

Steven Douglas
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BEFORE THE AIR RESOURCES BOARD

**COMMENTS OF
THE ALLIANCE OF AUTOMOBILE MANUFACTURERS (THE ALLIANCE)**

**NOTICE OF PUBLIC HEARING TO CONSIDER AMENDMENTS TO CALIFORNIA'S
EMISSION WARRANTY INFORMATION REPORTING AND RECALL
REGULATIONS AND EMISSION TEST PROCEDURES (RELEASED OCTOBER 10,
2006)**

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For Further Information Contact:

Steven Douglas
Director, Environmental Affairs
Alliance of Automobile Manufacturers
1415 L Street, Ste 1190
Sacramento, CA 95814
(916) 266-4532
sdouglas@autoalliance.org

Julie C. Becker
Assistant General Counsel
Alliance of Automobile Manufacturers
1401 Eye Street, N.W., Suite 900
Washington, D.C. 20005
(202) 326-5511
jbecker@autoalliance.org

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I. Introduction

The Alliance of Automobile Manufacturers (the "Alliance")¹ appreciates the opportunity to provide comments to the Air Resources Board concerning the Initial Statement of Reasons (or "ISOR") relating to Emission Warranty Information Reporting and Recall Regulations and Emission Test Procedures,² and ARB staff's willingness to meet with us to discuss the proposed changes.

The ISOR identifies three aspects of the regulation that ARB Staff believes need improvement (see ISOR page ii): (1) the proof required to demonstrate violations of ARB's emission standards or test procedures, (2) the corrective actions available to ARB to address the violations and, (3) the way emissions warranty information is reported to ARB. These issues can be addressed with reasonable changes to the regulations and the Alliance is willing to work with ARB staff to accomplish this task. However, the current proposal before the Board is fundamentally flawed on procedural and substantive legal and policy grounds. This letter

¹ The members of the Alliance of Automobile Manufacturers ("the Alliance") are BMW Group of North America, Inc., DaimlerChrysler Corporation, Ford Motor Company, General Motors Corporation, Mazda North American Operations, Mitsubishi Motor Sales of America, Inc., Porsche Cars North America, Inc., Toyota Motor North America, Inc., and Volkswagen of America, Inc.

² See Notice Of Public Hearing To Consider Amendments To California's Emission Warranty Information Reporting And Recall Regulations And Emission Test Procedures (Released October 10, 2006)

requests the Board to reject the current proposal and direct staff to work with stakeholders to craft a proposal that addresses issues raised by the current ISOR.

In addition to the policy discussion in this document, the Alliance is submitting a separate appendix on the legal issues that arise concerning this regulation.

II. History

Eighteen years ago (September 1988), the staff proposed changes very similar to those currently contained in the ISOR. Rather than adopting those changes, the Board rejected them and directed staff work with industry to resolve problems with the proposed regulation. After meetings with industry and at the Board's direction, the staff modified their proposal to 1) link recalls based on component failures to the exceedance of emission standards, 2) eliminate a provision linking new vehicle certification to in-use failures.

Since 1988, automobile manufacturers have certified and sold over 25 million vehicles in California represented by thousands of engine families. Out of this, the ISOR contains only two examples of problems implementing the current regulations. Moreover, the ISOR acknowledges that one of these examples has already been addressed with changes made to the OBD regulations three years ago.

Now, after 18 years, thousands of engine families, and millions of vehicles, the ARB staff proposes to establish draconian regulations that ignore emission standards, extend warranty beyond useful life, deny manufacturers due process, and require manufacturers to predict the future before a new vehicle is certified or perhaps putting that certification in jeopardy after the fact, all without any evidence of a systemic problem.

III. "Why do we need a change"

Regulatory changes are costly for the state, the regulated community, and for consumers. Consequently, the state's Administrative Procedure Act (APA) requires agencies to specify why they are proposing changes to a regulation. ARB does so in a number of places in the ISOR. The Executive Summary on page ii concludes, "the staff has identified three aspects of the existing regulations that need improvement, specifically: (1) the proof required to demonstrate

violations of ARB's emission standards or test procedures, (2) the corrective actions available to ARB to address the violations and, (3) the way emissions warranty information is reported to ARB." The ISOR reiterates these same three issues in Section IV, "Impacts – Why Do We Need a Change?" of the ISOR.

