UNITED STATES
ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE ADMINISTRATOR

In the Matter of:	)	
	)	
Taotao USA, Inc.,	)	**Docket No. CAA-HQ-2015-8065**
Taotao Group Co., Ltd., and	)	
Jinyun County Xiangyuan Industry	)	
Co., Ltd.	)	
	)	
Respondents.	)	

INITIAL DECISION

DATED: August 7, 2018

PRESIDING OFFICER: Chief Administrative Law Judge Susan L. Biro

APPEARANCES:

For Complainant:

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I. PROCEDURAL HISTORY[1]

This proceeding was commenced on November 12, 2015, when Complainant, Phillip A. Brooks, Director of the Air Enforcement Division, Office of Civil Enforcement, Office of Enforcement and Compliance Assurance, United States Environmental Protection Agency ("EPA" or "the Agency"), filed a Complaint against Respondents Taotao USA, Inc. ("Taotao USA"), Taotao Group Co., Ltd. ("Taotao China"), and Jinyun County Xiangyuan Industry Co., Ltd. ("Jinyun") alleging, in eight counts, 64,377 violations of sections 203 and 213 of the Clean Air Act (CAA), 42 U.S.C. §§ 7522, 7547, and implementing regulations codified at 40 C.F.R. Part 86, Subpart E and 40 C.F.R. §§ 1051, 1068. On June 14, 2016, the Agency filed an Amended Complaint that added two more counts alleging additional wrongdoing under CAA sections 203 and 213 and raising the total number of alleged violations to 109,964.[2] Am. Compl., ¶ 38. The action arises from Respondents' manufacture and import into the United States of motorcycles and recreational vehicles with catalytic converters not designed or built in accordance with Certificates of Conformity demonstrating compliance with CAA emissions requirements.

Respondents filed amended Answers to the Amended Complaint on August 17, 2016.[3] On August 25, 2016, the Agency filed its prehearing exchange materials followed by rebuttal prehearing exchange material on October 13, 2016. Respondents submitted their joint prehearing exchange on September 23, 2016.[4]

On November 28, 2016, the Agency filed a Motion for Partial Accelerated Decision, seeking a determination on the issue of liability. The same day, Respondents filed a Motion to Dismiss for Failure to State a Claim and a Motion for Accelerated Decision. The Agency supplemented its prehearing exchange on November 28, 2016, and January 3, 2017. On May 3, 2017, after the parties had submitted response and reply briefs, this Tribunal granted accelerated decision to the Agency as to liability on all ten counts (109,964 violations) and denied Respondents' dispositive motions. *See* Order on Partial Accelerated Decision and Related Motions ("AD Order"). Respondents then moved for reconsideration of the AD Order or a recommendation for interlocutory review by the Environmental Appeals Board ("EAB"). *See*

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[1] This section includes only a fraction of the procedural history of this case, which was intensely litigated over the course of almost three years and included the filing of nearly 180 pleadings, motions, and briefs, as well as a multitude of orders addressing those filings.

[2] I granted the Agency's request to amend the Complaint on July 5, 2016. *See* Order on Motion for Leave to Amend the Complaint and to Extend Prehearing Deadlines. After leave to amend was granted, the Agency served the Amended Complaint on Respondents by certified mail. *See* Proof of Service (Aug. 4, 2016).

[3] Although Respondents separately filed their Amended Answers, when appropriate, this Initial Decision refers to the three collectively as "Respondents' Amended Answers." Respondents answers to the original Complaint were filed January 19, 2016, and February 9, 2016.

[4] Respondents' prehearing exchange as filed with the Tribunal differed from the prehearing exchange it provided the Agency. Respondents submitted additional filings on October 28, 2016, and November 3, 2016, to correct the September filing discrepancies.

Motion for Reconsideration, or in the Alternative, Request for Interlocutory Appeal (May 15, 2017). That Motion was denied and Respondents did not ask the EAB to review this Tribunal's refusal to recommend interlocutory review of the AD Order. *See* Order on Respondents' Motion for Reconsideration or Interlocutory Appeal (June 15, 2017); 40 C.F.R. § 22.29(c). Consequently, the AD Order and Order on Respondents' Motion for Reconsideration together represent this Tribunal's rulings on liability in this matter.[5]

After liability was determined, the parties engaged in additional discovery on the remaining penalty issues. The Agency supplemented its prehearing exchange materials on June 16, July 31, August 21, and September 15, 2017.[6] This Tribunal also permitted the Agency to issue requests for admission, requests for production of documents, and to depose at least three of Respondents' proposed witnesses.[7] *See* Order Granting Complainant's Motion for Additional Discovery Through Requests for Admission (Aug. 17, 2017); Order Granting Complainant's Motion to Take Depositions (Aug. 17, 2017); Order on Agency's Motion for Additional Discovery (Sept. 20, 2017). Respondents supplemented their prehearing exchange materials on June 19 and September 15, 2017. Respondents were additionally granted leave to depose all three of the Agency's witnesses. *See* Order on Respondents' Motion to Take Depositions (July 7, 2017).

The hearing in this matter was conducted October 17-19, 2017, in Washington, D.C.[8] At hearing, 121 Agency exhibits ("CX") were admitted into evidence (CX nos. 1-10, 12-17, 19, 22-25, 28, 30-31, 35, 42-52, 61, 64, 67, 69-74, 76-79, 81, 92-95, 98-122, 140, 148, 155-156A, 159, 161-163, 167-171, 183-192, 194, 197-203, 205-209, 213, 215-218) along with five exhibits offered by Respondents ("RX") (RX nos. 1, 10 (pages 1 and 2 only), 33, 38-39). In addition, the testimony of the following three witnesses for the Agency was accepted at hearing:

1. Cleophas Cawthorn Jackson, Director of the EPA's Gasoline Engine Compliance Center ("GECC" or "Center") since 2002. Hearing Transcript ("Tr.") at 10-11, 24; CX 156A. The GECC "is responsible for certification and compliance for highway motorcycles, for recreational vehicles, off-highway motorcycles and ATVs [all-terrain vehicles], small spark-ignition engines, large spark-ignition engines, portable fuel containers, evaporative components, and heavy-duty spark-ignition engines." Tr. at 24. As Director, Mr. Jackson is responsible for the certification and compliance of

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[5] Accordingly, this Initial Decision does not revisit the issue of Respondents' liability for the 109,964 violations.

[6] The Agency asked to supplement its prehearing exchange for a seventh time the day before the hearing. *See* Complainant's Motion for Leave to File Out of Time & Motion to Correct Expert Report (Oct. 16, 2017). As stated at hearing, that request was **DENIED**. Tr. at 373, 394, 445.

[7] Only one of those three witnesses testified at hearing.

[8] The hearing was initially scheduled for July 18, 2017 but was later postponed for 90 days at Respondents' request. *See* Hearing Notice and Order (May 9, 2017); Respondents' Motion for Continuance of the Hearing (June 9, 2017); Order on Respondents' Motion for Continuance of the Hearing (June 27, 2017).

about 2,800 engine families annually, for the training and direction of staff who carry out those responsibilities, for ensuring compliance of those products and developing test programs and protocols to assess their performance, and for industry outreach. Tr. at 12, 24; CX 156A. Prior to his current role, Mr. Jackson was the Assistant Division Director for the Compliance Division and served in other senior technical staff roles. Tr. at 25-27; CX 156A. Mr. Jackson has Bachelor's and Master's degrees in Mechanical Engineering. Tr. at 16; CX 156A. In school, he studied combustion analysis and vehicle dynamics, which included work in the function of catalysts. Tr. at 16, 30-41. Mr. Jackson has also published journal articles on issues of emissions measurement and duty cycle development, as well as measurement strategies and technologies for measuring emissions. Tr. at 18. He has led some of the Agency's rulemaking efforts under the CAA and represented the Agency in international forums. Tr. at 19-23, 25. Based on his education, training, and experience, at hearing Mr. Jackson was qualified as an expert witness in the Agency's vehicle and engine certification and compliance program. Tr. at 27-28, 43.

2. James J. Carroll, Certified Public Accountant and Professor of Business Administration at Georgian Court University in Lakewood, New Jersey. Tr. at 374-75; CX 159. Mr. Carroll has been a full-time faculty member for 35 years teaching undergraduate and graduate courses in finance and accounting. Tr. at 380. Mr. Carroll has an undergraduate degree in industrial engineering and master's and doctorate degrees in business administration. Tr. at 377; CX 159. He is also certified as a management accountant, in financial forensics, as a fraud examiner, as a financial manager, and as a chartered global management accountant. Tr. at 378; CX 159. Based on his education, training, and experience, Mr. Carroll was qualified at hearing as an expert witness in accounting and corporate finance. Tr. at 391. Corporate finance "is the financing of running a business" and is different from individual finance or public finance. Tr. at 378. It includes such areas as bank loans, stock issues, and cash management. Tr. at 378. Financial management in the corporate sense refers to the management of a company, the source of its funding, and "things that relate to the money coming in and out of a business." Tr. at 380-81.

3. Amelie Cara Isin, environmental engineer with EPA's Vehicle and Engine Enforcement Branch ("VEEB").[9] Tr. at 542, 702; CX 155. An Agency employee since 2003, Ms. Isin is a licensed Professional Engineer with a Master's degree in environmental engineering from Virginia Tech. Tr. at 542-43; CX 155. In the VEEB, Ms. Isin worked on vehicle and engine import cases, conducting inspections, investigations, and providing technical support. Tr. at 544. She compiled information on violations, calculated penalties, and reviewed motor vehicle emission test reports. Tr. at 544-45. When investigating specific companies, Ms. Isin would conduct inspections, look at how a vehicle or engine was supposed to be built according to its COC application, research the company on the Internet and in state resources, and review a company's import history in the ACE database maintained by

[9] At the time, the office was known as the Mobile Source Enforcement Branch. Ms. Isin is currently employed in the Agency's Region 3 Air Protection Division. Tr. at 541-42.

U.S. Customs and Border Protection. Tr. at 546-47. Ms. Isin has performed roughly 150 vehicle and engine inspections as an EPA employee, the general purpose of which is "to see that the vehicle or engine was built according to the specifications described in the application for certification." Tr. at 548-49. Ms. Isin has been part of about 50 investigations. Her role in those instances includes collecting all of the information related to the violations, researching the companies involved, researching their corporate formation, calculating the initial penalty, and sending information request letters if the Agency wants additional information. Tr. at 552-53. Ms. Isin has calculated about 50 penalties, including the one in this proceeding, all under the Agency's Penalty Policy. Tr. at 553-54. She provides the initial calculation, and Agency management provides additional input and decision making. Tr. at 554. Ms. Isin was the lead investigator in the Agency's case against Respondents in this proceeding.[10] Tr. at 564.

Respondents' one witness at hearing was Jonathan S. Shefftz. Tr. at 861. Mr. Shefftz "is an independent consultant who specializes in the application of financial economics to litigation disputes, regulatory enforcement, and public policy decisions." RX 1 at 36. He has an undergraduate degree in economics and political economy and a Master's degree in public policy. RX 1 at 36. On previous occasions, Mr. Shefftz has served as a consultant for the Agency and provided support for the Agency's computer program ABEL, which analyzes a respondent's ability to pay civil penalties. Tr. at 691, 862, 878; RX 1 at 41. Mr. Shefftz was qualified as an expert economist and an expert on the economic benefit and ability to pay components of the Penalty Policy. Tr. at 863.

A transcript of the hearing was received by this Tribunal on October 30, 2017, and transmitted to the parties by email on November 1, 2017. On that same day, Respondents filed a motion seeking to reopen the record to introduce additional evidence. That motion was denied because Respondents' purported evidence was, among other things, irrelevant to this proceeding. *See* Order on Respondents' Motion for Leave to Reopen the Record (Dec. 7, 2017). Thereafter, the parties filed motions to conform the transcript to the testimony actually given, which this Tribunal granted in part and denied in part. *See* Order on Motions to Conform Transcript (Nov. 30, 2017).

The Agency filed its Initial Post-Hearing Brief ("AB") on December 21, 2017. Respondents filed their Initial Post-Hearing Brief ("RB") on December 26, 2017.[11] The Agency

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[10] Ms. Isin first became aware of Taotao USA in 2010 through a case she worked on then against the company. Tr. at 560. In that case, the company was importing vehicles with non-compliant carburetors, and U.S. Customs and Border Protection brought the company to the Agency's attention. Tr. at 560-61; CX 67.

[11] The document accepted and cited to as Respondents' actual Initial Post-Hearing Brief is found at Exhibit B to Respondents' Motion for Leave for Filing Post Hearing Brief (Dec. 26, 2017). This document supersedes "Respondents' Initial Post-Hearing Brief," filed December 23, 2017. As they have many times throughout this proceeding, Respondents submitted their filings late and without regard to directions contained in this Tribunal's previous orders. Nevertheless, this Tribunal accepted a tardy, revised version of the brief Respondents had initially submitted a day

filed a Reply Post-Hearing Brief ("ARB") on January 19, 2018. Respondents filed their Reply Post-Hearing Brief ("RRB") the same day.

