

The Texas Natural Resource Conservation Commission (commission) adopts new §117.109, System Cap Flexibility; §117.110, Change of Ownership - System Cap; and §117.139, System Cap Flexibility. Section 117.139 is adopted *with changes* to the proposed text as published in the December 1, 2000 issue of the *Texas Register* (25 TexReg 11883). Sections 117.109 and 117.110 are adopted *without changes* and will not be republished. The new sections will be submitted to the United States Environmental Protection Agency (EPA) as a revision to the state implementation plan (SIP).

BACKGROUND AND SUMMARY OF THE FACTUAL BASIS FOR THE ADOPTED RULE

On April 19, 2000 the commission adopted rules, which were published in the May 5, 2000 issue of the *Texas Register* (25 TexReg 4101 and TexReg 4140), that required electric generating facilities (EGFs) in the Dallas/Fort Worth (DFW) ozone nonattainment area and east and central Texas to meet specific nitrogen oxides (NO_x) emission limits. The counties of Collin, Dallas, Denton, and Tarrant are included in the DFW area. The counties affected in the attainment area are: Atascosa, Bastrop, Bexar, Brazos, Calhoun, Cherokee, Fannin, Fayette, Freestone, Goliad, Gregg, Grimes, Harrison, Henderson, Hood, Hunt, Lamar, Limestone, Marion, McLennan, Milam, Morris, Nueces, Parker, Red River, Robertson, Rusk, Titus, Travis, Victoria, and Wharton.

Under the adopted rules, owners or operators of EGFs are given the option of participating in a system cap to meet the emission requirements in Chapter 117. Under a system cap owners or operators of EGFs will have the option of averaging emissions among facilities as long as the facilities are under common ownership or control and an overall cap on the system is not exceeded. The purpose of this adoption is to give the owners and operators of EGFs in the affected areas additional flexibility in

meeting their system caps either through the use of emission reduction credits (ERCs), discrete emission reduction credits (DERCs), or through the transfer of emission allowables among EGFs participating in a system cap that are in the same nonattainment or attainment area.

SECTION BY SECTION DISCUSSION

The new §117.109 allows owners or operators of NO_x sources in the DFW ozone nonattainment area who are participating in a system cap under §117.108, System Cap, to trade emissions with other participating owners or operators of NO_x sources in the DFW ozone nonattainment area under the requirements in amendments to Chapter 101, Subchapter H, Division 1, 4, or 5, relating to Emission Credit Banking and Trading; Discrete Emission Credit and Trading Program; and System Cap Trading. The new Chapter 101, Subchapter H, Division 5 is being adopted in a concurrent rulemaking in this issue of the *Texas Register*.

The new §117.110 states that in the event that a unit of electric power generation is sold or transferred, the unit shall become subject to the transferee's emission cap. The value Ri in §117.108(c), System Cap is based on a unit's status as of January 1, 2000 and does not change as a result of the sale or transfer of a unit regardless of the size of the transferee's system.

The new §117.139 states that an owner or operator of a source of NO_x in an east or central Texas attainment area who is participating in the system cap under §117.138, System Cap may exceed his or her system cap provided the owner or operator is complying with Chapter 101, Subchapter H, Division 1, 4, or 5. In response to comment, the commission has changed the phrase "east and central Texas

area” to “any of the east and central Texas attainment counties listed in §117.131(4) of this title (relating to Applicability).”

FINAL REGULATORY IMPACT ANALYSIS DETERMINATION

The commission reviewed the rulemaking in light of the regulatory analysis requirements of Texas Government Code, §2001.0225. The commission determined that these new sections do not meet the definition of a "major environmental rule" as defined in Texas Government Code, §2001.0225. "Major environmental rule" means a rule, the specific intent of which, is to protect the environment or reduce risks to human health from environmental exposure, and that may adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, or the public health and safety of the state or a sector of the state. The commission is adopting these new sections to allow greater flexibility for EGFs in the affected areas to meet NO_x emission limitations and for NO_x emissions trading. The new sections do not adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, or the public health and safety of the state or a sector of the state; therefore, these proposed sections does not constitute a major environmental rule. In addition, Texas Government Code, §2001.0225, only applies to a major environmental rule, the result of which is to: 1.) exceed a standard set by federal law, unless the rule is specifically required by state law; 2.) exceed an express requirement of state law, unless the rule is specifically required by federal law; 3.) exceed a requirement of a delegation agreement or contract between the state and an agency or representative of the federal government to implement a state and federal program; or 4.) adopt a rule solely under the general powers of the agency instead of under a specific state law. This rulemaking is not subject to the regulatory analysis provisions of

