The Texas Commission on Environmental Quality (commission) proposes amendments to §§101.302, 101.306, 101.372, 101.373, 101.376, and 101.378; and the repeal of §101.338. The commission proposes new §§101.305, 101.338, 101.339, and 101.375. The repealed, new, and amended sections will be submitted to the United States Environmental Protection Agency (EPA) as revisions to the Texas State Implementation Plan (SIP).

BACKGROUND AND SUMMARY OF THE FACTUAL BASIS FOR THE PROPOSED RULES

The Emissions Banking and Trading Program (EBTP) has been designed to offer flexibility and provide a market-based method of meeting required emission reductions. The program makes use of several types of emission credits including emission reduction credits (ERCs), mobile emission reduction credits (MERCs), discrete emission reduction credits (DERCs), and mobile discrete emission reduction credits (MDERCs). Flexibility has been built into the rules to create incentives for the early or permanent retirement of volatile organic compounds (VOC) and nitrogen oxides (NO_x) emissions credits.

In the October 5, 2005, edition of the *Federal Register* (70 FR 58154), the EPA published the proposed conditional approval of the DERC program as part of the SIP. The conditional approval was based on the commission submitting corrected program deficiencies to the EPA by December 1, 2006. Unless the commission adopts and submits these corrections, the EPA will have to issue a finding of disapproval. These proposed revisions address the deficiencies, which the commission committed to correct in a letter to the EPA dated September 8, 2005.

The proposed corrections include the prohibition of the future generation of DERCs from permanent shutdowns and allow only DERCs generated from permanent shutdowns before September 30, 2002, to remain available for use for no more than five years from the date of the commission's commitment letter. Any DERCs generated after September 30, 2002, would be removed from the DERC registry and not be available for use. The conditions also required revisions to §101.302(f) and §101.372(f)(7) and (8) to clarify that the EPA must approve individual transactions involving emission reductions generated in another state or nation as well as those transactions from one nonattainment area to another or from attainment counties into nonattainment areas. The proposed revisions would revise Subchapter H, Emissions Banking and Trading, to include program audit and reporting requirements to satisfy the EPA's requirements for open market trading programs. The requirements concerning program audits were not included in the EPA publication of conditional approval but were the subject of discussion between the commission and the EPA.

The conditions also required the change to Form DEC-1, Notice of Generation and Generator Certification of Discrete Emission Credits; Form MDEC-1, Notice of Generation and Generator of Mobile Discrete Emission Credits; and Form DEC-2, Notice of Intent to Use Discrete Emission Credits, to include a waiver to federal statute of limitations defense for generators and users of discrete emission credits. With the revision of these forms and adoption of the proposed rule changes, the commission will have corrected all identified deficiencies in the DERC program.

The proposed rules also reflect changes to the Texas Health and Safety Code (THSC), §382.0172(c). Senate Bill (SB) 784 was adopted by the 79th Legislature, 2005, and allows additional options for

credit from emission reductions achieved outside of the United States. The revisions would allow the commission more discretion in its authorization to approve the substitution and crediting of emission reductions outside the United States that may be used to satisfy reduction or trading requirements.

SECTION BY SECTION DISCUSSION

§101.302. General Provisions.

The commission proposes administrative changes throughout the rules to conform with Texas Register requirements and agency guidelines.

In order to better organize similar rule requirements, the commission proposes to delete §101.302(a)(2) and relocate this language concerning emission creditable reductions occurring outside the United States to a new §101.305, Emission Reductions Achieved Outside the United States.

The commission proposes to amend §101.302(d)(1)(C)(vi) to allow the rejection of an emission credit quantification protocol if the EPA objects to the protocol during a 45-day adequacy review period or if the EPA publishes in the *Federal Register* a disapproval of the protocol. This does not impact the procedures to approve the quantification protocol. The commission has in practice always worked with the EPA to approve new quantification protocols. This revision clarifies in the rule that the quatification protocols would not be approved if the EPA objects.

§101.305. Emission Reductions Achieved Outside the United States.

The proposed new §101.305 would combine the existing language on using emission reductions from outside the United States that would be moved from §101.302(f)(3) and (a)(2) for better organization. The proposed revisions would also reflect the change to THSC, §382.0172(c), enacted under SB 784, which allows facilities to substitute emission reductions in criteria pollutants outside the United States if it is a reduction in an air contaminant for which the area, where the facility is located, has been designated as nonattainment, or if the reduction will result in a greater overall health benefit for the area. This will allow the continuance of beneficial emission credit programs for reductions in Ciudad Juárez in the event of El Paso being reclassified as an attainment area.

The commission is moving the rules governing optional credit to their own sections (§§101.305, 101.338, and 101.375) so that they may be considered separately by EPA for approval into the SIP and will not delay approval of other portions of the EBTP.

§101.306. Emission Credit Use.

The proposed amendment to §101.306(a)(5) would modify the section to be consistent with the allowed use of ERCs under §101.399, Allowance Banking and Trading. This revision is necessary because of a previous adoption of Chapter 101, Subchapter H, Division 6, Highly-Reactive Volatile Organic Compound Emissions Cap and Trade Program, and allows facilities to use ERCs as allowances under the highly-reactive volatile organic compound cap and trade program.

§101.338. Emission Reductions Achieved Outside the United States.

The existing §101.338 would be repealed. The proposed new §101.338 would reflect the revisions to THSC, §382.0172(c) and provide the commission more discretion in approving the substitution of emission reductions achieved outside the United States for emissions from electric generating or grandfathered facilities. The commission would also modify the arrangement of the existing section to parallel the arrangement of language in §101.305 and §101.375.

§101.339. Program Audits and Reports.