II. THE CAA AND THE COC CERTIFICATION PROCESS

As indicated above, this action arises from Respondents' unlawful manufacture and import into the United States of 109,964 motorcycles and recreational vehicles with catalytic converters not designed or built in accordance with their Certificates of Conformity demonstrating compliance with the CAA emissions requirements.[12] *See* AD Order.

In brief, the CAA authorizes EPA to prescribe emissions standards for vehicles and engines[13] that cause or contribute to air pollution and endanger public health.[14] 42 U.S.C. §§ 7521(a)(1), 7547(a)(3). To help ensure compliance with emissions standards, the Act prohibits "manufacturers"[15] from selling or offering for sale, introducing or delivering for introduction into "commerce,"[16] or importing into the United States a vehicle and/or vehicle engine unless it is covered by a "certificate of conformity" (COC) issued under applicable regulations. 42 U.S.C.

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after the filing deadline. *See* Respondents' Initial Post Hearing Brief (Dec. 23, 2017); Motion for Leave for Filing Post Hearing Brief (Dec. 26, 2017); Order on Motion for Leave for Filing Post Hearing Brief (Jan. 10, 2018).

[12] All of the 109,964 vehicles at issue except for 66 were placed into commerce, i.e., sold by Respondents, in the United States. Tr. at 596, 847, 851; CX 213.

[13] "Motor vehicles" and "nonroad vehicles" are two of the several categories of vehicles and engines regulated under the Act. 42 U.S.C. §§ 7521, 7547. "The term 'motor vehicle' means any self-propelled vehicle designed for transporting persons or property on a street or highway." 42 U.S.C. § 7550(2). A "nonroad vehicle" is "a vehicle that is powered by a nonroad engine and that is not a motor vehicle . . . ." 42 U.S.C. § 7550(11).

[14] EPA's CAA regulations are designed to limit emissions of unburned hydrocarbons, carbon monoxide, and oxides of nitrogen for the "useful life" of an engine. 42 U.S.C. § 7521(d); Tr. at 82. These byproducts of fuel combustion harm human health and the environment because they decrease lung function, inhibit the body's ability to absorb oxygen, have carcinogenic effects, and contribute to ground level ozone formation. Tr. at 83-85.

[15] "The term 'manufacturer' . . . means any person engaged in the manufacturing or assembling of new motor vehicles, new motor vehicle engines, new nonroad vehicles or new nonroad engines, or importing such vehicles or engines for resale, or who acts for and is under the control of any such person in connection with the distribution of new motor vehicles, new motor vehicle engines, new nonroad vehicles or new nonroad engines, but shall not include any dealer with respect to new motor vehicles, new motor vehicle engines, new nonroad vehicles or new nonroad engines received by him in commerce." 42 U.S.C. § 7550(1).

[16] "The term 'commerce' means (A) commerce between any place in any State and any place outside thereof; and (B) commerce wholly within the District of Columbia." 42 U.S.C. § 7550(6).

§ 7522(a)(1). Under the CAA, the Agency may issue COCs for up to a one-year period after the subject engines are tested by their manufacturers to determine whether they comply with the emissions regulations set forth under 42 U.S.C. § 7521.[17] 42 U.S.C. §§ 7525(a)(1). The Agency may also test engines previously issued a COC to determine if they still "conform with the regulations with respect to which the certificate of conformity was issued" and may suspend or revoke the certificate for non-conforming engines. 42 U.S.C. § 7525(b)(2).

The EPA's Gasoline Engine Compliance Center ("GECC" or "Center") within the EPA's Office of Air and Radiation oversees vehicle and engine certification utilizing a three-phase regulatory process: pre-certification, certification, and post certification work. Tr. at 44. At hearing, Mr. Jackson, the Director of the GECC, testified as to how the Center carries out the regulatory scheme through the COC program:

First, a vehicle producer must register with the Agency as a "manufacturer." CX 12; Tr. at 52.

Second, the manufacturer is required to identify and group its engines and vehicles into "engine families," *i.e.*, engines and vehicles that share the same catalysts, combustion cycle, fuel, and general design. CX 12; Tr. at 54. With regard to catalysts, an engine family must share the same "number, location, volume, and composition of catalytic converters."[18] CX 12 at EPA-000369; Tr. at 60.

Third, the manufacturer is required to subject its engine families to emissions testing to demonstrate and document that the engine as designed complies with CAA emissions standards. CX 12; Tr. at 55. The manufacturer tests at a low-hour point, then continues "to test at least four different test points over the course of the testing of the product" until reaching the end of the engine's "useful life." Tr. at 61. An engine's regulatory useful life "is the period of time over which that product must be compliant with the emission standards." Tr. at 63. Once full useful life compliance has been determined, the manufacturer is able to calculate a "deterioration factor" for the engine. Tr. at 61. A deterioration factor "is a ratio of end-of-life performance to low-hour life emissions performance" that allows a manufacturer "to demonstrate compliance

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[17] Agency regulations establish the precise methods and procedures for compliance testing and issuing COCs under the Clean Air Act for various types of vehicles and/or engines. *See* 42 U.S.C. § 7525(d); 40 C.F.R. Part 86, subparts E and F (motorcycles); 40 C.F.R. Parts 1051 and 1068 (all-terrain vehicles and off-road motorcycles).

[18] As explained in detail in the AD Order, catalytic converters reduce harmful emissions from vehicle exhaust caused by gasoline combustion. Their key active components are precious metals such as platinum (Pt), palladium (Pd), and rhodium (Rh), which are incorporated into a washcoat that covers a metal substrate, i.e., a honeycomb-matrix monolith, that is placed in steel housing. Different combinations of precious metals and other materials that may be used in the construction of a catalytic converter produce different chemical reactions and different rates of reaction, and the catalytic converter's design and composition determine its performance and longevity. The only reliable way to determine the emission rate of a given catalytic converter is through useful life testing of its performance in a given situation. AD Order at 8-9.

with simply using this mathematical expression and in the case of a catalyst providing a multiplicative factor in combination with a low-hour test result to determine an end-of-life report, end-of-life result." Tr. at 61. Significantly, the deterioration factor "must be developed on the product that is . . . materially similar to the product for which it's being applied." Tr. at 51-52.

Fourth, once it has obtained the necessary emissions data from testing, the manufacturer prepares its COC application, pays the certification fee, and submits the application to EPA to initiate the review process. *See e.g.*, CX 1-CX 10; *see also* CX 12; CX 15; Tr. at 55-56, 73-74. The COC application requires the manufacturer to provide certain specific information on the engine and to assure that such information is accurate and complete. CX 12 at EPA-000373; CX 15 at 000405; Tr. at 64, 73-74. As part of the application, the Agency "specifically request[s] at the outset a detailed description of the catalytic converters, the type, number, location, arrangement, volume, and composition . . . ." CX 13 at EPA-000393; *see also* CX 14 at EPA-000400; Tr. at 68. Guidance on providing such details is accessible to the regulated community through documents that are available on the Agency's website. CX 13; CX 14; CX 15; Tr. at 67-70, 72.

Next, based on data provided in the COC application, the Agency "assess[es] whether or not [it] believe[s] the engine as designed with the catalysts as described would actually be compliant [with CAA emissions requirements] over the full useful life of the product." Tr. at 114. Mr. Jackson explained that although the Agency sets emissions standards and limitations, manufacturers "are free to design their products using the technology they deem appropriate and cost effective for their market." Tr. at 74. That is, the regulations set performance limits but not design specifications, so as part of the certification process the Agency must be able to "review those design specifications [chosen by the manufacturer] to ensure . . . those design specifications will meet the [performance] standards over their useful life [before] we can issue a certificate of conformity." Tr. at 75. Indeed, he stated, a manufacturer's stated design specifications "are critical to how our compliance program functions. It's important for us to know that the design specifications provided by the manufacturer are in fact consistent with the production specifications." Tr. at 75.

GECC staff take a "multi-tiered approach" to the review of COC applications. Tr. at 116. There is an initial application review for accuracy and completeness. Tr. at 116. After that, the application is passed to an engineer for a more detailed, technical review. Tr. at 116. In addition, from time to time, Mr. Jackson will himself "spot-check" applications following review by his staff. Tr. at 116.

Mr. Jackson averred that "the Agency relies on the information provided by the manufacturer to assess whether or not the technology that the manufacturer has chosen will be compliant over the course of the useful life of a given product." Tr. at 65. "That is the basis by which [the Agency] make[s] decisions . . . on whether or not [the Agency] ought to test the product and subsequently whether or not [the Agency] ought to issue a certificate of conformity." Tr. at 65. *See also* Tr. at 109 ("[W]e take everything the manufacturer tells us as being what the manufacturer intends to tell us. We assume that it's accurate. We take it at face value."); Tr. at 116-17 ("The fundamental assumption that we make is that the manufacturer is being honest with us about their design, about their testing, about the compliance of their test facilities, and about the fact that their production will match what they've told us in the

application."). Consequently, if design information in a COC application is wrong or incomplete, Mr. Jackson explained, "[i]t would render our assessments inaccurate if in fact the design information did not match the production information. The Agency would be testing and making assessments based on a different product. We would have no way of knowing how that particular product would perform throughout its useful life." Tr. at 76; *see also* Tr. at 78 ("[T]he harm to the program would be such that [EPA] would not be able to make a determination, an accurate determination about full useful life compliance. It would be a different product altogether.").

In both pre- and post-certification settings, the GECC may engage in engine testing. Tr. at 45-46. If the Agency saw something "anomalous" about the catalyst description in the COC application, it could create concern such that the Agency might issue a test order for the engine before issuing the COC, Mr. Jackson advised. Tr. at 115. Before certification, the Center may order an engine be tested under low-hour conditions to confirm it is compliant with emission standards as claimed by the manufacturer. Tr. at 45.

Lastly, only *after* the Agency has evaluated the application *and* issued a COC for a product model year does the manufacturer "begin to build their products consistent with the certificate of conformity they receive. And so if a manufacturer builds a product, it should match that certificate of conformity. It must be identical in all material respects." Tr. at 56. This is crucial because a COC serves as the "license to produce products for sale in the United States of America." Tr. at 86. The document "identifies the engine family for which this permission has been granted. It identifies the applicable regulations associated with both the exhaust and evaporative standards. It also identifies the vehicle category, fuel type, engine type as well as key emissions-related components, including air injection and the presence of a catalyst." Tr. at 86; *see also* CX 43-CX 52. A COC "covers only those vehicles which conform in all material respects to the design specifications that apply to those vehicles described in the documentation required by [the regulations], and are produced during the model year production period stated on the certificate, as defined in [the regulations]." Tr. at 91, 200-01; *see also* CX 43-CX 52. COCs further identify the key emission components of the covered engines and the duration of useful lives for which the covered engines must comply with emissions standards. Tr. at 91-92; *see also* CX 43-CX 52. The COCs also themselves expressly state that they cover "only those vehicles which conform in all material respects to the design specifications that apply to those vehicles described" in their corresponding COC applications, and that "are produced during the model year production period stated on the [COC]." Tr. at 92-93, 101-102; *see also* CX 43-CX 52. Mr. Jackson testified that generally manufacturers engage in quality control processes to ensure production consistency, both internally and externally with their supplier base. Tr. at 65. This may occur as often as every quarter. Tr. at 66.

After a COC has been issued, the Center may request testing of a production vehicle that has already been manufactured or one that is already on the market or in use. Tr. at 46-47. A production vehicle test order also typically involves low-hour testing. Tr. at 47. Because these tests are conducted at low-hour test points, wrong or misleading information on a COC application prevents the Agency from determining the full useful life performance of a vehicle or engine. "There would be irreparable harm, and the only way, if we were to determine that their production vehicle somehow was different from the certification vehicle, it would require the Agency to test almost every production vehicle to ensure that it was compliant at multiple points

throughout its useful life." Tr. at 77. However, Mr. Jackson added, "[t]hat's not practical from an Agency perspective nor is it feasible for manufacturers, for the industry." Tr. at 77.

III. FACTUAL BACKGROUND

There are three Respondents in this case: Taotao China and Jinyun, the manufacturers of the subject vehicles, and Taotao USA, the importer of the 109,964 vehicles into the United States.

Taotao China is a corporation organized under the laws of the People's Republic of China and is located at No. 6 Xinmin Road, Jinyun County, Lishui City, Zhejiang, China. Am. Compl., ¶ 6; Resp'ts Am. Answers, ¶ 6. The company, founded in 1985, has 2,000 employees, 200 staff members, and owns multiple subsidiary companies. Its main products include ATVs, motorcycles, electric vehicles, electric bicycles, wooden doors, steel doors, running machines, fitness equipment, and garden tools. *See, e.g.*, CX 35 at EPA-000607; CX 168 at EPA-002297; CX 191 at EPA-002520. As recently as October 11, 2016, Taotao China boasted an annual sales volume of more than $80 million. CX 168 at EPA-002296. Taotao China manufactured the vehicles identified in Counts 1 through 4 of the Complaint. CX 1-CX 4; Tr. at 308.

