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File No. 018282-0000

Re: Regulatory Flexibility Group Comments on the 2007 Draft AQMP

Dear Mr. Cassmassi

Thank you for the opportunity to provide comments regarding the 2007 Draft Air Quality Management Plan. These comments are submitted on behalf of the Regulatory Flexibility Group, a coalition of Southern California businesses in the aerospace, automotive, electronics, energy and petrochemical sectors. The Regulatory Flexibility Group is committed to supporting strategies for achieving national air quality standards that are cost-effective and fairly allocated among all sectors of the Southern California economy.

We recognize that the District faces the unprecedented task of identifying innovative strategies for making further progress now that all, or nearly all, traditional strategies have been applied. The draft plan does an excellent job of identifying the potential range of options that the Board could consider for the final plan. Having reviewed these options, we provide below our comments regarding which approaches we believe the Board should pursue and which should be avoided.

### GENERAL COMMENTS

#### **1. The AQMP Should Rely to a Greater Extent on Incentive- and Market-Based Strategies.**

In recognition of the extent to which stationary sources already have been regulated over the past fifty-plus years, we believe that any further regulation should be incentive-based and should provide a wide range of compliance options for any further mandatory reductions. As most facilities already are at the point at which further regulation would occur at a relatively high cost, there is a significant risk that mandating further reductions (e.g., by imposing specific technology requirements or by prohibiting the use of certain coatings and solvents) could cause California businesses to incur costs that are well beyond those that would be considered reasonable relative to the corresponding environmental benefit. The Board has recognized various cost per ton thresholds as indicating the upper bound of expected cost as part of previous

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plans or programs. These levels usually have been in the range of up to \$15,000 per ton of pollutant reduced. This level is slightly above the level of \$10,000 per ton identified by President Clinton when the current national ambient air quality standards (NAAQS) for ozone and fine particulate matter were adopted. At that time, the President's Directive to EPA contained the following language:

*Cost-Effective Implementation Strategies*

*There is a strong desire to drive the development of new technologies with the potential of greater emission reduction at less cost. It was agreed that \$ 10,000 per ton of emission reduction is the high end of the range of reasonable cost to impose on sources. Consistent with the State's ultimate responsibility to attain the standards, the EPA will encourage the States to design strategies for attaining the PM and ozone standards that focus on getting low cost reductions and limiting the cost of control to under \$ 10,000 per ton for all sources. Market-based strategies can be used to reduce compliance costs. The EPA will encourage the use of concepts such as a Clean Air Investment Fund, which would allow sources facing control costs higher than \$ 10,000 a ton for any of these pollutants to pay a set annual amount per ton to fund cost-effective emissions reductions from non-traditional and small sources. Compliance strategies like this will likely lower the costs of attaining the standards through more efficient allocation, minimize the regulatory burden for small and large pollution sources, and serve to stimulate technology innovation as well.*

62 Fed. Reg. 38421, 38429 (July 18, 1997)(Presidential Documents, Memorandum of July 16, 1997, "Implementation of Revised Air Quality Standards for Ozone and Particulate Matter").

The President's Memorandum contains some important ideas, including the idea that air quality plans should be structured so as to provide maximum flexibility for sources as the cost of achieving further reductions approaches the upper bound of anticipated reasonable cost (e.g., \$10,000 per ton in the President's Memorandum, or \$15,000 per ton in the SCAQMD's own plans). Another important concept is the idea that such flexibility can be provided through market-based strategies, including the use of concepts such as the clean air investment fund. The SCAQMD has more experience with such funds than any other air quality control district in the nation, having initiated the idea through its Air Quality Investment Program under Regulation XXII. We believe that the District should rely heavily on such incentive- and market-based strategies to the extent it considers additional stationary source measures.