The proposed new §101.339 includes program audits and report requirements for emission credit programs applicable to electric generating and grandfathered facilities. The proposed section contains similar audit and report requirements as are applicable to the commission's other open market trading programs. These requirements are used by the commission and the EPA to evaluate the effectiveness of the program and include reportable items such as effect on ozone attainment, number of allowances or credits traded, cost of allowances or credits, and number of allowances in each compliance account.

§101.372. General Provisions.

In order to better organize similar rule requirements, the commission proposes to delete §101.372(a)(2) and relocate this language concerning emission creditable reductions occurring outside the United States to a new §101.375, Emission Reductions Achieved Outside the United States. The commission proposes to amend §101.372(d)(1)(C)(vi) to require the rejection of a quantification protocol if the EPA objects to the quantification protocol during the 45-day adequacy review period or if the EPA publishes in the *Federal Register* a disapproval of the quantification protocol. This does not impact the procedures to approve the quantification protocol. The commission has in practice always worked with

the EPA to approve new quantification protocols. This revision clarifies in the rule that the quantification protocols would not be approved if the EPA objects. The commission also proposes to remove language from this section concerning credits for emission reductions outside the United States and the options for applying them. This language, modified to be consistent with the changes to THSC, §382.0172(c), enacted under SB 784, would be moved to the new §101.375 in order to be considered separately by the EPA for approval into the SIP and not delay approval of other portions of the EBTP.

§101.373. Discrete Emission Reduction Credit Generation and Certification.

The proposed amendments to §101.373(a)(1) and (2) would remove the ability to generate DERCs from facility shutdowns. The commission proposes this action to respond to the *Federal Register* notice requiring the correction of program deficiencies prior to the approval of the EBTP into the SIP. The EPA has stated that open market trading programs are intended to encourage innovative and creative emission reductions and shutdowns generally do not fall into this category. Shutdowns are also problematic for these programs because of the possibility that a facility may shut down in one area, generate and sell credits, but then relocate operations to other areas or states. Additionally, when activity level increases cause emission increases, mitigating reductions are typically not required. Thus, allowing the generation of tradable credits as a result of activity level decreases (including shutdowns) may tend to promote emissions increases. Such patterns of activity related to shutdowns have the potential to interfere with attainment.

§101.375. Emission Reductions Achieved Outside the United States.

The proposed new §101.375 would relocate the existing language on using emission reductions from outside the United States in §101.372(f)(8) and (a)(2). The proposed revisions would also reflect the SB 784 change to THSC, §382.0172(c), which allows facilities to substitute emission reductions in criteria pollutants outside the United States if it is a reduction in an air contaminant for which the area, where the facility is located, has been designated as nonattainment, or if the reduction will result in a greater overall health benefit for the area. This will allow the continuance of beneficial emission credit programs for reductions in Ciudad Juárez in the event of El Paso being reclassified as an attainment area.

The commission is moving the rules governing optional credit to their own sections (§§101.305, 101.338, and 101.375) so that they may be considered separately by EPA for approval into the SIP and will not delay approval of other portions of the EBTP.

§101.376. Discrete Emission Credit Use.

The proposed amendment to §101.376 would correct the rule references to reflect the pending reorganization of 30 TAC §106.261 and repeal of 30 TAC §106.262 under Rule Project Number 2005-016-106-PR concerning maintenance, startup, and shutdown emissions.

§101.378. Discrete Emission Credit Banking and Trading.

The proposed amendment to §101.378 would change the lifetime of DERCs generated from shutdowns strategy. Companies that have previously certified DERCs from shutdown strategies will have no more than five years from the September 8, 2005, commitment letter to the EPA to use the DERCs.

As a result, DERCs that were generated from shutdowns prior to September 30, 2002, would be available for use until September 8, 2010. After that date, the DERCs that were generated from shutdowns before September 30, 2002, will be removed from the DERC registry and will no longer be available for use. DERCs generated from shutdowns after September 30, 2002, may not be used. The reason for this action is included in the discussion of changes to §101.373 in this preamble.

FISCAL NOTE: COSTS TO STATE AND LOCAL GOVERNMENT

Nina Chamness, Analyst, Strategic Planning and Assessment Section, has determined that, for the first five-year period the proposed rules are in effect, no fiscal implications are anticipated for the agency or other units of state or local governments as a result of administration or enforcement of the proposed rules. The proposed rules affect the EBTP and DERCs. Typically, governmental organizations do not participate in the DERC program.

The proposed rules implement EPA requirements concerning the EBTP, implement changes made by SB 784, 79th Legislature, and make other organizational and administrative changes to allow for more clarity in the administration of the EBTP.

The EPA is requiring the removal from the commission's DERC registry of credits generated after September 30, 2002, from permanent shutdowns so that the EBTP can be approved as a revision to the SIP. Only those DERCs generated from shutdowns prior to September 30, 2002, can be used in the EBTP, and they must be used by September 8, 2010.

The proposed rules also clarify that the EPA has to approve inclusions in the EBTP of emission reductions generated in another state or nation. The rules further clarify that the EPA must approve the inclusion of emission reductions in the EBTP if they are generated in and traded between nonattainment areas as well as those generated in an attainment area and traded to a nonattainment area. The proposed rules also implement THSC, §382.0172(c), as amended by SB 784, 79th Legislature, to give the agency more discretion in approving the use, by a Texas facility, of emission reduction credits generated outside the United States to satisfy emission reduction requirements.

PUBLIC BENEFITS AND COSTS

Ms. Chamness also determined that for each year of the first five years the proposed rules are in effect, the public benefit anticipated from the changes seen in the proposed rules will be the reduction of air contaminants and improved health and safety of Texas citizens. By disallowing DERCs for shutdown activities, staff estimates that approximately 19,774 tons of NO_x emissions, 576 tons of VOC emissions, and 80 tons of other hazardous air pollutant emissions will be reduced.