Jinyun is one of six subsidiary corporations owned by Taotao China. CX 35; CX 168 at EPA-002296; CX 191 at EPA-002522; CX 216 at 105; Tr. at 639, 695. It is also organized under the laws of the People's Republic of China and is located at Xinbi Industrial Zone, Xinbi Town, Jinyun County, Zhejiang, China. Am. Compl., ¶ 5; Resp'ts Am. Answers, ¶ 5. Jinyun manufactures nonroad recreational vehicles. Am. Compl., ¶ 10; Resp'ts Am. Answers, ¶ 10. Jinyun manufactured the vehicles identified in Counts 5 through 10 of the Complaint. CX 5-CX 10; Tr. at 308.

Taotao USA is a corporation organized under the laws of the State of Texas with an office located at 2201 Luna Road, Carrollton, Texas. Am. Compl., ¶ 4; Resp'ts Am. Answers, ¶ 4. Taotao USA imports into the United States highway motorcycles manufactured by Taotao China and nonroad recreational vehicles manufactured by Jinyun. Am. Compl., ¶ 10; Resp'ts Am. Answers, ¶ 10. Indeed, Taotao USA is the exclusive U.S. importer of vehicles manufactured by Taotao China and Jinyun, and it sells those vehicles to dealers throughout the United States. CX 95 at EPA-001212-13; CX 216 at 10-11, 25-30, 44, 46; CX 1 at EPA-000018; CX 5 at EPA-000171; Tr. at 308. Taotao USA does not purchase vehicles from any suppliers other than Taotao China and Jinyun. CX 216 at 45-46. Taotao USA imported all of the 109,964 vehicles in the Amended Complaint. Am. Compl. ¶¶ 45, 55, 65, 74, 84, 94, 104, 114, 122, 130; Resp'ts Am. Answers, ¶¶ 45, 55, 65, 74, 84, 94, 104, 114, 122, 130. According to Mr. Jackson, for the classes of products Respondents make and sell in the United States, based on production data they and other industry manufacturers have provided to the Agency, they are "the number [redacted] from a production volume perspective" in [redacted], and "[l]ast year [2016] they [were] number [redacted], and they're in the top [redacted] for production volume." Tr. at 96-97; *see also* 40 C.F.R. § 86.419-2006(b)(1) (providing for the division of motorcycles into classes based on engine displacement).

The three Respondents are among a number of related companies owned and controlled by Yuejin Cao and Matao "Terry" Cao, who are father and son respectively. Specifically,

Yuejin Cao is the owner of Taotao China and the President of both Taotao China and Jinyun. Am. Compl., ¶¶ 14-15; Resp'ts Am. Answers, ¶¶ 14-15; Tr. at 100, 155; CX 216 at 105. Matao Cao is the owner of Taotao USA and has been the President and registered agent for that company. Am. Compl., ¶¶ 12-13; Resp'ts Am. Answers, ¶¶ 12-13; Tr. at 100, 155; CX 73 at EPA-000869, 000885; CX 171 at EPA-002294; CX 191 at EPA-002522; CX 216 at 21-22, 89.

Prior to the violations at issue here, specifically on June 28, 2010, the Agency entered into an Administrative Settlement Agreement ("ASA") with Taotao USA in regard to the company committing 3,768 violations of 42 U.S.C. § 7522(a)(1).[19] Tr. at 598-99; CX 67. In that case, Taotao USA imported into the United States ATVs manufactured using emissions-related parts different from what was described in its COC applications. Specifically, the COCs stated the engines at issue had no adjustable parameters, but EPA inspectors determined the carburetors on those engines could be adjusted in ways that may affect emissions or engine performance during emissions testing or normal in-use operations.[20] Tr. at 600; CX 67 at EPA-000810-000812. Consequently, the ASA required a compliance plan for all new vehicles Taotao USA imported thereafter. CX 67 at EPA-000815, 000824-000846. The plan called for, among other things, pre-import catalyst testing on representative new model year vehicles and inspections to ensure the vehicles were built according to design specifications described in COC applications. Tr. at 601, 603-04; CX 67 at EPA-000830. Ms. Isin assisted in drafting the ASA, and Matao Cao signed it on behalf of Taotao USA. CX 67; Tr. at 599, 710-11. The purpose of the plan was to provide detailed instructions "to get Taotao USA on track to compliance." Tr. at 603-04.

Despite entering into the ASA and continuing discussions with the Agency thereafter, Taotao USA was unable to satisfy the compliance plan and catalyst-testing requirements set forth in the agreement. *See* CX 69-CX 74; CX 76-CX 81; CX 215; Tr. at 605-617, 622-24, 627-29, 743-44, 746-48, 750-51, 754. Between 2011 and 2012, Taotao USA submitted 14 pre-import catalyst test reports – fewer than required – and seven of those reports appeared to contain test results from catalysts taken from different vehicles than the reports claimed.[21] CX 73; CX 215; Tr. at 613, 616, 618-22, 735, 741-43. On another occasion, Taotao USA provided the Agency with three *post*-import catalyst test results, rather than the required pre-import tests, and one of the three catalytic converters tested was revealed to have precious metal ratios different from what was described in the corresponding COC. CX 4; CX 77; Tr. at 625-26, 816-18, 821, 823. Ultimately, Taotao USA was penalized for violating the ASA in 2012. CX 74; Tr. at 622, 745. Upon paying that penalty, Taotao USA agreed to hire an engineer to help it meet its compliance obligations. Tr. at 815-16. It hired a consulting firm that helped it create an Agency-approved

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[19] Those violations did not involve vehicles that are identified in the Amended Complaint. *See* CX 67; Tr. at 808.

[20] Carburetors introduce the fuel-air mixture into an engine's combustion chamber, and adjustable parameters allow the fuel to air ratio to be changed in ways that affect emissions. CX 67 at 000811; Tr. at 135, 141.

[21] For example, in one instance, Respondents tested vehicles from one model year and used the results to represent engine families from a different model year. CX 215; Tr. at 616, 619-622, 732-35, 741-42.

testing plan for some of its engines. RX 10 at 1-2; Tr. at 816. Even so, Taotao USA offered only three catalytic converter test reports in 2012, and none in 2013, 2014, or 2015. CX 69-CX 70; CX 72-CX 74; CX 78; CX 81; Tr. at 625-26, 630-31, 751-54.

In light of the fact that Taotao USA is a high-volume importer, the Agency and U.S. Customs and Border Protection in March 2012 began warehouse and port inspections of vehicles Taotao USA was importing and removing their catalysts for analysis. *See, e.g.*, CX 61; CX 64; CX 81; Tr. at 631, 717-721. Based on the inspections and catalyst analyses, in December 2013 the Agency sent to all three Respondents a Notice of Violation that 64,377 vehicles they had manufactured and imported into the United States from eight engine families were in violation of the CAA because their catalytic converters did not contain the concentration or ratio of precious metals as described in their corresponding COC applications.[22] CX 92; Tr. at 589. This discrepancy was of no small weight: The certification program "relies heavily on the truth and accuracy of the manufacturer's description of . . . the vehicle and engine that they plan to build," Ms. Isin testified. Tr. at 546. Manufacturers describe their vehicle and engine in the application for certification, which is "accompanied by emissions test data relating to that vehicle or engine, showing that it meets applicable federal emission standards." Tr. at 546. The Agency has no way of knowing how a vehicle or engine should be built other than the COC application. Tr. at 551.

In February 2014, the Agency ordered Respondents to test vehicles from the eight violating engine families. CX 94; Tr. at 591-92. After back-and-forth negotiations, the Agency accepted Respondents' plan to hire California Environmental Engineering, LLC ("CEE") to conduct "low-hour" emissions testing on 24 vehicles from the eight identified engine families.[23] CX 98; Tr. at 592-93. The Agency agreed to settle for low-hour testing based on the scope and cost to Respondents of such tests. Tr. at 593. CEE conducted the testing between May 2014 and October 2014, and all but one of the vehicles was found to be emissions-compliant at the low-hour mark. CX 99-CX 122; Tr. at 593, 831.

At hearing, the Agency introduced evidence to suggest that the low-hour results should not indicate the vehicles would remain emissions-compliant through the end of their useful life. By way of example, the Agency pointed to the engine family that is the subject of Count 4. In the COC application for that engine family, Respondents offered emissions test data from a vehicle representative of that engine family. CX 4 at EPA-000136-000150; Tr. at 117-18. According to Respondents' COC application, the representative vehicle was tested to its full useful life at 6,000 kilometers. CX 4 at EPA-000137; Tr. at 118-19. From the emissions data collected over the course of a full useful life test, a deterioration factor could be calculated. Tr. at 120. The deterioration factor may then be applied to low-hour test results to determine a

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[22] In this case, Taotao USA was the importer and served as the COC applicant and COC holder for Respondents. Tr. at 105; CX 1-CX 10. Taotao China and Jinyun are the original manufacturers listed in each application. Tr. at 105-06; CX 1-CX 10. Matao Cao signed the COC applications on behalf of Taotao USA as the applicant, and Yuejin Cao signed the COC applications on behalf of Taotao China and Jinyun as the original manufacturers. Tr. at 106-07, 219, 224; CX 1-CX 10.

[23] The Agency does not "approve" laboratories that do emissions-related work but does audit them at times. Tr. at 359.

vehicle's "full useful life performance without testing that particular vehicle to full useful life." Tr. at 121. Because deterioration factors are applicable to only one product as designed, a deterioration factor obtained from one engine cannot be applied to an engine with a different catalyst or different configuration. Tr. at 122, 134. In the low hour testing performed by CEE, the laboratory applied the deterioration factor that Respondents provided in their COC applications regarding the representative vehicle to obtain a full useful life emissions result for the post-import tested vehicle. *See, e.g.*, CX 110 at EPA-001477-001482, 001488, 001495; Tr. at 123-131. However, for the deterioration factor obtained from Respondents' COC application to be reliable, "[w]e would want to know that the engine that was used for this [tested] vehicle was the same, had the same control strategy, you would want to know that the exhaust system was the same, same catalyst, same precious metal loading, et cetera," as the representative vehicle, Mr. Jackson testified. Tr. at 133. And as he noted in his testimony about the CEE test report, the "useful life emissions information here is not based on actual testing to full useful life, but based on the application of a deterioration factor. However . . . my math comes up with a different number than what is provided in the table for the full useful life emissions." Tr. at 130.

More significantly, following the emissions testing at CEE, 23 of the 24 vehicles' catalytic converters were then sent to SGS Canada Inc. for analysis, which revealed that they all contained platinum, palladium, and rhodium in ratios *different* than described in their associated COC applications. AD Order at 12-13. Additionally, the testing showed that 20 of the catalytic converters did not have detectable concentrations of platinum, and 16 of the catalytic converters did not have detectable concentrations of rhodium. AD Order at 13. A catalyst with all three precious metals performs differently than a catalyst that is palladium only, Mr. Jackson testified: "[W]e would have concerns about its durability[,] about its full useful life. A palladium-only catalyst could potentially have very similar results as a palladium/platinum/rhodium catalyst at low-hour test points. However, a palladium-only catalyst may be subject to poisoning at higher useful life, at higher engine hours, engine mileage." Tr. at 136.

In March 2015, the Department of Justice ("DOJ") waived the $320,000 administrative penalty limitation on the Agency's authority to assess administrative penalties for Respondents' certification violations. AD Order at 18 n.25 (citing CX 26); *see also* 42 U.S.C. § 7524(c).

In November 2015, the Agency filed the original Complaint alleging CAA violations based on SGS catalyst testing of the eight engine families in Counts 1 through 8. The Agency conducted two additional inspections of Respondents' vehicle shipments in December 2015 and February 2016. AD Order at 13-14; CX 140; CX 148. Those shipments included vehicles from the engine families that are the subjects of Counts 9 and 10 of the Amended Complaint, and further testing of those vehicles' catalytic converters also revealed precious metal concentrations that were either not detectable or that were in quantities and ratios that did not match the engines' corresponding to Respondents' COC applications. AD Order at 13-14.

Shortly before the Agency filed its Amended Complaint in June 2016, the DOJ provided a second waiver of the penalty limitation for an additional 1,681 vehicles – those in Counts 9 and 10. CX 28. The waiver also applied to potential additional violations that may occur in the future so long as such future violations were "substantially similar to those covered under the waivers already issued to date, and do not cause the total number of waived vehicles in the matter to exceed 125,000." CX 28 at EPA-000546.

The Agency filed its Amended Complaint to account for the vehicles represented in these additional inspections in June 2016. In all, Taotao USA imported 109,964 vehicles manufactured by Taotao China and Jinyun that contained catalytic converters that did not match the COCs issued for the vehicles. AD Order at 8-14, 31. The vehicles were identified by their engine families and by Respondents in their production reports and responses to the Agency's information requests. Tr. at 714. The approximate value of these 109,964 vehicles was $[redacted].[24] CX 61; CX 64; CX 140; CX 148; CX 183-CX 189; Tr. at 565-68.

