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December 2002
SFR-077

Strategically Directed Regulatory Structure

A Report to the 78th Texas Legislature

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Prepared by
Strategic Environmental Analysis Group

SFR-077
December 2002



Robert J. Huston, *Chairman*
R. B. “Ralph” Marquez, *Commissioner*
Kathleen Hartnett White, *Commissioner*

Margaret Hoffman, *Executive Director*

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Contents

Executive Summary	1
Introduction	3
Figure 1. Conceptual Framework for SDRS	6
Conceptual Framework	7
Draft Rule	9
Development of Rules and Incentives	15
Potential Structural Elements	15
Eligibility	16
Environmental Needs	16
Innovative Programs/Incentives	16
Evaluation & Feedback	17
Other Project Management Issues	17
Program Participation	19
Federal Law Changes Affecting Implementation	21
Statutory and Regulatory Impediments to Implementation	23
Benefits to the Environment	25
Sources	27

Executive Summary

In 2001, the 77th Texas Legislature directed the Texas Commission on Environmental Quality (TCEQ) to develop an initial rule for a Strategically Directed Regulatory Structure (SDRS) to provide incentives for enhanced environmental performance. The directive appears in House Bill (HB) 2912, Article 4, Section 4.01. Strategically directed regulatory structure is defined as a program that is designed to use innovative programs to provide enhanced environmental performance and to reward compliance performance. This definition is taken from Texas Administrative Code, Section 5.752, Definitions.

The Legislature further directed the commission to develop the structure based on the compliance history classification of a person (as defined by law), and on any voluntary measures the person undertakes to improve environmental quality.

The TCEQ is in the process of developing a rule to implement an initial set of incentives for participation in the agency's innovative programs, including the Regulatory Flexibility Program, the Flexible Permits Program, the Leadership Level of Clean Texas, and the Environmental Management System Program. The draft rule will also provide incentives for enhanced environmental performance.

While establishing a deadline of September 2003 for this initial rulemaking, the Legislature also provided for final implementation of rules and incentives by September 2005.

In this rulemaking effort, the TCEQ has received advice and comments on a continuing basis from the Pollution Prevention Advisory Committee. The Legislature gave this committee the statutory responsibility of advising the agency for this rulemaking process under Section 361.0215, Texas Health and Safety Code.

The proposed initial incentive system set up by the TCEQ's current rulemaking effort would allow a person to apply for regulatory incentives by meeting mandatory criteria established in the legislation. These criteria concern the applicant's history of compliance with regulatory requirements, and with their volunteer environmental activities.

The applicant who qualifies to participate in the SDRS Program may also apply for an incentive under one of the following rules:

- ! the regulatory flexibility requirements found in Subchapter B of Chapter 90, Texas Administrative Code;
- ! the requirements for using an environmental management system found in Subchapter C of Chapter 90, Texas Administrative Code;
- ! the requirements for programs authorized as innovative by the executive director of the TCEQ; or
- ! the requirements of the SDRS Program found in 30 TAC Chapter 90, Subchapter D of Chapter 90 (the draft rule).

The TCEQ is planning to implement the initial set of incentives created by rule through a due process system involving applications for incentives, reviews of applications according to certain criteria, and approval or denial. Also included is a process that allows the applicant to file a motion to overturn the TCEQ decision.

Much of the initial rule is modeled on other successfully implemented provisions from existing rules. This initial rule may be substantially modified during the mandated second phase of rulemaking, based on experience gained through implementation of the initial incentive structure and under the terms of HB 2912.

Introduction

The 77th Texas Legislature re-authorized the commission following review by the Sunset Advisory Commission. The legislature re-authorized the commission in House Bill (HB) 2912, 77th Legislature, 2001, and added Texas Water Code (TWC) §5.755. The new Subchapter Q, Performance Based Regulation, Section 5.755 directs the commission to develop an initial rule for a Strategically Directed Regulatory Structure (SDRS) that will provide incentives for enhanced environmental performance. The legislature further directed the commission to develop the SDRS based on a person's compliance history classification and any voluntary measures undertaken by the person to improve environmental quality. HB 2912 also requires that this initial rule be adopted by September 1, 2003 and the final rule to be adopted by September 2005.

