California Environmental Protection Agency
Air Resources Board

Final Statement of Reasons for Rulemaking;
Including Summary of Comments and Agency Responses

PUBLIC HEARING TO CONSIDER ADOPTION OF AMENDMENTS TO THE CALIFORNIA CLEAN AIR ACT NONVEHICULAR SOURCE FEE REGULATIONS

Public Hearing Date: July 24, 2003
Agenda Item No: 03-6-5

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AIR RESOURCES BOARD

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I. GENERAL

On July 24, 2003, the Air Resources Board (ARB or Board) conducted a public hearing to consider amendments to the California Clean Air Act Nonvehicular Source Fee Regulations contained in sections 90800.8–90803, title 17, California Code of Regulations (CCR). The proposed action consists of the adoption of new sections 90800.75, 90800.9, and 90804 and amendments to sections 90800.8, 90801, 90802, and 90803, title 17, CCR, as authorized by sections 39612 and 39613 of the Health and Safety Code.

The Initial Statement of Reasons for Proposed Amendments to the California Clean Air Act Nonvehicular Source Fee Regulations (ISOR or Staff Report) released to the public on June 6, 2003, provides a description of the rationale and necessity for the proposed action, and is incorporated by reference herein. At the July 24, 2003 public hearing, the Board considered revised language that staff recommended to address issues raised during the preceding public comment period and at the public hearing. At the conclusion of the hearing, the Board approved Resolution 03-20, which initiated steps toward final adoption of the amendments, and made certain modifications to the originally proposed language. On November 12, 2003, the ARB released a Notice of Public Availability of Modified Text and Availability of Additional Documents, which made the revised regulatory language available for the required 15-day public comment period. The public comment period ended on December 2, 2003. This Final Statement of Reasons for Rulemaking (FSOR) updates the ISOR by identifying and explaining the modifications that were made to the original proposal. The FSOR also summarizes the written and oral comments received during the 45-day comment period preceding the public hearing, the hearing itself, and the 15-day comment period for proposed modifications, and contains the ARB's responses to those comments.

The purpose of this rulemaking action is to implement Assembly Bill (AB) 10X (Stats. 2003, Chapter 1X), which was enacted in March 2003 as a budget balancing measure intended to shift more of the ARB's Stationary Source Program budget from the General Fund to fee-supported programs. In the final Budget enacted by the Legislature, the proposed fees are designed to offset $14.4 million of the $16.4 million reduction in the General Fund allocation to the ARB's Stationary Source Program (the remaining $2 million

reduction has been absorbed by the ARB). As approved by the Board, the action provides a mechanism for the ARB to assess and collect fees from nonvehicular sources emitting 250 tons or more per year of any nonattainment pollutant or its precursors. It also provides a mechanism for the ARB to assess and collect fees from manufacturers of consumer products and architectural coatings if the manufacturer's total sales of those products result in the emission in the State of 250 tons per year or greater of volatile organic compounds. If the fees are not assessed and collected, the ARB will suffer a reduction of approximately 40 percent of its Stationary Source Program budget.

The ARB has determined that this regulatory action will not create costs or savings, as defined in Government Code sections 11346.5(a)(5) and 11346.5(a)(6), to any State agency or in federal funding to the State, costs or mandate to any local agency or school district whether or not reimbursable by the State pursuant to Part 7 (commencing with section 17500), division 4, title 2 of the Government Code, except as discussed below, or other non-discretionary savings to State or local agencies.

This regulatory action will impose a mandate upon and create costs to some local agencies. For fiscal year 2003-2004, facilities operated by three local agencies have been identified as being subject to the fees (i.e., the Los Angeles Department of Water and Power, the Imperial Irrigation District, and the City of Long Beach Southeast Resource Recovery Facility (SERRF) Project). The aggregate cost to these three local agencies will be approximately $141,000 to $188,000 for fiscal year 2003-2004. These costs, as well as any permit fees that may be paid in subsequent fiscal years by any local agency, are not reimbursable state mandated costs pursuant to Part 7 (commencing with section 17500), division 4, title 2 of the Government Code, because the fee regulations apply generally to all facilities in the State which emit 250 tons or more per year of nonattainment pollutants or their precursors and, therefore, do not impose unique requirements on local government agencies.

The ARB has also determined that individual local air pollution control and air quality management districts (districts) may incur some administrative costs as a result of the proposed regulatory action if a district chooses to collect fees from facilities for transmittal to the ARB. However, districts are not mandated by the proposed regulations to collect the fees; a district would incur no administrative costs unless it chooses to collect the fees itself. In addition, any administrative costs incurred by a district are not reimbursable state mandated costs because of the districts' authority to recover the costs through fee assessments; Health and Safety Code section 39612(e) and (f)(1), and proposed section 90800.9(e), title 17, CCR, authorize districts to recover these administrative costs from facilities subject to the fees.

The ARB has determined that no reasonable alternative considered by the agency or that has otherwise been identified and brought to the attention of the agency would be more effective in carrying out the purpose for which the regulatory action was proposed, or would be as effective and less burdensome to affected private persons or businesses, than the action taken by the ARB.

II. MODIFICATIONS MADE TO THE ORIGINAL PROPOSAL

Various modifications to the original proposal were made to address comments received during the 45-day public comment period. These modifications are described below. A "Notice of Public Availability of Modified Text and Availability of Additional Documents," together with a copy of the modified sections of the proposed regulations, was mailed on November 12, 2003, to each of the individuals described in subsections (a)(1) through (a)(4) of section 44, title 1, CCR. Additionally, this notice was made available on ARB's internet site on the same date. By these actions, the modified regulations were made available to the public for a comment period from November 12, 2003 to December 2, 2003, pursuant to Government Code section 11346.8. To be consistent with the terminology customarily used for rulemaking actions, the FSOR will refer to this comment period as the "15-day comment period" even though a total of 20 days was actually allowed for public comment because the Thanksgiving holiday occurred during the comment period, and staff wanted to provide the public with some extra time to review changes to the proposal. Responses to comments made during the 15-day comment period for these modifications are presented in Section III.J. of this FSOR. After the close of the 15-day comment period, the Board's Executive Officer determined that no additional modifications should be made to the proposed regulations. The Executive Officer subsequently issued Executive Order G-03-68, which adopted the regulations.

Following is a summary of the modifications that were made to the original proposal:

- Section 90800.8 was modified to provide that emissions and fees for facilities in the South Coast Air Quality Management District (SCAQMD) shall be determined on the District's fiscal year instead of a calendar year basis. Several conforming modifications were also made to sections 90800.8 and 90800.9 to be consistent with this provision. All of these modifications were made because the SCAQMD has historically calculated yearly emissions from facilities on a fiscal year basis instead of a calendar year basis. It would be too burdensome and confusing for the SCAQMD to change this existing system solely for the purpose of the ARB fee regulation.

- Sections 90800.8 and 90800.9 were modified to provide more time (i.e. one additional month) for affected sources to submit comments on preliminary emissions estimates.

- The definition of "Holding or parent company" in section 90801 was modified. Section 90802(a) was also modified to specify that, at the request of a holding or parent company, the Executive Officer shall provide separate written notice of their individual fee determinations to each consumer products or architectural coatings manufacturer within the holding or parent company.

III. SUMMARY OF COMMENTS AND AGENCY RESPONSES

The Board received numerous written and oral comments in connection with the 45-day public comment period, the July 24, 2003 hearing, and the supplemental 15-day comment period for this regulatory action. A list of commenters is set forth below with the date and form of all comments that were timely filed. Following the list is a summary of each objection or recommendation made regarding the proposed action, together with an explanation of how the proposed action has been changed to accommodate the objection or recommendation, or the reasons for making no change.

Comments Received During the 45-day Public Comment Period and at the July 24, 2003 Public Hearing

Abbreviation	*Commenter*
ASPA	Aaron Lowe Operating Committee Chairman, ASPA Board Member Automotive Specialty Products Alliance Written testimony: July 23, 2003 Oral testimony at Board Hearing: July 24, 2003
AVAQMD	Alan J. De Salvio Acting Supervising Air Quality Engineer Antelope Valley Air Quality Management District Written testimony: July 16, 2003
BM	Barry A. Jenkin Manager Regulatory Affairs - Product Compliance Benjamin Moore Written testimony through electronic mail: July 22, 2003
CCEEB	Cindy Tuck California Council for Environmental and Economic Balance Oral testimony at Board Hearing: July 24, 2003
CLOR	Victoria Jones Senior Manager of Government Affairs The Clorox Company Written testimony: July 21, 2003

CPC	Sande George Executive Director and Heidi K. McAuliffe Counsel, Government Affairs California Paint Council Written testimony: June 6, 2003
CSPA1	Joseph Yost Director, State Affairs Consumer Specialty Products Association Written testimony through electronic mail: July 10, 2003 Oral testimony at Board Hearing: July 24, 2003
CSPA2	D. Douglas Fratz Vice President, Scientific & Technical Affairs, and Joseph T. Yost Director, State Affairs Consumer Specialty Products Association Written testimony: July 22, 2003
CTFA	Thomas J. Donegan, Jr. Vice President and General Counsel The Cosmetic, Toiletry, and Fragrance Association Written testimony: July 24, 2003 Oral testimony at Board Hearing: July 24, 2003
DAP1	Matt Stewart Manager, Regulatory and Environmental Affairs DAP Inc. Written testimony: July 23, 2003
DAP2	Matt Stewart Manager, Regulatory and Environmental Affairs DAP, Inc. Written testimony: July 24, 2003
DAP3	Michele Boddy Attorney At Law, representing DAP, Inc. Oral testimony at Board Hearing: July 24, 2003
D-EP	Robert Wendoll Director of Environmental Affairs Dunn-Edwards Paints Corporation Written testimony: July 23, 2003

Dial	Bryan R. Ruble Regulatory Manager The Dial Corporation Written testimony: June 6, 2003
DW&P	Mark J. Sedlacek Manager of Environmental Affairs Department of Water and Power, City of Los Angeles Written testimony: July 22, 2003
FI	Freidum Anwari Technical Director Frazee Industries Written testimony: June 18, 2003
GMA	Kristin Power Director, State Affairs Grocery Manufacturers of America Written testimony: July 22, 2003
HC1	Paul A. Beemer Henry Company Written testimony: July 18, 2003
HC2	Paul A. Beemer Henry Company Written testimony: July 18, 2003 Oral testimony at Board Hearing: July 24, 2003
JD	Robert J. Israel, Ph.D. Director Corporate Product Responsibility Corporate Environmental Safety and Product Excellence Johnson Diversey Written testimony through electronic mail: June 12, 2003
MASCO	Paul J. Eisele, Ph.D. Manager, Special Projects MASCO Corporation Written testimony: July 21, 2003
MK	Dorene Markwiese Manager, Regulatory Affairs and Compliance Mary Kay Inc. Written testimony: July 16, 2003

MEG	Gary Silvers Vice President Research and Development Meguiar's Inc. Written testimony: July 2, 2003
MDAQMD	Alan J. De Salvio Acting Supervising Air Quality Engineer Mojave Desert Air Quality Management District Written testimony: July 21, 2003
NGKE	Carol Brophy Representing RPM International Nossaman, Guthner, Knox, & Elliott LP Written testimony: July 9, 2003
NPCA	Heidi McAuliffe Counsel, Government Affairs National Paints and Coatings Association Written testimony: July 24, 2003 Oral testimony at Board Hearing: July 24, 2003
P&G	Julie Froelicher Fabric & Home Care Regulatory Affairs Procter & Gamble Company Written testimony: July 24, 2003
PPG	Robert S. Gross Manager, Environmental Stewardship PPG Architectural Finishes, Inc. Written testimony: July 23, 2003
RB	Eileen Moyer Director of Regulatory Regulations Reckitt Benckiser Oral testimony at Board Hearing: July 24, 2003
RCMA	Russell K. Snyder Executive Vice President Roof Coatings Manufacturers Association Written testimony through electronic mail: July 23, 2003
RPM	Dennis F. Finn Vice President, Environmental and Regulatory Affairs RPM International Inc. Written testimony: July 23, 2003

RSC	Larry G. Beaver, Ph.D. Director of Research and Development Radiator Specialty Company Written testimony: July 21, 2003
SCAQMD CAPCOA	Barry Wallerstein, Ph.D. Representing: South Coast Air Quality Management District and California Air Pollution Control Officers' Association Oral testimony at Board Hearing: July 24, 2003
SCJ	F. H. Brewer Director, Worldwide Government Relations S. C. Johnson & Son, Inc. Written testimony through electronic mail: June 11, 2003
SLOAPCD	Larry R. Allen Air Pollution Control Officer San Luis Obispo County Air Pollution Control District Written testimony: July 21, 2003 Oral testimony at Board Hearing: July 24, 2003
SPC1	Christopher G. Foster Smiland Paint Company Written testimony: July 14, 2003
SPC2	Christopher G. Foster Smiland & Khachigian on behalf of: *Smiland Paint Company* *Conoco Paint* *California Paint Company* Written testimony: July 16, 2003
SPC3	Chase Alders Smiland Paint Company Oral testimony at Board Hearing: July 24, 2003
SW1	Madelyn Harding Manager, Product Compliance and Registration and Doug Raymond Director, Regulatory Affairs The Sherwin-Williams Company Written testimony: June 4, 2003

SW2	Madelyn Harding Manager, Product Compliance and Registrations The Sherwin-Williams Company Written testimony through electronic mail: July 3, 2003
SW3	Madelyn Harding Corporate Manager, Product Compliance and Registrations The Sherwin-Williams Company Written testimony: July 23, 2003
SW4	Madelyn Harding Corporate Manager, Product Compliance and Registrations The Sherwin-Williams Company Oral testimony at Board Hearing: July 24, 2003
SW5	Doug Raymond Director, Regulatory Affairs The Sherwin-Williams Company Oral testimony at Board Hearing: July 24, 2003
Wella	Mark Riedel Vice President and General Counsel Wella Corporation Oral testimony at Board Hearing: July 24, 2003
WHP1	Susan Hantak Executive Vice President Willert Home Products Written testimony: June 25, 2003
WHP2	Brian M. Warner Vice President Willert Home Products Written testimony: July 10, 2003

Comments Received During the 15-day Public Comment Period

(Note: Comments Received during the 15-day comment period are summarized and responded to in Section J. below)

Abbreviation	*Commenter*
CSPA3	D. Douglas Fratz Vice President, Scientific & Technical Affairs and Joseph T. Yost Director, State Affairs Consumer Specialty Products Association Written testimony: December 2, 2003
CTFA2	Thomas J. Donegan, Jr. Vice President and General Counsel The Cosmetic, Toiletry, and Fragrance Association Written testimony: December 2, 2003
RCMA 2	Reed Hitchock General Manager Roof Coatings Manufacturers Association Written testimony: December 2, 2003
HC3	Paul A. Beemer Henry Company Written testimony: December 2, 2003
NPCA 2	Heidi McAuliffe Counsel, Government Affairs National Paints and Coatings Association Written testimony: December 2, 2003
PSC	Joe Hudman, Ph.D., CHMM E, H, & S Manager Packaging Services Company, Inc. Written testimony through electronic mail: December 1, 2003
ZIN	Robert Senior President Zinsser Company, Inc. Written testimony: December 1, 2003

Comments and Responses

A. REGULATORY LANGUAGE

1. **Comment:** Section 90800.8(a)(2)(B) initially states that funds from a manufacturer must be deposited within 60 days of receipt of a notice. This was recently changed to 30 days. It is difficult to process any invoice for payment, especially one of the magnitude that ARB will impose, in such a short time-frame. Sixty days is the minimum time-frame necessary and thus ARB must revert to the language of the initial proposed amendments on this matter. (DAP1, 7/23/03)

2. **Comment:** Changing the due date from 60 days to 30 days is a significant problem. This allows 30 days from the time you receive an invoice to accomplish payment, which for my company is an incredible burden. The prenotification that has been mentioned by staff that we will be warned how much it will be doesn't get the check getting cut. Until we have an official invoice, I can't process anything. It needs to be the invoice and it needs to be official. And the number of signatures we need are somewhat significant because the amount of money is somewhat significant for the company. So I would like to ask the Board not to agree with the staff's change from the 60 days to 30 days, but to leave it to the original 60-day due date. This is somewhat minor, but it is somewhat significant, because getting it paid in 30 days is a miracle. (SW4, 7/24/03)

Agency Response to Comments No. 1 and 2: The regulation was modified as requested by the commenters. As originally proposed, section 90800.8 required fee payers to pay the fee within 60 days after receipt of the fee determination notice. This 60-day time period was applicable to the 2003-2004 fiscal year and to each subsequent fiscal year. At the Board hearing, staff proposed a modification to the original proposal to require the fee to be paid in 30 instead of 60 days, for the 2003-2004 fiscal year only. The Board did not approve staff's proposed modification. Accordingly, the final adopted language provides a 60-day period for all fiscal years, as requested by the commenters. See also Comments No. 201-203, in which commenters express support for the ARB's modifications.

3. **Comment:** *Provisions For Withdrawing From The Market:* § 90800.8(c)(5) states "Any consumer products or architectural coatings manufacturer for which the total sales of the manufacturer's consumer products or architectural coatings resulted in volatile organic compound emissions of 250 tons or more during the most recent calendar year for which emission estimates are available." The language "most recent calendar year for which emission estimates are available" is of concern. It will in essence limit a given company's ability to withdraw one or more of its products from the California market in order to reduce or eliminate its fee in the following year. In other words, after evaluating the profitability of a given product with the applicable California Air Resources Board (CARB) fee, a company may decide to no longer sell a given product in the California market. If so, the company

must not be forced to pay a fee for a product that is no longer sold in California (and for which there are no longer VOC emissions).

We propose that a section (presumably § 90805) titled "Provisions for Withdraw of a Consumer Product or an Architectural Coating From the Market" be added to the Draft Proposed Regulation. It would read as follows: "In the event that a manufacturer of a Consumer Product or an Architectural Coating wishes to withdraw a subject product from the California market, the manufacturer can petition the Board for a reduction in the tonnage on which the manufacturer's fee is based, provided that appropriate documentation of the reduction in tonnage is provided and such is endorsed by a responsible corporate officer of the manufacturer. A petition to withdraw must be received no later than 90 days prior to the date on which the manufacturer wishes to withdraw from the California market. The Board shall notify the petitioner in writing of the granting or denial of the petition within 30 days of receipt of the petition. If such petition is denied, the Board shall explain the rationale for the denial in writing as part of the denial and grant the petitioner the opportunity to contest the denial."

As part of this program, CARB must implement a system that will instruct companies on how to withdraw without the risk of continued liability in the event that their products appear incidentally in the California market after the withdraw is declared. For example, shipments by distributors and retailers into California after the manufacturer has withdrawn from the market. Thus, DAP requests clear instructions on how to withdraw from the California market without the risk of continuing liability for the proposed fee if their products appear incidentally in the California market after they have declared withdrawal from the market. This is extremely important because the tax (and the internal administrative costs) is so high it may truly make some products unprofitable in California. (DAP1, 7/23/03; DAP3, 7/24/03)

Agency Response: The requested modification is inappropriate and would be administratively unworkable. The proposed regulation is based on a straightforward concept—the fees paid by an emissions source is based on that source's emissions during a calendar year. For a particular calendar year, the fee assessed for each ton of emissions is determined by aggregating the emissions from all the sources over the 250-ton threshold for that calendar year, and then applying the formula specified in section 90800.8(c)(6). The fee paid by each source in a particular calendar year depends on the total tons emitted by all the other sources during that calendar year; the fewer tons emitted, the greater the fee per ton.

The commenter's proposal would make it impossible to administer this straightforward system. While the details of the proposal are somewhat unclear, the commenter seems to be proposing that a company be allowed to avoid paying for its past emissions simply by deciding to withdraw from the California market in the future. This is unfair to all of the other sources that emitted VOCs during the referenced calendar year; these sources will have to pay a greater amount per ton to make up for a company who has emitted VOCs during the same year as these sources, but whose emissions will not be counted based on the

company's decision to withdraw from the California market in the future. In addition, it would be virtually impossible to administer a system whereby the fee is fixed at a point in time (based on the total tons emitted by all products in a particular year), the bills are sent out and paid, and then a company that received a bill is allowed not to pay it based on promised conduct that would occur in future years. If a company is allowed to not pay for its past emissions, the ARB would have to either forego collecting the money (which could make prudent fiscal planning very difficult), or would have to recalculate everyone else's fee determination and send out supplemental bills. Such a system would be inefficient and unworkable. Under the regulation as it is currently written, a company would of course be able to stop selling any of its products in California—without having to petition the ARB—and thereby avoid paying fees for these products in future years.

4. **Comment:** ASPA and CSPA agree with the determination that districts cannot collect "fees" from consumer products. The ISOR states, "The amendments make it clear that the districts may collect fees from facilities but may not have the option to collect fees from consumer products manufacturers and architectural coatings manufacturers." In view of the fact that the ARB has sole statutory authority to promulgate statewide regulations for consumer products, ASPA and CSPA support the ARB's decision to state that the districts have no authority to collect "fees" from consumer products manufacturers. (ASPA, 7/23/03; CSPA1, 7/24/03; CSPA2, 7/22/03)

Agency Response: The ARB agrees that the regulations do not provide local districts with the option to collect fees from consumer products and architectural coatings manufacturers (see section 90800.9(a)).

5. **Comment:** The ARB's three percent "adjustment" is neither appropriate nor necessary. The clear language of AB 10X will authorize the ARB to collect "*...administrative costs* for collecting the fees. There is no indication that the Legislature intended the ARB to adjust the "fees" by an amount "... of up to three percent to cover shortfalls in revenues from the fees resulting from the undercollection of funds." There is a clear difference between "administrative costs" and the assessment of an additional amount (i.e., a percent of the total "fee") to address shortfalls that may be caused if the "fees" collected by the ARB do not total a targeted amount. (CSPA1, 7/24/03; CSPA2, 7/22/03)

Agency Response: AB 10X authorizes ARB to recover its administrative costs (see Health and Safety Code section 39612(e)). The ARB has chosen not to do so, however, and the proposed regulation does not provide for the ARB to recover any of its administrative costs (although the local districts are allowed to recover their administrative costs pursuant to section 90800.9(c)(4)). The response to the following comment explains why the three percent adjustment is appropriate and necessary.

6. **Comment:** The additional adjustment amount of three percent is not needed for consumer products or architectural coatings, and should be deleted in sections 90800.8(c)(2) and 90800.8(c)(6) (calculation "A").

Section 90800.9(a). This section needs to be modified to clearly state that the districts do not have an option to collect fees for consumer products and architectural coatings. (SW1, 6/4/03)

Agency Response: ARB staff does not agree with the commenter's statement that the three percent adjustment factor (calculation "A" in section 90800.8(c)(6)) is not needed for consumer products or architectural coatings. An adjustment factor for facilities has been included in this regulation since its inception. The adjustment factor is needed to offset under-collection of fees due to circumstances such as closures or bankruptcies, events which occur for consumer products and architectural coatings manufacturers as well as for facilities. It should be noted the regulation includes provisions in section 90800(c) to carry-over a balance to the subsequent fiscal year if the three percent adjustment factor for a given fiscal year results in an over-collection of fees. In other words, if there is an over-collection of fees in one fiscal year, the fees for the next fiscal year will be reduced accordingly. It should also be noted that the 3 percent adjustment to cover shortfalls streamlines the fee collection process for both companies and the ARB. Without the 3 percent adjustment factor, it would be necessary to institute a system whereby the ARB would send companies supplemental bills to cover any deficits caused by unexpected shortfalls resulting from business closures or bankruptcies.

Regarding section 90800.9(a), the commenter is apparently referring to an earlier draft of this section that was circulated before the start of the 45-day comment period. The language of section 90800.9(a) that was made available during the 45-day public comment period—and the language adopted by the Board—clearly states that local districts shall not have the option to collect fees from manufacturers of consumer products and architectural coatings.

7. Comment: *Section 908001(n)* The definition of VOC should be modified as it relates to consumer products to specifically exclude all substances exempted from consideration in VOC limits for consumer products. The proposed definition of "volatile organic compound" in section 90801(n) includes an extensive array of chemical compounds and materials that have little or no volatility, and little or no capability to be emitted as a vapor in the ambient air. It also includes many chemical compounds and materials exempted from regulation as VOC content in the consumer products regulations. These substances should be specifically exempted from this "fees" regulation for the same reasons. Specifically, the following ingredients should be excluded from the definition of "volatile organic compound" for consumer products:

- LVP-VOCs as defined in section 94508(a)(80).
- Fragrances up to a combined level of 2 percent as specified in section 94510(c).
- Air fresheners that are comprised solely of fragrance as specified in section 94510(f).

- VOCs in adhesives sold in containers of I fluid ounce or less as specified in section 94510(i).

- Fragrances in a personal fragrance product as specified in section 94510(j).

- VOCs incorporated into a bait station insecticide as specified in section 94510(k).

This section should also address the issue of VOC content that is not emitted during product use, and the handling of products reformulated to meet reactivity-based limits. (CSPA2, 7/22/03)

Agency Response: It is not appropriate to change the definition of VOC in section 90801(n). The definition in section 90801(n) is identical to the VOC definition specified in the ARB consumer products regulation (sections 94507-94517, title 17, CCR). While there are provisions in the consumer products regulation to exempt certain VOCs in determining product compliance with VOC limits, this is not a basis for concluding that these compounds do not contribute to ozone formation. The exemptions in the consumer products regulation are provided for a number of policy reasons which may be unrelated to the ozone formation potential of the exempted compounds, such as to provide formulation flexibility for manufacturers, or for other reasons. To give one example, "air fresheners comprised solely of fragrance" are exempt from complying with the VOC limit for "air fresheners." Fragrances are VOCs, but it is unlikely that VOC emission reductions would actually occur from requiring 100 percent fragrance products to lower their VOC content, because the result would likely be less concentrated products that would be used more often to achieve the same air freshener effect. It is therefore apparent that the existence of this exemption in the consumer products regulation is not a good reason to exempt 100 percent fragrance air fresheners from paying fees for their VOC emissions.

With regard to low vapor pressure VOCs (LVP-VOCs), these compounds will not be included in calculating a manufacturer's emissions for the 2003-2004 fiscal year. This is because the best emission inventory information currently available to the ARB staff does not include detailed LVP-VOCs, and there is no practical way at this time to bill manufacturers for these compounds. ARB staff plans to request more detailed information on LVP-VOCs in future consumer product surveys, and to bill manufacturers for these compounds when the information becomes available. After more detailed information becomes available, ARB staff will consider modifying the fee regulations to exclude from the fee assessments any LVP-VOCs that are unlikely to be emitted into the ambient air. Finally, the ARB staff does not believe there is any practical way to modify the VOC definition to address such complex factors as particular VOCs that might not be emitted during the use of particular products, or to account for products reformulated to meet reactivity-based limits.

8. **Comment:** Companies must be allowed more time to review and correct the ARB's emissions estimates in future years. These proposed regulations establish a time schedule for the final determination of "fees" to be assessed in year 2004-05 and beyond.

The schedule would provide preliminary estimates of emissions and "fees" to companies on May 1, with comments allowed through June 1, and a final determination of fees sent on July 1.

This proposed schedule provides insufficient time (i.e., 30 days) for companies to review the ARB's preliminary estimates of their VOC emissions. This timeframe also provides too little time to correct inaccuracies prior to issuance of a final assessment that must be paid in 60 days. The current process our members have experienced this year demonstrates that at least 60 days should be allowed for comments and corrections between issuance of the preliminary and final determinations of "fees." Therefore, ASPA strongly urges the ARB to change the May 1 date for distributing preliminary estimates to April 1 for future years. (ASPA, 7/23/03; ASPA Oral testimony at Board Hearing, 7/24/03)

9. **Comment:** Companies must be given sufficient time to review and correct the ARB's emissions estimates before receiving a "written fee determination notice." Proposed Sections 90800.8(c) and 90800(d) establish a time schedule for the final determination of "fees" to be assessed in year 2004-05 and beyond. The schedule would provide preliminary estimates of emissions and "fees" to manufacturers on May 1, with comments allowed through June 1, and a final determination of fees sent on July 1.

This proposed schedule provides much too little time (30 days) for companies to review the ARB's preliminary estimate of their VOC emissions and seek to get inaccuracies corrected prior to issuance of a final assessment that must be paid in 60 days. This is especially unreasonable for newly identified companies going through the process for the first time. The process our member companies and the ARB has experienced this year demonstrates that at least 60 days should be allowed for comments and corrections between issuance of the preliminary and final determinations of "fees." We therefore urge that the ARB change the May 1 date for distributing preliminary estimates to April 1 in 2004-05 and subsequent years. (CSPA1, 7/24/03; CSPA2, 7/22/03; GMA, 7/22/03)

Agency Response to Comments No. 8 and 9: In response to industry concerns, ARB staff modified section 90800.8 to provide 60 days instead of 30 days to comment on preliminary fee determinations. Although some commenters suggested that this modification could be accomplished by changing the May 1 preliminary determination date to April 1, the ARB decided to leave the May 1 date unchanged and instead specify that written comments may be submitted until July 1(instead of the originally proposed June 1 date). This modification still provides the 60-day comment period requested by the commenters, but it is a better approach than changing the May 1date to April 1. If the May 1 date were changed to April 1, districts would also have to submit facility emissions data a month earlier (i.e., on March 1 instead of the April 1 date currently specified in section 900800(b)). Based on past experience, some districts might have difficulty meeting the earlier March 1 date. See also Comments No. 201-203, in which commenters express support for the ARB's modifications.

10. **Comment**: The ARB staff has provided significant time and an informal process for companies wishing to challenge assessments and the emissions estimates on which they

are based. The need for this is clear, and some companies are pursuing this process. CTFA urges the Board to institutionalize this process and provide for a period of at least 90 days before the Executive Officer provides a fee determination notice for a company to be advised of its preliminary assessment and to have an opportunity to resolve any differences with the staff. This could be accomplished by amending section 90800.8 to require the Executive Officer to provide a Preliminary Determination of Fees by March 1.

With current resource limitations in the industry and change resulting from corporate mergers, reorganizations, etc., obtaining accurate and complete data from each ARB survey remains a challenge. With both sides working in good faith toward the goal of accurate data, complexity, inexperience, and frequent confusion about what is required often produce inaccurate data. Although the ARB staff has made significant efforts to find and rectify errors, this takes time. More time should be built into the future fee collection and assessment process to allow this process to take place. (CTFA, 7/22/03)

Agency Response: As discussed in the response to Comments No. 8 and 9, the ARB staff modified section 90800.8 to provide 60 days instead of 30 days to comment on preliminary fee determinations. Staff believes that 60 days is sufficient time, and that the 90 days is not necessary and would unduly delay the ARB's collection of fees. It should also be noted that the 60-day period does not apply to the first round of fees that will be collected under the fee regulations (i.e., for the 2003-2004 fiscal year), but will apply to the 2004-2005 and subsequent fiscal years. By the 2004-2005 fiscal year, companies will have had experience dealing with the fee collection process and should not need 90 days to correct preliminary fee determinations. Issues related to the fee collection process for the 2003-2004 fiscal year are addressed in the response to Comment No. 75, which explains how manufacturers will have over eight months to correct their preliminary fee estimates for the 2003-2004 fiscal year.

B. UNIFORM FEE

11. Comment: The fee system is neither fair nor equitable because the Agency is proposing a uniform fee per ton of emissions across stationary sources, consumer products and architectural coatings. The per ton fee should be industry specific. (MASCO, 7/21/03)

Agency Response: ARB staff disagrees with the commenter and believes that a uniform fee system is the most fair and equitable approach. As described in Chapter IV of the ISOR, a uniform fee approach is equitable because it requires the large emitters in each category to pay the same amount for each ton of pollution. As described in Chapter V of the ISOR (page 42), ARB staff considered the alternative of applying a variable dollar per ton by industry type. This alternative was rejected because it would require the stationary point sources (i.e., facilities) to pay about three times as much on a dollar per ton basis as the architectural coatings manufacturers and consumer products manufacturers. These fees would be in addition to the permit fees already paid by facilities to the districts.

12. **Comment:** A non-vehicular source fee threshold of 250 tons is easily justified for manufacturing operations, as stationary large sources require air permits, surveillance and administrative support from air agencies. Including the use of architectural products [coatings] and consumer products in this category represents a large collection of individual area sources. It is difficult to imagine a scenario where over 250 tons of VOC is emitted from architectural coatings used at one location, as it would take hundreds of thousands of gallons of coatings. ARB's administrative support for permits and surveillance related to these smaller operations are drastically reduced. In addition, the amount of money necessary to support such a program is much lower than that required for manufacturing operations. Therefore, the fees collected should reflect these differences. (MASCO, 7/21/03)

Agency Response: AB 10X requires the ARB to assess fees where a manufacturer's total sales of consumer products or architectural coatings result in 250 tons per year or greater of volatile organic compound (VOC) emissions in California. These emissions do not need to occur at a single location for a manufacturer to be subject to fees. A detailed description of the ARB's many activities related to consumer products and architectural coatings is contained in Chapter IV of the ISOR. This description shows that the commenter is simply incorrect in assuming that the ARB staff needs few resources to address pollution from area sources such as consumer products and architectural coatings.

13. **Comment:** We question the fairness of the fee schedule as discussed in Appendix D. Table 2 compares the economic impact of the fees on the three industry sectors covered. It points out that architectural coatings carry a ten-fold increased economic impact at the 13 million dollar fee level and a six-fold increased economic impact at the 17.4 million dollar fee level. ARB acknowledges that "the change in profitability was higher for selected businesses in the architectural coating category than for those in the consumer product and non-vehicular source categories". These facts would logically lead to a reduced fee for the architectural coatings group. Yet the uniform per ton fee is proposed instead of a graduated fee schedule using an equitable impact analysis. ARB does not adequately explain why, based on its own data, the fee allocation is not equitable but rather averages across business sectors to make them appear equal. The standard assumption that all product manufacturers pass increased cost to the consumer or can further reduce their costs may only be valid for high margin products. Architectural coatings have much greater margin pressure than industrial coatings. (MASCO, 7/21/03)

Agency Response: ARB staff disagrees with the commenter's belief that a uniform fee is unfair. ARB staff agrees that the impact on profitability is higher for some architectural coating manufacturers than for some consumer product manufacturers or facilities. This is the case because some architectural coating manufacturers sell coatings with a relatively high VOC content, and it is not necessary to sell large amounts of such coatings in order to create 250 tons or more per year of VOC emissions in California (the threshold for applicability under AB 10X). The commenter appears to be suggesting that it

would be more equitable for ARB to set regulatory fees based on the relative economic impact of the fees on each industry sector. This does not seem fair to ARB staff, since such a system would tend to result in lower fees per ton for individual companies that create more VOC emissions than other, comparatively sized companies. In other words, it would reward companies that create more pollution, and would provide little incentive for such companies to reduce their emissions.

It should also be noted that, although the impact on profitability is higher for some architectural coatings manufacturers, it is 100 times lower than the impact which is typically considered to be significant in other ARB regulatory actions (e.g., a 10% decrease in return on owner's equity). In addition, the estimated impact on profitability is a "worst-case" scenario, because it is based on the assumption that architectural coating manufacturers would absorb all of the increase in their costs of doing business. The typical increase in cost from the fee regulation is expected to be two to five cents per gallon of architectural coating. An architectural coating manufacturer could lessen or eliminate the impact on its profitability by passing some or all of the increased cost on to the consumer. Since a typical gallon of coating costs $15 to $20 (or even more for some specialty coatings), it is reasonable to assume that an architectural coating manufacturer could pass on to the consumer the additional cost of two to five cents per gallon.

14. **Comment:** ARB appears to interpret AB 10X language to "establish a uniform methodology for assessing population exposure to air pollution" (Sec. 1c2) as requiring uniform fees. AB 10X also requires that fees for architectural coatings and consumer products "shall be used to mitigate or reduce air pollution in the state created by consumer products and architectural coatings ... and shall be expended solely for those programs" (Sec. 2). It is clear that the legislative intent is not to make the per ton fees uniform with stationary sources, but rather for each group to pay a fee based on ARB's respective activity. (MASCO, 7/21/03)

Agency Response: The ARB staff does not interpret AB 10X to require that a uniform fee per ton must be imposed for consumer products, architectural coatings, and stationary point sources. There is nothing in the language or legislative history of AB 10X that would either prohibit or require a uniform fee approach. Rather, the ARB has chosen to utilize a uniform fee per ton approach because it is the most equitable approach, as described in Chapter IV of the ISOR and the responses to Comments No. 11 and 13.

Chapter IV of the ISOR also provides a detailed description of the ARB's activities related to consumer products, architectural coatings, and stationary point sources for which the fees will be used. We agree with the commenter that consumer products and architectural coatings manufacturers cannot be assessed fees greater than the amount "… used to mitigate or reduce air pollution in the state created by consumer products and architectural coatings." As described in Chapter IV of the ISOR, consumer product and architectural coating manufacturers could be assessed up to 19 percent of the total stationary source program costs, or about $7.6 million in fiscal year 2003-2004, based on their contribution to the emissions inventory. As explained in the ISOR, the fees that will be assessed for

consumer products and architectural coatings manufacturers will be less than that amount.

15. **Comment:** ARB has failed to follow the language of AB 10X. The authorizing statute does not require a "uniform" fee to be assessed on all three product categories. While AB 10X requires fees to be assessed on nonvehicular stationary sources, architectural coatings manufacturers and manufacturers of consumer products, the language of the statute does not indicate that these three sources should pay a uniform fee. In fact, construction of the statute reveals that these fee programs are separate, distinct programs, each of which require consideration of separate, distinct elements.

Section 1 of AB 10X, a pre-existing section of the statute, was amended to increase existing fees on non-vehicular stationary source facilities. Section 2, on the other hand, is a brand new section that created a brand new fee program for sources that are dramatically different than stationary source facilities. The very fact that the authority for collecting these fees is contained in separate sections is a strong indicator that the Legislature intended the ARB to implement and maintain separate and appropriate fee programs.

There are several other important distinctions between these two sections that lead to the conclusion that a uniform fee was never contemplated by the Legislature. For instance, there is a monetary cap on the amount of money that can be collected from the nonvehicular stationary source facilities; the air districts in California are authorized to collect this fee under certain circumstances; and the threshold of emissions is not limited to volatile organic compounds but includes any nonattainment pollutant or its precursors.

Section 2, however, which creates the fee program for architectural coatings manufacturers and consumer product manufacturers does not have a monetary cap; the fees cannot be collected by the air districts; and the emissions threshold is limited to volatile organic compounds. These items are significant differences in the fee programs. These differences and the statutory language should lead ARB to the conclusion that a uniform fee equation is not consistent with the language and intent of the statute. (NPCA, 7/24/03)

Agency Response: ARB staff disagrees with the commenter's assertion that a uniform fee system is inconsistent with State law. As explained in the response to the previous comment, the ARB believes that AB 10X neither prohibits nor requires a uniform fee approach. The commenter's attempt to create a statutory construction argument is not convincing. A "uniform fee approach" basically means that the ARB has chosen to charge all pollution sources the same dollar amount per ton of pollution. There is no basis for concluding that this approach is impermissible simply because the authority to assess fees from facilities is contained in one section of the Health and Safety Code, and the authority to assess fees from consumer products and architectural coatings manufacturers is contained in a different section. The fact that differences exist in the wording of these two sections does not decide the issue, because none of the differences address or in any way suggest the specific dollar amount per ton that could be assessed. This is an implementation decision that is not dictated by the statute; it is a decision left to the ARB to determine as part of the regulatory adoption process.