§2001.0225(b), because the rules do not meet any of the four applicability requirements. Specifically, the emission banking and trading requirements were developed in order to meet the ozone national ambient air quality standard (NAAQS) set by the EPA under the Federal Clean Air Act (FCAA), §109 (42 United States Code (USC), §7409), and therefore meet a federal requirement. Provisions of 42 USC, §7410, require states to adopt a SIP which provides for “implementation, maintenance, and enforcement” of the primary NAAQS in each air quality control region of the state. While §7410 does not require specific programs, methods, or reductions in order to meet the standard, state SIPs must include “enforceable emission limitations and other control measures, means or techniques (including economic incentives such as fees, marketable permits, and auctions of emissions rights), as well as schedules and timetables for compliance as may be necessary or appropriate to meet the applicable requirements of this chapter,” (meaning Chapter 85, Air Pollution Prevention and Control). It is true that 42 USC does require some specific measures for SIP purposes, like the inspection and maintenance program, but those programs are the exception, not the rule, in the SIP structure of 42 USC. The provisions of 42 USC recognize that states are in the best position to determine what programs and controls are necessary or appropriate in order to meet the NAAQS. This flexibility allows states, affected industry, and the public to collaborate on the best methods for attaining the NAAQS for the specific regions in the state. Even though 42 USC allows states to develop their own programs, this flexibility does not relieve a state from developing a program that meets the requirements of §7410. Thus, while specific measures are not generally required, the emission reductions are required; and these rules provide additional flexibility to meet emission limits. States are not free to ignore the requirements of §7410 and must develop programs to assure that the nonattainment areas of the state will be brought into attainment on schedule.

The requirement to provide a fiscal analysis of proposed regulations in the Texas Government Code was amended by Senate Bill (SB) 633 during the 75th Legislative Session, 1999. The intent of SB 633 was to require agencies to conduct a regulatory impact analysis (RIA) of extraordinary rules. These are identified in the statutory language as major environmental rules that will have a material adverse impact and will exceed a requirement of state law, federal law, or a delegated federal program, or are adopted solely under the general powers of the agency. With the understanding that this requirement would seldom apply, the commission provided a cost estimate for SB 633 that concluded “based on an assessment of rules adopted by the agency in the past, it is not anticipated that the bill will have significant fiscal implications for the agency due to its limited application.” The commission also noted that the number of rules that would require assessment under the provisions of the bill was not large. This conclusion was based, in part, on the criteria set forth in the bill that exempted proposed rules from the full analysis unless the rule was a major environmental rule that exceeds a federal law. As previously discussed, 42 USC does not require specific programs, methods, or reductions in order to meet the NAAQS; thus, states must develop programs for each nonattainment area to ensure that area will meet the attainment deadlines. Because of the ongoing need to address nonattainment issues, the commission routinely proposes and adopts SIP rules. The commission bases these actions on the presumption that the legislature understands this federal scheme. If each rule proposed for inclusion in the SIP was considered to be a major environmental rule that exceeds federal law, then every SIP rule would require the full RIA contemplated by SB 633. This conclusion is inconsistent with the conclusions reached by the commission in its cost estimate and by the Legislative Budget Board (LBB) in its fiscal notes. Because it is a rule of statutory interpretation that the legislature is presumed to understand the fiscal impacts of the bills it passes, and that presumption is based on information

provided by state agencies and the LBB, the commission believes that the intent of SB 633 was only to require the full RIA for rules that are extraordinary in nature. While the SIP rules will have a broad impact, that impact is no greater than is necessary or appropriate to meet the requirements of the FCAA. For these reasons, rules proposed for inclusion in the SIP fall under the exception in Texas Government Code, §2001.0225(a), because they are required by federal law. The rulemaking does not exceed a standard set by federal law, exceed an express requirement of state law (unless specifically required by federal law), or exceed a requirement of a delegation agreement. The rulemaking was not developed solely under the general powers of the agency, but was specifically developed to allow greater flexibility for EGFs in the affected areas to meet NO_x emission limitations and for NO_x emissions trading in order to meet the NAAQS established under federal law and authorized under Texas Clean Air Act (TCAA), §§382.011, 382.012, and 382.017, as well as under 42 USC, §7410(a)(2)(A).

