RENDERED: May 14, 2004; 10:00 a.m.
NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court of Appeals

NO. 2003-CA-000025-MR

HARSCO CORPORATION — APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE WILLIAM L. GRAHAM, JUDGE
ACTION NOS. 01-CI-01541 & 01-CI-01543

NATURAL RESOURCES AND ENVIRONMENTAL PROTECTION CABINET; RICHARD ELLIS; THOMAS ELLIS; AND RICHARD E. ELLIS EXECUTOR OF THE ESTATE OF VERNON ELLIS, DECEASED — APPELLEES

OPINION

REVERSING

** ** ** ** **

BEFORE: EMBERTON, CHIEF JUDGE; DYCHE AND TACKETT, JUDGES.

DYCHE, JUDGE. This matter is before this Court for a review of an Opinion and Order of the Franklin Circuit Court involving a decision of the Natural Resources and Environmental Protection Cabinet. Upon a full review, we reverse.

Appellant, Harsco Corporation, buys and processes slag through its Heckett Multiservice[1] division from Gallatin Steel Company, which uses an electric arc furnace to melt scrap steel and turn it into new carbon steel rolls. Slag is a waste product of steel production. The handling and processing of slag can emit pollutants into the air.

In order to continue the steel making process, slag must continually be removed. Likewise, in order for slag to be processed, steel must continually be made. Accordingly, Harsco and Gallatin Steel entered into a contract for their mutual benefit, which can best be termed as a supply and demand contract.

Other terms of the contract include that Gallatin Steel actually selected the site for Harsco's facility. The contract also specifies that Gallatin Steel can make Harsco move its facility to another mutually suitable location. Gallatin Steel also has the option to acquire Harsco's premises. However, Gallatin Steel does not have any ownership interest in Harsco, and they do not share employees.

Appellees Thomas Ellis, Richard Ellis, and Vernon Ellis[2] live on their family's farm which is near both the

[1] At times, Harsco has been referred to as Heckett throughout the prior proceedings and in various documents.
[2] Vernon Ellis died on March 9, 2004; his executor was substituted as a party to this appeal by order entered April 20, 2004.

Gallatin Steel and Harsco facilities. Dust from transporting and processing the slag is carried by the wind onto their farm.[3]

Appellee Natural Resources and Environmental Protection Cabinet ("Cabinet") through its Division for Air Quality ("DAQ") is the entity responsible in this matter for making the determination that Harsco and Gallatin Steel are a single source of air pollutants.[4] James E. Bickford was the Secretary ("Secretary") of the Cabinet when the single source determination at issue was made.

The issues in this case involve Kentucky regulations promulgated to comply with the Clean Air Act ("CAA"), 42 U.S.C. § 7401, et seq. Individual states can regulate companies within their respective boundaries under the CAA after developing State Implementation Plans ("SIPs"), which have to be approved by the United States Environmental Protection Agency ("US EPA"). However, even after approval of the SIPs, the US EPA continues to have oversight of each state's program. Kentucky's SIP has been approved by the US EPA. See 40 CFR § 52.923.

SIPs define source-by-source emissions limits to ensure that states are meeting the National Ambient Air Quality

[3] The Ellises have also been involved in citizen suits in the United States District Court for the Eastern District of Kentucky, Covington Division, against Harsco and Gallatin Steel.

[4] Another entity called Air Liquide Industrial Gas Plant was also included in this determination and is often referenced in documents. Air Liquide, under the terms of a contract with Gallatin Steel, operates an industrial gas production facility which provides all of the vaporized oxygen, nitrogen, and argon, which Gallatin Steel requires as part of its steel making process. However, Air Liquide is not a party to this appeal.

Standards ("NAAQS"), which specify the maximum allowable concentrations of air pollutants for different areas of the country. U.S. v. Duke Energy Corp., 278 F. Supp. 2d 619, 628 (M.D. N.C. 2003)(citing 42 U.S.C. § 7409). The CAA was amended to include measures entitled "Prevention of Significant Deterioration" ("PSD") to protect areas with relatively clean air. "PSD was designed to ensure that the air quality of relatively unpolluted areas, i.e., attainment areas, did not decline to the minimum levels permitted by NAAQS due to increases in total annual emissions." Id. Any company in Kentucky that is defined by 401 KAR 51:017 sec. 1(25)(a) as a "major stationary source" of air pollutants is included in the requirements of the PSD program and must receive a PSD permit.

