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**Samir Sheikh**  
Executive Director  
Air Pollution Control Officer

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Northern Region Office  
4800 Enterprise Way  
Modesto, CA 95356-8718  
(209) 557-6400 • FAX (209) 557-6475

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Central Region Office  
1990 East Gettysburg Avenue  
Fresno, CA 93726-0244  
(559) 230-6000 • FAX (559) 230-6061

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Southern Region Office  
34946 Flyover Court  
Bakersfield, CA 93308-9725  
(661) 392-5500 • FAX (661) 392-5585

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DATE: September 17, 2020

TO: SJVUAPCD Governing Board

FROM: Samir Sheikh, Executive Director/APCO  
Project Coordinator: Morgan Lambert

RE: **ITEM NUMBER 13: UPDATE ON DISTRICT  
RESPONSE TO CALIFORNIA AIR RESOURCES  
BOARD'S REVIEW OF THE DISTRICT EMISSION  
REDUCTION CREDIT SYSTEM**

**RECOMMENDATIONS:**

Authorize Executive Director/APCO to provisionally withdraw emission reductions from agricultural engine electrification projects associated with the AG-ICE incentive program and unbanked facility shutdowns ("orphan shutdowns") from the District's offset equivalency system, and continue Board-directed efforts to identify longer-term solutions associated with the offset equivalency system, including reintroducing the appropriate reductions from the provisionally withdrawn projects through mechanisms and methodologies informed by the ERC Public Advisory Workgroup process.

**BACKGROUND:**

At their January 2019 meeting, the California Air Resources Board (CARB) directed their staff to review the District's ERC program in response to a request from environmental advocacy groups. CARB staff worked cooperatively with District staff to review the ERC system, including the annual federal equivalency demonstration, in the context of the District's stationary source permitting program. District staff spent considerable resources in educating CARB staff regarding the District's permitting program and responding to numerous questions and inquiries.

Following nearly a year and a half of detailed review, CARB released its final report titled *Review of San Joaquin Valley Air Pollution Control District Emission Reduction Credit System* on June 5, 2020. District

staff drafted a response to the review that was included in the final report. The District Governing Board received and filed CARB's review at the June 18, 2020, Governing Board meeting and affirmed the District's commitments to evaluate and identify opportunities to enhance the District's ERC program moving forward in a manner that ensures an effective permitting program that protects public health and supports economic growth and development in the Valley.

On June 26, 2020, CARB held a hearing on the review to consider their staff's recommendations. At this hearing, CARB approved their staff's recommendations, including their commitment to support the District's local process moving forward.

## **DISCUSSION:**

To achieve the District's mission of improving air quality and public health for all Valley residents, the District has developed and implemented numerous air quality plans to reduce emissions from stationary sources through the adoption of nearly 650 of the most stringent rules in the nation and strong voluntary incentive programs that have invested more than \$3 billion of combined funds in clean-air projects. Over the past several decades, these air quality improvement efforts have reduced NOx emissions (primary precursor for both ozone and PM2.5) from mobile and stationary sources by over 75%, including a greater than 90% reduction from stationary sources under the District's jurisdiction, resulting in significant air quality progress towards meeting the health-based federal ozone and PM2.5 standards.

In addition to the District rules aimed at directly reducing emissions from stationary sources, the District also has a set of rules establishing a permitting program designed under state law to ensure on a regional basis there is no net increase in emissions of nonattainment pollutants or their precursors for new or modified sources. ERCs are one component of a stringent and rigorous permitting program that regulates emission increases from stationary sources.

Under the District's New and Modified Source Review (NSR) Rule, new facilities and modifications to existing facilities that result in increases in permitted emissions above specified levels are required to provide ERCs as mitigation, or "offsets", as a part of the requirements to obtain an "Authority to Construct" permit. Both federal and state law mandate NSR permitting programs that contain offsetting and ERC provisions. ERCs are intended by both federal and state law to be one part of a comprehensive NSR permitting program that has been specifically designed by Congress and the state legislature to allow for industrial growth while tightly regulating any emissions increases. Additionally, any emission increases due to growth are accounted for in State Implementation Plans that demonstrate how the District's overall air quality control program will require sufficient emissions reductions to attain national ambient air quality standards.

It is important to clarify that, despite a common misconception, ERCs cannot be used in lieu of meeting other air pollution control requirements, such as through market-based systems that other agencies may have in place. Instead, ERCs are required in addition to, and only after, establishing that the new emissions are controlled with the best available control technology (BACT) and will not cause a health risk to surrounding communities. The San Joaquin Valley's NSR permitting program, including the accompanying ERC program, ensures that new emissions are controlled with the best technologies, prevents the permitting of any operation that will cause a significant health impact, demonstrates that attainment is not endangered, and has historically been found by the state and federal governments to comply with state and federal laws governing NSR/ERC programs.

