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Implementing the Banking and Trading
of Emission Reductions
Made Outside the United States
under Senate Bill 1561, 77th Texas Legislature:
A Report to the 78th Texas Legislature

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A Report to the 78th Texas Legislature

Prepared by
Air Permits Division

SFR-080
January 2003



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Executive Summary

Senate Bill 1561 (SB 1561), 77th Texas Legislature, requires the Texas Commission on Environmental Quality (TCEQ; formerly the Texas Natural Resource Conservation Commission) to:

- (1) authorize the use of surplus emission reductions achieved outside the United States to satisfy otherwise applicable emission reduction requirements if the proposed reductions are appropriately quantifiable and enforceable;
- (2) allow the use of emission reductions of one non an attainment air contaminant to satisfy otherwise applicable requirements for reductions of another non an attainment air contaminant if the proposed reductions will increase the overall air quality of the area; and
- (3) submit a report to the governor and the Legislature regarding the implementation of the substitutions of reductions in emissions of air contaminants no later than January 3, 2003.

The changes authorized by SB 1561 will be administered by the Emissions Banking and Trading Program (EBTP) established in 1993. Based on the provisions of SB 1561 and comments from the public, the TCEQ adopted amendments to the rules covering emission reduction credits (ERCs), discrete emission reduction credits (DERCs), and allowances of the EBTP.

The rule amendments allow emission reductions from facilities outside the United States to be used by a facility located within 100 kilometers of the Texas portion of the U.S.-Mexico border to meet the requirements for reductions of another pollutant. The amendments also address the substitution of a reduction of a criteria pollutant for which the area has been designated as a non-attainment area. The executive director must determine that the reduction and substitution result in a greater health benefit for the community as a whole than would reductions at the original facility and is of equal or greater benefit to the overall air quality of the area.

Further discussion of the affected program areas is provided for reference:

The EBTP is a mechanism for certifying and recording ownership of ERCs which can be used as offsets for new major sources and major modifications to existing sources or as alternative compliance with regulatory requirements for volatile organic compounds (VOC) and nitrogen oxides (NO_x) emissions in the state's ozone non-attainment areas. Separate banks are maintained for ERCs of each pollutant in each of Texas' four non-attainment areas. ERCs are generated by making

enforceable and permanent emission reductions beyond those required by state or federal regulations. ERCs are created by eliminating future emissions, quantified during or before the period in which emission reductions are made, and are expressed in tons per year.

By contrast, DERCs from the Discrete Emission Credit Banking and Trading Program are created during a discrete time period, quantified after the period in which emissions reductions are made, and expressed in tons. Reductions of VOC, NO_x, carbon monoxide (CO), sulfur dioxide (SO₂), and particulate matter with an aerodynamic diameter of less than or equal to a nominal 10 microns (PM₁₀) may be certified as DERCs.

Senate Bill 7 of the 76th Legislature in 1999 established the permitting and allowance requirements concerning emission reductions of grandfathered EGFs. The mass emissions cap and trade system of the EBTP was developed to distribute emission allowances of NO_x and SO₂ for use by existing EGFs. The allowance trading program caps emissions from these facilities to a level consistent with regulatory goals, and divides the state into three trading regions. Each EGF must hold allowances equal to or greater than its emissions to be in compliance with the program. The program encourages EGFs to determine the methods of control which will allow the EGFs to comply with their allowances. Further, the program allows trading of allowances between EGFs in the same region, thereby creating alternatives for control.

Regarding the use of surplus emission reductions achieved outside of the United States, one application has been received to date for the approval of an international emissions reduction trade and substitution. On August 23, 2002, El Paso Electric Company (EPE) submitted a proposal to use reductions achieved in Ciudad Juarez, Chihuahua, Mexico, in lieu of acquiring additional allowances needed for compliance with the Emission Banking and Trading of Allowances Program. Under this program, EPE's Newman Station is required to reduce its historical emission of NO_x by 50 percent, and will be subject to the allowance program beginning May 1, 2003. Through combustion modifications and the use of flue gas recirculating systems, EPE has decreased its NO_x emissions to near the reduction target, but is still short of the necessary total by 10 to 12 percent. To achieve the remaining balance of necessary reductions, EPE proposed to replace approximately 60 existing open-top brick kilns in Ciudad Juarez with kilns of remarkably improved design (Marquez kiln). The replacement of the existing kilns with the Marquez kilns will generate 198 tons per year of emission reductions (consisting of NO_x, VOC, PM₁₀, and CO) that EPE will use to meet its NO_x allowance obligation.

