

The Texas Natural Resource Conservation Commission (commission) proposes an amendment to §101.351, Applicability. The amended section 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 PROPOSED RULE

On December 6, 2000, the commission adopted rules which established a program of emissions capping and trading as part of the Houston/Galveston (HGA) SIP for the control of ozone. These rules were published in the January 12, 2001 issue of the *Texas Register* (26 TexReg 283). In the preamble for these rules, under the SECTION BY SECTION discussion of §101.351, the commission stated its intent to propose an amendment to §101.351 shortly after the adoption of the cap and trade program rules.

The commission believed that the amendment would be necessary to specify that the requirement to operate under the cap and trade program applied to all facilities which emit nitrogen oxides (NO_x) in the HGA area with emission standards under Chapter 117, Control of Air Pollution from Nitrogen Compounds and which are located at a site where their collective design capacity to emit NO_x is ten tons or more per year. Section 101.351, as adopted on December 6, 2000, was proposed with language which could be interpreted to limit the application of the cap and trade program to individual facilities which have a NO_x design capacity of ten tons or more per year.

This proposal would apply the requirements of Chapter 101, Subchapter H, Emissions Banking and Trading, Division 3, Mass Emissions Cap and Trade Program to facilities emitting NO_x located at a single site in the HGA area with emission standards under Chapter 117 and which have a collective design capacity to emit ten tons of NO_x or more per year. The commission believes that the intended

applicability of the cap and trade has been made clear not only in the preamble that accompanied the December 6, 2000 rules, but also in the SIP adopted on the same date and in numerous contacts with representatives of the intended affected sources in the HGA area.

SECTION BY SECTION DISCUSSION

The proposed amendment to §101.351 would state that the requirements of Chapter 101, Subchapter H, Division 3 would apply to all stationary facilities which emit NO_x with emission specifications under §§117.106, 117.206, and 117.475 of this title (relating to Emission Specifications for Attainment Demonstration; Emission Specifications for Attainment Demonstration; and Emission Specifications) which are located at a site where they collectively have a design capacity to emit ten tons or more per year of NO_x. The amendment would require the owner or operator of facilities at a site to obtain and use allowances for actual total NO_x emissions from all affected facilities at the site once the collective design capacity of all the affected facilities has reached ten tons.

FISCAL NOTE: COSTS TO STATE AND LOCAL GOVERNMENT

John Davis, Technical Specialist with Strategic Planning and Appropriations, determined for each year of the first five-year period the proposed amendments are in effect, there will be fiscal implications which are not anticipated to be significant for units of state or local government as a result of administration or enforcement of the proposed amendment.

The proposed amendment specifies that the requirement to operate under the emissions cap and trade program in the HGA ozone nonattainment area would apply to facilities or groups of facilities located at

a site which have a collective design capacity to emit ten tons or more NO_x per year and which have emission requirements under Chapter 117, the commission's NO_x regulations.

The emissions cap and trade program rules, adopted by the commission in December 2000, are intended to implement and manage a mandatory annual NO_x emission cap, phased in between January 1, 2002 and January 1, 2005, on all existing and new stationary sources located in the HGA ozone nonattainment area consisting of: Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, and Waller Counties.

Examples of equipment and processes at sources that would be affected by the proposed amendments include: electric utility boilers and stationary gas turbines; industrial/commercial/institutional (ICI) boilers and stationary gas turbines; duct burners used in turbine exhaust ducts; process heaters and furnaces; stationary internal combustion engines; fluid catalytic cracking units (including catalyst regenerators and carbon monoxide (CO) boilers and furnaces); pulping liquor recovery furnaces; lime kilns; lightweight aggregate kilns; heat treating and reheat furnaces; magnesium chloride fluidized bed dryers; incinerators; and boiler and industrial (BIF) furnace units. The commission would allocate to a facility or group of facilities a number of allowances (NO_x emissions in tons) which a source would be allowed to emit during the calendar year. The facility or group of facilities would not be allowed to exceed this number of allocated allowances unless they obtained additional allowances from another facility's surplus allowances. Facilities with surplus allowances would be allowed to sell those allowances to other facilities operating under the emissions cap. New facilities would have to purchase allowances prior to beginning operations in the HGA ozone nonattainment area. Allowance trading is

intended to provide flexibility and potential cost savings in planning and determining the most economical mix of the application of emission control technology with the purchase of other facility's surplus allowances to meet emission reduction requirements.