16. **Comment:** Future "fees" on consumer products cannot be automatically adjusted to the California Consumer Price Index. The ISOR asserts that "fees" that will be assessed in fiscal year 2004-05 (and subsequent fiscal years) "may include a percentage increase in revenues by an amount not to exceed the annual percentage change, in the California Consumer Price Index, as provided in HSC section 39612(f)(2), if such an increase is necessary to collect the revenues authorized by the State Legislature for any fiscal year." Yet, the clear language of AB 10X states that, as amended, section 39612(f) will apply only to stationary sources - not consumer products and architectural coatings which are addressed in a different section.

A careful reading of the language of AB 10X reveals that the language in sections (e) and (f) has a subtle, but significant difference. Section (e) clearly applies to "The permit fees collected pursuant to this section [section 36912 (i.e., the provision dealing with stationary sources)] and section 39613. By contrast, section (f)(1) states, "The total amounts of funds collected and imposed pursuant to this section [section 36912], exclusive of district administrative costs…," and subsection (f)(2), the provision that authorizes the ARB to increase fees based upon the California Consumer Price Index, states that the ARB "may increase the limitation on the total amount of funds collected as described in paragraph (1) by an amount not to exceed the annual percentage change in the California Consumer Price Index as compiled and reported by the Department of Industrial Relations." Clearly, there is no reference to the authority conferred in section (e).

This conclusion is consistent with the opinion expressed by the ARB that the statutory cap of $13 million only applies to stationary sources and not to consumer products and architectural coatings: "fees from manufacturers of consumer products and architectural coatings are not capped at any numerical amount, but are to be used solely to mitigate or reduce air pollution in the State created by consumer products and architectural coatings." Applying this same reasoning, the ARB has no authority to automatically index "fees" that may be assessed on consumer products and architectural coatings to the California Consumer Price Index. Rather, under the clear and unambiguous language of AB 10X, the ARB is required to ensure that "Revenues collected from the imposition of this fee shall be used to mitigate or reduce air pollution in the state created by consumer products and architectural coatings, as determined by the state board, and shall be expended solely for those programs." (CSPA2, 7/22/03)

Agency Response: The commenter has misread the language of the amendments, and incorrectly believes that the amendments contain an automatic adjustment in consumer products fees to account for changes in the California Consumer Price Index. In fact, the amendments do not provide for an automatic increase, and any increase that might occur would apply only to fees assessed on facilities, and not to fees assessed on consumer products and architectural coatings manufacturers. The relevant provision regarding the California Consumer Price Index is contained in section 90800.8(c)(1), title 17, CCR, which specifically applies only to "… the total revenues collected from facilities…" Moreover, any increase in the statutory $13 million cap on facility fees is not automatic and would occur only "… if the increase is necessary to collect the revenues authorized by the State Legislature for any fiscal year." In other words, an increase could be triggered if the Legislature enacts a budget for a future fiscal year authorizing the ARB to collect a total fee amount large enough to exceed the $13 million cap on facility fees specified in Health and Safety Code section 39612(f).

17. Comment: GMA does not believe that automatic increases in future fees adjusted to the California Consumer Price Index is appropriate or necessary and questions the basis and necessity for the increases. (GMA, 7/22/03)

Agency Response: This comment is addressed in the response to the previous comment, which points out that any increase regarding the California Consumer Price Index would not be automatic and would not apply to consumer products or architectural coatings manufacturers.

18. Comment: The San Luis Obispo County Air Pollution Control District staff agrees that all sources of pollution should be required to pay their fair share for the cost of the regulatory programs needed to ensure their emissions are reduced to lowest feasible levels, and that the facilities are in compliance with applicable regulations and standards. The Air Resources Board has primary responsibility for regulating emissions from consumer products, and shares responsibility with local air districts for regulation of architectural coatings. Neither of those source categories has paid air quality fees to either ARB or the districts in the past. Thus, it is appropriate that such fees be levied to help cover the cost of implementing these regulatory programs.

Stationary source regulation consumes a substantial portion of district staff time and resources, and associated permit fees are often the largest source of revenue for many districts. The proposed fee regulation will more than double the amount these sources pay to ARB, which will make it more difficult in the future if or when we determine that a fee increase is necessary to cover the increasing costs of our programs.

We understand the need created by the statewide budget crisis to generate additional revenue to maintain essential programs. It is appropriate for pollution sources to pay their fair share for the regulatory programs needed to protect public health. We do not oppose the proposed fee increase; however, we do wish your Board to be aware of all

the implications associated with your decision-making on this issue, particularly as it affects the operations and revenue of the districts.

At ARB's June 24, 2003 workshop on the proposed regulation, representatives of the consumer products and architectural coatings industries commented that the proposed uniform dollar/ton fee was unfairly biased to benefit stationary sources. They contended that the proportion of nonpaying source emissions below the 250 ton fee threshold was far greater for stationary sources than for their industries. Therefore, stationary sources should pay a higher dollar/ton fee to compensate for this inequity. However, their argument fails to consider that stationary sources are already paying much higher dollar/ton fees because they pay fees to both the districts and ARB. Thus, we would urge the Board to maintain the proposed uniform dollar/ton fee structure recommended by ARB staff. (SLOAPCD, 7/21/03)

Agency Response: The ARB staff agrees that a uniform fee approach is appropriate.

19. Comment: As a supplier of architectural coatings in California, we believe the adoption of the proposed architectural coatings fees, under the pending Nonvehicular Source Consumer Products and Architectural Coatings Fee Regulations, will result in an unfair and inequitable fee structure for architectural coatings. (PPG, 7/23/03)

Agency Response: This comment is addressed in the responses to Comments No. 11–13, and the response to the following comment.

20. Comment: Imposing fees on architectural coatings manufacturers amounting to 16% of all fees is unauthorized, unanalyzed, and unwise. The ISOR notes (at D-1) that fees would be imposed on 95 businesses operating stationary facilities, 54 businesses manufacturing consumer products, and 24 businesses manufacturing architectural coatings. Using 2001 estimates (based on dubious adjustments to 2000 gallonage and tonnage data), the staff proposes to allocate about 16% of total fees to the 24 manufacturers of architectural coatings and the balance to stationary sources and consumer products. This overallocates the fees to the architectural coatings industry, considering both the quantity of the organic compounds it uses and their nature, compared to the other sources.

The ISOR acknowledges (at page 36) that architectural coatings is only one of 19 major categories in ARB's inventory (which constitute only about 2.4% of the total tonnage), and only one of 11 major categories to which it devotes resources. It indicates (at page 37) that, under an inventory-based allocation, facilities would pay up to 68% of the fee, and consumer products and architectural coatings would pay about 19%. It acknowledges (at pages 37-38), however, that facilities account for only 60% of the proposed fees, whereas consumer products and architectural coatings would jointly account for 40%. Thus, architectural coatings manufacturers would bear about 16% of

the total fees, even though they produce only about 2% of the total inventory of organic compounds and only about 6% of the regulated inventory thereof.

When the nature of the compounds in question are also considered, the proposed allocation is even more lopsided. The ISOR admits (at page 14) that facilities directly emit criteria pollutants, such as fine particulates, sulphur oxides, and nitrogen oxides, as well as organic compounds. SPC understands that the organic compounds emitted by facilities are diverse and that many of them are both highly volatile and highly reactive and, thus, certain ozone precursors.

The ISOR also reveals (at page 22) that consumer products, when used, emit fine particulates, as well as organic compounds. SPC understands that such organic compounds are diverse and include admitted ozone precursors. The ISOR also acknowledges (at page 22) that various organic compounds emitted by consumer products are toxic air contaminants.

In stark contrast, architectural coatings, when applied in the field, do not directly emit any criteria pollutants, including nitrogen oxides, which is also the main ozone precursor. (NRC, *Rethinking the Ozone Problem,* at pages 11-12) As discussed above, water-borne paints, about 85% of the market, generally contain three glycol compounds. Solvent-borne paints, about 15% of the market, generally contain eight organic compounds comprising mineral spirits. The former are low in volatility, and are not regulated at all in other consumer products. The latter are low in reactivity. It has not been established by ARB or any other clean air agency that such paints contribute to ozone nonattainment significantly, or at all. Thus, the quality of the compounds in architectural coatings, as compared to the other sources, is relatively innocuous.

The proposed regulations do not take account of these quantitative and qualitative differences between stationary sources and consumer products, on the one hand, and architectural coatings, on the other. The proposed regulations are therefore unlawful. They treat architectural coatings, relative to the other sources, much more harshly. This is improper, particularly since the former are less harmful (if harmful at all) than the latter on a ton-for-ton basis. (SPC2, 7/16/03)

Agency Response: ARB staff disagrees with the commenter's contention that the uniform fee per ton approach results in architectural coatings manufacturers paying a disproportionate amount of fees. The criteria for including sources in the fee program are specified in AB 10X. Under AB 10X, the billable emissions from a category are determined by the 250 tons per year threshold. As discussed in Chapter IV of the ISOR, architectural coating and consumer product manufacturers would pay approximately 40 percent of the fees because the majority of emissions from these categories come from manufacturers that exceed the 250 tons per year threshold amount. On the other hand, stationary point sources would pay approximately 60 percent of the fees because there are many small stationary point sources (less than 250 tons per year) that account for most of the emissions from this category. In other words, the amount paid by consumer products

and architectural coatings manufacturers is proportionately larger because these categories are dominated by large sources (i.e., sources that emit over 250 tons per year) that emit most of the VOCs.

The commenter is basically arguing that the only valid way to impose fees is to impose them on particular sectors of industry (i.e., the "consumer products sector," the "architectural coatings sector," or the "facilities" sector). The commenter wants the ARB to take the overall percentage of emissions from each industry sector, and impose the same percentage of fees on all pollution sources within the sector. The commenter's argument overlooks the fact that AB 10X authorizes the ARB to impose fees on large individual sources of pollution, and does not require an approach that imposes fees on particular industry sectors. The approach advocated by the commenter would result in stationary point sources (i.e., facilities) paying about three times as much on a dollar per ton basis as the architectural coatings manufacturers. The ARB believes that this is not the most equitable approach, and that it is more equitable to treat large sources of pollution in a similar fashion regardless of which industry sector the sources "belong" to.

ARB staff also disagrees with the commenter's assertion that the particular VOCs used in architectural coatings are "relatively innocuous" because they are insufficiently reactive or volatile to create ozone. Based on ARB survey data, the statewide VOC emissions from architectural coatings were 128 tons per day in 2000. The glycol compounds in water-borne paints and the mineral spirits in solvent-borne paints meet the regulatory definition of VOC. These compounds obviously evaporate into the air because if they did not, the paint could not form a film and dry. After they evaporate, the compounds react in the atmosphere to form ozone. Dr. William Carter of the University of California at Riverside has assigned Maximum Incremental Reactivity (MIR) values to these compounds indicating the rate at which they form ozone in the atmosphere. The assertions made in this comment have been repeatedly made by the commenter over the past decade. They have been extensively investigated by the ARB staff and determined to be incorrect. A good summary of the conclusions reached by ARB staff on both volatility and reactivity can be found in the June 2000 Final Program Environmental Impact Report for the Suggested Control Measure for Architectural Coatings. This document is included in the references listed in the ISOR (see page 45 of the ISOR), and is therefore part of the record for this rulemaking action. The responses to Comments No. 69 and 70 also address these issues in detail.

Finally, contrary to the commenter's assertion, the ISOR does not state on page 22 that "consumer products, when used, emit fine particulates, as well as organic compounds." The ISOR states that "consumer products are a significant source of VOC emissions in California and contribute to the formation of both ground level ozone and PM10, which are two of the criteria air pollutants of greatest concern in California." This statement is also true of architectural coatings; neither consumer products nor architectural coatings directly emit PM10, but the VOCs contained in both product categories can contribute to the subsequent formation of secondary PM10 in the atmosphere. Therefore, the commenter is incorrect in claiming that the compounds emitted by architectural coatings and consumer products are so different that the two categories should be treated differently in the fee

regulations. Regarding the solvents in water-borne and solvent-borne paints, please see the responses to Comments No. 69 and 70.

21. **Comment:** The ARB's proposed fee structure is contrary to the clear direction of the statute. It impermissibly combines two separate fee programs - fees on stationary sources, and fees on Consumer Products and Architectural Coatings. The proposed fee program violates the authorizing statute, ARB must establish and manage these programs separately, and account for these fees in separate programs.

During the emergency session of the Legislature, the Legislature passed AB 10X, which was signed by the Governor on March 18. This bill established three independent fee structures: an expansion of the fees paid by permitted stationary sources; a new fee on manufacturers of consumer products and architectural coatings; and, fees related to the discharge of waste which could affect the quality of waters within the state.

Apparently based on comments by the Governor at the signing (perhaps he signed by mistake and the law is void?), the ARB staff has persisted in combining the first two of these programs into a single program. AB 10X clearly requires the ARB to adopt independent fee programs. (HC1, 7/18/03)

Agency Response: For the reasons discussed in the responses to Comments No. 14 and 15, the ARB staff does not agree with the commenter's assertion that the fee structure is contrary to the provisions of AB 10X. In addition, the commenter also seems to be suggesting that the ARB has structured the fee regulations improperly. The commenter states that the "ARB must establish and manage these programs separately" and that "the ARB staff has persisted in combining the first two of these programs into a single program." Other commenters have made similar comments that the two fee programs must be "separate." The implication is that the ARB should perhaps have established two different subchapters in title 17. For example, the existing subchapter 3.8 in division 3, chapter 1 of title 17 could perhaps have addressed only fees assessed on facilities, and a new subchapter 3.9 could perhaps have addressed only fees assessed on consumer products and architectural coatings manufacturers.

The ARB staff could indeed have proposed two "separate" regulations, in the sense that the regulations for facilities and manufacturers could have been located in separate subchapters or sections of title 17. The ARB staff considered doing this early on in the regulatory development process. However, staff decided that taking this approach would be confusing because there would be numerous parallel, very similar regulatory provisions in each set of regulations. Staff therefore decided it would be clearer and avoid duplication to place all provisions into a single unified structure.

The ARB staff believes that an assertion that the regulations must be "separate" elevates form over substance, and is really just another way of arguing that a uniform fee per ton should not be assessed on all sources. Once the decision to impose a uniform fee per ton has been made, it does not matter whether the regulations are structured as "separate"

regulations, or whether they are combined in one structure for reasons of clarity and nonduplication. It is really the content of these regulations (i.e., the uniform dollar per ton assessment) and not their form that is being objected to. The ARB's rationale for the content of the regulations, including the uniform fee per ton, is discussed at length throughout the ISOR and FSOR.

Finally, there is no basis for the commenter's suggestion that Governor Davis might have signed AB 10X "by mistake," or that the law would be "void" even if the Governor had done so.

22. **Comment:** The fees to be collected from permitted stationary sources under the existing fee program are based on the actual emissions by those facilities of a broad range of potential pollutants. The local air district in which the emitting facility is located often collects these fees. ARB is required to spend all revenue collected for specific programs identified in the statute.

On the other hand, the new fees which are authorized to be collected from manufacturers of consumer products and architectural coatings are to be based only on potential emissions of VOCs from these products. These fees are to be collected directly by the ARB, from the manufacturers rather than from the actual user/emitter. The revenues collected from these fees on manufacturers must be used solely "to mitigate or reduce air pollution in the state created by consumer products and architectural coatings," programs which are completely separate from the tasks specified by the stationary source program.

The law clearly mandates separate bases for the collection of these fees, separate means of administration, and very different uses of the fees collected - the programs can not be lumped together into a single program. (HC1, 7/18/03)

Agency Response: This comment is addressed in the responses to Comments No. 14, 15, and 21.

23. **Comment:** Although AB 10X requires fees to be assessed on nonvehicular stationary sources (facilities) and on architectural coating and consumer products manufacturers, the statute clearly considers these two sources (facilities versus manufacturers) as separate programs. For example, the fee on facilities has a cap, while the fee on manufacturers shall be used solely to mitigate or reduce air pollution. It is blatantly unfair to charge a uniform fee per ton across all categories (facilities and manufacturers), when the contribution of emissions from these two segments is dramatically different. Based on the proposed method for calculating the fees, the architectural and consumer products segment will be paying 13.6%. - 18.2%, of the entire stationary source budget of $39.6 million while being responsible for 19% of the emissions. On the other hand facilities will be paying only 20.0% - 27% of the entire stationary source budget of $39.6 million while being responsible for 68% of the emissions. This is supported by the fact that ARB's own business impact analysis shows that the greatest impact on profitability will be placed on the architectural coatings industry

(this impact will be 10 times the impact on the other two categories (facilities and manufacturers). (SW3, 7/23/03)

Agency Response: This comment is addressed in the responses to Comments No. 11-15 and 21.

24. Comment: In light of California's budget shortfall, the Legislature, at the urging of the Governor, passed AB 10X authorizing ARB to develop a regulatory fee structure. AB 10X authorizes ARB to impose additional fees on nonvehicular sources that emit 250 tons or more per year of any nonattainment pollutant or its precursors in California. These fees are to be collected for the purpose of recovering the costs of State programs related to stationary point sources of pollution. AB 10X also authorizes ARB to impose a fee for emissions from consumer products and architectural coatings sold in California if a manufacturer's total sales will result in emissions of 250 tons or more per year of volatile organic compounds ("VOCs"). The fees recovered from these manufacturers are to be used for the reduction and/or mitigation of pollution in the State created by these products.

In response to the Legislation's mandate, ARB has proposed a uniform fee program on stationary source facilities, architectural coatings, and consumer products. However, a uniform fee is not consistent with the language of the Act, which directs ARB to regulate these industries in a distinct and separate manner. For instance, unlike section one of AB 10X governing stationary source facilities, section two, which creates the fee program for architectural coatings and consumer products, does not have a monetary cap. Moreover, only ARB can collect the fees for architectural coating and consumer product manufacturers, whereas the local air districts may continue to collect the fees from the stationary source facilities. Furthermore, the emission threshold is limited to VOCs for architectural coating and consumer products manufacturers in contrast to the inclusion of any nonattainment pollutant and its precursors for stationary source facilities.

Thus, the differences between the treatment of the industries in AB 10X should instruct ARB to create reasonable fee programs consistent with the pollution created by each of these distinct industries. Therefore, in accordance with the language of the statute, the regulatory fee program should be reasonably related to the activities of the three separate industries and attainment of the ozone standard. (RCMA, 7/22/03)

Agency Response: This comment is addressed in the responses to Comments No. 11-15 and 21.

25. **Comment:** The California Air Pollution Control Officer's Association and the South Coast District are here in support of your staff's recommendations pertaining to the architectural coatings and consumer products. We think it is very important that you move forward on that front. In fact, we would encourage you to think about increasing the amount of fees in that area and hiring additional staff to do analysis and rulemaking. Those two source categories are large VOC source categories that contribute to the state's ozone problem. If we look at South Coast as an example, as I mentioned earlier this morning, for the first time in five years we have stage one episodes. We've also had 40 days of violation in South Coast already this year with the heart of the smog season yet to come in August and September.

And when we look in South Coast at the upcoming air quality management plan, there is a 230 ton long-range measure black box that falls within this Board's jurisdiction. A significant portion of that is consumer products.

We need your help, so we urge you to go forward with establishing these fees, collect the moneys and put your staff to work preparing the regulations and other programs that are needed to reduce emissions from consumer products and architectural coatings. Thank you. (SCAQMD and CAPCOA, 7/24/03)

Agency Response: The ARB staff agrees with the commenter's statements that it is important to collect fees from consumer product and architectural coating manufacturers to fund work to reduce pollution from these large VOC source categories. Regarding the commenter's suggestion that the ARB should increase the amount of the fees and hire additional staff, such decisions are up to the Governor and Legislature as part of the budget process.

26. **Comment:** I would like to support what Mr. Wallerstein just said in terms of fees on architectural coatings and consumer products. Those two industrial categories currently are not paying fees. They are a very large source of emissions statewide and they're a very difficult source of emissions to deal with from a regulatory standpoint, just due to their very nature compared to other sources, like stationary sources. So I would echo Barry's recommendations that ARB assign additional staff to looking more closely at those sources in terms of additional rule development and what types of emission reduction strategies we can develop to reduce the impact of those sources on California's air quality.

For stationary sources, I'd like to point out that the districts spend a lot of staff time and resources in regulating those sources. And, as a result, the districts levy substantial fees in order to cover our costs for our programs. I attended the June 24th workshop put on by your staff and heard a lot of comments from the architectural and consumer product industry concerning what they feel is inequity in having a uniform fee structure. One of the things that their arguments failed to consider is the fact that stationary sources are already paying substantial fees to the district, more substantial than those charged by ARB.

So currently there is a large inequity in terms of dollar per ton that is paid by stationary

sources compared to architectural coatings and consumer products industry. And the current proposal would more than double those fees on stationary sources, which would further expand that inequity. That proposed doubling is going to make it more difficult for us in the future if we determine that we have to raise fees in order to cover increasing program costs.

I don't oppose the proposed fee increase. I realize that it is necessary, but I do want you to be aware of the implications in your decision making process, especially how that affects district operations and revenue. So I'd just like to reiterate we do support the architectural coatings and the consumer products fees and don't oppose the other fees. (SLOAPCD, 7/24/03)

Agency Response: This comment is addressed in the response to the previous comment made by the South Coast Air Quality Management District staff.

27. Comment: This statute actually creates two separate fee programs. If you look at the statute, it had an existing provision which increased fees on stationary source facilities. There's a whole other provision in the statute that provides for fees on architectural coatings and consumer products.

I know the ARB staff made an assumption that a uniform fee and one single fee program was the most fair and equitable way to proceed. I disagree with that decision. I disagree with their assumption. There are different considerations for the large stationary source facility, very, very different from architectural coatings and consumer products. And these differences actually are articulated in the statutory language. It's beyond my comprehension that this fee program is all lumped into one program. What needs to happen is a very tailored fee program for the architectural coatings industry and a very tailored fee program for the consumer products industry. That issue alone would take us more than 90 days to even discuss and ferret out all the issues that are corollary to that and peripheral to that. But again, here we are 90 days after the very first teleconference voting on adoption of this rulemaking. (NPCA, 7/24/03)

Agency Response: This comment is addressed in the responses to Comments No. 14, 15, and 21. In addition, staff does not agree with the commenter's implication that the public process for this rulemaking action was inadequate. Public process issues are addressed in the responses to the comments in Section III.H of this FSOR.

28. Comment: The second issue we have is with the uniform fee rate. AB 10X clearly separates the fees on facilities from the fees on architectural coatings and consumer product manufacturers. Thus, the statute provides the discretion to the Board in how to allocate these fees. The proposal sets a uniform fee per ton emitted from all categories. The result is that in consumer products and architectural coatings we'll be paying 13 to 19 percent of the entire stationary source budget, with emissions of 19 percent. On the other hand, the 21 facilities will pay only 20 to 27 percent of the

stationary source budget, but will contribute 68 percent of the emissions. We consider this very unfair.

Staff's own impact analysis showed that architectural coating payers will have a 10 X greater impact than the impact it will have on other payers. This is not fair. This is not equitable. And we recommend the rule be amended so that the fees are levied in an equitable manner.

Earlier, staff specifically said there is a close relationship between emissions and program costs. The emissions from architectural coatings and consumer products do not contribute the 40 percent that we are going to be getting billed. And that's not fair.

I had one comment, though, in correction of the correction, my calculations show that architectural and consumer products will be paying 13 to 18 percent of the stationary source budget. And they contribute 19 percent of the emissions, which would be okay if the other sources likewise were paying their share, which is 68 percent. That's where the difference is. So apparently all the other funds that are coming in are going towards the stationary source programs and not towards the architectural coating and consumer products, so that seems unfair. (SW4, 7/24/03)

Agency Response: In this comment, the commenter touches on most of the issues that have been raised in Comments No. 11 through 28. The issues are addressed at length in the ARB's responses to these comments.

C. NEXUS

29. **Comment:** The ARB has failed to provide a sufficiently detailed analysis of resources expended to regulate consumer products. We believe the staff analysis of the resources devoted to the regulation of consumer products overstates actual resources used for this activity. Acknowledging that there is no internal Agency system for tracing resources expended for consumer products and architectural coatings, the ARB staff on July 22 provided CTFA with a "Staff Preliminary Evaluation" based on interviews with program staff. This evaluation places the cost of these regulatory programs at $7,762,000, based on the assumption that 67 person years and $794,000 in other costs are devoted to these programs in five areas - enforcement, monitoring and laboratory, research, technical support and planning, and rule development and district oversight. However, no background information is available to enable further analysis of the accuracy of this data or the assumptions on which it is based. We believe that far more data must be produced to justify these assumptions, but this and all background analysis must be made available for public evaluation and comment. (CTFA, 7/22/03)

30. **Comment:** We are concerned that the required nexus between fees and emissions control has not been reasonably established. The ARB must establish a clearly articulated nexus between the money generated by the assessment of the fee and specific

programs that will be funded using the monies raised under the fee. (GMA, 7/22/03)

31. **Comment:** In order for this proposal to be considered a "fee," the ARB must establish a clear nexus between the money generated by the assessment of the "fee" and specific programs that will be funded with this money. However, this "nexus" between the proposed "fees" and consumer products emissions control has not been reasonably established. Therefore, a more detailed, comprehensive assessment of the "fees" collected and the regulations of consumer products is needed. (ASPA, 7/24/03, oral testimony at Board Hearing; CLOR, 7/21/03)

32. **Comment:** The proposed fee regulation fails to meet the required "nexus". ARB has failed to demonstrate a clear nexus between the fee and the resources spent on regulatory programs for architectural coatings and consumer products. The language of AB 10X requires the ARB to "impose a fee for any consumer product.... sold in the state and any architectural coating sold in the state, . .. Revenues collected from the imposition of this fee shall be used to mitigate or reduce air pollution in the state created by consumer products and architectural coatings, as determined by the state board, and shall be expended solely for those programs." This language explicitly limits the agency's use of the collected fees to programs solely devoted to mitigating or reducing air pollution created by architectural programs and consumer products.

Throughout this expedited rulemaking process, however, ARB has consistently argued that they are unable to breakdown their budget in this manner and that they are not organized or managed so that resources devoted solely to these programs could be accounted for. After several requests from industry to do so, ARB finally produced data attempting to break out the expenditures for each of its divisions that are devoted to architectural coatings and consumer products. This data, however, is based upon informal conversations with each of the divisions and is not traceable or accountable in any formal manner. In order to demonstrate the nexus required by the statute, ARB must track its divisions' use of resources in a more exacting fashion.

Furthermore, governing case law in the state of California requires a nexus on a different level. In *Sinclair Paint Company v. State Board of Equalization,* the Supreme Court of California held that regulatory fees must show a "clear nexus" between the fees being collected from the targeted sources and the reasonable cost of ARB's regulatory programs dedicated to reducing or mitigating emissions from these products. In addition, regulatory fees may not be levied for unrelated revenue purposes. In this instance, ARB's inability to exactly account for the resources of each division that are devoted to architectural coatings and consumer products makes it impossible to determine whether the costs being imposed under this proposed regulation are reasonable or whether fees are being diverted to unrelated purposes. See *Sinclair Paint Company v. State Board of Equalization*, Supreme Court of California, June 26, 1997.

ARB is required to do more than poll its divisions for an informal accounting of resources. In order to establish a valid nexus between this fee and the regulated industries, ARB must indicate how much time and resources from each division are devoted solely to architectural coatings programs and consumer products programs. ARB has failed to demonstrate this clear nexus. (NPCA, 7/24/03)

Agency Response to Comments No. 29 - 32: Chapter IV of the ISOR includes a discussion of the resources expended by the ARB for the consumer products and architectural coatings programs. The program costs for consumer products and architectural coatings were calculated using an emissions-based approach (i.e., an approach based on the relative contribution of these sources to the stationary source emission inventory, with appropriate adjustments as described in the ISOR). Since emissions from consumer products and architectural coatings account for 19 percent of the adjusted stationary source emissions inventory, this emissions-based approach determined that consumer products and architectural coatings manufacturers could be assessed up to 19 percent of the total program costs for the ARB Stationary Source Program, or up to approximately $7.6 million for fiscal year 2003-2004.

After the ISOR analysis was released, some industry commenters expressed concern that this emissions-based approach may overstate the ARB's actual costs for the consumer products and architectural coatings programs. These commenters believe that a different approach should be used—one that identifies the cost of specific personnel and other resources devoted to these programs. In response to these concerns, on July 21, 2003 the ARB released an evaluation that used a different approach than the one used in the ISOR. This evaluation is entitled "Staff Preliminary Evaluation: Resources Expended for Consumer Products and Architectural Coating Programs" (preliminary evaluation), and is attached hereto as "Appendix A." The preliminary evaluation was based on resource estimates provided by the divisions at the ARB that work on these programs. The preliminary evaluation indicated that 67 ARB staff work on the consumer products and architectural coatings programs at an annual cost of $7.8 million. The $7.8 million estimate was based on the average salary for ARB staff, preliminary information on other annual costs such as research contracts, and a 15.7 percent annual overhead cost.

After the preliminary evaluation was released, industry representatives requested ARB staff to provide more detail to substantiate the resource estimates contained in the preliminary evaluation. They suggested that the preliminary evaluation was not sufficiently detailed for them to analyze the accuracy of the information, that more data should be provided, and that the preliminary evaluation was based on informal "preliminary" resource estimates which should be verified with greater precision.

In response to this request, staff prepared and added to the rulemaking record a document entitled "*Consumer Products and Architectural Coatings Program Costs*." In this document the ARB refined the preliminary evaluation by: (1) identifying by each ARB division the employment classifications of the 67 staff working on consumer products and architectural coatings; (2) determining the actual cost for each of the individual staff

positions including annual salaries, benefits, and operating costs; (3) identifying other annual costs, by division, such as laboratory equipment maintenance contracts, laboratory supplies, laboratory facility leases, and other ongoing contracts; and (4) including the 15.7 percent annual overhead cost. This refined, more detailed analysis shows that the annual cost of the consumer products and architectural coatings programs using this methodology is $8.9 million, an increase from the $7.8 million estimated in the preliminary evaluation. The $8.9 million cost includes $6.8 million for 67 ARB staff positions, and over $2 million for other program costs. In accordance with Government Code section 11347.1, the *Consumer Products and Architectural Coatings Program Costs* document was added to the record and made available for public comment during the 15-day comment period for this rulemaking action.

In summary, the ARB staff believes that the "nexus" required by California law has been demonstrated both by the emissions-based approach set forth in the ISOR, and the alternative calculation methodology set forth in the "*Consumer Products and Architectural Coatings Program Costs"* document.

33. **Comment:** Determination of whether an assessment is a "regulatory fee" as opposed to a tax for purposes of raising revenue requires an assessment of two factors: (1) whether the assessment is a reasonable cost of regulation; and (2) whether the assessment is related to the regulatory activity.

Establishment of this "nexus" is required in order for there to be any basis to justify this action as a legitimate fee as opposed to an illegal tax. Our review of the ISOR and other publicly-available budget information to date does not shed sufficient light on the allocation of resources to consumer products within the ARB to justify these fees.

Although the ARB staff informally provided additional information regarding resource allocation to regulation of consumer products and architectural coatings a few days before this hearing, we have been advised generally throughout the regulatory process that the Agency does not compile detailed resource allocation information that would readily demonstrate the resources from each ARB component devoted to regulation of consumer products. We are advised that the information provided recently was obtained through interviews with ARB staff members.

While it may not have been necessary before, detailed record-keeping and tracking of resources collected and used to regulate consumer products now must be a requirement if the ARB is to rely on fees of this type to support its activities. This includes a detailed evaluation of the resources devoted to regulation of consumer products in 2001 in order to determine whether there is a reasonable relationship between the fees to be collected and the regulatory activity to be funded, and to determine specifically how those fees should be allocated within the ARB. Far more information than is provided in the ISOR must be made available for public review and comment before this regulation is adopted. (CTFA, 7/22/03)

Agency Response: This comment is addressed in the response to Comments No. 29-36. In addition, there is no basis for the commenter's assertion that the ARB must fundamentally change its current accounting and record-keeping system in order to demonstrate the legally required "nexus." This issue was addressed by the Third District Court of Appeal in *California Assn. of Professional Scientists v. Department of Fish & Game* (2000) 79 Cal.App.4th 935, 950-954. The Court, in upholding the constitutionality of a flat regulatory fee imposed by the Department of Fish and Game, held that it was not necessary for regulatory fees to be supported by a staff time-keeping system for a precise cost-fee analysis. The Court recognized that it was reasonable to determine that the administrative cost and burden of such a system might be too high, and that a legislative body retains the discretion to apportion the costs of regulatory programs in a variety of reasonable financing schemes. The ARB also believes that it would be too costly, inefficient, and burdensome to fundamentally change its current accounting and record-keeping system, which is similar to the one used by many other State agencies. The ARB also believes that it has provided sufficient information in the record to establish a nexus and demonstrate that the fee regulation is reasonable.

34. Comment: ARB's air emissions inventory assessments clearly demonstrate that consumer product manufacturers would be required to pay an unfairly large share of "fees." ARB is proposing to collect 25.2 percent of all "fees" from consumer product manufacturers that represent 4.0 percent of all stationary sources emissions and 5.9 percent of the total emissions ARB is currently seeking to regulate. The proposed "fees" on consumer product manufacturers far exceed their small percentage of overall emissions. (P&G, 7/24/03)

35. Comment: There are several questions raised by the record to date which call into question the fairness and legality of this process: Under both scenarios for collection of fees discussed in the ISOR - $13 million and $17.4 million - consumer product manufacturers will generate approximately 25 percent of the fees, totaling $3.282 million under the lower total and $4.393 million under the higher total. We believe this far exceeds the actual percentage of stationary source emissions contributed by consumer products.

In the ISOR, the ARB staff admits that the fees for consumer products and architectural coatings are inflated, stating that "...although consumer products and architectural coatings contribute 19 percent or 147,737 tons to the stationary source inventory, they account for 40 percent of the total fees based on their billable emissions (94,961 tons per year)." (ISOR at 37) The ISOR goes on to say that although facilities contribute 68 percent of the stationary source inventory, they pay only 60 percent of the total fees. The report justifies this with the statement that "Staff believes that this is consistent with the Legislature's intent to have large emitters defray some of the costs of the ARB's stationary source program." (ISOR at 38).

If this information is correct, it clearly demonstrates a disproportionate burden on consumer products and a failure to justify a reasonable "nexus" between the fees and regulatory activity to be funded. If not, the analysis needs to be corrected. In either

case, the proposed regulations should not be adopted until the issue is resolved. (CTFA, 7/22/03)

Agency Response to Comments No. 34 and 35: The responses to Comments No. 11-13 and 20 discuss why consumer products and architectural coatings manufacturers will not pay a disproportionate amount of fees. These responses, along with the response to Comments No. 29-32, demonstrate that a reasonable nexus has been established.

36. Comment: Our specific objections to the proposed regulations are primarily that they fail to implement the letter and intent of the law. Under AB 10X, ARB may impose fees on any manufacturer of consumer products or architectural coatings, if a manufacturer's total sales in either category result in emissions of at least 250 tons of VOC per year within California. These fees must be "expended solely" for ARB programs "to mitigate or reduce air pollution" caused by consumer products or architectural coatings.

We believe the intent of the law is a fairly straightforward and facially reasonable notion: if ARB expends resources to deal with emissions from a category of products, the manufacturers of those products should reimburse ARB for the amount expended - but no more. Manufacturers should not be taxed to support other program costs. The test for gauging the expenses to be reimbursed is to ask: How much would ARB save, that is, how much of ARB's resources would be freed up for other purposes, if this category of products ceased to exist? The answer to this question would determine the required nexus between fees and program costs - a nexus that, so far, has not been established.
(D-EP, 7/23/03)

Agency Response: As explained in the responses to Comments No. 29-35, the ARB disagrees with the commenter and believes that the required nexus has been established.

37. Comment: We question whether this proposal is more a tax than a user fee. The monies collected should be used to improve air quality from coatings and consumer products rather than used as a general fund. The company believes that the fee, if passed, should provide a real and tangible benefit to the industry sector paying the fees, therefore resulting in clean air. Since permits and other regulatory administrative activity don't fit this scenario, increased research on coating technology is appropriate. Presently, the ARB can only identify one tangible allocation of resources to architectural coatings and consumer products, that of $300,000 to research aerosols. This represents less than 4 percent of the 7.6 million dollar minimum fee for these industry sectors.

In that regard, we believe that ARB has only identified how to collect the fees not how to internally manage the fees. We believe that recent changes to accounting practices will require the Agency to keep fee and tax resources separate. Therefore, use of these fees should be limited to the particular industry as a restricted fund within the ARB. (MASCO, 7/21/03)

Agency Response: ARB staff disagrees with the commenter's assertion that the proposal is a tax instead of a fee. As described in Chapter IV of the ISOR, the fee regulation will provide only some of the funds necessary to support the ARB's activities to mitigate or reduce pollution from the affected source categories. Chapter III of the ISOR explains how the fees are based on the emissions from stationary point sources, consumer products and architectural coatings. Chapter IV of the ISOR describes ARB's extensive activities to directly reduce or assist the districts to reduce emissions from the affected source categories. As explained in Chapter IV, the ARB's activities are not limited to conducting research as the commenter suggests. The fees collected will be placed in the Air Pollution Control Fund and will be used solely to support the ARB's programs for the fee payers. The revenues from the fees will not be used to support other program costs. For example, none of the fees will be used for the ARB's mobile source program. This will happen under the ARB's current accounting system, and changes to accounting practices will not be necessary. In response to industry's concerns about the nexus issue, ARB staff released additional information about the resources required for consumer products and architectural coatings subsequent to the release of the ISOR. Industry was provided the opportunity to comment on the additional information during the 15-day comment period, as explained in the response to Comments No. 29-32.

38. Comment: ARB has statutory authority to regulate consumer products statewide, and has significant program costs related to consumer products. That statutory authority over consumer products, however, specifically excludes architectural coatings. Local air districts exercise authority over architectural coatings in California. Therefore, ARB has little in the way of program costs related to architectural coatings (e.g., for periodic surveys, occasional updates to a suggested control measure, assistance to local districts in implementing the suggested control measure, and some research).

ARB staff have not accounted for program costs specific to consumer products and, separately, to architectural coatings. Thus, staff is proposing to lump together emissions from all fee payers (including industrial facilities), and divide the total fee amount to be collected by total tons of emissions, charging each fee payer at the same dollar-per-ton rate.