**2. The AQMP Should Include Demand-Side Strategies to a Greater Extent.**

In addition to using market and incentive-based approaches to a much greater extent, we believe that the District should seriously consider demand-side strategies. Air pollution programs, particularly in the mobile source and consumer product sectors, typically focus on the supply side. Regulations place the burden on fuel, engine and product manufacturers to make new products cleaner. These programs have assured the supply of a wide range of clean and often near-zero emission fuels, engines and products. But there is very little effort to influence

the demand side. So the penetration of clean fuels, engines and products remains small. The District and other air quality agencies have in recent years recognized the need to turn over existing fleets of dirtier on- and off-road engines, but their strategies typically rely on government subsidies to achieve this important social goal. The 2007 Plan should include strategies that further incentivize the turnover of the so-called legacy fleets, such as by providing that, in appropriate circumstances, reductions from such fleets should generate tradable emissions credits that could be used to meet a facility's (or product manufacturer's) own emission reduction obligations or to offset new source growth, among other potential purposes. The Plan should go beyond the use of such credit strategies to consider other potentially more powerful demand-side strategies, including approaches that send a direct signal to consumers in a way that can provide both information and an incentive to change behavior towards less-polluting activities.<sup>1</sup>

### **3. The AQMP Should Recognize the Limits and Risks Associated with the Current New Source Review Offset Program and Should Anticipate its Replacement.**

As a final general comment, we urge the District to recognize that the new (and modified) source offset program has served its useful purpose and now, regrettably, poses significant risk to the future California economy due to the extreme scarcity of surplus emission reductions. This scarcity is due to two primary factors – the high degree of control already imposed on existing stationary sources and the discounting mechanism that prevents the generation of emissions reduction credits (i.e., offsets) except to the extent that a facility reduces emissions beyond Best Available Control Technology (BACT) levels. Neither Congress, nor previous SCAQMD Boards, intended for the offset program to prevent new stationary source growth in the South Coast Air Basin, particularly when, as is the case here, such sources would be the cleanest sources in the region, and indeed in the world. We believe that the time has come either for the Board to eliminate the offset requirement or to set aside sufficient reductions from the Plan's other measures to permit appropriate new, clean source growth in the region. As the Board seeks additional Congressional support for authority to address mobile source emissions, it must speak candidly about the offset crisis and seek an appropriate amendment to the Clean Air Act.

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<sup>1</sup> One example of such a demand-side program is the vehicle emissions pricing program developed during the mid 1990s by the Coalition for Local Environmental Solutions and a Competitive Economy (COALESCE). Under the COALESCE program, drivers would be allocated baseline emissions reflecting the anticipated annual miles driven between home and work. Miles driven beyond the baseline level would be charged differentially based on the emissions characteristic of the vehicle. The program would provide for the return of funds in restricted form (e.g., a targeted use coupon) so that they could be transferred or retained for ultimate use to purchase or use clean or high-occupancy transportation or to retrofit vehicles to improve emissions performance.

## SPECIFIC COMMENTS

### 1. Facility Modernization (MCS-01)

We are very concerned about the proposal to set predetermined useful life limits on valuable equipment. Almost certainly this proposal would result in a significant loss of economic value and productive capacity for the region. Such an approach would likely have a significant adverse affect on employment, as some manufacturers, instead of replacing equipment, could choose simply to leave the region. The risk of a shortened equipment lifetime also would likely discourage many potential new businesses from ever locating facilities in the basin in the first place. Given that most of the larger pieces of equipment in the basin already are controlled, it is also likely that the incremental potential environmental benefits would not be warranted by the large cost involved in replacing the equipment. Because of these concerns, we are opposed to this measure. Before considering such a measure, the District must carefully evaluate the potential adverse impacts of such a measure on employment and business retention and growth in the region.

Recognizing that the District faces an unprecedented challenge in finding further avenues to reduce emissions even from the already well-controlled stationary source sector, the RFG companies have considered possible alternative approaches other than mandatory equipment replacement. Instead of imposing mandatory limits on equipment, we recommend that the District consider allocating the remaining black box responsibility to stationary sources on a "fair share" basis. By "fair share" we mean those remaining required emission reductions that reflect that sector's (or facility's) proportional share of the overall basin emissions inventory. Under this approach, a stationary source would not be responsible for achieving emission reductions that more properly should come from area or mobile sources. But it would be assigned its appropriate share of the region's "black box" remaining emission reductions.