The loss of post-September 30, 2002, DERCs generated from permanent shutdowns will have a fiscal effect. The value of a DERC varies by nonattainment area and by contaminant. In the Houston-Galveston-Brazoria nonattainment area (HGB), the value of NO_x DERCs range from $145 per ton to $2,100 per ton. In the Beaumont-Port Arthur nonattainment area (BPA), the value of NO_x DERCs are estimated to be $750 per ton, and a carbon monoxide credit is estimated to be worth $700 per ton. The DERCs generated prior to September 30, 2002, represent the majority of the shutdown DERCs the commission currently has on its registry with an approximate total value of $40 million in HGB and

$600,000 in BPA. These credits remain available for compliance or trading by the 11 sites holding them until September 8, 2010, and will retain their full value until then. The loss of DERCs generated from permanent shutdowns after September 30, 2002, is estimated to cost, area wide, from $183,470 in HGB to $604,870 in BPA. These DERCs will expire on the effective date of this rule.

SMALL BUSINESS AND MICRO-BUSINESS ASSESSMENT

No adverse fiscal implications are anticipated for small or micro-businesses as a result of the proposed rules because they do not generally participate in the EBTP.

LOCAL EMPLOYMENT IMPACT STATEMENT

The commission has reviewed this proposed rulemaking and determined that a local employment impact statement is not required because the proposed rules do not adversely affect a local economy in a material way for the first five years that the proposed rules are in effect.

DRAFT REGULATORY IMPACT ANALYSIS DETERMINATION

The commission reviewed the proposed rulemaking in light of the regulatory impact analysis requirements of Texas Government Code, §2001.0225, and determined that the rulemaking action does meet the definition of a "major environmental rule" as defined in that statute. A "major environmental rule" is 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, productivity, competition, jobs, the environment, or the public health and safety of the state or a sector of the state. The proposed amendments to Chapter 101 and revisions to the SIP would phase out

DERCs generated from shutdowns prior to September 30, 2002, require removal of DERCs generated from shutdowns after September 30, 2002, from the DERC registry, implement the provisions of SB 784, reorganize various rules, correct one citation, specify the time the EPA has to object to quantification protocols, eliminate future generation of shutdown DERCs, and add a reference to the highly-reactive volatile organic compound cap and trade program. With the exception of the portions of the rulemaking regarding shutdown DERCs, the proposed amendments to Chapter 101 are not specifically intended to protect the environment or reduce risks to human health from environmental exposure to air pollutants; although, the underlying emissions banking and trading programs are intended to achieve these goals. The rulemaking provides flexibility regarding credits near the Texas-Mexico border by implementing SB 784 and makes various administrative changes. The changes to shutdown DERCs generation and use are proposed to bring the DERC program into compliance with EPA program requirements, allowing the DERC program to be approved as part of the SIP and to ensure air quality standards will be met. This rulemaking does not meet any of the four applicability criteria of a "major environmental rule" as defined in the Texas Government Code. Texas Government Code, §2001.0225 applies only 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. Specifically, the banking and trading program amendments in this proposal were developed to implement the provisions of SB 784, limit the use of DERCs generated from shutdowns to bring the banking and trading program into

compliance with federal requirements, and make several administrative changes. This rulemaking does not exceed an express requirement of federal or state law or a requirement of a delegation agreement, and was not developed solely under the general powers of the agency, but was specifically developed under federal law and authorized under the THSC.

The rulemaking implements requirements of 42 United States Code (USC), §7410, which requires states to adopt a SIP that provides for "implementation, maintenance, and enforcement" of the national ambient air quality standard (NAAQS) in each air quality control region of the state. While 42 USC, §7410 does not require specific programs, methods, or reductions to meet the standard, 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 the Federal Clean Air Act (FCAA) does require some specific measures for SIP purposes, such as the inspection and maintenance program, but those programs are the exception, not the rule, in the SIP structure of 42 USC, §7410. The provisions of the FCAA 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 to attain the NAAQS for the specific regions in the state. Even though the FCAA allows states to develop their own programs, this flexibility does not relieve a state from developing a program that meets the requirements of 42 USC, §7410. Thus, while specific measures are not generally required, the emission reductions are required. States are not free to ignore the requirements

of 42 USC, §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 adopted regulations in the Texas Government Code was amended by SB 633 during the 75th Legislature, 1997. The intent of SB 633 was to require agencies to conduct a regulatory impact analysis 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 discussed earlier in this preamble, 42 USC, §7410 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 regulatory impact analysis 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 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 Legislative Budget Board, the commission contends that the intent of SB 633 was only to require the full regulatory impact analysis 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 42 USC, §7410. For these reasons, rules adopted for inclusion in the SIP fall under the exception in Texas Government Code, §2001.0225(a), because they are specifically required by federal law.

In addition, 42 USC, §7502(a)(2) requires attainment as expeditiously as practicable, and 42 USC, §7511(a), requires states to submit ozone attainment demonstration SIPs for ozone nonattainment areas such as the HGB area. The adopted rules, which will reduce ambient concentrations of ozone precursors in nonattainment areas, will be submitted to the EPA as one of several measures in the federally approved SIP. As discussed earlier in this preamble, the banking and trading scheme in the adopted rules are necessary to address some of the elevated criteria pollutant levels observed in various nonattainment areas in Texas; this scheme will result in reductions in criteria pollutants in nonattainment areas and help bring areas into compliance with the air quality standards established under federal law as NAAQS.