This approach is unfair to architectural coating manufacturers, who would be paying more than ARB program costs for architectural coatings. In effect, manufacturers of architectural coatings would pay part of ARB program costs for consumer products and industrial facilities. Therefore, in our view, the proposed regulation imposes not a legitimate fee, but a tax to support general program costs. (D-EP, 7/23/03)

Agency Response: The commenter is incorrect in the assumption that the ARB staff has minimal program costs related to architectural coatings simply because the local districts, not the ARB, have direct statutory authority to regulate this source category. The ARB staff provides a great deal of assistance to local districts who have or plan to adopt architectural coatings rules. For example, at the request of the districts the ARB is

administering the statewide averaging provisions contained in district architectural coatings rules. The response to Comment No. 36 (and the portions of the ISOR mentioned in the response to Comment No. 36), describe the ARB's extensive activities related to architectural coatings. These activities include periodic surveys of architectural coatings emissions, ongoing Suggested Control Measure development, assisting the districts in adopting architectural coatings rules, performing technology assessments, and investigating reactivity as a possible regulatory approach. In addition, surveys are not a trivial matter, since they can take from two to three years to develop, conduct, and analyze.

The responses to Comments No. 11- 28 address the commenter's claim that architectural coatings manufacturers would pay a disproportionate amount of fees, and the responses to Comments No. 29-36 explain why the ARB believes that the required nexus has been established.

39. **Comment:** Local districts and the U.S. EPA both have long claimed and actively exercised direct rulemaking jurisdiction over architectural coatings. ARB however, has never had such jurisdiction. Most of its current activities relating to architectural coatings are discretionary, duplicative, or nonessential. The amount of money needed by ARB to provide any necessary services relating even in part to architectural coatings -- conducting a triennial survey of all sources -- is a small fraction of the $2,849,149 the staff proposes to impose on this industry in 2003-04 alone. (SPC2, 7/16/03)

40. **Comment**: Imposing fees of $2,849,149 on manufacturers of architectural coatings in 2003-04 to finance nonessential programs is unauthorized, unanalyzed, and unwise. Section 39613 mandates that fees "shall be used to mitigate or reduce pollution . . . created by . . . architectural coatings" and "shall be expended solely for those programs."

The ISOR discusses (at 18, 33-34) ARB's role with respect to architectural coatings. It admits that other agencies, such as U.S. EPA and local districts, claim and exercise direct authority to regulate paints. ARB's role, by contrast, is limited to assisting the agencies which claim and exercise rulemaking power. ARB's one mandated activity relating in part to paints is limited to conducting surveys of all sources every three years. It also publishes discretionary suggested control measures every eight years or so. The ISOR suggests (at E-2) that ARB will use and expend in 2003-04 $2,849,149 in connection with such support services. "Collectively," the ISOR claims (at 34), these efforts are "an integral and necessary part" of mitigating and reducing organic compounds in paints. SPC believes this claim is not supportable.

The only ARB statutory duty of which SPC is aware relating, even in part, to architectural coatings is the triennial update of the emissions inventory. This should require little or no staff attention in most years. In any year when staff attention is required, it should not demand significant resources, at least as to architectural coatings. There are relatively few paint manufacturers to survey. ARB and those manufacturers have participated in preparing forms, filling them out, and tabulating the results on several prior occasions, and the task has become fairly routine.

In addition, ARB has on four prior occasions — about once every eight years — published a suggested control measure relating to paints. But these steps were and will remain wholly discretionary. After 26 years of direct regulation, the districts are now well able to regulate paints without significant further assistance of ARB. Furthermore, U.S. EPA has been actively studying and regulating architectural coatings for a decade.

It seems quite obvious that ARB does not any longer need to spend, and probably could not possibly spend, anywhere near $3 million in 2003-04 or any year thereafter in conducting architectural coatings studies. The issues ARB proposes to address and finance by the fees have been studied extensively by numerous agencies at three levels of government for 26 years.

The necessary implication of the staff's proposal is that the nearly $3 million ARB would collect each year from two dozen paint makers would, in reality, be used primarily to subsidize the costs of regulating consumer products and studying stationary sources.

In a budget crisis, especially like the one California now finds itself in, policy makers can increase revenues, decrease spending, or both. It seems clear that limiting ARB spending to only a small fraction of $3 million each year on paint studies is a compelling policy option, one the board should not only consider, but also adopt.

Article XIIIA, section 3 requires that the fee bear a clear nexus to the costs of the government program. *Sinclair Paint*, 15 Cal.4th at 876, 881; *California Assn. of Professional Scientists*, 79 Cal.App.4th at 950. When the agency fails to prove such nexus, the fee will be held to be an unconstitutional tax. *Beaumont*, 165 Cal.App.3d at 234-36; *Bixel*, 216 Cal.App.3d at 1218-20.

Under section 39613 the fees collected must be spent to "mitigate or reduce air pollution . . . created by . . . architectural coatings." The Administrative Procedure Act requires that the proposed regulations be "reasonably necessary" to carry out that purpose.

Here, the ARB programs in question are intermittent and either discretionary or inexpensive, and there is no established nexus between the proposed annual fees and reducing any air pollution caused by paints.

Furthermore, as shown above, the ISOR or the Notice under the Administrative Procedure Act must assess the necessity of the fees and their economic impacts. The staff's two documents do not explain why ARB should spend roughly $3 million per year on triennial paint surveys or discretionary model rules. Nor does the ISOR describe ARB's efforts to avoid "duplication" with the work of other agencies. Government Code § 11346.2(b)(5). Indeed, in the case of the paint studies at issue, there has been "triplication" for 26 years. (SPC2, 7/16/03)

Agency Response to Comments No. 39 and 40: The ARB staff disagrees with

the commenter's assertions. The responses to Comments No. 36 - 38 discuss the ARB's many activities related to architectural coatings. These activities are not minimal, as the commenter suggests. The fact that the districts have regulated architectural coatings for many years does not absolve the ARB of its responsibility to assist districts to obtain further reductions from architectural coatings. Many districts, particularly the smaller ones, need the ARB's help because they simply do not have the resources to adopt architectural coatings rules and effectively deal with the many rule implementation issues that arise.

Further reductions from architectural coatings are necessary to attain and maintain the federal and State ambient air quality standards for ozone. Although architectural coatings have been regulated for many years, they are still a major source of VOC emissions in California. Based on the ARB's 2001 survey, the statewide VOC emissions from architectural coatings were 128 tons per day in 2000. This is greater than the statewide VOC emissions from petroleum production, refining, and refueling combined. In light of the significant emissions from this category and California's serious air quality problems, it is rather meaningless for the commenter to label the ARB's actions as "discretionary." Most ARB actions are "discretionary" under a strict legal definition of this term, but the ARB cannot afford to ignore a category with emissions as significant as architectural coatings.

The commenter is also making the assumption that "architectural coatings activities" can be completely separated from "consumer products activities," and that the fees collected from architectural coatings manufacturers can only be spent on "architectural coatings activities." The ARB has many years of regulatory experience in these program areas, and has concluded that the two areas are so closely intertwined that it is not possible to completely separate the resources expended for architectural coatings from those expended for consumer products. Both consumer products and architectural coatings are widely distributed area sources that present similar, overlapping regulatory and compliance issues. Following are some specific examples of overlapping activities conducted by ARB staff that apply to both programs: (1) reactivity and health effects research that apply to both programs; (2) statewide nonattainment pollutant monitoring; and (3) air quality modeling for State Implementation Plan attainment demonstrations.

Because of this overlap, the ARB has not attempted to separate the resources expended on consumer products activities from those expended on architectural coatings activities, but has instead treated both areas as part of a single unitary program. Although the exact resources for each program cannot truly be separated or quantified, the greater fees paid by consumer product manufacturers reflect the fact that they are a larger source of VOC emissions and, in general, require more ARB resources than architectural coatings. The preliminary fee estimates indicate that consumer product manufacturers will pay about 70 percent more in fees than architectural coating manufacturers in fiscal year 2003-2004 (e.g., $4.6 vs. $2.7 million dollars).

41. **Comment:** The commenter is concerned that the enabling legislation establishes a cap of $13 million, yet ARB does not interpret the legislation in this fashion. (CPC, 6/6/03)

Agency Response: The ARB is interpreting the legislation as it is written. Health and Safety Code section 39612(f)(1) specifies that the $13 million cap applies to stationary point sources, not to consumer products and architectural coatings.

42. Comment: It's the commenter's position that in order for the proposed fee to meet the nexus and other requirements of a regulatory fee it must be based on sales and tons as close in time to the assessment as possible. Pursuant to § 90800.8(c) and (d) of the proposed regulations and the requirement that a regulatory fee have the appropriate nexus between the fee payer and the purported harm to be remedied *(see Sinclair Paint Co. v. State Board of Equalization,* 15 Cal Ath 866, 881 (1997)), SPC requests that any fee assessed against it under the proposed regulations be based on SPC's actual sales in California in 2002. (SPC, 7/14/03)

Agency Response: The fees for the 2003-2004 fiscal year will be based on California sales in 2001 because 2001 is the most recent year for which emissions data are available for all affected source categories. ARB surveys for consumer products and architectural coatings collect sales data for the previous calendar year because that is the most recent data that manufacturers' are able to provide. For example, most manufacturers are unable to provide sales data for 2001 until mid-2002. Because the sales data collected from manufacturers must then be reviewed for quality assurance before it is finalized by ARB staff, the emission inventory for 2001 is not finalized until 2003. The same time lag exists for the emission inventory for stationary point sources, for the same reason. Hence, the fees for fiscal year 2003-2004 are based on emissions in 2001. Even though some individual manufacturers are able to provide sales data earlier than other manufacturers, it would be administratively unworkable to use different calendar years for different manufacturers. For all of these reasons, the ARB believes that using the 2001 calendar year for fiscal year 2003-2004 is the most feasible and appropriate approach, and that this approach does not present any "nexus" problems.

43. Comment: There is no evidence to support the ARB's tacit contention that it allocates regulatory personnel and resources according to emission inventories. The allocation of personnel and other budgeted resources according to emissions inventories seems extremely difficult, if not impossible, for the ARB to accomplish, nor would it seem to be the best way to allocate resources. Indeed, the ARB provides no evidence in the ISOR to support its tacit contention, and thereby support any logical connection between inventories, resource allocation within the agency, and the nexus issue relating to VOC "fees."

Our review of the Governor's Budget Summary and the Governor's Proposed 2003-04 Budget found no reference to the allocation of resources within the agency according to source category emissions. We have also reviewed the documents currently available on the ARB web site that relate to its various emissions control programs, including the Consumer Products Program and Architectural Coatings Program, and can find no evidence that funding and resources are now or have ever been allocated according to source category emissions.

CSPA therefore believes that the assessment provided by the ARB in Section IV of the ISOR has no logical relationship to the statutory requirement to demonstrate a nexus between the fees collected from consumer products and architectural coatings manufacturers and the ARB's activities related to controlling air emissions from these products. (CSPA2, 7/22/03)

Agency Response: The commenter misunderstands the ARB's position. The ARB is not attempting to justify an emissions-based fee approach because the ARB "allocates regulatory personnel and resources according to emission inventories." Rather, the ARB believes that an emissions-based fee approach is the most appropriate way to determine the agency resources that can be attributed to the various programs within the ARB's stationary source budget. This is because, as discussed in Chapter IV of the ISOR, there are numerous ARB programs that are necessary to mitigate and reduce emissions from consumer products, architectural coatings, and facilities---but there is no easy, straightforward way (other than using an emissions-based approach) to attribute a specific percentage of these program resources to each program area.

For example, the ARB cannot decide what sources it makes sense to regulate unless staff knows what sources generate air pollution in California. Only by having the "big picture" of where pollution comes from can the ARB make rational regulatory decisions about what sources should be regulated and where staff resources can best be spent. The "emission inventory" provides such answers; it consists of a list of all emission sources in California (including consumer products, architectural coatings, and facilities) and an estimate of the emissions coming from each source. A number of staff at the ARB work on compiling the emission inventory, but there is no obvious way to say that Person X spends a specific percentage of his or her time on consumer products or architectural coatings. Compiling the inventory includes many tasks that support the inventory development as a whole, and are necessary to compile the consumer products or architectural coatings portion of the inventory, but cannot be directly assigned or attributed to these specific program areas. The most rational way to make such an attribution is to use an emission-based approach that recognizes the emissions contribution of each source category to the overall emission inventory. This is the approach that the ARB has taken. The emission inventory is just one example; Chapter IV of the ISOR describes other ARB program areas where similar reasoning is appropriate.

45. **Comment:** The ARB hasn't provided meaningful information regarding the nexus. A clearly articulated nexus must be established between the money generated by the assessment of the "fee" and specific ARB programs. Under applicable California case, there is a distinction between taxes (which are enacted for the purpose of generating revenue) and regulatory fees (which are imposed to equitably recoup the costs of particular executive branch programs). See *Sinclair Paint Company v. State Board of Equalization, et. al.*, 15 Cal.4th 886 (1997). (SW1, 6/4/03)

46. **Comment:** The commenter states that, as an industry, they are being targeted for

underwriting these regulatory programs, and respectfully requests an accounting of the true and actual costs to the ARB for staff salaries and benefits, equipment costs, and all other resources that are solely devoted to agency programs for reducing VOC emissions from consumer products and architectural coatings. (CPC, 6/6/03)

47. **Comment:** The commenter is concerned about the amount of money it actually takes to support the ARB programs that focus specifically on consumer products and architectural coatings. This issue is a key element in this rulemaking and one that only ARB can answer. (CPC, 6/6/03)

48. **Comment:** The required "nexus" between the proposed "fees" and consumer product emissions control has not been appropriately or reasonable established. Notwithstanding an attempt to provide further clarification on the issue, the ARB has not yet articulated a clear nexus between the proposed "fee" and the programs that deal directly with consumer products. CSPA and ASPA believe that the information provided in the ISOR falls far short of providing an adequate or reasonable basis to assure that a nexus exists between the fees proposed to be imposed on consumer products manufacturers and the costs incurred by the ARB in seeking to control VOC emissions from consumer products.

Therefore, the ARB must provide detailed information to afford affected parties a reasonable opportunity to assess the fairness of the "fee" allocation for all three broad categories of "fee payers" and, in particular, for the apportionment of the "fees" collected to finance the ARB's activities related to consumer products. CSPA believes that this statutory requirement makes it incumbent on the ARB to conduct a comprehensive budget audit of its Consumer Products Program to provide an assessment of what specific personnel and other resources are applied to the regulation of these specific products. Only such a comprehensive assessment can provide the basis for the ARB to assure that this statutory requirement is met.

Absent such detailed information, it will be difficult (if not impossible) for the ARB to establish the fact that the "fees" do not exceed the reasonable cost of their stationary source programs. Moreover, without a comprehensive assessment of its budget, it would be exceedingly difficult for the ARB to substantiate the fact that the "fees" were not levied for any *unrelated* revenue purposes. Therefore, if the ARB cannot establish the requisite "nexus" between the proposed "fees" and consumer products emissions control programs, this compulsory "fee" would likely be construed as a tax. California's constitution requires a two-thirds vote of the Legislature before any tax (i.e., a tax imposed for a specific purpose) may be imposed. Since both chambers of the Legislature passed AB 10X by a simple majority vote, this "fee" could thus be held to be an illegal tax. (CSPA2, 7/22/03; ASPA, 7/23/03)

49. **Comment:** The ARB has provided no assessment showing what specific personnel and resources are expended for the control of consumer products. A true assessment of what personnel and resources are dedicated to the ARB's Consumer

Products Program and its Architectural Coatings Program would require a comprehensive budget audit and determination of which specific personnel and other resources are to be utilized for what purposes related to controlling emissions from these source categories, as opposed to other source categories. We believe that any less rigorous assessment falls clearly short of the standard required by the statute to satisfy its requirement for a nexus between the fees collected from companies in these sectors and the programs to control emissions from these companies' products. Lack of an annual audit would draw into question the ARB's intent to meet its statutory requirements, but also make the proposed provisions in section 90800.8(a)(4) unenforceable.

However, the ARB has failed to provide even a rudimentary economic audit or assessment in this ISOR of what funding is required to control air emissions related to consumer products and architectural coatings. The ISOR contains a number of sections that refer to the nexus issue. The sections relating to this issue, and the information provided, are as follows:

- In Section IV.B., it is stated that the proposed 2003-04 ARB budget provides $39.6 million for the "stationary source program," which is admitted to include a wide range of emissions sources in addition to consumer products and architectural coatings.

- In Section IV.B.2, the ARB also lists the five divisions that perform duties relevant to consumer products and architectural coatings, and lists the responsibilities of each of the divisions that are believed to be related in some way to controlling emissions from those two emission source categories.

- In Section IV.C., the ARB assesses the emissions of air pollutants attributed to various stationary source categories, and finds that current inventories show that consumer products and architectural coatings emissions represent 19 percent of all stationary source category emissions.

- Based on these findings, the ARB states in Section IV.C. 1. that, "consumer products and architectural coatings could be assessed up to 19 percent of total program costs, or approximately $7.6 million in the fiscal year 2003-2004."

CSPA fails to find any coherence in the logic of this finding, and strongly questions its relevance to the statutory requirement that fees collected from consumer products and architectural coatings manufacturers must be spent solely for programs that reduce emissions from consumer products and architectural coatings. The finding presented makes sense only if the ARB contends that personnel and resources within the Stationary Source Program are being allocated to each of its source-specific programs according to the relative air emissions of each of those sources. (CSPA2, 7/22/03)

50. **Comment:** The ARB's air emissions inventory assessments clearly demonstrate that consumer products manufacturers would be required to pay an unfairly large share of

"fees." While the inventory analyses developed by the ARB have no logical relationship to the nexus issue, they do demonstrate that the "fees" proposed for consumer products manufacturers exceed the amount that can be considered fair or reasonable based on their share of air emissions. This is clearly shown in ARB's own analysis in the ISOR, which states: "For example, although consumer products and architectural coatings contribute 19 percent or 147,737 tons per year to the stationary source inventory, they account for 40 percent of the total fees based on their billable emissions (94,961 tons per year)." These two source categories are being required to pay twice as much as can be justified by the emissions inventory.

For consumer products alone, this disproportionate share of proposed fees is even greater. This is clearly demonstrated by a review of the "Fee Nexus Emission Inventory Description" dated June 30, 2003, and distributed subsequent to the issuance of the ISOR.

This inventory assessment found total air emissions of pollutants and sources believed to be relevant to the operations of the ARB Stationary Source Program for 2001 to be 1,649,179 tons. (This total is referred to as emissions from "nexus sources"). Total air emissions of all pollutants from all stationary sources in the state in 2001 were 2,422,997 tons. The difference between these two numbers represents those pollutants not currently regulated by the ARB or emitted by stationary sources in "attainment areas" for those pollutants. Of these amounts, 97,221 tons can be attributed to consumer products. Consumer products therefore represent 5.9 percent of the emissions from "nexus sources" and 4.0 percent of the air emissions from all stationary sources.

The "fees" proposed for consumer products manufacturers, however, far exceed these small percentages. The ARB proposes to impose fees of $3,282,048 on consumer products manufacturers if total collections are limited to $13,000,000, or to impose fees of $4,392,578 on consumer products manufacturers if total collections are limited to $17,400,000. The ARB is therefore proposing to collect 25.2 percent of all "fees" from consumer product manufacturers that represent 4.0 percent of all stationary source emissions, and 5.9 percent of the emissions the ARB is currently seeking to regulate. Even when one considers the entire $39 million budget for the ARB Stationary Source Program, the ARB is proposing to collect 8.3 percent to 11.1 percent of its total budget from consumer products. These data clearly demonstrate that a disproportionate and unfair burden is proposed for consumer products manufacturers. (CSPA2, 7/22/03)

51. **Comment:** AB 10X created a new fee system for Consumer Products and Architectural Coatings, with the fees to be collected from the larger manufacturers of these products. This enabling statute requires that "Revenues collected from the imposition of this fee shall be used to mitigate or reduce air pollution in the state caused by consumer products and architectural coatings . . ." and may be "expended solely for these programs."

In addition, to avoid being properly characterized as a "tax" rather than a "fee" - in which case the enabling statute fails Constitutional tests -the expenditures must be shown to have a "clear nexus" between the amount of fees collected and the actual expenditures on these

programs.

The ARB supporting documents, and the workshops and public meetings on these fees, have failed to adequately address what has been called "the nexus issue." The proposed fee structure makes no attempt to show that revenues collected will be "expended solely for these programs," or even that the expenditures will have any clear relationship to the fees collected. Staff have repeatedly stated that they can not demonstrate that any specific amount has been expended on specific purposes, and not on unrelated activities. Instead, ARB proposes an allocation method in which they attempt to spread out all of the Stationary Source Division's costs over a portion of the total potential pollutants and their precursors.

Any allocation scheme is an admission that the ARB can not demonstrate that the fee revenues are being expended for the limited purposes required by AB 10X or even that they are being expended for purposes which are sufficiently closely related that the fees would pass Constitutional muster. Unless and until the ARB can demonstrate in a concise, auditable way that the moneys collected will be and continue to be used for the mandated purpose, the proposed fee structure must fail both under the enabling statute and under the Constitution. (HC2, 7/18/03)

52. **Comment:** The language of AB 10X requires a clear and definite link between the air emissions created by these products and ARB's use of the money collected by manufacturers of the targeted products. ARB has failed to demonstrate any such link.

Both the plain language of the statute and applicable case law require that a clear relationship be established between the amount of fees collected from these two emissions sources and the direct costs specifically associated with the regulation of these emission source categories. This requirement is recognized by ARB in its proposed rule in section 90300.8(a)(4). This requirement sets a *de facto* limit on the amount of fees that can be collected from consumer products and architectural coatings manufacturers.

Therefore, ARB must provide detailed information to afford affected parties a reasonable opportunity to assess the fairness of the "fee" allocation for all three broad categories of "fee" payers" and, in particular, for the apportionment of the "fees" collected to finance ARB's activities related to architectural coatings and consumer products. This statutory requirement makes it incumbent on ARB to conduct a comprehensive budget audit of its programs to provide an assessment of what specific personnel and other resources are applied to the regulation of emissions from specific products. Only such a comprehensive assessment can provide the basis for ARB to assure that this statutory requirement is met.

A true assessment of what personnel and resources are dedicated to ARB's Consumer Products Program and its Architectural Coatings Program would require a comprehensive budget audit and determination of which specific personnel and other resources are to be utilized for what purposes related to controlling emissions from these source categories, as opposed to other source categories. We believe that any less rigorous assessment clearly

falls short of the standard required by the statute to satisfy its requirement for a relationship between the fees collected from companies in these sectors and the programs to control emissions from these companies' products. Lack of an annual audit would draw into question ARB's intent to meet its statutory requirements, and also make the proposed provisions in section 90800.8(a)(4) unenforceable. To date ARB still has failed to provide a link between emissions and resources. (SW3, 7/23/03)

53. **Comment:** The language of AB 10X requires ARB to impose a fee on any architectural coating sold in the state to generate revenues that shall be used solely for programs designed for the reduction and/or mitigation of air pollution in the state created by these products. The statutory language of AB 10X requires a clear link between the fee collected from architectural coatings manufacturers and the actual air pollution created by these products.

California's Constitution provides that any changes in state "taxes" enacted for "the purpose of increasing revenues collected" must be imposed by an act of at least two-thirds of all members of each house of the Legislature. Cal. Const. art. XIIIA, §3. Therefore, in order for the fee structure promulgated by ARB to be valid, rather than an invalid tax, there must be a clear nexus between the amount of the fee imposed on the payer, the harm created by the payer, and the government program designed to prevent or mitigate that harm. *See Sinclair Paint Co. v. State Board of Equalization, 15* Cal.4th 866, 876, 881 (1997) (prohibiting the imposition of regulatory fees that are merely revenue-increasing taxes where "no clear nexus" exists between the payer's product sales and any social burden those products impose-the amount of the fee must bear a reasonable relationship thereto and it must not exceed the reasonable costs of providing programs to protect against such burdens). Thus, there must be a "clear nexus" between the fees being collected from architectural coating manufacturers and the reasonable cost of ARB's regulatory programs designated to air pollution reduction or mitigation from these sources.

The ISOR outlines the activities performed by each of the various divisions of the ARB that could possibly relate to architectural coatings without specifically identifying the administrative costs applicable to regulating this industry. In light of the holding in *Sinclair,* ARB is required to do more. Accordingly, ARB must establish a clear nexus between the fees imposed by the new regulation and the regulated industries, meaning ARB must include in the administrative record the amount of resources from each division that are devoted solely to architectural coatings programs. *See Beaumont Investors v. Beaumont-Cherry Valley Water District,* 165 Cal. App. 3d 227, 233-36 (1985) (finding regulatory fee was an unconstitutional tax because the agency's administrative record was devoid of substance and specificity relating to the need to recover administrative costs). (RCMA, 7/22/03)

54. **Comment**: P&G strongly objects to the imposition of the proposed "fees" since this could constitute an illegal tax on consumer product manufacturers. A clear nexus must be established between the amount of fees collected from consumer product manufacturers and the direct costs specifically associated with the ARB programs

established to control consumer product emissions. Until this nexus is appropriately and reasonably established, the proposed 'fee" is, in reality, a tax. California's constitution requires a two-thirds vote of the Legislature before any tax may be imposed. Since both chambers of the Legislature passed AB 10X by a simple majority vote, this "fee" can be construed as an illegal tax. (P&G, 7/24/03)

55. **Comment:** The staff needs to refine its accounting for the fee. Only two days before the Board hearing there was a document released showing only remotely a relationship between emissions and resources. We continued to ask for this document since before the first workshop. Before two days ago we did not get anything from the staff. Industry needs more time to review this document and we need, definitely need more explanation into what is put into it. This accounting is the only means that architectural coatings and consumer products have for a fee cap. A fee cap is not put in by the Legislature, so we definitely need more time to refine this document. (SW5, 7/24/03)

56. **Comment:** We are an alliance of three nonprofit associations. The Automotive After Market Industry Association, Consumer Products Specialty Association, and the Motor Equipment Manufacturers Association, and we're representing companies engaged in the manufacture, formulation, and distribution of sales of automotive specialty products. We have actively participated in this rulemaking and submitted written comments on July 23rd, and you have my written comments.

And I don't want to duplicate what's been said already, but I have to take issue -- echo the comments that were made regarding the absence of a clear nexus between the money generated by this fee and specific programs that would be funded by this money. We think the nexus between the fees, NOx emission control has not been reasonably established, and a more detailed assessment of the fees collected and the regulation of consumer products is needed. (ASPA, Oral testimony at Board Hearing, 7/24/03)

57. **Comment:** In terms of the specific issues we'd like you to consider, Mr. Raymond referred to one, and that is I think the agency needs to do a far better and more detailed job of linking the fees to the costs of regulating consumer products. The information that we received a few days ago was appreciated. We really haven't had time to analyze it and there's not enough backup data to really allow us to determine whether, for example, the 67 people noted on that document spent all of their time on consumer products, some of their time or exactly what they do.

The impressionistic data is not what is called for to substantiate a regulation like this, and I think the imbalance in the regulation is illustrated by one statement in the initial statement of reasons, where the staff indicates that consumer products and architectural coatings taken together have 19 percent of the emissions, but will pay 40 percent of the fees under this proposal. That does not seem to be the kind of balance that we ought to be seeking here. And again, this is justified by saying as long as we go after the big emitters this is okay. We think that's inappropriate. (CTFA, Oral testimony at Board Hearing, 7/24/03)

58. **Comment:** As was articulated by speakers who preceded me, CSPA believes that the requisite nexus between the proposed fees and consumer product emissions has not been adequately established. A clear nexus must be established between the money generated by the assessment of this fee and the specific programs that will be funded. If this is not done, the fee would in reality constitute a tax. And as was noted earlier, the Legislature voted -- passed AB 10X by a mere majority vote. Thus, CSPA believes that the ARB must provide more detailed information to afford affected parties a reasonable opportunity to assess the fairness of the fee allocation in all three broad categories of fee payers, and in particular, for the fees collected to finance the regulation of consumer products. We believe that any less rigorous assessment falls short of the standard required by the statute.

The ARB's analysis does not meet the requisite standard for the nexus. But we do think that this analysis clearly demonstrates that the proposed fee on consumer products exceeds the amount that can be considered fair or reasonable based on their share of emissions. As cited by Dr. Donegan earlier, the ARB in the initial statement of reasons states, and I quote, although consumer product and architectural coatings contribute 19 percent of the stationary source inventory, they account for 40 percent of total fees. End quote. (CSPA1, Oral testimony at Board Hearing, 7/24/03)

59. **Comment:** Another issue that's been addressed somewhat by the other speakers is this nexus issue. As it stands right now, we don't really know, you know, where the fees are going at the Air Resources Board, because they're unable to tell us. We have been asking since the very beginning of this dialogue and we've gotten some information.

We got some information two days before the Board hearing with regard to allocation of resources for architectural coatings and consumer products. We barely had two days to digest that information and in just a cursory examination, the information tells us there's no breakout for architectural coatings and consumer products in that information. I think that's required under Sinclair Paint. And what you don't see in the regulation is a provision requiring the ARB to give us more information on their allocation of resources, or any kind of a provision, requiring the Air Resources Board to institute, other generally accepted-type accounting practices so that we can oversee those, so we can check that, or we can determine whether or not in our own minds they're complying with Sinclair Paint and the language of the statute. That's not in there anywhere. (NPCA, Oral testimony at Board Hearing, 7/24/03)

60. **Comment:** The "nexus" is even more suspect in the case of architectural coatings. In California, the authority to regulate architectural coatings lies solely with the individual districts. While ARB surely plays a minor supporting role due to its development of the suggested control measure, ARB has failed to demonstrate a clear nexus between the fees being assessed on the manufacturers of architectural coatings products and the work conducted by the Stationary Source Division that is devoted solely to architectural coatings.

As indicated above, the ISOR merely cites the work conducted by all five of the divisions within the ARB, arguing that the collective work of these divisions contribute to the agency's environmental mission. This argument does not fulfill the "nexus" requirement under current case law. Despite a request for specific information on several occasions, the ARB has failed to produce any specific information regarding the time and resources that each of the divisions devote to regulating architectural coatings. (NPCA, 7/24/03)

61. **Comment:** I think and I know this has been addressed before, so I'll address it really quickly. We're talking about 24 paint companies identified -- why don't we just charge those paint companies for the program costs incurred by the ARB. And I know we've addressed the fact that we want more specific analysis of what those costs are and I don't feel those are that complicated to get to. Whatever your program costs are, whether they're the survey that's conducted every three years, whatever the costs are, let us know. And if they're necessary costs and you have to pass those fees along, pass them along that way, not just a blanket form. We are not asking for a free ride in that respect. We are just objecting to paying more than our fair share and we think the 40 percent, I know we've been through that before, so I won't go through it again, because that's much more than our fair share here. (SPC3, Oral testimony at Board Hearing, 7/24/03)

Agency Response to Comments No. 45-61: In Comments No. 45-61, the commenters restate most of the issues raised in the comments listed in Section B (Uniform Fee) and Section C (Nexus) of this FSOR. While Comments No. 45-61 do not raise any new issues, we have listed them separately here because the commenters often intertwine these previously raised issues in various combinations, with an overall “nexus” theme. The responses to Comments No. 45-61 can be found in the responses to Comments No. 11-44 (i.e., in sections B and C of this FSOR.)

62. **Comment:** The elimination of some air pollution sources from the "fees" system has not been fully justified by the ARB. The ISOR explains that there are a total of 19 major categories listed in the ARB's stationary source emission inventory. The ISOR further states that, in aggregate, these sources amount to 1,521,459 tons per year in 2001. The ARB has eliminated 49 percent (i.e., 748,141 tons per year) of these emissions from eight of the 19 categories. The ARB's only stated rationale is that it expends "little or no resources on controlling these categories or they are covered under ARB's mobile source program." This decision has the practical effect of significantly enlarging the percentage of emissions that the ARB attributes to consumer products (and the other affected categories). Since the underlying emission estimates are unduly inflated, the corresponding "fees" assessed on consumer products will be calculated unfairly. The cursory justification stated in the ISOR is patently insufficient for a decision that has such a profound effect on the "fee" that the ARB will seek to collect. (CSPA2, 7/22/03)

63. **Comment:** The impact on architectural coatings manufacturers is disproportionate to its emissions. Emissions from billable architectural coatings (37,361 tons) constitute less than five percent of the total billable stationary source program emission inventory (773,318 tons), according to ARB's own data. This impact, however, is greatly overstated.

The real impact of emissions from architectural coatings should not be measured against only the "billable" emissions in the state; rather it should be measured against the total universe of emissions in the state of California, even those emissions from the eight categories of products that the ARB claims it spends little or no resources on. (NPCA, 7/24/03)

Agency Response to Comments No. 62 and 63: ARB staff disagrees with the commenters' belief that a larger universe of emissions should be used as the emissions base when evaluating "nexus" issues for the fee regulations. Utilizing a larger universe of emissions is not appropriate because it would artificially minimize the contribution of consumer products and architectural coatings sources to the emissions base by including emissions that the ARB expends few or no resources addressing.

It is through the classifications within the emission inventory that the emissions base is established for the fee regulations. On page 36 of the ISOR, 19 major categories in the ARB's stationary source emission inventory are listed. To determine the appropriate emissions base for purposes of the fee regulations, staff excluded those source categories that are covered under the ARB's mobile source program, or for which few or no resources are allocated to controlling emissions. The reason that these emissions are excluded is that the level of effort expended by the ARB staff on these categories is far less than the expenditure of effort required on other source categories that are being regulated. Regulated source categories receive far greater scrutiny during planning, regulatory, and enforcement activities of the ARB staff.

A more detailed explanation may be helpful. The ARB staff excluded a total of 748,141 tons per year (tpy) of nonattainment area emissions from the emissions base because either: (1) the source categories are mobile source related (469,606 tpy), or (2) few if any ARB resources are focused on the source categories (278,535 tpy). For example, 333,084 tpy of PM10 emissions are excluded because, although not directly

emitted by mobile sources and therefore technically "part" of the stationary source emissions inventory, these emissions are directly related to mobile source activity because they are caused by vehicular traffic on unpaved and paved roads. There is also a second, independent reason for excluding these 333,084 tpy of PM10 emissions; the ARB expends few if any resources addressing these emissions because there isn't too much that can be done about them. The few limited control options that are available (e.g., paving roads or restricting traffic on roads) have serious practical, funding, and enforcement problems.

An additional 112,226 tpy of PM10 emissions are excluded because they are fugitive dust emissions caused by blowing wind. The ARB expends few if any resources on controlling fugitive windblown dust emissions because they result from acts of nature over large geographic areas, and there are few or no practical control options for this source category. Yet another example of excluded emissions are 17,825 tpy of VOC emissions from pesticides (e.g., pesticides sprayed in agricultural applications). The ARB focuses minimal resources on this source category because the Department of Pesticide Regulations (DPR) has regulatory jurisdiction over pesticides used in pesticidal applications, and DPR provides the ARB with emissions data for pesticides. These three categories alone account for 463,135 tons of the 748,141 excluded tons mentioned above. Similarly, the ARB expends few or no resources on addressing emissions from the other source categories listed on page 36 of the ISOR, and these categories were also properly excluded from the inventory.

Finally, it should also be emphasized that the emissions-based approach is only one of two different approaches used by the ARB staff to determine the resources expended by the ARB on the consumer products and architectural coatings programs. In response to concerns expressed by industry that this emissions-based approach might overstate the ARB's actual resources expended on these programs, the ARB used a second, different approach that is described in the response to Comments No. 29-32. Both approaches led to similar results; the emissions-based approach showed that the ARB annually expends $7.6 million on its consumer products and architectural coatings programs, and the alternative methodology described in the response to Comments No. 29-32 came up with the even larger figure of $8.9 million. This is a strong indication that the emissions-based approach used by the ARB does not overstate the resources expended on the consumer products and architectural coatings programs.

64. **Comment:** ARB's Enforcement Division does not expend significant time or resources enforcing State regulations for architectural coatings. The ARB does not have any statutory authority to regulate architectural coatings. Consequently, air quality regulations that specifically target architectural coatings have been adopted by most of the air quality districts in California. Primary enforcement of these air district rules is conducted by the individual air districts, not by the ARB. We do know from our conversation two days ago with the Air Resources Board staff that they do expend some in enforcement activities relative to architectural coatings and they do institute, or they do the SCM for architectural coatings, but we don't know specifically what their allocation of resources is for architectural coatings.

After repeated requests for a breakdown of the agency's budget devoted solely to architectural coatings and consumer products, ARB finally produced some data which quantified the "person years" in each division that are dedicated to such programs. This data does not distinguish resources dedicated to architectural coatings activities and resources dedicated to consumer products activities, there remain significant questions about the amount of resources devoted solely to architectural coatings. (NPCA, 7/24/03; NPCA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: As explained in the response to Comments No. 39 and 40, the architectural coatings and consumer products areas are so closely intertwined that it is not possible to completely separate the resources expended for architectural coatings from those expended for consumer products. It is therefore not possible to quantify the "allocation of resources" for architectural coatings activities within the ARB Enforcement Division. It is possible, however, to state that the ARB Enforcement Division does expend resources on architectural coatings activities. For example, the ARB is currently implementing the statewide averaging provision in district architectural coatings rules. Enforcement of this provision involves (among other things) ARB inspectors going to retail paint stores, purchasing products that are part of various companies' approved averaging programs, and having the products tested to determine if they comply with the parameters of the approved programs. The ARB Enforcement Division has also assisted some districts in enforcing their architectural coatings rules, particularly the smaller districts that have few enforcement resources. ARB enforcement assistance has included identifying and purchasing coating products for analysis, and assisting the districts in investigation and prosecution of companies selling coatings that do not comply with local district rules.

65. Comment: Even if permissible on an interim basis, the proposed allocation method is distorted; it imposes a cost on consumer products and architectural coatings far out of proportion to the adverse effects caused or to the ARB's actual expenditures.

The proposed fee structure attempts to blindly apportion all of the ARB's budgeted costs over a small portion of the emission sources. This clearly indicates that revenue from the fee-payers is being diverted to unrelated activities.

If an allocation method were required in the first year to enable the ARB to develop explicit accounting practices, a method far less likely to result in spending fee revenues for unrelated activities would be to:

Take the proposed FY-2003-2004 SSD budget ($39.6 M) and subtract the $13 M in stationary source fees, since by statute these revenues must be used for purposes unrelated to mitigating or reducing air pollution in the state caused by consumer products and architectural coatings. For purposes of architectural coatings, subtract the amount spent by the enforcement division ($1.1 M in FY 2002-2003), since ARB has no role in the enforcement of any architectural coatings regulations.

Subtract any other specific expenses unrelated to these activities (e.g., again for architectural coatings the enumerated expenditures budgeted for consumer products rulemaking and enforcement).

This provides a "net expenditure pool" to be allocated.

Allocate this amount across the total quantity of pollutants and precursors emitted in the state by stationary or "area-wide" sources. Note that the proposed elimination of 70% of the actual emissions from the denominator can not be justified, since:

Every gram of emissions must be estimated, cataloged, inventoried, researched, and modeled, regardless of where or by what mechanism it is emitted.