The new Subchapter Q, Section 5.752, defines "strategically directed regulatory structure" as "a program that is designed to use innovative programs to provide maximum environmental benefit and to reward compliance performance." This section defines "innovative program" as "a program developed by the commission under this subchapter, TWC, Chapter 26 or 27, or Texas Health and Safety Code (THSC) Chapter 361, 382, or 401 (THSC) that provides incentives to a person in return for benefits to the environment that exceed benefits that would result from compliance with applicable legal requirements under the commission's jurisdiction." Section 5.755 requires that an innovative program offered as part of the strategically directed regulatory structure must be consistent with other law and any requirement necessary to maintain federal program authorization. The commission's flexible permit program and regulatory flexibility program are also defined as innovative programs. Additionally, in the Sunset Advisory Commission Staff Report, 2000, Management Action, 3.5, the Sunset Advisory Commission recommended that the commission "expand opportunities for public participation within innovative regulatory programs." The Sunset Advisory Commission stated that this recommendation, "...would encourage the TNRCC to find more ways for the public to participate in its innovative regulatory programs. Since these programs offer an alternative to traditional regulatory processes, greater public participation is a key to ensuring accountability." (Sunset Advisory Commission Staff Report, Texas Natural Resource Conservation Commission, 2000, page 38.)

To meet these legislative mandates and the Sunset Advisory Commission recommendation, the commission solicited comments from the PPAC and reviewed strategically directed regulatory structure programs found in other states. The executive director's staff worked with the Pollution

Prevention Advisory Committee in developing the process, structural elements, and appropriate incentives for this rule. The legislature designated the committee, created by HB2912 from the Waste Reduction Advisory Committee, as a stakeholder organization for this rulemaking process under THSC §361.0215. Accordingly, agency staff made a series of presentations to the committee during the development of this proposal to solicit feedback, and will continue to do so throughout the rulemaking process.

Additionally, the agency staff reviewed rules from other state environmental agencies regarding strategically directed innovation programs, and identified several common elements. These elements include:

- ! using a person's compliance history classification as a basis for tracking and/or admission to innovative regulatory programs;
- ! using a tiered regulatory approach, in which the conventional compliance system is used as the base-level tier and "beyond compliance" schemes are used for higher tiers;
- ! providing technical assistance that is explicitly linked to compliance and enforcement strategies;
- ! using environmental management systems as compliance tools and requirements for participation in upper tier programs; and,
- ! encouraging participation in upper tier programs through incentives.

Some of the incentives used to move entities into higher tiers include recognition for superior performance, regulatory flexibility, "single point of contact" management through the regulatory process, and additional technical assistance for meeting goals. Finally, several programs that the executive director's staff reviewed contain strong public participation components, like active stakeholder involvement in decision making about project goals or in managing projects either through a contract or a charter.

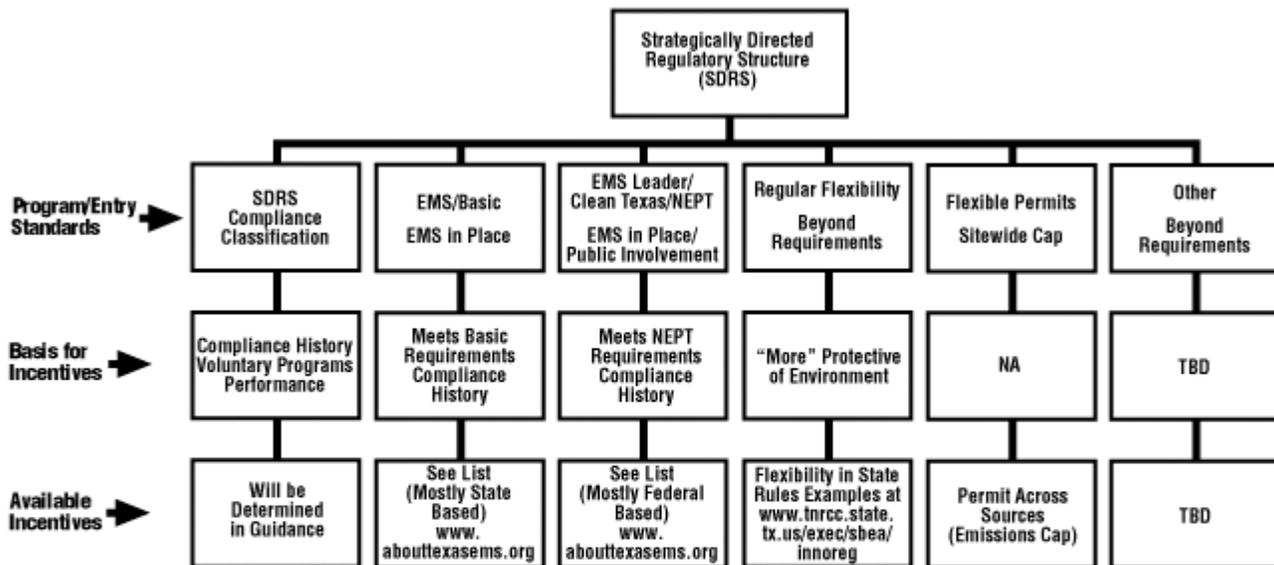
The purpose of this initial proposed rule is to establish a systematic approach for using innovative programs to achieve maximum environmental benefit and to reward compliance performance. As required by TWC, §5.755, one of the factors the executive director will use to determine whether a person is eligible for an incentive under an innovative program is that person's compliance history classification. In December 2001, the commission adopted the definition of compliance history and in August 2002 amended 30 TAC Chapter 60, Compliance History, to include the process the commission will use in determining a person's compliance history classification. This proposed rule rewards good compliance and

