A trust indenture, the Agency explains, is simply a documentation of what collateral secures the debt and how the collateral will be maintained, and is not a separate decision from the original financial assistance decision. The Agency appears to include actions under trust indentures as within the excluded “servicing actions” definition.

Here, the Agency clearly rejected environmental group claims that indentures allow RUS to improperly outsource its decision-making authority to third parties without a proper NEPA review. The Agency explained that a trust indenture is simply a shared security instrument where the trustee behaves in a ministerial capacity.

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| * 1. **NRECA’s comment**: RUS approval of work planning documents is not a proposal requiring NEPA analysis. | **New Rule**:  Accepted |

The Agency clarified that its approval of financial assistance is the major decision point triggering NEPA, not the approval of planning documents like construction work plans submitted for RUS approval.

1. **Specific revisions to categorical exclusions**

The Agency adopted some but not all of NRECA’s suggestions for improving and expanding certain categorical exclusions. Under NEPA, an agency can identify categories of actions that, based on experience, are unlikely to result in significant environmental effects and therefore, do not need to routinely undergo the full NEPA process. When consolidating categorical exclusions from several different Agency programs, the Agency narrowed some of the exclusions, and it similarly drafted a few new exclusions narrowly. In the final rule, the Agency dropped some of these narrowing features but ignored others.

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| * 1. **NRECA’s comment**: Mileage limits for construction of electric transmission lines in the “small-scale energy proposal” categorical exclusion and other similar categorical exclusions should not be trimmed to conform to other departments’ limits. | **New Rule**:  Partially accepted |

The Agency agreed that its own experiences supported retaining the existing limits, and the Agency noted its own lengthy administrative record supporting that conclusion. However, the Agency only reverted to prior language in the construction and reconstruction of electric transmission lines (in § 1970.54(c)(2) and (3)), and not for the numerous other new and replaced categorical exclusions where lower mile limits were carried through to the final rule (e.g., power line mileage limitations for various hydroelectric, geothermic, solar, and small electric generating facilities).

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| * 1. **NRECA’s comment**: In the safety, environmental, and energy efficiency categorical exclusion, broaden it to apply to all pollution control devices and potential decommissioning to meet emissions targets, and remove the requirement that the action not increase pollutant emissions, effluent discharges, or waste products. | **New Rule**:  Rejected |

The Agency refused to modify the categorical exclusion to apply more generally to all pollution control devices because some could have significant environmental impacts and therefore must go through the NEPA review process. NRECA had requested exclusion for pollution control projects consistent with applicable federal, tribal, state, or local requirements or that are approved by relevant permitting authorities or consistent with existing permits. The Agency noted that any these agencies typically only determine if applicable regulatory standards are met, not whether environmental impacts could be significant, and that the Agency had its own independent obligation to comply with NEPA.

The Agency also rejected NRECA’s request to eliminate the requirement that the action not increase pollutant emissions, effluent discharges, or waste products. The Agency stated that if there was an increase, the pollution control project could still potentially qualify under a different categorical exclusion (§ 1970.54(c)(12)) for modifications or enhancements to existing facilities or structures for pollution prevent or safety that would not substantially change the footprint or function of a facility.

The Agency also disagreed that the categorical exclusion should apply to decommissioning because it could not envision a scenario where it would be taking a major federal action (i.e., providing financial assistance) where the relevant assets serving as collateral would be subject to decommissioned activities.

In addition to rejecting NRECA’s comments on this categorical exclusion, the Agency also rejected comments from environmental groups seeking to require full NEPA reviews for all pollution control device projects. The environmental groups’ theory was that such devices prolong the life of a facility, and therefore, the Agency must consider all of the environmental impacts of a facility that is able to continue operating. The Agency explained that there are numerous factors that influence the useful life of a facility, that the issue was also subject to federal and state control and jurisdiction, and that it would be difficult for the Agency to determine whether its financial assistance for pollution control equipment directly contributed to an extension of the useful life, or was simply used to meet environmental requirements.

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| * 1. **NRECA’s comment**: Clarify the loan servicing action categorical exclusion to only address those few loan servicing actions that are “major federal actions,” and remove confusing language that makes it appear as though there is a deferral of NEPA review. | **New Rule**:  Accepted |

As noted above, the Agency revised how it addressed loan servicing actions in the final rule. Here, the Agency deleted the categorical exclusion language discussing loan servicing actions (which are no longer actions requiring NEPA reviews), and the Agency also removed the language implying the potential for multiple reviews.

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| * 1. **NRECA’s comment**: Expand the “pollution prevention” categorical exclusion to apply to “pollution control.” Expand energy efficiency improvements categorical exclusion to encompass efforts to address heat rate efficiencies. | **New Rule**:  Accepted |

The Agency accepted both of these requests without significant discussion.