If ARB can not provide an accurate, quantitative basis to show that the expenditures will be used solely for the specific activities required by the statute, then by the same rationale they have no basis for asserting that "few or no resources are allocated" to any other sources or activities.

Dividing the "net expenditure pool" by total emissions gives a crude method for allocating ARB's actual expenditures for the programs specified in the enabling statute. The proposed 3% hedge for uncollectable amounts and the corresponding correction in later years for the resulting over-collection seem to be reasonable administrative actions. (HC2, 7/18/03)

66. **Comment:** There needs to be two separate programs for the different classes of payers and products. In terms of allocation, if it's true that the ARB is not capable of actually accounting for what they spend on different things, then I suppose we could do an allocation. I would take the ARB's current stationary source division budget, which is 39.6 million, take off the 13.3 million from the stationary sources, because by definition that cannot be used for things related to consumer products and architectural coatings. Take off the million dollars that's used in enforcement, because as far as architectural coatings are concerned, enforcement is not one of the ARB's activities, and then divide that by all the emissions. And I mean all the emissions.

ARB staff has proposed ignoring 70 percent of the total emissions because we don't spend a lot of effort on that. Well, you can't have it both ways. Either you can account for what you do spend, in which case you could give a specific accounting, or you can't account, in which case you have no basis for ignoring those. You have to put those into the denominator. (HC2, Oral testimony at Board Hearing, 7/24/03)

Agency Response to Comments No. 65 and 66: In these comments, the commenters suggest a particular methodology that they believe the ARB should use to calculate the resources expended on the ARB's consumer products and architectural coatings programs. This methodology is not appropriate, because: (1) it assumes that the entire universe of stationary source emissions should be used as a "base" emission

inventory, instead of a subset of this universe; (2) it assumes that the ARB Enforcement Division spends zero resources on architectural coatings activities; and (3) it assumes that the ARB will collect the statutory maximum of $13 million per year in fees from stationary point sources (i.e., facilities). The response to Comments No. 62 and 63 describe the ARB's rationale for determining the proper emissions "base" for allocating emissions among the various source categories. The response to these comments explain why it would be inappropriate to use the total universe of stationary source emissions for identifying "nexus" allocations among the various sources categories. The response to Comment No. 64 explains that the ARB Enforcement Division does expend enforcement resources on architectural coatings activities. It would therefore be inappropriate, as the commenters do, to assume that the ARB spends zero enforcement resources on architectural coatings activities. Finally, the ARB will not be collecting $13 million from facilities, but instead will collect much less than that amount under the approach used in the fee regulations. Thirteen million dollars is the maximum amount that the ARB is authorized to collect from facilities under Health and Safety Code section 39612. Since the ARB is not required to collect the full statutory maximum and will not be doing so, it is inappropriate to assume, as the commenters do, that the ARB will collect the full $13 million from facilities.

D. EMISSIONS

67. **Comment:** Stationary sources are mandated to pay fees on emissions in excess of 250 tons per year. In certain circumstances, the emissions on which these stationary source fees are caused result from the use of consumer products and architectural coatings. Consequently, the State will be collecting emission fees from both the manufacturer of the consumer product/architectural coatings and the stationary sources using them. A mechanism must be developed to eliminate this phenomenon and stationary sources must be made aware of the fact that they are entitled to omit their use of consumer products and architectural coatings from their fee calculations. (DAP1, 7/23/03; DAP3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The emissions from the use of architectural coatings and consumer products are not included in the emissions from stationary point sources for the purpose of assessing the fees. The commenter is therefore incorrect in assuming that "double-counting" will occur, and a corrective mechanism is not necessary.

68. **Comment:** CSPA does not concur with the ARB's inclusion of "paint thinners" with consumer products instead of architectural coatings. The ISOR notes that for the purpose of assessing "fees," paint thinners have been included with the emissions of consumer products. This is at variance with the current ARB emissions inventory, which includes paint thinners in the architectural coatings emissions inventory. The only reason provided for this in the ISOR is that, "Because the architectural coatings surveys do not cover these products, paint thinner emissions can only be attributed to specific manufacturers through consumer products data ... Paint thinners are not included in each architectural coating

company's emissions for the purpose of determining fees."
CSPA does not believe that this is adequate reasoning to move the VOC emissions attributable to paint thinners to the consumer products inventory. These products are being planned for regulation as architectural coatings, not consumer products. The tonnage from paint thinners should be removed from the consumer products inventory that is used as a basis for "fees" just as it was removed for the basis of developing future consumer products regulations. (CSPA2, 7/22/03; CSPA1, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The commenter has confused two separate issues: (1) how the ARB reports VOC emissions from particular products in its emission inventory accounting system, and (2) who pays the fee for emissions from paint thinners. Paint thinners have not been moved from the architectural coatings inventory to the consumer products inventory. No inventory changes have been made for purposes of the fee program. While paint thinners are primarily (but not exclusively) used in connection with architectural coatings application and clean up, they are produced by consumer products manufacturers, not architectural coatings manufacturers. The consumer product manufacturers provided ARB sales information for paint thinners in the 1997 Consumer and Commercial Products Survey. It is reasonable to charge the manufacturer of a product the fee for that product's emissions, which is what the fee regulations do.

69. **Comment:** The proposal to impose fees on sales of water-borne paints without first determining that glycol compounds are volatile is unauthorized, unanalyzed, and unwise. New section 39613 of the Health and Safety Code provides the ARB shall impose a fee for any architectural coatings sold in the state only "if" a manufacturer's total sales of architectural coatings will result in the "emission" in the state of 250 tons per year or greater of "volatile" organic components.

The major organic compounds in most water-borne paints are three glycol compounds. *Allied Local and Regional Manufacturers Caucus v. EPA*, 215 F.3d 61, 70 (D.C. Cir. 2000). ARB's staff proposes to implement the proposed regulations, if adopted, against manufacturers of architectural coatings by treating the glycol compounds contained in water-borne paints as if they are "volatile," result in "emissions," and create ozone "pollution." But ARB only assumes these necessary predicates. Neither it nor any other clean air agency has ever so established.

The ISOR acknowledges (at 23-27) that many organic compounds in consumer products would not be subjected to the fees. In particular, it states (at 26) that "[l]ow vapor pressure (LVP) [organic compounds] are not currently included . . .," and, because ARB "did not require speciation of these compounds . . ., we do not at this time have the ability to determine" whether any such compound is "likely to evaporate," or is "likely to see an atmospheric fate." SPC understands that these statements, among other things, refer to glycol compounds in products other than paints. However, staff proposes to take the opposite position as to glycol compounds in paints.

The evidence that glycol compounds in paints are insufficiently volatile to contribute significantly to ozone nonattainment is substantial. Section 183(e) of the CAA explicitly requires that the organic compounds to be regulated must be "volatile." U.S. EPA formally exempts from its consumer products rule organic compounds having a vapor pressure of less than 0.1 mm of mercury at 20^{o}C, including glycol compounds. 63 Fed.Reg.48819, 48835 (Sept. 1, 1998). U.S. EPA could not measure the volatility of organic compounds in water-borne paints unless it heated them. *ALARM Caucus,* 215 F.3d at 76 n.9. ARB's jurisdiction over other consumer products similarly extends only to "volatile" organic compounds. Health and Safety Code § 41712. ARB also exempts from its consumer product rules any organic compounds having a vapor pressure of less than 0.1 mm of mercury at 20^{o}C, including glycol compounds. 17 Cal. Code Regs. §§ 94508(a)(78)(A), 94510(d). South Coast AQMD's expert, Eastern Michigan University, reported in 1998, as follows:

> "We recommend that the concentration in the atmosphere of the common oxygenated paint solvents be determined. The UC Riverside Center of Atmospheric Measurement is capable of investigating this problem. In a study recently published, 52 waterborne coating samples were analyzed for solvent content and [organic compound] level. The four most common solvents were identified . . . All of these polar molecules have a possibility of being removed from the atmosphere by adsorption/absorption mechanisms.
>
> ". . . Sources of uncertainties include . . . if a solvent . . . is volatile enough to become airborne and non-polar enough to stay airborne."

South Coast AQMD's 1999 staff report acknowledged:

> "Several solvents that are currently used in . . . architectural coatings are considered low volatility compounds, meaning that they have a vapor pressure of less than 0.1 mm of Hg at 20 degrees Celsius. The CARB has included a low vapor pressure (LVP) exemption in their Consumer Products regulation. CARB staff indicate that the LVP exemption was placed into the proposed rule for some additives found in consumer products, such as . . . heavier compounds that do not readily evaporate into the atmosphere and are typically washed away into the sewer."

Obviously, the staff's proposal — to impose the fee on sales of water-borne architectural coatings, but not to impose them on sales of consumer products containing the very same compounds — is, on its face, highly problematic. A number of legal and policy grounds so confirm.

ARB has not attempted to show, let alone succeeded in showing, that the glycol compounds in water-borne paints are sufficiently volatile to contribute significantly to ozone nonattainment. A persuasive and ever-growing body of evidence strongly suggests that they may well not be — instead of evaporating and becoming and staying airborne, these

heavy and polar compounds may be removed from the atmosphere by adsorption or absorption mechanisms or washed away to the sewer. Therefore, adoption of the regulations prior to so proving, as proposed by the staff, would exceed ARB's constitutional and statutory powers.

Neither the Notice nor the ISOR discusses the question of the volatility of the glycol compounds in architectural coatings, let alone purports to determine that they are sufficiently volatile to contribute significantly to ozone nonattainment. Thus, adoption on the current record would violate section 11346.3(a) of the Administrative Procedure Act. (SPC2, 7/16/03; SPC3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The issues raised in this comment are not new ones; they have repeatedly been raised by the commenter over the last decade. The commenter's assertions about the volatility of glycol compounds have been extensively investigated by ARB staff and found to be without merit. A good summary of the conclusions reached by ARB staff on volatility can be found on pages V-148-150 of the June 2000 Final Program Environmental Impact Report for the Suggested Control Measure for Architectural Coatings (PEIR). The PEIR is included in the references listed in the ISOR (see page 45 of the ISOR), and is therefore part of the record for this rulemaking action.

In preparing the PEIR, the ARB staff carefully examined the issue of whether low vapor pressure VOCs (LVP-VOCs) used in architectural coatings will evaporate into the atmosphere and become available to form ozone. Staff reviewed a number of indoor air quality studies, which are listed as references at the end of Section V of the PEIR. Staff's conclusion is that all or almost all of the LVP-VOCs contained in architectural coatings do eventually volatize and enter the atmosphere, although in some situations it may take several months or years for all of the compounds to completely volatilize. Furthermore, once these compounds initially enter the atmosphere, they may be temporarily absorbed onto other materials (known as "sinks"), but these VOCs are subsequently desorbed and transported through air exchange into the ambient air.

In addition to this scientific evaluation, it is useful to examine the issue from a common-sense perspective. Because of the way that architectural coatings are formulated and used, an LVP-VOC exemption for paints is a totally different issue than an LVP-VOC exemption for consumer products. Almost all types of paint are designed to stay on a surface for years without being washed off, whereas many consumer products have very different formulation and usage characteristics (such as "down-the-drain" effects). In the case of architectural coatings, these products are designed to be spread as a thin film across walls and other surfaces, and then allowed to completely dry in the air. Basically, the way most coatings work is that the solvent in the coating evaporates and leaves behind the other constituents of the coating (*e.g.*, resins and pigment) as a film on the surface. If the solvent did *not* evaporate, the paint would not dry. It is a matter of common sense that solvents used in paint (such as glycol compounds), whether these solvents are LVP-VOCs or non-LVP-VOCs, are very likely to evaporate and enter the

atmosphere. This common sense conclusion is supported by the various indoor air quality studies considered by ARB staff in the PEIR.

In addition, the U.S. EPA test method (Method 24) for architectural coatings automatically excludes from regulation all VOCs that do not evaporate. Therefore, the pigments and resins contained in architectural coatings that are left behind on the painted surface as a film after the coating dries, many of which are LVP-VOCs, are excluded from being counted as VOCs under the test method. However, the "glycol compounds" being discussed by the commenter do evaporate under the test method, and therefore are by definition VOCs. (See pp. V-150-151 of the PEIR.)

70. **Comment:** The proposal to impose fees on sales of solvent-borne paints without first determining that mineral spirits are reactive is unauthorized, unanalyzed, and unwise. As discussed above, section 39613 provides that fee revenues shall only be used to mitigate or reduce any "air pollution . . . created by . . . architectural coatings." To create ozone pollution, solvent-borne paints must contain organic compounds which are, in addition to being volatile, also reactive. Proposed Rule 90801(l) would define the term nonattainment precursor to mean any compound which "reacts" in the atmosphere with nitrogen oxides to contribute to ozone nonattainment. Rule 90801(n)(B) would define volatile organic compound as any carbon-containing compounds, but excluding certain "low-reactive" organic compounds identified by U.S. EPA, including acetone and perchlorethylene.

The ISOR concedes (at 16) that an organic compound must be "reactive" to be an ozone precursor. It further notes (at 22) that certain organic compounds in consumer products are not regulated "in recognition of their very low ozone-forming capability." The ISOR also acknowledges (at 18) that a recent subject of inquiry relating to the regulation of architectural coatings has been investigating the feasibility of "reactivity-based" limits.

Section 183(e) of the CAA explicitly focuses on reactivity of products. It mandates that U.S. EPA consider products which emit "highly reactive" volatile organic compounds. 42 U.S.C. § 7511b(e)(2)(B)(iii). U.S. EPA also shall list products which account for 80% of emissions, "on a reactivity-adjusted basis." *Id.* at § 7511b(e)(3)(A). Eight compounds constituting mineral spirits are used in most solvent-borne paints. *ALARM Caucus,* 215 F.3d at 70. In its 1995 scientific and regulatory studies and list, U.S. EPA did not evaluate the reactivities of most organic compounds, including mineral spirits. *Id*. at 72. U.S. EPA has never officially identified mineral spirits as an ozone precursor. 42 U.S.C. § 7602(g). The leading study U.S. EPA commissioned on the role of organic compounds in ozone formation makes clear that they vary widely in reactivity. [National Research Council, *Rethinking the Ozone Problem in Urban and Regional Air Pollution* (National Academy Press, Washington, D.C., 1992) at 153, 154, 161, 170, 224.] Indeed, U.S. EPA maintains a list — which is ever-growing — of organic compounds that turn out to have only "negligible" reactivity and, therefore, become exempt from regulation. 40 C.F.R. § 51.100(s); *ALARM Caucus*, 215 F.3d at 69, 71,72. It is not at all an unknown phenomenon for U.S. EPA and other regulators, including the South Coast AQMD, to have

regulated an organic compound for years on the assumption it may be sufficiently reactive, only belatedly to investigate the question and determine otherwise. In connection with South Coast AQMD's 1999 rulemaking proceedings relating to architectural coatings, such as non-flat enamels and industrial maintenance coatings, many of which are solvent-borne, work of leading experts, such as Professor Chameides of Georgia Tech and Professor Carter of U.C. Riverside, was presented reflecting the view that the reactivity, if any, of mineral spirits should be investigated. Accordingly, in 1999 the South Coast AQMD board directed its staff to conduct an analysis assessing "reactivity" of such compounds. Again, that assessment is not yet complete.

The Legislature in enacting section 39613 provided that revenues collected from any fees shall be used and expended solely to mitigate or reduce any "air pollution . . . created" by architectural coatings. The statute must be interpreted so as to avoid fees on organic compounds which are not sufficiently reactive to contribute materially to ozone nonattainment.

ARB has not attempted to show, let alone succeeded in showing, that the mineral spirits in solvent-borne paints are sufficiently reactive to contribute significantly to ozone nonattainment. A persuasive and ever-growing body of evidence strongly suggests that they may well not be. There exists the very real prospect that mineral spirits — like acetone and perchlorethylene — will have been regulated for years with no real beneficial effect on the air. Therefore, adoption of the regulations, as proposed by the staff, would exceed ARB's constitutional and statutory powers.

Furthermore, the ISOR was required to set forth the staff's rationale for determining why the proposed regulations are "reasonably necessary" to carry out the purpose. Government Code § 11346.3(a). Adoption thereof must be based on adequate information concerning any "need" for the regulations. *Id*. at § 11346.3(a)(1).

Neither the Notice nor the ISOR discusses the question of the reactivity of the mineral spirits in solvent-borne architectural coatings, let alone determines that they are sufficiently reactive to contribute significantly to ozone nonattainment. Thus, adoption of the proposed regulations would violate section 11346.3(a) of the Administrative Procedure Act. (SPC2, 7/16/03; SPC3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: Like the issues raised in the previous comment, the assertions made in this comment have also been made by the commenter numerous times over many years. The commenter's assertions about the reactivity of mineral spirits have been extensively investigated by ARB staff and found to be without merit. The conclusions reached by ARB staff on reactivity can be found in the June 2000 Final Program Environmental Impact Report for the Suggested Control Measure for Architectural Coatings (PEIR).

"Mineral spirits" is a term that generally refers to various hydrocarbon solvents that are commonly used in solvent-borne paints and other products. The existing scientific data

indicate that hydrocarbon solvents are reactive and form ozone once emitted. For example, most commonly used mineral spirits in paints have maximum incremental reactivity (MIR) values of 0.91 to 1.82 grams ozone per gram VOC. This means that every gram emitted will have the potential to lead to formation of 0.91 to 1.82 grams of ozone. It should be further noted that U. S. EPA currently uses the reactivity of ethane as a "bright line" to determine whether a VOC is negligibly reactive in the atmosphere. Using the MIR scale as a basis, the reactivity of ethane is 0.31 grams ozone per gram of VOC emitted. Hence, mineral spirits are roughly three to six times more reactive than ethane. This indicates that mineral spirits are sufficiently reactive to participate in ozone formation, and hence, contribute to the excess ozone levels in the ambient air. (See pp. IV-76 of the PEIR.)

Although Dr. Carter is performing chamber experiments on several mineral spirits, this research is not to determine if they are reactive. It is to determine if the theoretically derived reactivity values above need to be adjusted up or down somewhat. None of the participants in this research, including the solvent manufacturers, believe that the experiments will show mineral spirits to be non-reactive. In addition, the mineral spirits being discussed by the commenter evaporate (i.e., volatize) under U. S. EPA Test Method 24, and therefore are by definition VOCs (see the response to the previous comment.)

71. **Comment:** Quantifying the fee based on sales which occurred two years prior to the most recent year is unauthorized, unanalyzed, and unwise. Section 39613 directs ARB to impose a fee for any architectural coatings sold in this state if a manufacturer's sales of architectural coatings "will" result in the emission of volatile organic compounds. Proposed Rule 90800.8(c)(5) would impose the fee on sales of architectural coatings which resulted in emissions "during the same calendar year identified" in proposed Rule 90800.8(c)(4), which refers to "the most recent calendar year for which emission estimates are available."

Because ARB cannot know what gallonage or tonnage "will" be produced in the current or any future year, it may be reasonable to use data from "the most recent calendar year." Such figures can readily be "available" for each completed calendar year and they are "available" for SPC. But the staff proposes not to use any available data for 2002.

The ISOR reveals that ARB's staff intends to disregard section 39613, as interpreted in proposed Rule 90800.8(c)(5). It shows (at 6, 19-21) that, instead, it intends to use for the 2003-04 fee data not from 2002, as its own proposal would require, but from 2000, two years earlier than that. It explains that 2000 data were "reported" and, thus, "available." Then tons are "estimated" and "increased" for 2001, not with reference to actual sales, but by an artificial 1% factor based on growth of dwelling units. The ISOR makes no further effort to explain why ARB proposes to rely on 2000 data, as so adjusted, rather than actual 2002 data. For these reasons, the statutory reference to sales that "will" occur, properly interpreted, disallows the proposed reach-back to data which is three years old.
The ISOR and the Notice also fail to discuss the economic impacts of using gallonage and tonnage data from 2000 (as adjusted), rather than available data from 2002, the most recent year. There are very real reasons why a manufacturer's California gallonage in one

year may be significantly higher or lower than that in a year two years earlier. Take SPC as an illustrative case.

The distinction between the most recent year (2002) and the year two years earlier (2000) is by no means academic, as applied to SPC. ARB's staff believes (incorrectly, as shown in appendix 2) that architectural coatings SPC sold in California in 2000 contained 3,649 tons of organic compounds. Then staff estimates, based on the irrelevant adjustment factor, that SPC presumably produced 3,697 tons in 2001. Based thereon, it proposes (at E-2) to bill SPC $280,561 for 2003-04. Had staff proposed a 2003-04 fee based on SPC's correct tonnage in 2002, the most recent year, as required, the tonnage would have been only 527 tons, and the fee would have been $40,189. The staff's use of 2000 data (combined with (a) an erroneous tabulation for that year and (b) an unrealistic adjustment for 2001) would, thus, result in a fee to SPC which is about seven times too high.

The reasons for the sharp drop of SPC's sales of gallons in California and, therefore, tons during the three-year period in question are due to certain significant market changes. In 2000 CPC sold roughly four million gallons of paint to California stores of The Home Depot, the industry's largest retail paint customer. But in 2001 and 2002 CPC sold not one gallon to Home Depot. In late 2000, Home Depot replaced all regional paint suppliers, of which there were a half dozen, with one world-wide supplier. Thus, ARB's proposal to charge SPC the $240,372 difference between what it proposes to charge for 2003-2004 ($280,561) and what the proposed regulations would require ($40,189) should, instead, be born by others. Thus, while the direct purpose of the fee, as the ISOR acknowledges (at 2), is "budget balancing," it will also have a major regulatory impact in the marketplace, at least on small manufacturers. (SPC2, 7/16/03)

Agency Response: The response to Comment No. 42 explains why it is appropriate for the ARB to use 2001 instead of 2002 data for the purpose of assessing the fees for the 2003-2004 fiscal year.

Every four or five years, the ARB performs a comprehensive survey of all architectural coatings sold in California. The most recent survey was conducted in 2001 to collect 2000 sales data. The commenter (SPC) supplied a response to that survey which reported emissions of 3,649 tons of VOC. Using a growth factor of roughly 1 percent per year, the ARB staff estimated their 2001 emissions to be 3,679 tons. Incidentally, this is not an "irrelevant" or "unrealistic" growth factor; it is the growth parameter that staff uses in the official ARB emission inventory and is tied to the growth in dwelling units in the State. Contrary to the commenter's claims, the ARB did not erroneously calculate SPC's emissions; SPC misreported their emissions.

During the course of the development of the proposed amendments to the fee regulations, SPC reported corrected survey data, which resulted in revised 2000 emissions of 1,916 tons. They also supplied new 2001 and 2002 emissions data. Their new 2001 data show 541 tons of VOC emissions, while their 2002 data show 521 tons. The ARB will use their 541 tons to estimate their fiscal year 2003-2004 fee, because 2001 emissions data are being used for all affected source categories. This represents about an 85 percent reduction in their previously reported emissions. The difference in using the 2001 emissions now instead of the 2002 emissions is a difference of about 4 percent in emissions and fee amount. This translates to a difference of about $1,600 on an estimated $42,000 fee. This difference is so small that the use of 2001 instead of 2002 emissions data will have no significant economic impact on SPC. For the fiscal year 2004-2005 fee, the ARB staff will use SPC's 2002 emissions of 521 tons, unless SPC provides corrected data during the time period specified in the fee regulations for comment on their fiscal year 2004-2005 fees. It can thus be seen that manufacturers will receive "credit" for any reductions in their 2002 and subsequent year emissions, since reductions in emissions will lead to reduced fees in future fiscal years.

72. **Comment:** Imposing the fee on sales in attainment areas is unauthorized, unanalyzed, and unwise. Proposed Rule 90800.8(c)(6) provides for a fee per ton formula, the denominator of which is the total tons of "nonattainment . . . precursors" emitted. This term is defined in proposed Rule 90801(l) to refer to a subsection which applies to nonattainment pollutants "in an area designated . . . as not having attained" the standard. Yet the staff proposes to impose fees on gallonage sold in attainment areas, as well as nonattainment areas. Many areas in California are in attainment of the ozone standard. Manufacturers sell architectural coatings to many retailers located in these areas. And these retailers sell paints to many users who apply them there.

The proposed regulations are overly broad to the extent they impose fees on sales in ozone attainment areas. (The same fees are imposed on stationary sources located in attainment areas, but not those in nonattainment areas.) Accordingly, they offend the constitutional and statutory norms discussed above. Furthermore, the Notice and the ISOR fail to assess the necessity of applying the regulations to sales in attainment areas, as well as the adverse economic impacts of doing so, as required by the Administrative Procedure Act. (SPC, 7/16/03)

Agency Response: Health and Safety Code section 39613, which was added by AB 10X, specifies that architectural coatings and consumer products manufacturers are to be assessed fees based on their annual sales and VOC emissions "in the state." There is no provision in section 39613 to exclude those VOC emissions that occur in attainment areas. Past ARB surveys have always gathered VOC emissions and sales data on a statewide basis, which has been quite acceptable to industry because most manufacturers either lack the ability to provide detailed area-specific data, or do not want to incur the considerable additional expense of doing so. The issue is somewhat academic, however, because it has long been recognized that VOC emissions from consumer products and architectural coatings correlate closely with population, and more than 98 percent of

California's population resides in areas that are nonattainment for one or more of the State ambient air quality standards. Therefore, approximately 98 percent of the architectural coatings and consumer products emissions occur in nonattainment areas. Excluding emissions that occur in attainment areas would thus have only a very minor impact on the fees paid by architectural coatings and consumer products manufacturers, and there is no need to specifically analyze the impact of such an exclusion.

73. **Comment:** Imposing the fee on sales during the winter months is unauthorized, unanalyzed, and unwise. Section 39613 fees shall only be used to mitigate or reduce any "air pollution . . . created" by architectural coatings. Proposed Rule 90800.8(a)(1)(B) would apply to architectural coatings sold "during a calendar year." Proposed Rule 90800.8(c)(5) also refers to sales made during an entire "calendar year."
Sales of architectural coatings used during the non-ozone season (the winter months) do not contribute to ozone nonattainment. Even if the compounds in such products were both volatile and reactive, the third necessary ingredient — sunlight — is insufficient during the winter. Thus, the proposed regulations would impose fees on non-problematic sales.

Under the constitutional and statutory provisions discussed above, the proposed regulations are, thus, overbroad. Furthermore, the need to impose fees on winter sales, and the economic impacts of doing so, are not discussed in either the ISOR or the Notice. (SPC2, 7/16/03)

Agency Response: Health and Safety Code section 39613 specifies that architectural coatings and consumer products manufacturers are to be assessed fees based on their annual statewide emissions. There is no provision in section 39613 to exclude those VOC emissions that occur in the winter months. Even if there were, however, there are several reasons why excluding winter sales would not be good public policy. First of all, VOCs are not just precursors to ozone pollution, which is what the commenter is referring to in this comment. VOC emissions are also precursors to the formation of PM10 pollution, which is a serious air quality problem that occurs year-round in California. In some areas of the State, PM10 pollution is a much more serious problem in the winter than it is in the summer.

Second, there would be administrative problems with implementing a winter sales exclusion. Although some manufacturers may be willing to supply California sales data for only the winter months, some would not be willing to incur the additional expense of doing so. To be fair, the ARB would have to re-survey all manufacturers subject to the fee to obtain a seasonal breakdown of their sales. Some manufacturers have distribution systems that would make it either extremely difficult or prohibitively expensive to obtain this information. Finally, not all paint sold in the summer is actually used in the summer. VOC emissions from cans of paint obviously do not occur until the cans are opened and the paint is used. It is common knowledge that many individuals buy paint and then do not use it for weeks or months. No practical way exists to accurately identify how much paint sold in the winter would actually be used in the winter. Although the commenter has focused on

sales of architectural coatings, the same reasoning applies to consumer products sales and emissions.

74. **Comment:** The total 2003-4 fee for architectural coatings, listed as $5,410,878 to $7,241,727 based on the 2001 billable tons of 140,038 (Appendix E-1) does not accurately reflect the billable VOCs currently in coatings. District regulations have reduced the VOC in many categories for 2001 and 2003. I feel Appendix E-1 over states the billable VOCs produced by the Architectural Coatings Industry and, therefore, shifts an inappropriate financial burden on architectural coatings. (FI, 6/18/03)

Agency Response: ARB staff does not agree with the commenter's assertions. The fee amounts and emissions cited by the commenter apply to consumer products and architectural coatings combined, not to architectural coatings alone. Also, the VOC emissions for architectural coating manufacturers were reduced by assuming that manufacturers met the July 2001 South Coast Air Quality Management District (SCAQMD) limit for flat coatings (see Chapter III, page 19 of the ISOR). The flat limit in the SCAQMD was the only limit that took effect for architectural coatings in 2001. The reported VOC emissions will be reduced further for fee assessments in future years when new VOC limits take effect.

75. **Comment:** Significant problems exist with the process that the ARB uses to establish the "VOC emissions" on which to base the proposed VOC tax on consumer products manufacturers. The ISOR contains a section entitled, "Preliminary Estimate of Emissions and Fees for Facilities and Manufacturers of Consumer Products and Architectural Coatings for Fiscal Year 2003-2004 as of June 6, 2003." The list for consumer products shows 54 companies with total billable emissions of 57,600 tons/year based on the year 2001.

The basic process by which the ARB developed its list of "estimated billable emissions" for consumer product manufacturers contains numerous flaws. The choice of the year 2001 seems arbitrary as it relates to consumer products. While the ARB does indeed have data available on approximately 50 consumer product categories for the year 2001, based on the survey completed earlier this year, these data have yet to be compiled by the ARB or reviewed by the industry, and these data therefore were not used in developing the estimates in Appendix E. The ARB's estimates were primarily extrapolated from data in the 1997 consumer products survey, data which are now six years old. Significant changes have occurred among consumer products and consumer products manufacturers since 1997. And even that 1997 survey did not cover all consumer products, and excluded several large categories as well as dozens of small categories of consumer products.

This process clearly falls short of providing an accurate or rigorous basis for the imposition of taxes or "fees" on companies in the consumer products industry. (CSPA2, 7/22/03)

Agency Response: ARB staff conducts comprehensive surveys of consumer products every three or four years, and aerosol coatings every four or five years. The 1997 Consumer and Commercial Products Survey and 1997 Aerosol Coatings Survey provide the most complete data available for consumer products (including paint thinners) and aerosol coatings sold in California. The 100 categories of consumer products covered in the 1997 Consumer and Commercial Products Survey represent about 90 percent of the total emissions from consumer products. Information gathered during the 1990 U. S. EPA Consumer Products Survey indicates that these 100 categories represent all but about 20 tons per day of consumer product emissions in California. The 2001 Consumer and Commercial Products Survey (which was collected in 2002-2003 and has not yet been finalized) represents only 44 categories, a subset of the larger consumer products inventory.

As discussed in the response to Comment No. 42, a baseline 2001 emissions year has been selected for Fiscal Year 2003-2004 fees because that is the most recent year for which emissions data are available for all affected source categories. To estimate the 2001 emissions, 1997 sales data for consumer products were "grown" using California Department of Finance population estimates for 1997 and 2001. This approach is consistent with ARB practices for projecting emissions in the State Implementation Plan. ARB staff recognizes that the consumer products industry is dynamic, and that the growth in VOC emissions may vary by product category or company. This is why the fee regulations provide ample opportunity for individual companies to refine their fee estimates by providing comments and suggesting corrections to the information they provided in their 1997 survey submittals. For the 2003-2004 fiscal year, the fee determinations will not be final until written notices are sent to each affected source, an event that will not occur until after the fee amendments are approved by the Office of Administrative Law and are legally operative (see section 90900.8(a)(2)(A)). To give sources as much advance notice as possible, and to give them time to submit comments and corrections, Appendix E to the ISOR (released on June 6, 2003) contained tables showing staff's preliminary fee estimates. ARB staff then received comments from many companies and spent months working with them to correct their data. In December 2003, all affected sources were mailed a refined preliminary fee estimate based on the updated comments and information provided by manufacturers and facilities. This provided affected sources yet another opportunity to provide comments and corrections.

We believe that the process described above has resulted in accurate emissions inventory information, and has provided sources with numerous opportunities to provide input and corrections to the ARB staff before fee determinations are finalized and mailed out to affected sources. Starting with the first preliminary fee estimates released on June 6, 2003, sources will have been provided more than 8 months to make comments and provide information. Comprehensive surveys planned by ARB staff to collect sales data for 2003 and later years will also provide updated and comprehensive information for future fee determinations.

76. **Comment:** ARB reliance on "adjusted" data from the 1997 Survey to assess "fees" on consumer products is unreliable. The proposed "fee" regulation attempts to base the consumer products VOC emissions inventory on information gathered in the 1997 ARB Consumer and Commercial Products Survey, because it represents the latest and most comprehensive information available. Subsequently, to develop 2001 emission estimates, the ARB factored in California's approximate population growth (at 1.3 percent per year for a four-year period) and any reductions that were achieved by regulations in effect at that time.

ASPA strongly disagrees with this method and asserts that the ARB cannot rely on the "adjusted" 1997 Survey data, which is now six years old and is not an accurate reflection of where the industry is today. As such, it cannot and should not serve as the basis for determining this "fee." The automotive specialty products industry is highly competitive and constantly changing; therefore, the use of such old data is highly questionable and inappropriate. In addition, the purpose of the 1997 Survey was to determine the need for future regulation. The survey was not conducted for the purpose of fairly determining a "fee" on consumer and automotive specialty product manufacturers.

ASPA disputes the validity of the ARB's assumption that there is a direct and corresponding relationship between California's population growth and the use of automotive specialty products. Contrary to this assumption, there is no such correlation. ASPA's own annual industry benchmarking survey clearly shows that automotive specialty product sales over the past several years are not growing at a rate equal to population growth. (ASPA, 7/23/03; ASPA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The response to the previous comment describes why the process used by the ARB staff results in accurate emission inventory data. Regarding the population growth issue raised by the commenter, it is used by ARB staff to make annual adjustments to the consumer products emission inventory for years when a survey has not been conducted, and for inventory projections in the State Implementation Plan. Past ARB regulatory actions have relied on the reasonable assumption that consumer products sales will grow at a rate proportional to population growth for the consumer products industry as a whole. However, ARB staff recognizes that trends within a particular product category may not always follow population growth. Companies who sell products in a particular product category are likely to be the most knowledgeable about whether sales are growing for that particular category. These companies, including the commenter, are provided ample opportunity to provide any comments or corrections to ARB staff as part of the fee determination process. Any corrections will be reflected in the final fee assessments. Thus, the process used to determine product emissions should result in the most accurate available emissions inventory, and should resolve the concerns of the commenter.

77. **Comment:** We have questions about the method to calculate each company's emissions and fees and the process to challenge these findings. (CPC, 6/6/03)

Agency Response: ARB staff is working with individual companies to answer any company-specific questions regarding the method to calculate emissions and fees.

78. **Comment:** The fee listed for Frazee Industries is $172,137 to $230,381 (Appendix E-2) based on 3,021 billable tons of emissions. Yet in recently available data, Frazee reports 1.75 million pounds from January 2002 through December 2003 for their VOC emissions averaging plan. Converting that to an annual basis would add about 8% or a total of 1.9 million pounds for calendar year 2002. This does not include industrial products or products not in the averaging plan. At the most, this would double our emissions to 3.8 million pounds or 1,900 tons. This is far less than the 3,021 billable tons listed on Appendix E-2. (FI, 6/18/03)

Agency Response: ARB staff has worked with this manufacturer to correct erroneous data they reported to the ARB in the 2001 architectural coatings survey. Consequently, their estimated VOC emissions and fees will be reduced.

79. **Comment:** The particulate matter emissions reported in the California Emission Inventory Development and Reporting System (CEIDARS) for Antelope Valley's Aggregate Inc. and Granite Construction Inc. are too high. The emissions reported include emissions that are both permitted and non-permitted sources, including vehicular and non-road emissions. Once these emissions are corrected, both companies will be under the threshold and not subject to the fees. (AVAQMD, 7/16/03)

Agency Response: The ARB staff agrees with the commenter. As a result, the facilities identified by the commenter will not be assessed fees because they have annual emissions that are less than the 250 tons per year threshold.

80. **Comment:** The commenter is a local air quality management district that has reviewed the emissions for several facilities within the district. The commenter states that some of the facilities' emissions, once corrected, would be lower and that as a result, some would not be subject to the fee regulation. (MDAQMD, 7/21/03)

Agency Response: In response to this comment, the ARB staff has worked with the district to evaluate the emissions from several affected facilities. As a result, these facilities will not be assessed fees because the ARB staff agrees that they have annual emissions that are less than the 250 tons per year threshold.

81. **Comment:** Significant errors have been found by CSPA member companies in the VOC emissions attributed to their companies in the lists released by the ARB. Soon after the ARB distributed its original draft list of consumer products companies and estimated "billable emissions," CSPA was contacted by numerous member companies

expressing serious concerns that there were significant errors in data for their company and products. Some of those errors were corrected by the ARB staff prior to issuance of the ISOR, which contains updated tables in the ISOR in Appendix E. Most of the errors, however, remain to be corrected in the consumer products emissions attributed to various CSPA member companies in the table in Appendix E. (CSPA2, 7/22/03)

Agency Response: As explained in the response to Comment No. 75, ARB staff will continue working with individual consumer product manufacturers to refine the emissions estimates for 2001 and correct any errors in the preliminary fee estimates contained in the ISOR.

82. Comment: The ARB's proposed process to correct the emissions tonnage on which these "fees" are based falls short of allowing all necessary corrections. The ARB appropriately recognized the deficiencies in the basic data on which the 2003-04 "fees" are proposed to be based by issuing on May 15, 2003, a document entitled, "Suggested Process for Consumer Products Manufacturers to Request Refinement of the ARB Adjusted 2001 VOC Emissions Determinations." The process delineated in this document is aimed almost solely at correcting errors in the 1997 survey data and correcting errors caused by the process used by the ARB in extrapolating 1997 companies' product formulations and sales to 2001.

Of the 54 consumer products companies targeted for imposition of "fees" in 2003-04, only 15 are currently CSPA members, but at least five found very significant errors that remain to be corrected. In total, we estimate that for those five companies, VOC emissions are overestimated by more than 5,500 tons, which represents approximately 10 percent of the entire "billable emissions" for consumer products manufacturers. Many of the errors fall into categories not specifically included in the ARB's "suggested process" to obtain corrections.

We believe that the ARB must allow companies to correct their emissions data due to errors and inaccuracies that go well beyond those listed in the "suggested process" document. To meet the statutory requirement that any "fees" collected from consumer product manufacturers be based on VOC "emissions," the ARB must also allow manufacturers to correct the VOC emissions attributed to their company due to any of the following factors:

- Errors in compiling and reporting survey data by the ARB, including the inclusion of products for which the company is not the manufacturer as defined in the regulation.

- Divestiture of products, including divestiture of entire business units, as well as discontinuance of products.

- Emissions reductions documented as part of Alternative Control Plan (ACP) programs.