The commission has consistently applied this construction to its rules since this statute was enacted in 1997. Since that time, the legislature has revised the Texas Government Code but left this provision substantially unamended. The commission presumes that "when an agency interpretation is in effect at

the time the legislature amends the laws without making substantial change in the statute, the legislature is deemed to have accepted the agency's interpretation." *Central Power & Light Co. v. Sharp*, 919 S.W.2d 485. 489 (Tex. App.–Austin 1995), *writ denied with per curiam opinion respecting another issue*, 960 S.W.2d 617 (Tex. 1997); *Bullock v. Marathon Oil Co.*, 798 S.W.2d 353, 357 (Tex. App.–Austin 1990), *no writ*; *Cf. Humble Oil & Refining Co. v. Calvert*, 414 S.W.2d 172 (Tex. 1967); *Sharp v. House of Lloyd, Inc.*, 815 S.W.2d 245 (Tex. 1991); *Southwestern Life Ins. Co. v. Montemayor*, 24 S.W.3d 581 (Tex. App.–Austin 2000), *pet. denied*; and *Coastal Indust. Water Auth. v. Trinity Portland Cement Div.*, 563 S.W.2d 916 (Tex. 1978).

As discussed, this rulemaking action implements requirements of 42 USC, §7410. There is no contract or delegation agreement that covers the topic that is the subject of this action. Therefore, the rulemaking does not exceed a standard set by federal law, exceed an express requirement of state law, exceed a requirement of a delegation agreement, nor is it adopted solely under the general powers of the agency. Finally, this rulemaking action was not developed solely under the general powers of the agency, but is authorized by specific sections of THSC, Chapter 382 (also known as the Texas Clean Air Act), and Texas Water Code that are cited in the STATUTORY AUTHORITY section of this preamble, including THSC, §§382.011, 382.012, 382.014, 382.016, 382.017, 382.021, and 382.034. Therefore, this rulemaking action is not subject to the regulatory analysis provisions of Texas Government Code, §2001.0225(b), because the rulemaking does not meet any of the four applicability requirements.

The commission invites public comment regarding the draft regulatory impact analysis determination during the public comment period.

TAKINGS IMPACT ASSESSMENT

The commission completed a takings impact assessment for this rulemaking action under Texas Government Code, §2007.043. The proposed amendments to Chapter 101 and revisions to the SIP would phase out DERCs generated from shutdowns prior to September 30, 2002, require removal of DERCs generated from shutdowns after September 30, 2002, from the DERC registry, implement the provisions of SB 784, reorganize various rules, correct one citation, specify the time the EPA has to object to quantification protocols, eliminate future generation of shutdown DERCs, and add a reference to the highly-reactive volatile organic compound cap and trade program. Specifically, the banking and trading program amendments in this proposal were developed to implement the provisions of SB 784, limit the use of DERCs generated from shutdowns to comply with federal requirements, and make several administrative changes. Promulgation and enforcement of the proposed amendments will not burden private real property. The proposed rules do not affect private property in a manner that restricts or limits an owner's right to the property that would otherwise exist in the absence of a governmental action. Additionally, the credits created under these rules are not property rights (§101.372(j)). Because DERCs are not property, phasing out shutdown DERCs does not constitute a taking. Consequently, this rulemaking action does not meet the definition of a takings under Texas Government Code, §2007.002(5).

Additionally, Texas Government Code, §2007.003(b)(4) provides that Chapter 2007 does not apply to this rulemaking action because it is reasonably taken to fulfill an obligation mandated by federal law. The changes regarding shutdown DERCs within this proposal were developed to meet the EPA conditional program approval so that these requirements can be approved into the SIP and used to meet NAAQS set by the EPA under 42 USC, §7409. States are primarily responsible for ensuring attainment and maintenance of NAAQS once the EPA has established them. Under 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, one purpose of this rulemaking action is to meet the air quality standards established under federal law as NAAQS. However, this rulemaking is only one step among many necessary for attaining the ozone NAAQS.

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 CMP. As required by §281.45(a)(3) and 31 TAC §505.11(b)(2), relating to Actions and Rules Subject to the Coastal Management Program, the commission's 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 rules of the Coastal Coordination Council, and determined that the action is consistent with the applicable CMP goals and policies. The CMP goal applicable to this

rulemaking action is the goal to protect, preserve, and enhance the diversity, quality, quantity, functions, and values of coastal natural resource areas (31 TAC §501.12(l)). No new sources of air contaminants will be authorized and the proposed revisions will maintain the same level of emissions control as the existing rules. The CMP policy applicable to this rulemaking action is the policy that the commission's rules comply with federal regulations in 40 Code of Federal Regulations, to protect and enhance air quality in the coastal areas (31 TAC §501.14(q)). This rulemaking action complies with 40 Code of Federal Regulations Part 51, Requirements for Preparation, Adoption, and Submittal of Implementation Plans. Therefore, in accordance with 31 TAC §505.22(e), the commission affirms that this rulemaking action is consistent with CMP goals and policies.

The commission solicits comments on the consistency of the proposed rulemaking with the CMP during the public comment period.

EFFECT ON SITES SUBJECT TO THE FEDERAL OPERATING PERMITS PROGRAM

The new and amended sections are applicable requirements under the Federal Operating Permits Program, but no revisions to operating permits will be required.

ANNOUNCEMENT OF HEARING

The commission will hold a public hearing on this proposal in Austin on May 22, 2006, at 2:00 p.m. in Building B, Room 201A, at the commission's central office located at 12100 Park 35 Circle. 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 be

permitted during the hearing; however, commission staff members will be available to discuss the proposal 30 minutes before the hearing and will answer questions before and after the hearing.

Persons who have special communication or other accommodation needs who are planning to attend the hearing should contact Lola Brown, Office of Legal Services, at (512) 239-0348. Requests should be made as far in advance as possible.