actions which exceed regulatory requirements by providing meaningful incentives. When a person's compliance history classification is poor, the executive director may consider a limited list of incentives designed to increase compliance. Once compliance is demonstratively improved, further incentive categories would become available. Examples of categories of innovative programs and incentives include alternative methods of compliance, burden reduction and recognition.

Additional incentives considered in this proposed rule include on-site technical assistance, accelerated access to program information, and modification of state or federal regulatory requirements that do not change emission or discharge limits. These classes of incentives were identified in a related piece of legislation, HB2997, dealing with the establishment of an environmental management system, and in a set of incentives proposed for the United States Environmental Protection Agency's (EPA) National Environmental Performance Track Program and the EPA's Innovation Policy. These classes of incentives were included in this proposed rule because they were broad enough to cover most incentives available to the commission, because they are similar to the list of incentives related to compliance history, and finally because they are authorized by HB2997.

Under the initial proposed rule, another factor that the executive director will take into account when determining whether a person is eligible for an incentive is whether the environmental need the person will fulfill is statewide or regional. To determine the environmental needs for different geographic areas of the state, the executive director will look to the most current version of the Environmental Issues Ranking in Volume 2 of the commission's Strategic Plan. Potential environmental needs include, but are not limited to, reducing ozone and ozone precursors in air quality nonattainment and near-nonattainment areas; reducing water pollution in impaired waters and waters of concern; taking corrective action or remediating contaminated sites; addressing potential cumulative impacts from air emissions or wastewater discharges; and, providing needed ambient monitoring to enhance current efforts.

Conceptual Framework for SDRS



▲ Incentives eligibility is keyed to compliance classification.

▲ Incentives option added to existing innovative programs.

▲ Incentives framework created for future innovative programs.

Level of effort (criteria) should be balanced with reward (incentive) across all SDRS programs.

Figure 1

Conceptual Framework

The Strategically Directed Regulatory Structure accomplishes three basic tasks in fulfillment of the legislative mandate.

First, it creates a system of incentives for which certain eligibility determinations are keyed to the compliance status of the regulated person.

Second, it creates an option to take advantage of incentives to participate in already-existing innovative programs, but does not interfere with the implementation of the environmental management system program, which also offers specific incentives to regulated persons.

Third, the new framework allows room for expansion, to embrace future innovative programs that may develop over time.

The conceptual framework for SDRS developed by the TCEQ may be illustrated in terms of a matrix (please see Figure 1 on page 28). The matrix demonstrates how the new SDRS structure integrates with existing and newly implemented innovative programs in order to provide a number of flexible options for persons who wish to apply to the TCEQ for incentives. Incentives may be granted in recognition of performance in innovative and/or voluntary projects, and in recognition of compliance classification. Incentives for compliance classification are intended to be on a graduated scale, with the greatest variety of flexibility options for those persons with the highest classifications and voluntary projects.

Under the umbrella of the SDRS are three basic categories: First, the innovative programs involved (including SDRS itself). Second, there are the bases for incentives, which vary somewhat between programs. The third category under the SDRS umbrella are the incentives available to participate in each program under the SDRS structure.

SDRS is one of several innovative programs that offers a person incentives to participate. SDRS recognizes performance as reflected by a person's compliance history classification by keying eligibility to enter the program directly to a person's compliance classification, along with his or her performance in voluntary environmental enhancement efforts.

Incentives for participation in environmental management systems at the basic level were laid out in the separate EMS rule, which was newly adopted by the TCEQ in 2002. The basic entry standard is that a person applying for incentives should have an environmental management system that meets the basic requirements for EMS. Further eligibility is

established by compliance history classification. A specific set of incentives is available to persons with EMS systems in place, under the terms of the EMS rule and an accompanying guidance document now under development.