Although the exact number is unknown, the commission estimates that approximately 6,000 pieces of equipment would be affected by the proposed amendment and the existing cap and trade rules, some of which are owned and operated by units of state or local governments. This is the same figure that was estimated for the cap and trade rules adopted on December 6, 2000 and includes the facilities that would be affected by this amendment. Affected facilities can purchase or sell allowances for approximately \$500 to \$5,000 per allowance, depending on market demand and availability. The total cost or revenues gained by units of state and local government sites will depend on the total number of allowances purchased or sold.

PUBLIC BENEFIT AND COSTS

Mr. Davis also determined for each of the first five years the proposed amendment to Chapter 101 is in effect, the anticipated public benefit as a result of implementing the amendment would be providing flexibility to those sources covered by Chapter 117 which would facilitate the reduction of emissions of NO_x in the HGA ozone nonattainment area to a level that would allow the area to meet the national ambient air quality standard (NAAQS) for ozone.

The proposed amendment specifies that the requirement to operate under the emissions cap and trade program in the HGA ozone nonattainment area would apply to facilities or groups of facilities which

have a collective design capacity to emit ten tons or more of NO_x per year and which have emission requirements under Chapter 117.

Examples of equipment and processes at sources which would be affected by the proposed amendments include: electric utility boilers and stationary gas turbines; ICI boilers and stationary gas turbines; duct burners used in turbine exhaust ducts; process heaters and furnaces; stationary internal combustion engines; fluid catalytic cracking units (including catalyst regenerators and CO boilers and furnaces); pulping liquor recovery furnaces; lime kilns; lightweight aggregate kilns; heat treating and reheat furnaces; magnesium chloride fluidized bed dryers; incinerators; and BIF units. The commission would allocate to a facility or group of facilities a number of allowances (NO_x emissions in tons) which a source would be allowed to emit during the calendar year. The facility or group of facilities would not be allowed to exceed this number of allowances unless they obtain additional allowances from another facility's surplus allowances. Facilities with surplus allowances would be allowed to sell those allowances to other facilities operating under the emissions cap. New facilities would have to purchase allowances prior to beginning operations in the HGA ozone nonattainment area. Allowance trading is intended to provide flexibility and potential cost savings in planning and determining the most economical mix of the application of emission control technology with the purchase of other facility's surplus allowances to meet emission reduction requirements.

Although the exact number is unknown, the commission estimates that approximately 6,000 pieces of equipment would be affected by the proposed amendment and the existing cap and trade rules, the majority of which are privately owned and operated. This is the same figure that was estimated for the

cap and trade rules adopted on December 6, 2000 and includes the facilities that would be affected by this amendment. Affected facilities can purchase or sell allowances for approximately \$500 to \$5,000 per allowance, depending on market demand and availability. The total cost or revenues gained by privately owned and operated facilities will depend on the total number of allowances purchased or sold.

SMALL BUSINESS AND MICRO-BUSINESS ASSESSMENT

There will be adverse fiscal implications for small or micro-businesses as a result of administration or enforcement of the proposed amendment, because affected owners and operators of new facilities will have to pay for allowances under the emission cap and trade program. Additionally, owners and operators of existing facilities will have their emissions capped. However, allowance trading is intended to provide flexibility and potential cost savings in planning and determining the most economical mix of the application of emission control technology with the purchase of other facility's surplus allowances to meet emission reduction requirements.