1. **Comments on miscellaneous NEPA issues**

In its comments on the proposed rule, NRECA identified a number of discrepancies in the preamble and in the proposed rule, most of which either showed the Agency going above and beyond its legal requirements in implementing NEPA or represented the imprecise use of language that might cause confusion. The Agency clarified most of the confusing language in the final rule, but generally, the Agency rejected NRECA’s arguments about its overreach. Our initial review of the Agency’s rejection of these comments shows that generally, the Agency has provided a reasoned explanation in the preamble, and that these issues do not immediately appear invite a fruitful challenge to the final rule on its face. However, we continue to analyze the final rule, and we are also mindful that a challenge to the rule as applied may also be fruitful in the right circumstances.

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| * 1. **NRECA’s comment**: The treatment of “connected actions” and “cumulative actions” exceed CEQ requirements by using the terms “closely related” or “related.” | **New Rule**:  Clarified |

The Agency disagreed with NRECA’s argument but sought to clarify the language by removing the problematic “related” language from § 1970.9(c) and § 1970.53(b)(3).

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| * 1. **NRECA’s comment**: The Agency incorrectly applies the “connected action,” “cumulative action,” and “cumulative effects” requirements to actions qualifying for categorical exclusion. | **New Rule**:  Rejected |

In its comments on the proposed rule, NRECA provided caselaw explaining why agencies can properly limit the scope of actions to be considered in the categorical exclusion process. The Agency disagreed with NRECA’s position but did not directly respond to the authorities provided in NRECA’s comments. Instead, the Agency provided limited authority of its own from CEQ guidance materials, a quick review of which appears only to support a portion of the Agency’s position.

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| * 1. **NRECA’s comment**: The Agency should provide a categorical exclusion documentation requirement to ensure a defensible record is created. | **New Rule**:  Rejected but explained |

Recognizing some of the difficulties faced by parties in the Sunflower litigation with deficiencies in the administrative record, NRECA recommended that the Agency identify in its final rule what documentation will be prepared to confirm the applicability of each categorical exclusion. The Agency agreed that such documentation will be prepared, but it explained that it will do so in accordance with internal guidance, and not through the final rule.

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| * 1. **NRECA’s comment**: Remove the requirement that applicants must cooperate with the Agency on achieving environmental goals as part of a requirement for financial assistance. | **New Rule**:  Rejected |

The Agency chose to keep language confirming an applicant’s obligation to assist the Agency in meeting its NEPA goals of protecting, restoring, and enhancing the environment. The Agency explained that this language is intended to address uncooperative applicants and those who provide insufficient documentation during the environmental review process. The Agency further stated that it does not intend to use this provision to condition financial assistance on anything other than the action under consideration and those actions over which the Agency has control and responsibility. Although the Agency has authority under its organic statutes to impose reasonable terms and conditions on its provision of financial assistance, this is an area where an applicant could bring an as-applied challenge if the Agency sought to impose unreasonable environmental terms that deviated from the specific action over which the Agency has authority.

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| * 1. **NRECA’s comment**: Revise the prohibition on critical actions occurring in the floodplain to apply to the 100-year floodplain, not the 500-year floodplain. | **New Rule**:  Mostly rejected |

In the proposed rule, the Agency sought to limit development of “critical actions” in the 500-year floodplain, and NRECA’s prior comments explained that the Agency did not need to encumber an area so vast as the 500-year floodplain for this purpose. In response, the Agency removed some of the foreclosing language in the rule (e.g., the phrase “there are no exceptions to this policy”), but it otherwise retained the requirement that no critical actions occur within the 500-year floodplain unless the applicant demonstrates there is no practicable alternative and designed the facility according to more stringent standards. The Agency provided some authority for its position. The Agency did not address NRECA’s comment that “electric generating facilities” in the “critical action” definition should not be interpreted to encompass non-generating components (e.g., substations, transmission lines).

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| * 1. **NRECA’s comment**: The Agency should clarify its mitigation provisions to note that the Agency can only impose substantive mitigation requirements under some other organic statute, not NEPA. | **New Rule**:  Rejected |

As noted above, the Agency claims that it has adequate authority under its organic statutes to impose reasonable terms and conditions on its provision of financial assistance, including mitigation to reduce environmental impacts. Here, the Agency reiterated its position that NEPA has an action-forcing component, and the Agency will therefore include appropriate conditions in grants, permits, and other approvals, including conditioning funding of actions on mitigation. The Agency stated that it provides guidance documents on its website discussing examples of types of mitigation and explaining the development and use of formal mitigation plans.

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| * 1. **NRECA’s comment**: Revise standards for supplementing an EA to align with standards for supplementing an EIS. | **New Rule**:  Mostly rejected |

In its prior comments, NRECA sought to clarify and limit the circumstances where the Agency would require a supplemental environmental assessment (EA). The Agency adopted one suggestion and clarified that the duty to supplement an EA only exists before the action is implemented, and not after. The Agency, however, disagreed that there were any inconsistencies between its rule and CEQ’s regulations, and it rejected NRECA’s other suggestions to narrow when supplemental EAs need to be prepared.