In an effort to harmonize state and federal participation standards for persons displaying leadership in bringing innovation to environmental management, an effort is being made to provide a consistent set of standards for those persons who participate in the Leadership, or highest, level of the EMS program, as well as the Leadership Level of the Clean Texas Program, another TCEQ voluntary initiative. These entry standards are also intended to be consistent with the U.S. Environmental Protection Agency's National Environmental Performance Track (NEPT) program, which will provide incentives in exchange for exemplary environmental performance. The basic entry standard in each of these programs will be that a person must have an environmental management system in place and have a public involvement component in their project(s). Within these programs, the bases for granting incentives will be compliance history classification and compliance with NEPT requirements. There will be a specific list of incentives available through the TCEQ's EMS program and through the NEPT program.

For persons participating in TCEQ's Regulatory Flexibility Program, entry standards will now require that the persons offer evidence of environmental performance beyond compliance requirements, under the terms of newly promulgated rules mandated by the 77th Legislature. The basis for incentives will be that any projects receiving regulatory flexibility be more protective of the environment than full compliance. The incentives available through this option will be flexibility orders granting some specific flexibility from rule requirements in exchange for results that are more protective of the environment.

For the Flexible Permits option, persons seeking incentives will need to receive a flexible permit from the TCEQ. The basis for incentives is the flexibility order and compliance classification.

Finally, the SDRS framework will include an additional category for innovative projects that have not yet been developed.

Draft Rule

While the rule is still under development, the drafting process is now sufficiently advanced to provide a brief discussion of the key provisions of the proposed rule. Specific language is subject to change prior to adoption by the commission.

It is proposed to change the name of Texas Administrative Code, Chapter 90 from Regulatory Flexibility and Environmental Management Systems to Innovative Programs to better reflect the contents of the chapter.

Subchapter A: Purpose, Applicability, and Eligibility

Proposed amended §90.1, Purpose, clarifies that one of the purposes of this chapter is to implement TWC, §5.755, relating to Strategically Directed Regulatory Structure.

Proposed amended §90.2, Applicability and Eligibility, clarifies that the applicability and eligibility requirements.

Subchapter D: Strategically Directed Regulatory Structure

The commission proposes to create a new Subchapter D, Strategically Directed Regulatory Structure (SDRS).

Proposed new §90.50, Purpose, explains that the purpose of Subchapter D is to establish a framework for innovative programs to provide for enhanced environmental performance and to reward compliance performance.

Proposed new §90.52, Applicability, clarifies what activities to which Subchapter D applies.

Proposed new §90.52(b) clarifies that this subchapter does not apply to occupational licensing programs or to the Texas Low-Level Waste Disposal Authority and the Texas Low-Level Radioactive Waste Compact.

Proposed new §90.54, Eligibility, clarifies the eligibility requirements for a person whose application to participate in an innovative program.

Proposed new subsection (b) clarifies that a person who has incurred a judgment in a suit brought by the Texas or United States attorney general against the site for which the person is requesting regulatory incentives is ineligible.

Proposed new subsection (c) clarifies that a person who has been convicted of willfully or knowingly committing an environmental crime is ineligible to receive regulatory incentives for using an EMS.

Proposed new subsection (d) provides that a person will be accepted into SDRS by meeting the criteria and standards for regulatory flexibility under Subchapter B; the criteria and standards to receive incentives for using an environmental management system under Subchapter C; the criteria and standards of programs authorized as innovative by the executive director; the criteria and standards for flexible permits under Chapter 116; or the criteria and standards set forth under this subchapter.

Proposed new subsection (e) clarifies that incentives granted under one innovative program do not guarantee incentives offered under another innovative program, except where those incentives are equivalent.

Proposed new §90. 56, Definitions, defines the terms used in Subchapter D.

Applicable legal requirement is defined as an environmental law, regulation, permit, order, consent, decree, or other requirement.

Enhanced environmental performance is defined as an activity by a person which reduces or eliminates discharges or emissions of pollutants, or reduces a negative impact on air, water, land, natural resources, or human health to an extent that is greater than required by applicable environmental regulations, including any measurable voluntary action undertaken by a person to improve environmental quality.

Environmental outcome is defined as a measurable or discernable improvement in the quality of air, water, land, or natural resources or in the protection of the environment as determined by the executive director.

