355 South Grand Avenue, Suite 100
Los Angeles, California 90071-1560
Tel: +1.213.485.1234 Fax: +1.213.891.8763
www.lw.com

LATHAM & WATKINS LLP

FIRM / AFFILIATE OFFICES

| | |
|---|---|
| Austin | Milan |
| Beijing | Munich |
| Boston | New York |
| Brussels | Orange County |
| Century City | Paris |
| Chicago | Riyadh |
| Dubai | San Diego |
| Düsseldorf | San Francisco |
| Frankfurt | Seoul |
| Hamburg | Silicon Valley |
| Hong Kong | Singapore |
| Houston | Tel Aviv |
| London | Tokyo |
| Los Angeles | Washington, D.C. |
| Madrid | |


May 3, 2024

Michael Krause, Assistant Deputy Executive Officer
Heather Farr, Planning and Rules Manager
Planning, Rule Development and Implementation
South Coast Air Quality Management District
21865 Copley Drive
Diamond Bar, CA 91765

Re: Regulatory Flexibility Group Comments on Proposed Amended Rule 1146.2

Dear Mr. Krause and Ms. Farr:

We write on behalf of our client the Regulatory Flexibility Group ("RFG") regarding Proposed Amended Rule 1146.2 ("PAR 1146.2"). The RFG is an industry coalition that includes companies in the refining, utility and aerospace sectors that operate facilities within the jurisdiction of the South Coast Air Quality Management District ("SCAQMD" or the "District") that will be affected by PAR 1146.2.

We appreciate the work that Staff has done so far to incorporate stakeholder feedback into PAR 1146.2, and we are thankful for the opportunity to comment on the proposed amendments and rulemaking process. We write to raise concerns with the legality of a ban on natural gas-fired water heaters, the sufficiency of the current cost-effectiveness analysis, the lack of environmental analysis under the California Environmental Quality Act ("CEQA"), and the ability of the electrical grid to handle PAR 1146.2's wide-scale electrification. We also propose extending the timeline for PAR 1146.2 implementation in order to accommodate needed infrastructure upgrades, and for RECLAIM and former RECLAIM facilities to replace existing units. Each issue is discussed below.

**PAR 1146.2 Effectively Bans Energy Policy and Conservation Act Covered Products**

The Energy Policy and Conservation Act ("EPCA") preempts any "State regulation concerning the... energy use... of [a] covered product."[1] EPCA defines "energy use" as "the quantity of energy directly consumed by a consumer product at point of use."[2] The Ninth Circuit recently interpreted EPCA preemption in the context of a City of Berkeley building code ordinance

[1] 42 U.S.C. § 6297(c).

[2] *Id*. § 6291(4).

that banned installation of natural gas piping in new construction, invalidating the ordinance as preempted by EPCA.[3] While the case concerned the legality of Berkeley's ordinance and the application of EPCA preemption to building codes,[4] the court's reasoning indicates that EPCA preemption likely also applies to a ban on natural gas appliances, such as water heaters and pool heaters, that are "covered products" under EPCA.[5]

In reaching the conclusion that EPCA preempted Berkeley's ordinance, the Ninth Circuit reasoned:

> "EPCA preempts regulations... that relate to 'the quantity of [natural gas] directly consumed by' certain consumer appliances at the place where those products are used.... EPCA is concerned with the end-user's ability to *use* installed covered products at their intended final destinations, like restaurants. After all, a building code that prohibits consumers from using natural gas-powered appliances in newly constructed buildings necessarily regulates the "quantity of energy directly consumed by [the appliances] at point of use.... ***In other words, a regulation on 'energy use' fairly encompasses an ordinance that effectively eliminates the 'use' of an energy source***."[6]

PAR 1146.2, by mandating the installation of zero-emission equipment after the applicable effective date, effectively eliminates the use of an energy source (natural gas) for these EPCA-covered appliances. Accordingly, PAR 1146.2 falls squarely within the scope of the Ninth Circuit's EPCA preemption analysis. "Put simply, by enacting EPCA, Congress ensured that the States and localities could not prevent consumers from using covered products in their homes, kitchens, and businesses."[7] EPCA therefore preempts PAR 1146.2.