SUBMITTAL OF COMMENTS

Comments may be submitted to Lola Brown, Texas Register Team, Office of Legal Services, MC 205, P.O. Box 13087, Austin, Texas 78711-3087, or faxed to (512) 239-4808. Comments must be received by 5:00 p.m., May 30, 2006, and should reference Rule Project Number 2005-054-101-PR. Copies of the proposed rules can be obtained from the commission's Web site at *http://www.tceq.state.tx.us/nav/rules/propose_adopt.html*. For further information, please contact Beecher Cameron, Air Permits Division, at (512) 239-1495 or Steve Sun, Air Permits Division, at (512) 239-3554.

SUBCHAPTER H: EMISSIONS BANKING AND TRADING

DIVISION 1: EMISSION CREDIT BANKING AND TRADING

§§101.302, 101.305, 101.306

STATUTORY AUTHORITY

The amended and new sections are proposed under Texas Water Code, §5.103, concerning Rules, and §5.105, concerning General Policy, that authorize the commission to adopt rules necessary to carry out its powers and duties under the Texas Water Code; and under Texas Health and Safety Code (THSC), §382.017, concerning Rules, that authorizes the commission to adopt rules consistent with the policy and purposes of the Texas Clean Air Act. The amended and new sections are also proposed under THSC, §382.002, concerning Policy and Purpose, that establishes the commission purpose to safeguard the state's air resources, consistent with the protection of public health, general welfare, and physical property; §382.011, concerning General Powers and Duties, that authorizes the commission to control the quality of the state's air; and §382.012, concerning State Air Control Plan, that authorizes the commission to prepare and develop a general, comprehensive plan for the control of the state's air. The amended and new sections are also proposed under THSC, §382.014, concerning Emission Inventory, that authorizes the commission to require a person whose activities cause air contaminant emissions to submit information to enable the commission to develop an emissions inventory; §382.016, concerning Monitoring Requirements, that authorizes the commission to prescribe reasonable requirements for the measuring and monitoring of air contaminant emissions; and §382.051 and §382.0518, concerning Permitting Authority of Commission and Preconstruction Permit, that authorize the commission to issue preconstruction and operating air permits. The amended and new

sections are also proposed under 42 USC, §7410(a)(2)(A), that requires state implementation plans to include enforceable measures or techniques, including economic incentives such as fees, marketable permits, and auction of emission rights.

The proposed amended and new sections implement THSC, §§382.002, 382.011, 382.012, and 382.017; and Senate Bill 784, 79th Legislature, 2005.

§101.302. General Provisions.

(a) Applicable pollutants. Reductions of criteria pollutants, excluding lead, or precursors of criteria pollutants for which an area is designated nonattainment, may qualify as emission credits. Reductions of one pollutant may not be used to meet the requirements for another pollutant, unless [:]

[(1)] urban airshed modeling demonstrates that one ozone precursor may be substituted for another, subject to executive director and United States Environmental Protection Agency (EPA) approval. [; or]

[(2) the facility generating the emission reductions is located outside the United States; and]

[(A) the substitution:]

[(i) results in a greater health benefit and is of equal or greater benefit to the overall air quality of the area, as determined by the executive director;]

[(ii) is from the reduction of an air contaminant for which the area has been designated as nonattainment or which leads to the formation of a criteria pollutant for which an area has been designated as nonattainment; and]

[(iii) is for any air contaminant for which the area has been designated as nonattainment or leads to the formation of a criteria pollutant for which the area has been designated as nonattainment; and]

[(B) the user:]

[(i) demonstrates that the use of the reduction does not cause localized health impacts, as determined by the executive director;]

[(ii) submits all supporting information for calculations and modeling, and any additional information requested by the executive director; and]

[(iii) is located within 100 kilometers of the Texas - Mexico border.]

(b) - (c) (No change.)

(d) Protocol.

(1) All generators or users of emission credits shall use a protocol that has been submitted by the executive director to the EPA for approval, if existing for the applicable facility or mobile source, to measure and calculate baseline emissions. If the generator or user wishes to deviate from a protocol submitted by the executive director, EPA approval is required before the protocol can be used. Protocols must be used as follows.

(A) - (B) (No change.)

(C) If the executive director has not submitted a protocol for the applicable facility or mobile source to the EPA for approval, the following requirements apply:

(i) - (v) (No change.)

(vi) quantification protocols shall not be accepted for use with this division <u>if the executive director receives a letter objecting to the use of the protocol from the EPA during the 45-day adequacy review or the EPA proposes disapproval of the protocol in the *Federal Register*</u> [after a proposed disapproval of the protocol by the EPA in the *Federal Register*].

(2) - (3) (No change.)

(e) (No change.)

(f) Geographic scope. Except as provided in §101.305 of this title (relating to Emission Reductions Achieved Outside the United States) [paragraph (3) of this subsection], only emission reductions generated in nonattainment areas can be certified. An emission credit must be used in the nonattainment area in which it is generated unless the user has obtained prior written approval of the executive director and the EPA; and[:]

(1) (No change.)

(2) the emission credit was generated in a nonattainment area that has an equal or higher nonattainment classification than the nonattainment area of use, and a demonstration has been made and approved by the executive director and the EPA to show that the emissions from the nonattainment area where the emission credit is generated contribute to a violation of the national ambient air quality standard in the nonattainment area of use. [; or]

[(3) a facility is using emission reductions generated outside the United States that have been determined by the executive director to be real, permanent, enforceable, quantifiable, and surplus to any applicable international, federal, state, or local law and the result would provide a greater health benefit to the area as determined by the executive director; and the facility:]

[(A) demonstrates that the use of the reduction does not cause localized health impacts, as determined by the executive director;]

[(B) submits all supporting information for calculations and modeling, and any additional information requested by the executive director; and]

[(C) is located within 100 kilometers of the Texas - Mexico border.]

(g) - (l) (No change.)

§101.305. Emission Reductions Achieved Outside the United States.

(a) A facility may use reductions achieved outside the United States of criteria pollutants or precursors of criteria pollutants if the facility meets the requirements of subsection (c) of this section.