TAKINGS IMPACT ASSESSMENT

The commission evaluated this rulemaking action and performed an analysis of whether the rules are subject to Texas Government Code, Chapter 2007. The following is a summary of that analysis. The new sections are adopted as part of a strategy to reduce and permanently cap emissions of NO_x to a level which would allow the DFW nonattainment area to attain the NAAQS for ozone and to maintain air quality in east and central Texas. Promulgation and enforcement of the rules will not burden private real property. The new sections do not affect private property in a manner which restricts or limits an owner's right to the property that would otherwise exist in the absence of a governmental action. Additionally, the NO_x emissions under the system cap that are the subject of these rules are not property

rights. Consequently, the new sections do not meet the definition of a takings under Texas Government Code, §2007.002(5). Although the new sections do not directly prevent a nuisance or prevent an immediate threat to life or property, they do prevent a real and substantial threat to public health and safety, and partially fulfill a federal mandate under the USC, §7410. Specifically, the emission limitations and control requirements within this rulemaking were developed in order to meet the ozone NAAQS set by the EPA under the USC, §7409. States are primarily responsible for ensuring attainment and maintenance of the NAAQS once the EPA has established them. Under the USC, §7410 and related provisions, states must submit, for approval by the EPA, SIPs that provide for the attainment and maintenance of NAAQS through control programs directed to sources of the pollutants involved. Therefore, the purpose of the rules is to implement a NO_x strategy which is necessary for the DFW area to meet the air quality standards established under federal law and to maintain air quality in east and central Texas. Consequently, the exemption which applies to these rules is that of an action reasonably taken to fulfill an obligation mandated by federal law. Therefore, these adopted revisions do not constitute a takings under Texas Government Code, Chapter 2007.

CONSISTENCY WITH THE COASTAL MANAGEMENT PROGRAM

The commission determined the rulemaking relates to an action or actions subject to the Texas Coastal Management Plan (CMP) in accordance with the Coastal Coordination Act of 1991, as amended (Texas Natural Resources Code, §§33.201 et seq.), and the commission's rules in 30 TAC Chapter 281, Subchapter B, concerning Consistency with the Texas Coastal Management Program. As required by 30 TAC §505.11(b)(2) and 30 TAC §281.45(a)(3), relating to actions and rules subject to the CMP, commission rules governing air pollutant emissions must be consistent with the applicable goals and

policies of the CMP. The commission reviewed this action for consistency with the CMP goals and policies in accordance with the regulations of the Coastal Coordination Council and determined the rules are consistent with the applicable CMP goal expressed in 31 TAC §501.12(1) of protecting and preserving the quality and values of coastal natural resource areas, and the policy in 31 TAC §501.14(q), which requires the commission protect air quality in coastal areas. The new sections allow greater flexibility in meeting system cap requirements by trading NO_x emissions among EGFs in the affected areas. The new sections do not authorize any new NO_x air emissions.

EFFECT ON SITES SUBJECT TO THE FEDERAL OPERATING PERMITS PROGRAM

The new sections are part of the state's ozone attainment strategy; therefore, these revisions are to be submitted as part of the SIP. As a result, the new sections are applicable requirements under the federal operating permit program and sources are required to revise their permits if they choose to participate in the system cap.

HEARINGS AND COMMENTERS

The commission held public hearings on the proposal in Irving on January 3, 2001 and in Austin on January 4, 2001. Eight commenters submitted comments during the public comment period which closed on January 5, 2001.

American Electric Power (AEP), the Association of Electric Companies of Texas, Inc. as submitted by Jenkins and Gilchrist (AECT), and TXU Business Services (TXU), generally supported the proposal but suggested changes for clarity. Entergy Services, Inc. (Entergy) and Reliant Energy, Inc. (Reliant)

supported the concept of the proposal but advocated its expansion to other regions of the state. The City of Garland and the City of Denton as submitted by the Law Office of Erich Birch, P.C. (the Cities) supported the concept of the proposal but suggested specific changes. The North Central Texas Council of Governments supported the proposal. Environmental Defense opposed specific parts of the proposal.