- Emissions reductions (below percent VOC limit) documented for Innovative Product

exemptions.

- VOC content that is not emitted to the air during use of the product, but instead is eluted with wastewater ("down the drain"), polymerized into non-volatile materials, or combusted.

Failure to allow companies to correct fully and comprehensively ARB's estimates of the emissions attributed to their company would draw into question the fairness and legitimacy of the assessment of "fees" in this area. (CSPA2, 7/22/03; GMA, 7/22/03)

Agency Response: The response to Comment No. 75 describes the basic process used by ARB staff to correct emissions data for consumer products and architectural coatings manufacturers. As part of this process, the ARB staff created, at the request of industry, a document entitled "Suggested Process for Consumer Products Manufacturers to Request Refinement of CARB Adjusted 2001 VOC Emissions Determinations." This document was posted on the ARB's internet site on May 15, 2003, and was designed to provide further assistance to manufacturers in resolving common issues that might arise. The following introductory paragraph of the document explains its purpose and makes clear that it is intended to be a suggested process that manufacturers are not required to follow :

> "California Air Resources Board (CARB) staff has received numerous requests from consumer products stakeholders for a process for working with staff to refine Adjusted 2001 Emissions Determinations on a per-company basis. In response, CARB staff suggests that a consumer products manufacturer or company follow a two-step process described below to determine if a refinement should be pursued. CARB staff is not requiring that a company follow this process; staff is simply suggesting it as an efficient way to address issues that may arise. . ."

In addition to being only a suggested process, the document does not claim to address all types of inaccuracies or errors that might exist in a particular manufacturer's emission estimates. ARB staff is therefore willing to consider any suggested corrections that a manufacturer may wish to make, including corrections based on any of the five factors listed in this comment. The ARB staff believes that the process being followed is fair and will result in accurate emissions estimates.

83. Comment: CSPA also believes that, if VOC emission inventory data is to continue in future years to be used as the basis for "fees," it is incumbent upon the ARB to allocate any research funding necessary to correct the current consumer products VOC inventory to remove VOC content that is not emitted, but instead is eluted with wastewater ("down the drain") polymerized into nonvolatile materials, or combusted during product use. (CSPA2, 7/22/03)

Agency Response: The ARB staff has spent many years refining the emissions inventory for consumer products, and has extensively considered research submitted by

industry on “down-the-drain” and other factors that may result in the non-emission of some portion of a product’s VOC content. The current emission inventory incorporates the results of staff’s past analysis. The ARB will continue to consider research conducted by industry on any inventory issues that may remain unresolved.

84. **Comment:** The use of "adjusted" data from the 1997 Survey to assess "fees" on consumer products is questionable. The ARB states, "Our current consumer products VOC emissions inventory is based on information gathered in the 1997 ARB Consumer and Commercial Products Survey (ARB, 1997 CP Survey). The stated rationale for using this data is that the 1997 Survey "represents the latest and most comprehensive information available" since the agency gathered information on 100 categories of consumer products. To develop its 2001 emission estimates, the ARB factored in California's approximate population growth (at 1.3 percent per year for a four-year period) and any reductions that were achieved by regulations in effect at that time. CSPA strongly disagrees with this approach and believes that the ARB's reliance on the "adjusted" 1997 Survey data to be so fundamentally flawed that it cannot serve as the foundation for determining and assessing the "fee."

As a threshold matter, the 1997 Survey is six years old. Given the undisputed fact that the consumer products industry is highly competitive, the use of such old data is highly questionable and inappropriate. Furthermore, the 1997 Survey was conducted to determine the need for future regulation - it was not conducted for the purpose of fairly determining a "fee" on consumer product manufacturers. In addition, CSPA continues to question the validity of the ARB's assumption that there is a direct and corresponding relationship between California's population growth and the use of consumer products. Contrary to the ARB's assumption, there is no such correlation. Independently verifiable data clearly shows that over the past decade, sales of many of the largest VOC-emissions categories were not growing at a rate equal to population growth. (CSPA2, 7/22/03)

Agency Response: This comment is addressed in the response to Comments No. 75 and 76. Regarding the commenter’s point that the 1997 Survey was not conducted for the purpose of assessing a fee on consumer products manufacturers, this is not a relevant criticism. Regardless of the original purpose of the 1997 Survey, the data collected by the survey is the best available and, with appropriate corrections, will work adequately to estimate a manufacturer’s emissions.

85. **Comment:** These companies have requested a review and possible corrections be made, to their company's 1997 Consumer and Commercial Products Survey. (MK, 7/16/03; Dial, 6/6/03; SCJ, 6/11/03; MEG, 7/2/03; DAP, 7/24/03; JD, 6/12/03; RSC, 7/21/03)

Agency Response: As explained in the response to Comment No. 75, ARB staff will continue working with individual consumer product manufacturers to refine the emissions estimates for 2001 and correct any errors that the companies may have made when they submitted their 1997 Consumer and Commercial Products Survey.

86. **Comment:** The company has requested that ARB consider their company's recently submitted 2001 Consumer & Commercial Products Survey instead of their 1997 survey data. (WHP, 6/25/03)

Agency Response: ARB staff has worked with the commenter and pointed out that their 2001 survey submittal did not contain information on all of their consumer product sales. After discussions with ARB staff, the commenter decided to withdraw its request that the 2001 survey submittal be used as the basis for its fiscal year 2003-2004 fee determination.

87. **Comment:** The commenter requested assistance in resolving a potential double-billing of fees to the commenter and other stationary sources in the South Coast Air Quality Management District (SCAQMD) under the AB 10X amendments to the nonvehicular source fee regulation. The commenter was concerned that the fees for two consecutive years would be based on the same emissions. (DW&P, 7/22/03)

Agency Response: The South Coast Air Quality Management District (SCAQMD) emission inventory is based on a fiscal year (July-June) rather than calendar year (January-December) basis. By contrast, other local air districts in California base their emission inventory on a calendar year basis. To avoid confusion and insure that facilities in the SCAQMD are not billed twice for some of their 2001 calendar year emissions, section 90800(c)(4) of the regulations was modified to provide that the amount of each facility's emissions in the SCAQMD shall be determined on a fiscal year instead of a calendar year basis. All other local air districts in the State will submit facility emissions on a calendar year basis. To determine the appropriate fiscal year to use for the first year of the modified fee regulations, ARB staff worked with the staff of the SCAQMD and determined that SCAQMD fiscal year 2001-2002 emissions were the most appropriate to consider as being equivalent to calendar year 2001 emissions. Accordingly, section 90800(c)(4) provides that for calendar year 2001, the SCAQMD will submit facility emissions for the 2001-2002 fiscal year. These modifications to section 90800(c)(4) should resolve all the concerns of the commenter.

88. **Comment:** ARB is adjusting the 1997 survey data to develop a per-company emissions inventory adjusted to 2001. If data under the 1997 surveys is inaccurate, then calculations based on that data are flawed. Companies should be given the opportunity to provide data on VOC emissions of their consumer products and architectural coatings to ARB for relevant years. Allocations should not be based on inaccurate survey data and arbitrary assumptions from staff. (RPM, 7/23/03)

Agency Response: The response to Comment No. 75 explains that ARB staff is working with individual manufacturers to refine the emissions estimates for 2001 and correct any errors that may have been made in the preliminary fee estimates. This process should result in accurate emissions determinations.

89. **Comment:** Assumptions could have been made by companies when completing the 1997 surveys. These assumptions could have included sales in California, based on a population percentage of California's population compared to that of the nation, or estimates based on maximum allowable VOCs per products, instead of actual VOCs per product. If companies were aware of the financial implications of their survey answer they may have investigated real sales into California, minus resale outside of California. They may also have distinguished between products manufactured specifically for sale in California, such as low solvent aerosol paints, from products sold throughout the rest of the country. Using national sales numbers does not address these distinctions. (RPM, 7/23/03)

Agency Response: As explained in the response to Comment No. 75, ARB staff will continue working with individual manufacturers to refine the emissions estimates for 2001 and correct any inaccurate data that companies may have submitted in their 1997 Consumer and Commercial Products Surveys.

90. **Comment:** The emissions reported in Table 3 and Appendix E for the year 2000 were calculated by ARB from data submitted by architectural coatings manufacturers in response to ARB's survey of paint sales in California in the year 2000. It is SPC's contention that ARB has inadvertently overstated SPC's 2000 sales in California by approximately a factor of two with a concomitant error in the calculated tonnage. The emissions for the year 2001 were derived by ARB by adjusting the 2000 tonnage to account for ARB's estimate of the rate of growth in the architectural coatings industry. The error as to SPC in 2000 also makes the "adjusted" tonnage for 2001 incorrect. In addition, we report below SPC's actual gallonage and tonnage for 2001, which shows that ARB's adjusted estimate is about seven times too high and that, even if the 2000 data is corrected, it would still be nearly four times too high. (SPC, 7/14/03)

Agency Response: As described in the response to Comment No. 71, the ARB staff has worked with this manufacturer to correct erroneous data they reported in the 2001 architectural coatings survey. Consequently, their estimated emissions and fees have been reduced by about 85 percent.

91. **Comment:** The preliminary estimates in Appendix E significantly overestimate the emissions for many CSPA member companies. As noted earlier in these comments, the preliminary estimates of emissions included in Appendix E of the ISOR contain many errors that must be corrected prior to issuance of billings for fees for the year 2003-2004. We believe that these corrections will be substantive, and will require that ARB re-issue these estimates for further public comment. It is important that companies be given as much opportunity as needed to assure that the emissions basis for their "fees" is as accurate as possible. (CSPA2, 7/22/03)

Agency Response: The response to Comment No. 75 explains how ARB staff is working with individual manufacturers to refine the emissions estimates for 2001 and correct any errors that may have been made in the preliminary fee estimates. The

response to Comment No. 75 also describes how manufacturers have been provided with ample time and opportunity to comment on the preliminary fee estimates. The ARB believes that this process will result in accurate emissions determinations.

92. **Comment:** The basis for assessing the fees - the 1997 Consumer Product Survey - is both limited in scope and far too old to provide a reasonable basis for assessing fees. This survey was conducted to measure emissions from a finite number of product categories to analyze whether those products might be candidates for regulation - not to determine a fair basis for imposing fees on the entire consumer product industry. At a very minimum, the ARB should delay this process until the 2002 survey is completed, fully analyzed and emissions data for overlapping categories is updated. In the long run, a more complete and current picture of all taxable emissions is necessary. Although the ARB staff has attempted to "adjust" the 1997 emission levels to reflect 2001 emissions, the basis for doing so is flawed and incomplete. First, the use of standard population growth statistics to compute emissions in 2001 based on 1997 data is inappropriate in a highly competitive consumer product category. Sometimes sales increase with increased population, but if a product is out of style or a brand is not competing effectively, they can also decrease. One period of declining sales during this four year period could substantially change the emissions from a product, yet the ARB has made no affirmative effort to obtain actual data to assess this possibility.

Reliance on a patchwork of old survey information adjusted based on flawed assumptions and guesswork is not the kind of accounting that is legally required to justify a regulatory fee. In addition, although companies have been advised that they can challenge their emissions data, our members have been advised by the ARB staff that, if they seek to correct their emissions data downward for one category, they can expect an extremely stringent audit of all their consumer product emissions data before any corrections are made. This process does not encourage the determination of fees based on real-world emissions. Companies that have legitimate reasons to challenge their assessments should not be penalized for seeking to do so by being required to submit unnecessary additional data. Filing an amended tax return does not trigger a full IRS audit. Seeking to amend emissions data should not trigger a full emissions audit that goes well beyond the data required of others subject to a survey conducted by the ARB. (CTFA, 7/22/03)

Agency Response: The issues raised in this comment are addressed in the responses to Comments No. 75, 76, 82, and 84. The ARB staff believes that the process described in these responses will result in accurate emissions data, and that it is not necessary to delay assessing fees until the 2002-2003 survey is finalized. Based on past consumer products surveys, it takes at least two years to perform quality control and finalize survey data. The 2001 Consumer and Commercial Products Survey (which was collected in 2002-2003 and has not yet been finalized) represents only 44 categories, a subset of the larger consumer products inventory. Moreover, waiting until this data is finalized would mean that the fees for fiscal year 2003-2004 would not be collected until sometime in fiscal year 2004-2005.

The commenter is not accurate in stating that "…our members have been advised by the ARB staff that, if they seek to correct their emissions data downward for one category, they can expect an extremely stringent audit of all their consumer product emissions data before any corrections are made." All suggested corrections are considered by ARB staff on a case-by-case basis. In general, however, the ARB staff believes that it is reasonable to ask a company to report all their consumer product sales, instead of just revised sales figures for a few products, because there is a strong financial incentive for companies to only report products with a downward sales trend. Since sales of a company's other products may be increasing during the same time period, reporting of product sales for all of a company's products would ordinarily be appropriate to ensure equitable treatment of all companies affected by the fee program. This is because a possible consequence of a reduction in emissions for one company would be an increase in the fee rate and higher fee determinations for other companies. ARB staff is committed to working with individual companies to identify appropriate information and supporting documentation that will meet the needs of both the individual companies and ARB staff. In most cases, ARB staff can correct errors in 1997 survey submittals without the need for a company to submit sales figures for all of their products.

93. **Comment:** CTFA believes it is inappropriate to tax manufacturers after the fact for previous fiscal years. In this case, the fees are imposed based on 2001 data ("adjusted" from the 1997 survey). As has been noted in informal comments during ARB Workshops, this action can deprive manufacturers after the fact of their profits for previous years. While a manufacturer might decide not to sell in California if a prospective fee would eliminate or severely reduce profits on its products, that option is not available if the fee is imposed retroactively.

Fees that are to be applied to 2003 ARB regulatory activity should be based on 2003 sales and should be announced and applied prospectively so that manufacturers can accurately assess whether their business in California is profitable and therefore economically feasible. Some regulated product categories present situations where profit margins are now so thin after years of regulation that the fee can eliminate any prospect of a profit. Although the "fees" assessed may seem small for large companies, when combined with other California regulatory fees and substantial costs for research and development and reformulation necessary to meet the ARB standards, they can erase what is left of already thin profit margins. (CTFA, 7/22/03)

Agency Response: The commenter's proposal is administratively unworkable. There is no practical way that fees collected by the ARB during the 2003-2004 fiscal year could be based on 2003 emissions, because it takes one to two years after the end of a calendar year to finalize the emissions for that calendar year. A time lag for the fee regulations is therefore necessary and cannot realistically be avoided. See also the response to Comment No. 3 for a discussion of the problems associated with a similar proposal by another commenter.

94. **Comment:** There are also several issues related to the collecting of the fees.

We're using as a basis a 1997 survey that was conducted not for the purpose of assessing fees like this, but for the purpose of identifying emissions from various products which may or may not be targets for regulation in the future. That survey is too old to really shed much light on 2001, let alone 2003.

I think some of the ways in which the staff has attempted to update that information are flawed. For example, the sort of default assumption is that if population increases, sales increase, and therefore emissions increase. Well, in a highly competitive consumer market, that simply is not the case. Some products do well. Some products do better than population growth. Some products are worse. And so you just can't assume X percent per year and that's what your emissions are.

The staff is working with many companies to try to resolve some of those issues, but it takes a great deal of time to do that. We would suggest that because there is another consumer product survey now in the building, but not yet fully analyzed for 2002 that final action on this be deferred until whatever information that is relevant in that more recent survey could be brought to bear on what emissions actually are and therefore what fees should be assessed.

I think it's important that the process of correcting data be institutionalized and the staff has made a proposal to do that, which we appreciate. We think a period of about 90 days is really necessary to assess whether preliminary assessments are, in fact, accurate or not, based on surveys, and we would suggest a little more time than staff has proposed. But that's very important. It's also important that that process be one in which manufacturers could come in without being put through almost -- an inquisition is too strong of a word -- but being asked to produce all of their emissions data on consumer products that were not even part of the survey in the first place.

When you file an amended tax return, you're not automatically subject to an IRS audit. And similarly here I think when manufacturers come in and try to correct data it's important that they be given a hearing and the corrections be made where those are appropriate. (CTFA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The issues raised in this comment are addressed in the responses to Comments No. 10, 75, 76, 82, 84, and 92.

95. Comment: You have already mentioned there would be some change to the opportunity to challenge your original invoice, so we are very appreciative that we're going to be given more time to take a look at working with ARB staff in the event a company determines that their emission numbers are not the same as what staff feels they are. But we do think that as long as a company has notified staff that they feel there is an error and they're working with staff to correct that error, that actually they should be given time up to the time that bill is due to be able to work that problem out.

It is a very intensive process. I know in looking at our numbers there is a discrepancy with

the amount of time and effort it would take for my company to come in and work with staff on that discrepancy and it just isn't worth it, because the cost is just too high

and we don't have the resources at our company to do that, even though we are a large company. (RB, Oral testimony at Board Hearing, 7/24/03)

Agency Response: As described in the response to Comment No. 75, the fee determinations for the 2003-2004 fiscal year will not be final until written notices (i.e., "the bills") are sent to each affected source, an event that will not occur until after the fee amendments are approved by the Office of Administrative Law and are legally operative (see section 90900.8(a)(2)(A)). Before the final written notices are sent out, manufacturers will have been provided with more than eight months from the publication of the preliminary fee estimates to work out any corrections with ARB staff.

96. Comment: We also take issue with the use of the 1997 consumer products survey data and the use of the population growth. We don't think that properly reflects the true amount of VOCs that are being emitted by these products and we think there needs to be consideration of the real world statistics in that area. (ASPA, Oral testimony at Board Hearing, 7/24/03)

97. Comment: As was stated before, we feel the use of the 1997 survey data is problematic. We also continue to question the validity of the ARB's assumption that there is a direct causal relationship between the growth in California's population and the use of consumer products. Independently verifiable data shows over the past decade sales of many of the largest categories are not growing at a rate equal to California's population growth. (CSPA1, Oral testimony at Board Hearing, 7/24/03)

Agency Response to Comments No. 96 and 97: These comments are addressed in the responses to Comments No. 75 and 76.

98. Comment: Another way of accomplishing the goals, a more accurate cost of business is to require ARB to use more accurate sales data. The data for 2002 is available. I don't believe it would be too difficult to use that sales data and come up with a more accurate system for billing the companies. When you're talking about small businesses, that makes a huge difference. What we did in 2000 doesn't equate to what we did in 2002. It's definitely not going to equate to what we do in 2003. It makes a big difference when you're talking about small businesses. (SPC3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: 2002 data are not yet available for all sources subject to the fee regulations. This is explained in the response to Comment No. 75, which also explains the basis for using the VOC emissions in 2001 to assess fees for fiscal year 2003-2004. If the commenter can substantiate that their sales and VOC emissions decreased after 2001, this decrease will be reflected in reduced fee assessments for subsequent fiscal years.

E. REACTIVITY

99. **Comment:** The proposal for an equal tonnage "fee" for all pollutants and sources is unfair for the low-reactivity VOCs used in consumer products. ARB proposes to use the same "fee" per ton across all sources and emissions. While this may at first glance seem fair and equitable, it does not take into account the widely differing impacts of the same tonnage of emissions from differing sources. Regarding VOCs and impacts on ambient ozone, ARB has supported research that shows that there is more than an order of magnitude (factor of ten) difference between low-reactivity VOCs and high-reactivity VOCs. Nitrogen oxides (NOx) emissions can also have a greater impact than VOCs in many parts of the state. Consumer products VOC emissions, however, are of low reactivity, and have low impact on ozone formation.

ARB has previously acknowledged that consumer products VOCs are generally lower in photochemical reactivity than VOCs from many other sources. ARB's draft State Implementation Plan revision for the South Coast states that, "ROG emissions from consumer products are relatively less reactive when compared to some other ROG emissions sources" and that, "on a pound for pound basis, the ROG emissions from vehicle exhaust are estimated to lead to the formation of more than twice as much ozone than the ROG emissions from consumer products." CSPA's reactivity assessments suggest that, on a total organic gas basis, mobile source emissions average close to three times the ozone formation potential per pound when compared to consumer products, and those same mobile sources also are the primary source of NOx. It is clear that a mass-based inventory overestimates the impact of consumer products on ozone nonattainment in the South Coast and elsewhere in California.

Scientific studies funded by CSPA suggest that a mass-based inventory approach overestimates the actual impact of consumer product VOC emissions on ozone attainment in the South Coast and other areas of California. Subsequent to the previous statewide revision of the California SIP in 1994, CSPA and The Cosmetic, Toiletry and Fragrance Association (CTFA) funded an air quality modeling study to determine the specific role of consumer products in ozone attainment in both South Coast and in Sacramento regions. That study, "Impact of Consumer Products on California's Air Quality" used the exact Urban Airshed Model (UAM), inventories and meteorology utilized in the attainment demonstrations for the 1994 SIP.

The study compared UAM outputs for two scenarios in the South Coast air basin: (1) the attainment demonstration in the SIP, which included an 85 percent reduction in the VOC emissions from consumer products, and demonstrated attainment with the one-hour ozone standard in 2010; and, (2) the exact same modeling run with only a 30 percent reduction in consumer products VOC emissions (the reduction already assured by ARB regulations already adopted by 1994). The results showed that both scenarios demonstrated attainment of the one hour ozone standard of 0.12 ppm in both South Coast and Sacramento. In both cases, the additional consumer product emissions, despite their significant mass, had such small impacts on peak ozone formation that insufficient ozone

was formed to cause non-attainment. This extreme result was probably attributable to both the low reactivity of the consumer product emissions, and the geographic distribution of those emissions in areas that minimized impacts on peak ozone levels. Aerosol consumer products are especially low reactivity, since aerosol propellants tend to be among the lowest photochemical reactivity of all VOCs in the emissions inventory.

We therefore believe that assessing "fees" based on equal tonnage of emissions does not provide a fair basis for assessing "fees" on VOCs due to the wide range of reactivities and ozone impacts represented by various sources of emissions. Basing fees on ozone impact instead of mass VOC or NOx emissions would provide a more fair and reasonable approach. (CSPA2, 7/22/03)

Agency Response: There are several reasons why it is not appropriate to base AB 10X fees on the relative reactivity (i.e., ozone-forming potential) of consumer product VOC emissions. Implementing a fair reactivity-based fee system would require that the particular VOC emissions from each individual consumer product be speciated to determine their relative reactivities. VOCs vary widely in reactivity, and the reactivity of the VOCs emitted by a particular consumer product may also vary widely depending on the particular VOCs used in that product. When assessing fees on the emissions from individual companies, it is therefore meaningless to know that consumer product emissions “in general” are lower in reactivity than emissions from certain other source categories. The question that must be answered is the relative reactivity of the particular VOCs emitted from products manufactured by a particular company, as compared to other companies and facilities subject to the fee regulations. Not only would such a reactivity-based system be enormously complex to implement, it is also not currently possible to do so because a detailed speciation database does not yet exist for the thousands of products whose emissions are subject to fees.

The ARB staff does agree that, in general, the VOCs emitted from consumer products are less reactive than the VOCs from some other sources, including motor vehicle exhaust. The commenter’s discussion of the high relative reactivity of motor vehicle exhaust is not particularly relevant, however, because the fee regulations do not apply to motor vehicle exhaust. It is also worth pointing out that, although the rate at which the VOCs in consumer products produce ozone may be slower than that for some other sources, consumer products are nonetheless a major source of VOC emissions that participate in ozone formation.

ARB staff disagrees with the commenter’s assertion that a mass-based inventory overestimates the impact of consumer products on ozone nonattainment. The mass-based inventory includes detailed VOC species profiles that are provided to ARB by the consumer products industry and are used in models for SIP attainment demonstrations. ARB staff also disagrees with the commenter’s assertion that the Urban Airshed Model (UAM) used for South Coast Air Basin demonstrates that reductions in VOC emissions from consumer products have minor impacts on ozone formation. The fact that UAM modeling for the South Coast Air Basin may not have demonstrated measurable changes

in ozone formation from reducing the VOC content of consumer products does not mean that these reductions are not impacting ozone formation. UAM is a photochemical grid model that numerically simulates the effects of emissions, advection, diffusion, chemistry, and surface removal processes on pollutant concentrations within a three-dimensional grid. The model is designed to estimate ozone effects for a particular air basin, and the sensitivity of the model is often not high enough for any measurable change to result when emissions from a specific source category are varied in the model. The results mentioned by the commenter are therefore not particularly relevant; they do not contradict the fact that ambient air quality data over the last 20 years demonstrate that reductions in VOC emissions along with reductions in NOx emissions contribute to lower ozone levels. The conclusion of ARB scientists and engineers, based on many years of experience, is that mass reductions in VOC emissions from consumer products are resulting in less ozone formation.

100. **Comment:** ARB should not assess fees based upon a mass-based equation for all consumer products when aerosol coatings are regulated on a reactivity basis. The proposed fee equation would apply uniform fees on a dollar per ton basis to all covered facilities and the manufacturers of architectural coatings and consumer products with annual emissions over 250 tons per year. Such an assessment is entirely based upon the amount of volatile organic compounds emitted, a mass-based calculation. Not all consumer products, however, are regulated by a mass-based control strategy.

Currently, aerosol coatings, a consumer product, are not regulated according to the volume of solvents in each formula. Rather, they are regulated based upon the degree to which each solvent included in a formula will operate to create air pollution. In this reactivity-based system of regulation, all VOCs are not treated the same. Some VOCs have a greater propensity to create ground-level ozone and these VOCs are assigned higher MIR values than VOCs which have a relatively low propensity to create ground-level ozone.

To date, aerosol coatings are the only consumer product to be regulated on this reactivity scale. However, ARB has indicated on many occasions that reactivity-based regulatory schemes are under consideration for other consumer products and architectural coatings. It is inconsistent, then, to assess fees based solely upon the amount of VOCs emitted by a broad category of products.

At the June 24 workshop on this proposed regulation, ARB indicated that specific language would be added to the regulation to recognize that certain products are regulated according to reactivity standards. As this language has not yet been shared with industry, it is not clear that the "newly proposed but not yet disclosed language" will be sufficient. (NPCA, 7/24/03; SW3, 7/23/03)

Agency Response: At the June 24, 2003 workshop, the ARB staff did not commit to include specific language in the fee regulations to address the reactivity-based limits for aerosol coatings. Instead, ARB staff indicated that specific regulatory language was not necessary to address the reactivity-based limits for aerosol coatings.

The aerosol coatings category is the only source category subject to the fee program that is regulated on a reactivity basis. The reactivity-based limits in the Aerosol Coatings Regulation (sections 94520-94528, title 17, CCR) superceded the previously adopted mass-based limits for aerosol coatings, and were designed to provide an equivalent reduction in ozone formation. Consequently, the ozone reductions achieved from the reactivity-based limits can easily be converted into equivalent VOC emission reductions. This will allow aerosol coatings manufacturers to be assessed on the same dollar-per-ton fee amount applicable to all product categories. It will not be necessary to do this until fiscal year 2004-2005 because the limits in effect for aerosol coatings in 2001 were mass-based. The response to Comment No. 102 discusses what the ARB staff will do if new reactivity-based limits for products other than aerosol coatings are proposed in the future.

101. **Comment:** In the case of aerosol coatings, manufacturers are being taxed for the total emissions of solvents in their products when the air quality regulation for that product category is no longer based on a quantitative measure of emissions but rather on a qualitative evaluation of the total emissions. (CPC, 6/6/03)

Agency Response: This comment is addressed in the response to the previous comment.

102. **Comment:** The ARB must determine how to handle reactivity reductions that occur due to reactivity-based VOC limits. If the "fees" are continued in 2004-05 based on 2002 emissions data, the ARB will need to determine how to handle the emissions of companies that comply with the aerosol coatings limits through the reduction of reactivity to meet reactivity-based limits. It would be unfair for companies that choose to meet California's air quality goals by reducing reactivity to be subject to higher "fees" than companies that choose to meet the equivalent mass-based limits. In the ARB rulemaking designated "CONS I" this year, other products might be subjected to reactivity-based limits, potentially without the benefit of alternative mass-based limits. The ARB needs to develop a strategy to handle those products fairly as well, if "fees" are to be assessed in later years when those limits are in effect. (CSPA2, 7/22/03)

Agency Response: The response to Comment No. 100 describes how the ARB intends to address aerosol coatings emissions in connection with the fee regulations. Regarding consumer products other than aerosol coatings, the ARB staff is evaluating the feasibility of establishing additional reactivity-based limits for consumer products on a case-by-case basis. The ARB staff is not planning to propose reactivity-based limits for all consumer product categories, because doing so would not be feasible or appropriate for many categories. The ARB staff is using the 2001 Consumer Products Survey to gather detailed information on VOCs (including hydrocarbon solvent mixtures) used in consumer products. The 2001 Survey data and future survey data will improve the solvent inventory and facilitate the possible development of reactivity-based limits for more product categories. If the ARB decides to propose reactivity-based standards in the future for product categories other than aerosol coatings, it is possible that these new standards may use a different approach than the one used for the aerosol coatings standards (which

were designed to be equivalent to existing mass-based limits). If future reactivity-based standards are proposed for some consumer product categories, at that time the ARB staff will evaluate whether amendments to the fee regulations are necessary to accommodate whatever approach is being proposed.

103. **Comment:** We recommend that ARB adopt the concept of reactivity as a fee basis for all consumer product categories and not limit it to only aerosol coatings. (WHP2, 7/10/03)

104. **Comment:** Utilizing the reactivity concept offers the Board a unique opportunity to use the regulatory and fee collection process to influence behavior which will benefit all Californians. Use of low reactivity chemicals in consumer products is recognized as the best means of attaining ARB's real goal, the reduction of ozone or smog formation from consumer product emissions. Using this concept as a fee basis will emphasize to manufacturers and to the public that the Board is focused on the goal of reducing the amount of smog in California's air. (WHP2, 7/10/03)

105. **Comment:** Using reactivity as a fee basis will provide further incentive to manufacturers to formulate with low reactivity components wherever possible. Reactivity MIR values established in the aerosol coatings regulations cover many, if not most consumer product chemicals. Manufacturers whose products do not have published MIR values will now have further incentive to measure the reactivity of their chemicals. Manufacturers who have diligently participated with ARB staff over the past several years as the reactivity concept was developed, and who have reformulated products with reactivity in mind, will be rewarded for "doing the right thing." (WHP2, 7/10/03)

106. **Comment:** Relative reactivity is the newest concept in regulations. It was voted in by this Board in June of 2000. However, to date it has not been recognized in this regulation at all. This issue has been brought to the staff's attention. It needs a specific section put into this regulation for this concept. (SW5, Oral testimony at Board Hearing, 7/24/03)

Agency Response to Comments No. 103-106: The response to Comment No. 99 explains why it would not be feasible or appropriate to base fees on the relative reactivity (i.e., ozone-forming potential) of VOC emissions that are subject to the fees.

F. OPERATIVE DATE

107. **Comment:** Because the new statutory provision created by AB 10X has not yet take effect, the Board has no legal authority to take final action on the fee. The newly created section 39613 of the Health and Safety Code does not take effect until "the 91st day after adjournment of the special session at which the bill was passed." The first special session that was convened on December 9, 2002, has not adjourned. Therefore,

the Board has no legal authority to take final action on the "fee" until this 91-day period has elapsed. (SW1, 6/4/06; CPC, 6/6/03; GMA, 7/22/03)

Agency Response: ARB staff does not agree with the commenters' position that the ARB has no legal authority to adopt the fee regulation before the enabling statute becomes legally operative. AB 10X was passed at a special session of the Legislature (i.e., the 2003-2004 First Extraordinary Session of the Legislature). The California Constitution provides that bills passed at a special session of the Legislature do not become operative until the 91st day after adjournment of the special session (see Article 4, section (8)(c)(1), California Constitution, and Government Code section 9600(a)). Since the proposed amendments cannot become operative until the enabling legislation (AB 10X) becomes operative, section 90800.75 of the fee regulation specifies that the proposed amendments shall become operative on the later of the following dates:

(a) the date on which the amendments are filed with the Secretary of State by the Office of Administrative Law, or

(b) the 91st day after adjournment of the special session of the Legislature at which AB 10X (Stats. 2003, chapter 1X) was passed.

Section 90800.75 therefore insures that the amendments will not become operative until AB 10X becomes operative.

Some commenters believe that this approach is impermissible, and that the ARB simply cannot adopt a regulation before the enabling statute becomes legally operative. As discussed on page 5 of the ISOR, there is a 1955 Attorney General's opinion which directly addresses this issue and concludes that state agencies can do this so long as the regulations specify that they will not become operative until the statute becomes operative (see 26 Ops. Cal. Atty. Gen. 141, Sept. 1955). Section 90800.75 was designed to meet this condition. Opinions of the California Attorney General are entitled to "great weight" by the courts, and ARB staff believes that the 1955 Opinion cited above is directly on point.

Moreover, it is important to point out that the ARB did not take final action to adopt the fee amendments until after the 91 days had elapsed and AB 10X had become operative. The 2003-2004 special session of the Legislature was officially adjourned on July 31, 2003 (by SCR7), a few days after the July 24, 2003 Board hearing on the proposed regulation. AB 10X therefore became operative on October 30, 2003. At the July 24, 2003 hearing, the Board did not take final action to adopt the amendments, but instead delegated this duty to the Executive Officer (see page 5 of Resolution 03-20, which states that the Board "… is initiating steps toward the final adoption of the regulatory amendments…" and "… directs the Executive Officer to take final action to adopt the regulatory amendments …" after making the modified regulatory language available for a 15-day comment period, considering such written comments as may be submitted, and making such additional modifications as may be appropriate.) Final action to adopt the amendments did not occur until January 2004 when the Executive Officer signed Executive Order G-03-68.

The Board has used this process for over 20 years in regulatory actions, like the present one, where modifications are made to the originally proposed regulatory language. The reason the ARB uses this approach is that the California Administrative Procedure Act (APA; Government Code 11340 et seq.) specifically prohibits state agencies from taking final action to adopt a regulation until all modifications to the originally proposed language are made available for an additional comment period of at least 15 days, and all written comments are responded to in the FSOR (see Government Code section 11346.8(c)). The APA therefore prohibited the Board from taking final action to adopt the modified fee regulation at the July 24, 2003 Board hearing, which is why the Board delegated this responsibility to the ARB Executive Officer. The ARB Executive Officer is specifically empowered to adopt regulations on behalf of the Board by Heath and Safety Code section 39515(a) and (b), and section 39516.

Therefore, even if the commenters' legal argument were correct, the ARB did not violate the law cited by the commenters because the ARB did not take final action to adopt the fee amendments until after AB 10X became operative.

108. **Comment:** Section 39613 of the Health and Safety Code was created by AB 10X during the 2003-04 First Extraordinary Session. The bill was signed by the Governor on March 18, 2003, and filed with the Secretary of State on March 18. As passed, AB 10X does not contain a specific date on which the new law takes effect. Thus, under applicable California Law, the new law does not take effect until "the 91st day after adjournment of the special session at which the bill was passed." The Legislature's 2003-04 First Extraordinary Session has not adjourned. "It has been uniformly held in this state that a statute has no force whatever until it goes into effect pursuant to the law relating to legislative enactments. It speaks from the date it takes effect and not before. Until that time it is not a law and has no force for any purpose." *People v. Righthouse*, 10 Cal. 2d 86, 88 (1937). Since, at the present time,
section 39613 has not taken effect, it is a nullity and the Board has no legal authority to perform acts in preparation in anticipation of the operative date.

The ISOR presents the argument that a California Attorney General opinion issued in 1955 directly addresses this issue and that the ARB can initiate its rulemaking process "so long as the regulations specify that they will not become operative until the statute becomes operative." CSPA respectfully disagrees with this conclusion. The 1955 opinion cited in the ISOR is not directly on point. As a threshold matter, the facts are significantly different. The rulemaking processes reviewed by the Attorney General in 1955 involved recently enacted statutes requiring the issuance of a license that was dependent upon the existence of regulations and provided "that a violation of such rules and regulations is a misdemeanor." Thus, the opinion states that, "[U]nless the administrator has the power to adopt rules and regulations prior to the effective or operative dates of the statutes .... He would be required to condone misdemeanors by this delay." No such draconian result would occur in this present rulemaking. Consequently, the provisions set forth in section 90800.75 of the proposed regulation do not adequately address the fundamental

requirement that an agency cannot take final action on a regulation until there is statutory authority for such action.
(CSPA2, 7/22/03)

Agency Response: The legal issues raised by the commenter are addressed in the response to the previous comment. In addition, the ARB staff believes that the 1955 Attorney General's opinion (opinion) is directly on point. The commenter quotes some language from this opinion, but the quoted language articulates only one of the reasons that the opinion relies on to support its conclusion. The opinion describes several other legal and public policy considerations to support its conclusion, and these considerations apply to the ARB's current situation with the fee regulation. Moreover, the 1937 case relied on by the commenter was specifically mentioned in the 1955 opinion; the opinion distinguished the case and concluded that its broad, general language did not apply to the situation being discussed.

109. Comment: ARB has no authority to promulgate a rulemaking before the authorizing statute is final and effective. AB 10X was passed at a special session of the Legislature (the 2003-2004 First Extraordinary Session of the Legislature). Under the California Constitution, bills passed at a special session of the Legislature do not become enforceable and operative until the 91st day after adjournment of the special session (see Article 4, section (8)c(l), California Constitution and Government Code 9600(a).

To date, the special session in California has not adjourned. Consequently, ARB has created a floating "operative date" for this regulation. This is necessary, according to ARB, so that ARB can begin the process of collecting the fee revenues as quickly as possible.

Although ARB justifies this action under the guise of a 1955 Attorney General's opinion, it is a bad public policy and ARB should not establish this precedent when considering regulations that have as broad and significant economic impacts as this proposed fee regulation.

Because the special session has not yet adjourned, AB 10X is a prime target for additional consideration during the continuing budget negotiations. Indeed, it has already been targeted for significant, substantive changes as the Legislative Analyst's Office has recommended that the $13 million goal in the statute should be increased to $17.4 million. There could also be other changes to the statute that could affect the fee formula even further, or the universe of potential payers.

Consequently, it is premature for ARB to implement and complete a rulemaking process when the enabling statute is not yet final and effective. This proposed fee regulation is based upon legislation that is not yet a finished product and is still subject to change. ARB should be required to wait until the underlying enabling statute is final before it can begin the rulemaking process. (NPCA, 7/24/03; SW3, 7/23/03; CSPA2, 7/22/03)

110. Comment: Because the special session has not yet adjourned, AB 10X is a prime target for additional consideration. It is very possible that there will be substantive changes to the enabling statute at issue here, not the least of which includes the budget recommendation of the Legislative Analyst's Office. There could also be other changes to the statute which could affect the fee formula even further, or the universe of potential fee payers. It is premature for ARB to implement and complete a rulemaking process under these circumstances. The proposed fee regulation in this instance is based upon legislation that is not yet final and still subject to change. ARB should be required to wait until the underlying enabling statute is final before adopting and implementing regulations. By waiting until the legislation is complete, SW will be able to appropriately comment on the fees that are being assessed. (SW3, 7/23/03)

Agency Response to Comments No. 109 and 110: The responses to Comments No. 107-109 address the legal issues raised by the commenters. However, the commenters have also questioned the wisdom of proposing a regulation when the enabling legislation "is not yet final and still subject to change."