The term "stationary source" of air pollutants means "a building, structure, facility, or installation which emits or may emit an air pollutant subject to regulation under 42 U.S.C. §§ 7401 to 7671q (Clean Air Act)." 401 KAR 51:017 sec. 1(38). In turn, a "'[b]uilding, structure, facility, or installation' means all of the pollutant activities which belong to the same industrial grouping, are located on one (1) or more contiguous or adjacent properties, and are under the control of the same person (or persons under common control). . . ." 401 KAR 51:017 sec. 1(9). Each of these three factors must be met for multiple sources to be considered a single source.

There is no dispute that Gallatin Steel is a major stationary source of air pollutants. However, Harsco, if not grouped with Gallatin Steel, is not a major stationary source of air pollutants and would not be required to apply for a PSD permit.[5] The main issue in the present matter is whether Harsco and Gallatin Steel's mutual contractual obligations and nature of their dependent operations are relevant factors to support a determination that they are a single source of air pollutants for PSD purposes pursuant to 401 KAR 51:017 sec. 1(9).

Kentucky's DAQ, via its PSD program, issues PSD permits for Kentucky sources. The DAQ has not been consistent in making this determination with these two entities.[6] From 1995 until July of 2000, the DAQ did not treat Gallatin and Harsco as a single source. However, in July of 2000, the DAQ made a determination that Gallatin Steel and Harso were one source for PSD purposes.

Harsco filed for an administrative review of this determination pursuant to KRS 224.10-420(2) and 401 KAR 50:060 sec. 5(2). Because of the potential impact on Gallatin Steel,

[5] Apparently, applying for a PSD permit is time consuming and costly. Further, if an entity is required to operate under a PSD permit, additional burdens are placed on it to comply with the CAA.

[6] The Ellises and the Cabinet maintain that the DAQ was misled regarding the extent of the relationship between Harsco and Gallatin Steel in 1995. However, the DAQ had copies of the contract between the two entities in 1995, when it first determined that they should not be considered as a single source. Yet, in reviewing the matter in 2000, the primary reason given for the single source determination was the mutual dependency created by the contractual obligations.

it was permitted leave to intervene in that matter. After discovery, the parties filed cross motions for a summary recommendation before the hearing officer. After oral argument on the motions, the hearing officer filed a seventy-nine page Report and Recommendation concluding that the DAQ erred in its determination that Gallatin Steel and Harsco were one source.

Thereafter the Cabinet and Ellises filed exceptions thereto to the Secretary of the Cabinet.[7] The Secretary declined to adopt the Report and Recommendation and upheld the earlier determination by the DAQ that Gallatin Steel and Harsco were a single source for PSD purposes.

Gallatin Steel and Harsco filed separately for review of the matter in Franklin Circuit Court pursuant to KRS 224.10-420. The two matters were thereafter consolidated. The Circuit Court upheld the Secretary's determination, and Harsco filed a timely notice of appeal. Gallatin Steel did not join in this appeal.

The main issue regarding the single source determination is one of law, not fact, regarding the proper construction of 401 KAR 51:017 sec. 1(9).[8] This Court is

[7] Gallatin Steel also filed exceptions. However, those exceptions are not under review as Gallatin Steel did not join in the appeal from the circuit court.

[8] Harsco maintains that the Circuit Court used the wrong standard of review in deferring to the Secretary by adopting the substantial evidence standard normally used to review agency decisions. Instead, it argues that the Circuit Court should have reviewed the matter de novo arguing that the initial matter was resolved under summary judgment standards where no

authorized to review issues of law on a de novo basis. Aubrey v. Office of Attorney General, Ky. App., 994 S.W.2d 516, 518-519 (1998) (citing American Beauty Homes Corp. v. Louisville and Jefferson County Planning and Zoning Commission, Ky., 379 S.W.2d 450, 458 (1964)).

The rules of regulatory interpretation follow the same standards as those for statutes. Aubrey, 994 S.W.2d at 520 (citing Revenue Cabinet v. Gaba, Ky. App., 885 S.W.2d 706, 707 (1994) (citing Revenue Cabinet v. Joy Technologies, Inc., Ky. App., 838 S.W.2d 406 (1992))). "It is a fundamental rule that 'all statutes should be interpreted to give them meaning, with each section construed to be in accord with the statute as a whole.'" Aubrey, id. (citing Transportation Cabinet v. Tarter, Ky. App., 802 S.W.2d 944 (1990)). "Statutes should not be construed such that their provisions are without meaning, whether in part or in whole." Aubrey, id. (citing George v. Scent, Ky., 346 S.W.2d 784 (1961)). "A court may not interpret a statute at variance with its stated language." SmithKline Beecham Corp. v. Revenue Cabinet, Ky. App., 40 S.W.3d 883, 885 (2001).

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evidentiary hearing was held. Our resolution of this matter does not involve issues of fact. Therefore, Harsco's argument on the correct standard of review is moot.

