



Emergency Regulation Agency Background Document

Approval authority name	State Air Pollution Control Board
Primary action	9 VAC 5-140
Secondary action(s)	None
Regulation title	Regulation for Emissions Trading
Action title	NO _x Budget Trading Program Set-aside Auctions (Rev. F02)
Document preparation date	December 8, 2003

This information is required for executive review (www.townhall.state.va.us/dpbpages/apaintro.htm#execreview) and the Virginia Registrar of Regulations (legis.state.va.us/codecomm/register/regindex.htm), pursuant to the Virginia Administrative Process Act (www.townhall.state.va.us/dpbpages/dpb_apa.htm), Executive Orders 21 (2002) and 58 (1999) (www.governor.state.va.us/Press_Policy/Executive_Orders/EOHome.html), and the *Virginia Register Form, Style, and Procedure Manual* (http://legis.state.va.us/codecomm/register/download/styl8_95.rtf).

Preamble

The APA (Section 2.2-4011) states that an "emergency situation" is: (i) a situation involving an imminent threat to public health or safety; or (ii) a situation in which Virginia statutory law, the Virginia appropriation act, or federal law requires that a regulation shall be effective in 280 days or less from its enactment, or in which federal regulation requires a regulation to take effect no later than 280 days from its effective date. Please explain why this is an "emergency situation" as described above.

Subparagraph D 1 of Item 383 of Chapter 1042, 2003 Acts of Assembly, in part, provides the following: "The Department of Environmental Quality may auction the NO_x emissions credits allocated under the NO_x SIP call as set asides for new sources and any revenue generated shall be deposited to the general fund of the state treasury." Subparagraph D 2 continues on to say: "The State Air Pollution Control Board may promulgate emergency regulations to implement the provisions of the preceding subparagraph." Although there is no emergency situation, subparagraph D 2 provides explicit authority for the use of the emergency regulation procedure.

Summary

Please provide a summary of the key provisions of the new regulation or substantive changes to an existing regulation.

The regulation establishes a NO_x Budget Trading Program as a means of mitigating the interstate transport of ozone and nitrogen oxides including the following provisions: permitting allowance methodology, monitoring, banking, compliance supplement pool, compliance determination and opt-in provisions for sources not covered by the regulation.

Beginning May 31, 2004, electric generating units with a nameplate capacity greater than 25 MWe and non-electric generating units above 250 mmBtu will be subject to the provisions of the regulation. NO_x emissions from subject units shall be subject to a specific limited budget (measured in tons) during the summer months of May 1 through September 31, otherwise known as the control period. The NO_x budget shall be determined through a methodology based upon emission rates multiplied by heat input. If a unit does not use all of its allowances for a specific control period, those extra tons may be banked for future use or sold. If a unit exceeds the budget limit, additional allowances may be purchased or the source may use banked allowances to offset the amount of NO_x generated above the budget limit.

An allocation set-aside budget is available to accommodate new sources that receive permits and commence operation after the distribution to the qualifying units (those in operation at least two years before the distribution date).

Emissions will need to be monitored according to 40 CFR Part 75 for all sources subject to the regulation and for any sources wishing to opt-in to the program.

A compliance supplement pool is provided for sources that generate early reduction credits or demonstrate "undue risk". The allowances from the pool are good for only two years and cannot be banked after that two-year period.

Amendments to 9 VAC 5-140 (the addition of 9 VAC 5-140-421) provide for conducting an auction of the set-aside budget allowances. The amendments clearly identify that if an auction is conducted, the current process of requesting and receiving set aside allowances on a pro-rata basis (9 VAC 5-140-420) is vacated and identify the overriding legal authority to conduct an auction. The amendments also identify the parameters of how an auction will be conducted including, in part, who can bid in an auction, what will be auctioned, how the bids will be paid for and what happens to any unsold allowances.

Statement of Final Agency Action

The State Air Pollution Control Board adopted the emergency regulation at its meeting on December 8, 2003.

Statutory Authority and Legal Basis

Please confirm that the Office of the Attorney General has certified that the agency has the statutory authority to promulgate the emergency regulation. Also, please indicate that the regulation is not otherwise exempt under the provisions of subdivision A.4 of Section 2.2-4006 of the APA.