The emission reductions from the replacement of the existing kilns are surplus and quantifiable. The reductions have been quantified through testing which meets state requirements and has been approved by the

TCEQ. Also, since the replacement kilns will be unchangeable, reductions attributable to them are considered permanent. Quarterly inspections during the first year of operations, followed by annual inspections thereafter, will ensure that the replacement kilns are operating as required. The inspections will be certified by EPE and the City of Juarez Ecology Department.

EPE's proposal has been approved by the TCEQ, and demonstrates the use and benefits of the EBTP regulations affected by SB 1561. On a case-by-case basis, the TCEQ will continue to evaluate any future traded reductions to ensure they will be surplus to those required by any applicable law, and appropriately quantifiable and enforceable. The TCEQ will also ensure that any and all substituted reductions will be of an equal or greater benefit to the overall air quality of the area.

Introduction

The TCEQ has adopted Senate Bill 1561 (SB 1561) legislation that allows surplus emission reductions achieved outside the United States to satisfy emission reduction requirements within 100 kilometers of the Texas portion of the U.S.-Mexico border by allowing reductions in a nonattainment air contaminant to substitute for reductions in another nonattainment air contaminant under the specific conditions. The surplus emissions must be appropriately quantifiable and enforceable and any substitution should increase the overall air quality of the area.

Numerous air emission control programs would benefit from the ability to encourage emissions reductions achieved outside the United States to satisfy otherwise applicable emissions reductions. Rules have been adopted to address the relationship of the requirements of SB 1561 and the generation of emission reduction credits (ERCs), discrete ERCs (DERCs), and the existing emission credit system for electric generating facilities (EGFs). The TCEQ is required to submit a report to both houses of the Legislature and the governor by January 3, 2003, regarding the implementation of the substitutions of reductions in emissions of air contaminants.

Background

The changes authorized by SB 1561 will be administered by the EBTP. The EBTP was established in 1993 to provide additional flexibility for complying with certain state and federal air quality requirements, while creating a net reduction in total air emissions. This program provides a market-based framework for trading reductions in VOC, NO_x and certain other criteria pollutant emissions from stationary, area, and mobile sources.

Emission Reduction Credit

Based on the provisions of SB 1561 and comments from the public, the TCEQ adopted amendments to the rules covering ERCs, DERCs, and allowances of the EBTP. ERCs are one form of creditable reductions available for certification through the EBTP. An ERC is a permanent reduction in VOC or NO_x emissions, expressed in tons per year, reviewed and certified by the TCEQ, and represented by a numbered certificate. Once certified, ERCs are available for trade or use within the same nonattainment area in which they were generated. Certified ERCs are listed in the TCEQ Emission Reduction Credit Registry and may be banked unused within the registry for up to five years. Traditionally, ERCs have been used as an alternative means of compliance with the reduction requirements VOC and NO_x and as offsets for major sources and major modifications of Nonattainment New Source Review Permits. Once applied to a facility for use, an ERC is valid for the life of that facility.

For certification, an ERC must meet five criteria of creditability at both the time of generation and the time of use. The five criteria are: real, surplus, quantifiable, permanent, and enforceable. To qualify as real, an ERC must be a reduction in actual emissions. No credit will be given for reductions in allowable emissions. An ERC must be generated from voluntary reductions, surplus beyond any applicable local, state, and/or federal requirements. Quantifying the amount of reduction which occurred must take place using replicable methodologies and standard protocols. Reduction strategies generating ERCs are required to be permanent and enforced by a signed commitment from the generating facility to operate at the lower emission level.

