

## AIR RESOURCES BOARD

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San Joaquin Valley Unified  
Pollution Control District

September 29, 1993

David Howekamp, Director  
Air and Toxics Division  
U.S. EPA, Region IX  
75 Hawthorne Street  
San Francisco, CA 94105

Dear Mr. *Howekamp*:

The purpose of this letter is to express the Air Resources Board's (ARB) concern with the July 21, 1993, policy memorandum issued by John Seitz, Director of the Environmental Protection Agency (EPA) Office of Air Quality Planning and Standards providing guidance on the use of emission reduction credits (ERCs) from prior shutdowns (enclosed). This memorandum was discussed with you and representatives from my staff, and Sacramento Municipal Utility District (SMUD), Campbell Soup Company, Sacramento Metropolitan Air Quality Management District (SCMAQMD), and San Joaquin Valley Unified Air Pollution Control District (SJVAPCD) at meetings held on August 23, September 2, and September 3, 1993, at your offices in San Francisco.

The ARB appreciates EPA's guidance which would allow nonattainment areas (without approved attainment demonstrations) to follow the same shutdown restrictions applicable to areas with attainment demonstrations, during the interim period between the present and the date when EPA acts to approve or disapprove an attainment demonstration. However, along with this flexibility, EPA has outlined a policy which could severely devalue ERCs from prior shutdowns. The memorandum states "where appropriate, emissions reductions from source shutdowns or curtailments must be discounted to reflect reasonably available control technology (RACT), new source performance standards, or any other Act requirement applicable to the source or reasonably foreseeable at the time of use of emission reductions as offsets." This policy differs from the practices districts in California have used for banking ERCs. Districts usually perform a surplus determination for emission reductions at the time of deposit into the bank, not at the time of withdrawal and use.

At your request, we are providing information on why ARB believes EPA Region IX should exercise the discretion outlined in the July 21, 1993, policy memorandum to recognize that air pollution control districts

(districts) in California have programs which sufficiently assure that ERCs meet all applicable state and federal requirements, particularly the criteria that all ERCs are surplus.

The district emission reduction banking programs in California are based upon the 1986 Federal Emissions Trading Policy and California Health and Safety Code requirements and contain safeguards to prevent double-counting and assure ERCs are surplus. In general, district banking programs require that when emission reductions are evaluated and issued ERC certificates, specific criteria must be met:

- 1) Each emission reduction must be certified to be real, permanent, quantifiable, enforceable and surplus.
- 2) Each emission reduction must be compared against existing district rules and regulations as well as state and federal laws and regulations to determine if the reduction is surplus. This step requires the district to discount the ERC for RACT, and, if applicable, go further to discount the ERC for the California Clean Air Act requirement for Best Available Retrofit Control Technology (BARCT).
- 3) Each emission reduction must be compared against the measures identified in a district's air quality management plan, and if such measures require the emission reduction then it is not surplus and will not be granted an ERC.
- 4) If an ERC is issued prior to the baseline inventory and is not reflected as growth in the inventory, the district must adjust the baseline inventory to include the amount of the ERC in the inventory as emissions growth.
- 5) Districts have the option to impose a moratorium on the use of ERCs if the district is not making expeditious progress toward attainment of the ambient air quality standards.
- 6) Most districts do not claim emission reductions from New Source Review rules in air quality management plans even though an offset ratio of greater than one to one would result in emission reductions. NSR measures are shown as maintenance measures.

The ARB supports the concept of emission reduction banking as a means to facilitate emission trading required by district New Source Review rules. California has experienced a serious shortage of offsets and banking is a means to address this need and preserve emission reductions for future offset needs. Certainty is an important element to ensure stability of the banking system. Districts are required by regulation to perform proper procedures at the time of deposit to certify the value of the ERC for sale

in the emissions trading market. If ERCs are significantly devalued by applying RACT at the time of use, the entire credibility of the banking system is jeopardized and sources receive no assurance that banked emission reductions will be available for future use.

As an example, in 1986, Campbell Soup Company shut down three boilers and rebuilt one boiler and created approximately 100 tons of NOx ERCs. The ERCs were documented with the Sacramento Metropolitan AQMD and processed according to proper procedures. The ARB and the EPA were given an opportunity to review and comment on the transaction. No adverse comments were received from EPA, and ARB's concerns were addressed by the district. SMUD, acting under the assumption that the ERCs were valid and had longevity, used rate-payers money to purchase part of the ERCs from Campbell Soup at a cost of \$8.2 million. The ERCs are to be used to site cogeneration facilities in Sacramento being built to replace energy capacity lost due to the closure of the Rancho Seco nuclear power plant. The effect of the July 21, 1993 policy memorandum requiring the SMUD/Campbell Soup's ERCs to be discounted by RACT at the time of use will essentially eliminate the ERC value which SMUD purchased in good faith.

No company exercising good business judgement would ever purchase ERCs which could become worthless within an unforeseeable future time. This would also tend to discourage modernizations, since a valuable ERC would be rendered valueless on the open market.

ARB strongly urges EPA to exercise the discretion outlined in the July 21, 1993, memorandum to evaluate the effectiveness of California districts' ERC banking systems. EPA could then make a finding that California's banking programs meet the intent of the Emissions Trading Policy by assuring that ERCs are real, permanent, enforceable, quantifiable and surplus. Since districts perform an evaluation of RACT at the time of deposit, as well as an analysis of future measures in the district air quality management plans, it is legally unnecessary and unwise from an economic and policy perspective to RACT-adjust prior shutdown ERCs upon use.

If EPA OAQPS does not allow EPA Region IX flexibility and discretion in interpreting its policy memorandum, ARB is concerned that EPA is taking regulatory action outside the public participation process without allowing proper input from affected parties. We believe that the so-called "policy memorandum" is a substantive rule subject to notice and comment pursuant to either Section 307 (d)(i)(V) of the Clean Air Act or 5 U.S.C. Section 553.

At the very least, ARB recommends that EPA not make this policy retroactive to ERCs which have already been properly established through existing banking procedures. If EPA does not change its position and insists that shutdown credits be RACT-adjusted upon use, the policy should apply to future ERCs, so that companies affected by this policy will be aware of the rules and can act accordingly.

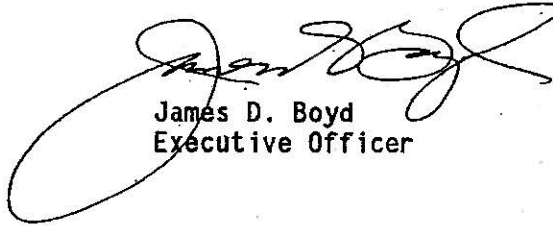
David Howekamp

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ARB appreciates this opportunity to provide information on California's ERC banking systems and we look forward to working closely with you and your staff to meet the intent of the July 21, 1993, policy memorandum. Please contact Mr. Peter Venturini at (916) 445-0650 if you would like further information or additional meetings to resolve this issue.

Sincerely,



James D. Boyd  
Executive Officer

Enclosure

cc: S. David Freeman, SMUD  
Norm Covell, Sacramento Metropolitan Air Quality Management District  
Ron Fermer, Campbell Soup Company  
David Crow, San Joaquin Valley Unified Air Pollution Control District