In Hagan v. Farris, Ky., 807 S.W.2d 488, 490 (1991), the Kentucky Supreme Court summarily laid out the guidelines to be followed in reviewing agency action:

> An agency must be bound by the regulations it promulgates. Shearer v. Dailey, 312 Ky. 226, 226 S.W.2d 955 (1950). Further, the regulations adopted by an agency have the force and effect of law. Linkous v. Darch, [Ky.] 323 S.W.2d 850 (1959). An agency's interpretation of a regulation is valid, however, only if the interpretation complies with the actual language of the regulation. Fluor Constructors, Inc. v. Occupational Safety and Health Review Commission, 861 F.2d 936 (6th Cir. 1988). KRS 13A.130 prohibits an administrative body from modifying an administrative regulation by internal policy or another form of action.
> ****
> In most cases, an agency's interpretation of its own regulations is entitled to substantial deference. Fluor Constructors, Inc., supra. A construction of law or regulation by officers of an agency continued without interruption for a long period of time is entitled to controlling weight. Barnes v. Department of Revenue, Ky., 575 S.W.2d 169 (1978). It is usually the practice to conform to an agency's construction when that agency was responsible for a regulation's adoption. Passafiume v. Shearer, Ky., 239 S.W.2d 456 (1951).

In Board of Trustees of the Judicial Form Retirement System v. Attorney General of the Com., Ky., ___ S.W.3d ___, 2003 WL 22415383, *16 (Oct. 23, 2003), the Court added further guidance on the deference due an agency, holding that the deference generally given pursuant to Chevron, U.S.A., Inc. v.

Natural Res. Def. Council, Inc., 467 U.S. 837, 844-45 (1984), "is normally granted only when the agency interpretation is in the form of an adopted regulation or formal adjudication." Board of Trustees, ___S.W.3d at ___, 2003 WL 22415383, at *16 (citing Christensen v. Harris County, 529 U.S. 576, 687, (2000) ("Interpretations such as those in opinion letters—like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant Chevron-style deference."); Mid-American Care Found. v. N.L.R.B., 148 F.3d 638, 642 (6th Cir. 1998) ("Chevron deference is limited in application to those situations in which the administrative agency has formally adopted a particular interpretation of a statute."); Johnson City Med. Ctr. v. United States, 999 F.2d 973, 976 (6th Cir. 1993) ("[A] revenue ruling, as opposed to a legislative regulation, is not entitled to the deference accorded a statute.")). However, "courts do not face a choice between Chevron deference and no deference at all. Administrative decisions not subject to Chevron deference may be entitled to a lesser degree of deference; the agency position should be followed to the extent persuasive." Scharpf v. AIG Marketing, Inc., 242 F. Supp. 2d 455, 465 (W.D. Ky. 2003) (citing U.S. v. Mead Corp., 533 U.S. 218, 228 (2001)(citing Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944))).

The phrase under review in 401 KAR 51:017 sec. 1(9) is "under the control of the same person (or persons under common control)." [9] "[U]nder common control" is defined in a 1985 Policy Manual as follows:

> The term "under common control" in 401 KAR 51:017, Section 2(6) shall mean that persons with as much as 50% voting interest in an entity are considered to control the entity.

This Policy Manual was thereafter incorporated by reference in 401 KAR 50:016, which remains a properly promulgated regulation. Nonetheless, the Secretary determined that this was not the exclusive definition of "common control."

Unfortunately, the Secretary failed to justify his reasons for his conclusion that the above reference was non-exclusionary. On the contrary, courts in this Commonwealth have long interpreted "shall" as a mandatory term. See Alexander v. S & M Motors, Inc., Ky., 28 S.W.3d 303 (2000); Commonwealth v. Fint, Ky., 940 S.W.2d 896, 897 (1997). Moreover, in KRS 446.010 (29), our legislature pronounced that in statutory construction, "shall" is a mandatory term. Because we use rules of statutory construction to interpret regulations, we apply this principle

[9] While there is no issue regarding whether Harsco and Gallatin Steel are on contiguous property, there is an issue regarding the correct industrial grouping of Harsco. Nonetheless, if one factor listed in 401 KAR 51:017 sec. 1(9) is absent, multiple sources cannot be combined. Because we ultimately conclude that under the current regulations Harsco and Gallatin Steel are not under common control, a determination of Harsco's industrial grouping is irrelevant. Hence, we decline to review it.

in the matter. Thus, "shall" is a mandatory term, not open to alternatives meanings.

Moreover, the Secretary's interpretation has not gone through the regulatory promulgation process, nor is it a longstanding interpretation. Thus, we find it is entitled to little deference. We make this finding based on his unsupported conclusion which is not persuasive in light of the unambiguous regulatory language. We conclude that his decision was arbitrary and not in accord with a properly promulgated regulation.