Small or micro-businesses located in the HGA ozone nonattainment area can purchase or sell allowances for the same unit price as larger businesses, approximately \$500 to \$5,000 per allowance. Actual costs for the allowances will be dependent on market demand and availability. The total cost or revenues gained to affected small or micro-businesses will depend on the total number of allowances purchased or sold.

Of the 6,000 identified pieces of equipment at sources in the HGA ozone nonattainment area, some will

be owned and operated by small or micro-businesses. Examples of likely equipment at sources operated by small or micro-businesses include boilers, process heaters, and internal combustion engines. There is no feasible way to further reduce the impact of the proposed amendment for small businesses. However, including these businesses in the cap and trade program is expected to provide them flexibility in meeting existing requirements under Chapter 117.

Under Texas Government Code, §2006.002(c), the commission is required to analyze the cost of compliance with the proposed rule amendment on small businesses, as compared to the cost of compliance for the largest businesses affected by the rules. Using the criteria under §2006.002(c)(2), the commission estimated the cost or revenues would range from as low as \$5.00 - \$50 per employee, assuming 100 employees, to as high as \$25 - \$250 per employee, assuming 20 employees. The cost or revenue for a large business affect by the proposed amendment would be approximately \$.50 - \$5.00 per employee, assuming 1,000 employees.

DRAFT REGULATORY IMPACT ANALYSIS DETERMINATION

The commission reviewed the proposed rulemaking in light of the regulatory analysis requirements of Texas Government Code, §2001.0225. The proposed rulemaking would affect owners and operators of new and existing facilities emitting NO_x subject to §§117.106, 117.206, and 117.475 requirements in the HGA nonattainment area which individually emit less than ten tons per year of NO_x, but which are located at a site with a total of at least ten tons per year of NO_x emission from subject facilities. The commission determined the proposed rulemaking meets 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. Existing facilities would be limited to NO_x emission levels under an emissions cap based on historical operating data and specific emission rates determined by Chapter 117. New facilities would be required to identify a source(s) of allowances equal to allowable emissions prior to commencing operation. All facilities subject to this division would be required to hold a quantity of allowances in their compliance account by January 31 following the end of a control period, which is equal to or greater than the total emissions from the preceding control period. The cost of allowances in similar programs nationwide ranges from approximately \$500 to \$5,000 per allowance (ton), depending on availability and demand. Actual costs in the HGA nonattainment area will be dependent upon market demand and availability. The commission is proposing this amendment as part of a strategy to reduce and permanently cap NO_x emissions to a level which would allow the HGA nonattainment area to attain the ozone NAAQS. 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 proposed amendment does not meet any of the four applicability requirements. Specifically, the emission banking and trading requirements within

this proposal were developed in order to meet the ozone NAAQS set by the EPA under the Federal Clean Air Act (FCAA), §109 as codified in 42 United States Code (42 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 42 USC, 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. 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 legislature is presumed to understand 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 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 42 USC. 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 commission performed photochemical grid modeling which predicts that NO_x emission reductions, such as those required by this amendment, will result in reductions in ozone formation in the HGA ozone nonattainment area. This rulemaking does not exceed an express requirement of state law. This rulemaking is intended to obtain NO_x emission reductions which will result in reductions in ozone formation in the HGA ozone nonattainment area and help bring HGA into compliance with the air quality standards established under federal law as NAAQS for ozone. The rulemaking does not exceed a standard set by federal law, exceed an express requirement of state law, nor 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 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).

The commission invites public comment on the draft regulatory impact analysis.