Section 10.1-1308 of the Virginia Air Pollution Control Law (Title 10.1, Chapter 13 of the Code of Virginia) authorizes the State Air Pollution Control Board to promulgate regulations abating, controlling and prohibiting air pollution in order to protect public health and welfare. Section 10.1-1322.3 indicates that the Board may promulgate regulations to provide an emissions trading and banking program that results in net air emission reductions, creates an economic incentive for reducing air emissions, and allows for economic growth. However, no regulation shall prohibit the direct trading of credits or allowances

between private industries provided such trades do not adversely impact air quality in Virginia. Section 10.1-1322.3 also provides that the regulations applicable to the electric power industry shall provide new source set-asides of five percent for the first five plan years and two percent per year thereafter. Paragraph D of Item 383 of Chapter 1042 of the 2003 Acts of Assembly authorizes the Department of Environmental Quality to auction the set aside credits created in the NOx SIP Call.

Written assurance from the Office of the Attorney General that the State Air Pollution Control Board possesses the statutory authority to promulgate the proposed regulation amendments is available upon request.

The regulation amendments do not otherwise qualify as an exemption under the provisions of § 2.2-4006 A 4 of the APA.

Substance

Please detail any changes that are proposed. Please outline new substantive provisions, all substantive changes to existing sections, or both where appropriate. Set forth the specific reasons the agency has determined that the proposed regulatory action is essential to protect the health, safety, or welfare of Virginians. Delineate any potential issues that may need to be addressed as a permanent final regulation is developed.

New section number	New requirement	Rationale for new requirement
421 A	Vacates the procedures for distribution of the NO _x allocation set-aside budget in 9 VAC 5-140-420 only for the year or years that an auction of set-aside budget takes place.	Necessary to ensure that no regulatory conflict will exist during the time an auction is conducted for the distribution of the set-aside budget.
421 B	Under the authority of the Appropriations Act or any other provision of the Code of Virginia, the department may auction the NO _x allocation set-aside budget.	Provides the authority to conduct the auction.
421 C	Only NO _x authorized account representatives with an NO _x Allowance Tracking System account number may submit bids in the auction.	Necessary so that EPA can maintain records of all allowances in the regional NO _x program.
421 D	The department may set a reserve price for any auction and may hold additional auctions for any unsold allowances. For purposes of this section, reserve price is the minimum price that the department is willing to accept for an allowance. The reserve price is established prior to any auction, and the department is under no obligation to disclose the reserve price.	Necessary to ensure greatest revenue.
421 E	The auction will be limited to vintage 2004 and 2005 allowances.	Necessary to identify which allowances will be auctioned.

421 F	Unsold allowances will be retired for environmental benefit.	Necessary to identify what will happen to any allowances not auctioned.
421 G	Prospective bidders shall use the bid forms and procedures made available by the department or the contractor prior to the auction.	Necessary to ensure consistency in the auction process.
421 H	The total value of any bid shall be secured by a certified check, unless the department, upon public notice, allows other forms of payment.	Necessary to ensure that bids for allocations are properly funded.
421 I	Winning bids are legally enforceable and are a firm, contractual obligations.	Necessary to ensure that those who have winning bids during an auction are required to actually pay that price.
421 J	The department will return payment from unsuccessful bids.	Necessary to clarify what will happen to certified checks of unsuccessful bids.
421 K	The department may solicit and hire a contractor to conduct the auction.	Necessary to ensure an auction is conducted properly and designed to meet the needs of the Commonwealth.

One of the primary goals of the federal Clean Air Act (Act) is the attainment and maintenance of the National Ambient Air Quality Standards (NAAQS) and the prevention of significant deterioration (PSD) of air quality in areas cleaner than the NAAQS.

The Act gives the U.S. Environmental Protection Agency (EPA) the authority to establish the NAAQS, which are designed to protect the health of the general public with an adequate margin of safety. The NAAQS establish the maximum limits of pollutants that are permitted in the ambient air. The Act requires that each state submit a plan (called a State Implementation Plan or SIP), including any laws and regulations necessary to enforce the plan, showing how the air pollution concentrations will be reduced to levels at or below these standards (i.e., attainment). Once the pollution levels are within the standards, the plan must also demonstrate how the state will maintain the air pollution concentrations at reduced levels (i.e., maintenance).