**The Cost-Effectiveness Analysis Excludes Substantial Costs**

We appreciate that Staff has updated its cost-effectiveness analysis throughout the rulemaking process. We note, however, that the most recent analysis does not include the substantial costs associated with the on-site electrical infrastructure upgrades necessary to transition to zero-emissions technology at many facilities, particularly at facilities with multiple units subject to PAR 1146.2, spread across many buildings.

---

[3] *California Restaurant Association v. City of Berkeley* (9th Cir. 2024) 89 F.4th 1094, 1098.

[4] *Id*. at 1101.

[5] See 42 U.S.C. §§ 6292(a) (covered products include water heaters and pool heaters). EPCA preemption also extends to certain industrial equipment. 42 U.S.C. § 6316(a). See also 88 Fed. Reg. 69686 (Oct. 6, 2023) (establishing standards for commercial water heating equipment).

[6] *California Restaurant Association*, 89 F.4th at 1101–02.

[7] *Id*. at 1103

Other than the potential need for an electrical panel upgrade, Staff's analysis regarded the difference in installation costs between natural gas-fired and zero-emission units to be negligible.[8] This is a vast underestimation. Staff's assumption fails to appropriately consider the cost of the electrical infrastructure design, engineering, and installation that is necessary to support the installation and operation of zero-emissions units at a facility. Such infrastructure upgrades depend on the specifics of each facility and may include replacement of air handlers, installation of new switch gears, seismic building upgrades, and ***even new electrical substations to handle increased electricity demand***. For larger facilities, these infrastructure upgrades could result in facilities expending tens of millions of dollars (if not more) to comply with PAR 1146.2 requirements. As detailed fully in a comment letter submitted by RFG member SoCalGas,[9] this is a substantial cost that is unique to the deployment of zero-emissions units, making the cost of installing zero-emission units significantly higher than the costs associated with replacing natural gas-fired units with like units. Specifically, SoCalGas calculated a multi-unit installation scenario and concluded that replacing five natural gas-fired units with zero-emission units would be over $1.8 million more expensive than replacing the natural gas-fired units with like units. This incremental cost increase will quickly compound to substantial capital outlays for facilities that must replace many units and for entities with multiple facilities. These costs must be considered in order to conduct an accurate cost-effectiveness analysis.

**The Cost-Effectiveness Exceeds Screening Thresholds**

The 2022 Air Quality Management Plan ("AQMP") adopted a cost-effectiveness threshold of $325,000 per ton of NOx reduced, which was updated to $349,000 to reflect 2022 dollars for the PAR 1146.2 rulemaking.[10] Pursuant to the AQMP, when the cost-effectiveness threshold is exceeded, District Staff must hold a public meeting to discuss "emission standards with a cost-effectiveness at or below the proposed screening threshold and/or compliance or implementation options to address an emission standard that is above the proposed screening threshold."[11] Further, at the public hearing for the proposed amendments, Staff must present the various emission standard options and the emission reductions associated with each.[12]

The most recent cost-effectiveness figures calculated by Staff exceed the screening threshold for Type 1 High Temperature Units.[13] When including the costs associated with electrical infrastructure design, engineering, and installation, SoCalGas' analysis confirms that the cost-effectiveness for replacement of all unit categories will greatly exceed the screening threshold.[14] For example, when considering all installation costs, the cost-effectiveness of replacing a Type 1 water heater with a heat pump water heater is over $3 million per ton of NOx

---

[8] SCAQMD, PAR 1146.2 Preliminary Draft Staff Report (Jan. 2024) p. 2-14 (*hereafter*, "Staff Report").

[9] See March 8, 2024 letter from Kevin Barker, SoCalGas, to Yangrong Zhu, SCAQMD, regarding Comments on the Initial Preliminary Draft of Proposed Amended Rule 1146.2, appendix (*hereafter*, "SoCalGas Comment").

[10] Staff Report, pp. 2-16 to 2-17.