As stated above, the Alliance is convinced that these three aspects of the regulation can be adequately addressed. The Alliance is equally convinced that alternatives to the ISOR will adequately address the ARB issues with far less burden on the regulated community than that required by the changes in the ISOR. Unfortunately, the ISOR does not analyze any alternative other than the status quo, even though at least two other alternatives have been offered – one by the ARB staff itself in Mail-Out #MSO 2006-01 issued April 4, 2006 (hereafter, "MSO 2006-01") and the other offered by the Alliance (see Attachment A) at a meetings with ARB staff on June 8 and August 9, 2006. ARB held one workshop to discuss alternatives, but that workshop was based on MSO 2006-01 and NOT on the significantly different proposal in the ISOR.

Attachment B outlines how the different proposals address each of the three aspects that need improvement. Note that the current ISOR contains additional changes that do not appear related to any of the three aspects that need improvement. A discussion of each of the three aspects and how they could be addressed follows:

A. Proof of violation

ARB staff finds it difficult to demonstrate that an engine family will exceed the emission standards on average over the useful life. Under the current regulatory regime, remedial action is not required if the manufacturer can demonstrate any of three elements with respect to emissions are not met: 1) emissions with the failure exceed the emission standard, 2) over the useful life of the vehicle, and 3) across the entire engine family. ARB maintains that "the potential expense of conducting emission testing to support a contested recall may alone deter the ARB from ordering one." (ISOR, page 6)

(i) ISOR

The ISOR's response to the difficulty of proving these three elements is to simply *ignore emission standards*. While simple, this response is entirely inappropriate. Recalls and other remedial actions are very costly for manufacturers and consumers alike. As such, they should be the last resort; applicable only when vehicles actually EXCEED emission standards, not as a method to reduce workload on ARB staff. A proposal that requires very costly recalls of vehicles that emit well below the emission standard is unreasonable on its surface.

(ii) **MSO 2006-01**

The ARB staff's proposal in MSO 2006-01 was to simply eliminate two elements of the demonstration (fleet average and useful life) such that if a defect caused a vehicle to exceed emission standards, then remedial action would be required. Ignoring, for the moment, the issue of whether it is reasonable to eliminate the fleet average and useful life elements, the MSO contained several additional elements that would need to be addressed. These elements tie the hands of both the ARB and manufacturers, forcing illogical results and consequences.

First, the MSO proposal required a test to be conducted based on the worst-case failure mode. Testing a typical failure mode would be far more reasonable. In some cases, the typical failure mode is the worse case mode. For example, some failures deteriorate over time resulting in increasing emissions (e.g., a small crack in an exhaust manifold might increase over time). In such a case, a typical failure might be one that has fully deteriorated rather than a failure that has only partially deteriorated, but will obviously continue to do so over the life of the vehicle.

However, it is possible that multiple failure modes may exist for the same component. One failure mode might account for 99 percent of the failures but have zero impact on emissions. Another failure mode may have a significant impact on emissions but represent a very small portion of the fleet. In this case, testing the worst-case failure mode is illogical. Although the failure causing the warranty rate to exceed 4 percent would have no impact on emissions, remedial action would be required.

Moreover, by definition, the typical failure mode is the failure that occurs most frequently in the field. Because of this, the typical failure mode is the failure for which consequences are definite and not speculative and the emission impact is most likely to be determined accurately. For these reasons, testing a typical failure mode would be far more reasonable.

Second, the MSO proposal required the manufacturer to demonstrate the emissions impact based on a single test of a single vehicle. Or rather, the proposal prohibited the manufacturer from submitting test results from multiple vehicles to establish a solid and accurate understanding of the true emissions impact of the failure. The proposal placed an irrational burden on the accuracy of a single test to represent the failure impact of components on possibly hundreds of thousands of vehicles. It is beyond dispute that both ARB and industry would benefit from a better understanding of the actual emissions impact of a failure rather than simply "rolling the dice" with a single test of a single vehicle. Such a test could as easily misrepresent that emissions do not exceed the standard and requiring no remedial action, as it could misrepresent that emissions exceed the standard demanding remedial action.

