

# Client Alert

Energy

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## Texas, Utah and Small Modular Reactor (“SMR”) Developer Launch Lawsuit Alleging “Unlawful” Regulatory Regime

Complaint filed United States District Court, Eastern District of Texas (Case No. 6:24-cv-00507)

### KEY TAKEAWAYS

- The States of Texas and Utah, together with private developer Last Energy, have sued to exempt certain SMRs from federal licensing requirements.
- This lawsuit could impact the U.S. energy industry, which is increasingly turning towards SMRs as a solution for providing clean, base-load (i.e. 24-hour) energy as demand for electricity increases as a result, in part, to new data center and AI requirements.
- Plaintiffs argue that the U.S. Nuclear Regulatory Commission (“NRC”) overstepped its authority in requiring the licensing of low-power reactors given that they use insignificant amounts of nuclear material and cannot release radioactivity even in a worst reasonable case scenario.
- The lawsuit rests on a claim that the NRC’s “Utilization Facility Rule” represents an unlawful extension of its authority under the Atomic Energy Act (“AEA”), which authorizes the NRC to require licenses only for those reactors deemed “capable of making use of special nuclear material in such quantity as to be of significance to the common defense and security, or in such manner as to affect the health and safety of the public.”

- A ruling in favor of plaintiffs (i) would exempt Last Energy’s 20-MW reactor design and research reactors located in the plaintiff states, and (ii) may exempt certain other small nuclear reactors, based on the scope of relief granted, in each case from certain licensing requirements. The Department of Energy would continue to regulate Nuclear fuel required for the operation of such small reactors.
- The plaintiffs’ lawsuit, if successful, would mark a turning point in the regulatory framework for the U.S. nuclear industry. The plaintiffs contend such action is paramount to ensuring the U.S. remains an industry leader, but a reduction in regulatory oversight naturally runs a level of unforeseeable risk and may undermine public confidence in SMR technology, an essential element for the roll-out of such technology at scale.
- With the imminent change in U.S. government, one possible outcome is a settlement between the plaintiffs and the new Trump administration officials who may be amenable to a refreshed version of the Utilization Facility Rule that is tailored towards certain SMRs.
- Regardless the outcome, the lawsuit underscores the need for licensing regulations to be updated to reflect modern technology. In 2023, the NRC appeared to recognize this need and proposed, under its Part 53 rulemaking package, technologically flexible licensing standards aimed to streamline approval of the types of reactors at issue in the lawsuit. This lawsuit may influence the NRC as it finalizes new rules ahead of its 2027 deadline.
- As a result of other recent changes in U.S. law, regulated parties may have an increased appetite for challenging federal regulations in federal courts more receptive to these types of challenges. This lawsuit may ultimately prove a harbinger of other challenges to federal rules in the energy sector.
- The King & Spalding Nuclear Industry Team is closely monitoring this lawsuit and has extensive experience advising clients on all aspects of nuclear energy law and project development, including on some of the country’s first and most advanced SMRs. If you have any questions or would like to discuss developing strategic responses to potential new regulations related to this lawsuit, please contact us.

## BACKGROUND

On December 30, 2024, the State of Texas, the State of Utah, and SMR developer Last Energy, Inc. (the “**Plaintiffs**”), filed suit in the U.S. District Court for the Eastern District of Texas, Tyler Division seeking a declaratory judgment:

- (i) holding unlawful the NRC’s “Utilization Facility Rule” (10 CFR § 50.2) and
- (ii) exempting certain Texas- and Utah-based university research reactors, along with Last Energy’s SMRs, from the NRC’s utilization-facility licensing requirements.

(the “**SMR Complaint**”).