TAKINGS IMPACT ASSESSMENT

The commission completed a takings impact assessment for the proposed amendment. The following is a summary of that assessment. The amendment is proposed as part of a strategy to reduce and permanently cap NO_x emissions to a level which would allow the HGA nonattainment area to attain the ozone NAAQS. Promulgation and enforcement of the rule will not burden private real property. The

proposed amendment does not affect private real 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 credits and allowances that are the subject of this rule are not property rights. Consequently, this amendment does not meet the definition of a takings under Texas Government Code, §2007.002(5). Although the proposed rule revisions 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 42 USC, §7410. Specifically, the emission limitations within this proposal were developed in order to meet the ozone NAAQS set by the EPA under the 42 USC, §7409. States are primarily responsible for ensuring attainment and maintenance of the NAAQS once the EPA has established them. Under the 42 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 rule proposal is to implement a NO_x strategy which is necessary for the HGA area to meet the air quality standards established under federal law as NAAQS. Consequently, the exemption which applies to this proposed amendment is that of an action reasonably taken to fulfill an obligation mandated by federal law. Therefore, these proposed revisions will not constitute a takings under Texas Government Code, Chapter 2007.

CONSISTENCY WITH THE COASTAL MANAGEMENT PROGRAM

The commission determined that this rulemaking action relates to an action or actions subject to the Texas Coastal Management Program (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 §281.45(a)(3) and 31 TAC §505.11(b)(2), 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 that the proposed rule is 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 that the commission protect air quality in coastal areas. If adopted, the amended section would require all NO_x sources in the HGA area with emission standards under Chapter 117 which are located at a site and have a collective design capacity to emit ten tons of NO_x or more per year to operate under the requirements of Chapter 101, Subchapter H, Division 3. This requirement is part of the ozone attainment strategy for the HGA area. No new contaminants will be authorized by this amendment, and a reduction of NO_x emissions should occur.

EFFECT ON SITES SUBJECT TO THE FEDERAL OPERATING PERMITS PROGRAM

The amended section will become part of the state's ozone attainment strategy; therefore, these amendments will be submitted as part of the SIP. As a result, the amended section and any allowances allocated under the section would become applicable requirements under the federal operating permit program.

ANNOUNCEMENT OF HEARING

The commission will hold a public hearing on this proposal in Houston on April 26, 2001 at 2:00 p.m. at the City of Houston Pollution Control Building Auditorium, located at 7411 Park Place Boulevard.

The hearing is structured for the receipt of oral or written comments by interested persons. Individuals may present oral statements when called upon in order of registration. Open discussion will not occur during the hearing; however, agency staff members will be available to discuss the proposal 30 minutes prior to the hearing, and will answer questions before and after the hearing.

Persons with disabilities who have special communication or other accommodation needs, who are planning to attend the hearings, should contact the Office of Environmental Policy, Analysis, and Assessment at (512) 239-4900. Requests should be made as far in advance as possible.

SUBMITTAL OF COMMENTS

Comments may be submitted to Lola Brown, Office of Environmental Policy, Analysis, and Assessment, MC 205, P.O. Box 13087, Austin, Texas 78711-3087 or faxed to (512) 239-4808. All comments should reference Rule Log Number 2001-015-101-AI. Comments must be received by 5:00 p.m., April 26, 2001. For further information, please contact Matthew R. Baker at (512) 239-1091 or Beecher Cameron at (512) 239-1495.

STATUTORY AUTHORITY

The amendment is proposed under 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.

The proposed amendment implements TCAA, §382.011, General Powers and Duties; §382.012, State Air Control Plan; §382.017, Rules; and 42 USC, §7410(a)(2)(A).

SUBCHAPTER H: EMISSIONS BANKING AND TRADING

DIVISION 3: MASS EMISSIONS CAP AND TRADE PROGRAM

§101.351

§101.351. Applicability.

This division applies to all stationary facilities which emit nitrogen oxides (NO_x) in the Houston/Galveston nonattainment area which [and] are subject to the emission specifications under §§117.106, 117.206, and 117.475 of this title (relating to Emission Specifications for Attainment Demonstration; Emission Specifications for Attainment Demonstration; and Emission Specifications) and which are located at a site where they collectively have a design capacity to emit ten tons or more per year of NO_x.