Upon Motion granted on May 3, 2017, Respondents were found liable for the violations alleged in the Amended Complaint. The facts in this case, as they relate to liability, were previously recounted in detail in the AD Order[25] and in subsequent orders.[26] In brief, Respondents manufactured and imported into the United States 109,964 highway motorcycles and nonroad recreational vehicles, such as dirt bikes and all-terrain vehicles, that were not covered by COCs as required under the CAA. Specifically, the COCs the Agency issued for Respondents' vehicles, at their request, did not cover the vehicles they *actually* manufactured and imported, because the catalytic converters in those vehicles were not the same in volume and composition as those described in the COC applications and authorized by the Agency. Thus, the vehicles and engines Respondents manufactured and imported did not "conform, in all material respects, to the design specifications that applied to those vehicles described" in their COC applications. *See, e.g.*, CX 1-CX 10; CX 43-CX 52; CX 63 at EPA-000724; CX 66 at EPA-000806; CX 86 at EPA-001003; CX 89 at EPA-001089, 1091, 1093, 1095, 1097, 1099; CX 99 at EPA-001240; CX 100 at EPA-001262; CX 101 at EPA-001284; CX 102 at EPA-001308; CX 103 at EPA-001327; CX 104 at EPA-001352; CX 105 at EPA-001371; CX 106 at EPA-001395; CX 107 at EPA-001414; CX 108 at EPA-001436; CX 109 at EPA-001455; CX 110 at EPA-001478; CX 111 at EPA-001497; CX 113 at EPA-001538; CX 114 at EPA-001560; CX 115 at EPA-001579; CX 116 at EPA-001601; CX 117 at EPA-001618; CX 118 at EPA-001640; CX 119 at EPA-001657; CX 120 at EPA-001676; CX 121 at EPA-001693; CX 122 at EPA-001715; CX 125 at EPA-001752; CX 127 at EPA-001769; CX 129 at EPA-001786; CX 131 at EPA-001803; CX 132 at EPA-001818; CX 133 at EPA-001832; CX 144 at EPA-001931; CX 147 at EPA-001944; CX 152 at EPA-002004; CX 213; AD Order.

In May 2017, Mr. Jackson and other Agency staff conducted a selective enforcement audit of Respondents' vehicles at their production facility in China. Tr. at 143-44, 216, 222.

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[24] This is based on the declared value of the imports, *i.e.*, the price the importer paid for the goods it is importing, not the final retail value of the product. Tr. at 571. Ms. Isin calculated this amount after reviewing import paperwork for various vehicle models and multiplying the per unit price for each model by the number of models in this case. Tr. at 565, 571.

[25] Notably, prior to the Agency's Motion for Partial Accelerated Decision and this Tribunal's ruling on liability, the only evidence in the record in support of Respondents' arguments/defenses were Respondents' Exhibits 1 to 3, which they provided as part of their prehearing exchange. Respondents did not seek to introduce any additional evidence until after liability was established.

[26] *See also* Order on Respondents' Motion for Reconsideration or Interlocutory Appeal (June 15, 2017); Order Denying Respondents' Motion for Reconsideration of the Orders on Respondents' Motion in Limine and Respondents' Motion to Take Depositions (Sept. 8, 2017).

While there, the Agency delegation met with both Matao Cao and Yuejin Cao, as well as other employees. Tr. at 144, 148, 154-55. Respondents gave a presentation during their meeting that included information about Respondents' corporate structure and relations. The Caos stated that Respondents "were all related and that Mr. Yuejin Cao had the responsibility for the overall company, but that Mr. Matao Cao had specific responsibility for the U.S. entities."[27] Tr. at 155, 213-15, 367; *see also* CX 191 at EPA-002522-002523. Mr. Jackson and others also visited the production lines where the vehicles that Taotao USA imported were being produced. Tr. at 156-57. Respondents' representatives told Mr. Jackson they were in the process of building a new, larger production facility. Tr. at 157-58.

At some point after the prehearing exchange in this proceeding, counsel for Respondents apparently submitted documents to Agency counsel that purport to amend information about some of the catalytic converters in this case. The documents are unsigned and undated. *See* RX 26; Tr. at 351-57. To the extent these documents attempt to serve as a "running change" to the COC applications that correspond to the engine families they list, they cannot, according to Mr. Jackson. Manufacturers cannot make substantive changes, such as changes to catalyst formation, by amending a previously submitted application. Nor can a "running change" be made after the end of the model year. Tr. at 369-371.

As liability was previously determined through accelerated decision, the hearing in this matter and this Initial Decision focus on the appropriate penalty to be imposed for the violations found. Tr. at 7. The Agency's three witnesses testified about the regulatory program, calculation of the penalty, the nature of Respondents' business and their relationships to each other, and the Agency's assessment of Respondents' ability to pay the penalty. Respondents' witness testified about the economic benefit they received from their violations and, to a lesser extent, their ability to pay the penalty.

IV. PENALTY CRITERIA

In assessing an administrative penalty, this Tribunal's role is to decide matters in controversy based on a preponderance of the evidence[28] and to issue an initial decision containing a recommended civil penalty assessment. 40 C.F.R. §§ 22.24(b), 22.27; *John A. Biewer Co. of Toledo, Inc.*, 15 E.A.D. 772, 780 (EAB, 2013). The recommended penalty amount

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[27] The Agency delegation was accompanied by an interpreter from the U.S. State Department. Tr. at 206. According to Mr. Jackson, Matao Cao spoke English "very well," while Yuejin Cao spoke "some English." Tr. at 206. The presentation was mostly delivered in Chinese and translated into English by the State Department interpreter. At times, however, the Caos spoke in English. Tr. at 211-12, 366.

[28] To prevail under this standard, a party must demonstrate that the facts the party seeks to establish are more likely than not to be true. *See, e.g.*, *Smith Farm Enterprises, LLC*, 15 E.A.D., CWA Appeal No. 08-02, 2011 EPA App. LEXIS 10, at *14 (EAB, Mar. 16, 2011) ("A factual determination meets the preponderance of the evidence standard if the fact finder concludes that it is more likely true than not.") (citing *Julie's Limousine & Coachworks, Inc.*, 11 E.A.D. 498, 507 n.20 (EAB 2002), aff'd, No. Civ-02-907, 2004 WL 1278523 (D. Minn. June 7, 2004), aff'd, 406 F.3d 981 (8th Cir. 2005); and *Bullen Cos., Inc.*, 9 E.A.D. 620, 632 (EAB 2001)).

is to be determined based on evidence in the record and in accordance with statutory authority. 40 C.F.R. § 22.27(b); *Biewer*, 15 E.A.D. at 780. The CAA authorizes the Agency to assess an administrative penalty of up to $37,500 *per vehicle or engine*, against any person who sells or imports into the United States highway motorcycles or recreational vehicles not covered by a COC.[29] 42 U.S.C. §§ 7522(a)(1), 7524(a), (c)(1), 7547(d); 40 C.F.R. § 19.4, 40 C.F.R. § 1068.101(a)(1); *see also Peace Industry Group (USA) Inc., et al.*, CAA Appeal No. 16-01, 2016 EPA App. LEXIS 56, at *8 (EAB, Dec. 22, 2016). In determining the penalty amount, the Act requires the following seven factors be taken into account: (1) the economic benefit or savings resulting from the violation; (2) the gravity of the violation; (3) actions taken to remedy the violation; (4) the size of the violator's business; (5) the violator's history of compliance; (6) effect of the penalty on the violator's ability to continue in business; and (7) other matters as justice may require.[30] 42 U.S.C. § 7524(c)(2).

In addition, the Agency has published civil penalty guidance under the CAA in the form of the Clean Air Act Mobile Source Civil Penalty Policy (January 2009) ("Penalty Policy"). CX 22; Tr. at 553-55. As such, in assessing the penalty, this Tribunal is required by the applicable rules of procedure to consider such guidance. *Biewer*, 15 E.A.D. at 780 (quoting 40 C.F.R. § 22.27(b)). However, this Tribunal is not obligated to follow the penalty guidance or to impose the Agency's recommended penalty calculated thereunder. *Id.* Rather, in determining the appropriate penalty in this case I am authorized to depart therefrom with explanation and am only ultimately constrained by the statutory penalty criteria and any statutory cap limiting the size of the assessible penalty. *In re U. S. Army*, 11 E.A.D. 126, 137, 170 (EAB 2003); *M.A. Bruder & Sons, Inc.*, 10 E.A.D. 598, 610 (EAB 2002).

V. THE PARTIES' PENALTY ARGUMENTS

The Agency utilized the Penalty Policy as a framework for calculating the penalties it proposed in this case. In determining the appropriate penalty, the Penalty Policy first calls for calculation of a "preliminary deterrence amount" by adding together an "economic benefit penalty component" and a "gravity penalty component." CX 22 at EPA-000457; *see also Peace Industry Group*, 2016 EPA App. LEXIS at *17. The economic benefit component "recovers the economic benefit of noncompliance," while the gravity component "reflects the seriousness of the violation." CX 22 at EPA-000457-000458. The Penalty Policy then authorizes the Agency to apply several factors to adjust the preliminary deterrence amount up or down. *See* CX 22 at EPA-000457; *Peace Industry Group*, 2016 EPA App. LEXIS at *17. As such, the Agency took into account (i) Respondents' economic benefit from the violations, (ii) the gravity of their violations, (iii) adjustments that are appropriate to the facts of this case, and (iv) Respondents'

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[29] Section 4 of the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, requires EPA to adjust the statutory maximum to reflect inflation. *See* 31 U.S.C. § 3701 note; 28 U.S.C. § 2461 note; 40 C.F.R. § 19.4 (containing updated statutory maximums based on inflation); *see also* CX 23 (2013 inflation policy); CX 24 (2016 inflation policy). The proposed penalty in this matter was increased in accordance with the Agency's inflation policies. Tr. at 600-01.

[30] These factors, and the terms and phrases used therein, are not defined in the CAA. 42 U.S.C. § 7550 (Definitions).

ability to pay. There were no other matters for which justice required further consideration, according to the Agency.

Following that guidance, the Agency initially sought a penalty of $3,295,556.32. CX 160. After various revisions prior to hearing, the Agency cut the total proposed penalty it was requesting by more than half, to $1,601,149.95,[31] when it accepted an economic benefit calculation proposed by Respondents' expert witness. CX 213; Complainant's Motion for Leave to Reduce the Proposed Penalty (Oct. 9, 2017); Tr. at 683-84.

Of the total proposed penalty, the Agency alleges that between them the Respondents are jointly and severally responsible for varying amounts based on their different importing and manufacturing roles. Thus, as the sole importer of all of the vehicles at issue, the Agency contends that Taotao USA is responsible for the entire penalty. Of that total, the Agency holds Taotao China jointly and severally liable with Taotao USA for $225,473.50 based on its manufacture of all of the vehicles in Counts 1 through 4. Meanwhile, the Agency calculates Jinyun is jointly and severally liable with Taotao USA for $1,375,676.45 of the total penalty because it manufactured all of the vehicles in Counts 5 through 10.[32] CX 213.

Respondents assert that the proposed penalty is "unreasonable, arbitrary, and exceeds the Act's jurisdictional limits." RB at 2.[33] As such, they argue that the Agency is barred from recovering "any penalty in this action." RB at 3. More specifically, Respondents challenge the Agency's use of the Penalty Policy as a framework for determining the penalty, stating that this case involves "unique facts and circumstances" demanding a departure therefrom. RRB at 1. Even if use of the Penalty Policy is appropriate, they argue that the Agency did not correctly follow it. RRB at 2.

As this Tribunal is required to consider both the statutorily enumerated penalty factors and the Agency's Penalty Policy, I have considered both the Agency's penalty analysis under the Penalty Policy and Respondents' challenges thereto as appropriate. Any arguments raised by the parties but not expressly addressed in this Initial Decision were considered and rejected as without merit.

A. Economic Benefit

In determining the penalty under the CAA, I am required to take into account "the economic benefit or savings resulting from the violation." 42 U.S.C. § 7524(c)(2). The Penalty Policy breaks down economic benefit into three categories: delayed costs, avoided costs, and

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[31] The total proposed penalty averages just under $15 for each of the 109,964 vehicles found in violation. Tr. at 683.

[32] As indicated below, this Initial Decision departs slightly from the proposed penalty allocation between Taotao China and Jinyun but not from the overall proposed penalty. *See infra* p. 50 and n.54.

[33] As indicated in note 11, Respondent's Initial Post Hearing Brief is found as Attachment B to Respondent's Motion for Leave for Filing Post Hearing Brief, submitted December 26, 2017.

benefit from competitive advantage gained as a result of the violation. CX 22 at EPA-000458. Delayed costs refer to the "ability to delay making the expenditures necessary to achieve compliance" and may involve recurring capital expenses or one-time non-depreciable costs. CX 22 at EPA-000458. Avoided costs "enable a violator to avoid certain costs associated with compliance" and include "[f]ailure to install pollution control devices on vehicles or engines, which normally result in uncertified vehicles or engines," or "importing uncertified, instead of certified, vehicles or engines into the United States." CX 22 at EPA-000460. Finally, the Penalty Policy seeks to redress any competitive advantage a violator obtained in the marketplace through its noncompliance because other companies complied with vehicle emissions laws and regulations. CX 22 at EPA-000461. This may be based on the violator's net profits from improper transactions, such as profits from the sale of uncertified engines versus certified engines. CX 22 at EPA-000461. In a situation where an imported engine cost less to produce because it was manufactured with a non-compliant catalyst, "the cost of purchasing and installing [a compliant] catalytic converter may be used to approximate the violator's economic benefit from the introduction into commerce or importation of the uncertified engine." CX 22 at EPA-000462.