Regarding this issue of testing, the Alliance would have recommended allowing manufacturers to propose a test plan of a representative sample of vehicles using the defective component to produce an accurate and statically relevant answer. It is not clear why ARB would limit the number of tests given that: 1) they could specify the maximum amount of time to conduct testing, preventing additional testing from delaying the ultimate determination; and 2) the manufacturer would conduct the testing at no cost to ARB. Thus, additional testing would provide better information to make a decision and would cost ARB neither time nor resources.

(iii) Alliance Proposal

The Alliance proposal would have preserved the 1988 Board's direction to consider the vehicle fleet average emissions over useful life. The rationale for considering fleet average emissions over useful life is still reasonable. Using a number of

different techniques, manufacturers design robust emission control systems to ensure that a single component failure will not cause the vehicle to exceed the emission standard. First, a failed component rarely loses all capability, or put another way, the part is still reducing emissions. Moreover, many computer-operated emission control systems use adaptive learning to attempt to restore the emissions performance of the vehicle. On a system level, manufacturers always include redundancies to ensure that even with a single failure the vehicle will not exceed the emission standard. Finally, manufacturers always certify their vehicles with significant headroom to prevent the vehicles from exceeding the emission standards. All of these techniques and strategies combine to ensure that vehicles meet the emission standards in a wide variety of uses.

However, to address ARB staff's stated concern about providing for a quick resolution, the Alliance proposal contained three critical and reasonable elements. First, the Alliance proposal, similar to ARB's MSO 2006-01, establishes a timeline for determining whether remedial action is appropriate and then implementing the remedial action. Second, by shifting the testing burden *from* ARB *to* the manufacturer, the Alliance proposal addresses the concern raised in the ISOR on page 6, that "[u]nder the current regulations, the potential expense of conducting emission testing to support a contested recall may alone deter the ARB from ordering one." Third, to provide for better definition for both manufacturers and ARB, the Alliance proposed a formula based on the percentage of vehicles affected, the emissions impact of vehicles with the defective component, and the expected length of time the vehicle would be operated with the defective components.

While the Alliance proposal attempted to address the stated concerns of ARB staff, we recognized that our proposal needed additional consideration and revision and asked ARB staff for comments and input. However, we received no clear response until after the ISOR was issued. Again, the intent of our proposal was to resolve the perceived problems and do so without undue burden on the regulated industry.

B. Corrective Actions

ARB staff would like the ability to order extended warranties BEYOND the useful life of the vehicle. The current regulations do not authorize ARB to order extended warranties. Instead, the regulations allow ARB the flexibility to order a recall and/or negotiate any other remedial action with the manufacturers.