In 1979, EPA established a NAAQS for ozone of 0.12 parts per million (ppm). This standard was based on a 1-hour averaging period and is commonly called the 1-hour standard. When concentrations of ozone in the ambient air exceed the federal standard the area is considered to be out of compliance and is designated as "nonattainment." Numerous counties and cities within the Commonwealth have at one time been identified as ozone nonattainment areas according to the Act. Currently, only the Northern Virginia area is a nonattainment area for the 1-hour standard.

The Act has a process for evaluating the air quality in each region and identifying and classifying each nonattainment area according to the severity of its air pollution problem. There are five nonattainment area classifications called marginal, moderate, serious, severe and extreme. Marginal areas are subject to the least stringent requirements and each subsequent classification (or class) is subject to successively more stringent control measures. Areas in a higher classification of nonattainment must meet the mandates of the lower classifications plus the more stringent requirements of its own class. If a particular area fails to attain the federal standard by the legislatively mandated attainment date, EPA is required to reassign it to the next higher classification level (denoting a worse air quality problem), thus subjecting the area to more stringent air pollution control requirements. The Northern Virginia Ozone Nonattainment Area is classified as serious and therefore has to meet the requirements for the marginal, moderate, and serious classes.

The Act contains comprehensive air quality planning requirements for areas that do not attain the federal air quality standard for ozone (that is, nonattainment areas). Once the nonattainment areas were defined, each state was then obligated to submit a SIP revision or plan demonstrating how it will attain the air quality standard in each nonattainment area. Failure to develop adequate plans to meet the ozone air

quality standard: (i) will result in the continued violations of the standard, (ii) may result in assumption of air quality programs by EPA at which time the Commonwealth would lose authority over matters affecting its citizens, and (iii) may result in the implementation of sanctions by EPA, such as more restrictive requirements on new major industrial facilities and loss of federal funds for highway construction.

The heart of the plan is the control strategy. The control strategy describes the measures to be used by the state to attain and maintain the air quality standards. There are three basic types of measures: stationary source control measures, mobile source control measures, and transportation source control measures. Stationary source control measures are directed at emissions primarily from commercial/industrial facilities and operations. Mobile source control measures are directed at tailpipe and other emissions from motor vehicles, and transportation source control measures affect motor vehicle location and use. The Act encourages the use of market-based programs to facilitate the attainment of the milestones and goals in the SIP. One market-based program to assist in meeting these goals is emissions trading.

Emissions trading consists of bubbles, netting, offsetting and emissions reduction credit banking. These steps involve the creation of surplus emissions reduction credits at sources of air pollution for use to meet SIP air pollution control requirements by the same or other sources. The source creating the emission reduction credit could either sell (trade) the credit to another source or store (bank) the credit for later use or sale. Such a program can provide more flexibility to meet environmental requirements, thus reducing costs and encouraging faster compliance. Moreover, the development of generic trading rules enables states to expedite the attainment of SIP goals and eliminates the need for case-by-case review of emission trading projects. New and existing sources can take advantage of emissions trading. In order to obtain an air quality permit in some air quality areas, new industry and existing industry that is significantly expanding or modifying its operations must find credits to offset the amount of new pollution released so there is no net increase in pollution levels in the area.

Properly utilized, emissions trading can provide more flexibility for both new and existing industry to meet environmental requirements, while reducing pollution control costs and encouraging faster compliance with regulatory requirements. Emissions trading can also provide an incentive for industry to install innovative pollution control equipment and increase pollution prevention efforts.

Many areas within the eastern half of the United States petitioned EPA regarding their inability to achieve the ozone standard due to significant amounts of ozone and oxides of nitrogen (NO_x), a precursor to ozone, being transported across state boundaries. EPA made a determination (Finding of Significant Contribution and Rulemaking for Certain States in the Ozone Transport Assessment Group Region for Purposes of Reducing Regional Transport of Ozone; 63 FR 57356, October 27, 1998) that sources in 22 states and the District of Columbia emitted NO_x in amounts that significantly contribute to nonattainment of the ozone NAAQS in one or more downwind states. EPA also required that each of the affected upwind jurisdictions (sometimes referred to as upwind states) submit SIP revisions prohibiting those amounts of NO_x emissions which significantly contribute to downwind air quality problems. Virginia was included as one of the upwind states.