[11] SCAQMD, 2022 Air Quality Management Plan (Dec. 2, 2022) p. 4-83.

[12] *Id*.

[13] SCAQMD, PAR 1146.2 Public Consultation Presentation (Feb. 23, 2024), p. 10.

[14] See SoCalGas Comment.

reduced, and the cost-effectiveness of replacing a Type 2 boiler with a heat pump water heater is over $2.5 million.[15] Staff must adhere to the public process outlined in the 2022 AQMP before bringing PAR 1146.2 to the Board for a public hearing.

**PAR 1146.2 Requires Additional CEQA Analysis**

We are concerned that the District's decision not to prepare additional environmental analysis for PAR 1146.2 may run afoul of CEQA. The scope of the proposed amendments in PAR 1146.2 is greater than the project descriptions of the relevant control measures analyzed in the Final Program Environmental Impact Report for the 2022 AQMP ("2022 AQMP PEIR"). While the analysis of control measure C-CMB-01 in the 2022 AQMP PEIR appears to encompass the replacement of Type 1 and Type 2 water heaters subject to PAR 1146.2, the scope of the project has changed substantially in regard to replacement of instantaneous water heaters and Type 1 pool/spa heaters.

Specifically, control measure C-CMB-01 was analyzed to include the replacement of 64,000 Type 1 and 32,000 Type 2 water heaters,[16] but there appears to be no analysis for the 300,000 instantaneous water heaters that Staff estimates will be subject to replacement under PAR 1146.2.[17] Additionally, control measure R-CMB-04, which includes replacement of pool heaters with zero-emission technology, analyzed replacement of only 200,000 pool heaters[18] while Staff estimates that PAR 1146.2 will apply to 708,000 units.[19]

Beyond the substantial increase in the number of affected sources, the District continues to vastly underestimate the on-site infrastructure upgrades that will be required to install PAR 1146.2-required units. Replacing natural gas-fired boilers with zero-emission units requires replacing the associated infrastructure as well, particularly at larger facilities. Most notably, some facilities will need to construct new substations to support the electrical needs of PAR 1146.2-required units. Existing electrical supplies are already strained to accommodate planned facility growth and other in-process electrification efforts such as installing electric vehicle charging infrastructure. Other infrastructure upgrades may also be necessary, for example:

- Replacing a boiler can also require replacing associated air handlers, and facilities with many boilers may have scores of air handlers to replace.
- At facilities with boilers spread across multiple buildings, new switch gears will need to be installed in each building.
- Seismic upgrades may be necessary when equipment is installed on the roofs of buildings because heat pumps and associated equipment can be considerably heavier than natural-gas fired equipment.

---

[15] See *id*., appendix, p. 4.

[16] SCAQMD, 2022 AQMP Final Program Environmental Impact Report (Nov. 2022), p. 4.2-32.

[17] SCAQMD, PAR 1146.2 Public Consultation Presentation (Feb. 23, 2024), p. 6.

[18] SCAQMD, 2022 AQMP Final Program Environmental Impact Report (Nov. 2022) p. 4.2-32.

[19] SCAQMD, PAR 1146.2 Public Consultation Presentation (Feb. 23, 2024) pp. 5, 6.

Staff has concluded that the 2022 AQMP PEIR "adequately describes the activities associated with implementing PAR 1146.2 for the purposes of CEQA" and that PAR 1146.2 is a "later activity" within the scope of the 2022 AQMP PEIR.[20] However, the project changes described above may lead to different effects or more severe effects than those analyzed in the 2022 AQMP PEIR. Further, the on-site infrastructure upgrades needed to install zero-emissions units at larger facilities greatly exceed what the District has acknowledged to date, and the impacts from that construction were not considered in the 2022 AQMP PEIR. Accordingly, further environmental analysis is required to comply with CEQA.[21] Prior to considering the rule for adoption, the District should conduct a subsequent environmental analysis of PAR 1146.2 and release the resulting document for public comment.