Under our proposed fair share approach, a facility's responsibility could be calculated based on its reported emissions during a base year, or the responsibility could be assigned by category. Under a categorical approach, for example, a facility that emits 100 tons per year of a pollutant would be responsible for obtaining further emission reductions of "x" tons per year by some future year (e.g., 2015 for PM or 2024 for ozone). Given the high likely cost of finding further reductions within already well-controlled facilities, it would be important to provide facilities with the widest possible options for finding such reductions. Thus, each facility would have a range of compliance options, including the reduction of surplus emissions from company or employee vehicles, energy-efficiency measures, the generation or purchase of emission reduction credits from other sources in the region, investment in consumer-based strategies (including advertising to discourage high-polluting activities), investment in strategies to plug existing gaps in high-occupancy or low-emissions transportation, or any other measure that can be determined to be beneficial in reducing basin emissions. The menu of qualifying actions should be broad and creative, as we should encourage any strategy that might reduce emissions and this approach could offer a good laboratory for finding innovative strategies. Of course, the District could revise the menu over time as it learns which measures prove to be the most effective in reducing emissions.

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Finally, it would be important for such a program to offer a safe harbor, that is, some cost-effective means of compliance should other opportunities not be available. Our suggestion is that such a safe harbor may take the form of an emissions fee similar to the mitigation fee option that was provided to the power sector under RECLAIM. The fee would serve three purposes. First, it would provide a safe harbor option for compliance, assuring the region that businesses would not be required to pay unreasonable cost under the program. This assurance obviously will be important so as to preserve overall business investment in the region and to preserve vital employment opportunities. Second, it would create an ongoing incentive for conservation, as any facility certainly would seek opportunities to reduce emissions so as to reduce the required fee. Finally, the fee would provide a mechanism for aggregating funds for larger scale investment in emission reduction opportunities or low-emissions technologies. The fee could be administered either by the District or by one or more appropriate private sector entities, following certification by the District.

It is important to note that our proposed approach would **not** impose a cap on facility emissions. Should a facility's economic activity grow, emissions may rise at the facility (even if the emissions rate stays constant or drops). Under such circumstances, the facility would take on the larger emission reduction obligations that apply to a higher-level category. Of course, the program creates implicit pressure for reducing facility emissions, but permits the facility to find the most cost-effective means of reducing its fair share of the basin's black box emissions.

## **2. Energy Efficiency and Conservation (MCS-03)**

We support the use of incentives for energy efficiency and stand ready to work with the District to explore opportunities in this area. Should the new source review offset requirement stay in place, however, then we caution against claiming emission reduction credit in this category for the Plan, as that could make it difficult for sources to generate credits from energy-efficiency strategies.

## **3. All Feasible Measures (MCS-07), CTS-02 (Clean Coating Certification Program), and CTS-03 (Consumer Product Labeling)**

While continued technology advancement may warrant the further strengthening of retrofit rules in appropriate circumstances, we are very concerned about the potential imposition of even more restrictive limits in coating and solvent categories. Many of the District's coating and solvent regulations already have been revised on numerous occasions (e.g., SCAQMD Rule 1124, the aerospace coatings rule, has been amended 20 times since it was first adopted in 1979) and, in certain instances, the limits have become so stringent that the industry cannot find low-VOC coatings and solvents that also meet the strict requirements for high-performance applications. The net result of imposing even more stringent coating and solvent limits would likely be the continued, and probably the accelerated, loss to Southern California of important high-performance manufacturing activities, particularly in high-employment but low-emissions

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categories such as aerospace and electronics. Such a prospect would be very troubling at a time when our region needs jobs growth and, in our view, taking such risks would not be warranted by the tiny overall emissions benefits that further amendments would yield. We recommend instead the more flexible approach recommended above.