After its enactment by the Legislature, AB 10X was signed by Governor Davis and filed with the Secretary of State on March 18, 2003. AB 10X was therefore already "final" when the ISOR was released for public comment on June 6, 2003. It was no more "subject to change" than any enacted statute is "subject to change" while the Legislature is in session. What was not yet known on June 6, 2003 was the exact date when AB 10X would become legally operative, because the 2003-2004 special session of the Legislature had not yet been adjourned. Since the exact language of AB 10X was already established, however, the commenters were in no way impeded in their ability to comment on the bill or on the ARB's proposed regulations. Moreover, the date the Legislature adjourns is widely publicized, thereby providing affected parties with 91 days advance notice of the date that AB 10X would become legally operative. In this case, the 2003-2004 special session of the Legislature was officially adjourned on July 31, 2003 (by SCR7), a few days after the July 24, 2003 Board hearing on the proposed regulation. No changes were made to AB 10X after it was enacted by the Legislature and signed into law.

Also unknown during the 45-day comment period was the exact amount of fees that would ultimately be authorized by the Legislature in the ARB's 2003-2004 fiscal year budget. When the State budget was enacted shortly after the ARB's July 24, 2003 hearing, the ARB was authorized to assess $17.4 million in fees to recover costs related to our stationary source program. Anticipating this potential outcome, the ISOR addressed the impacts on industry of assessing fees at the $17.4 million level, as well as at the $13

million level that was originally in the Governor's Proposed Budget. The affected industries were therefore provided with an opportunity to comment on this potential fee amount during the 45-day comment period. Moreover, the public was again provided an opportunity to comment on the authorized $17.4 million level during the 15-day comment period. The $17.4 million, as authorized by the Budget Act of 2003 (Stats 2003, Chapter 157), was specifically mentioned on page four of the ARB document entitled "*Consumer Products and Architectural Coatings Program Costs.*" This document was made available for public comment during the 15-day comment period, prior to final action by the Board's Executive Officer.

Finally, it is important to note that the fee amendments basically establish a process for assessing and collecting fees. This process is designed to work with whatever fee amount the State Legislature authorizes the ARB to collect for any fiscal year. No specific fee amounts are mentioned anywhere in the regulations. Accordingly, commenters were not impeded in their ability to comment on the regulations simply because the exact fee amount for the 2003-2004 fiscal year was not known at the time of the Board hearing.

G. ECONOMIC IMPACTS

111. **Comment:** ASPA strongly objects to the imposition of the proposed "fees" because we believe they constitute an unjustified tax on certain ASPA member companies and place an undue burden on the automotive specialty products industry. (ASPA, 7/23/03)

Agency Response: The responses in Sections B and C of this FSOR discuss why the regulations will assess "fees," not "taxes," and why the proposed fees are fair and equitable. There is no reason to believe that the fees will place an undue burden on the automotive specialty products industry. See also the response to Comment No. 123 regarding the impacts on the automotive specialty products industry.

112. **Comment:** The costs associated with this tax on consumer products are an unfair burden on the citizens of California; and, as a manufacturer, we will have to pass these charges on to our customers in California. (RSC, 7/21/03)

113. **Comment:** As a practical matter, the "fee" that will be authorized by AB 10X imposes increased costs that ultimately will be borne by the consumer at a time when they can least afford it - particularly since California residents may be required to pay an additional one-cent state sales tax. (CSPA2, 7/22/03)

114. **Comment:** Additionally, the "fee" that AB 10X imposes will increase costs that ultimately will be borne by the consumer at a time when they already face increased taxes (such as a likely increase in the sales tax) to help reduce the state's current budget deficit. (ASPA, 7/23/03)

Agency Response to Comments No. 112-114: Staff does not agree. Even if all of the fee cost is passed on to California consumers, only a few cents would typically be added to products purchased by consumers. In the case of hairsprays, for example, ARB staff has estimated that passing on all of the costs would result in an increase of about one cent on a typical can of hairspray (at 55 percent VOC and 10 ounces). Most customers would probably not consider such a price increase significant as the retail price of hairspray products typically range from several dollars to as high as $10. In addition, California citizens benefit from funding the ARB's regulatory program because the work of the ARB results in better air quality.

115. Comment: CSPA has serious concerns that the proposed "fee" will have the perverse effect of imposing a substantial economic burden on those companies that have already paid the largest portion of the significant costs to achieve these significant emission reductions. (CSPA2, 7/22/03)

116. Comment: ASPA has serious concerns that the proposed "fee" will have the negative effect of imposing a substantial economic burden on those companies that have already paid the largest portion of the significant costs to achieve these significant emission reductions. (ASPA, 7/23/03)

Agency Response to Comments No. 115 and 116: ARB staff recognizes that the fee regulations will lead to added costs, but does not agree with the commenters' assertion that these costs constitute a "substantial economic burden". As discussed in Chapter V of the ISOR, the average return on owners equity will decline only 0.02 to 0.03 percent, over 300 times less than what is ordinarily considered significant in other ARB regulatory actions. Moreover, this is a "worst case" analysis--it assumes that the manufacturer will be unable to pass along any of the increased costs to the consumer.

117. Comment: Imposing a fee of $280,561 on SPC in 2003-04 is unauthorized, unanalyzed, and unwise. The staff paints a rosy picture about the economic effects of its proposed regulations. The ISOR (at 41) and the Notice (at 5) assert that they will "not have a significant adverse economic impact on businesses." The former (at 41) and the latter (at 5) claim they will not impair "the ability of California businesses to compete with businesses in other states." The former (at 42) and the latter (at 6) allege that the proposed regulations will not affect the "elimination" or prevent the "expansion" of California businesses. Staff's rationale in the ISOR (at 41) for these comforting conclusions is that the affected industries "are among the largest in California and the nation, both in size and financial strength." It states (at 41-42) that among the operators of affected businesses are "major" manufacturing enterprises and "large" manufacturers and sellers of products.

But certain other factual admissions by the staff contradict these glib and unsubstantiated claims. The Notice acknowledges (at 6) that the regulations "will affect small businesses," including "some . . . architectural coatings manufacturers." The ISOR states (at 42) that "[a]bout 13 businesses . . . are considered to be small businesses."

SPC, including its subsidiaries, is one of those small businesses, as defined by the Administrative Procedure Act. It is "[i]ndependently owned and operated" and "[n]ot dominant in its field of operations." Government Code § 11342.610(a). It has less than 250 employees. *Id*. at § 11342.610(b)(10). None of CPC's four retail stores exceeds $2 million in annual gross receipts. *Id*. at § 11342.610(c)(4).

As shown above, a fee of nearly $300,000 in 2003-04 and each year thereafter is comparable to SPC's annual average profit during the past decade and could confiscate in a few years SPC's entire equity, as reflected in its most recent year-end balance sheet.

The ISOR and the Notice neglect to disclose the massive — indeed, the confiscatory — adverse economic impact of the fees on certain businesses, including SPC, as mandated by the Administrative Procedure Act.

Furthermore, the ISOR shall include a description of each alternative that would "lessen any adverse impact on small business" and the reasons for rejecting them. Government Code § 11346.2(b)(3)(B).

Each of our comments suggests an alternative which would lessen the impact on small business, including SPC. Furthermore, the ISOR should have analyzed and the Board should consider, the alternative of exempting small businesses, as defined in the Administrative Procedure Act, from the fee. This could prevent the elimination of up to 13 small businesses, including SPC, but would have no material impact on the 160 major businesses otherwise subject to the fee. (SPC2, 7/16/03)

118. **Comment:** SPC is one of the small businesses adversely impacted by the proposed regulations. The staff proposes to charge SPC up to $280,561 in fiscal year 2003-04, and a comparable amount each year thereafter. This would require SPC to pay about 10% of the total fees to be imposed on manufacturers of architectural coatings and about 2% of the total fees to be imposed on all payers. The fee will impose an impact on SPC which is several hundred times greater than the impact it will impose on, other large multinational fee payers. It would immediately destroy SPC's profitability and, indeed, in a short period of time confiscate its equity.

For some perspective on the immense impact of the fee on SPC, consider these comparisons. The fee the staff would charge SPC the first year is almost as large as that it would impose on a leading California paint company which is nearly 10 times larger, a national paint company which is about 20 times larger, and another national paint company which is about 100 times larger. The proposed SPC fee would be more than roughly twice that of another California company which is about 10 times larger and higher than another California company twice as big. Major global competitors which are at least 20 times and as much as 100 times larger than SPC would be charged fees which are less or many times less than the fee SPC would be charged. Compared to major consumer products manufacturers, the fee the staff would assign to SPC is, for example, larger than that of Unilever, twice as large as that of Bristol Meyers Squibb, three times as large as that of

Proctor & Gamble, and four times as large as that of Gillette. Compared to power and oil company facilities, SPC would pay more than Mobil or Phillips 66, several times more than Southern California Edison and Los Angeles Department of Water and Power, more than Reliant Energy's two facilities, and more than Southern California Gas' three facilities. Indeed, the fee ARB's staff proposes to charge SPC (including subsidiaries) in 2003-04 is comparable in amount to SPC's average annual profit during the past decade. Furthermore, the fee would in only several years likely confiscate SPC's entire shareholder equity. (SPC2, 7/16/03)

Agency Response to Comments No. 117 and 118: ARB staff has worked with this manufacturer to correct erroneous data the manufacturer reported to us in the 2001 architectural coatings survey. Consequently, its estimated emissions and fees have been reduced by about 85 percent from the amounts cited in this comment. The remaining cost impact to this manufacturer could be minimized or eliminated by passing on some or all of the cost increase to the consumers. Consequently, staff does not believe that the economic impact on the commenter will be "massive" and "confiscatory." Staff also does not believe that an exemption for small businesses is warranted. Throughout the ISOR and the responses in Section B of this FSOR, staff's position is that the most equitable approach is to treat all large emitters the same by charging the same dollar amount per ton of pollution. Exempting small businesses would undercut this principle. If a manufacturer's products result in 250 tons per year or more of VOC emissions in California, it is fair to treat that manufacturer the same as other large sources of VOC emissions—even it that manufacturer happens to meet the rather generous definition of "small business" contained in the APA.

119. Comment: The increased "fees" imposed on consumer product manufacturers will redirect money away from innovation. The proposed VOC fee is not the only economic burden to consumer product manufacturers. Pesticide products, including antimicrobials, are assessed very significant pesticide registration fees annually in California. Added to the VOC fees, this can represent a significant economic burden to these products, which provide significant public health benefits to residents of the State. Consumer product manufacturers could better serve consumers by investing the money intended for California fees into technological innovation of our products to lower overall VOC content and emissions. (P&G, 7/24/03)

Agency Response: ARB staff acknowledges that industry's efforts to comply with the consumer products regulations have reduced VOC emissions and consequently the fees imposed on the industry by the fee regulation. The ARB staff does not agree that the fee regulations will redirect money away from innovation. The regulations may actually encourage technological innovation. This is because consumer products manufacturers have an economic incentive to lower the VOC
content and emissions from their products. Those manufacturers that are able to lower the VOC content of their products could reduce or avoid paying the fees.

120. Comment: ARB's own business impact data indicate that the greatest impact on

profitability falls on the architectural coatings industry. See Table 2 on page D-4. This table purports to show the Fee Impact on Owner's ROE in Affected Category. If the legislative mandate remains at $13 million, the average profitability of the architectural coatings industry will decrease by .1%; but the average profitability of the consumer products industry and the nonvehicular sources will only decrease by .01%. ARB's own analysis shows that the economic impact on architectural coatings manufacturers is 10 times that of the impact on the other two categories -- even when the emissions from architectural coatings are the smallest of all three affected industries and ARB does not have any statutory authority to regulate architectural coatings. (NPCA, 7/24/03)

121. Comment: According to ARB's data, emissions from billable architectural coatings (37,361 tons) account for less than five percent of the total billable stationary source program emission inventory (773,318 tons). Moreover, ARB's business impact data indicates that the architectural coatings industry will suffer the greatest impact on profitability. If the legislative mandate remains unchanged at $13 million, the average profitability of the architectural coatings industry will decrease by .1%. In contrast, the average profitability of the consumer products and the nonvehicular sources industries will decrease by only .01%. This economic analysis shows that the impact on architectural coating manufacturers will be ten times greater than the impact on the other two regulated industries. This is especially troubling because, comparatively, the emissions from architectural coatings is the smallest of the three affected industries.

RCMA appreciates the opportunity to take part in this important regulatory process that significantly impacts its membership. We ask that ARB carefully review the proposed fee regulation. We believe that the proposed regulation is unconstitutional and that it will result in an inequitable fee structure for architectural coating manufacturers. Thus, it is RCMA's position that it should not be adopted in its present form. (RCMA, 7/22/03)

Agency Response to Comments No. 120 and 121: The response to Comments No. 11-13 and 20 describe why the ARB staff believes the fee regulations are equitable for architectural coatings manufacturers. The claim that the regulations are "unconstitutional" (i.e., a constitutionally adequate "nexus" has not been established) is addressed in Section C of this FSOR. As explained in Section C ("Nexus"), the ARB staff believes that the fee regulations meet all constitutional and other legal requirements.

122. Comment: We are now particularly concerned and disagree with the following ARB statement in the "Initial Statement Of Reasons" regarding Economic Impact on Businesses (Page 41-42): "The staff believes that adoption of these regulations will not have a significant adverse economic impact on businesses, including the ability of California businesses to compete with businesses in other states." We also disagree with the following: "The staff believes that the proposed regulatory action will not affect the creation or elimination of jobs within the State of California, the creation of new businesses or the elimination of existing businesses within California or the expansion of businesses currently doing business within California." All of our manufacturing operations nationwide compete against one another for capital improvement and expansion projects, as well as

for additional personnel. When the cost of business in one particular state is too high, those projects go to other less costly areas of the country. Therefore, additional regulatory fees and taxes do affect and impact these types of important business decisions. (CLOR, 7/21/03)

Agency Response: The fee regulations will impose fees on all consumer products and architectural coatings manufacturers whose products result in VOC emissions in California of 250 or more tons per year. The geographic location of the facilities where the products are manufactured (or the company headquarters) is irrelevant, because products sold in the State are subject to the same fee regardless of where they are manufactured. Therefore, the existence of the fee should have no bearing on manufacturing location decisions, because manufacturers would not be able to reduce their fees by relocating or expanding somewhere else.

123. Comment: This "fee" will have a significant financial impact on automotive specialty products manufacturers. ASPA and our members will be directly and negatively impacted by the implementation of this "fee." Currently, six ASPA member companies will be subject to substantial fees under the proposed regulation. Contrary to the ARB's assertion that, "...the impact of the proposed fee regulations appear to be miniscule," this proposed rule will impose hundreds of thousands of dollars in annual costs upon some companies.

Within the automotive specialty products industry, only a minority of companies will be assessed fees, while many competitors will not be subject to fees. Therefore, ASPA believes that the ARB should have considered a more reasonable and accurate approach of estimating the "potential impacts" by comparing the "fee" assessed with the net income achieved from selling their consumer products in California. ASPA believes that this assessment might demonstrate that there are some companies for which the fees approach or even exceed the net income from selling their products in the state. This amount is substantial and may result in higher prices for consumers in California, and also could severely limit the ability of some companies to do business in the State. (ASPA, 7/23/03; ASPA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: Most automotive products typically sell for several dollars per unit. Even if the entire cost increase from the fee were passed on to the consumer, this would result in a typical cost increase of a few cents per unit. The ARB staff does not believe such a small added cost would substantially change product competitiveness. The commenter also suggests that the ARB should use a company-specific approach to estimate the potential economic impacts of the fee regulations. The relative impact of fees will of course vary from business to business, and it is obvious that a more complete economic impact picture could be obtained by conducting a detailed financial analysis for each affected company. However, it is not feasible to use such a company-specific approach because it would require the ARB to have access to detailed internal financial information for each affected company. Such information is not available to ARB staff, and is unlikely to be made available in the future because most companies consider such

information to be highly confidential.
The response to Comment No. 125 contains a detailed description of the methodology used by the ARB staff to assess the economic impacts of the fee regulations.

124. **Comment:** CSPA believes that the "potential impacts" on consumer products companies are underestimated and cannot be assessed using industry averages.
The cursory assessment of the "potential impacts" on consumer products companies included in Appendix D of the ISOR falls far short of providing an accurate and reliable picture of the economic impacts of this regulation. We strongly disagree with the statement in the ISOR that, "...the impact of the proposed fee regulations appears to be minuscule."

Economic impacts on specific consumer products manufacturers cannot be assessed using simplistic industry averages of "return on owner's equity." ARB admits that at least 13 of the companies subject to fees are small businesses, and these companies will potentially bear a more significant burden from these fees. In the consumer products industry, only a minority of companies will be assessed fees, with competing products being sold in each product sector by companies not subject to fees.

An accurate and reliable assessment would also have to take into account the other fees that are also imposed on these products. Pesticide products, including antimicrobials, are assessed very significant pesticide registration fees annually. Added to these VOC fees, this can represent a significant economic burden to these products, which provide significant public health benefits to residents of the State.

A more reasonable and accurate approach would have been to assess the impact on specific companies by comparing the "fee" assessed with the net income achieved from selling their specific consumer products in California. We believe that this assessment might demonstrate that there are some companies for which the fees approach or even exceed the net income from selling their products in the state. This could make selling those products in the state of California unprofitable, which we believe is a significant impact for both those companies and the residents of California. (CSPA2, 7/22/03)

Agency Response: This comment is addressed in the response to the previous comment and Comment No. 125. In addition, the commenter suggests that the ARB's economic analysis should somehow "take into account" other fees that are currently being assessed by other governmental agencies on certain categories of consumer products. The commenter is unclear on exactly how this is to be done. In general, however, the existence of other currently imposed fees is part of the "baseline" for the economic analysis. The impact of such existing fees should already be reflected in the current price and profits for products that are now being sold, and it is proper for the ARB's analysis to focus on the incremental impact of the new ARB fees as compared to the existing baseline.

125. **Comment:** The study approach used to determine the economic impact on California businesses is flawed and resulted in several misstatements. In Appendix D,

ARB attempts to measure the economic impact of the proposed fee regulation on California businesses. The study approach utilized does not provide an accurate methodology for examining the economic impact and it is contradictory. The ARB's economic impact analysis fails to consider the unique business environment in California. ARB's reliance on its "Return on Owner's Equity" impact is significantly flawed and fails to consider the unique business environment in California for both large and small companies. Under this study approach, "Owner's Equity" appears to include global net profit data for all companies considered, rather than evaluating the net profit data that is limited to California sales of architectural coatings or consumer products. In other words, the ARB only evaluated the impact of the fees on the entire universe of the industry.

The ARB must limit their study methodology to California sales of the targeted products. Examining the impact of the proposed fees on the California sales of architectural coatings and/or consumer products will reveal a much different and much more significant impact of the proposed fees. (NPCA, 7/22/03)

Agency Response: The ARB does not agree that the economic impacts analysis is flawed. The methodology used to estimate the economic impacts of the fee regulation is consistent with that used for many years for other ARB regulations. The analysis does not include global net profit data as indicated by the commenter, but does assume that a typical business on a nationwide basis in each industry is representative of a typical California business in that industry. The analysis also assumes a “worst-case” scenario that the affected businesses must absorb all of the costs because they are unable to increase the prices of their products or lower their costs of doing business through short-term cost-cutting measures. Under U.S. EPA guidelines, a decrease in the Return on Owners’ Equity (ROE) of greater than 10 percent is considered to indicate a potential for significant adverse economic impacts. Based on the ARB’s worst-case analysis, the maximum decrease in the ROE for the architectural coatings industry is estimated to be .13 percent, which is nearly 100 times less than the threshold commonly used to determine significant adverse economic impacts. (See the response to Comment No. 13 and Chapter V and Appendix D of the ISOR.)

Based on the California sales data provided by the industry, ARB staff analyzed what the increase in product cost would be if a manufacturer elected to pass the entire cost of the fees on to the consumer. This analysis shows that the cost of a typical consumer product would increase by less than one cent, and the cost of a typical architectural coating would increase by two to five cents per gallon. This analysis also shows that the maximum cost increase could be 20 to 30 cents per product for some consumer products, and 20 cents per gallon for an architectural coating. The maximum cost increases could occur for consumer products and architectural coatings that have high VOC contents.

Finally, as stated in the response to Comment No. 123, the type of analysis suggested by the commenter requires access to detailed financial information for different divisions and product categories of the affected companies. Such detailed financial information

is simply not available to ARB staff. In the absence of such information, staff used the best publicly available financial data to perform its financial impact analysis.

126. Comment: ARB's economic analysis makes invalid assumptions. The study approach uses financial data from 2000-2002 and ARB staff made some assumptions in order to make certain calculations. One of the assumptions made by ARB staff was that "[a]ffected businesses neither increase the prices of their products nor lower their costs of doing business through cost-cutting measures because of the fee regulations." However, later in the analysis, when discussing why the potential impacts "might be high" (see page D-4), ARB indicates that "affected businesses probably would not absorb all of the increase in their costs of doing business. They would be able to either pass some of the cost on to consumers in the form of higher prices, reduce their costs, or both." ARB cannot rely upon a study approach that makes certain assumptions for the purpose of making economic predictions and then contradict those assumptions in order to explain unusually high impacts.

There are also other misstatements in the economic impact analysis. For instance, ARB writes that "[n]o noticeable change in consumer prices is expected from the estimated fees for fiscal year 2003-2004." ARB attributes this to the "small impact on profitability of affected businesses." See page D-5. This statement is not true. ARB admitted this earlier in the document when it noted that manufacturers will not absorb this cost but will pass it on to customers in the form of higher prices. (NPCA, 7/24/03)

Agency Response: ARB staff does not agree that the economic analysis makes invalid assumptions and misstatements. The ARB's economic analysis first makes the "worst-case" assumption (high impact scenario) that the entire fees are absorbed by businesses. The point of this analysis is that if it is found under this high impact scenario that the fee has no noticeable economic impact on businesses, there is no real need to estimate how much less the impact would be if some of the costs were passed on to the consumer. However, ARB staff economists clearly understand that in the real world businesses will be able to pass on at least a portion of their costs to the consumers. It therefore makes sense to acknowledge this fact in the ISOR. The potential impacts of the fee regulations on consumer prices is discussed in the response to the previous comment. These impacts should be so small that they would not be noticeable by most consumers. The statements in the ISOR are consistent with this observation.

127. Comment: GMA's member companies and industry colleagues have worked cooperatively with ARB staff in helping improve California's air quality through reductions in VOC content of consumer products, while maintaining safe and effective products. As required by the California Health and Safety Code, the ARB's standards achieve the "maximum feasible reduction" that is technologically feasible and necessary to meet applicable ambient air quality standards. Consequently, the consumer products industry has spent hundreds of millions of dollars to reformulate its products to meet the ARB's current stringent technology-forcing standards. GMA is concerned that implementation of the proposed fee will have the perverse effect of imposing a substantial economic burden

on those companies that have already paid the largest portion of the significant costs to achieve these significant emission reductions. (GMA, 7/22/03)

Agency Response: The ARB staff recognizes that the consumer products regulations have cost impacts on companies that must reformulate products to comply with the VOC limits. This has led to significant reductions in VOC emissions, and will also lead to reduced fees being paid by the companies that have done the most to reduce the VOC content of their products. As explained in the responses to Comments No. 111-126, the ARB staff does not agree that the costs associated with the fee regulations are excessive or will have a significant economic impact on the consumer products industry.

128. Comment: As stated in the "Potential Impact on Consumers", we disagree with the assessment that the proposed regulations are monetarily insignificant and believe that the fee authorized by AB 10X imposes increased costs that ultimately will be borne by the consumer. (GMA, 7/21/03)

Agency Response: This comment is addressed in the responses to Comments No. 111-126 and in Chapter V and Appendix D of the ISOR.

129. Comment: Launching a new fee program and assuming it will continue and increase for the foreseeable future could in many ways do more harm to the California economy than good. Every additional economic burden that falls on manufacturers trying to sell products in California has a risk. It may cost jobs. Very important from the Board's perspective, it may take dollars away from research and development for new technology that can reduce emissions even further than we've done so far. It may raise prices, but then on the other hand, in some situations, and you'll hear about one today, it may not be possible to raise those prices anymore and still sell your product in California, because the consumers will not pay those prices, in which case the company takes a large hit.

So I'd ask you to think about that. We think that taxing manufacturers for activities that really cannot be expected to achieve continuing environmental benefits or benefits for the consumer really doesn't help anyone. (CTFA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: This comment is addressed in the responses to Comments No. 119 and 152.

130. Comment: Wella is a holding company for Wella, Sebastian, and Graham Webb. All of these companies are based in California. Combined, we have about a thousand employees, of which about 500 are here in California. Sebastian is the reason I'm here and the reason we have an objection to this fee.

Sebastian has been successful in the hair spray and styling care market to the point it has the top selling professional hair spray in the United States. And consequently, it bears a disproportionate burden of the VOC taxes in regulation, vis a vis or our competitors who might make shampoos, hair colors, and the like. Since the end of 2000, and really that's the year the 55 percent VOC had its impact, the sales for our top selling product have declined 25 percent. That's really coincident with the impact of the regulation.

There are other reasons this may have occurred. Let me go into how this affects our company. We sell Shaper in California, in 50 states, and in 60 countries. We were forced to reformulate our top selling hair sprays so they had both an 80 percent formula and 55 percent formula. While normally making the formulas is not that difficult -- it's a small expense -- making a new formula that matches the performance characteristics of an old formula is very difficult. So these formulas – these reformulations cost tens of thousands of dollars, whereas making a new formula might cost $10,000. The cost of that 55 percent VOC hair spray was 30 to 40 percent more than the out of state 80 percent formulas. We did not pass that along. We did not raise our prices in California. We did not and we could not. If we did, that $12 can of Shaper hair spray would cost $16 in California and from a marketing perspective, it simply is unacceptable. It could not happen.

I've witnessed three rounds of layoffs in the last three years, probably 75 employees. If I add up the cost of reformulating and selling 55 percent VOC hair spray in California, it's probably around $800,000 per year. That's the number we absorbed that we did not pass on with a company with declining sales. There's a cumulative trauma that goes with this, and I want to talk about that. Many of our customers when we switched formulas complained bitterly about the new formula. It didn't work. It didn't work as well. Some of our best customers actually went out and had contract fillers make competitive hair sprays to sell against our product. These were our customers. I can't imagine what our competitors did. Our sales declined. We also have the cost now of maintaining twelve new products, so we have twelve -- we have three new hair sprays. We make it in four different sizes, so in some warehouse on some product list or some price list you have twelve new products. All of this has cost.

We had to create a computer system that prohibited 15 customers in California from ordering 80 percent while prohibiting walk-in customers out of California from ordering the 55. So we had to create a whole computer system to manage this system of formulas.

To add insult or just to make it worse, when we did introduce the 55, there was a defect in the valve, and we ended up doing a recall of tens of thousands of products that were on the shelves in California. I don't know what the costs were, but I'm sure it was tens of thousands of dollars to go out and recall, bring back and fix the valve on these cans.

Finally, in terms of procedural fairness of this tax, I've gone through the list of who's being assessed and who's not. And I notice a number of my competitors are not, and I presume that's because they haven't met the 250 ton threshold. And I question the fairness of that. Certainly it will give those of our competitors who are below that an unfair competitive

advantage, so it simply, in practice, distorts the market. They would have a cost advantage over us. (Wella, Oral testimony at Board Hearing, 7/24/03)

Agency Response: ARB staff does not believe that the added cost of the fees will have any noticeable impact on the competitive position of the commenter. The fee regulations do not require that any products be reformulated, so the commenter will not have to incur additional reformulation costs. As discussed in the responses to Comments No. 112-114 and 125, passing on the cost of the fees to consumers would add only about one cent to a typical can of 55 percent hairspray. Since the commenter indicates that a can of Shaper hairspray may currently cost about $12, it is difficult to see how an added cost of one cent per can could affect the commenter's competitive position, whether this added cost is passed on to consumers or absorbed by the company. Therefore, ARB staff does not agree with the commenter's assertion that paying the fee will place them at a competitive disadvantage compared to those companies that do not pay the fee. See response to Comment No.132. The commenter also questions the fairness of the 250 tons per day threshold for fee payers. The Legislature established the 250 tons per day threshold, therefore, the ARB has no control over this issue.

131. Comment: There's been an assertion that there's not really a significant impact, financial impact, assigned to these fees. And I'd like to dispute that. And I know there's nothing that can be done from the legislative standpoint. But I think you need to understand the impact is significant.

The gentleman from San Luis Obispo mentioned the fact that stationary sources, smoke stacks, already pay a fee and they're being double charged. Well, antimicrobial products or disinfectant products will be paying three fees, three charges. We pay the Department of Pesticides registration to register our products so we can sell them in the states. We pay a mill tax on every dollar of sales on those products in this state, and now we will be paying a VOC tax. And to give you some perspective of the dynamics of that, our company pays approximately half a million dollars a year to register our disinfectant products and pay our mill tax. Those costs are also increasing due to the severe economic situation in the State of California.

We're going to be facing a 55 to 60 percent increase in the cost for us to market those products in California. Now add on a VOC fee. Our total increase to do business in California is going to be approximately another half a million dollars. So you're looking at a total of a million dollars in fees to sell products in California.

Add this on to what's happening across the nation. California's not the only state having severe economic problems. All other states are as well, and we are facing significant increases in fees throughout the nation. This is significant. It is not an insignificant cost for us to do business.

I'm very sympathetic to the fact that ARB does have to work with less people, with less dollars, because we are all facing that. In industry, that has been a common occurrence.

Last year we had downsizing and we faced the loss of 8 percent of our work force. So I am very sympathetic and the folks at the ARB have been very cooperative. They work very hard and they do a very good job. (RB, Oral testimony at Board Hearing, 7/24/03)

Agency Response: This comment is addressed in the response to Comment No. 124. In addition, the responses in this Section G of the FSOR explain in detail why the ARB does not agree with the commenter's general assertion that the fees will have a "significant" financial impact.

132. Comment: Mention was made of competitive disadvantage and Mark talked about what we've faced from our competitors. The cutoff of 250 tons a day seems to be arbitrarily assigned to consumer products simply because that's what you did for smokestacks.

When we look at what we have to pay versus what a competitor who's under that 250, we are at a competitive disadvantage. We do not then have the dollars to put into research, into our marketing efforts. And just because you're below that 250 tons a day doesn't mean you're a small company. You may actually be a very large company.

I'll give you an example. I mentioned we make institutional products. And we sell products to hospitals, to janitorial service to service buildings like this. Our company is a very small player in the institutional market. The reason our emissions are so high and our tonnage is so high is primarily due to our retail sales. As a small player in the institutional market, we're paying a significant cost on those products.

The largest player in the institutional market is below the 250 tons a day. Do they have less VOCs in their institutional product? Not necessarily. They may actually have products that have higher levels of VOCs in their product line. It's just a matter of how your products mix is for your company to where you may fall out of that 250 tons a year. (RB, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The 250 ton per day threshold was chosen by the Legislature, not the ARB. The use of this threshold in the ARB fee regulations reflects the policy decision made by the Legislature. The ARB staff does not agree with the commenter's assertion that paying the fee will place them at a competitive disadvantage compared to companies that do not pay the fee. The ARB staff's reasons for this conclusion can be found in the response to Comments No. 125 and 130 and in Chapter V and Appendix D of the ISOR.

133. Comment: I also want to echo the comments that were made in the documents regarding the impact of the fee on the companies as being inconsequential. These fees are going to impose thousands of dollars in annual costs on our members.

Within the automotive specialty products industry only a minority of companies will be assessed these fees, while many competitors will not be assessed fees. This is going to

be a huge competitive impact on a lot of these companies. Therefore, we believe that ARB should consider a more reasonable and accurate approach of estimating potential impacts by comparing the fee assessment with the net income achieved from selling these consumer products in California.

We believe the assessment Mike demonstrated up there -- some for which a fee approached or even exceeded the net income from selling their products in this State -- the amount is substantial and may result in higher prices for consumers in California, and also severely limit the ability of some companies to do business in this State and actually provide more research in reducing their VOCs in this State. (ASPA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The ARB staff does not agree with the commenter's assertion that paying the fee will place them at a competitive disadvantage compared to companies that do not pay the fee. The ARB staff's reasons for this conclusion can be found in the response to Comments No. 125 and 130 and in Chapter V and Appendix D of the ISOR. The other issues touched on by the commenter are addressed in the responses to Comments No. 112-114, 119, and 123.

134. Comment: The economic impact analysis in the staff report looks to me like it only evaluates the economic impact for businesses; their business from coast to coast, their business on a global enterprise. What wasn't analyzed in the staff report was the impact on these companies' businesses in California. How much of their profit from their business in California is going to be wiped out by this regulatory fee? That wasn't evaluated at all. (NPCA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: This comment is addressed in the responses to Comments No. 123 and 125.

135. Comment: Let's protect small businesses whose profitability -- we talk about costs, but whose profitability and net worth will be disproportionately affected by these fees. I'm talking about maybe an exemption for the 14 -- or excuse me -- 13 small businesses that are included within these companies.

These businesses are going to be disproportionately affected because even those small fees, whatever they are, we don't think they're small, but they have a larger effect when you're talking about a small business. And I know nobody wants to put small businesses out of California, but I think this is a way to take an exemption and still accomplish a goal. It's not going to have a drastic effect on the overall outcome. (SPC3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: ARB staff does not agree that it is appropriate to include an exemption for small businesses. Staff's reasons for this position are articulated in the response to Comments No. 117-118.

136. **Comment:** To address your specific question, we have products -- we do roofing, not typical architectural coatings. We have products that are zero grams per liter. We have products that are 500 grams per liter. We have products in the middle, depending on what the product category is. The zeros aren't going to be affected very much. For the 500 gram per liter of products, our cost will go up on the order of a dime, I would say, taking Madelyn's number. We don't sell retail. I don't know what retail price would do, double that probably. So you're talking a quarter per gallon kind of numbers for those.

I have submitted written comments on those first two points. I'd like to address the economic effects analysis. We think it was extremely cursory. In particular, it looks at the amount of the fee divided by the total net income of the company. I don't think there are any companies that can't adopt a regional response to a regional change, and the right basis would be the effect of the fee on the income from the specific properties involved, products involved in the state.

Henry Company is a privately held California corporation. We've been making adhesives and sealants and coatings and specialty products for the last 70 years. We employed about 150 people in the State. Depending on the numbers that are batting around, the number of our fee would be somewhere between 50 and $70,000 a year. In 2000, Henry lost money. In 2001, Henry lost money. Last year we got our act together, and before special charges caused by the change in IRS code, we earned one point three million dollars nationwide sales, net bottom line. So the amount of these fees are three to five percent of our total return on owner's equity.

If you look at sales of the products being assessed fees, those constitute about 7 percent of our gallons. 7 percent of 1.3 million is $100,000. These fees are 50 to 70 percent of our total net margin on these products. That's a little out of line. We don't think that is appropriate. We don't think that is -- that certainly will have business consequences. (HC2, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The responses to Comments No. 123 and 125 explain why the ARB's economic analysis was appropriate. For the reasons discussed throughout Section G of this FSOR, staff does not agree that the commenter is being assessed an unfair or excessive amount of fees.

137. **Comment:** We're opposed to the proposed fee. The proposed fee will have a significant adverse impact on small manufacturers. For small manufacturers like DAP, the amount of the proposed fee will be high compared to the amount of the profit generated.

In addition, the cost to the company to administer this fee will be significant. We are concerned that the economic impact study for the proposed fee did not adequately reflect the cost of the company to administer this fee, such as figuring out not only their

sales to the State but distributors and retailers. (DAP3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: As described in detail in the responses to Comments No. 115, 116, and 125, the ARB staff does not agree that the fees will have a significant adverse impact on small manufacturers. The ARB staff also does not agree that companies will incur significant costs to "administer" the fee. Fee determinations will typically be based on information historically submitted by a company in response to periodic ARB surveys. Companies are already required by Health and Safety Code section 94513 to respond to such information requests and have historically been asked to do so every three to four years. In the future, staff plans to continue the same practice and does not plan to conduct surveys any more frequently in response to the fee regulations. The ARB will use this information to make a preliminary fee determination for a company, which can then simply pay the assessed amount with minimal administrative costs. In any individual year, however, a company may choose to submit supplemental information to ARB staff if it believes that the ARB's preliminary fee determination for that year is incorrect. It is up to each individual company whether they will choose to submit such additional information, and thereby incur the "costs" of compiling it and interacting with ARB staff. Presumably, companies will make this choice based on their own judgement about whether it is worth the effort; they will not incur costs to submit additional information unless they believe that the costs of doing so will result in a large enough revision to the ARB's preliminary fee determination that they would save money overall. Since it is up to each company whether they wish to incur such "administrative" costs, and they are unlikely to incur such costs unless doing so will save them money in reduced fees, it is reasonable to conclude that the costs to "administer" the fee would not be significant for companies subject to the fees.

138. Comment: With respect to the ARB, Clorox has already expended substantial capital to reformulate our products to meet past and future strict volatile organic compound (VOC) limits and to modify our state-of-the-art manufacturing facilities to meet strict pollution controls. Many of our products provide important public health benefits to Californians. Also, our Clorox packages are manufactured to meet strict requirements for post-consumer recycled content under the regulatory authority of the Integrated Waste Management Board. Adding another fee or tax on our products, especially those where VOC emissions have already been substantially reduced, places yet another regulatory cost burden on our company and is not good public policy. (CLOR, 7/21/03)

Agency Response: The policy decision to assess fees on manufacturers of consumer products was made by the Legislature and is beyond the purview of ARB staff.

H. PUBLIC PROCESS

139. **Comment:** Aggregate Inc. and Granite Construction Inc. told the Antelope Valley District that they did not receive any documentation from the ARB regarding information on the proposed amendments to the regulation. (AVAQMD, 7/16/03)

Agency Response: Several letters regarding the implementation of AB 10X were sent to facilities potentially subject to the fees, including to the facilities noted in the comment. As these facilities are included in mailing lists that were used to mail notices to facilities, we cannot be sure why the facilities did not receive the letters. (See also the response to Comment No. 79 regarding these two facilities.)

140. **Comment:** The automotive specialty products industry has a proven record of working with the ARB staff to achieve significant improvements to California's air quality. These companies produce products that are beneficial for the citizens of California and they should not be labeled as polluters. ASPA and this industry stand behind our proactive efforts and we will continue to work toward meeting VOC limits coming into effect through 2005.