Discrete Emission Reduction Credit

By contrast, DERCs from the Discrete Emission Credit Banking and Trading Program are created during a discrete time period, quantified after the period in which emissions reductions are made, and expressed in tons. Reductions of VOC, NO_x, CO, SO₂, and particulate matter with an aerodynamic diameter of less than or equal to a nominal 10 microns (PM₁₀) may be certified as DERCs. Once certified, DERCs are available for trade or use in attainment and nonattainment areas depending on where they were created. Certified DERCs are listed in the TCEQ DERC Registry and have no expiration. DERCs may be used as an alternative means of compliance with the reduction requirements VOC and NO_x, as offsets for Nonattainment New Source Review Permits, as allowances under the Houston-Galveston Cap and Trade Program, and to exceed permit allowables. Once applied to a facility for use, a DERC is valid until the total amount is used in a specified time period.

For certification, a DERC must meet the three criteria of creditability at the time of generation. A DERC must be real, surplus, and quantifiable. The three criteria qualifications are the same as in the ERC Program.

Senate Bill 7 Allowances

Senate Bill 7 (SB 7) in the 76th Legislature of 1999 established the permitting and allowance requirements concerning emission reductions of “grandfathered facilities.” The Emission Banking and Trading of Allowances (EBTA) Program was developed to distribute emission allowances of NO_x and SO₂ for use by existing EGFs. Two categories of EGFs are eligible to use the trading system. The first category consists of EGFs in existence on January 1, 1999, which were not subject to the requirement to obtain a permit under the Texas Clean Air Act (TCAA). These facilities are commonly referred to as grandfathered facilities. SB 7 also mandated that grandfathered EGFs apply for a permit on or before September 1, 2000, and obtain a permit by or cease operation after May 1, 2003. The second category of EGFs consists of permitted EGFs that are

not subject to the permitting requirements of SB 7, yet elect to participate in the allowance trading system.

Emission allowances were allocated to grandfathered EGFs in three defined regions of the state. The three regions are East Texas, West Texas, and El Paso County. The Legislature mandated that the total annual emissions of NO_x would not exceed 50 percent of the emissions during 1997 as reported to the TCEQ, and that for coal-fired grandfathered EGFs, total annual emissions of SO₂ would not exceed 75 percent of the emissions during 1997 as reported to the TCEQ.

Each EGF must hold allowances equal to or greater than its emissions to be in compliance with the program. The EBTA program encourages EGFs to determine the methods of control which will allow the EGFs to comply with their allowances. Further, the program allows trading of allowances between EGFs in the same region, thereby creating alternatives for control. For example, if an EGF emitted 100 tons over the control period and has a balance of 150 allowances in its compliance account, the EGF may sell the unused portion—50 tons or allowances—to another EGF. This trading provision allows companies to determine the most economical method of meeting the regulation, either by purchasing surplus allowances created by another EGF's reductions or by making their own reductions.

Implementation of SB 1561

SB 1561 allows surplus emission reductions achieved outside the United States to satisfy emission reduction requirements in Texas by allowing reductions in one nonattainment air contaminant to substitute for reductions in another nonattainment air contaminant under the specific conditions described below.

The relationship of the requirements of SB 1561 and the generation of ERCs was addressed in adopted amendments to the ERC rules. The amendments allow emission reductions from facilities located outside the United States to be used to meet the requirements for reductions in another pollutant in Texas, provided the executive director determines that the substitution results in a greater health benefit and is of equal or greater benefit to the overall air quality of the area. The TCEQ will make this determination. The amendments involve the substitution of a reduction of a criteria pollutant for which the area has been designated as a nonattainment area. The substitution must clearly result in greater health benefits for the community as a whole than would reductions at the original facility. When determining whether an emissions reduction outside the United States will be of greater health benefit, the TCEQ may consider the amount of air contaminant removed, the frequency that concentrations of an air contaminant have exceeded the national ambient air quality standard (NAAQS), existing air quality demonstrations

performed under SIP requirements, the air quality index, and any other information which would indicate a clear benefit of a proposed emission reduction substitution. While the TCEQ will closely examine any proposed emission reduction, it does not plan to specify or endorse any particular method of demonstration. The TCEQ recognizes the influence of air contaminant sources outside the United States on the El Paso airshed and will encourage emission reductions. The amended rules will not affect federally required reductions. In order for the reductions to be eligible for substitution, they must be real, permanent, quantifiable, enforceable, and surplus to any applicable, federal, state, or local law.