We are prepared to work with District staff to explore the voluntary coating strategies outlined in measures CTS-02 (Clean Coating Certification Program) and CTS-03 (Consumer Product Labeling and Emission Reductions from Use of Consumer Products at Institutional and Commercial Facilities). Consistent with our comments above regarding demand-side strategies, we generally support the use of labeling and certification strategies to encourage increased penetration of low-emitting products. Such programs can yield significant emission reductions without prohibiting the selective use of other products that may be needed to meet high-performance industrial specifications.

#### 4. RECLAIM (LTM-02)

We are concerned about the proposed long-term RECLAIM adjustments. We oppose the proposed Phase I reduction to address potential NO<sub>x</sub> increases due to changes in the natural gas supply. There is no basis of which we are aware on which the District could make an adjustment to the RECLAIM allowances for reasons other than a determination that RECLAIM sources can achieve further cost-effective and technologically feasible emission reductions. During testimony related to the previous RECLAIM amendments, we suggested that RECLAIM adjustments should be made incrementally based on long-term price performance in the RECLAIM market. The District rejected such an approach and instead stated its view that RECLAIM adjustments must be made in the same manner in which one would determine BARCT – that is, by evaluating available and cost-effective technology. Having taken that position, the District cannot now suggest that it would be appropriate to impose further reductions on RECLAIM sources to offset NO<sub>x</sub> increases that it believes may occur as a result of changes in natural gas supply. The Phase I reduction of 2.5 tons per day should be removed from the Plan.

We cannot comment at this time on the appropriateness of any Phase II reductions, without knowing more about the technological and economic basis for any proposed further reductions. As such further reductions are speculative at this time, we strongly recommend that the Plan not commit to achieve further reductions at this time. We do not believe that it is appropriate for the District to project a 3 to 5 ton per day further reduction on the basis of historical advances. Given the already high level of control on NO<sub>x</sub> sources in the RECLAIM program, there is no reason to believe that further technological advances of the magnitude experienced in the past could be replicated in the future. To the contrary, future reductions would be expected to be much lower given the advances already achieved.

#### **5. Compliance Flexibility Programs (FLX-01 and -02)**

For the reasons set forth above, we strongly support the increased use of compliance flexibility programs, including the intercredit trading program and the refinery pilot program. Achieving further reductions in the basin will become increasingly difficult and costly. If we are to preserve our remaining industrial base, it will be vitally important to provide regulated sources with the maximum degree of flexibility so that any further obligations can be achieved at the lowest cost. As noted in the draft AQMP, flexibility programs also encourage the development of advanced technologies and finance reductions from sources that otherwise cannot be regulated by traditional means.

#### **6. NOx Reductions from Non-RECLAIM Ovens, Dyers and Furnaces (CMB-01)**

We are prepared to work with District staff to determine the appropriate extent to which further NOx reductions can be achieved from small ovens, dryers and furnaces. We can support reductions from such sources if sufficient time is provided and if the cost-effectiveness of such reductions indeed falls below \$13,000 per ton NOx reduced. We urge the District to extend the compliance flexibility mechanisms of FLX-01 to such sources, including credit trading and a mitigation fee option, so that the business impact of the additional regulation can be minimized.

#### **7. PM Emission Hot Spots – Localized Control Programs (BCM-02)**

We support the localized control concept outlined in this measure for the reasons set forth in the draft Plan. We note, however, that many of the local strategies that might be considered in such an approach could be the only available sources of offsets for new source growth. As noted above, we urge the District to consider carefully how it will resolve the current offset crisis in the region. To the extent the offset requirement is retained in the basin, then we urge the District to exercise caution in implementing local strategies so as not to deprive new sources of a supply of emission reduction credits that could be needed as offsets.

#### **8. PM Emission Reductions from Under-Fired Charbroilers (BCM-05)**

We support the approach of further studying this category to determine whether further reductions would be cost-effective. We also concur that no tonnage commitment should be included at this time given the uncertainty regarding future technology. We suggest that any future measure should be focused on charbroilers that are used at facilities that are primarily in the restaurant business and should not apply to small scale charbroiler use at facilities whose primary business is not food preparation and sale.