Stakeholders that have dealt with the NRC are familiar with lengthy and costly licensing processes that affect all new nuclear development in the U.S. From the smallest demonstration reactor capable of powering a lightbulb to reactors powering cities, all industry players, for decades, have had to incorporate into their planning these burdens associated with obtaining the NRC’s proverbial “green light.” With the SMR Complaint, the State of Texas, the State of Utah, and Last Energy seek to upend this regulatory framework, at least as applied to certain SMR projects, by exempting these reactors from the NRC licensing process.

If Plaintiffs are successful in having the Utilization Facility Rule declared unlawful, this could leave a significant regulatory gap in the near term – offering both potential financial windfall alongside downside risks, in what would become a new, uncharted regulatory environment for all involved. However, success might, ironically, hamper SMR

development in the U.S. and global jurisdictions. For example, developers may be less prone to making financial commitments to develop SMR projects and to improve SMR technology against an evolving U.S. regulatory landscape.

### THE NRC'S UTILIZATION FACILITY RULE

As noted, the NRC derives its authority to license the construction and operation of nuclear reactors in the U.S. from the AEA. The AEA superseded earlier legislation (the McMahon Act (1946)), under which the NRC's predecessor agency, the Atomic Energy Commission ("AEC") enjoyed broad licensing authority over "any" equipment or device capable of making fissionable material or peculiarly adapted for making use of atomic energy.

Congress updated the licensing authority of the McMahon Act with a more nuanced approach under the AEA by imparting nuclear licensing authority specifically over "*utilization facilities*"; defined as "*any equipment or device, except an atomic weapon, determined by rule of the Commission to be capable of making use of special nuclear material in such quantity as to be of significance to the common defense and security, or in such manner as to affect the health and safety of the public.*" 42 U.S.C. § 2014(cc) (emphasis added).

As argued by the Plaintiffs, the AEA does not grant power to license all nuclear reactors. The definition of utilization facility includes two express limitations, which they allege apply to certain SMRs, because they do not make use of specific nuclear material:

- (i) in such quantity as to be of significance to the common defense and security (the "**Quantity Threshold**");  
or
- (ii) in such manner as to affect health and safety of the public (the "**Manner Threshold**").

A nuclear reactor failing to meet both the Quantity Threshold and the Manner Threshold falls outside the licensing purview of the NRC because the AEA does not grant the NRC authority to license such reactors, according to the Plaintiffs.

Nevertheless, the AEC (and later the NRC) adopted formal rules in 1956 implementing its authority to license "*utilization facilities*" as pertaining to "[a]ny nuclear reactor other than one designed or used primarily for the formation of plutonium or U-233." 21 Fed. Reg. 355, 356 (Jan. 19, 1956) (codified at 10 C.F.R. 50.2) (emphasis added) ("**Utilization Facility Rule**"). This appears at odds with the more limited authority granted to the NRC by Congress under the AEA. The Plaintiffs argue that the Utilization Facility Rule not only exceeds on its face the NRC's prescribed authority under the AEC, but it also undermines Congress's deliberate narrowing of nuclear licensing authority when it updated the McMahon Act with the more limited approach expressed in the AEA. Yet for nearly seventy years, the NRC's regulatory approach has stood effectively unchallenged.

### THE CHALLENGE TO THE UTILIZATION FACILITY RULE

The Plaintiffs have challenged the Utilization Facility Rule on the basis that it exceeds the NRC's authority (Count 1 of the SMR Complaint) and is arbitrary and capricious (Count 2 of the SMR Complaint). Under the Administrative Procedure Act, regulations may be set aside ("vacated") if made either without statutory authority or on an arbitrary and capricious basis. Plaintiffs also seek that Texas, Utah, and Last Energy SMR projects be declared exempt from the NRC's utilization-facility licensing requirements.