ANALYSIS OF TESTIMONY

AECT and AEP commented that §117.139 should be clarified to state that it is not owners or operators that may exceed a NO_x cap but sources with the same owner or operator. They also commented that, since the term “east and central Texas area” is not defined in Chapter 117, the applicability of §117.139 be referenced as “any of the east and central Texas attainment counties listed in §117.131(4) of this title (relating to Applicability).”

The commission has not changed the rule in response to the comment on system caps. A system cap is determined by a group of sources under common ownership or control located within the same area that has unique NO_x emission limits, and management of the system cap is the responsibility of the owner or operator. In order for that system cap to be exceeded, the owner or operator of the cap must obtain surplus emission allowables from another owner or operator also participating in a system cap. The commission has made the recommended change concerning the designation of the “east and central Texas area” because the suggested Chapter 117 citation contains a listing of specific counties.

Entergy and Reliant commented that in the May 2000 rulemaking which established daily NO_x emission limits for utility boilers in the DFW area, similar limits were established for utility boilers in the Beaumont/Port Arthur (BPA) nonattainment area. They stated that the requirement for flexibility in meeting NO_x limits is as great in BPA as it is in DFW and that the flexibility that is proposed for DFW be extended to BPA as well. They stated that in the preamble for the System Cap Trading rules (25 TexReg 11878) the commission stated that the proposed procedure may be applied to other facilities subject to a system cap under Chapter 117 in subsequent rulemaking. Reliant also commented that the trading flexibility should apply in the Houston/Galveston (HGA) nonattainment area.

The commission has not changed the rule in response to this comment. The commission desires to extend maximum flexibility to any group of electric generating facilities subject to emission limits or system caps. However, these amendments were proposed for the DFW area and certain other counties of east and central Texas, and there was no opportunity for full public comment from the BPA or HGA areas. Trading flexibility is an issue closely related to the SIPs for the BPA and HGA areas, and the commission believes there should be an opportunity for comment in a separate rulemaking before this flexibility is further extended. The commission may consider extending this flexibility in future rulemaking.

Environmental Defense supported trading between owners or operators of two system caps and stated that this would not jeopardize the overall regional cap. They expressed concern over the proposed §117.109 and §117.139 which allow the use of ERCs and DERCs. Environmental Defense expressed that the use of these credits creates the possibility that reduction credits generated from a control

strategy no longer in place can be used to meet system cap requirements (in the case of DERCs) and would lead to exceedences of the cap. They urged the commission to limit the trading flexibility in §117.109 and §117.139 to compliance with the requirements of Chapter 101, Subchapter H, Division 5.

The commission has not changed the rule in response to this comment. The commission has previously examined the use of ERCs and DERCs and their effect on system caps and adopted §117.570 to extend the flexibility of using these credits within a system cap. The commission has analyzed the use of DERCs within the DFW system caps. A DERC represents one ton of emission credit and may only be used once. Because of the limited amount of DERCs available for use in the DFW area, the commission believes their use under the system caps will not significantly affect the SIP. Sections 117.109 and 117.139 clarify an existing flexibility that was created with the adoption of §117.570 in December 2000.

The Cities commented that they and TXU are the only operators of electric generating facilities in the DFW area with the Cities supplying about 10% of the power and TXU supplying the other 90%. The trading program would therefore be limited to these three participants. The Cities do not anticipate having any surplus allowables that would be of significance to TXU and the only source of allowables to the Cities would be TXU. The Cities do not imply any bad motive to TXU, but stated that they are concerned that TXU's near monopoly will allow them to control the price of allowables. The Cities suggested that, until such time as other electric generating operators move into the DFW area, the commission tie the price of allowables to some independent standard such as the average cost of

installation of electric generator emission controls in DFW. Another option would be to establish a ceiling on prices based on the price of credits in markets similar to DFW.

The commission has not changed the rules in response to this comment. The trading of allowables is an alternative to meeting emission limitations, and the commission would expect that, under the flexibility of trading programs, an owner of an electric generating unit would choose the least expensive option of either obtaining additional allowables or lowering emissions. The commission acknowledges the relative size of the generating capacity of the eligible participants in the DFW program but disagrees that the Cities would not have excess allowables that would be of significance to TXU. The price of allowables will be determined by several factors including the need of a supplier to increase generation and the amount of allowables available. Even a small amount of excess allowables available from a relatively small generator could be important when maximum generation is required from a larger generator. The commission will continually monitor the operation of the program and will address problems if and when they emerge.