The rulemaking, known as the NO_x SIP call rule (40 CFR 51.121), also includes statewide NO_x emissions budget levels that each state must achieve by the year 2007. Furthermore, the NO_x SIP call rule identifies specific source categories that are covered by the budget. Failure to achieve the budget will result in a Federal Implementation Plan (FIP) for which EPA has also published final regulations, (40 CFR Part 97).

The NO_x SIP Call Final Rule (the Rule) identified jurisdictions which had substantially inadequate SIPs to comply with requirements of the Clean Air Act that address interstate transport of nitrogen oxides. These jurisdictions have NO_x emissions in amounts that contribute significantly to nonattainment in one or more other states with respect to the 1-hour ozone national ambient air quality standards. The Rule mandated that, for each jurisdiction identified, a SIP revision be submitted to EPA that imposed enforceable mechanisms to assure that, collectively, all sources identified in the budget, will not exceed the NO_x emissions projected for the year 2007 ozone season. The SIP revisions must include control measures

to limit the amount of NO_x so that the jurisdiction's budget is not exceeded. The control measures must be implemented no later than May 1, 2003 (later adjusted by the United States Court of Appeals for the District of Columbia Circuit to May 31, 2004). Emission reductions used to demonstrate compliance with the revision must occur during the ozone season. The revision must include a description of enforcement methods including monitoring compliance with each selected control measure and procedures for handling violations. For large electric generators and industrial boilers, the control measures must include a NO_x mass emissions cap on each source, and impose a NO_x emission rate so that the State can comply with the 2007 ozone NO_x budget.

The NO_x SIP call rule permits the states to include an allowance trading program as an option in their SIP revisions. This element is allowed under 40 CFR 51.121(p) and is contained in both 40 CFR Part 96 and 40 CFR Part 97 of the federal NO_x SIP Call rules. The allowance trading system is very similar to the emissions trading system described above in this notice except the geographic area is different and the pollutant and sources covered are limited as described in the preceding paragraph. For this reason the allowance trading system is classified as a closed market trading system.

Virginia submitted its response to the federal NO_x SIP Call to the EPA in June of 2002. The Virginia program provides for a new source set aside for sources that are not part of the initial allocation process. By the Acts of Assembly, the General Assembly authorized the Department of Environmental Quality to auction the allocations reserved for the new source set aside.

Alternatives

Please describe all viable alternatives to the proposed regulatory action that have been or will be considered to meet the essential purpose of the action.

The Department determined that the first alternative is appropriate, as it is the least burdensome and least intrusive alternative that fully meets the purpose of the regulation. The alternatives considered by the Department, along with the reasoning by which the Department has rejected any of the alternatives being considered, are discussed below.

1. Amend the regulations to satisfy the provisions of the law and associated regulations and policies. This option is being selected because it provides an affirmative response to the directive in Paragraph D of Item 383 of Chapter 1042 of the 2003 Acts of Assembly.
2. Make alternative regulatory changes to those required by the provisions of the law and associated regulations and policies. This option is not being selected because it would not necessarily meet the stated requirements as set forth in the Acts of Assembly.
3. Take no action to amend the regulations and continue to operate under the current regulations. This option is not being selected because it clearly would not be consistent with the intent of the General Assembly as set forth in the Acts of Assembly.

Family impact

Please assess the impact of the emergency regulatory action on the institution of the family and family stability including to what extent the regulatory action will: (1) strengthen or erode the authority and rights of parents in the education, nurturing, and supervision of their children; (2) encourage or discourage economic self-sufficiency, self-pride, and the assumption of responsibility for oneself, one's spouse, and one's children and/or elderly parents; (3) strengthen or erode the marital commitment; and (4) increase or decrease disposable family income.

It is not anticipated that these regulation amendments will have a direct impact on families. However, there will be positive indirect impacts in that the regulation amendments will ensure that the Commonwealth's air pollution control regulations will function as effectively as possible, thus contributing to reductions in related health and welfare problems.

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