

# Perry & Shaw, Inc.

## General Engineering Construction

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February 22, 2008

California Air Resources Board  
1001 "I" Street  
P.O. Box 2815  
Sacramento, CA 95812

Attn: California Air Resources Board

Re: **PROPOSED IN-USE OFF ROAD DIESEL REGULATIONS  
SOON PROGRAM - CONTRACT DOCUMENT**

Dear Sirs / Madams,

The purpose of this letter is to comment on the SOON program. In reading of *ATTACHMENT 2: DESCRIPTION OF SURPLUS OFF-ROAD OPT-IN FOR NOx (SOON) PROGRAM* provided on the ARB website as supporting documentation to SOON, I take exception to the staff's oversimplification of the real impact of this regulation on business. I am addressing two of the notable flaws in this proposed regulation.

### **ISSUE 1 - REAL LOSS IN EQUITY VALUE OF EQUIPMENT AND DOWNSTREAM IMPACTS OF THIS LOSS:**

#### **STAFF ECONOMIC ANALYSIS:**

The economic analysis provided by staff relative to the "cost" to the owner of a piece of equipment could be somewhat accurate when the piece of equipment is taken out of the context of fleet ownership, or, in other words "...in an ideal world...". Some of the staff comments relating to compliance costs:

*"...a fleet participating in the SOON program may face slightly higher compliance costs..."*

*"...the participating fleet will realize an economic benefit..."*

*"...Although the SOON program will ultimately lessen the costs of compliance..."*

*"...the SOON program could also potentially increase the estimated cost of the off-road regulation in its initial years...by a small amount (less than one percent)."*

*"Even with the slight increase in the regulatory cost of the regulation, staff expects...(it) is still in the cost effectiveness range of previous measures..."*

The conclusion is that there might be a very minor cost to the Owner on the front end but it will be more than made up on the back end and everything will be O.K. In the real world, the world where we all go to work each day, things don't work this way, not even close.

Heavy equipment ownership is a complex business. When it is joined with contracting, it is even more complex. As an industry, we have tried in vain to educate CARB staff about how our business and our financing and our bonding and our contracting work. They have no understanding.

## **AN EXAMPLE OF THE HOW THE PROPOSED SOON REGULATION IMPACTS EQUIPMENT OWNERSHIP:**

The example presented below is a real scenario based on current cost and market conditions:

STEP 1: The Owner of a fleet of heavy, off road equipment is a contractor. In that fleet is a 1995 CAT 657E scraper with engines in good condition.

- Current market value of the machine is about \$285,000 (most recent auction value).
- The machine is owned 100% by the fleet owner, there is no direct debt.
- The owner has a line of credit with a lender that is backed by the equity in this and other equipment in the fleet. This line of credit is used for equipment procurement and to cash flow the contracting business.
- In addition, the owner has a bonding capability based on a balance sheet that uses the equity built up in this and other pieces of equipment as a large part of the financial base of the company. The real equity base in the company is used as a part of a direct calculation used by the Owner's bonding company to determine the amount of bonding available to the owner.
- The largest portion of the Owner's equity in his contracting business is the equity built up in each piece of equipment.
- The Owner of this equipment utilizes it throughout California on large projects as bids are won.

STEP 2: Even though the owner does not request or want to repower the machine and has no need to repower the machine to meet CARB Off Road Diesel regulations, this machine is chosen to be in the mandatory SCAQMD SOON program by the air district.

- The repower cost is approximately \$345,000 to go to Tier 3 for both engines. The Owner contributes \$45,000 to the repower cost. The remaining \$300,000 is paid for by the air district.
- THE PROBLEM: There is no where near dollar for dollar value added to the equipment by doing these repowers. The value of the machine is based on the condition of the machine and the condition of the engines, not their Tier. On day one following the repower of the machine it is now worth \$300,000 to \$325,000, certainly no more and more realistically still \$285,000. For purposes of this review, I will be generous and assume the new value of the machine is \$325,000.
- On that day the owner of the machine also has a new liability against that machine in terms of the air district's position of their contribution to the machine of \$300,000. Therefore, the owner's equity in the machine has dropped from \$285,000 to  $(\$325,000 - \$300,000)$  or \$25,000. In addition, the Owner has spent \$45,000 as a part of his contribution to the repower. The net loss to the owner on the first day after the repower is all of the that day for the repower is all but \$25,000 of his equity in this machine and an additional \$45,000 out of pocket.
- The finance company that has the line of credit will no longer use any remaining equity in this machine to support the line of credit because the ownership of the machine is "clouded."

(This can be affirmed by reviewing the terms and conditions of SCAQMD Moyer contract and affidavits in the previous public comments by representatives of equipment finance companies). Financing companies are dealing with the Moyer attachment to machines by simply not considering these encumbered machines as a part of the fleet for financing purposes..