Innovative program is defined as a program developed by the commission under TWC, Chapter 5 Subchapter Q, Performance-Based Regulations, TWC, Chapter 26 or 27, or THSC, Chapter 361, 382, or 401..

Maximum environmental benefit is defined as the overall long-term goal of the commission for environmental improvement which is accomplished by enhanced environmental performance over time from individual reductions in discharges or emissions of pollutants by persons who reduce the negative impacts on water, air, land, natural resources, or human health to an extent that is greater than required by applicable commission regulations.

Permit is defined as a license, certificate, registration, approval, permit by rule, standard permit, or other form of authorization issued by the commission.

Public participation is defined as activities by a person under this subchapter intended to enhance public input that are not otherwise required by law or by commission rules.

Region is defined as a region of the commission's Field Operations Division or that division's successor. This definition is taken from TWC, §5.752, Definitions.

Regional planning area is defined as any one of eight planning regions developed and used by the commission in the agency's strategic plans.

Site is defined as, except with regard to portable units, all regulated units, facilities, equipment, structures, or sources at one street address or location that are owned or operated by the same person.

Strategically directed regulatory structure is defined as a program that is designed to use innovative programs to provide enhanced environmental performance and to reward compliance performance.

Voluntary measure is defined as any program undertaken by a person to improve environmental quality that is not required by rule or law.

Proposed new §90.58, Incentives, clarifies the criteria the executive director will use when determining whether to grant an incentive.

Proposed new §90.58(b) allows the executive director to consider any other factors that provides enhanced environmental performance that the executive director finds relevant.

The executive director may also consider whether a person voluntarily engages in restoring, enhancing, or preserving natural resources, or whether a person mentors and/or helps other individuals and entities to comply with environmental requirements, limit discharges or emissions of pollutants, or in some other way minimizes the negative effects on air, water, land, natural resources, or human health.

Moreover, the executive director may also take into consideration the voluntary measures a person has undertaken that contribute towards goals set in the Commission's Strategic Plan.

Proposed new §90.58(c) clarifies that the incentives the executive director may offer for participation in innovative programs.

Proposed new §90.58(d) requires that an innovative program offered as part of the strategically directed regulatory structure must be consistent with other law and any requirement necessary to maintain federal program authorization.

Proposed new §90.60, Application, explains the requirements a person must follow to apply for a regulatory incentive.

Proposed new §90.60(b) clarifies that within 30 days of receipt after an application to use an innovative program or to request an incentive, the executive director must mail written notification informing the person that the application is administratively complete or that it is deficient.

Proposed new §90.60(c) requires the executive director to review the person's application as well as the person's and site's compliance history.

Proposed new §90.60(d) lists the items an application must, at a minimum, include for participation in the SDRS.

Proposed new §90.60(e) requires the application to be signed and certified that all information is true, accurate, and complete to the best of the signatory's knowledge.

Proposed new §90.60(f) requires the person to submit an original and two copies of the signed application to the executive director for review, and to send one additional copy to the commission's regional office for the region in which the site is located.

Proposed new §90.62, Requests for Modification of State or Federal Regulatory Requirements, clarifies the requirements that a person must meet when requesting modifications of state or federal regulatory requirements.

Proposed new §90.62(a) requires persons who request modifications of state or federal regulatory requirements which cannot be authorized by any other approval method except a commission order.

Proposed §90.62(b) requires that persons who request modification of federal regulatory requirements under this subchapter to also meet the requirements of agreements between the EPA and the commission to receive federal regulatory incentives.

Proposed new §90.62(c) requires persons who request modification of federal regulatory requirements under this chapter to include a public participation component in the project proposal.

Proposed new §90.64, Periodic Review by Executive Director, clarifies that the incentives the executive director grants may be terminated if a person's compliance classification changes.

Proposed new §90.64(b) allows the executive director to begin termination proceedings under §90.66 if the annual review indicates that a person's or site's compliance history classification has declined to a lower classification.

Proposed new §90.64(c) allows the executive director to begin termination proceedings under §90.66 if the executive director finds that a person's voluntary environmental improvements no longer provide an enhanced environmental performance.

Proposed new §90.66, Termination of Regulatory Incentives Under the Strategically Directed Regulatory Structure, allows either the recipient of the incentives or the executive director to terminate the incentives.

Proposed new §90.66(b) outlines the requirements for termination of incentives by the executive director.

Proposed new §90.68, Motion to Overturn, specifies that a person can file a motion to overturn.