ASPA remains actively opposed to this "hidden tax." This fundamentally flawed legislation (AB 10X) bypassed normal taxation procedures. The Legislature failed to provide meaningful opportunities for public review and participation in the debate on AB 10X. Additionally, the "fee" that AB 10X imposes will increase costs that ultimately will be borne by the consumer at a time when they already face increased taxes (such as a likely increase in the sales tax) to help reduce the State's current budget deficit. (ASPA, Oral testimony at Board Hearing, 7/24/03)

141. **Comment:** Our company would like to express disagreement with the ARB implementing new fees on consumer products. The process for adopting this fee bypassed normal procedures that allow for the needed public scrutiny of tax proposals and therefore has discouraged government accountability. (RSC, 7/21/03)

142. **Comment:** CSPA takes umbrage that the Legislature would apply the pejorative "polluter pays" principal to tax the very companies that have done the most to achieve significant improvements to California's air quality. (CSPA2, 7/22/03)

143. **Comment:** CSPA strongly opposes the imposition of VOC "Fees" on consumer products manufacturers and believes such hidden "taxes" do not represent prudent public policy. CSPA actively opposed AB 10X because this hastily developed and fundamentally flawed legislation bypassed normal taxation procedures and denied any meaningful opportunity for public review and participation. (CSPA2, 7/22/03)

144. **Comment:** ASPA also strongly objects to the characterization of this tax as a "polluter pays" proposal. This "fee" affects the very companies that have made significant

improvements to California's air quality. These companies produce products

that are beneficial for the citizens of California and they should not be unfairly labeled as polluters. (ASPA, 7/23/03)

145. Comment: This "hidden tax" does not represent good public policy. While the ARB has made significant efforts to include all parties affected by this regulation, ASPA remains actively opposed to this "hidden tax." This fundamentally flawed legislation (AB 10X) bypassed normal taxation procedures. The Legislature failed to provide meaningful opportunities for public review and participation in the debate on AB 10X; therefore, both the public and companies directly affected by this "fee" were not able to express legitimate concerns with the legislation.

ASPA believes that the "fees" required by AB 10X are new taxes that cannot be imposed by the Legislature with a simple majority vote. California's constitution requires a two-thirds vote of the Legislature before any special tax (i.e., a tax imposed for a specific purpose) may be imposed. Therefore, ASPA strongly believes that the new statutory authority that will be created by AB 10X constitutes an illegal tax, thus we will exhaust all available options to challenge this legislation. (ASPA, 7/23/03; ASPA Oral testimony, 7/24/03)

146. Comment: We would like to express our strong opposition to the proposed amendments to ARB fee regulations, which are to be on July 24, 2003. We have serious concerns regarding the underlying legislation (AB 10X), which gives ARB new authority to impose fees on manufacturers of consumer products and architectural coatings. Unfortunately, because of the great haste in which the legislation was drafted and passed, we feel that we were effectively denied an opportunity to express those concerns during the legislative process. (D-EP, 7/23/03)

147. Comment: Clorox actively opposed AB 10X earlier this year and were extremely disappointed when it was approved. Although our company recognizes the State is facing a huge budget crisis, we remain strongly opposed to the imposition of yet more fees and taxes on our products. We have suggested that the State consider additional spending cuts and program efficiencies prior to tax increases. (CLOR, 7/21/03)

148. Comment: We think it's fundamentally unfair imposing taxes on larger companies who are exactly the companies that have borne the greatest expense and done the greatest amount of work to develop new technology from which the entire industry has benefited in reducing emissions and improve air quality in California. We know you can't repeal AB 10X, so we're not going to ask you to do that.
(CTFA, Oral testimony at Board Hearing, 7/24/03)

Agency Response to Comments No. 140-148: It is the ARB's responsibility to implement laws enacted by the Legislature. It is beyond the purview and expertise of ARB staff to address the commenters' remarks on the performance, wisdom, or legality of the Legislature's actions in adopting AB 10X.

149. Comment: We want to commend the ARB staff for their efforts to provide interested parties with an opportunity to participate in this rulemaking process. In particular, CSPA appreciates the ARB's efforts to allow interested parties to participate in scheduled conference calls and the two workshops in Sacramento (these workshops were accessible via conference call and "webcast"). (CSPA2, 7/22/03)

150. Comment: Since the Air Resources Board began its efforts to reduce the volatile organic compound (VOC) emissions from consumer products, CTFA and its members have worked cooperatively with the ARB to limit the VOC content of personal care products where such actions were both technologically and commercially feasible. Although we oppose this particular measure, we wish to again thank the ARB staff with responsibility for this proceeding for providing frequent opportunities for public comment and dialogue on these issues. (CTFA, 7/24/03)

Agency Response to Comments No. 149 and 150: ARB staff appreciates the commenters' remarks. ARB staff has found that an active public process in our rulemaking efforts has led to more effective regulations. ARB staff strives to develop cooperative working relationships with industry and will continue the open public process.

151. Comment: In this rulemaking process, a consumer products fee regulation workgroup conference call was conducted on April 28, 2003. The proposed draft regulation was not available at that time for distribution to the public. The first workshop was conducted on May 1, 2003. At this workshop, the draft regulation was distributed and industry members and potential payers had the first opportunity to review it and provide substantive feedback to ARB on its content.

Since then, ARB has conducted one additional conference call for the workgroup and conducted one additional workshop in order to discuss the issues and answer questions regarding the draft regulation. This second workshop was conducted on June 24, 2003. Exactly one month later, the proposed regulation is being heard by the Air Resources Board for adoption. If there are any modifications made to the draft regulation, there will be a 15-day comment period available to the public. Following this process, there are other internal administrative reviews which must be conducted and then the proposal will become a Final Regulation Order by some date in "Late 2003."

By any standards at ARB, this is a lightening fast rulemaking process. From the date of the Governor's signing of the bill in March 2003, until the implementation of the Final Regulation Order, only approximately seven to eight months has elapsed (assuming the regulation is final in October of 2003 and then invoices can be mailed in November 2003, as has been discussed at the workshops). It is unheard of for an agency like ARB to propose, conduct workshops, and finalize a complex rulemaking in seven to eight months.

And in this instance, this has been accomplished only because ARB has refused to devote the time and resources necessary to produce a fee regulation that is fair and equitable to all affected categories. It is well understood in the industry that the State of California is

suffering a disabling budget crisis and that all State agencies have also suffered budget cutbacks. It is, however, no excuse for simply refusing to consider all of the very complex issues involved with a fee regulation that impacts three very different source categories and rushing an inadequate draft regulation through the administrative process. The Air Resources Board should reject this draft proposed regulation because it fails to establish a fair and equitable fee structure for all three source categories. (NPCA, 7/24/03)

Agency Response: ARB staff agrees that the regulatory process was expedited for the fee regulations. This was necessary to provide the ARB with the ability to collect fees during the 2003-2004 fiscal year. However, ARB staff devoted considerable resources to this rulemaking effort to insure that it would be completed both rapidly and fairly. Staff believes that the fee regulations adopted by the ARB are equitable to all affected sources categories, that complex issues were properly addressed, and that all provisions of the Administrative Procedures Act were complied with.

152. Comment: A more appropriate first step in addressing the budget crisis - one which individual agencies can address as well as the Legislature - is to take a hard look at the cost-effectiveness of all regulatory activity in the State, and to focus limited resources on the activities that will provide the greatest benefit to California citizens. In that regard, it should be noted that the effort to reduce the VOC content of consumer products is fast reaching the point of diminishing returns -most significant reductions that meet the requirement of technological and commercial feasibility have been achieved. Taxing manufacturers for activities that cannot be expected to achieve continuing benefits for the environment or the consumer is not in anyone's interest. (CTFA, 7/22/03)

Agency Response: The ARB staff agrees that significant reductions in the VOC content of many consumer products have been achieved. With remaining VOC emissions of approximately 265 tons per day (2001), however, consumer products are still a major contributor to ground level ozone. With California's ever increasing population, ongoing regulatory activities are necessary or the consumer products emissions inventory will continue to grow. The ARB staff believes that it is possible to achieve significant additional emission reductions from consumer products, and that regulatory activity in this area is justified.

153. Comment: The imposition of fees on architectural coatings manufacturers regulated by U.S. EPA is unauthorized, unanalyzed, and unwise. The ISOR refers (at 34) to "U.S. EPA's national architectural coatings rule." Yet the Notice claims that "[t]here are no federal regulations that are comparable." SPC contends that the U.S. EPA's 1998 rule is comparable and, indeed, bars the proposed regulations.

In 1990, Congress enacted section 183(e) of the CAA. 42 U.S.C. § 7511b(e). It requires U.S. EPA to study and list for regulation various products containing organic compounds. *Id*. at § 7511b(e)(2), (3)(A). It also provides that U.S. EPA shall regulate listed products requiring "best available" controls, as defined therein. *Id*. at §§ 7511b(e)(1)(A), (3)(A). The entities to be regulated are "manufacturers" of products for sale "in interstate commerce."

Id. at §§ 7511b(e)(1)(C), (3)(B). U.S. EPA is authorized to employ "any . . . systems" of regulation, including "prohibitions" or "limitations," as well as "economic incentives (including marketable permits and auctions of emissions rights)" and may use in prescribed ways any "amounts collected" under such regulations. *Id*. at §§ 7511b(e)(4), (5). Section 183(e) mandates that any state which proposes a product regulation "other than those adopted" thereunder, shall consult with U.S. EPA regarding "whether any other state" is promulgating such regulations. *Id*. at § 7511b(e)(9).

In 1998, U.S. EPA promulgated a rule regulating virtually all water-borne and solvent-borne architectural coatings. 40 CFR § 59.400 *et seq.* The rule requires each manufacturer of an architectural coating to ensure that the organic compound content does not exceed a certain limit. *Id*. at § 59.402. It also imposes labeling, record keeping, and reporting requirements. *Id*. at §§ 59.405, 59407, 59.408. U.S. EPA's rule also provides that any manufacturer exceeding a limit "pays an annual exceedence fee." *Id*. at § 59.403.

The validity of U.S. EPA's 1998 rule has been upheld under section 183(e) and the Commerce Clause. The court first held:

> "EPA readily persuades us that nationwide regulation is reasonably related to the statutory objective. [A]rchitectural coating products are widely distributed and easily transportable across area boundaries. End-users (e.g., commercial painters) themselves may well utilize these products in different locations from day to day [Citation]." *ALARM Caucus*, 215 F.3d at 76.

The court then noted:

> "As the National Paint & Coatings Association wrote in its intervening brief in support of EPA:
>
> > A manufacturer or distributor, whether big or small, that sells an architectural coatings product can never be sure where that product will end up being used. For example, a small manufacturer in Maryland who manufactures his paint solely in Maryland and sells his paint to contractors only in Maryland may have his paint used in Washington, D.C. one day, Virginia the next day, West Virginia the next day, and finally used to paint a weekend beach house in Delaware the next day. [Citation]." *Id*. at 76 n.8.

The court than stated that "there is nothing attenuated about the interstate effects of the activity regulated here." *Id*. at 82. The court concluded that "the rulemaking record sustains the proposition that the large majority of the products regulated by the rule are distributed nationally, and then applied by end-users in multiple locations [citations] . . .." *Id*. at 83.

The Supremacy Clause of the U.S. Constitution preempts state laws which conflict with federal law or are in a field occupied by federal law. In 1990, Congress legislated, and in 1998, U.S. EPA regulated, with respect to consumer products and architectural coatings. The 1998 paint rule is comprehensive both as to the coatings regulated and as to the types of controls imposed, which include not only content limits and record keeping, reporting, and labeling requirements, but also the payment and collection of fees. The federal government has thoroughly occupied the field of the regulation of organic compounds in paints, and no room is left for state regulation of manufacturing and selling, such as that now proposed by ARB's staff. Indeed, the fees would conflict with U.S. EPA's 1998 rule. Congress and U.S. EPA acted in the 1990s for the express purpose of bringing national uniformity to what was becoming a chaotic patchwork of inconsistent and overlapping state and local regulation. No state, including California, can now resurrect that chaos or impair that uniformity.

The proposed regulations also affront the dormant or negative aspect of the federal Commerce Clause. It is manifest that one state's regulation or taxation of paint manufacturers has significant effects on interstate commerce. As shown above, at least as applied to small paint manufacturers, such as SPC, any minimal benefit the fee might provide to the state is massively outweighed by the burdens imposed. It is equally obvious that alternative means of regulation are readily available to ARB which would be far less burdensome to small paint manufacturers, including SPC.

Furthermore, section 11346.3(a) requires that ARB adhere to requirements which "do not conflict" with federal law. The staff's interpretation of new section 39613, reflected in the broadest possible proposed regulations, without the slightest effort to carefully tailor them, creates just such a conflict with federal law prohibited by state statute.

Finally, various provisions of the Administrative Procedure Act mandate that the ISOR or the Notice describe the difference between the federal and the proposed regulations, as well as efforts to avoid conflict and duplication. The staff documents are wholly deficient on these matters. (SPC2, 7/16/03)

Agency Response: The ARB staff does not agree with the commenter's legal theory that ARB fee regulations are preempted by federal law and affront the dormant or negative aspect of the federal Commerce Clause. In general, the federal Clean Air Act (CAA) expressly authorizes states and political subdivisions to adopt their own air pollution regulations (see 42 U.S.C. section 7416). CAA section 183(e) recognizes that states may adopt their own consumer products and architectural coatings regulations (see 42 U.S.C. section 7511b(e)(9)), and the legislative history of section 183(e) also recognizes a continued state regulatory role in this area (see *A Legislative History of the Clean Air Act Amendments of 1990*, Vol. I, p. 884). In situations like the present one where Congress has passed legislation expressly authorizing state and local regulation, the U.S. Supreme Court has stated that state actions so authorized are invulnerable to constitutional attack under the Commerce Clause. (see *Western and Southern Life Insurance Co. v. State*

Board of Equalization of California (1981) 451 U.S. 648, 652-653; and *Northeast Bancorp Inc. v. Board of Governors* (1985) 472 U.S. 159, 174). In addition, in 1996, the commenter filed a lawsuit in which these same legal theories were alleged in an attempt to prevent regulation of architectural coatings in California (*Dunn-Edwards Corporation, Smiland Paint Company, et. al. v. U.S. Environmental Protection Agency, South Coast Air Quality Management District, et. al.*, (Case No. 96-8539 DDP (VAPX)), United States District Court, Central District of California). On August 22, 1997, the District Court issued a written decision rejecting the commenter's theories set forth above, and dismissing (without leave to amend) all causes of action based on these theories.

The commenter also claims that the ARB's fee regulations "would conflict with" the U.S. EPA's national architectural coatings rule, and that the 45-day notice for the fee regulations incorrectly stated that: "There are no federal regulations comparable to the fee regulations." ARB staff does not agree with these assertions. The national architectural coatings rule (the "national rule;" 40 CFR section 59.400 et seq.) is designed to reduce air pollution by establishing volatile organic compound (VOC) limits for various categories of architectural coatings. As such, it is comparable to the architectural coatings rules adopted by the local air pollution control and air quality management districts (districts); these local rules also establish VOC standards for architectural coatings in order to reduce air pollution. The ARB fee regulations are not comparable because they do not set VOC limits, and are instead intended to raise revenue to support the ARB's regulatory program. There is a provision in the national rule that allows manufacturers and importers to pay an "exceedance fee" instead of complying with some of the VOC limits in the national rule (see 40 CFR section 59.403). Unlike the mandatory fees imposed by the ARB fee regulations, the national "exceedance fees" are optional; they are a voluntary compliance option that manufacturers may choose if they wish to continue selling certain coatings that do not meet the national VOC limits.

Finally, the ARB fee regulations do not "conflict with" the national rule, because the two rules impose totally independent requirements which do not overlap or contradict one another. Moreover, the national rule contains a section explicitly stating that the provisions of the national rule must not be construed in any manner to preclude any state or political subdivision from adopting their own architectural coatings rules.
(see 40 CFR section 59.410).

154. **Comment:** Adopting the proposed regulations without considering reasonable alternatives is unauthorized, unanalyzed, and unwise. The ISOR (at 42-43) identifies, but does not propose, three alternatives to the proposed regulations.

The first such alternative is "a variable dollar per ton by industry type." Under this approach, stationary sources would pay "about three times as much on a dollar per ton basis" as architectural coatings manufacturers. The staff recommends rejecting this

alternative, claiming that under its proposal the "large emitters" all pay the same amount for each ton of "pollution."

There is real doubt about whether manufacturers of water-borne paints are "emitters" and whether manufacturers of any paints create "pollution." Furthermore, the organic compounds used in paints are relatively benign, whereas those emitted by other sources are known to be malign. The 13 small businesses gravely impacted by the proposed fee can hardly be said to be "large." This alternative would mitigate certain of the discriminatory effects of the staff's proposal.

The second alternative identified by the staff is "[a]ssess billable tons as only those tons in excess of the 250 ton per year threshold." It does not recommend this approach, because "the company emitting double the pollution is not paying double the fees."
This reasoning is flawed because of the invalid assumptions it makes. In addition, it ignores the distinction between the small businesses just over the threshold and those just below it. For example, a small manufacturer producing 251 tons would pay about $20,000 every year. But its competitor producing 249 tons would pay zero.

The staff's third alternative is: "Do not collect the full budgeted fee amount." It recommends against this alternative too, claiming it would "restrict the ARB's existing ability to mitigate and control pollution thereby endangering public health."

Again, this assumes a fact ARB has not proved — that paints pollute. It also incorrectly suggests that ARB has the existing ability to control any pollution paints may cause. Only EPA and districts claim and exercise direct control over paint formulas. The staff also ignores that the nearly $3 million to be charged each year to the paint industry is a grossly excessive allocation as against the other two categories of sources. It is also grossly excessive, in absolute dollar terms, in light of ARB's intermittent and discretionary or minimal responsibilities relating to paints.

Thus, the staff's facile dismissals of the three alternatives identified are not persuasive. Even more fatal is the fact that other reasonable alternatives are not addressed at all by the staff.

As shown above, the ISOR must assess all reasonable alternatives and the reasons for rejecting them. Government Code § 11346.2(b)(3)(A). The Notice must state that none of them would be "as effective and less burdensome" to affected businesses.
Id. at 11346.5(a)(13). The ISOR must, in particular, describe any alternative that would "lessen any adverse impact on small business" and the reasons for rejecting it.
Id. at 11346.2(b)(3)(B). The ISOR and the Notice omit any such discussion of these reasonable alternatives:

(1) waiting to impose fees on water-borne paints until ARB proves, if it can, that glycol compounds are sufficiently volatile to contribute significantly to ozone nonattainment;

(2) waiting to impose fees on solvent-borne paints until ARB is able to prove, if it can, that mineral spirits are sufficiently reactive to so contribute;

(3) imposing fees on the basis of gallonage sold in the most recent year;

(4) imposing fees only on paints sold in the summer;

(5) imposing fees only on paints sold in nonattainment areas;

(6) reallocating total fees less heavily to paints and more heavily to other sources;

(7) reducing the total amount to be charged to paint manufacturers to reflect only ARB's minimal survey duty every three years; and

(8) exempting the 13 impacted small businesses, including SPC, from the fee.

A thorough discussion of these eight alternatives is required to meet the requirements imposed by applicable constitutional principles, governing statutes, including the Administrative Procedure Act, and sound policy. (SPC2, 7/16/03)

Agency Response: The ARB staff believes that it has adequately assessed all reasonable alternatives. With regard to the specific alternatives mentioned by the commenter, all of them have been considered and rejected for the reasons identified below:

(1) & (2) These alternatives are premised on the commenter's discredited "paints do not pollute" theory that has been considered and rejected many times by both the courts and numerous governmental agencies. The issues related to these "alternatives" are discussed in the responses to Comments No. 69 and 70.

(3) This alternative is discussed in the response to Comments No. 42 and 63.

(4) This alternative is discussed in the response to Comment No. 73.

(5) This alternative is discussed in the response to Comment No. 72.

(6) This alternative is discussed in the response to Comments No. 11-21, and in Chapter IV and Alternative No. 1 (page 42) of the ISOR.

(7) This alternative is discussed in the response to Comments No. 38-40.

(8) This alternative is discussed in the response to Comments No. 117 and 118.

The commenter also criticizes the reasoning used in the ISOR in ARB staff's analysis of

alternatives. One criticism is that staff's analysis of the Alternative No. 2 (on page 42 of the ISOR) ignores the distinction between manufacturers with emissions just over the 250 ton threshold (which must pay a fee) and manufacturers just under the threshold (which do not have to pay a fee). The 250 ton threshold has been set by the Legislature. The ARB's analysis properly focuses on those manufacturers who are subject to the fee because their emissions are over the threshold. For those manufacturers who are subject to the fee, staff's analysis correctly observed that Alternative No. 2 would result in a situation where '"a company emitting double the pollution is not paying double the fees." The commenter also claims that staff's analysis of Alternative No. 3 is defective because it ignores that architectural coatings manufacturers would pay disproportionate and excessive fees. Staff does not agree for the reasons set forth in the responses to Comments No. 11-13 and 20.

155. **Comment:** I'm here today to ask the Board to postpone this action on this regulation. There are several issues that are still pending with the staff and we need more time to work it out. The Legislature is not done with this budget. Given the severe problem of the state deficit, no one knows what could happen in the near future over the next month. It is fundamentally unfair to expect us to comment until the budget is final. For example, the cost to our company -- under the $13 million scenario, it cost us $477,000. Under the 17.6 million, it's going to cost us $640,000 per year. That's a 35 percent change just in those two numbers and we do not know if that number will go up in a given month. I believe it's unfair to ask us to comment on something we don't know what the outcome is going to be. (SW5, Oral testimony at Board Hearing, 7/24/03)

Agency Response: A delay is not necessary. The response to Comments No. 109 and 110 explains why the lack of a final enacted budget during the 45-day comment period did not impede the public's ability to comment on the proposed fee regulations.

156. **Comment:** We respectfully request the Board postpone this regulation, thus allowing the staff time to refine the document. What you have before you is a regulation developed in haste which is fraught with errors. I do have one question. What is the hurry on this regulation? The Board as it appears will not have to be able to enforce this regulation until November. If this was put on the October [Board meeting] it would give us significant time to go over the document that we received two days ago and we'd be able to work through all of these issues. (SW5, Oral testimony at Board Hearing, 7/24/03)

157. **Comment:** And in closing I'd like to echo the comments that have been made by speakers before me by CTFA by Doug Raymond, by Mark and ask that there be a delay in moving this forward from today. (RB, Oral testimony at Board Hearing, 7/24/03)

158. **Comment:** We think the ARB should delay consideration of this proposal right now. (ASPA, Oral testimony at Board Hearing, 7/24/03)

Agency Response to Comments No. 156-158: A delay is not appropriate. As discussed in the response to Comment No. 151, an accelerated rulemaking schedule was necessary to complete the regulatory process, obtain OAL approval, and provide the ARB with the ability to collect fees during the 2003-2004 fiscal year. The ARB staff believes that there was sufficient time in this rulemaking action to adequately explore the issues and areas of disagreement between the ARB and the regulated industry.
The great majority of these areas of disagreement represent fundamental policy differences that would not be resolved even if a long delay were provided.

159. Comment: I just want to say we've been a good corporate citizen, we've reformulated twice. Now we're being punished with new fees. I think we've done our fair share. I think we've done enough. I think there are more productive, easier targets. I'd like to say that you should regulate Hummers and not hair spray. Thank you very much. (Wella, Oral testimony at Board Hearing, 7/24/03)

Agency Response: Motor vehicles are regulated at both the State and federal levels, and significant regulatory resources are devoted to reducing emissions from motor vehicles. Consumer products and other emission sources cannot be ignored, because California's air quality problems are so great that emission reductions must be achieved from all feasible sources.

160. Comment: We oppose this regulation. We urge this Board to strongly reject the regulation with very specific instructions to the staff to continue the outreach efforts to the stakeholders and begin to address some of the many issues that all of my predecessors who have just spoken in opposition to the regulation, to address many of these issues that we have brought up.

I think that we have just really started the process with regard to hammering out what the issues are. The legislation is, I believe, a fairly small package that was handed to the Air Resources Board and it instructs the Air Resources Board to take certain actions and I believe the Air Resources staff has attempted to do that.

I disagree with many of the decisions that they have made and many of the assumptions that they have made in attempting to create this regulatory program, but again the situation is that they have been handed this legislation.

First of all, I would just like to comment that the ARB really has no authority to proceed at this point in creating this regulatory program. I know this issue has been addressed already by many of the speakers before me. But I do want to make just a few comments. AB 10X is not a finished product yet. We all know the number that's indicated in that bill could go up from 13 million dollars to $17.4 million. We've already heard testimony about the impact on specific companies about what that increase is going to do to their bottom line. That's a very substantive issue. There's no telling what could happen to this statute over the next couple of weeks and, in fact, the next couple of months.

So I know the Air Resources Board is relying on a 1955 Attorney General's opinion to justify the fact that they're going forward at this moment. That's a very old opinion. I don't believe that it's on point and I think it's very bad public policy to proceed at this point.

Other California agencies in the same financial crises that the Air Resources Board is in, and faced with the same situation of imposing fees on other industry or new fees on industries are waiting until AB 10X is finished before they begin the rulemaking process. And I would encourage the Air Resources Board to do that.

The next point I'd like to make is the speed at which this regulation has proceeded to this point. The very first workshop or teleconference phone call, formal or informal activity, I'm not sure how that's listed on your website. But the very first activity we had as stakeholders involved in this process was an April 28th teleconference, and in that teleconference we discussed general regulatory concepts implementing this program. We didn't even have draft proposed language that was in front of us to respond to these draft concepts.

That was less than 90 days ago. And here we are standing in front of the Board members and you're getting ready to vote on this proposal. That's a lightning fast expedited process pretty much in anybody's experience. I mean, I've been working with the Air Resources Board for ten years now, and I can't think of a regulation that took less than two years. (NPCA, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The commenter offers a number of arguments regarding why the ARB should not adopt the fee regulations. All of these arguments have been made by other commenters. The ARB staff does not find these arguments to be persuasive for the reasons discussed in the responses to Comments No. 108-110, 151, and 155-159.

161. Comment: I suggest possibly imposing the fee at the consumer retail level. That way I think we'll, number one, get a more accurate picture of what the actual sales are, and number two, I think that will help to protect small businesses against the large manufacturers. I know we have long faces here, so I will conclude to just say there are several viable alternatives, and I think that this has been passed through rather hastily and without a chance to look at those viable alternatives. And if we can do that, I think we can come up with something that has a much lesser devastating effect on small businesses and on business in general. I don't want to exclude the big guys out there. Thank you very much for your time. (SPC3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The response to Comment No. 154 addresses the commenter's general contention that the ARB has not adequately considered viable alternatives in this rulemaking action. The suggestion that fees be imposed at the consumer retail level is completely unworkable. There is no practical way to collect fees on the millions of individual sales of consumer products and architectural coatings that take place in California every year. Collecting such fees would require the creation of an extremely costly and inefficient administrative structure. For many consumer products, the fees would amount to only a fraction of a cent per can and could not realistically be

collected. Collecting fees directly from manufacturers is the only realistic option.

162. **Comment:** AB 10X is the law. And ARB has to implement it now. At the time of signing, we didn't ask for a veto. We said that it was going to be critical to have fair implementation of this program. And I think so far nobody has mentioned there's a signing message that the Governor wrote along with the legislation when he signed it. And he referenced there he wanted staff to implement this in a fair way and that the $13 million cap would not just be applied to stationary sources. It would be applied to stationary, consumer and architectural coatings. It would be looked at together. And I'd suggest that the signing message be included in the record for this regulation.

I would just like to take one second to say the Legislature currently -- CCEEB is opposing the additional 4.4 million in additional stationary source fees across the board. We think that AB 10X with an over 300 percent increase this year in stationary source program fees is enough for now, and a further increase is not appropriate.

But in closing, I just want to reiterate that as far as the proposal that's before you today, CCEEB is neutral. (CCEEB, Oral testimony at Board Hearing, 7/24/03)

Agency Response: The ARB staff does not believe it is necessary to add the Governor's AB 10X signing message to the administrative record for this rulemaking action. Signing messages for legislative bills are widely available to anyone who wishes to see them, and there is little to be gained by formally adding them to the rulemaking record. The $13 million mentioned in Governor's Davis' signing message for AB 10X referred to the Governor's proposed budget which, at the time AB 10X was signed, provided for the ARB to collect a total of $13 million in fees from consumer products manufacturers, architectural coatings manufacturers, and facilities. Although CCEEB and other industry representatives opposed increasing this amount by an additional $4.4 million, the Legislature subsequently enacted—and Governor Davis signed--a final budget authorizing the ARB to assess a total of $17.4 million in fees. This increase in the fee amount means that it is no longer relevant that Governor Davis' earlier signing message mentioned the $13 million contained in his originally proposed budget.

I. DEFINITION OF "HOLDING OR PARENT COMPANY"

163. **Comment:** The commenter concurs with ARB's proposed definition of "holding or parent company". (CSPA1, 7/10/03)

Agency Response: The ARB staff agrees that the originally proposed definition of "holding or parent company" is appropriate, in general. However, the ARB staff did make one change to this definition in response to comments submitted by

RPM International, Inc. (RPM). This change and its rationale are explained in the response to Comment No. 166.

164. Comment: ARB's position is that the Proposed Amendments allow a fee to be assessed on either the individual architectural coating manufacturers ("ACMs") or the holding company that owns the individual ACMs. The amendments define holding or parent company to mean "any company that:

> (A) ... directly or indirectly or acting through one or more other persons owns, controls or has power to vote 25% or more of any class of voting securities of the other company; or
>
> (B) ... controls in any manner the election of a majority of the directors or trustees or individuals exercising similar functions of the other company; or
>
> (C) ... has the power to exercise, directly or indirectly, a controlling influence over the management or policies of the other company."

For the reasons set forth below, RPM requests that the ARB adopt an alternative definition of "Holding or Parent Company" such that wholly distinct and operationally independent operating companies that manufacture architectural coatings will not be aggregated merely because they are owned by the same holding company.
(NGKE, 7/9/03)

Agency Response: In the following comments, attorneys representing RPM International, Inc. (RPM) articulate various reasons why the ARB's definition of "holding or parent company" is not appropriate and should not be adopted. Each of these reasons is addressed in the ARB staff responses to RPM's comments, as set forth below.

165. Comment: ARB's definition of "holding or parent company" should be revised so that a fee is assessed only on holding companies that exert actual meaningful control over the manufacturing operations of their operating companies.

RPM is a holding company that owns stock in over 150 corporations, of which 30 are involved in the manufacture or importation of architectural coatings. Each company in RPM's portfolio manages its own manufacturing operations, without interference from RPM. Not only are these companies managed independently, but in some cases they manufacture product lines that compete head to head in the marketplace. Further, many of the operating companies have their own environmental compliance staffs.

By contrast, RPM has only 9 executives with managerial authority. Consequently, the advice RPM can provide is limited to goal setting and helping its holdings locate legal, accounting, or technical consultants to assist decision-makers at each operating company.

RPM is concerned because the Proposed Amendments' definition of "holding or parent

company" lacks a triggering requirement for actual meaningful control. As a result, the definition includes companies outside the intent of AB 10X, specifically passive investment companies. The intent of AB 10X is to assess a fee on those companies that "manufacture", and therefore are responsible for emissions from architectural coatings. However, passive investment companies, such as holding companies, exert little or no meaningful control over the manufacturing operations of their operating companies. RPM, as a holding company, merely owns ACMs; it does not itself manufacture architectural coatings.

Equity favors regulating holding companies only where they exert actual meaningful control over their operating companies. There are important public policy interests served by allocating responsibility for environmental compliance to only those entities that have meaningful control over the conduct that creates the pollution. Specifically, equity requires that only those companies that exert meaningful control over, and therefore have responsibility for, the manufacture of architectural coatings be assessed a fee to control the emissions created by such coatings. Equitable interests include fundamental fairness and the equitable principles upon which our common law tradition was built. Likewise, there is a strong public interest in recognizing that "ownership" and "control" are not synonymous, and that in today's economic scheme regulators should not allocate responsibility based on ownership alone. It is well known that the willingness of investors, whether individuals or holding companies, to invest necessary capital into an operating company is inversely proportional to the inherent risk. Cornerstones of corporate law recognizes this axiom by limiting the responsibilities and liabilities of investors who own shares in a company, but are not involved in the daily operations of that company. (NGKE, 7/9/03)

Agency Response: The commenter asserts that the intent of AB 10X is to limit the assessment of fees to “manufacturers” of architectural coatings, and that passive investment companies like RPM are not “manufacturers.” Therefore, the commenter concludes that the Legislature must have intended that “passive” holding companies are not subject to AB10X fees. We do not agree with this reasoning. While AB 10X refers to “a manufacturer’s total sales,” the term “manufacturer” is not defined, and there is nothing in the legislative history of AB 10X to support the commenter’s interpretation. AB 10X says very little about exactly how the ARB should implement the statute, and deciding on a regulatory definition of “manufacturer” is the kind of decision that is delegated to the administrative agency charged with implementing and interpreting the statute (which, in this case, is the ARB). The definition adopted by the ARB includes “holding or parent companies” as “manufacturers”, and for the following reasons the ARB staff believes that this is a reasonable approach.

The basic idea is that whether a entity pays the fee should not depend on the details of the entity’s ownership structure. Some entities are organized as single corporations, while others are organized in complex ownership relationships consisting of holding companies, partially or wholly owned subsidiaries, or other even more complicated relationships. For both fairness and ease of administration, the ARB has attempted to level the playing field by including “holding or parent companies” within the definitions of “consumer products

manufacturer" and "architectural coatings manufacturer. The ARB believes it would be unfair for one company to pay fees because it has emissions of 250 tons per year or greater, and a second company to not pay any fees because it is organized as a holding company with multiple subsidiaries, and no individual subsidiary by itself has emissions of more than 250 tons per year--even though all of the subsidiaries aggregated together may emit thousands of tons. The ARB's approach also avoids the possibility that a company otherwise subject to fees could simply reorganize its ownership structure so that it does not have to pay any fees.

Finally, the ARB staff believes that, for regulatory purposes, it is reasonable to treat a company that owns a second company as "controlling" the second company. The ARB's definition of "holding or parent company" was closely modeled on the federal definition of "bank holding company" that has been in place for almost 50 years (see the Bank Holding Company Act of 1956; 12 U.S.C. section 1841). A similar definition of "savings and loan holding company" can be found at 12 USC section 1467a(1)(D) and 1467a(2). Both of these definitions provide that a holding company is an entity that "controls" another company, and "control" is defined as owning or controlling more than 25 percent of the voting securities of the second company. It is reasonable for the ARB to take the same approach that has worked for many years at the federal level.

166. **Comment:** The definition of "holding or parent company" is so broad as to include companies outside the intent of the regulation.

The proposed amendments' definition of "holding or parent company" is so broad as to include companies with little or no meaningful control over, and therefore responsibility for, the manufacture of architectural coatings. Specifically, the current definition captures holding companies who own too little stock to effectively control an ACM's manufacturing process (i.e., 25%), or who in practice exert little or no control over such operations by its ACMs. In other words, the definition captures holding companies that merely own or have invested in an architectural coatings manufacturer.

For example, the definition specifies that a regulated holding company is one that merely owns, controls or has the power to vote 25% of any class or series of the voting securities of another company. However, this definition improperly captures even passive investors. Passive investors are entities that invest in a company with the intent to simply achieve a specific rate of return. For example, banks, insurance companies, and entities that manage mutual funds or pension plans often invest in companies in order to achieve a higher rate of return on their clients money. By virtue of the large amounts of money held by such entities, they often buy company stocks in a large block. However, if the entity buys a block of shares in a small or even mid-sized company, that block could very well constitute 25% or more of any class or series of that company's voting stock. Thus, even though such an entity bought stock merely as an investment, if it happened to be stock in an ACM the entity would be assessed a fee under the current broad definition of "holding or parent company". For example, if the managers of the California Public Employee Retirement System ("CalPERS") had decided to invest in a small shop that produced specialty

coatings, it too would be subject to the proposed fee. As another example, Berkshire Hathaway, by virtue of owning Benjamin Moore Paints, may also be subject to the proposed fee. Clearly, neither CalPERS nor Berkshire Hathaway contemplated becoming liable for an
emissions fee for architectural coatings when they simply invested as shareholder in a company.

The definition also specifies that a regulated holding company is one that *merely has the power to control* the manufacturing operations of its ACMs, either through the election of a majority of the directors or by some other means, even if such power is not actually exercised. This improperly assumes that a holding company will actually exert such power. For example, venture capitalists often elect a board of directors to run a company. However, their intent is usually not to elect directors through whom they can exert control over the daily operations by which a product is manufactured. On the contrary, venture capitalists elect directors whom they can rely on to properly run such day-to-day operations, and thus ensure a good return on their invested capital. Moreover, the board of directors' ability to successfully run a company's daily operations is often a significant factor venture capitalists consider when deciding whether to invest.

In addition, because the definition includes companies that own a mere 25% or more of any class of stock, the proposed amendments capture holding companies with too small a percentage of shares to have meaningful control over their ACMs. For example, an ACM may offer a limited issuance of preferred stock to raise funds to retool the production line of a specialty coating. Because such a limited number of stocks may be offered to only a few investors, a single holding company may end up with 25% or more of that particular class of preferred stock. However, that percentage of preferred stock relative to the total number of outstanding shares could still be quite low. The holding company's relative percentage of outstanding shares is low; so is its actual or real voting power. For example, 25% of a class of preferred stock constituting only 10% of the total amount of outstanding shares represents only 2.5% of the voting power. A holding company with such limited voting power could not exert meaningful control over the manufacturing operations of its ACMs.

At least one other California regulatory agency has recognized the need for a company to either hold a meaningful percentage of stock in another company or to actually exert control over another company before it can be subject to a fee or tax based on the activities of the other company. For example, the California Franchise Tax Board ("FTB") recognizes that it may only include a holding company in a unitary tax group with its operating companies if these entities act as a single *unitary* business. In determining whether the entities are part of a unitary group, the FTB requires that the holding company own at least 50% of the voting stock in the individual operating company, and that there be some evidence that the holding company and its operating companies are, in fact, operated and managed as a single business entity (e.g., the holding company exerts actual control over the other company). (NGKE, 7/9/03)

Agency Response: The commenter makes some good points in arguing that the

"25 percent" threshold is too low, and that the threshold should apply to all of the voting shares of the company instead of what staff originally proposed, which was "25 percent or more of any class of voting securities" (emphasis added). For the reasons articulated by the commenter, therefore, the ARB modified the definition of "holding or parent company" to provide that a company has control over another company if:

> "… the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote ~~25 percent of more of any class~~ more than 50 percent of the voting securities of the other company.

The commenter is correct that the "50 percent" threshold is consistent with the approach taken in decisions of the California Franchise Tax Board (e.g., Franchise Tax Board Legal Ruling No. 410 (January 16, 1979)). We do not agree, however, that the "single unitary business" concept is a useful one to apply to the fee regulation. This is a tax law concept that addresses how the income from certain multi-state businesses should be allocated among different states for tax law purposes. The concept is not directly analogous or relevant to the ARB fee regulation.

