



April 14, 2025

South Coast Air Quality Management District
21865 Copley Drive
Diamond Bar, California 91765

Re: April 1, 2025, Draft PAR 1121

To Stationary Source Committee:

A. O. Smith Corporation (“A. O. Smith” or “Company”) appreciates the opportunity to provide comments on the April 1, 2025, Draft PAR 1121: Reduction of NO_x emissions from residential type, natural gas-fired water heaters (“PAR 1121”) by South Coast Air Quality Management District (“SCAQMD” or “District”). The Company appreciates the work that SCAQMD staff has invested in the development of this rule, including its commitment to listening to stakeholders. While the Company is supportive of SCAQMD’s overarching goals to reduce greenhouse gas (“GHG”) emissions in the District, it does have concerns with the mitigation fee structure proposed in the PAR.

I. About A. O. Smith

A. O. Smith Corporation, with global headquarters in Milwaukee, Wisconsin since 1874, applies technology and energy-efficient solutions to products manufactured and marketed worldwide with operations in the U.S., Canada, China, India, Mexico, the Netherlands, and the UK. Listed on the New York Stock Exchange (NYSE: AOS), the Company is one of the world’s largest manufacturers of residential and commercial water heating equipment and boilers, as well as a leading manufacturer of water treatment and air purification products. Along with its wholly owned subsidiaries, A. O. Smith is the largest manufacturer and seller of residential and commercial water heating equipment, high efficiency residential and commercial boilers, and pool heaters in North America.

II. Overview

On September 20, 2024, after six public working group meetings, SCAQMD published PAR 1121 draft rule language proposing zero-NO_x requirements for small water heaters with compliance dates of 2026 for new construction and 2027 for retrofits.¹ This draft rule language also provided several exceptions and alternate compliance options to address concerns regarding: mobile homes, emergency

¹ <https://www.aqmd.gov/docs/default-source/rule-book/Proposed-Rules/1111-and-1121/par-1121-preliminary-draft-rule-language.pdf>

replacements, and retrofits that would require construction. Following the publication of this draft rule language SCAQMD staff gathered a broad set of stakeholder feedback on the rule and published the Second PAR 1121 Draft Rule language on November 5, 2024.² This second draft rule language maintained the same zero-NOx compliance dates as the initial draft rule language but added additional compliance pathways for multifamily properties and water heaters for installation or use in existing buildings at High-Altitude. The Second draft also added more concrete labeling and record keeping requirements for “Rental Companies”. The Company is supportive of the Second Draft rule language.

During the eighth public working group meeting, District staff stated a need to modify the approach taken in the Second proposed rule to allow for consumer choice. The updated PAR 1121 added an alternative compliance pathway that would allow manufacturers to phase down the sale of gas-fired appliances in the District and sets a base mitigation fee of \$50 per gas-fired appliance sold into the District. Further the alternate compliance pathway would impose a \$250 mitigation fee per appliance sold outside of the District’s defined sales targets for zero-emission and NOx Emitting Units.³ In addition, this alternative compliance pathway would add reporting requirements to track all water heating appliance sales into the District, which is a level of information not currently tracked on these types of appliances to the level of granularity required by PAR 1121.

III. Mitigation fee

The use of mitigation fees is not new to the District and has been used in Rule 1121 in the past. However, the proposed mitigation fee structure in the pending proposal represents a significant departure from the District’s prior use and implementation of these fees. Previously, mitigation fees have been used when manufacturers were unable to produce the technology required to comply with the rule. The fees acted both to offset the impact of the increased stringency of NOx emissions levels by funding rebate programs for consumers but also acted as a regulatory catalyst to incentivize manufacturers to accelerate the manufacture, and subsequent sale of, products that comply with the more stringent standards.

The proposed PAR is fundamentally different from the existing structure as it seeks to compel a compliance outcome (i.e., fuel switching by a consumer) versus incentivizing manufacturers to develop new technology that would comply with a new or future standard. In this respect, manufacturers that wish to serve the SCAQMD market would be compelled to pay the mitigation fees. As the District knows, there is no commercially viable technology to enable gas-fired equipment to comply with a zero-NOx standard. Moreover, these products would still maintain a level of emissions that would be banned in other regions pursuing air quality standards, making a future investment thesis infeasible, which further undermines commercial viability. Hence, the proposed PAR would, under its own terms, add a \$300 per

² <https://www.aqmd.gov/docs/default-source/rule-book/Proposed-Rules/1111-and-1121/par-1121-second-preliminary-draft-rule-language.pdf>

³ The initially proposed mitigation fee was set at \$500 and subsequently reduced to \$250 in further updates to draft PAR 1121.

unit cost to gas-fired products (e.g., initial \$50 mitigation fee per unit plus an additional mitigation fee of \$250 per unit if a manufacturer misses its sales target in a given year). Given the current state of technology, and the District's intent to preserve consumer choice, the mitigation fees assessed on gas-fired products will be unavoidable for manufacturers.