(b) A facility may use reductions achieved outside the United States of criteria pollutants or precursors of criteria pollutants and substitute these reductions for reductions in other criteria pollutants if the facility meets the requirements of subsection (c) of this section; and

(1) the reduction is substituted for the reduction of another criteria pollutant if the substitution results in a greater health benefit and is of equal or greater benefit to the overall air quality of the area; or

(2) a reduction of an air contaminant for which the area in which the facility is located has been designated as nonattainment or which leads to the formation of a criteria pollutant for which an area has been designated as nonattainment is substituted for any air contaminant for which the area has been designated as nonattainment or leads to the formation of any criteria pollutant for which the area has been designated as nonattainment.

(c) The use of reductions outside the United States must be approved by the executive director and the United States Environmental Protection Agency, and the user of the emission reduction must:

(1) demonstrate to the executive director that the reduction is real, permanent, enforceable, quantifiable, and surplus to any applicable international, federal, state, or local law;

(2) demonstrate that the use of the reduction does not cause localized health impacts, as determined by the executive director;

(3) submit all supporting information for calculations and modeling, and any additional information requested by the executive director; and

(4) be located within 100 kilometers of the Texas - Mexico border.

(d) This section does not apply to reductions in emissions of lead.

§101.306. Emission Credit Use.

(a) Uses for emission credits. Unless precluded by a commission order or a condition or conditions within an authorization under the same commission account number, emission credits may be used as the following:

(1) - (4) (No change.)

(5) an annual allocation of allowances as provided in §101.356 and §101.399 of this title (relating to Allowance Banking and Trading);

(6) - (7) (No change.)

(b) - (c) (No change.)

SUBCHAPTER H: EMISSIONS BANKING AND TRADING

DIVISION 2: EMISSIONS BANKING AND TRADING ALLOWANCES

[§101.338]

STATUTORY AUTHORITY

The repeal is proposed under Texas Water Code, §5.103, concerning Rules, and §5.105, concerning General Policy, that authorize the commission to adopt rules necessary to carry out its powers and duties under the Texas Water Code; and under Texas Health and Safety Code (THSC), §382.017, concerning Rules, that authorizes the commission to adopt rules consistent with the policy and purposes of the Texas Clean Air Act. The repeal is also proposed under THSC, §382.002, concerning Policy and Purpose, that establishes the commission purpose to safeguard the state's air resources, consistent with the protection of public health, general welfare, and physical property; §382.011, concerning General Powers and Duties, that authorizes the commission to control the quality of the state's air; and §382.012, concerning State Air Control Plan, that authorizes the commission to prepare and develop a general, comprehensive plan for the control of the state's air. The repeal is also proposed under THSC, §382.014, concerning Emission Inventory, that authorizes the commission to require a person whose activities cause air contaminant emissions to submit information to enable the commission to develop an emissions inventory; §382.016, concerning Monitoring Requirements, that authorizes the commission to prescribe reasonable requirements for the measuring and monitoring of air contaminant emissions; and §382.051 and §382.0518, concerning Permitting Authority of Commission and Preconstruction Permit, that authorize the commission to issue preconstruction and operating air permits. The repeal is also proposed under 42 USC, §7410(a)(2)(A), that requires state

implementation plans to include enforceable measures or techniques, including economic incentives such as fees, marketable permits, and auction of emission rights.

The proposed repeal implements THSC, §§382.002, 382.011, 382.012, and 382.017; and Senate Bill 784, 79th Legislature, 2005.

§101.338. Emission Reductions Achieved Outside the United States.

SUBCHAPTER H: EMISSIONS BANKING AND TRADING

DIVISION 2: EMISSIONS BANKING AND TRADING ALLOWANCES

§101.338, §101.339

STATUTORY AUTHORITY

The new sections are proposed under Texas Water Code, §5.103, concerning Rules, and §5.105, concerning General Policy, that authorize the commission to adopt rules necessary to carry out its powers and duties under the Texas Water Code; and under Texas Health and Safety Code (THSC), §382.017, concerning Rules, that authorizes the commission to adopt rules consistent with the policy and purposes of the Texas Clean Air Act. The new sections are also proposed under THSC, §382.002, concerning Policy and Purpose, that establishes the commission purpose to safeguard the state's air resources, consistent with the protection of public health, general welfare, and physical property; §382.011, concerning General Powers and Duties, that authorizes the commission to control the quality of the state's air; and §382.012, concerning State Air Control Plan, that authorizes the commission to prepare and develop a general, comprehensive plan for the control of the state's air. The new sections are also proposed under THSC, §382.014, concerning Emission Inventory, that authorizes the commission to require a person whose activities cause air contaminant emissions to submit information to enable the commission to develop an emissions inventory; §382.016, concerning Monitoring Requirements, that authorizes the commission to prescribe reasonable requirements for the measuring and monitoring of air contaminant emissions; and §382.051 and §382.0518, concerning Permitting Authority of Commission and Preconstruction Permit, that authorize the commission to issue preconstruction and operating air permits. The new sections are also proposed under 42 USC,

§7410(a)(2)(A), that requires state implementation plans to include enforceable measures or techniques, including economic incentives such as fees, marketable permits, and auction of emission rights.

The proposed new sections implement THSC, §§382.002, 382.011, 382.012, and 382.017; and Senate Bill 784, 79th Legislature, 2005.

§101.338. Emission Reductions Achieved Outside the United States.

(a) A grandfathered or electing electric generating facility (EGF) may use reductions achieved outside the United States of criteria pollutants or precursors of criteria pollutants if the facility meets the requirements of subsection (c) of this section.