The Plaintiffs are seeking to reduce the regulatory burden at a time when nuclear technologies (e.g., SMRs, and their smaller counterparts, microreactors) are being positioned to meet increasing energy demands for clean, reliable energy that avoids the intermittency and grid infrastructure challenges of renewables. SMRs harness the heat of fission reactions analogous to conventional large nuclear power plants, but use fundamentally different technology (e.g., coolants, safety mechanisms, material handling, and the like) in a small (300 MW or less) and modularly constructible

reactor system – essentially, small nuclear power generators rolling off a factory production line and delivered to convenient sites ready to operate. SMRs promise solutions for numerous use cases, including co-locating SMRs with dedicated electricity off-takers such as AI data centers, oil and gas production operations and other off-takers requiring firm (24/7) power, often in remote or conventional-grid constrained locations.

The Plaintiffs all tout their own nuclear SMR / research reactors as a basis for injury sustained by the NRC's licensing requirements. The University of Texas at Austin, Texas A&M, and the University of Utah house research and test reactors, each of which use less nuclear fuel and produce less energy than many other SMRs. Last Energy wants to deploy its SMR 20-MW technology in the U.S. The Plaintiffs argue that despite their innovative technological efforts, the NRC's licensing requirements make new SMR development virtually impossible, leaving the U.S. behind in the race for clean, affordable energy.

The answer, according to the Plaintiffs? Remove the NRC's ability to license the construction and operation of certain nuclear reactors under the Utilization Facility Rule. If Plaintiffs succeed, the NRC could then issue a proper and lawful rule that recognizes and gives effect to the statutory carve out of the Quantity Threshold and the Manner Threshold. This would, in turn, have the effect of exempting certain SMRs, and the Plaintiffs' projects specifically, from NRC construction and operation licensing requirements. Regulation of certain SMRs would then presumably fall to state governments.

Under the Quantity Threshold, the NRC's licensing authority depends on whether a nuclear reactor is capable of making use of special nuclear material "in such quantity as to be of significance to the common defense and security." SMRs generally use special nuclear material of a different type than that used for nuclear weapons, and in such small quantities of nuclear material that a single SMR, such as those contemplated in the SMR Complaint, could not, according to Plaintiffs, be of significance to the common defense and security.

Under the Manner Threshold, the NRC's licensing authority depends on whether a nuclear reactor is capable of making use of special nuclear material "in such manner as to affect health and safety of the public." Plaintiffs argue that SMRs generally, and their SMRs specifically, fail to meet the Manner Threshold, and should therefore be exempt from the NRC licensing authority. Nuclear energy production already enjoys a stronger safety record than most energy production methods (e.g., coal, hydroelectric, etc.). Further, advanced nuclear technologies inherently imbue SMRs with safety features that ensure their reactors revert to a subcritical, non- or nominal radioactive state, even under catastrophic failure conditions. As such, according to the Plaintiffs, nuclear material in such walk-away safe SMRs could not affect the health and safety of the public.

Under Count 1, the Plaintiffs contend the NRC's Utilization Facility Rule exceeds the NRC's statutory authority granted by Congress under the AEA because the Rule captures essentially all reactors under its regulatory purview, even certain SMRs clearly not meeting the Quantity Threshold and the Manner Threshold. The Utilization Facility Rule, according to Plaintiffs, essentially gives the NRC the same authority it enjoyed under the McMahon Act, when Congress long ago stepped in with an edict for more limited authority.

Under Count 2, the Plaintiffs argue that the NRC made its Utilization Facility Rule in an arbitrary and capricious manner. Supreme Court precedent mandates that federal agencies engage in "reasoned decision making," which articulates a satisfactory explanation for their actions. The SMR Complaint sifts through legislative history and agency rulemaking from the 1950s in an attempt to demonstrate a lack of reasoned decision making – "the AEC offered no explanation for ignoring the statutory text, nor for backtracking from its recognition that its authority had been narrowed by Congress, nor did the NRC provide any explanation for its silent assumption that all nuclear reactors are significant within the meaning of the AEA." (SMR Complaint, ¶ 225.)