The Cities commented that the estimated price of reduction credits of \$3,600 per ton, as based on prices in HGA, is significantly underestimated. The market will tighten as SIP deadlines approach resulting in a price for credits that can be from ten to 100 times as much. They stated that the program as proposed allows the option of control installation or participating in the trading program. As the market tightens those operators that chose to forego the installation of controls could find the cost of credits prohibitively expensive.

The commission has not changed the rules in response to this comment. The estimate of the price of reduction credits was based on the best data available to the commission. The commission understands that the conditions affecting the cost of credits will change and has purposely established this program to allow individual operators to analyze their operation and its relation to other operations and make their best business judgement. The commission expects that the market for credits will tighten based on the relative stringency of the DFW emission standards. Owners of electric generating facilities should consider this possibility when making the decision whether to install additional emission controls or to purchase credits for compliance.

The Cities commented that the trading option should be extended to other NO_x sources, stationary and mobile, as an incentive to reductions and as a method of reducing the potential of a monopolistic market.

The commission has not changed the rules in response to this comment. This rule was proposed as applicable to electric generating facilities in the DFW area and certain counties in east and central Texas. Trading flexibility is an issue closely related to the SIP, and the commission believes there should be an opportunity for public comment before this flexibility is further extended. The commission may examine extending this flexibility for future rulemaking.

STATUTORY AUTHORITY

The new sections are adopted under the Texas Health and Safety Code, TCAA, §382.011, which authorizes the commission to control the quality of the state's air; §382.012, which authorizes the

commission to develop a plan for control of the state's air; §382.017, which provides the commission the authority to adopt rules consistent with the policy and purposes of the TCAA; and 42 USC, §7410(a)(2)(A), which requires SIPs to include enforceable emission limitations and other control measures or techniques, including economic incentives such as fees, marketable permits, and auction of emission rights.

SUBCHAPTER B: COMBUSTION AT MAJOR SOURCES

DIVISION 1: UTILITY ELECTRIC GENERATION IN OZONE NONATTAINMENT AREAS

§117.109, §117.110

§117.109. System Cap Flexibility.

An owner or operator of a source of nitrogen oxides (NO_x) in the Dallas/Fort Worth ozone nonattainment area who is participating in the system cap under §117.108 of this title (relating to System Cap) may exceed their system cap provided that the owner or operator is complying with the requirements of §117.570 of this title (relating to Use of Emissions Credits for Compliance) or Chapter 101, Subchapter H, Division 1, 4, or 5 of this title (relating to Emission Credit Banking and Trading; Discrete Emission Credit and Trading Program; and System Cap Trading).

§117.110. Change of Ownership - System Cap.

In the event that a unit within an electric power generating system is sold or transferred, the unit shall become subject to the transferee's system cap. The value Ri in §117.108(c) of this title (relating to System Cap) is based on the unit's status as part of a large or small system as of January 1, 2000, and does not change as a result of sale or transfer of the unit, regardless of the size of the transferee's system.

SUBCHAPTER B: COMBUSTION AT MAJOR SOURCES

DIVISION 2: UTILITY ELECTRIC GENERATION IN EAST AND CENTRAL TEXAS

§117.139

STATUTORY AUTHORITY

The new section is adopted under the Texas Health and Safety Code, TCAA, §382.011, which authorizes the commission to control the quality of the state's air; §382.012, which authorizes the commission to develop a plan for control of the state's air; §382.017, which provides the commission the authority to adopt rules consistent with the policy and purposes of the TCAA; and 42 USC, §7410(a)(2)(A), which requires SIPs to include enforceable emission limitations and other control measures or techniques, including economic incentives such as fees, marketable permits, and auction of emission rights.

§117.139. System Cap Flexibility.

An owner or operator of a source of nitrogen oxides (NO_x) in any of the east and central Texas attainment counties listed in §117.131(4) of this title (relating to Applicability) who is participating in the system cap under §117.138 of this title (relating to System Cap) may exceed their system cap provided that the owner or operator is complying with the requirements of Chapter 101, Subchapter H, Division 1, 4, or 5 of this title (relating to Emission Credit Banking and Trading; Discrete Emission Credit and Trading Program; and System Cap Trading).