## **9. Emissions Growth Management (New or Redevelopment Projects)(EGM-01,-02,-03)**

We agree with the District staff that regional development and its effect on transportation-related emissions should be an important component of the Plan. We also support the concept of building into the Plan mechanisms for accommodating future growth. As these mechanisms are developed, however, it will be important to ensure that there is sufficient accommodation for future growth so that the mechanisms do not inadvertently chill future development. We believe that the continued development and redevelopment of the region is one of the ways in which our region's overall energy and transportation design can be improved. We believe that the best way to harness future development activities so as to improve the overall functioning of our energy and transportation systems is to provide guidance to local and regional planning agencies and to developers regarding the air quality impacts of various development decisions. Projects that conform to good design should be rewarded with prompt approvals and minimum economic burden, while projects that do not should be required to provide appropriate mitigation. A fee can play an appropriate role in such a program, but it should be an element that can be avoided entirely if the developer or the jurisdiction demonstrates that the project will conform to design criteria or otherwise can demonstrate that the project will not result in significant adverse impacts on regional air quality.

If the region is ever to address transportation-related emissions, however, it is important for the District to consider demand-side strategies for the transportation sector. These could include concepts such as those proposed during the mid 1990s by the Coalition for Local Environmental Solutions and a Competitive Economy (COALESCE). Under the COALESCE proposal, drivers would receive a baseline allocation of miles representing employment-related mileage (e.g., annual miles between home and work). A differential fee would be imposed on miles traveled in excess of the baseline according to the emissions characteristics of the vehicle driven. So, for example, a well-maintained car would pay very little per mile, while a higher-emitting vehicle would pay more. Revenues collected would be returned in the form of a targeted use coupon. Coupons could be transferred freely but could be used only for improving vehicle performance (e.g., replace catalyst, repair oxygen sensor) or for public transportation (e.g., bus, train, shuttle). Although the amount charged alone would not individually be sufficient to alter driving behavior, the fee-bate strategy would educate drivers as to the air quality and congestion impacts of their decisions and the revenues collected in the aggregate could provide the necessary funding for new transportation services (e.g., home-to-transit linkage) that may be necessary to increase regional public transportation ridership. Over time, demand-side strategies of this type also could provide an important signal to encourage infill development, to reduce vehicle miles traveled for discretionary trips and to improve public transportation. Without a significant demand-side component, it is unlikely that any transportation strategy can deliver the benefits needed to bring the basin into attainment and to maintain that progress for the foreseeable future.

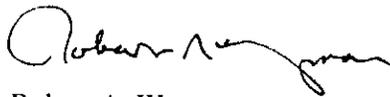
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**10. District's Mobile Source Control Measures (MOB-01,-02,-03,-04)**

We support the District's efforts to continue to address the relatively under-regulated mobile sources in the region, including the legacy fleets of engines in the region whose emissions disproportionately impact regional air quality. We look forward to further discussions with District staff regarding the strategies that will be considered under this series of measures. We raise here also, however, the same caution that we have identified above. The legacy fleet of engines has become one of the very few remaining sources of surplus emissions reductions. To the extent the District (or other agencies) regulate these engines, there may be no source of surplus emissions reductions for offset use by new and modified sources or for other entities who may need to obtain surplus credits (e.g., under the flexibility provisions proposed in the draft Plan). We do not believe that this concern should prevent the District or CARB from evaluating control opportunities under these mobile source categories, but we do believe that it will be important to re-evaluate the appropriateness of requiring stationary source offsets in a basin in which all sources become fully regulated. We urge the District to consider this relationship as part of the Plan.

Thank you sincerely for the opportunity to provide these comments. We look forward to further discussion regarding the Plan.

Sincerely,



Robert A. Wyman  
of LATHAM & WATKINS LLP