On the basis of the alleged unlawfulness of the Utilization Facility Rule, and in the alternative, on the basis of arbitrary and capricious manner of the Rule's creation, the Plaintiffs demand that the Rule be set aside, and their SMR projects be allowed to continue without being subject to the NRCs licensing regime.

## IMPLICATIONS

The implications of the Plaintiffs' lawsuit will unfold over the coming months, but if successful, it could be very significant. In the absence of additional congressional or federal regulatory action to replace the Utilization Facility Rule (see below as to what this might look like) nuclear licensing would fall largely to state governments. However, the requested relief leaves intact the Department of Energy's strict oversight of nuclear fuel for reactors. Some state governments (such as the State of Texas) may be better equipped to immediately move forward with an oversight function on construction and operation of certain SMRs, whereas other states might not. While winners and losers under a state government led regulatory regime will come into focus over time, appropriately tailored standards in light of the differences between certain SMRs and traditional, large scale nuclear plants could help spur the growth and development of these SMRs. However, a patchwork of state government regulation may lead to inconsistent standards that could potentially increase costs to the nuclear industry (e.g., due to complying with many different standards) and raise questions in the mind of the general public as to the safety of new reactor technologies. And if the U.S. regulatory framework becomes a patchwork of state regulations, then other global jurisdictions will not have a regulatory framework that they can readily benchmark against, thereby potentially slowing the development of regulatory frameworks for certain SMRs across the globe.

Rather than wipe out the Rule altogether, the Plaintiffs may have a different goal: a new, different Utilization Facility Rule that accounts for the Quantity Threshold and Manner Threshold of the AEA. In light of the looming change in Administrations with a possible new Commissioner to be appointed at the NRC, there is a potential pathway for a "sue and settle" resolution whereby the new Commissioner settles this lawsuit, and the NRC agrees to issue new licensing regulations. Any new licensing regulations would still be subject to standard notice and comment provisions of APA rulemaking, but this lawsuit may be a vehicle to help prompt this new rulemaking, and perhaps impose a specified timeframe for the development of new rules.

If litigated on the merits, the recent overturning of the U.S. legal principle of "Chevron deference" could be critical to how courts read and apply the NRC's authority under the AEA. For decades, the Supreme Court mandated (in line with a principle established in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* (1984)) that the federal judiciary give deference to an executive agency's interpretation of a statute, if the interpretation is reasonable. In 2024, the Supreme Court overruled this principle in *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024), increasing the scope of federal judicial review of agency decisions. The Plaintiffs are taking advantage of this transformational legal shift by arguing that the court need not give any deference to the NRC's Utilization Facility Rule; the court alone, per Plaintiffs, must apply its own judgment as to the scope of the AEA. (SMR Complaint, ¶ 209.) This lawsuit therefore has the potential to pave the way not just for the striking down of the NRC's regulations, but to also serve as a roadmap to striking down other federal agency interpretations, now unshielded by Chevron deference.

Regardless the outcome, the Plaintiffs' lawsuit highlights the challenges in applying the Utilization Facility Rule to the advanced nuclear reactors now under development in the U.S. Even if it would be undesirable to abolish all federal regulation in the way the Plaintiffs seek, the 69-year-old Utilization Facility Rule may be ill equipped to regulate certain SMRs and microreactors due to their small size and technological sophistication. In 2023, the NRC appeared to recognize this very issue and initiated a rulemaking package designed to refresh licensing requirements for SMRs and microreactors. (SECY-23-0021: Proposed Rule: Risk-Informed, Technology-Inclusive Regulatory Framework for Advanced Reactors (RIN 3150-AK31).) The final rule, per the NRC's timetable, is due in 2027. The Plaintiffs lawsuit

may influence, or even render moot, this in-process rulemaking, creating even greater uncertainty as advanced nuclear technologies get closer to commercial readiness.

Any new licensing regulations put forward by the NRC in response to this lawsuit will be available for public comments. Stakeholders are encouraged to consider how the potential deregulation would impact future construction and energy developments.

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