- The Owner's's bonding company will follow the finance company in terms of viewing the owner's equity when calculating the contractor's ability to bond. There will be a direct, significant reduction in the Owner's bonding capacity.

#### NET EFFECT:

The real net effect of this mandatory repower is that the owner has:

- A real loss in equipment equity of \$260,000,
- A real loss of borrowing ability due to decreased equity,
- A real loss of bonding ability
- An out of pocket the \$45,000 spent for the repower
- This negative impact must be multiplied by the number of machines brought under the SOON program. The true impact could quickly have a 7 figure negative impact rippling through the company's balance sheet and bonding ability.

#### OTHER POTENTIAL ECONOMIC IMPACTS:

- In addition, the program will require that the machine be used within the bounds of the air district 75% of the time for 7 years. *The air district essentially conscripts the machinery from the Owner, in that the Owner unwillingly must enter an agreement restricting the ability to use the equipment where and when he chooses to.*
- There will be times when the Owner has work for the equipment out of the district but not in the district and will have to supplement his fleet to make up for the loss of productivity for this piece of equipment by renting. This is an additional, indirect cost of the program to the Owner.
- Because the Owner is a large fleet owner, the severity of the impact of the SOON program puts him at a distinct economic disadvantage when competing with other fleet owner's that are not compelled to be in this program including but not limited to small and medium fleet owners. Other Owner's with exactly the same machines are allowed to do things with their equipment that this Owner is not allowed to do.
- **THE OVERRIDING ECONOMIC IMPACT - THE CURRENT ECONOMY:** Currently our business is depressed. Our business is heavy earthmoving and we are running at about 12% of the volume we were doing two years ago. We are currently operating 21% of our fleet when weather permits. It is taking all the creativity and resources we have just to keep enough cash flow to keep the doors open. There currently is no capacity to spend any capital on the equipment except as needed to keep the few pieces moving that are needed and it is my belief that there won't be significant work for at least another 2 years. To be mandated to spend money on this program would be a real financial disaster and, without

question, if this program is mandated, there will be good, substantial contractors that will go out of business because of this.

The CARB staff presentation of this analysis is testimony to the CARB staff's underlying inability (or intended refusal) to understand the real impact to business. I can go on and on about the real impact to the Owner's contracting business that will result from this program. These are simply a few of the ways that there will be a real impact to a real business that staff does not begin to understand and for which staff is not qualified to make a truly valid economic analysis. If the program is as good as is portrayed by staff, contractors and owners would be lined up to take advantage of it. But they're not.

### **THE CONTRACT:**

The second place this program is flawed is that it is mandated that the Owner unwillingly sign a contract with the air district. It does not directly state that the Owner of a piece of equipment is compelled to sign a binding contract with the air district. Rather, it states that it is mandatory for the Owner to make application for funding. It then says that the Owner shall complete any projects selected through SOON. I believe it is implied that, through the SOON program, the Owner is compelled to sign these contracts and if he refuses to, he will be subject to action by either the air district or the state.

THE PROBLEM: Upon review of the current SCAQMD Carl Moyer contract, I am convinced that I could never negotiate this contract to what I would consider reasonable terms. If this is the case, then by what authority am I compelled by the air district to unwillingly sign the contract? Some examples of issues:

- Review by counsel: The language in the contract states that I have had the contract reviewed by counsel. My attorney will recommend that I not execute this contract. How is this to be dealt with?
- Indemnity Language: There is very strong indemnity language in favor of the air district. If I am being compelled to execute this contract, why would I want to provide any indemnity to this agency or its employees or consultants. I would require that I receive complete indemnity in my favor from the air district. No public agency will provide my company with complete indemnity for machinery I own.
- Insurance: The insurance requirements of the contract are well in excess of any insurance I may consider having on the equipment.

These are just a couple of the areas of the contract that I know I could not work out with the air district. I have no incentive to try to work this out because the air district is mandating that work be done to my equipment that I can not afford to do and that I don't want to because I am in compliance with all current regulations.

### **SUMMARY:**

If my fleet is currently in compliance with the air quality requirements of the State of California, how can I be mandated to participate in this program? How can I be compelled to spend money I do not

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have a need to spend, to give up real equity (value) in my machinery, to have my ability to contract diminished and have my ability to use my equipment as I need arbitrarily constrained without my willing participation?

A more honest and thorough analysis, including real consideration for the input from industry, should be made before any form of this program is considered for implementation. I would expect that if this program is presented as a voluntary program with more reasonable constraints, it might be as effective as the Moyer program has been to date.

Sincerely,

Mike Shaw