Development of Rules and Incentives

Preparations for development of a TCEQ rulemaking project to implement the Strategically Directed Regulatory Structure (SDRS) provisions of HB2912 began almost immediately following enactment of the law. Commission staff developed background research to assist the rulemaking effort, and to develop a concept paper incorporating the group's findings into a conceptual framework for the SDRS rulemaking project. Regulatory innovation programs from several states and the federal government were analyzed and and policy papers of the Environmental Council of the States (ECOS) and other organizations familiar with state environmental policy were reviewed. Several key concepts emerged from review of other states' programs that could be used to describe characteristics of a "strategically driven regulatory structure." These included:

- ! Use of compliance histories as a basis for tracking and/or admission to innovative regulatory programs.
- ! Use of tiered regulatory approaches, with conventional regulatory system used as the base-level tier and "beyond compliance" schemes used for higher tiers.
- ! Technical assistance is explicitly linked to compliance and enforcement strategies.
- ! Environmental Management Systems are used as compliance tools and requirements for participation in upper-tier programs.

Incentive systems are used to encourage participation in upper tier programs, including recognition for superior performance, regulatory flexibility, "single point of contact" management through the regulatory process, and additional technical assistance for meeting goals.

Several programs have public participation components, including active stakeholder involvement in either managing projects (through contract or charter) or in decision-making about project goals.

Potential Structural Elements

Potential elements of a strategically directed regulatory structure could include several features common to innovative programs in Texas and other states, including:

Eligibility

Eligibility for incentives could be based on a variety of criteria, in order to meet the requirements of HB2912. Compliance history classification could be used as an objective standard for determining eligibility in recognition of compliance performance. Participation in innovative programs could be used to determine eligibility for incentives in recognition of innovative program participation. A variety of criteria could be used for demonstrating participation in voluntary programs, in order to provide recognition for the initiative taken by regulated persons to improve their environmental performance. A separate set of eligibility criteria and incentives have already been developed for voluntary participation in environmental management systems, and these can be left intact and distinct withing an overall strategically directed regulatory structural framework. Finally, compliance assistance can still be made available to those regulated persons who would benefit most from it, regardless of compliance history classification.

Environmental Needs

Innovative programs and incentives are described in terms of environmental issues or problem areas in order to provide measurable, defined objectives and a benchmark for enhanced environmental performance. Needs could be derived from TCEQ priorities as identified in the State of the Environment report and other environmental assessments, e.g., the CWA 305(b) water quality inventory. Considerations of environmental needs could include geographical scope, i.e., statewide needs and/or regional area needs. The TCEQ has several appropriate measures in its Strategic Plan.

Volumes I and II, that would help to define environmental needs on either a regional or media (air, water and waste) basis. These are being addressed in the current rulemaking effort.

Innovative Programs/Incentives

The strategically-based regulatory structure would reward good compliance and actions which exceed regulatory requirements by providing meaningful incentives. When a person's compliance history classification is poor, consideration could be given in terms of a limited list of incentives designed to increase compliance. Once compliance is demonstratively improved, further categories would become available. Since this list was first developed last year, the Rulemaking Team is incorporating the classes of incentives defined in HB2997. Although HB2997 was intended to implement an Environmental Management Systems program in Texas, the broad classes of incentives in the bill are very similar to those in the original concept paper,

and represent those activities which the TCEQ could undertake without the need for further state or federal legislation. The SDRS rules team has also followed the development of an incentives project related to implementation of the rule governing the new EMS system. An extensive stakeholder process in that project has led to the development of an extensive list of potential incentives that the TCEQ could offer in the future. The TCEQ is also in ongoing discussions with the U.S. EPA over appropriate incentives for future participation in EPA's National Environmental Performance Track, a relatively new attempt by EPA to encourage innovative environmental projects by the regulated community. The TCEQ and the EPA have developed a Memorandum of Understanding committing the two agencies to work together to develop complementary standards and incentives for both the federal program and the state's Clean Texas voluntary initiative.

Evaluation & Feedback

The strategically-based regulatory structure could contain mechanisms for evaluation and feedback of both programs and participating facilities to gauge progress toward compliance and meeting environmental needs identified by the TCEQ. The Rules Team is currently considering a set of outcome measures for SDRS projects that would allow participants to report their progress in implementing innovative projects, and to allow the Executive Director an objective way to evaluate their progress. The TCEQ has developed a number of outcome measures for various environmental media, and has incorporated them into its strategic plan. The rules team is currently studying another list of criteria for evaluating projects such as gallons of water conserved and tons of hazardous waste reduced, that are relatively straightforward measures. The TCEQ's Small Business and Environmental Assistance Division has been working to develop a set of measures for innovative programs in fulfillment the requirements of a related piece of legislation, SB356. These measures will also be useful for the SDRS rule. In addition, the agency's new compliance history classification use rule will provide a basic set of measures for determining eligibility for SDRS participation.