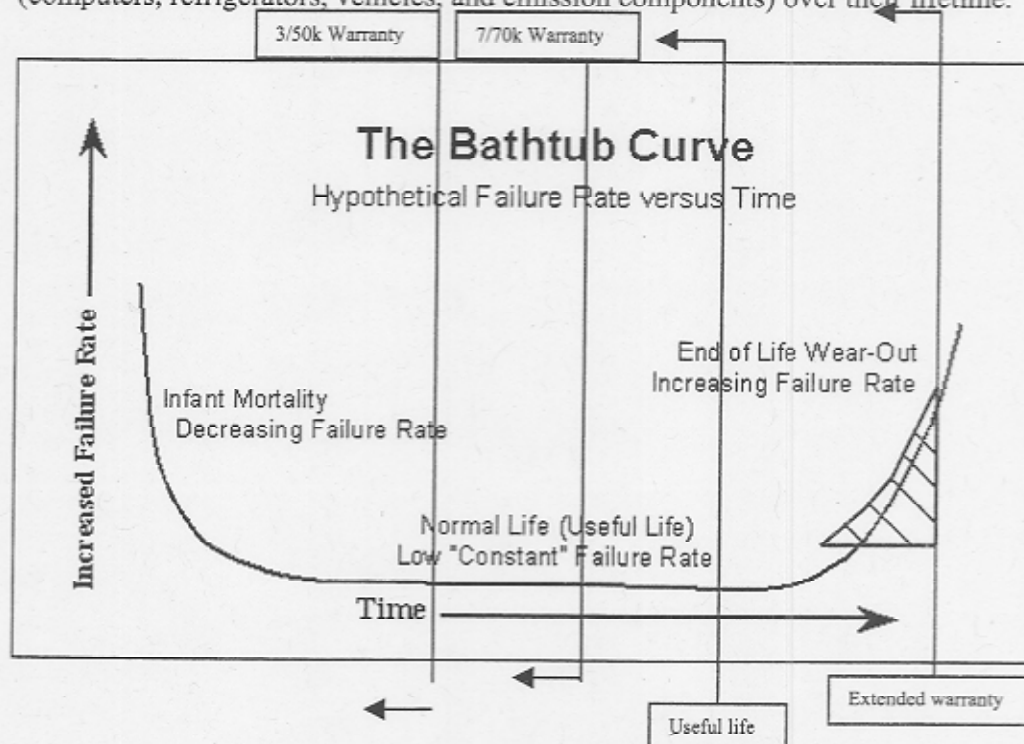
(i) ISOR

The ISOR rightly notes that the current regulations do not give ARB the authority to order "other remedial actions such as extended warranties." In fact, the legislature did not grant ARB the authority to require extended warranties. Moreover, the rationale for requesting a change to allow ARB to order extended warranties is misplaced. In effect, the ISOR argues that using OBD, which effectively detects emission system defects, in combination with ordered extended warranties is far more cost effective than ordered recalls. In fact, ARB rightly points out that many manufacturers have negotiated with ARB to provide extended warranties in lieu of recalls.

However, the fallacy of ARB's argument is that if indeed the extended warranty will be much cheaper for manufacturers, then ARB should have no trouble obtaining manufacturers agreement for extended warranties instead of recalls. As noted in the ISOR, ARB reached agreements for manufacturers to provide extended warranties on 80 separate occasions during the two years reported in the ISOR. Thus, it is unclear why ARB staff feels compelled to draft regulations allowing them to order extended warranties beyond the legislature's carefully constructed statutory warranty (in clear violation of the Health and Safety Code) when the ARB has such a long history of successfully negotiating extended warranties. Not only is this a violation of the law, as discussed in the attachment, but removes the flexibility that the ARB currently enjoys.

The ISOR adds another wrinkle to ordered extended warranties. The ISOR would require manufacturers to provide extended warranties beyond useful life and effectively require manufacturers to replace parts that meet original design criteria and have *absolutely no defect*. Reliability experts often refer to the "bathtub curve"

(below) to describe the NORMAL failure rate of virtually any population of products (computers, refrigerators, vehicles, and emission components) over their lifetime.



As shown in the example above, extending the warranty beyond useful life requires manufacturers to pay for component replacement even though the component has absolutely no design nor manufacturing defect (e.g., the components shown by the red hatches).

Moreover, forced extended warranty to, or beyond, useful life completely fails to rationally address those component failures that are completely captured. "Infant mortality" is the best example of this, but in addition, for example, where the failure was the result of manufacturing error and contained within a specific build period, the problem can be easily contained without engine family-wide extended warranty.

The ARB states in the ISOR that this approach benefits manufacturers, but the ARB completely fails to account for the wasted cost of warranty administration and unnecessary repairs.

In summary the requirement in the ISOR fails in at least two policy areas. First, it is entirely unnecessary if, as the ISOR claims, ARB only wants this authority to reduce the cost to manufacturers. Second, it extends the warranty beyond useful life forcing manufacturers to replace parts that have no defects. The proposal also fails on numerous legal grounds as discussed in the legal appendix being filed by the Alliance..