Evidence of Respondents' economic benefit was provided primarily by Respondents' expert witness, Jonathan S. Shefftz. Mr. Shefftz was qualified as an expert economist and an expert in the economic benefit component of the Penalty Policy. Tr. at 861, 863. Mr. Shefftz calculated four different economic benefit scenarios that might apply to this case. Tr. at 692, 864; RX 1.

In the first scenario, Mr. Shefftz assumed the violations could have been avoided if Respondents had simply taken the added administrative step of ensuring that the precious metal content represented for those engines in the COC applications matched the precious metal content of the engines in the vehicles actually manufactured, imported, and sold. This would require additional costs for staffing, consultants, and engineers to ensure the Respondents' COC applications accurately reflected the true precious metal composition of their catalytic converters. Tr. at 866-68, 891-93; RX 1 at 14. That is, assuming the catalytic converters in this case were not changed, what additional costs would have been required to ensure the COCs accurately described the engines? Tr. at 896. "This is not something that could have been done costlessly, but some additional level of effort and oversight, supervision, testing, et cetera, would have been necessary to ensure that the COCs match up with the catalytic converters, even if the catalytic converters were to have physically remained the same," he testified. Tr. at 867. Mr. Shefftz determined that cost to be $104,961 (with $64,493 attributed to Counts 1-4 and $40,468 attributed to Counts 5-10). RX 1 at 21. He did not consider the costs of additional testing that would be needed for compliance. Tr. at 898.

In the second, third, and fourth scenarios, Mr. Shefftz assumed the Respondents' COC applications as approved by the Agency remained the same, but the catalytic converters the Respondents used were changed in certain ways. Further, these calculations subsumed the first scenario costs based on the notion "that it wasn't just a matter of having different precious metals compositions in the catalytic converters, but ensuring that those compositions matched up with the COCs." Tr. at 868, 896-97. Thus, the first scenario's fiscal calculation serves as a proxy for the minimum overhead costs that would be required in scenarios two, three, and four as well to assure compliance with the CAA. Tr. at 897-98. Mr. Shefftz indicated he considered the costs of additional staffing, even though it was contrary to the financial interest of his clients,

the Respondents, because it was "more comprehensive" and "the most accurate approach that I felt was justified here." Tr. at 898. He also noted that in reality, the staffing costs required to correctly fill out COC applications as envisioned in the first scenario would be "slightly different" than the staffing costs required to ensure that the engines were themselves compliant. Tr. at 896-97. Presumably the staffing costs for scenarios two through four would have been higher because they would involve engine testing, which Mr. Shefftz "conceptually" considered, "but I did not have any information at the time on what those tests – or what the tests that had been performed did cost, and what additional tests would have cost," he added. Tr. at 898.

In scenarios two and three, Mr. Shefftz calculated the cost of Respondents "paying more to their catalytic converters supplier for higher precious metals contents (i.e., so as to match the COC specification) as approved by the Agency." RX 1 at 15; *see also* Tr. at 869-70. For each engine family, he then compared the actual precious metal content of the catalytic converters as revealed by post-import testing to the precious metal content claimed in Respondents' COC applications and calculated the cost of purchasing additional precious metals to match the COC numbers. RX 1 at 15; Tr. at 869-70. In Mr. Shefftz's second scenario, where in some engines testing revealed surpluses of one precious metal and shortfalls of another, he allowed the surpluses to offset the shortfalls in his cost calculations. He then determined the economic benefit remained at $64,493 for Counts 1-4 and added up to $129,843 for Counts 5-10, yielding a total benefit of $194,336. RX 1 at 15-16, 21; Tr. at 869-70. In the third scenario, Mr. Shefftz did not allow any shortfalls to be offset by surpluses, and he calculated an economic benefit of $90,888 for Counts 1-4 and $129,843 for Counts 5-10, producing a total benefit of $220,731. RX 1 at 15, 17, 21; Tr. at 870-71.

In scenario four, rather than looking at the incremental cost of "building up metal by metal, gram by gram, or fraction thereof, a catalytic converter whose composition matched that of the COCs," Mr. Shefftz considered instead the net cost of Respondents simply buying catalytic converters that were compliant with the precious metals numbers claimed in the COCs. Tr. at 871; *see also* RX 1 at 18. To make these calculations, Mr. Shefftz relied on a spreadsheet that Respondents provided to him listing two columns of numbers "that appeared to be representing the cost for the actual catalytic converters that were used in the vehicles at issue in this case, and the cost for catalytic converters that would have met the COC compositions."[34] Tr. at 872. From those numbers, and factoring in exchange rates, Mr. Shefftz determined that there existed an economic benefit of $104,942 for Counts 1-4 and $114,357 for Counts 5-10 for a total of $219,299. Tr. at 872-74; RX 1 at 21.

Agency witness Amelie Isin also testified about the economic benefit calculation. Tr. at 541, 580. According to Ms. Isin, the economic benefit component of a penalty seeks to recover the economic advantage derived from the violations, including any competitive advantage, profit, or avoided costs gained as a result of the violations. Tr. at 580. In this case, Ms. Isin stated, Respondents' economic benefit was the avoided cost of catalyst testing and monitoring that should have been done, as well as the cost of using compliant catalytic converters. Tr. at 580-81. After receiving a copy of Mr. Shefftz's expert report, Ms. Isin testified the Agency

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[34] Mr. Shefftz conceded that "I really can't tell you anything about that spreadsheet because I don't know anything else about it[.]" Tr. at 872.

adopted the fourth scenario as the proper measure of Respondents' economic benefit, noting that it was "based on the cost – the difference in cost between compliant and non-compliant catalytic converters, as well as . . . four years of staff time for prevention of these types of violations." Tr. at 583-84. That scenario "most closely aligned to the penalty policy," Ms. Isin testified, because the "penalty policy actually specifically lays out how in catalytic converter cases you can use the cost of a compliant catalyst as a component of the economic benefit." Tr. at 584; *see also* CX 22 at EPA-000462.

1. Agency Argument

The Agency contends in its briefs that the fourth scenario of Mr. Shefftz's analysis is the proper measure of Respondents' economic benefit because it is based on the cost of purchasing conforming catalytic converters (and not merely the cost of missing constituent precious metals). AB at 6, 7. The Agency points out that when a violator introduces into commerce an engine without a catalytic converter, according to the Penalty Policy, "the cost of purchasing and installing the catalytic converter may be used to approximate the violator's economic benefit[.]" CX 22 at EPA-000462; AB at 6. The Agency asserts that because Mr. Shefftz's calculation takes into account these costs *plus* the cost of additional staffing to ensure compliance, it is "the most comprehensive and accurate approach to calculating Respondents' economic benefit in this matter based on available information consistent with the Penalty Policy[.]" AB at 7.

2. Respondents' Argument

Respondents declare in their Post-Hearing brief that they derived "no benefit" from the violations because they were "inadvertent" and correcting them "simply required accurately describing the design specifications in on [sic] the COC applications." RB at 4. As such, Respondents assert, if any amount of economic benefit were to be assessed against them, it should be no more than the cost of hiring additional staff for the relevant time period which would have ensured that COC applications were fully and accurately completed. RB at 5 (citing Tr. at 895). They suggest that their expert witness Mr. Shefftz estimated such staffing costs to be $105,000 (scenario one). RB at 5.

Furthermore, Respondents claim that the three additional economic benefit scenarios Mr. Shefftz provided relied on "facts that Complainant was unable to prove at the hearing." RB at 5 (citing RX 1 at 1-3). Specifically, they challenge as unsupported scenario four selected by EPA based upon the net present value of the cost of purchasing different catalytic converters that conform to the descriptions of composition in the COC applications as well as the net present value of additional staffing and/or consultants to ensure the installed catalysts matched the descriptions for them in their approved COCs. RB at 5. "Respondents did not have to purchase the catalytic converters with the precious metal concentrations described in the COC applications," they argue. RB at 5. In support they cite Mr. Jackson's testimony to the effect that manufacturers are free to set their own design standards so long as emissions standards are met. RB at 5 (citing Tr. at 74). Because liability was based on Respondents' catalytic converters not matching "the design specifications on the COC applications, and the evidence shows that all vehicles passed emission tests," according to Respondents, "there is no reason to hold that [they] needed to purchase catalytic converters with the precise precious metal concentrations specified on their COC applications ***and*** hire additional staff to ensure accurate reporting." RB at 5-6 (emphasis in original). Rather, "Respondents could either hire additional staff and correctly

report the actual catalytic converter design on their COC applications, ***or*** purchase catalytic converters that conformed to the design specifications as they were listed." RB at 6 (emphasis in original). That is, if Respondents had used catalytic converters with the certified specifications, they contend "there would be no avoided costs" related to additional staffing. RRB at 5. To that end, as an alternative to Mr. Shefftz's first scenario as the proper measurement of economic benefit based upon staffing costs, Respondents indicate in their brief that they would also accept the net cost of just using different catalytic converters – $114,000. RB at 6. In support they cite the provision of the Penalty Policy which suggests that where violations arise from missing or nonconforming catalysts, "'***the cost of purchasing and installing the catalytic converter***' is an appropriate measure of the violator's economic benefit." RRB at 5 (emphasis in original) (citing CX022 at EPA-000462).

The Agency has not shown why both costs (staffing and purchasing compliant converters) must be incurred, Respondents complain. RB at 6; RRB at 5-6. They note that Mr. Shefftz admitted at hearing that those scenarios represented a "more aggressive approach or a more upwardly-biased approach[ ]" to economic benefit. RRB at 5 (citing Tr. at 898). "Complainant cannot seek an economic benefit that is not supported by the facts, nor prescribed by the Penalty Policy, simply because it's a possible economic benefit provided by an expert," Respondents assert. RRB at 6.

3. Analysis

The fourth scenario Mr. Shefftz presented is the best measure of economic benefit available in this proceeding. In this scenario, Respondents' economic benefit includes the net cost of purchasing compliant catalytic converters from a different supplier using the figures provided on Respondents' spreadsheet *plus* the cost of having the necessary staffing, consultants, and engineers to ensure the catalysts they actually installed in their vehicles accurately represented what was in their COC applications. *See* RX 1 at 14, 18; Tr. at 866-68, 871, 891-93.

Respondents are wrong to claim that that both types of costs cannot be included in a calculation of economic benefit. It is true that Respondents could initially design their engines and draft the description thereof in their COC applications using whatever catalytic converters they wished and, assuming testing of representative vehicles showed full useful life compliance with U.S. emissions requirements, likely obtain COCs. However, once the COCs for their engines as described and purportedly tested were approved and issued by EPA, they were legally obliged to purchase and install in those engines catalytic converters matching the description in their COC applications or not import vehicles under those COCs. In this case, they purchased and installed converters with metals that did not match the application descriptions and were, in fact, cheaper by about $115,000. Still they imported and sold their vehicles under the COCs. Therefore, this actual economic benefit may be recovered by the government.

Moreover, once the COCs for their vehicles were issued, Respondents were *also* obliged to incur the cost of staffing, etc., to ensure that what they were actually purchasing and installing in their engines matched what was in their approved COC applications. Mr. Jackson testified that generally manufacturers engage in quality control processes to ensure production consistency, both internally and externally with their supplier base, as often as every quarter. Tr. at 65-66. It is clear from the facts here that, at least as to the catalytic converters, Respondents were not undertaking such quality control, or at least not undertaking it competently, and did not

do so over the course of many years.[35] They incurred a financial savings as a result and perhaps a competitive advantage as well. As such, this actual economic benefit may also be recovered by the government.

Respondents are in error when they suggest that merely recovering the cost of accurately describing in their COC applications the design specifications of the catalytic converters as actually installed would fully reflect their economic benefit. RB at 4. First, there is insufficient evidence that Respondents' vehicles, utilizing the design specifications as actually built, would meet emissions standards throughout their useful life and/or that a COC application that accurately described Respondents' catalysts would have been approved by the GECC. When CEE tested the vehicles, one was found not to be emissions-compliant even at the low-hour mark. CX 99-CX 122; Tr. at 593, 831. In addition, most of the catalytic converters installed in Respondents' vehicles contained only palladium, which Mr. Jackson testified would increase their likelihood of poisoning and make them less effective later in their useful lives. AD Order at 12-13; Tr. at 136. As such, it is pure speculation to assume that Respondents' COC applications would have been approved had they originally submitted accurate descriptions of their catalysts as actually installed, particularly given that an accurate description would raise questions about the long-term durability of said catalysts.