A. Alternative Compliance Pathway

The Company recognizes that the mitigation fee structure only exists under the alternate compliance pathway. However, it also should be acknowledged that for manufacturers of both gas and electric products, the alternative compliance pathway may become more attractive as a means to comply with the proposed PAR while meeting market demand for its products. Manufacturers produce products, and along with their distribution partners, stock and sell products to meet market demand in a given geographic area. As long as gas-fired products remain an option for residents to utilize in the District, then it stands to reason that some manufacturers may not see the value of pursuing compliance with the base rule (i.e., the phase out approach) and instead opt to use the alternative compliance pathway as a mechanism to meet a continued market demand for gas-fired products.

B. Costs

The Company is concerned with the impact of the mitigation fees, as well as the newly proposed reporting requirements, which combined, will raise the cost of gas-fired products to the consumer. While manufacturers are investing heavily in the promotion of zero-emissions products and contractor training, as can be seen from the work done through the California Heat Pump Partnership and the Energy Star Manufacturer Action Council,^{4,5} manufacturers have minimal line of sight on where and when products are sold once they leave the manufacturing facility. The interplay between this dynamic and the rule's goal to change consumer behavior means that manufacturers, and ultimately District residents, will bear the increased costs to comply with the proposed PAR.

C. Recommendation

The Company would recommend that the District consider a different approach that would assist in meeting its NOx emission reduction goals, while also affording greater business certainty to manufacturers. In lieu of a tiered mitigation fee – (i.e., a base mitigation fee and an additional sales target fee) – that a single fee at the point of sale or point of installation on all gas-fired products sold into the market be utilized. This approach would be sufficient in driving market transformation toward zero-emission products, which will lower NOx emissions over time. By assessing this fee at the point of sale/installation, consumers will have greater transparency of the total cost of the products they are

⁴ <https://heatpumppartnership.org/>

⁵ https://www.energystar.gov/partner_resources/products_partner_resources/state-and-tribal-rebate-programs/connecting-partners/action

purchasing and the District can ensure that the mitigation fees on each NOx emitting appliance goes directly to the Go Zero Fund. It would also reduce the reporting burden required to comply with the proposed rule. This recommendation would provide transparency and consumer choice, while maximizing equity benefits through price transparency, while also addressing the importation into the District of non-compliant products to avoid paying the mitigation fee (i.e., leakage).

To implement this proposed recommendation, the mitigation fee would be assessed annually and be adjusted (e.g., lowered or raised) based on a demonstrated correlation that the mitigation fee is driving the market to reach the proscribed targets outlined by staff to obtain the necessary NOx emissions reductions. For example, if sales of zero-emission products increase at the rate the District deems sufficient to meet the emissions targets, the mitigation fees can remain at the same level for the following year. Conversely, if zero-emission sales are not increasing at a rate sufficient to meet the emissions target, the District could raise the fee.

If the District decides to maintain the rule as currently proposed, further guidance and regulatory reporting requirements will need to be established to ensure a uniform reporting structure that all impacted manufacturers must follow. Absent a standard for collecting data, there is a risk that bad actors find reporting loopholes to minimize reporting the amount of NOx emitting appliance sold into the District.

IV. Conclusion

The Company appreciates SCAQMD's goal to reduce NOx emissions in its District to ensure that it meets its requirements under the Clean Air Act. However, as currently drafted the Company cannot support the proposed PAR. Under the proposed PAR manufacturers will be challenged to accurately assess what their given market share is across product types within the District for the purpose of assessing market share-based mitigation fees. This is primarily due to the fact that the manufacturer does not know where or when its unit is ultimately sold to an end-consumer. Those final sales, in the aggregate, provide a more accurate measure of their share of the market. The proposed PAR 1121 will increase business uncertainty for manufacturers while raising the compliance costs associated with selling essential products for consumers' health and comfort in the District. The Company believes that by modifying the proposed PAR 1121 to a single point of sale/installation fee charged on all gas-fired appliances, that can be reassessed annually, the District can meet the goals of the rule while minimizing costs to consumers and maximizing the funds paid into the Go-Zero Fund.

The Company appreciates the opportunity to comment on the SCAQMD's draft rule language pertaining to NOx standards for small water heaters and looks forward to continuing the dialogue and working with the SCAQMD Staff throughout the rulemaking process.

Please do not hesitate to contact me if you have questions.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kyle Bergeron", with a stylized flourish at the end.

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