SB 1561 provisions applies to the existing emission credit system for EGFs. The new rules allow for the substitution of reductions of one criteria pollutant for another criteria pollutant outside the United States provided the substitution meets the same requirements as described in the ERC rule amendments.

DERC rules have also been amended to address the relationship of SB 1561 requirements to the generation of DERCs. The adopted amendments allow the substitution of emission reductions in one nonattainment air contaminant of reductions of another nonattainment air contaminant outside the United States under the same restrictions as described in the ERC rule amendments.

Proposed Trade between Texas and Mexico

Regarding the use of surplus emission reductions achieved outside of the United States, one application has been received to date for approval of an international emissions reduction trade and substitution. On August 23, 2002, EPE submitted a proposal to use reductions achieved in Ciudad Juarez, Chihuahua, Mexico, in lieu of acquiring additional allowances needed for compliance with the EBTA Program established by SB 7 of the 76th Legislature.

Proposal

EPE owns and operates three natural gas-fired grandfathered boilers at the Newman Generating Station located in El Paso County, Texas. Under the EGF system cap program, EPE's Newman Station is required to reduce its historical emission of NO_x by 50 percent, and will be subject to the allowance program beginning May 1, 2003. Through combustion modifications and the use of flue gas recirculating systems, EPE has decreased its NO_x emissions to near the reduction target, but is still short of the necessary total by approximately 10 to 12 percent. To achieve the remaining balance of necessary reductions, EPE proposed to replace 60 existing open-top brick kilns in Ciudad Juarez with kilns of remarkably improved design (Marquez kiln). The replacement of the existing kilns with the Marquez kilns will generate 198 tons per year of emission

reductions (consisting of NO_x, VOC, PM₁₀, and CO) that EPE will use to meet its NO_x allowance obligation.

The existing brick kilns in Ciudad Juarez consist of open top structures measuring approximately 3 meters in length, width and height above grade. The brick makers stack unfired “green” bricks for firing in the kiln. A fire is maintained at the base of the kiln primarily by burning wood and sawdust. Brick makers may also use other fuels such as tires, used motor oil, plastics and garbage, but this practice has been discouraged by the Mexican federal government through a formal agreement developed between PROFEPA (the Mexican federal environmental enforcement agency) and the brick makers. The open-top kilns emit CO, NO_x, VOCs and PM directly to the open atmosphere. The kilns are fired for a period ranging from 20 to 30 hours at an approximate temperature of 600 degrees Celsius in order to completely bake the bricks. Monitoring by the City of Juarez indicates each kiln is fired 14 times per year on average. Based on EPE’s testing of unmodified kiln firings, a total of 863 pounds of pollutants per firing per kiln were quantified. This is a conservative amount when considering that the tests were conducted using pallet wood, a relatively clean fuel.

The existing kilns would be replaced by the Marquez kiln, the design of which incorporates two adjacent chambers of approximately the same circumference, with an additional wall height of 2 to 4 feet. Both are covered with a dome and release stacks. An underground duct connects the two chambers so the combustion gases from one chamber can be directed to the adjacent. Prior to firing, “green” bricks are loaded in both chambers through a door that is sealed after the loading is completed. One chamber is then fired and the emissions are routed through the underground duct to the adjacent unfired chamber. The unfired bricks in the cold chamber provide a filtering step for the combustion gases from the hot kiln prior to their exit through the cold chamber’s stack to the atmosphere. The testing conducted on the Marquez kiln indicated emissions of 397 pounds per firing per kiln. The destruction of an existing kiln and its replacement with the Marquez kiln results in an overall emission reduction of 466 pounds per firing per kiln and an annual reduction of 3.3 tons per kiln. EPE proposes to replace 60 kilns for this project which would yield a project total reduction of 198 tons/year. The pollutants for which emissions will be reduced consist of NO_x, VOCs, PM, and CO. These reductions will be substituted for the additional NO_x allowances.

