

**TENTATIVE AGENDA  
STATE AIR POLLUTION CONTROL BOARD SPECIAL  
MEETING VIA ELECTRONIC COMMUNICATIONS  
MONDAY, DECEMBER 8, 2003**

**DEPARTMENT OF ENVIRONMENTAL QUALITY OFFICES AT  
629 EAST MAIN STREET  
RICHMOND, VIRGINIA  
And  
13901 CROWN COURT  
WOODBIDGE, VIRGINIA  
And  
3019 PETERS CREEK ROAD  
ROANOKE, VIRGINIA**

Convene - 10:00 A.M.

**I. Regulations - Emergency**

Virginia NOx Budget Trading Program - Emergency Auction Regulation  
Major  
(Rev. F02)

**ADJOURN**

**NOTE:** The Board reserves the right to revise this agenda without notice unless prohibited by law. Revisions to the agenda include, but are not limited to, scheduling changes, additions or deletions. Questions arising as to the latest status of the agenda should be directed to Cindy M. Berndt at (804) 698-4378.

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**SUBJECT:** Emissions Trading, Virginia NOx Budget Trading Program (9 VAC 5 Chapter 140, Rev. F02) - Public Participation Report and Request for Board Action on Emergency Regulation

**INTRODUCTION**

On May 21, 2002, the State Air Pollution Control Board adopted a regulation which establishes a NOx Budget Trading Program as a means of mitigating the interstate transport of ozone and nitrogen oxides. The regulation includes the following provisions: applicability, 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.

EPA has established an annual regional trading budget of NOx allowances (measured in tons) and

assigned each state a portion of the regional budget. The trading budget covers the summer months of May 1 through September 31, otherwise known as the control period. The Commonwealth is given the responsibility to allocate its portion of the NOx budget allowances to the affected units, including the set-aside for new sources required by §10.1-1322.3 of the Code of Virginia. The regulation includes provisions that codify Virginia's portion of the regional budget, an annual allowance budget for EGUs of 17,091 tons per control period and for nonEGUs, 4,104 tons per control period. The new source set-aside budget is 1,855 tons each control period for first five years (2004-2008); 1,342 tons each control period thereafter. EPA administers most other aspects of the trading program.

Affected units are allocated a portion of the Virginia NOx trading budget for each control period. The NOx allowance allocations are determined through a methodology based upon emission rates multiplied by actual heat input and distributed pro rata. Owners must have sufficient NOx allowances to cover the emissions from their affected units during the control period. If the allowances allocated by the state are insufficient, additional allowances may be purchased from the regional market or any banked allowances may be used to offset the amount of NOx generated above the allocated allowances. 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.

At the end of each control period, owners found to be out of compliance (i.e., actual emissions exceed the allowances in their account) will be forced to surrender allowances for the next year on a ratio of 3:1 (i.e., for every ton over the allowances in their account, three tons will be forfeited from the next year's allocation).

The Appropriations Act includes a provision to enable the auctioning of NOx emission credits. 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 NOx emissions credits allocated under the NOx 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. In addition, the Appropriations Act also includes \$8.8 million in the general revenue estimates based on auctioning the NOx emissions credits allocated as set-asides for new sources. Under the current regulation, distribution of set-aside is limited to newly permitted Virginia industries on a pro-rata basis.

The Department is recommending that the Board adopt emergency regulation amendments concerning the auctioning of the new source set-aside budget in order that the Commonwealth may be able to meet its obligations under the Appropriations Act in a timely manner.

Attached is a copy of the regulation followed by a copy of the agency background document which contains additional information that is the basis for the emergency regulatory action.

The emergency regulation will be enforced under applicable statutes and will remain in full force and effect for one full year from the effective date, unless sooner modified or vacated or superseded by permanent regulations adopted pursuant to the Administrative Process Act.

## **PUBLIC PARTICIPATION ACTIVITIES**

To solicit comment from the public on the proposed regulation amendments, the Department issued a notice that provided for receiving comment during a public comment period of 21 days. Responses to the public testimony will be provided at the Board meeting.