Further, Respondents are also in error when they suggest that merely purchasing compliant converters would reflect the total economic benefit of the violations. Respondents' own expert witness testified that, essentially as a baseline, Respondents avoided staffing and other costs needed to ensure their engines as installed accurately reflected those as approved in their COCs. *See* Tr. at 866-68, 891-93; RX 1 at 14. To know they were complying with the CAA, regardless of what converters they purchased, Respondents would have had to monitor and evaluate that the catalysts they were buying and installing on their engines to confirm the catalysts did in fact meet their claimed specifications. Although Mr. Shefftz calculated the cost of hiring an engineer on a part time basis and used this calculation as a broad proxy for compliance costs generally, his methodology and assumptions are acceptable based on the evidence available in this case. Undoubtedly, his staffing calculation is less than the costs Respondents actually avoided given that he did not also include the cost of testing that would be necessary for compliance. *See* Tr. at 896-98.

In sum, in scenario four, Mr. Shefftz presented clear calculations of the minimum economic benefit Respondents gained from their violative acts. First, they avoided the higher cost of purchasing catalytic converters which would have met the description in their previously approved COCs by instead purchasing and installing in their vehicles cheaper, nonconforming catalysts with lower precious metal content.[36] Second, they avoided the cost of not hiring

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[35] Mr. Jackson testified that even when he met with Respondents in China in May 2017, long after these alleged violations occurred, he was unable to determine "what level of detail quality review actually happened. There may have been some that happened periodically, but we did not get the impression that it was a quarterly review process." Tr. at 67.

[36] I find neither scenarios two nor three to be appropriate measure of economic benefit. Both of those scenarios calculate merely the difference in the cost of the raw precious metals contained in the converters described in the COCs and those actually installed in the vehicles to determine

engineers and other staff to ensure the catalytic converters they actually installed met the description of the same as set forth in their approved COCs or that the COCs submitted for approval accurately described what they intended to install in their vehicles. *Cf.* CX 22 at EPA-000462 (the cost of purchasing and installing a catalytic converter may be used to approximate the economic benefit of a violator who manufactures or imports an engine without a catalytic converter). Therefore, I find Respondents obtained an economic benefit from their violations in the amount of $219,299.

B. Gravity/Size of Business/Remedying Actions

In addition to economic benefit, under the statutory penalty factors I am required to also consider the "gravity of the violation," "actions taken to remedy the violation," as well as "the size of the violator's business" in assessing a penalty. 42 U.S.C. § 7524(c)(2). Using a multi-step formula, the Penalty Policy attempts to quantify the "gravity," or seriousness of a violation, incorporating consideration of those other two separate statutory penalty factors of remediation and business size. CX 22 at EPA-000465. The Policy states that "linking the dollar amount of the gravity component to objective factors is a useful way of ensuring that violations of approximately equal seriousness are treated similarly." CX 22 at EPA-000466.

The first step in the Policy's gravity calculations involves determining "Base Per-Vehicle or Per-Engine Penalty." CX 22 at EPA-000470. Such base amount is calculated by using company records in a "straightforward and objective manner" to determine the *horsepower* of each vehicle or engine in violation. CX 22 at EPA-000466, 470. The idea behind starting with the horsepower of an engine to determine gravity is that the engine's size is "proportional" to its "potential for *excess* emissions." CX 22 at EPA-000466 (italics in original). The Policy then contains a table (Table 1) which assigns a monetary sum in decreasing amounts as the incremental level of horsepower increases, e.g., assigning $80 per horsepower (hp) to the first 10 horsepower of the engine, $20/hp to the next 90 horsepower, $5/hp to the next 1000 horsepower, etc. It gives as an example a forklift powered by an uncertified 125 horsepower engine, where utilizing the base per-engine gravity penalty would be calculated as: $80 x (first) 10hp = $800, plus $20 x 90hp = $1,800, plus $5 x 25 = $125, for a total of $2,725. CX 22 at EPA-000470.

The second step is to characterize the "egregiousness" of the violation as either "major," "moderate," or "minor" based upon "the likelihood that the emissions from the vehicles or engines in violation may exceed certified levels or applicable standards." CX 22 at EPA-000467. A major violation is one "where excess emissions are likely to occur," such as in engines with defective catalytic converters. CX 22 at EPA-000467. A moderate violation involves "uncertified vehicles or engines where the emissions . . . are likely to be similar to

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economic savings. However, the cost difference in designing and manufacturing a catalytic converter containing more precious metals and/or all three precious metals, so as to be in compliance with the COCs and/or CAA, may involve more than merely purchasing the added precious metals themselves, as the metals are but one component in the converters. As the higher cost for purchasing compliant converters given in scenario four suggests, it may well be that compliant converters simply involve a more extensive manufacturing process, or there is such a market demand for such converters that they cost more than the mere difference in the value of the metals contained therein alone.

emissions from certified vehicles or engines." CX 22 at EPA-000467. Minor violations are those involving defective emissions control labels. CX 22 at EPA-000468. Once the violation is characterized, Table 2 identifies an "Adjustment Multiplier" for each egregiousness category, either 6.5 (major), 3.25 (moderate), or 1 (minor), against which the base penalty determined in step one is multiplied. CX 22 at EPA-000471. Using again the example of the forklift with an uncertified 125hp engine with a missing catalytic converter, a "major" violation, the base per-engine gravity penalty of $2,725 would be multiplied by 6.5 for egregiousness, giving an adjusted base per engine gravity penalty of $17,712.50. CX 22 at EPA-000471.

Step three involves "scaling" the adjusted base per engine penalty to reflect the total number of vehicles or engines in violation. CX 22 at EPA-000470. The Policy indicates that scaling is included because cases may range widely in terms of numbers and sizes of engines, and "in cases where the number of uncertified engines and/or engine size is very large" using the "same per-horsepower or per-engine gravity amount [as in smaller cases] may result in penalties that are inappropriately or unreasonably large, beyond what could reasonably be obtained in court." CX 22 at EPA-000469. Again, the Policy provides a reference table (Table 3) with a decreasing incremental scaling factors for increasing numbers of vehicles or engines. CX 22 at EPA-000470. For example, the scaling factor for 1-10 vehicles/engines is "1;" for 1001-10,000 vehicles/engines it is .008; and for over 100,001 vehicles, it is .00032. CX 22 at EPA-000472. The Policy states that the Agency has the discretion in scaling to sum all violations or to group violations, and re-start the scaling, depending on the facts. CX 22 at EPA-000472.

Step 4 of the Policy allows for the arranging of violations involving more than one size engine and/or more than one egregiousness category, with the largest adjusted base penalty being scaled first, using the scaling figures in Table 3.[37] CX 22 at EPA-000472.

Step 5 addresses the penalty factor of remediation. The Policy provides that penalties may be reduced for violators who act promptly to remedy any violation upon discovery of noncompliance. CX 22 at EPA-000468. For uncertified vehicles, remedial action may include exportation, destruction, or recall. CX 22 at EPA-000468. Alternatively, the gravity penalty component may be increased when no remedial action has been taken. CX 22 at EPA-000468. The Policy in fact permits up to a 30% upward adjustment of the "average" scaled, adjusted, per vehicle/engine gravity amount to reflect the lack of remediation in regard to those vehicles. CX 22 at EPA-000474. For example, if the forklift with an uncertified 125hp engine with a missing catalytic converter was not remediated before being sold into commerce within the United States, then an upward adjustment of 30% could be applied.

Step 6 provides for a further upward adjustment of the penalty to reflect the entire size of the violator's business as reflected by the company's net worth, or another appropriate basis, such as gross revenues or number of employees. CX 22 at EPA-000469. The Policy states that a violator's business size is relevant to determining whether a given penalty amount will be a sufficient deterrent against future violations. CX 22 at EPA-000469. Thus, a larger penalty is necessary to deter a larger company, while a smaller penalty may be sufficient to deter a smaller company. CX 22 at EPA-000469. The Policy provides in Table 4 figures for an incremental

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[37] To properly undertake the calculation, such an arrangement would need to be done prior to undertaking scaling in step 3. CX 22 at EPA-000472-73.

gravity component based on the size of the violator's business going from "none" for businesses worth under $50,000 to more than $70,000 (plus an additional "$25,000 for every additional $30 million or fraction thereof,") for businesses worth over $70 million. CX 22 at EPA-000475. The Policy states that with regard to parent and subsidiary operations, "only the violative entity should be considered, unless the case team determines that the parent company was involved with or directly oversaw the activities that gave rise to the violation." CX 22 at EPA-000475

1. Agency's Argument

The Agency states that it followed the Penalty Policy's multi-step formula in calculating the "gravity" of the violations in this case and that its calculations are appropriate. AB at 11 n.1; ARB at 3. In calculating the base per engine gravity penalty at Step 1, the Agency first determined, count by count, (with each count representing an engine family), the horsepower of the engines in the 109,964 total vehicles found in violation.[38] Tr. at 558-59; CX 213. The Agency then multiplied such horsepower amounts by the figures provided in Table 1 of the Policy, so for example each of the 17,665 vehicles in Count 1 with an average horsepower of 2.94 were each calculated to have a base per vehicle gravity penalty of $235.20 ($80 per horsepower x 2.94). CX 213 at EPA-002808. The total initial base penalty for the vehicles covered only by Count 1 at this step of the formula would total over $4 million dollars.

Next, at Step 2, the Agency assigned an egregiousness level to the violations. For Counts 1 through 8, the Agency assessed a "moderate" egregiousness level, giving them a multiplication factor of 3.25 on Table 2. CX 213. In reaching this determination, EPA said it took into account that CEE's emissions tests did not reveal excess emissions but that those results were obtained from only low-hour testing. Tr. at 559, 587. Although Respondents represented to the Agency that those low-hour results would accurately predict the "full use, full-life results" of its vehicles, Ms. Isin testified that she had "some concerns with the deterioration factor that they used because those deterioration factors were obtained from the application for certification, which our whole case is about how the vehicles that were built did not conform to those applications." Tr. at 587. For that reason, the Agency determined the violations were of moderate egregiousness "although I think one could make an argument that they would be major," Ms. Isin testified. Tr. at 588. She noted, however, that by labeling the egregiousness level as "moderate" instead of "major," the Agency "essentially cuts the gravity component in half." CX 22 at EPA-000471; Tr. at 596. Using the moderate egregious multiplier of 3.25 for the violations in Count 1 resulted in an adjusted base per-vehicle gravity penalty of $764.40 ($235.20 x 3.25) or, as I calculate out, a penalty that at this step would exceed $13.5 million for the vehicles in Count 1. *See* CX 213.

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[38] The horsepower in the ten engine families was determined to span from a low average of 2.94 to a high average of 8.37. CX 213. The Agency obtained the horsepower of the vehicles from Respondents' COC applications "because that's the best description of the vehicles and engines that EPA has." Tr. at 558, 586-87. If the COC application listed more than one power rating for a given engine family, the Agency used the average. Tr. at 558. Where the power rating was provided in kilowatts, the Agency converted to horsepower. Tr. at 558-59.

For Counts 9 and 10, which involve a relatively small number of vehicles found in violation (1,681), the Agency assessed a "major" egregiousness level, giving them an adjustment multiplier of 6.5 on Table 2, because the emissions of those vehicles were not tested. Tr. at 559, 588, 595, 767, 769-70; CX 213 at EPA-002810. Ms. Isin testified that the Agency did not order Respondents to conduct emissions testing for the vehicles in Counts 9 and 10 because they were discovered after the original Complaint was filed and testing "is a pretty lengthy process." Tr. at 595. However, the Agency would have considered any testing that Respondents voluntarily undertook and submitted, but none was. Tr. at 595, 835. Consequently, the Agency did not have any test data to suggest emissions would not exceed permissible levels. Further, according to Ms. Isin, "under the penalty policy, in cases where you're dealing with a certification violation of an emission-related part – in this case, the catalyst is the primary emission control device on these vehicles – it's appropriate to assess major egregiousness." Tr. at 588. Using a "major" egregious multiplier of 6.5 for the violations in these counts resulted in an adjusted base per-vehicle gravity penalty of $589.60. CX 213 at EPA-002810.

In this case, to account at Steps 3 and 4 for properly scaling the base penalties due to the number of vehicles in violation, the Agency arranged the base penalties from greatest to least and then multiplied the base penalty amounts by the scaling factors set forth in the Penalty Policy's Table 3. CX 22 at EPA-000472; CX 213; Tr. at 585. Thus, the Agency applied the scaling factors to the 108,283 vehicles in Counts 1 through 8, starting with the vehicles in Count 5, and then restarted the scaling for 1,681 vehicles in Counts 9 and 10. CX 213; Tr. at 585, 831-32. Consequently, there are "two sets of vehicles that have the highest per-vehicle penalty at full value" – the vehicles in Count 5 and the vehicles in Count 9. Tr. at 585; CX 213. The Agency grouped the vehicles this way because Counts 9 and 10 were discovered after the original Complaint was filed, and scaling is typically restarted when there are several model years and to reflect the longevity of violations, Ms. Isin testified. Tr. at 586, 832. Using Count 1 as an example, the use of the scaling factor reduced at Steps 3 and 4 the penalties for all 17,655 vehicles in Count 1 to just $21,605. CX 21 at EPA-002808; CX 213 at EPA-002808.