Other Project Management Issues

Development of the SDRS rule has taken place within the larger context of implementation of several pieces of legislation passed by the 77th Legislature. Most critical to SDRS have been the development of Compliance History Classification Definitions and Compliance History Classification Use Rules mandated by HB2912; rules for Environmental Management Systems under HB2912 and HB2997, revisions to the Regulatory Flexibility Rule mandated by HB2912, and the development of performance measures for innovative programs mandated by SB356.

All rulemaking and implementation projects have gone forward during the past legislative interim, and rules to implement these various provisions either have been promulgated, or will be by the end of 2002. The SDRS Rules Team will integrate these other rules with the draft SDRS rule, so that processes for applying for incentives will be both clear and consistent.

In a related effort, the SDRS Rules Team is addressing Texas Sunset Advisory Commission Management Recommendation 1.4, that the TCEQ encourage an expansion of opportunities for public participation in innovative programs. The Rules Team is working on draft language that would reward innovative projects with incentives for public participation, as well as requiring a public participation component in projects asking for variances in state and federal requirements. A similar provision in the Environmental Management System rule is being used as a model for this effort.

The proposed initial incentive system addressed by the TCEQ's current rulemaking effort would set up a structure that would allow a person to apply for incentives for either compliance performance or for participation in voluntary innovative programs by meeting the mandatory criteria set forth in the legislation regarding compliance history classification and voluntary measures, and would proceed under:

- ! the regulatory flexibility requirements found in 30 TAC Chapter 90, Subchapter B;
- ! the requirements for using an environmental management system found in 30 TAC Chapter 90, Subchapter C;
- ! the requirements for programs authorized as innovative by the executive director of the TCEQ; or the requirements of SDRS program found in 30 TAC Chapter 90, Subchapter D.

It is anticipated by the TCEQ that the initial set of incentives created by rule will be implemented through a due process system involving applications for incentives, reviews of applications according to certain criteria, and approval or denial, with an appeals process for TCEQ decisions. Much of the initial rulemaking is modeled on successfully implemented provisions from existing rules. It is anticipated that the initial rule may be substantially modified during the mandated second phase of rulemaking based on experience gained through implementation of the initial incentive structure under the terms of HB2912.

Program Participation

At this juncture, it is too early to report on participation in a Strategically Directed Regulatory Structure by eligible persons, since the initial incentive framework is not due to be adopted until September of 2003. The rulemaking process, however, has featured regular participation by the Pollution Prevention Advisory Committee (PPAC), as required by Section 361.0215, Texas Health and Safety Code, as amended by HB2912. The PPAC is a nine-member advisory committee of the TCEQ with broad stakeholder representation including industry and local government associations, public interest groups and environmental groups.

Federal Law Changes Affecting Implementation

There have been no significant changes in major federal environmental statutes related to strategically directed regulatory programs during the current legislative initial. Nevertheless, there has been some progress through administrative means in providing for more flexible approaches to environmental protection by the U.S. EPA and state governments. Since 1995, the EPA has provided the regulated community and stakeholders with an avenue for regulatory innovation projects through its Project XL. Based on recognition of the need for new approaches to environmental regulation, Project XL was designed to allow private businesses, as well as states and local governments, to test innovative ideas to enhance environmental protection. In exchange for improved performance, participants are given the flexibility to explore new approaches to environmental protection. Although most of the more than 50 XL projects approved to date were submitted by private facilities, some federal and local government agencies have submitted proposals as well. In addition, four states, including Texas, have submitted proposals designed to apply to multiple facilities within states.

EPA also developed the National Environmental Performance Partnership System (NEPPS) in 1995 to give states greater flexibility in setting their priorities and in the way they carry out their programs. NEPPS provides a framework for the state's relationship with EPA, laying out the state's environmental goals and priorities, and the ways in which they will measure progress in meeting those goals. Under the system, a state agency may enter into a Performance Partnership Agreement with its EPA regional office that typically specifies the signatories' respective roles. While not intended to focus solely on innovation, some states have used their Performance Partnership Agreements for that purpose.