ERCs are granted to permitted sources for voluntary emissions reductions when facilities control emissions to levels beyond current or future regulatory requirements, and are only granted after a thorough review by the District has confirmed compliance with a number of criteria defined by District Rules 2201 and 2301, which rules are vetted and approved by both CARB and federal EPA. In addition, every ERC and ERC evaluation are provided to CARB, EPA, and the public for their review and comment prior to the ERCs being issued. ERCs approved by the District are then available for use to offset a subsequent permitted emissions increase by surrendering the ERC, whether used at the same location of the emissions decrease, or at another location, generally after the sale of the ERC to a third party.

As allowed by the federal Clean Air Act, the District's ERC program differs from a direct implementation of the federal offsetting requirements. EPA approved the District's approach in 2001 as the District's local NSR program was at least as stringent as the federal program. As included in the District's EPA-approved NSR Rule, to demonstrate equivalency with the federal NSR offsetting requirements the District is required to prepare and submit an annual offset equivalency report to EPA and CARB that demonstrates both of the following:

- Offset Quantity (Test 1) – the quantity of offsets required by the District from new and modified stationary sources equals or exceeds the quantity of offsets otherwise required under federal regulations; and
- Surplus Value (Test 2) - the amount of reductions, after discounting at the time of use, required by the District from new and modified stationary sources, plus any additional surplus creditable emission reductions, equals or exceeds the amount of offsets otherwise required under federal regulations.

Under the District's NSR rule, if the system ever fails to demonstrate equivalency with federal requirements, immediate and specified remedies are required to be enacted for each of the above tests. For example, if the system fails to demonstrate equivalency for the surplus value test, the District's NSR rule requires that the District immediately default to requiring "surplus at time of use" credits to satisfy offset requirements under the rule for each new major source or federal major modification. This means that

credits that are not surplus of requirements at time of ATC issuance would not be able to be used to offset federal major projects.

The findings of CARB's review point to the need to revisit the assumptions used in the District's equivalency demonstrations for the surplus value test. Consistent with the District's offset equivalency agreement with the federal EPA and with the provisions of the District's NSR rule, the District utilizes the surplus value of emission reductions across various categories to demonstrate equivalency with federal surplus value offsetting requirements on an annual basis. Two particular categories that have been utilized were agricultural engine electrification projects associated with the AG-ICE incentive program and unbanked facility shutdowns ("orphan shutdowns"). CARB raised valid questions regarding the assumptions, quantification methodologies, and creditability of the emission reductions associated with these projects when viewed in an NSR context. In response to the review, the District committed to revisiting the emission reductions used in the equivalency demonstration from these two categories.

After further review of these projects and given the significant questions surrounding the assumptions, quantification methodologies, and creditability of the emission reductions from these two categories, the District believes it would be prudent at this point to recommend the provisional withdrawal of the emissions reductions from these projects from the equivalency system. This recommended action is consistent with your Board's direction for a proactive response to the review, and would allow the public process, including the recently created ERC Public Advisory Workgroup, to inform the development of mechanisms and methodologies for the use of these and other types of creditable emission reductions in demonstrating equivalency. Once EPA and ARB accepted mechanisms and methodologies are developed, the District would reintroduce the appropriate portion of the emission reductions from provisionally withdrawn projects.

With the recommended provisional removal of the emissions reductions associated with the AG-ICE and orphan shutdown projects, the system would no longer be able to demonstrate equivalency with the surplus value test for NO<sub>x</sub> and VOC. Pursuant to the District's NSR rule, immediately following this action, any ATC requiring NO<sub>x</sub> or VOC offsets under the NSR rule for a new major source or federal major modification would be required to supply ERCs with sufficient "surplus at time of use" credit at the time of ATC issuance until such time that equivalency is again demonstrated.

Surplus value test equivalency for PM<sub>10</sub>, PM<sub>2.5</sub>, and SO<sub>x</sub> has not relied on the significant use of emissions reductions associated with the AG-ICE and orphan shutdown projects. Therefore, the provisional removal of these reductions is not anticipated to affect the ability to demonstrate surplus value test equivalency for these pollutants. Similarly, these reductions are not used in demonstrating offset quantity test equivalency for any pollutant, so their provisional removal is not anticipated to affect offset quantity test equivalency. The District will incorporate today's recommendations, finalize the equivalency demonstrations for the surplus value test for PM<sub>10</sub>, PM<sub>2.5</sub>, and

SOx, and finalize the offset quantity test for all pollutants, in the annual offset equivalency report due November 20, 2020.

**NEXT STEPS:**

Upon approval of today's recommendations by your Board, the District will provide information to interested parties consistent with the District's ongoing outreach efforts on this matter. Additionally, the District will continue to conduct engagement efforts with affected stakeholders, CARB, EPA, and the interested public to discuss the District's offset equivalency system and identify long-term solutions, including the following next steps:

- September 2020, kick-off of ERC Public Advisory Workgroup process
- October 2020, public workshop on draft 2020 Annual Equivalency Demonstration
- November 2020, final 2020 Annual Equivalency Demonstration submitted to EPA and ARB
- December 2020, final 2020 Annual Equivalency Demonstration presented to the District Governing Board

Due to the complexity and importance of the issues, it is likely that the process will occur over an extended period. District staff will provide regular progress reports to the Governing Board at the regularly scheduled public meetings.