(ii) MSO 2006-01

The MSO 2006-01 proposal would grant the ARB authority to order extended warranties and thus suffers from the same defects discussed above. However, it did not mandate extended warranties that exceeded the useful life of the component and consequently did not put manufacturers in a position of replacing non-defective parts, which met the emissions standards for the useful life.

(iii) Alliance Proposal

The Alliance proposes that ARB and manufacturers maintain the flexibility to negotiate extended warranties or other alternatives to costly recalls. It has never been clear why ARB is so interested in obtaining the authority to mandate extended warranties when it is clearly prohibited by the Health and Safety code. The ISOR claims that ARB staff needs this authority so that it can reduce costs for manufacturers. However, if in fact, an extended warranty is far cheaper than a recall, then ARB should have no difficulty negotiating an extended warranty in lieu of an expensive recall. According to the staff report, in 2001 and 2002, ARB did just this over 80 times. Of course the draft regulations allow ARB to order BOTH an extended warranty BEYOND useful life AND a recall. This would NOT be a least-cost solution.

Allowing ARB to order extended warranties violates California law and is completely unnecessary. Consequently, the Alliance recommends eliminating this provision in its entirety.

C. Emission Warranty Reporting

The ISOR suggests that staff would like to eliminate unnecessary reports that are a burden to both manufacturers and ARB staff. The Alliance supports these changes and applauds ARB's efforts to eliminate unnecessary reports, although, the Alliance is at a loss to understand why staff is requesting funds for staffing two more people to administer the program. Further, the Alliance recommends ARB staff work with the regulated community to regularly review reporting requirements and eliminate or consolidate these reports where such action is appropriate.

IV. Additional changes unrelated to any stated reason for the changes

As outlined in Section III of this letter, the ARB has stated some reasons for changing the regulation in the ISOR. However, the ISOR contains additional changes that do nothing to advance the stated aspects that need improvement. Nor has the ARB provided any legitimate stated reason for these proposed changes in the ISOR. These changes are costly to implement, assuming manufacturers (or ARB Staff for that matter) knew how to implement them, place manufacturers' new vehicle certification in jeopardy, and eliminate due process.

A. Compliance statement

Attachment B to the ISOR, revises the new vehicle certification test procedures by stating "at the time of certification manufacturers shall demonstrate that the emission control devices on their vehicles or engines will not exceed a valid failure rate of 4% or 50 vehicles, whichever is greater, in an engine family, test group or subgroup over the useful life of the vehicles or engines they are installed in." (Appendix B, page 3) The ISOR expands upon the Appendix B changes stating, "manufacturers must present data proving that its emission related components will not fail in use at rates higher than the warranty reporting threshold [of 50 vehicles or 4 percent]." (ISOR, page 19).

Neither the Alliance nor ARB is aware of any "data" that could possibly be submitted at the time of certification that would prove that its emission related components will not fail in more than 50 vehicles or 4 percent. Vehicle components are not designed to fail at such levels and therefore any such failure rates that emerge are unforeseeable at the time of certification.

Proving the future is impossible, and yet, that is exactly what the ISOR requires manufacturers to do at the time of new vehicle certification. In meetings with ARB staff, they have stated that this is not meant to require manufacturers to generate any new or additional information, but is rather a legal device to tie the test procedures to the emission warranty and recall requirements.

This change does not advance the "three aspects of the existing regulations that need improvement" and should be deleted. It would be extremely costly to implement, if at all possible, and is nothing more than a legal charade if implemented as stated by ARB staff.

B. Due Process

The second change made in the ISOR that appears unrelated to the "three aspects of the existing regulations that need improvement," is elimination of public hearings for any remedial action other than recalls, AND a severe limitation on the evidence that can be presented.

The existing regulations allow the Board and the Executive Officer to order only recall remedies if violations are found. The reason is that Health & Safety Code section 43105 specifically contemplates the Board ordering recall remedies, but talks about other forms of corrective action (such as extended warranties) as being undertaken by manufacturers only voluntarily.

