

EPA's Nonconformance Penalty Rulemaking for On-Highway Heavy-Duty Diesel Engines

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EPA's 2001 NOx Rulemaking

- **Long Lead Time:** The 2010 emissions standard was finalized and promulgated in January 2001 and fully implemented in 2010, **providing 9 years of lead time.**
- **Significant Environmental Benefits:**
 - It required 95% reduction in NOx emissions from heavy-duty diesel engines by 2010.
 - The rule promises extraordinary reductions in NOx emissions, over 2.6 million tons by 2030.

Industry's Response to NOx Rulemaking

- All engine manufacturers *except Navistar* adopted Selective Catalytic Reduction (SCR) technology to meet this standard.
- DTNA, Volvo/Mack and Cummins alone spent over **\$800 million** to develop and implement SCR technology, which is extremely effective and reliable. The full industry investment in SCR is well over \$1 billion.
- One company, Navistar, made a “bet” it could meet the standard without using SCR in the U.S.
- Instead of developing compliant technology over the last 11 years, Navistar chose to:
 - First challenge the feasibility of the standard.
 - Amass NOx emissions credits to delay compliance.
 - Sue EPA and ARB, challenging certification of SCR (eight different lawsuits filed by Navistar).
 - Heavily promote and sell nonconforming, lower cost EGR systems while denigrating SCR in the marketplace.

Nonconformance Penalty Rulemaking

- When Navistar’s gamble failed, it asked EPA to promulgate Nonconformance Penalties (NCPs) on an emergency basis, without notice and comment, to allow it to sell nonconforming engines, while paying a small penalty.
- The Clean Air Act and EPA’s regulations allow EPA to publish NCPs only under specific limited circumstances:
 1. EPA must find that there is a “technological laggard” and that “substantial work” is required.
 2. If a penalty is set, it must be high enough to “remove any competitive disadvantage” to compliant manufacturers who have invested in successful emissions technology.
 - EPA has frequently recognized that “satisfying the statutory objective of protecting the complying manufacturer was paramount.” 67 *Fed. Reg.* 2,169 .

D.C. Circuit Opinion on NCP Rulemaking

- In striking down EPA's interim NCP rulemaking in June, the D.C. Circuit expressly stated that it believed the preconditions to NCP rulemaking were NOT met.
 - The court concluded that “**NCPs are likely inappropriate**” on the record presented.
 - The court urged EPA to address these flaws “**before the ink is dry**” on the final rule and reminded EPA that its rule would remain “**subject, of course, to the Court's review.**”

D.C. Circuit Opinion on NCP Rulemaking

- **No Technological Laggard:** Regarding the need to prove the existence of a technological laggard, and substantial work:
 - At argument Judge Brown asked EPA: “[H]ow do we even have a technological laggard here? They had nine years. They have apparently produced this engine. They sell its [SCR engines] in other places. How are they lagging.”
 - The court stated that Navistar had made a “bet” on non-SCR technology and that EPA’s interim rule was for the sole purpose of “rescu[ing] a lone manufacturer from the folly of its own choices.”
 - The court reminded EPA that “NCPs are not designed to bail out manufacturers that voluntarily choose, for whatever reason, not to adopt an existing compliant technology.”

D.C. Circuit Opinion on NCP Rulemaking

- The D.C. Circuit was also skeptical about EPA's methodology for calculating the penalty, and that the EPA's penalty amount was high enough:
 - At oral argument, Judge Brown asked: **“the level that you set, if you start halfway down the line, aren't you, in fact, discounting what the manufacturers who have, in fact, complied, what their costs were?”**
 - The court concluded its opinion by stating: **“We are highly skeptical that the penalty . . . satisf[ies the] congressional demand to protect compliant manufacturers.”**

Recent Events Confirm Same Flaws:

1. Navistar Does Not Meet the Mandatory “Technological Laggard” and “Substantial Work” Criteria.

- On July 6, 2012, Navistar announced that it would switch to SCR to meet NOx standards and explained that this switch would be easy because it was already using SCR in Brazil.
- This revelation makes it impossible to argue that it is a technological laggard or that substantial work is needed, as required for NCP rulemaking.

Recent Events Confirm Same Flaws

2. EPA's Methodology for Setting the Penalty Is Still Flawed.

- For over 27 years, and through 5 previous NCP rulemakings, EPA has consistently used compliant manufacturers' **actual cost of compliance** to determine the appropriate penalty amount.
- This is the only methodology that can “remove any competitive disadvantage to compliant manufacturers.”
- EPA has replaced “actual cost” method, with a method that measures costs using a **hypothetical baseline engine**, which has never been produced. EPA only focused on unverifiable “hypothetical” costs during the rulemakings.
- EPA never sought the actual cost of compliance information from SCR engine manufacturers that is necessary for EPA to set an NCP at an appropriate level, in conformity with the requirement to ensure no competitive harm to compliant manufacturers.
- EPA's new method would make it impossible to issue future NCPs on any emissions standards with consumer side-benefits, like future GHG standards which improve fuel economy.

NCP Must Be Based on Verifiable Actual Cost of Compliance

- Complying manufacturers all have documentation of the research, development, materials, and manufacturing costs of complying.
- After years of production, there are documented costs of warranty, maintenance and operation of complying vehicles.
- Only documented, verifiable data can ensure complying manufacturers are protected and that intentional laggards are not rewarded.
- EPA's flawed methodology resulted in penalty levels in the NPRM and Interim Final Rule that were only 10-20% of compliant manufacturers' actual costs of compliance.
- Compliant manufacturers' actual per-engine cost of compliance ranged as high as >\$20,000 per engine.

Conclusions

- Navistar has chosen to delay compliance for commercial reasons, not lack of technological capability.
- The now-confirmed absence of a true technological laggard prevents EPA from lawfully finalizing NCPs for the 2010 NOx standard.
- If the rule is nevertheless finalized, EPA's failure to seek detailed information from compliant manufacturers on actual costs of compliance makes it impossible to set the NCP at the required level, and insures significant competitive harm to manufacturers who have complied with the standards at great cost and effort.
- If there is an NCP, it must be based on actual costs of compliance.
- If a final rule is issued without fixing these issues, another legal challenge should be expected.

Conclusions

- Allowing EPA to make these mistakes in the NCP rule will:
 - significantly undermine a >\$1 billion investment compliant manufactures have made in effective emissions controls.
 - Incentivize companies to pursue lower cost noncompliance strategies on important future rulemakings, like GHG emissions, rather than invest in advanced technology and true environmental compliance.