To further facilitate innovation at the state level, in 1998 the EPA signed an agreement with the Environmental Council of the States (ECOS), an organization of state environmental agencies including the TCEQ, to encourage experimentation with new approaches to environmental protection. The EPA/ECOS agreement outlined a process by which states could submit innovative projects through the EPA regional offices and provided time lines during which EPA must provide a response. The agreement also lays out a set of principles intended to guide the development and implementation of innovations. Specifically, it states that innovation often involves experimentation that should not harm human health or the environment but may include some chance of failure;

innovations must seek more efficient or effective ways of meeting environmental performance goals; innovations should seek creative ways to tackle environmental problems; stakeholders should be involved in the development and evaluation of innovations; results of innovations must be measured and analyzed; innovations must be enforceable and accountable; and states and EPA must work as partners to promote innovation.

More recently, the EPA has developed the National Environmental Performance Track (NEPT), a project designed to recognize and encourage top environmental performers among the regulated community. The first round of applications for the new program occurred between February and April of 2002, with a second round scheduled between August and October of that year. NEPT participation is available to facilities of all types, sizes, and complexity, public or private, including manufacturing and service industries. Multi-facility corporations are encouraged to develop company-wide policies supporting participation across their facilities, such as corporate Environmental Management System policies, but facilities must meet program requirements individually. In exchange for committing to development of EMS systems, setting environmental improvement goals and developing public outreach and performance reporting of goals achieved, participants are eligible to receive incentives such as low priority for inspection targeting, discretion in penalty assessment, and public recognition for improved environmental performance. The TCEQ is currently working with EPA on this project, as well as implementing its own EMS program and a voluntary environmental improvement program with similar features, Clean Texas. Toward that end, the TCEQ and EPA have signed a Memorandum of Agreement, and federal and state staff confer on a regular basis regarding joint development of these programs.

Statutory and Regulatory Impediments to Implementation

The TCEQ's SDRS Rules Team has encountered few statutory impediments to implementation during the initial stage of rules development. The team has studied related projects within the EPA, to identify incentives for participation in their new NEPT program. The team has also reviewed the TCEQ rulemaking for Environmental Management Systems (EMS), which included an extensive, and ongoing, stakeholder process to identify specific incentives for persons who elect to participate in the development of EMSs. The federal effort has identified opportunities for participating persons to receive a lower priority than other facilities for inspection targeting purposes, and for the EPA to exercise some discretion in the assessment of penalties where an NEPT participant has made good faith efforts to be in compliance with federal standards. Other public recognition incentives have also been identified, including use of a logo and listing on a participant's web site.

In Texas, the TCEQ's EMS rules development stakeholder project identified a preliminary list of dozens of incentives available for EMS participants under existing state and federal laws and regulations. Other potential incentives would require a case-by-case review for their appropriateness for certain uses. This ongoing project also noted that a number of other incentives suggested by stakeholders could not be implemented under current rules and laws. This project is still on-going, and a final list of incentives will likely be developed through a guidance document process at a later date.

Other barriers do remain to the implementation of innovative programs, as the federal General Accounting Office noted in a January, 2002 report, *Environmental Protection – Overcoming Obstacles to Innovative State Regulatory Programs*. The report noted two different sets of problems in encouraging the development of innovative state regulatory programs. At the federal level, the GAO found that highly prescriptive regulations left the states without the necessary flexibility to try novel approaches. The GAO report states in its conclusions that federal statutes contain no explicit language authorizing the use of innovative environmental approaches in lieu of specific regulatory requirements, and the absence of a "safe legal harbor" for EPA that would allow the EPA more flexibility has been a significant obstacle to states and others in their efforts to test innovative proposals. At the state level, the GAO found innovative regulatory programs hampered by a lack of resources, both because of growing workloads, and because federal mandates consume a large portion of agency resources.

Nevertheless, the TCEQ continues to work closely with the EPA on the development of the National Environmental Performance Track, and to discuss changing priorities and the need for more flexibility through participation in ECOS and through ongoing discussions with EPA as part of the agency's Performance Partnership Agreement with its federal counterpart.

Benefits to the Environment

It is still too early in the rulemaking process to assess the impact of SDRS in providing benefits to the environment. Nevertheless, the rulemaking team is working to include environmental outcome measures and to provide a means of accounting for regional environmental priorities through the developing SDRS framework. The early development of a concept paper addressing SDRS proved helpful in providing a context for several related agency rulemaking projects, including compliance history classification use, environmental management systems, regulatory flexibility, among others. The opportunity now exists to integrate the outcomes of these other rulemaking projects into the evolving SDRS system.

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