(b) A grandfathered or electing EGF may use reductions achieved outside the United States of criteria pollutants or precursors of criteria pollutants and substitute these reductions for reductions in other criteria pollutants if the facility meets the requirements of subsection (c) of this section; and

(1) the reduction is substituted for the reduction of another criteria pollutant if the substitution results in a greater health benefit and is of equal or greater benefit to the overall air quality of the area; or

(2) a reduction of an air contaminant for which the area in which the facility is located has been designated as nonattainment or which leads to the formation of a criteria pollutant for which an area has been designated as nonattainment is substituted for any air contaminant for which the area has been designated as nonattainment or leads to the formation of any criteria pollutant for which the area has been designated as nonattainment.

(c) The use of reductions outside the United States must be approved by the executive director and the United States Environmental Protection Agency, and the user of the emission reduction must:

(1) demonstrate to the executive director that the reduction is real, permanent, enforceable, quantifiable, and surplus to any applicable international, federal, state, or local law;

(2) demonstrate that the use of the reduction does not cause localized health impacts, as determined by the executive director;

(3) submit all supporting information for calculations and modeling, and any additional information requested by the executive director; and

(4) be located within 100 kilometers of the Texas - Mexico border.

(d) This section does not apply to reductions in emissions of lead.

§101.339. Program Audits and Reports.

(a) No later than three years after the effective date of this division, and every three years thereafter, the executive director will audit this program.

(1) The audit will evaluate the impact of the program on the state's ozone attainment demonstration, the availability and cost of allowances, compliance by the participants, and any other elements the executive director may choose to include.

(2) The executive director will recommend measures to remedy any problems identified in the audit. The trading of allowances may be discontinued by the executive director in part or in whole and in any manner, with commission approval, as a remedy for problems identified in the program audit.

(3) The audit data and results will be completed and submitted to the United States Environmental Protection Agency (EPA) and made available for public inspection within six months after the audit begins.

(b) No later than September 30 following the end of each control period, the executive director shall develop and make available to the general public and EPA, a report that includes:

(1) number of allowances allocated to each compliance account;

(2) total number of allowances allocated under this division;

(3) number of actual nitrogen oxides (NO_x) allowances subtracted from each compliance account based on the actual NO_x emissions from the site; and

(4) a summary of all trades completed under this division.

SUBCHAPTER H: EMISSIONS BANKING AND TRADING

DIVISION 4: DISCRETE EMISSION CREDIT BANKING AND TRADING

§§101.372, 101.373, 101.375, 101.376, 101.378

STATUTORY AUTHORITY

The amended and new sections are proposed under Texas Water Code, §5.103, concerning Rules, and §5.105, concerning General Policy, that authorize the commission to adopt rules necessary to carry out its powers and duties under the Texas Water Code; and under Texas Health and Safety Code (THSC), §382.017, concerning Rules, that authorizes the commission to adopt rules consistent with the policy and purposes of the Texas Clean Air Act. The amended and new sections are also proposed under THSC, §382.002, concerning Policy and Purpose, that establishes the commission purpose to safeguard the state's air resources, consistent with the protection of public health, general welfare, and physical property; §382.011, concerning General Powers and Duties, that authorizes the commission to control the quality of the state's air; and §382.012, concerning State Air Control Plan, that authorizes the commission to prepare and develop a general, comprehensive plan for the control of the state's air. The amended and new sections are also proposed under THSC, §382.014, concerning Emission Inventory, that authorizes the commission to require a person whose activities cause air contaminant emissions to submit information to enable the commission to develop an emissions inventory; §382.016, concerning Monitoring Requirements, that authorizes the commission to prescribe reasonable requirements for the measuring and monitoring of air contaminant emissions; and §382.051 and §382.0518, concerning Permitting Authority of Commission and Preconstruction Permit, that

authorize the commission to issue preconstruction and operating air permits. The amended and new sections are also proposed under 42 USC, §7410(a)(2)(A), that requires state implementation plans to include enforceable measures or techniques, including economic incentives such as fees, marketable permits, and auction of emission rights.

The proposed amended and new sections implement THSC, §§382.002, 382.011, 382.012, and 382.017; and Senate Bill 784, 79th Legislature, 2005.

§101.372. General Provisions.

(a) Applicable pollutants. Reductions of volatile organic compounds (VOC), nitrogen oxides (NO_x), carbon monoxide (CO), sulfur dioxide (SO_2), and particulate matter with an aerodynamic diameter of less than or equal to a nominal ten microns (PM_{10}) may qualify as discrete emission credits as appropriate. Reductions of other criteria pollutants are not creditable. Reductions of one pollutant may not be used to meet the reduction requirements for another pollutant, unless[:]

[(1)] urban airshed modeling demonstrates that one may be substituted for another subject to approval by the executive director and the United States Environmental Protection Agency (EPA). [EPA; or]

[(2) the facility generating the emission reductions is located outside the United States and:]

[(A) the substitution:]

[(i) results in a greater health benefit and is of equal or greater benefit to the overall air quality of the area, as determined by the executive director;]

[(ii) is from the reduction of a criteria pollutant for which the area has been designated as nonattainment or which leads to the formation of a criteria pollutant for which an area has been designated as nonattainment; and]

[(iii) is for any criteria pollutant for which the area has been designated as nonattainment or leads to the formation of a criteria pollutant for which the area has been designated as nonattainment; and]

[(B) the user:]

[(i) demonstrates that the use of the reduction does not cause localized health impacts, as determined by the executive director;]

[(ii) submits all supporting information for calculations and modeling, and any additional information requested by the executive director; and]

[(iii) is located within 100 kilometers of the Texas - Mexico border.]

(b) - (c) (No change.)

(d) Protocol.

(1) All generators or users of discrete emission credits must use a protocol which has been submitted by the executive director to the EPA for approval, if existing for the applicable facility or mobile source, to measure and calculate baseline emissions. If the generator or user wishes to deviate from a protocol submitted by the executive director, EPA approval is required before the protocol can be used. Protocols shall be used as follows.