Staff now proposes to read into section 43105's silence about whether the Board can order extended warranties not only the existence of such a remedial power, but also a command from the Legislature to deny manufacturers hearings if they seek to contest an extended warranty ordered by the Executive Officer. That reading of the statute is backwards, because staff's interpretation would unconstitutionally deny manufacturers due process before they would have to comply with very costly enforcement orders that they would otherwise contest. Instead, that constitutional difficulty is an important reason to read section 43105 to *limit* the Board and the Executive Officer solely to recall remedies. Even if the Board disagrees, however, and decides to authorize regulations to the contrary, it would be unlawful if it did so without providing manufacturers a hearing right *in parallel* to their hearing right to contest recalls. Reading section 43105 to authorize the Board to order extended warranties is itself an unlawful stretch, but reading section 43105 to authorize the Board to order extended warranties that manufacturers

must obey before they have been given a meaningful opportunity to contest such an order reworks the statute beyond recognition.

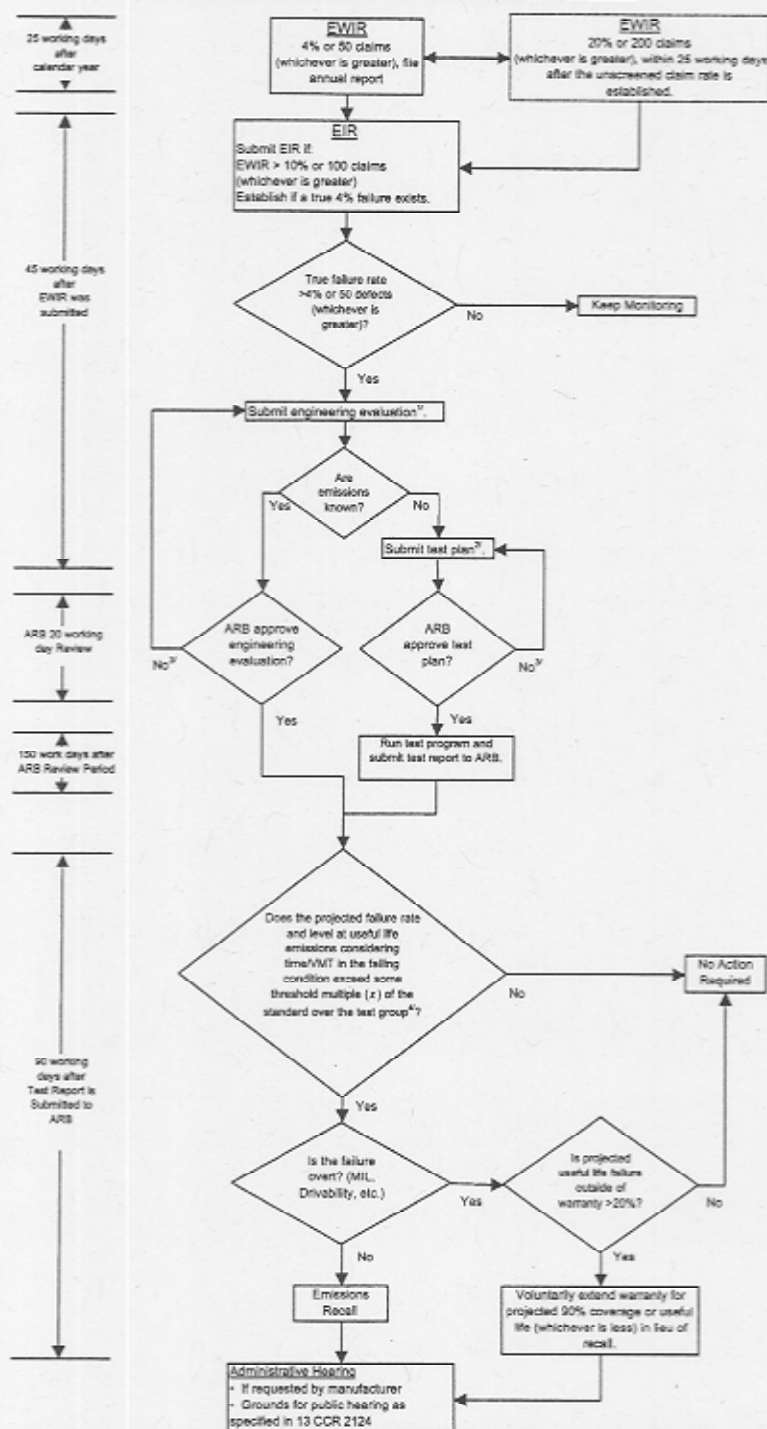
Furthermore, the hearing right that manufacturers have previously enjoyed in contesting recalls is being drastically scaled back in the proposed rules. Staff seeks to take a process that currently allows manufacturers to submit virtually any relevant evidence bearing on emissions testing, the cost of potential remedies, consumer behavior, and the effectiveness of potential remedies, among other issues, into a process that limits the only relevant evidence to whether a mechanical 4% defect threshold has been crossed. The proposed rules confer enormous "sole discretion" on the Executive Officer to choose whatever remedy she sees fit for any such violations. At the very least, due process requires manufacturers to be able to submit any evidence relevant to an abuse of that discretion, and the proposed amendments to the hearing procedures for recalls do not at present grant manufacturers that opportunity.