At Step 5, the Agency added 30 percent to the gravity amount because "all but 66 vehicles . . . were unremediated in this case." Tr. at 596, 851; CX 213. Indeed, the vehicles were all sold by Taotao USA to retail dealers who then sold them to the public. Tr. at 847. The 30 percent increase "was the right thing to do given the lack of any attempt to remediate the vehicles here," Ms. Isin noted. Tr. at 596. However, the penalties for the 66 vehicles that were exported outside of the United States, and thus remediated, were not adjusted upward, she added. Tr. at 597, 847. Again, using Count 1 as an example, this 30 percent increase brought the penalty for those vehicles to a total of $28,086.50. CX 213.

The Agency made no further upward adjustment to the penalty based on Respondents' business size or net worth, although such was permitted under step 6 of the penalty policy. Tr. at 600-01. However, the Agency did make certain minor upward adjustments in Counts 9 and 10 to reflect increases in the penalty amounts due to inflation. CX 213 at EPA-002810. The total inflation adjusted gravity penalty for all 10 counts as calculated by the Agency using the penalty policy was approximately $987,036, representing slightly less than $9 per vehicle found to be in violation. CX 213.

The Agency asserts that its gravity penalty calculations are appropriate, noting that they are not alleging that Respondents' certification violations actually resulted in excess emissions.

AB at 11 n.1; ARB at 3; Tr. at 61-63, 120-22, 587; CX 99-CX 122. However, the Agency does contend it is likely that Respondents' violations would eventually lead to excess emissions, and its penalty calculation, utilizing the Policy's formula, considers actual or potential harm to the environment as well as the regulatory scheme. Tr. at 841.

The Agency asserts that the *potential* for harm to the environment is inherent in Respondents' violations even if no *actual* harm results. AB at 7. Specifically, the Agency argues, the risk of excess emissions is inherent in the act of importing and selling uncertified vehicles with non-conforming catalytic converters. AB at 8. Violations of "moderate" or "major" egregiousness assume potential or actual harm. Tr. at 839.

Moreover, Respondents' actions harmed the regulatory scheme, the Agency contends. AB at 8. The CAA calls for a pre-import, pre-sale certification program that "relies on manufacturers providing EPA with complete, accurate information and test data for review before the vehicles and engines are sold and put into use," the Agency notes. AB at 8. According to the Agency, by manufacturing and importing vehicles with "untested catalytic converters different from those described in COC applications submitted to the EPA," Respondent caused "significant harm" to the CAA's certification program and created potential environmental harm in the form of excess emissions. AB at 8.

The Agency recognizes that all but one sample vehicle engine tested in connection with Counts 1 through 8 passed the low-hour emissions test. AB at 9. However, the Agency contends these results "only suggest the vehicles produced might not have exceeded standards at the low-hour service level," not that there was no potential for harm. AB at 9. As for the untested vehicles in Counts 9 and 10, the Agency proclaims that "we simply don't know" whether their engines comply with emissions standards, "which is precisely what the certification program is designed to prevent." AB at 9.

2. Respondents' Argument

Relying upon the DOJ waiver granted to the Agency, Respondents assert that the Agency may only seek a penalty for harm to the regulatory scheme and is prohibited from seeking a penalty based upon actual or even potential harm to the environment from excess emissions. RB at 3 (citing Complainant's Ex. 28 at EPA-000546-47). In that three of the four factors considered in determining the "Base Per-Vehicle or Per-Engine Penalty" relate to determining actual or potential harm from emissions (engine size, egregiousness, and remediation), those factors may not be used to determine the penalty. RB at 6-7, RRB at 2. The only factor EPA may consider is harm to the regulatory scheme, which they note the Penalty Policy defines as the "importance of the requirement to achieving the goals of the Clean Air Act and its implementing regulations." RB at 7 (citing CX 22 at EPA000465).

The only evidence presented on harm to the regulatory scheme, Respondents assert, was Mr. Jackson's opinion that "if design information did not match the production information, then the agency would have no way of knowing how the product would perform throughout its useful life." RB at 8 (citing Tr. at 76-77). However, the facts of this case do not support that being the situation in this case because, "First, there is no evidence that the full useful life emission tests conducted on the emission data vehicle and submitted to the agency for approval of each COC application were based on catalytic converters that was [sic] different from the catalytic

converters on all other vehicles in each engine family," Respondents argue. RB at 8. They note that the Agency assumed for the purposes of this case that all the vehicles in an engine family were the same, so why would the engines in the emission data vehicle for that family not also be the same? RB at 8-9. Second, Respondents contend, "the evidence shows that the non-compliant vehicles tested at low-hour/mileage testing pursuant to the agency's "low mileage/low hour" test order issued in 2014 passed emission tests, just like the emission data vehicles had passed full useful life emission tests." RB at 9. Consequently, Respondents conclude, "there is no reason to suspect that the agency did not have accurate useful life emission tests that are typically submitted with a COC application, simply because Complainant has submitted no evidence to show that the emission data vehicles did not match the remaining production vehicles." RB at 9.

Finally, even if the regulatory scheme were harmed, Respondents argue that the EPA's use of the Penalty Policy to calculate gravity is still inappropriate because "the only examples the Penalty Policy provides for calculating a penalty for violations that harm the regulatory scheme in the absence of excess emissions involve labeling violations." RB at 9 (citing CX22 at EPA-000469); RRB at 2.[39] "The DOJ, by restricting penalty to mere harm to the regulatory scheme, created a situation where application of the Penalty Policy in this case is inappropriate," Respondents conclude. RB at 10.

Respondents also take issue with the Agency's numerical calculations, contending that it used the wrong engine multiplier when calculating the gravity amount, and that, in any event, there is a $500 gravity cap on each engine violation. RB at 10-11; RRB at 2-3. Specifically, Respondents assert that the Agency should have skipped the first step of the calculation based upon engine size because that relates to potential emissions or should have used the "'rule of thumb' for nonroad engines, recreational vehicles and heavy-duty highway vehicles," assessing $15 per horsepower for engines under 15 horsepower instead of a multiplier set forth in Table 1, because the multiplier is a method for calculating harm from excess emissions. RRB at 3 (citing CX022 at EPA-000466); RB 11 (citing CX 22 at EPA-000462). If EPA used such rule, then each vehicle in Count 1 would have a base gravity penalty of $44.10, instead of $235.20, they calculate. RB at 11 n.1. In addition, they argue the $500 cap on emission label violations "logically extends" to the violations here because it is the only example given in the penalty policy for violations "that harm the regulatory scheme without exceeding emissions." RRB at 3, and n.1 (citing CX022 at EPA-000465 n.12, EPA-000468-9).

Further, Respondents also claim the Agency should have assessed a "minor" egregiousness level because the Policy indicates that violations which harm the regulatory scheme but do not cause excessive emissions, such as labeling violations, are "minor." RB at 12 (citing CX 28); *see also* RRB at 3-4. In further support they quote Ms. Isin's response to the question "if there is no actual or potential harm from excess emissions," what egregiousness

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[39] Respondents also assert that "the Penalty Policy, itself, states that '[t]he method of calculating the gravity penalty component described in this Penalty Policy is ***not to apply to cases*** that involve violations other than uncertified vehicles or engines, or violations of the tampering or defeat device prohibitions,' thereby implicitly excluding certification violations that do not exceed emissions." RRB at 2 quoting CX022 at EPA-000476 (emphasis added).

multiplier, is applied under the Penalty Policy, to which Ms. Isin replied: "I suppose minor." RB at 12 (citing Tr. at 839). They note that the multiplier for minor violations is 1. RB at 12.

Additionally, while asserting the "necessity for scaling [in this case] is indisputable," Respondents dispute the Agency's decision to restart scaling for Counts 9 and 10 after the vehicles in Counts 1 through 8 were scaled together. RB at 13. Specifically, they argue that "the separate grouping of Counts 9 and 10 has resulted in precisely what the Penalty Policy sought to prevent through scaling," as evidenced by EPA's proposed penalty worksheet. RB at 13-14 (citing CX 213 at EPA-002808–11). The worksheet reflects that "grouping of Counts 1 through 8 for scaling resulted in a total gravity of $983,539.42 for 108,283" total violations; while restarting and scaling the remaining 1,681 violations in Count 9 and 10 alone is an additional $508,744.86. RB at 14. "Therefore, simply by grouping Counts 9 and 10 separately, Complainant is seeking more than 35% of the total gravity in this action for only 1.5% of the total non-compliant engines," which is contrary to the intent of the scaling factor. RB at 14. Respondents note that while the violations in Count 9 and 10 were discovered after the initial Complaint was filed, the liability for all vehicles are based on the "exact same 'certification' violation." RB at 14. They also assert it is illogical to mitigate the penalty for all the 2012 and 2013 model year vehicles Respondents manufactured and sold before they received the notice of violation in December 24, 2013, but to not mitigate the penalty for those they imported after. RB at 14-15.

Respondents also contest the Agency's determination that the violations of Counts 9 and 10 were greater than the rest, i.e., of major egregiousness. RRB at 3-4. They assert that given that there is no allegation or evidence of excess emissions and that the penalty cannot be increased for excess emissions, the Agency's claim that lack of emission data justifies a "twofold increase in adjusted base gravity" "strains logic." RRB at 4. "What's even more bewildering is that Complainant has previously stipulated that the useful life emission test results submitted with each of the ten COC applications in this case had the same catalytic converters as those on the 109,964 imported vehicles, therefore, there is information on emissions from Counts 9 and 10, which shows that these vehicles do not exceed emissions." RRB at 4 (citing Complainant's Second Motion to Supplement the Prehearing Exchange and Combined Response Opposing Respondents' Motion to Dismiss for Failure to State a Claim and Motion for Accelerated Decision at 14-15 (Jan. 3, 2017) ("Combined Response")).[40]

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[40] Respondents assert in their Reply Brief that if "Complainant simply followed the Penalty Policy by grouping all counts together for scaling purposes, *[ ]* capping base per-vehicle gravity at $500, and categorizing Counts 9 and 10 at "Moderate" egregiousness, the gravity component of the proposed penalty would go down from $1,381,850.95 to approximately $693,455.20." RRB at 4 (noting that this figure "does not include adjustments for Counts 9 and 10 to account for inflation using Penalty Policy inflation amendments, but it also does not remove the 66 vehicles that were remediated from the 30% upward adjustment for failure to remediate; the two adjustments should offset each other. If there isn't a complete offset, any difference remaining would be small.") (citing CX213 at EPA-002808–11; CX022 at EPA-000467, EPA-000469-72).

3. Analysis

I find no merit to Respondents' threshold contention that the DOJ's June 2016 CAA waiver prohibits consideration of the potential risk of excess emissions from the violations and that, therefore, the Penalty Policy, which incorporates the excess emissions into its analytical structure, cannot in part or in whole be applied in this proceeding. RB at 1-3, 7; RRB at 6-10, CX 28.

In March 2015, the DOJ waived the $320,000 administrative penalty limitation on the Agency's authority to assess administrative penalties for Respondents' certification violations set forth in Counts 1-8. AD Order at 18 n.25 (citing CX 26); *see also* 42 U.S.C. § 7524(c). In June 2016, the DOJ further extended the waiver for the additional recreational vehicles in Counts 9 and 10 that had been subsequently found to violate CAA certification requirements. CX 28. In the second waiver, the DOJ also granted "a waiver for certain potential additional violations that may occur in the future . . . as long as such violations are *substantially similar* to those covered under" the waivers already issued. CX 28 at EPA-000546. The second waiver defines "*substantially similar*" to include future violations "that harm the regulatory scheme, but do not cause excess emissions" and future violations "of provisions on certification, labeling, incorrect information in manuals, or warranty information violations." CX 28 at EPA-000546. The waiver goes on to define "violations that are *not substantially similar*" to include "any future violations:

> --*that go beyond mere harm to the regulatory scheme*;
> --that cause excess emissions;
> --that are other than violations of provisions on certification, labeling, incorrect information in manuals, or warranty information violations; or
> --that are willful, knowing, or otherwise potentially criminal; or
> --that increase the aggregate number of waived vehicles in the matter to over 125,000 total.

CX 28 at EPA-000547 (emphasis added). In this case, the violations are based upon regulatory provisions relating to certification and are not seeking a penalty based upon proof that Respondents vehicles in fact "cause[d] excess emissions." *See* Am. Compl.; AB at 11 n.1; ARB at 3; CX 99-CX 122; Tr. at 61-63, 120-22, 587. As such, to that extent they clearly fall within the waiver.

Respondents rest their challenge to the Agency's gravity calculation on the phrase in the waiver regarding violations "that go beyond mere harm to the regulatory scheme." Specifically, they argue that a penalty/violation which includes consideration of even the risk of excess emissions is one that goes beyond seeking compensation for "mere harm to the regulatory scheme."[41] However, they cite no legal authority in support, and upon consideration of the issue, I find the argument unconvincing.