(A) - (B) (No change.)

(C) If the executive director has not submitted a protocol for the applicable facility or mobile source to the EPA for approval, the following applies:

(i) - (iii) (No change.)

(iv) the chosen quantification protocol shall be made available for public comment for a period of 30 days and shall be viewable on the commission's Web [web] site;

(v) (No change.)

(vi) quantification protocols shall not be accepted for use with this division (relating to Discrete Emission Credit Banking and Trading) if the executive director receives a letter objecting to the use of the protocol from the EPA during the 45-day adequacy review or the EPA proposes disapproval of the protocol in the *Federal Register* [after a proposed disapproval of the protocol by the EPA in the *Federal Register*].

(2) - (3) (No change.)

(e) (No change.)

(f) Geographic scope. Except as provided in paragraph (7) of this subsection and §101.375 of this title (relating to Emission Reductions Achieved Outside the United States) [paragraphs (7) and (8)

of this subsection], only emission reductions generated in the State of Texas may be creditable and used in the state with the following limitations.

(1) - (7) (No change.)

[(8) A facility may use discrete emission reductions generated outside the United States provided that the emission reductions are quantifiable, real, and surplus to any applicable international, federal, state, or local law and the result would provide a greater health benefit to the area as determined by the executive director. The applicant must:]

[(A) demonstrate that the use of the reduction does not cause localized health impacts, as determined by the executive director;]

[(B) submit all supporting information for calculations and modeling, and any additional information requested by the executive director; and]

[(C) be located within 100 kilometers of the Texas - Mexico border.]

(g) - (i) (No change.)

(j) Authorization to emit. A discrete emission credit created under this division is a limited authorization to emit the specified pollutants in accordance with the provisions of this section, the Federal Clean Air Act [FCAA], and the Texas Clean Air Act [TCAA], as well as regulations promulgated thereunder. A discrete emission credit does not constitute a property right. Nothing in this division should be construed to limit the authority of the commission or the EPA to terminate or limit such authorization.

(k) - (m) (No change.)

§101.373. Discrete Emission Reduction Credit Generation and Certification.

(a) Methods of generation.

(1) Discrete emission reduction credits (DERC) may be generated using one of the following methods or any other method that is approved by the executive director:

[(A) the permanent shutdown of a facility that causes a loss of capability to produce emissions;]

(A) [(B)] the installation and operation of pollution control equipment that reduces emissions below the level required of the facility; or

(B) [(C)] a change in the manufacturing process that reduces emissions below the level required of the facility.

(2) DERCs may not be generated by the following strategies:

(A) permanent or temporary shutdowns [temporary shutdown] or permanent curtailment of an activity at a facility;

(B) - (K) (No change.)

(b) - (d) (No change.)

§101.375. Emission Reductions Achieved Outside the United States.

(a) A facility may use discrete emission credits for reductions achieved outside the United States of criteria pollutants or precursors of criteria pollutants if the facility meets the requirements of subsection (c) of this section.

(b) A facility may use reductions achieved outside the United States of criteria pollutants or precursors of criteria pollutants and substitute these reductions for reductions in other criteria pollutants if the facility meets the requirements of subsection (c) of this section; and

(1) the reduction is substituted for the reduction of another criteria pollutant if the substitution results in a greater health benefit and is of equal or greater benefit to the overall air quality of the area; or

(2) a reduction of an air contaminant for which the area in which the facility is located has been designated as nonattainment or which leads to the formation of a criteria pollutant for which an area has been designated as nonattainment is substituted for any air contaminant for which the area has been designated as nonattainment or leads to the formation of any criteria pollutant for which the area has been designated as nonattainment.

(c) The use of reductions outside the United States must be approved by the executive director and the United States Environmental Protection Agency, and the user of the emission reduction must:

(1) demonstrate to the executive director that the reduction is real, permanent, enforceable, quantifiable, and surplus to any applicable international, federal, state, or local law;

(2) demonstrate that the use of the reduction does not cause localized health impacts, as determined by the executive director;

(3) submit all supporting information for calculations and modeling, and any additional information requested by the executive director; and

(4) be located within 100 kilometers of the Texas - Mexico border.

(d) This section does not apply to reductions in emissions of lead.

§101.376. Discrete Emission Credit Use.

(a) - (b) (No change.)

(c) Discrete emission credit use prohibitions. A discrete emission credit may not be used under this division:

(1) - (3) (No change.)

(4) to allow an emissions increase of an air contaminant above a level authorized in a permit or other authorization that exceeds the limitations of §106.261 [§106.261(3) or (4) or §106.262(3)] of this title (relating to Facilities (Emission Limitations) [; and Facilities (Emission and Distance Limitations)]) except as approved by the executive director. This paragraph does not apply to limit the use of discrete emission reduction credits (DERC) or mobile discrete emission reduction credits in lieu of allowances under §101.356(h) of this title;

(5) - (6) (No change.)

(d) - (e) (No change.)

§101.378. Discrete Emission Credit Banking and Trading.

(a) (No change.)

(b) Life of a discrete emission credit. A discrete emission credit is available for use after the DEC-1 Form, Notice of Generation and Generator Certification of Discrete Emission Credits, has been received, deemed creditable by the executive director, and deposited in the commission credit registry in accordance with subsection (a) of this section, and may be used anytime thereafter except as stated

in this subsection. All credits are deposited in the credit registry and reported as available credits until they are used or withdrawn.

(1) Discrete emission credits generated from shutdown strategies prior to September 30, 2002, will be available for use until September 8, 2010.

(2) Discrete emission credits certified from facility shutdowns after September 30, 2002, may not be used.

(c) (No change.)