Further, we find the reasons stated in the record for not following 401 KAR 50:016 in making the single source determination a compelling buttress for our conclusion. Reasons given by those in decision making authority in the DAQ[10] include that the Policy Manual was old and outdated and that the DAQ "just never got around to updating [it]." Instead, of relying on 401 KAR 50:016, decision makers relied on case studies and guidance documents. Pursuant to KRS 13A.130, this was an impermissible attempt to alter or modify a regulation by internal policy.

The bulk of the argument put forth by the Ellises in their brief is that "under the control of the same person" is an alternative definition of control. The reason they advocate

[10] These persons include Edd Frazier, John Hornback, and Dan Gray.

this so strenuously is that this phrase is not limited by a specific definition anywhere in the regulations, whereas "under common control" is limited in meaning by 401 KAR 50:016.

The Ellises brought up this argument before the hearing officer, but did not include it in their exceptions to the Report and Recommendations. Pursuant to KRS Chapter 13B, "the filing of exceptions provides the means for preserving and identifying issues for review by the agency head. In turn, filing exceptions is necessary to preserve issues for further judicial review." Rapier v. Philpot, Ky., ___ S.W.3d ___, 2004 WL 102199, *3 (Jan. 22, 2004). Hence, this argument was not properly before the Circuit Court and is not properly before us.

Nonetheless, the Circuit Court reviewed this issue and agreed with the Ellises.[11] The Circuit Court, in its Opinion and Order, upheld the Secretary's determination. However, we conclude the Circuit Court's analysis and conclusions are erroneous as it misstated the findings made by the Secretary. The Circuit Court stated in relevant part as follows:

> The Secretary interprets the "under common control" clause as merely one option. The alternative clause, "under the control of the same person", is not defined by either the Kentucky or the EPA regulations. In the absence of a definition, a word must be given its ordinary meaning. Consalvi v. Cawood, Ky. App., 63 S.W.3d 195, 198 (2001). The Secretary applied the ordinary meaning

[11] Most likely the Circuit Court reviewed this issue because Harsco did not argue preservation before it. Nor has Harsco argued it before us.

> of the phrase “under the control of the same person” and made a finding that Harsco and Gallatin were under such control.

The Secretary, however, did not use the phrase “under the control of the same person” as an alternate definition of control. Thus, the Circuit Court clearly erred.

Moreover, in the relevant documents relating to this matter and in the Secretary’s Final Order, 401 KAR 51:017 sec. 1(9) has not been treated as having two alternative definitions. Instead, the two phrases have been used cooperatively. The reasonable conclusion is that the phrase in parenthesis, “(or persons under common control),” is descriptive or explanatory of “under the control of the same person.” Neither the Cabinet nor the Ellises point us to any authority reaching a different conclusion.

The Ellises argue, nonetheless, that, if 401 KAR 51:017 is the exclusive definition of common control, it is less stringent than the federal law. They, therefore, conclude that, due to this conflict, Kentucky’s definition is in violation of the Supremacy Clause of Article VI of the United States Constitution. We, however, disagree.

Under considerations concerning the Supremacy Clause, among other factors, we look for a conflict between state and federal law, where federal law has preempted an area. However,

> a conflict arises when "compliance with both federal and state regulations is a physical impossibility," Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43, 83 S.Ct. 1210, 1217-18, 10 L.Ed.2d 248 (1963), or when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Hines v. Davidowitz, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed. 581 (1941).

Ohio Mfrs. Ass'n v. City of Akron, 801 F.2d 824, 828 (6th Cir. 1986). However, the US EPA has not defined the term "common control." There being no definition by the US EPA, we cannot say that Kentucky's definition creates a conflict wherein an entity cannot comply with both federal and state law.

As a side note to their Supremacy Clause issue, the Ellises point out that 401 KAR 50:016 is not part of the federally approved SIP regarding PSD's. However, there are a number of DAQ regulations under Kentucky's CAA program which were not included in the federally approved SIP program.[12] We have found no authority to say that simply because a state regulation is not specifically incorporated into the federally approved SIP, it has no force as state law. To say otherwise would be to invalidate a number of properly promulgated regulations. We decline to do so.

[12] For example, the following regulations are not included in the federally approved SIP for Kentucky: 401 KAR 50:031; 401 KAR 50:033; 401 KAR 50:034; 401 KAR 50:038.

For the reasons so stated, we hereby reverse. This matter is remanded to Franklin Circuit Court for proceedings consistent with this Opinion.

EMBERTON, CHIEF JUDGE, CONCURS.

TACKETT, JUDGE, DISSENTS.

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