Nonattainment

Reductions of a criteria pollutant for which an area has been designated as nonattainment may be substituted for reductions of another criteria pollutant for which the area has been designated as nonattainment. Emission reduction substitutions are also allowed for pollutants which

lead to the formation of a criteria pollutant. El Paso County is considered nonattainment for PM, CO, and ozone (O₃). Since NO_x is an ozone precursor, this project proposes to use the interpollutant trading rules to substitute reductions of total pollutants reduced (comprised of PM, CO, VOC, and NO_x) in Mexico for required reductions of NO_x in the United States. The “exchange rate” of the substitution will be on a one-for-one basis.

The TCEQ reviewed available data, rules, and procedures to determine whether the project would result in a greater health benefit and equal or greater air quality benefit in the El Paso area. The scale of the nonattainment areas and the sources and dispersion of emissions involved in the project were analyzed. The city of El Paso is a PM nonattainment area. Releases of PM near ground level would have a local effect on the air quality near the kilns and the neighborhoods within which they exist. PM also exhibits transport characteristics that would extend its effect throughout the border area of El Paso. The CO nonattainment area is limited to the border region of El Paso and is directly related to mobile sources. The ozone nonattainment area encompasses El Paso County and is related to mobile and stationary sources. NO_x emissions are precursors to ozone; emissions from EPE’s Newman Station would be from greater heights than the kilns, and would exhibit greater long-range transport effects than local effects. Since the majority of the population affected by air emissions from the kilns is located within the border between El Paso and Juarez, it would be more directly affected by reductions in PM and CO sources near them.

Nonattainment requirements do not apply to NO_x emissions in the El Paso County. The EPA has granted a NO_x waiver which excludes El Paso County from the requirement to reduce emissions of NO_x. This waiver was based on TCEQ’s attainment demonstration for the EPA that reductions of VOCs were sufficient to reach attainment levels for ozone, thus not requiring reductions in NO_x emissions. In addition, NO_x emissions are precursors for NO₂, and the El Paso area is in attainment for NO₂. Accordingly, the nonattainment pollutants of greatest concern are PM and CO, and reductions of these pollutants thereby meet the health and air quality requirements of the rules. The TCEQ determined that the 1.00:1 ratio for allowance substitution will satisfy the requirements of the EBTA Program. The amount of reductions quantified by EPE is based on conservative results, and actually results in a 10-15 percent greater reduction total than what is claimed, and therefore meets the requirement for a greater than 1.00:1 offset ratio.

Air Quality Benefit

The TCEQ looked for other sources of readily available data that would lend credible evidence to the hypothesis that EPE’s project would result in

an equal or greater health and air quality benefit. The EPA makes information about outdoor air quality available to the public through the Air Quality Index (AQI). The AQI provides the public with timely and easy-to-understand information on local air quality and whether air pollution levels of criteria pollutants pose a health concern on a daily basis. Calculated values relate to the following categories of concern: “good” and “moderate” (which indicate concentrations are less than or equal to the NAAQS) and “unhealthy for sensitive groups,” “unhealthy,” “very unhealthy,” and “hazardous” (for concentrations above the NAAQS). The TCEQ obtained the highest concentrations for PM, CO, and ozone for the years 1996 through 2001 from EPA’s AIRData Monitor Values Report (Table 1) and noted AQI values as well as the number of exceedances of the NAAQS. The breakdown provides the total number of NAAQS exceedances and maximum number of exceedances in any year, the worst AQI category that occurred during a year and the number of years the category occurred.

Table 1. Air Quality Index Data from EPA’s AIRData Monitor Values Report

Pollutant	Exceedances		Number of years the worst AQI category was ...			
	Total	Maximum (any one year)	Moderate	Unhealthy for sensitive groups	Unhealthy	Hazardous
PM	19	7	2	2	1	1
CO	11	4	1	4	1	
Ozone	11	3		6		

The TCEQ reviewed the daily AQI values for 2001 to determine the controlling pollutant in the El Paso area. The highest of the AQI values for the individual pollutants becomes the AQI value for the day. In frequency of occurrence, the AQI values are: ozone (187 days), PM (165 days), CO (13 days). Since NO_x reductions were not required to lower ozone, the TCEQ determined that reductions in PM and CO from this project would be of at least an equal benefit as a reduction in ozone that might occur from a reduction in NO_x.