Finally, we do not agree with the commenter that, if a holding company has the power to control the manufacturing of its subsidiaries, then before imposing the fee the ARB staff must somehow assess whether such power is actually being exercised in each individual case. The ARB staff believes that the power to exercise control is *de facto* control, and that as a practical matter it would be virtually impossible for ARB staff to conduct individualized inquiries into the inner workings of the corporate structure.
It is also worth mentioning that RPM has informed the ARB staff that they own 100 percent of the stock for the architectural coatings manufacturers that they own. This fact makes it somewhat difficult to believe that RPM does not have ultimate "control" over these manufacturers.

167. Comment: ARB's concern that a company will create spin-off companies just to avoid paying the proposed fee is unwarranted because the cost to create and manage such companies would likely far exceed any anticipated fee amount. For example, to create a company, articles of incorporation must be drafted and filed with the State and facilities procured. All of these activities cost money. To ensure the continued success of such a company, new management and administrative personnel must be hired and procedures developed. This new level of people and procedures in addition to that which already exists within the parent company further increases costs. (NGKE, 7/9/03)

Agency Response: If "holding or parent companies" were not treated as a single entity for fee payment purposes, the ARB staff believes that there is a good chance that some companies may have an incentive to reorganize their ownership structure to avoid paying the fee. There would be costs associated with any such reorganization, but paying the fee every year also imposes costs. It is reasonable to believe that for some companies, the long-term costs of paying the fee would exceed the costs of the reorganization. Even for companies where the cost of the fee alone would not justify a

reorganization, the cost of the fee might be the deciding factor that would cause a company to reorganize as a holding company. After all, some entities have currently chosen to organize themselves as holding companies, presumably because they believe it provides them with tax, accounting, or other economic benefits. Other companies currently contemplating such a change might decide to reorganize because avoiding the fee would be one more incentive added to other economic incentives that may already exist.

Finally, if “holding or parent companies” were not treated as a single entity for fee payment purposes, companies that are currently organized as holding companies may also be able to avoid fee payments. They could do this by transferring ownership of individual product lines between their subsidiaries, so that some or all of their subsidiaries would fall under the 250 ton threshold and avoid paying the fee. Such a strategy would not require any changes in the basic ownership structure of each subsidiary, so that corporate reorganization expenses mentioned by the commenter would not occur. The potential for this to happen was pointed out by the Sherwin-Williams Company (which is itself a holding company) in Comments No. 174 and 175.

168. <u>Comment:</u> The Supreme Court's reasoning in Bestfoods: that corporate law principles should not be ignored and thus liability should only attach if a parent directly manages its subsidiary or the corporate veil can otherwise be pierced is applicable to the proposed amendments.

In *United States v. Bestfoods,* 118 S.Ct. 1876 (1998) (“Bestfoods”), the U.S. Supreme Court considered two issues. First, whether fundamental principles of corporate separateness could be disregarded when U.S. EPA assigned liability for pollution caused by a subsidiary. Second, whether a parent corporation could be held liable for violations under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") by its subsidiary. The Supreme Court's decision on both of these issues applies equally well to the proposed amendments.

For the first issue, the Supreme Court considered whether Congress intended an environmental statute to allow the U.S. EPA to overturn basic tenants of corporate law when the statute itself remained silent on this issue. The court concluded that in order to abrogate law principles, the statute must speak directly to the question addressed by the common law. The Court reasoned that the environmental statute, in that case CERCLA, had given no indication that principles of corporate law should be ignored. Like CERCLA, the proposed amendments to the California Clean Air Act ("CaICAA") are part of a statutory scheme of environmental regulations that assigns responsibility and liability for pollution. Clearly then, the Supreme Court's reasoning applies equally well to the proposed amendments. Like CERCLA, AB 10X is silent as to whether corporate law principles should be ignored; thus, the method by which the proposed amendments assign a fee on architectural coating manufacturers should not ignore these fundamental principles.

For the second issue, the court considered when liability under CERCLA attaches to a parent for environmental contamination by its subsidiary. The Court reasoned that the

actions for which liability would attach must be related to the pollution or environmental concern at issue. In *Bestfoods,* CERCLA's concern was assigning liability for contamination so that responsible parties would pay for remediation. Thus a parent was only liable if it managed or directed operations which caused the contamination. In AB 10X, the concern is emissions from architectural coatings; therefore, similarly, a parent should only be liable if it manages or directs the manufacturing operations of the architectural coatings that create the emissions. However, the proposed amendments do not limit such liability. On the contrary, the proposed amendments assign liability for an emissions fee merely if a parent-subsidiary relationship exists.

Since the reasoning in *Bestfoods* applies just as well to AB 10X, regulations implementing AB 10X should not ignore fundamental principles of corporate law. For example, it is a fundamental principle of corporate law that the mere fact that there exists a holding company-operating company relationship does not make the holding company liable for the torts of its operating companies. Mere stock ownership in an operating company does not create liability for the shareholding company. Furthermore, the separateness of the shareholding company and the operating company in which it owns shares must be observed and respected.

However, the proposed amendments ignore these "bedrock principles" of corporate law. Specifically, the proposed amendments define a "holding or parent company" as any company that "owns or has the power to vote" stock in another company, or "controls in any manner the election of a majority of the directors" of another company. This definition is inconsistent with the fundamental principles stated above, specifically that mere stock ownership or exercise of that ownership (i.e., election of directors) will not attach liability to a parent. (NGKE, 7/9/03)

Agency Response: *Bestfoods* is fundamentally a statutory interpretation case. The decision focuses on the correct interpretation of the term “owner or operator” found in 42 U.S.C. section 9601(20)(A)(ii), for the purposes of imposing liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), 42 U.S.C. section 9601 et seq. As such, the holding of the Court is not directly applicable to the ARB fee regulation or AB 10X.

However, the commenter believes that the reasoning employed by the Court should be applied to the ARB fee regulation. Specifically, the commenter believes the ARB‘s definition of “holding or parent company” is inconsistent with the common law doctrine of “piercing the corporate veil,” as discussed by the Court in the *Bestfoods* case. The ARB does not agree that the fee regulation “pierces the corporate veil” as that term is ordinarily understood. “Piercing the corporate veil” is a doctrine most commonly applied in tort and contract law. It usually arises in the context of litigation, where the corporate entity is sought to be disregarded in the interest of, and at the request of, a third party.
In the environmental area, a litigant is usually attempting to identify an entity with “deep pockets” to assume liability for an expensive hazardous waste cleanup, where the subsidiary is bankrupt or has insufficient assets to pay the cost of the cleanup. The ARB

fee regulation does not deal with tort liability, hazardous waste cleanup, or other situations such as these. Rather, the ARB definition is basically designed to find the most equitable way of determining when a company has exceeded the 250 tons per year threshold specified in AB 10X, and must therefore pay the fee. The ARB does not believe that this approach, used in the context of a fee regulation, undermines principles of corporate law that are applicable in other situations.

169. Comment: The definition improperly subjects holding companies which do not directly manage their operating companies' manufacturing operations to potential liability under various environmental statutes.

The proposed amendments create unfair liability for holding companies under various environmental statutes. Under *Bestfoods,* and under various other environmental statutes, a holding company is liable for environmental violations by its operating companies only if (1) a direct action by the holding company leads to the violation in question, or (2) an action by the holding company supported piercing the corporate veil.

However, the proposed amendments force a holding company to take "direct" action, and thereby satisfy the requirement for liability to attach. Specifically, the proposed amendments force a holding company to make decisions about which of its ACM's product lines to reformulate, and thus which chemicals are present in the final product. This results from the requirement that ACMs be aggregated to determine their total emissions, and a fee assessed upon their total emissions. In order to reduce the fee amount, a holding company might decide to reformulate those coatings that create high emissions. Thus a prosecuting agency or a "bounty hunter" plaintiff could use such a "direct" action to bootstrap arguments that the holding company should be included as a defendant in an environmental enforcement action or lawsuit against the operating company.

In addition, the proposed amendments provide a basis upon which a prosecuting agency or "bounty hunter" plaintiff could argue that the corporate veil should be pierced. For example, a plaintiff could argue that the fee, assessed on the holding company rather than its individual operating companies, shows that the holding company is the alter ego of its ACMs; thus the corporate veil should be pierced. As a result, a holding company could be held liable for statutory environmental violations simply because it fell under the current definition of a "holding or parent company". (NGKE, 7/9/03)

Agency Response: The “bounty hunter” scenario suggested by the commenter seems very unlikely to occur. In their previous comments, RPM stated that each company in RPM’s portfolio independently manages its own manufacturing operations, without any interference by RPM. RPM further stated that some of these companies manufacture product lines that compete head-to-head in the marketplace, and RPM does not interfere with this practice. In the comment set forth above, however, RPM states that the fee regulations may “force” RPM to take “direct action … to make decisions about which of its product lines to reformulate” in order reduce the fee. If RPM is willing to tolerate direct competition between companies it owns, with no interference whatsoever, it seems unlikely

that the fee regulation would "force" RPM to dramatically alter its long-standing management practices and start micromanaging the reformulation decisions of these companies. Any such action would also be a conscious choice made by RPM, and it seems unlikely that RPM would make such a choice given its expressed concern that doing so may cause the corporate veil to be pierced. If RPM is concerned about a potential reduction in profits from fees (assuming that the cost of the fees cannot be passed on to the consumer), it seems far more likely that RPM would choose to rely on the management of each company to make appropriate reformulation or marketing decisions, the same way RPM currently relies on each company's management to make all other operational decisions. Another viable alternative would be for RPM to request that the management do what they can to reduce the fee amount, and then rely on them to implement this general directive in the most efficient manner. Such a request would accomplish RPM's goal with no need to become involved in the "direct action" that they are concerned about. Moreover, individual subsidiaries clearly have an economic incentive to reduce their emissions, even without any communication from the holding company, because it is obvious that reducing emissions will reduce the fee. This obvious fact should eliminate any need for RPM to become involved in its subsidiaries' management decisions.

To ensure that a holding or parent company can avoid direct involvement in paying the fee, however, the ARB modified section 90802 of the regulations by adding the following language: "At the request of a holding or parent company, the Executive Officer shall provide separate written notice of their individual fee determinations to each consumer products or architectural coatings manufacturer within the holding or parent company." This language will allow a holding company to decide if the bills should go directly to their subsidiaries, who can then pay the bills without any action or involvement by the holding company. This provision should further ensure that a "veil-piercing" legal argument will not succeed.

Finally, RPM is also concerned that the corporate veil might be pierced simply because "holding companies" are included in the definition of "manufacturer," even if the holding company never directly interferes in their subsidiaries' operations. While this concern seems far-fetched, it is worth mentioning that such a definitional change has already occurred. In the national architectural coatings rule (40 CFR section 59.400 et seq.), there is a definition of "manufacturer" which states:

> "… For the purposes of applying this definition, divisions of a company, subsidiaries, and parent companies are considered to be a single manufacturer." (40 CFR section 59.401)

The national architectural coatings rule imposes direct liability on "manufacturers" who sell any coating with a volatile organic compound content greater than specified limits. The rule was promulgated by U.S. EPA in 1998, and the ARB is not aware of any "veil-piercing" that has occurred because of this rule. Even in the unlikely event that the U.S. EPA definition could give rise to a plausible veil-piercing argument, it is extremely doubtful that the existence of a similar definition in an ARB fee regulation would make the current situation

any worse for parent or holding companies.

170. **Comment:** The definition improperly subjects holding companies which do not directly manage their operating companies' manufacturing operations to potential tort liability via piercing the corporate veil.

The proposed amendments unfairly make holding companies susceptible to tort liability claims via piercing the corporate veil. Normally, holding companies are not liable for the torts of their operating companies. However, a plaintiff could use the proposed amendments to claim that a holding company is actually an alter ego, and that therefore the corporate veil should be pierced and liability attached. For example, a plaintiff could argue that the fee, assessed on the holding company rather than its individual operating companies, shows that the holding company does manage and operate, and therefore is the alter ego of, its ACMs. Otherwise, why would a state agency assess a fee for a product whose manufacture the holding company has no control over? As a result, a holding company may be found liable simply because it fell under the current definition of a "holding or parent company".

Even worse, the proposed amendments create a catch-22 whereby holding companies could be found liable no matter what they do. Because a plaintiff could use the proposed amendments as a basis to pierce the corporate veil, the amendments will force an otherwise passive investment holding company to assume control over the manufacturing operations of its ACMs. Holding companies will likely assume such control simply to ensure that conduct by its ACMs do not subject it to liability. However, if a holding company proactively manages the operations of its ACMs to ward off such liability, it has thus likely satisfied the requirement for piercing the corporate veil. Specifically, that a parent company must act as an "alter ego" for liability to attach. Thus, the proposed amendments create a catch-22 for holding companies. (NGKE, 7/9/03)

Agency Response: For the reasons discussed in the response to the previous comments, the amendments will not force holding companies to assume direct control of their subsidiaries' manufacturing operations. Therefore, there is no basis to conclude that the amendments would subject holding companies to tort liability claims via piercing the corporate veil.

171. **Comment**: The definition of "holding or parent company" subjects holding companies to a competitive disadvantage and possible anti-trust violations.

The definition places ACMs owned by a holding company at a competitive disadvantage relative to ACMs that are not so owned. In practice, the Amendments will force holding companies to assume some control over the daily manufacturing operation of its ACMs. Thus, ACMs owned by a holding company will now be burdened with management and administrative procedures at both the holding company and ACM levels. Such a double level of procedures will increase costs, decrease market responsiveness, and add to the overall difficulties of operating an ACM. Further still, the ACM will now be managed, at

least in part, by a holding company which may have little or no previous experience in the architectural coating business. Such lack of expertise will surely place a once-competitive ACM at a disadvantage compared to ACMs not burdened with holding company ownership.

The definition opens up a holding company to possible anti-trust violations. For example, a holding company may own a number of individual ACMs that compete in the same market. However, the proposed amendments require that these competing ACMs be aggregated to determine their total emissions, and a fee assessed upon their total emissions. In order to reduce the fee amount, a holding company might decide to reformulate or discontinue those coatings that create high emissions. Thus, the proposed amendments will, in effect, force a holding company to make decisions about which of its competing ACMs' product lines to discontinue or reformulate. As a result, the holding company may be susceptible to possible antitrust violations. (NGKE, 7/9/03)

Agency Response: For the reasons discussed in the responses to the previous two comments, the amendments will not force holding companies to assume direct control of their subsidiaries' daily manufacturing operations. Therefore, there is no basis to conclude that the amendments would subject holding companies to possible antitrust violations, or that the amendments would result in increased costs from a holding company making daily manufacturing decisions on behalf of its subsidiaries.

172. Comment: ARB should revise the proposed amendments' definition of holding or parent company to ensure that only holding companies that exert actual meaningful control over their operating company's manufacturing operations are considered regulated entities.

The definition of "holding or parent company" should be revised as follows:

"(i) Holding or parent company means any company which owns or controls, directly or indirectly, more than 50% of the voting power of another company and engages in one or more of the following activities or functions:

(A) The holding or parent company actually exercises a meaningful level of management and operational control over the other company specifically in connection with the other company's product line;

(B) The executive officers of the holding or parent company exercise control or influence over the day-to-day operational decisions of the other company;

(C) The holding or parent company provides legal, accounting, purchasing, personnel, or other administrative functions or provides technical assistance to the other company; or

(D) The holding or parent company and the other company have common product line or product lines that are vertically integrated and are engaged in active manufacture or distribution." (NGKE, 7/9/03)

173. **Comment:** We agree with and support RPM's definition of a holding company and request you move forward with amending the appropriate regulations to include this definition! (BM, 7/22/03)

174. **Comment:** The Sherwin-Williams Company (SW) concurs with the definition of "holding or parent company" as set forth in ARB's proposed regulation. SW does not support the modifications recommended by RPM International, Inc. In summary, SW is concerned about the practical effect of the proposed change in the requisite percentage of control that a company must exercise (directly or indirectly) over another company. Moreover, we have a concern that under the definition proposed by RPM, the total volatile organic compound (VOC) tonnage of a "holding or parent company" could be diluted by a company dividing its products line among its subsidiaries; consequently, it could be possible for a company to unfairly reduce (and potentially eliminate) its exposure to the VOC fee. (SW3, 7/23/03)

175. **Comment:** Thank you for providing The Sherwin-Williams Company with the opportunity to evaluate and comment on the change in the definition of "holding or parent company" proposed by RPM. The provisions seem neither measurable nor enforceable nor logical and do not capture the needs of the regulation. We are satisfied that the definition as proposed by the ARB is sufficient and do not
believe the changes recommended by RPM contribute anything but a loophole for specific companies.

To us the critical factor is that a "holding company" may be the owner of a group of entities, which if combined, would be required to pay this fee but, as separate entities would not need to. [This is one of the disadvantages inherent in purchasing companies: the tax burden faced by the large combined entity may be higher than that faced by each the purchased company (progressive income taxes, for example) and thus, the profit would automatically go down.]

We have the following comments concerning the specific provisions found in the RPM-proposed definition:

There is no need to change the level of ownership from 25% to 50% and thus we do not support such a change.

The RPM-proposed definition section [a] states, "The OPC actually exercises a meaningful level of management and operational control over the other company specifically in connection with the other company's product line." From this provision we can assume that RPM specifically does not exercise control over their individual company's product lines. But, why is that a specific issue in defining a holding company? The only purpose seems

to be to exclude one or more specific companies.

The RPM-proposed definition section [b] says "The executive officers of the OPC exercise control/influence over the day-to-day operational decisions of the other company." However, the Executive Officers of the parent company (such as, Corporate Management or the Corporate Board of Directors) do not need to be involved in nor exercise control over such day-to-day activities. In fact, at most very large companies neither Corporate Management nor the Corporate Board of Directors would exercise such day-to-day control. Each operating division would have its own management (Presidents, Vice-Presidents, etc.) to exercise such control.

The RPM-proposed definition section [c] says "The OPC provides legal, accounting, purchasing, personnel, or other administrative functions or provides technical assistance to the other company." As a point of fact, during the Federal
Regneg RPM had a corporate representative present -- that indicates that they have now, or have had in the past, a set up whereby the corporate function provided some sort of administrative or technical assistance or information to the companies.

The RPM-proposed definition section [d] says, "The OPC and the other company have common product lines or product lines that are vertically integrated and are engaged in active manufacture or distribution." This is a particularly unusual provision since in most cases we would not expect the parent company to have common product lines with a company it holds.

If adopted, the RPM definition would establish a set of fuzzy parameters that would require the ARB to make value judgments on such things as " meaningful level of control" [RPM section (a)], "control/ influence over day-to-day operational decisions" [RPM section (b)], "other functions or technical assistance" [RPM section (c)], etc.

It is important for the ARB to be able to establish a definition that provides clear and measurable parameters and The Sherwin-Williams Company believes that the definition as proposed by the ARB accomplishes this. (SM2, 7/23/03)

Agency Response Comments No. 172-175: As mentioned in the response to Comment No. 166, as requested by RPM, the ARB modified the definition of “holding or parent company” to specify that a company has “control” over another company if the company has power to vote more than 50 percent (instead of the originally proposed 25 percent) of the voting securities of the other company. This response also explains the ARB’s rationale for making this modification. The ARB did not make any of the other modifications to the definition that were requested by RPM. Staff believes that these modifications are not appropriate for the reasons articulately set forth in the comment above by the Sherwin-Williams Company. The basic problem with RPM’s proposed definition is that it contains numerous vague, undefined terms that would make it virtually impossible for ARB staff to determine whether a company meets the definitional criteria. For example, staff has no idea what constitutes a “meaningful level of management and

operational control," or how to determine whether the two companies "have common product line or product lines that are vertically integrated and are engaged in active manufacture or distribution." Furthermore, there does not seem to be any good reason for including many of the criteria listed in the definition. For example, it is unclear why the definition should be limited to situations where "the executive officers of the holding or parent company exercise control or influence over the day-to-day operational decisions of the other company" (e.g., why does the control have to be exercised "day-to-day"), or why a parent company's "meaningful level of management and operational control" does not count unless it is exercised "specifically in connection with the other company's product line." RPM offers no reasons why these very specific criteria should be included. As the Sherwin-Williams Company points out, the criteria may be aimed more at excluding RPM from the definition rather than a logically thought-out approach. For all of these reasons, the ARB staff believes
that RPM's requested modifications (with the one exception mentioned above) are not appropriate.

176. **Comment:** The sales data on which the State intends to levy fees for consumer products and architectural coatings must be based on independently operating companies, not those aggregated from its parent (in the event that a company is owned by a conglomerate/holding firm). Failure to structure the fees in this way ignores the fact that small and mid-sized independently operated firms such as DAP (whose stock is owned by an entity that happens to own other companies in the industry) must compete in the market place with other firms of the same size which may not be owned by a conglomerate or holding firm. In the case of DAP in particular, many of the companies we compete with are the same size as DAP and have similar emissions but are privately held. They will not be required to pay the ARB-mandated fees. This will create a trade barrier and a climate of unfair competition whereby companies that, despite the fact that they truly operate independent of their holding firm, must bear business costs above and beyond those of privately held companies of the same size. (DAP1, 7/23/03; DAP3, Oral testimony at Board Hearing, 7/24/03)

Worse still, particular to DAP, simply by a change of ownership and not increased emissions, DAP is now liable for the proposed fee. To illustrate, the proposed regulatory scheme assesses fees based on 1997 emissions. In that year, DAP was owned by a British company that owned no other ACMs [architectural coatings manufacturers] or consumer product manufacturers in the U.S. In 1997, DAP's emissions were lower than 250 tons per year. Thus, DAP should not be liable for the proposed fee. However, DAP had the misfortune of being bought by an American company that holds other ACMs [architectural coatings manufacturers] and consumer product manufacturers. Thus, under the current aggregation scheme, DAP will now be liable for the proposed fee merely because of its change in ownership. (DAP3, Oral testimony at Board Hearing, 7/24/03)

Agency Response: In the response to previous comments, the ARB staff has explained why it would be unfair to allow some companies to avoid paying the fee simply by reorganizing their internal ownership structure. This commenter argues the reverse side

of the issue by asserting that DAP's competitive position may be damaged by paying the fee because they have the "misfortune" of being part of a holding company, while some of their competitors operate as totally independent companies. While there will be "winners" and "losers" no matter how the ARB structures the fee regulation, staff believes that the approach used in the regulation is the most equitable overall. A discussion about competitive impacts should recognize that a subsidiary may gain significant advantages from being part of a holding company. Such advantages may include shared tax benefits, intercompany financing (loans, loan guarantees, and debt retirement), improved credit worthiness (bond security, and more favorable insurance rating or interest rates on borrowed capital), and access to accounting or other technical expertise. Such advantages may well offset the impact of the fees, which some of DAP's competitors may not have to pay.

177. **Comment:** ARB has never sent an "ownership survey." Thus in the event that ARB chooses to regulate independent companies whose stock is owned by an entity that happens to own other companies in the industry, the universe of manufacturers included in the fee program must be reassessed to ensure that no firms that are held by a holding firm have been left out. (DAP1, 7/23/03)

Agency Response: It is not necessary to do a formal "ownership survey." Before the fee regulations were developed, the ARB staff already possessed considerable institutional knowledge about ownership patterns in the consumer products and architectural coatings industries, based on many years of past experience. Past ARB surveys have requested that each company identify whether they are part of a parent or holding company. Building on this base of knowledge, staff did internet searches and spoke extensively with other companies with knowledge of industry ownership structures. This was a manageable task, because only a relatively small number of manufacturers are subject to fees under the fee regulations. A number of companies subject to the fees were quite willing to share with ARB staff their knowledge of ownership structures within the industry. Companies subject to the fees had a strong financial incentive to share such information, because their fees would be reduced if additional companies had to pay fees (i.e., because they were part of a holding or parent company with enough emissions to exceed the 250 ton threshold). Based on this process, the ARB staff believes that it is not necessary to conduct an additional, formal "ownership survey." In the future, ownership information will be updated through a continuation of the process described above, and as part of the ARB's periodic industry-wide surveys.

178. **Comment**: Masco Corporation is listed as the parent company of Behr Process Corporation and Masterchem Industries, both manufacturers of architectural coatings with their own chief executives. It appears that the reason that ARB has aggregated these separate manufacturers under the parent company is to create a greater likelihood of meeting the 250-ton threshold. The company believes that each manufacturer should be separately evaluated. (MASCO, 7/21/03)

Agency Response: Masco Corporation is treated as a "holding or parent

company" because it meets the definition of "holding or parent company." The responses to the previous comments explain why ARB staff believes this definition to be an appropriate one. It should also be noted that Behr Process Corporation, when considered independently, has VOC emissions that are well above the 250 ton per year threshold. Masterchem Industries also has VOC emissions that are well above this threshold. Thus, both of these companies would independently be subject to the fee regulation even if their emissions were not aggregated as part of the Masco Corporation.

J. COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD

Several of the comment letters received during the 15-day public comment period either: (1) included comments identical to those that the commenters had previously made during the 45-day public comment period, or (2) incorporated by reference the commenters' previous comment letters submitted during the 45-day public comment period. These duplicate comments are not summarized and responded to below, because they have already been summarized and responded to above in Sections A through I of this FSOR. Only new comments received during the 15-day public comment period are summarized and responded to below.

179. Comment: In Resolution 03-20, the following statement is found:
"The proposed amendments will not have a significant adverse economic impact on the affected companies or on other businesses or private persons affected;"

The economic impact information was found in the Initial Statement of Reasons for Proposed Amendments to the California Clean Air Act Nonvehicular Source Fee Regulations released on June 6, 2003 for consideration on July 24, 2003. It is not clear what billable rate was used in the economic impact review. The following statement was made in that review and is found on page D-3 of that document - "(3) Annual fees for the fee program are estimated for each of these businesses based on the fee rates adopted by the Board for the 2003-4 fiscal year." This rate for the $13,000,000 total fee was $56.98 per ton. The new proposed rate is $80-85 per ton to recover the $13,000,000. This is a 40-50% increase in the rate. How can the June 2003 review of the economic impact be relevant to current situation?

I am verbally told that the proposed billable tons for my company are 334 tons which equates to a fee of $26,720 - $28,390 for this fiscal year ($80-$85 per ton). This is more than 10% of our gross margin for these billable tons and if you factor in the federal tax, the impact nears 20% of the gross profit.

This impact exceeds the acceptable threshold used by agencies such as U.S. EPA and others. This impact will greatly influence our ability to sustain profitable business in the State of California and influence the business decision of whether to remain in this market. (PSC, 12/01/03)

Agency Response: Because ARB staff was aware that the Legislature was considering authorizing the ARB to collect $17.4 million instead of the originally proposed $13 million in Governor Davis' proposed budget for fiscal year 2003-2004, the June 2003 ISOR addressed the impacts of both amounts. On page E-1 of the ISOR, staff estimated that fee rates of $56.98 per ton and $76.26 per ton would be needed to recover $13 million and $17.4 million, respectively. After the July 24, 2003, public hearing on the fee regulations, the Legislature enacted a final budget which authorized the ARB to collect $17.4 million in fees for fiscal year 2003-2004. ARB staff was working with many companies to refine their billable emissions and informed them that to collect the authorized $17.4 million the expected fees would probably be in the range of $80-$85 per ton. The estimated fee rate was $81.55 for the preliminary fee estimates that were mailed out in early December 2003.

In the ISOR, ARB staff estimated the fee impact on both the high and low fee scenarios. Even for the higher fee scenario, the impact on profitability of affected companies was not considered significant. ARB staff believes that the methodology used to calculate the economic impacts of the proposed fee regulation is consistent with U.S. EPA methodologies. ARB staff does not have sufficient information to address the impact of the proposed regulation on profitability of products marketed in California by the commenting company but believes that the company would be able to pass on all or part of the added cost to its customers. As a result, the fee impact on the company would be less than assumed in this comment.

195. Comment: We wish to comment on the fee schedule that the Board has proposed concerning VOC fees on non-stationary sources. While we disagree with the entire concept of the fee, we feel that the imposition of a fee only on those companies that sell products in California where the combined VOCs exceed 250 tons/year, is grossly unfair. If a fee is to be charged then all companies should share equally in paying the largess of this tax burden.

Companies that sell Architectural Industrial Maintenance (AIM) coatings products in California are governed by the same VOC regulations administered by either the Board directly, or by the local air districts. This fee is supposed to cover the administration costs of various regulations for all companies, not just administration of the larger companies. We feel that this uneven taxing is unfair to the larger companies, such as Zinsser. Those companies that are required to pay the fee will undoubtedly pass along this price increase to the consumers in order to recover their costs. Is it fair that only the larger companies will have to raise their prices?

In conclusion, while we may have to live with this fee, we strongly feel that it should be fairly distributed to all manufacturers of AIM coatings products. (ZIN, 12/01/03)

Agency Response: The threshold of 250 tons per year was set by the Legislature in AB 10X. Accordingly, ARB cannot change the threshold to capture more or all of the architectural coatings manufacturers. With regard to architectural coatings, however,

products sold by the 27 companies subject to the proposed fees emit 85 percent of the VOC emissions from all architectural coatings sold in California. The remaining 151 companies are only responsible for the remaining 15 percent of VOC emissions. Therefore, especially with respect to architectural coatings, we believe the 250 ton per year threshold has captured a large majority of the emissions. Based on the 2001 architectural coatings survey data, the typical cost increase would be 2 to
5 cents per gallon, which is not expected to result in a competitive disadvantage for a large manufacturer.

196. Comment: We believe that the fees violate Gov. Schwarzenegger's Executive Order S-2-03. (RCMA2, 12/02/03)

197. Comment: The ARB's continued action on this proposed rulemaking must comply with the mandate of Executive Order S-2-03. Pursuant to Governor Schwarzenegger's Executive Order, the ARB is precluded from submitting the proposed fee regulation to the Office of Administrative Law (OAL) for a period "not to exceed
180 days." Accordingly, CSPA urges the ARB to comply with the Executive Order regarding this proposed regulation. (CSPA3, 12/02/03)

198. Comment: Governor Schwarzenegger issued Executive Order S-2-03 on November 17, 2003 calling for immediate cessation of the processing of regulations by all State agencies including the ARB, with limited emergency exceptions not applicable to these fee regulations for 180 days. Continued further processing of these regulations, including imposing a deadline of 15-day comments, violates Executive Order S-2-03 and should be suspended immediately until the end of the 180-day period. (CTFA2, 12/02/03)

199. Comment: Governor Scharzenegger's Executive Order S-2-03 requires additional review of this proposed regulation. The Air Resources Board must heed the Governor's order to halt processing of all proposed regulations for a period not to exceed 180 days in order to conduct a more thorough review. This review must analyze the impact of the proposed regulation on the local business environment. NPCA has consistently argued that the methodology ultilized to measure the economic impact of this proposed regulation was fatally flawed. Executive Order S-2-03 requires a more thorough examination. (NPCA2, 12/02/03)

Agency Response to Comments No. 196-199: The ARB has complied with Executive Order S-2-03. Under Paragraph 1(b) of Executive Order S-2-03, State agencies are to "cease processing" proposed regulatory actions for a time period of not to exceed 180 days, subject to certain exceptions. While "processing" includes submitting regulations to the Office of Administrative Law (OAL) for final approval, it does not refer to every action taken by State agencies pursuant to the Administrative Procedure Act, such as setting deadlines for public comment. Under Paragraph 1 of Executive Order S-2-03, the Department of Finance (DOF) is charged with the responsibility to grant exceptions to Executive Order S-2-03. On December 10, 2003, DOF granted an exception to the ARB for the fee regulations, thereby allowing the ARB to submit this regulatory action to OAL for

final approval.

200. **Comment:** These comments address the concerns of the RCMA membership on ARB's proposed fee regulations that would impose an annual fee on sales by manufacturers of architectural coatings in California. ARB's Consumer Products and Architectural Coatings Program Costs Analysis claims that 67 employees are needed to implement the consumer products and architectural coatings programs. We believe that this, at most, to be employees engaged in various aspects of regulation, but not those specifically engaged in the regulation of volatile organic compounds (VOCs). We believe that a proper analysis has not been done to justify this fee.

The business impact analysis used to support the fee structure is fundamentally flawed. By comparing the fee to a company's total net income, rather than to the income derived from the sale of fee-bearing products within California, the analysis significantly underestimates the effect of the fees on those products. A realistic comparison would restrict this comparison to the profits derived from sales of the products which will bear the fee, which can be a substantially different number. The analysis also erroneously asserts that these additional costs will not be passed on to end users. They may or may not be passed on based on individual manufacturers' decisions. (RCMA2, 12/02/03)

Agency Response: The ARB staff believes that a proper analysis has been done to support the fee. The commenter seems to be referring to the "nexus" arguments made by various commenters, which are responded to in Section C of this FSOR. ARB staff has also provided a detailed accounting of the personnel and other resources allocated to the Board's consumer products and architectural coatings programs. This accounting is contained in the document entitled "Consumer Products and Architectural Coatings Program Costs," and is discussed in the response to Comments No. 29-32. This response, along with the responses to Comments No. 123-125, address all of the issues raised by the commenter in this comment.

201. **Comment:** The Consumer Specialty Products Association (CSPA) supports the ARB's decision to provide 60 days for affected companies to pay the tax for fiscal year 2003-04. This is a more reasonable time-frame than the originally proposed 30-day period. Moreover, the 60-day period is consistent with the general practice of California's local government entities and private industry. Finally, the 60-day period is consistent with the timeframe for companies to pay their tax bills in subsequent years.

Second, CSPA supports the ARB's decision to establish a 60-day period to review and correct the ARB's emissions estimates that form the basis of the preliminary "fee determination." The original proposal to allow only 30 days would have been especially unreasonable for newly identified companies going through the process for the first time. (CSPA3, 12/02/03)

202. **Comment:** CTFA supports the two changes to the proposed rule that provide more time for companies facing a VOC "fee" to respond to the agency. First, CTFA has argued that companies should be allowed 90 days to respond to a fee determination notice to resolve any differences with the staff, but 60 days is helpful. The 30 days

originally proposed in the rule to respond to the fee determination was woefully inadequate given the newness of this "fee" and the number of products involved in calculating the fee assessment. Second, allowing 60 days for a company to remit a "fee" after the final fee determination, compared to the 30 days in the earlier proposal, allows a more realistic time period for companies to process and remit such a "fee." This 60-day remittal practice is consistent with the assessment of other taxes levied by government entities on industry. (CTFA2, 12/02/03)

203. Comment: NPCA supports the modified text which permits additional time for fee payers to review ARB's emissions estimates and to submit payment. The modified text which permits affected companies more time to submit payment after receiving a fee invoice is absolutely necessary and reasonable. So also is the modified text affording affected companies additional time to review the agency's emissions estimates that are the basis for the fee determination. Large and small companies alike require at least 60 days to review and process similar invoices. To require action from potential fee payors in less than 60 days would be impractical. (NPCA2, 12/02/03)

Agency Response to Comments No. 201-203 : The ARB staff acknowledges the commenters' support for the modifications made by ARB staff. These modifications are discussed in the responses to Comments No. 1, 2, 8, 9, and 10.

204. Comment: The ARB should also address the appropriate allocation of "fees" in future years for products complying with reactivity-based limits. ARB failed to address one important issue that was raised by CSPA and others in comments and testimony regarding the proposed rule. Specifically, the ARB should articulate how it intends to assess "fees" for products that have been reformulated to meet reactivity-based "MIR" limits. CSPA believes that this issue should be the subject of a further notice to allow full public comment on ARB's proposed handling of this issue, which will impact 2004-2005 "fees" for aerosol coatings products, and potentially other products subject to MIR-based limits in future. (CSPA3, 12/02/03)

Agency Response: This issue is addressed in the responses to Comments No. 99-102. Staff does not believe that additional notice and comment is necessary because it is a simple engineering calculation to convert a company's ozone reduction, achieved from complying with the aerosol coatings reactivity limits, into equivalent VOC reductions for the purposes of the fee regulation. The ARB staff will continue discussions with the regulated industry, however, and will propose appropriate amendments to the fee regulations in the future if any unforeseen reactivity fee issues arise as a result of these discussions. As mentioned in the response to Comment No. 100, reactivity-based limits for aerosol coatings were not in effect during the 2001 calendar year and will thus not be relevant in fee assessments for the 2003-2004 fiscal year.

205. Comment: National Paint & Coatings Association, Inc. (NPCA) submits these supplemental comments following the availability of modified text and additional

documents regarding the newly created solvents fee program for architectural coatings and consumer products. We appreciate this opportunity to debate the appropriateness, legality and parameters of this proposed regulation. NPCA strongly opposes the fee program. As always, NPCA appreciates the professionalism of the ARB staff and their willingness to engage in debate and especially, their accessibility.

The additional documents available relative to program costs for architectural coatings and consumer products do not cure the flawed economic impact analysis for this proposed regulation.

As articulated in our comment letter of July 24, 2003, the economic impact analysis conducted by the ARB staff in support of this proposed regulation relies upon invalid assumptions and fails to consider the unique business environment in the state of California. During the rulemaking process, several NPCA members indicated that the proposed fees would all but wipe out any real revenue from their products' sales in California. There is no doubt that Governor Schwarzenegger had this type of proposed regulation in mind when he signed Executive Order S-2-03.

This additional opportunity to comment on the modified text and available documents does not cure ARB's failure to devote the appropriate amount of time to develop a rational regulation that is tailored to the architectural coatings industry and the consumer products industry.

In this instance, the ARB continues to move forward towards final approval of a proposed regulation that did not receive adequate attention during the rulemaking process. Important issues that were never addressed during the rulemaking process include how to deal with products regulated by reactivity standards.
(NPCA2, 12/02/03)

Agency Response: For the reasons described in Section G of this FSOR (i.e., the responses to Comments No. 111-162), the ARB staff believes that its economic impacts analysis is adequate. The response to Comments No. 196-199 addresses the ARB's compliance with Executive Order S-2-03. The concern that the ARB did not spend sufficient time on this rulemaking action is addressed in the responses to Comments No. 151 and 156-158. The ARB staff believes that it has adequately addressed products regulated under reactivity-based standards, as explained in the responses to the previous comment and Comments No. 100-102.

206. Comment: ARB has still not provided a lawful basis supported by substantial facts and data, for assessing the proposed fees against consumer product manufacturers. We previously commented that the ARB had failed to provide a sufficiently detailed analysis of its resources expended regulating consumer products to justify the proposed fees. The ARB's response has been to create a second analysis to "refine" the initial analysis. The second analysis does not succeed in establishing a basis for the "fees" to be collected pursuant to this regulation. In fact, it raises more questions than it answers. (CTFA2,

12/02/03)

Agency Response: The "second resource analysis" mentioned by the commenter is the document entitled "Consumer Products and Architectural Coatings Program Costs," which is discussed in the response to Comments No. 29-32. The basis of the fees was established using the emissions-based approach described in Chapter IV of the ISOR, and the "Consumer Products and Architectural Coatings Program Costs " uses an alternative approach which also demonstrates that the fees on consumer products manufacturers are justified. The commenter was provided an opportunity to comment on this document during the 15-day pubic comment period and submitted the statements set forth above. These statements are so general that it is not possible to respond specifically to them, other than to say that the ARB believes the document does succeed in establishing an alternative basis for the fee regulations.