**The Compliance Dates Should be Extended to Allow Time for Infrastructure Upgrades and Development of a Robust Supply Chain**

As discussed above, replacement of natural gas water heaters with electric units will require significant infrastructure upgrades at many facilities. This will take both significant time and require significant capital outlay. Implementation of PAR 1146.2 on the currently proposed timeline may therefore cause facilities to forgo growth opportunities and have the effect of slowing the progress of other important electrification initiatives in order to meet PAR 1146.2 compliance deadlines. Additionally, we are concerned that the proposed compliance timelines do not adequately account for the needed ramp up in manufacturing and supply chains sufficient to provide the electric units that facilities will need in order to comply with the rule. Facilities will be unable to maintain compliance if supply is not sufficient and may be forced to incur inflated costs in order to obtain units that are in short supply. ***For all of these reasons, we propose that the compliance dates in PAR 1146.2, Table 3 each be extended ten years***.

**We Are Concerned with the Grid's Ability to Handle the Transition**

Implementation of PAR 1146.2 will significantly increase the load on the power grid. As RFG raised in letters commenting on the 2022 AQMP, the electrification measures proposed in the 2022 AQMP will require increased electrical generation and development of associated infrastructure. The increased load on the grid could adversely impact the affordability, availability, and reliability of the regional energy market. Further, there are significant cost and timing challenges associated with the deployment of needed infrastructure, including likely delays driven by strategic litigation brought under CEQA. Increased litigation risk may discourage investments from public utilities and private parties that are necessary to realize a resilient and reliable grid that can handle the wide-scale deployment of zero-emission technologies. These challenges are yet to be solved and may threaten the ability for facilities to implement wide-scale electrification measures like those contemplated by PAR 1146.2.

---

[20] SCAQMD, PAR 1146.2 Stationary Source Committee Presentation (March 15, 2024), p. 13.

[21] See Cal. Code Regs. tit. 14, § 15168(c)(1) ("If a later activity would have effects that were not examined in the program EIR, a new initial study would need to be prepared leading to either an EIR or a negative declaration."); see also Cal. Code Regs. tit. 14, § 15162(a)(1) (subsequent EIR required when "[s]ubstantial changes are proposed in the project which will require major revisions of the previous EIR or negative declaration due to the involvement of new significant environmental effects or a substantial increase in the severity of previously identified significant effects.")

As discussed above, proposed amendments in PAR 1146.2 will prompt electrification on a scale even more expansive than contemplated in the relevant 2022 AQMP control measure. The resulting environmental effects of the expanded scope of electrification driven by PAR 1146.2 must be carefully considered and fully understood prior to the adoption of the rule to avoid unintended consequences.

**It is not Feasible for RECLAIM and Former RECLAIM Facilities to Replace Certain Existing Boilers Within One Year of Rule Adoption**

Another area of concern is the requirement that RECLAIM and former RECLAIM facilities replace existing units that do not meet specific NOx limits within one year of rule adoption. Specifically, effective one year after rule adoption, PAR 1146.2 paragraph (d)(9) prohibits current and former RECLAIM facilities from operating Type 2 units manufactured prior to January 1, 2010 that do not meet NOx emission limits of 30 ppmv and Type 1 units manufactured prior to January 1, 2012 that do not meet NOx emission limits of 55 ppmv. One year is not sufficient time for the required design, planning, engineering, permitting, and infrastructure upgrades necessary to replace these units with zero-emissions units. To facilitate a successful transition, we propose that current and former RECLAIM facilities be given three years to phase these units out.

**Conclusion**

We greatly appreciate the opportunity to provide these comments on PAR 1146.2. We would also appreciate a meeting to discuss the concerns expressed in this letter. Please contact me at (213) 891-7395, or by email at john.heintz@lw.com with your availability to schedule a discussion.

Best regards,

John C. Heintz

John C. Heintz
of LATHAM & WATKINS LLP

Cc: Yanrong Zhu, SCAQMD
Jennifer Vinh, SCAQMD
Peter Campbell, SCAQMD
Emily Yen, SCAQMD
RFG Members
Nick Cox, Latham & Watkins LLP