The TCEQ attempted to include agency effects screening levels (ESL) in the benefits evaluation process to add weight to its demonstration of relevant benefit. This review was not as straightforward as the reviews taken in preceding steps, in that: (1) no unique ESLs are available for criteria pollutants; the ESLs for criteria pollutants are the pollutant standards; (2) the time periods of concern for PM, CO and NO₂ (as a surrogate for NO_x) are not the same; and (3) PM may contain speciated metals of concern which would have lower ESLs.

Table 2. TCEQ Health Effects Screening Levels

Pollutant	Period	ESL ($\mu\text{g}/\text{m}^3$)	Period	ESL ($\mu\text{g}/\text{m}^3$)	Period	ESL ($\mu\text{g}/\text{m}^3$)	Period	ESL ($\mu\text{g}/\text{m}^3$)
PM	1 hour	50			24 hours	150	annual	50
Metals	1 hour	1					annual	0.1
CO	1 hour	40,000	8 hours	10,000				
NO ₂							annual	100

The TCEQ inferred from this review that reductions in PM emissions would have at least an equal benefit to reductions in NO_x based on a comparison of level of concentrations. However, this review could suggest that NO₂ emission reductions could be of greater benefit than CO emission reductions, but a much more detailed analysis would be required to confirm this observation.

EPE has agreed to submit an initial certification packet for each replaced kiln. Included in this initial certification will be: (1) a copy of the agreement signed by EPE and the individual brick maker; and (2) a document signed by a representative from EPE and the COJED certifying the replacement of a primitive kiln as well as GPS coordinates and photos of the destroyed and replacement kilns. EPE has agreed to quarterly inspections for kilns which are in their first year of operation. These inspections entail certification of the proper utilization and structural integrity of the modified kiln. The certification will be signed by a representative from EPE and will be accompanied by documentation detailing number of firings, type of fuel used and number of bricks produced provided and signed by the COJED. Upon satisfactory quarterly inspections, kilns that have been in service for at least one year will undergo annual inspections that are conducted in the same manner as the quarterly inspections. These inspection requirements will also be included as part of the “Special Conditions” contained in the Senate Bill 7 permit. If these conditions are not satisfied for one or more kilns, TCEQ may elect not to renew the corresponding annual allowances for these reductions and EPE will still need to meet their allowance obligations.

Based on the proposal, EPE will be given 3.3 tons per year per modified kiln in their EBTA compliance account for Newman Station. The reductions made in Juarez meet the criteria of an emission reduction for the purposes of international trading and substitution. This project proposes the replacement of 60 kilns for a total annual reduction and allowance conversion of 198 tons/year. The agreements and determinations pertain to this specific project and may be re-evaluated should any new and/or pertinent considerations become available.

Conclusion

SB 1561 encourages emissions reductions achieved outside the United States to satisfy otherwise applicable emissions reductions. Rules have been adopted to address the relationship of the requirements of SB 1561 and the generation of ERCs, DERCs, and the existing emission credit system for EGFs. EPE's proposal, which has been approved by the TCEQ, demonstrates the use and benefits of the those EBTP regulations affected by SB 1561.

On a case-by-case basis, the TCEQ will continue to evaluate any future traded reductions to ensure they will be surplus to those required by any applicable law, and appropriately quantifiable and enforceable. The TCEQ will also ensure that any and all substituted reductions will be of an equal or greater benefit to the overall air quality of the area.

Acronyms and Initialisms Used

AQI	Air Quality Index
CO	carbon monoxide
COJED	City of Juarez Ecology Department
DERC	discrete emission reduction credit
EBTA	emission banking and trading of allowances
EBTP	emission banking and trading program
EGF	electric generating facility
EPA	U.S. Environmental Protection Agency
EPE	El Paso Electric Company
ERC	emission reduction credit
NAAQS	National Ambient Air Quality Standard
NO _x	nitrogen oxides
PM	particulate matter
PM ₁₀	particulate matter with a nominal aerodynamic diameter of 10 microns or less
SB	Senate bill
SO ₂	sulfur dioxide
TCAA	Texas Clean Air Act
TCEQ	Texas Commission on Environmental Quality
VOC	volatile organic compound