## **SUMMARY OF PROPOSAL**

Below is a brief summary of the proposal that is being recommended by the Department for emergency regulatory action. Any changes to the recommendation based on the public comments will be provided at the Board meeting.

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.

## **DEPARTMENT RECOMMENDATION**

It is recommended that the Board adopt the attached proposal, with the effective date being the date the regulation is confirmed as being filed with the Registrar of Regulations.

9 VAC 5 CHAPTER 140.  
REGULATION FOR EMISSIONS TRADING.

PART I.  
NO<sub>x</sub> Budget Trading Program.

ARTICLE 5.  
NO<sub>x</sub> Allowance Allocations.

9 VAC 5-140-421. Distribution of NO<sub>x</sub> allocation set-aside budget.

A. The procedures for distribution of the NO<sub>x</sub> allocation set-aside budget in 9 VAC 5-140-420 shall be vacated for any control period for which the distribution of any portion of the NO<sub>x</sub> allocation set-aside budget takes place under this section.

B. Under the authority of the Appropriations Act or any other provision of the Code of Virginia, the department may auction the NO<sub>x</sub> allocation set-aside budget.

C. Only NO<sub>x</sub> authorized account representatives with an NO<sub>x</sub> Allowance Tracking System account number may submit bids in the auction.

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.

E. The auction will be limited to vintage 2004 and 2005 allowances.

F. Unsold allowances will be retired for environmental benefit.

G. Prospective bidders shall use the bid forms and procedures made available by the department or the contractor prior to the auction.

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.

I. Winning bids are legally enforceable and are firm, contractual obligations.

J. The department will return payment from unsuccessful bids.

K. The department may solicit and hire a contractor to conduct the auction.



## Emergency Regulation Agency Background Document

<b>Approval authority name</b>	State Air Pollution Control Board
<b>Primary action</b>	9 VAC 5-140
<b>Secondary action(s)</b>	None
<b>Regulation title</b>	Regulation for Emissions Trading
<b>Action title</b>	NO <sub>x</sub> Budget Trading Program Set-aside Auctions (Rev. F02)
<b>Document preparation date</b>	Enter date this form is uploaded on the Town Hall

This information is required for executive review ([www.townhall.state.va.us/dpbpages/apaintro.htm#execreview](http://www.townhall.state.va.us/dpbpages/apaintro.htm#execreview)) and the Virginia Registrar of Regulations ([legis.state.va.us/codecomm/register/regindex.htm](http://legis.state.va.us/codecomm/register/regindex.htm)), pursuant to the Virginia Administrative Process Act ([www.townhall.state.va.us/dpbpages/dpb\\_apa.htm](http://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](http://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](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<sub>x</sub> emissions credits allocated under the NO<sub>x</sub> 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<sub>x</sub> 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<sub>x</sub> 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<sub>x</sub> 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<sub>x</sub> 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.

## 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 NO<sub>x</sub> 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 <sub>x</sub> 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 <sub>x</sub> allocation set-aside budget.	Provides the authority to conduct the auction.
421 C	Only NO <sub>x</sub> authorized account representatives with an NO <sub>x</sub> 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 <sub>x</sub> 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	Necessary to ensure consistency in the auction process.



	by the department or the contractor prior to the auction.	
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<sub>x</sub>), 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<sub>x</sub> 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<sub>x</sub> emissions which significantly contribute to downwind air quality problems. Virginia was included as one of the upwind states.

The rulemaking, known as the NO<sub>x</sub> SIP call rule (40 CFR 51.121), also includes statewide NO<sub>x</sub> emissions budget levels that each state must achieve by the year 2007. Furthermore, the NO<sub>x</sub> 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<sub>x</sub> 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<sub>x</sub> 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 NOx emissions projected for the year 2007 ozone season. The SIP revisions must include control measures to limit the amount of NOx 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 NOx mass emissions cap on each source, and impose a NOx emission rate so that the State can comply with the 2007 ozone NOx budget.

The NOx 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 NOx 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 NOx 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.*

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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.*

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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.