V. Summary

The current ISOR fails in procedure, policy, and substance. However, a reasonable regulation can be fashioned that will address the concerns raised by the ARB staff. The current regulations have lasted 18 years with only a handful of identified incidents where the staff believed three aspects hampered their ability to effectively regulate the industry. Adopting draconian, costly, and illegal measures in a manner that violates state law is irrational.

The Alliance requests that the Board reject the current ISOR and direct their staff to work with stakeholders to develop more appropriate regulations. The Alliance would appreciate the opportunity to work with ARB staff in this effort and to develop regulations that address their concerns.

Proposed Amendments to the Warranty Reporting Requirement Regulations - Flowchart
Process Description for Passenger Cars and Light Duty Trucks (LDTs)



¹ Engineering Evaluation includes: description of the defect, description of potentially affected vehicles, projected failure rate at useful life (UL), evaluation of the emissions impact of the defect, available data, description of indicators that will notify the driver to the problem (e.g. drivability, MIL illumination), projected repair rate due to overt indication.

² Test plan must be representative of a typical failure mode to determine the emissions impact for a substantial number of vehicles.

³ The manufacturer may request an Adjudicatory Hearing pursuant to Sections 60040 through 60053, Title 17, CCR after good faith efforts to resolve issues about the test plan or engineering evaluation have been exhausted.

⁴ Please see attached examples for clarification.

Issues	Current Reputation	MSO 2006-01 (Apr 4, 2006)	Alliance (June 8, 2006)	ISOR (Oct 10, 2006)
1. Proof of violation	1. Avg. emissions over engine family 2. Exceed emission standard 3. Over useful life	1. Emissions of defective vehicles > Std. 2. Worst case	Formulae to combine useful life, engine family, and emissions impact and determine if remedial action is required.	50 defects or 4 percent
2. Corrective Actions	Recall	1. Recall 2. Useful life extended warranty	1. Recall 2. Voluntarily extend warranty	1. Recall 2. 15 year/50,000 mile extended warranty
3. Reporting Requirements	1 percent 4 percent 10 percent	4 percent 10 percent	4 percent 10 percent	4 percent 10 percent
Other Changes 1 (New Vehicle Certification requirements)	Requirements to conduct ARB approved durability testing.	Same as current reg	Same as current reg	"...present data proving that its emission related components will not fail in use at rates higher than the warranty reporting threshold [of 4 percent or 50 vehicles]"
Other Changes 2 (Due Process)	1. Manufacturer may request public hearing for any ordered remedial action 2. Manufacturer may present applicable evidence of defect and emissions impact	1. Manufacturer may request public hearing for any ordered remedial action 2. Manufacturer limited to presenting evidence specified by ARB	1. Manufacturer may request public hearing for any ordered remedial action 2. Manufacturer may present applicable evidence of defect and emissions impact	1. Public hearing only allowed for ordered recalls. 2. Manufacturer may only present evidence regarding the number of defects.