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[41] To the extent the Respondents' appear to raise the DOJ waiver argument in their post-hearing briefs to challenge liability, I find it barred, noting that they failed to pursue this jurisdictional argument either in support of their own Motion to Dismiss/Motion for Accelerated Decision or

A "regulatory scheme" consists of the regulations, interpretation and guidance issued by an Agency based upon its congressionally endowed authority to implement a legislative act. *New York v. FERC,* 535 U.S. 1, 18 (2002); *Reno v. Koray*, 515 U.S. 50, 61 (1995) (noting the regulatory scheme is entitled to deference and that even "an internal agency guideline, which is akin to an "interpretive rule" that "does not require notice and comment," [ ] is still entitled to some deference, [ ] since it is a "permissible construction of the statute") (citations omitted). "An effective regulatory scheme includes imposing and enforcing penalties to uphold the law." *Digman v. Quarterman*, 2006 U.S. Dist. LEXIS 62726 (W.D. Tex. Aug. 26, 2006)

One of the declared purposes of the CAA is pollution prevention: "A primary goal of this chapter is to encourage or otherwise promote reasonable Federal, state and local government actions . . . for pollution prevention." 42 U.S.C. § 7401(c). *See also Sierra Club v. Duke Energy Ind., Inc.*, No. 1:08-cv-437-SEB-TAB, 2010 U.S. Dist. LEXIS 97260, at *4 (S.D. Ind. Sep. 14, 2010) (CAA's purpose is "to protect and enhance the quality of the Nation's air resources so as to promote the public health and welfare and the productive capacity of its population."). As such, the Agency's regulatory scheme implementing the Act does not merely provide for injunctions and remediation for excess emissions which have occurred, but also includes a complex compliance scheme, involving permits and COCs, etc., all directed at reducing the risk of polluting emissions occurring. *Sierra Club,* 2010 U.S. Dist. LEXIS 97260, at *5 (noting the CAA includes permit programs "designed to prevent the deterioration of air quality by requiring [pre]authorization for the construction of any new or modified source of air pollution.") (citing 42 U.S.C. §§ 7470-7492; 40 C.F.R. § 51.166; 69 Fed. Reg. 29071).

In this case, Respondents failed to comply with the regulatory scheme, manufacturing and importing vehicles which did not match their COCs. This clearly harmed the regulatory scheme because it conflicted with the regulations. *United Food & Commer. Workers Int'l Union v. Wal-Mart Stores, Inc.*, 453 Md. 482, 497, 162 A.3d 909, 917-18 (2017) (conflicting with a substantive rule constitutes harm to the regulatory scheme).

However, the risk of excess emissions created by the failure to have valid COCs also harmed the regulatory scheme as the scheme was designed to prevent such risks. *Sintra, Inc. v. Seattle*, 119 Wash.2d 1, 15, 829 P.2d 765, 773 (1992) ("preventing harm" part of valid "regulatory scheme"); *Buckeye Cablevision, Inc. v. FCC*, 128 U.S. App. D.C. 262, 387 F.2d 220,

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in Opposition to the Agency's Motion, both of which were ruled upon by Order issued on May 3, 2017. *See* AD Order at 18 n.25. Moreover, Respondents lost this argument when they later separately, and unsuccessfully, specifically raised it in support of another motion to dismiss they filed. *See* Respondents' Motion to Dismiss for Lack of Subject Matter Jurisdiction (Aug. 2, 2017); Order Denying Respondents' Motion to Dismiss for Lack of Subject Matter Jurisdiction (Oct. 10, 2017) ("Jurisdictional Order"). By attempting to relitigate this issue for a third time, Respondents *yet again* violate the "law of the case doctrine." *See* Jurisdictional Order at 8-20 (denying Respondents' jurisdictional claims); *Service Oil, Inc.*, 2011 EPA App. LEXIS 41, *20–21 (EAB, Dec. 7, 2011) ("Under the [law of the case] doctrine, once a court decides an issue of fact or law, either explicitly or by necessary implication, that court's decision on the issue will be treated as binding – i.e., as the 'law of the case' – in subsequent proceedings in the same case.").

224 (1967) ("Harm to regulatory scheme" can occur if rapid growth of CATV proceeds unabated before Agency can act.).

Respondents attempt to have this Tribunal categorize the risk of excess emissions as something more than "*mere* harm to the regulatory scheme," and so to ignore that risk as beyond a harm for which the Agency was allowed to seek a penalty. However, as the Agency notes, harm to the regulatory scheme ultimately leads to potential harm to the environment, so it would be absurd to adopt Respondents' interpretation of the DOJ waiver because their reasoning would exclude the Agency from penalizing violations that harm the regulatory scheme despite the waiver's express authorization to do so. *See* ARB at 3-4. Moreover, the risk in this case was not theoretical. All of the catalysts at issue in this case contained platinum, palladium, and rhodium in ratios different than described in their associated COC applications; 20 did not have detectable concentrations of platinum, and 16 did not have detectable concentrations of rhodium. *See* AD Order at 12-13. That is, "[t]hey are essentially [palladium] catalytic converters." AD Order at 14. And as Mr. Jackson testified at hearing, this raises concern about their long-term durability even if they pass low-hour tests, because "a palladium-only catalyst may be subject to poisoning at higher useful life, at higher engine hours, engine mileage." Tr. at 136. Respondents claim that full useful life emissions tests conducted on their emissions data vehicles ("EDV") prior to certification demonstrate the long-term viability of catalysts in this case, but as the Agency correctly points out, "all of the engine families named in the Amended Complaint relied on an EDV from a previous model year for certification, meaning the EDVs were not manufactured at the same time as the production vehicles." ARB at 6; *see also* CX 1 at EPA-000001, 29 (2012 EDV for 2014 engine family); CX 2 at EPA-000037, 69 (2012 EDV for 2013 engine family); CX 3 at EPA-000080, 108 (2012 EDV for 2013 engine family); CX 4 at EPA-000116, 140 (2011 EDV for 2012 engine family); CX 5 at EPA-000151, 181 (2010 EDV for 2014 engine family); CX006 at EPA-000187, 217 (2010 EDV for 2013 engine family); CX 7 at EPA-000220, 249 (2009 EDV for 2013 engine family); CX 8 at EPA-000252, 282 (2010 EDV for 2013 engine family); CX 9 at EPA-000288, 318 (2010 EDV for 2015 engine family); CX 10 at EPA-000321, 351 (2010 EDV for 2016 engine family). Thus, performance characteristics of the EDVs cannot be presumed to apply to vehicles in this case based on a shared production process. Likewise, the reverse comparison between emissions of the tested vehicles and Respondents' EDVs are invalid.

Furthermore, I note that even if Respondents' vehicles never exceed emissions standards during their useful lives, the Agency seeks an appropriate penalty by applying a "moderate" egregiousness level. According to the Penalty Policy a moderate violation involves "uncertified vehicles or engines where the emissions . . . are likely to be similar to emissions from certified vehicles or engines." CX 22 at EPA-000467. That is, the Agency picked an egregiousness multiplier that treats Respondents' vehicles as if their emissions will be no different than certified vehicles or engines. Based on the evidence discussed above and at hearing, the Agency could justifiably have applied a "major" egregiousness level to all the violations because Respondents' catalytic converters were defective/noncompliant and "excess emissions are likely to occur." CX 22 at EPA-000467. But the fact that it did not renders moot Respondents' argument that their vehicles in Counts 1 through 8 were unlikely to harm the environment. As for the vehicles in Counts 9 and 10, there was no evidence produced to indicate that they will remain emissions-compliant throughout their useful lives. Rather, the evidence points only to the fact that their catalytic converters contain inadequate quantities and proportions of precious metals, and that they therefore cannot be expected to produce emissions similar to emissions

from certified vehicles or engines. *See* AD Order at 13-14; Tr. at 594. Respondents' argument that useful emissions information can be gleaned from the COC applications for vehicles in Counts 9 and 10 falls flat because the information in those applications has already been proven unreliable. *See* RRB at 3-4; CX 9; CX 10.

Moreover, the Agency presented clear harm to the regulatory scheme. By providing inaccurate descriptions of their catalysts in their COC applications, Respondents caused the Agency to rely on false information in determining whether to certify that their vehicles would comply with emissions standards throughout their useful lives. Respondents' conduct inherently undermines the entire certification program because it leads the Agency to certify engines that are unlikely to remain emissions compliant, or at the very least whose emissions compliance cannot be known. For the certification program to function properly, the Agency must be able to assume the accuracy of submitted design specifications; indeed, as Mr. Jackson testified, a manufacturer's stated design specifications "are critical to how our compliance program functions. It's important for us to know that the design specifications provided by the manufacturer are in fact consistent with the production specifications." Tr. at 75. And he added: "It would render our assessments inaccurate if in fact the design information did not match the production information. The Agency would be testing and making assessments based on a different product. We would have no way of knowing how that particular product would perform throughout its useful life." Tr. at 76; *see also* Tr. at 78 ("[T]he harm to the program would be such that we would not be able to make a determination, an accurate determination about full useful life compliance. It would be a different product altogether."). Ultimately, wrong or misleading information on a COC application causes "irreparable harm, and the only way, if we were to determine that their production vehicle somehow was different from the certification vehicle, it would require the Agency to test almost every production vehicle to ensure that it was compliant at multiple points throughout its useful life." Tr. at 77. *See also* Tr. at 114-15, 135-36 (Mr. Jackson describing how a COC applicant's reported design information affects the Agency's assessment of an engine's likelihood of compliance); Tr. at 545-46, 551 (Ms. Isin testifying that the COC program "relies heavily on the truth and accuracy" of information submitted by manufacturers about the vehicle and engine they plan to build). Because the COC program relies on applicants providing accurate information about their vehicles before they are sold in the United States, Respondents' violations are of a type that cause significant harm to the regulatory program.[42] It is the provision of false data that is the source of the harm. In that sense, it is largely irrelevant whether Respondents' alternatively-designed vehicles at issue in this matter would in fact remain emissions-compliant throughout their useful lives.

Additionally, Respondents' argument that the Penalty Policy caps at $500 the base gravity calculation for non-emission related violations is a misreading of the Policy. *See* RRB at 2-3; CX 22 at EPA-000470. Although Respondents would surely like to apply this cap to the base gravity calculation in Counts 2, 5, 6, and 8-10, the policy makes clear that the cap applies only "[i]in the case of violations of the emissions label requirements." CX 22 at EPA-000470.

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[42] Respondents appear to believe that harm to the regulatory program in this case is premised on their failure to test the useful life emissions of all 109,964 vehicles before they were imported. *See* RRB at 9-11. Their belief is incorrect. Respondents harmed the regulatory scheme by submitting false data about their catalytic converters in their COC applications.

This case does not involve emissions label violations. Further, the Agency used the correct multiplier for the horsepower range occupied by Respondents' vehicles. Respondents point to Ms. Isin's testimony that the applicable multiplier "is about $15 per vehicle" even though the Agency used an $80 multiplier. RB at 11; Tr. at 558-59. In fact, Ms. Isin misspoke during her testimony, because the Penalty Policy clearly calls for an $80 multiplier, and that is what the Agency applied in its penalty calculation. *See* CX 22 at EPA-000470; CX 213 (multiplying each engine family's "average horsepower" by 80 to equal the "base per-vehicle gravity"); ARB at 5 n.1.

As for the Agency's scaling calculations, it was appropriate for the Agency to group Counts 1 through 8 separately from Counts 9 and 10. The violations in Counts 9 and 10 were discovered after the original Complaint was filed. Additionally, Respondents were on notice of the violations outlined in Counts 1 through 8 at least as early as December 24, 2013. *See* CX 92. They did not submit COC applications for vehicles in Counts 9 and 10 until June 2014 and June 2015. *See* CX 9; CX 10. Thus, Respondents knew about problems with their catalytic converters, could have made changes to their manufacturing/quality control/importation processes before importing the vehicles in Counts 9 and 10, but chose not to. *See* ARB at 10-11. Consequently, it is reasonable for the Agency to rescale the violations in those counts separately from Counts 1 through 8.

Based on consideration of the parties' arguments and the evidence adduced in this proceeding, it is clear that for each count the Agency reasonably and correctly calculated the base per-vehicle gravity penalty amount, and it applied failure to remediate, scaling, egregiousness, and inflation multipliers that are appropriate under the Penalty Policy. *See* CX 213.

The only point upon which I find the Agency's penalty assessment lacking was that it did not adjust the penalty upward based upon the Respondents' size of business. As indicated above, as of October 11, 2016, Taotao China boasted an annual sales volume of more than $80 million. CX 168 at EPA-002296. The company also represents that it has 2,000 employees and owns multiple subsidiary companies, including Jinyun. *See, e.g.*, CX 35 at EPA-000607; CX 168 at EPA-002296; CX 191 at EPA-002520. The value of the vehicles at issue here imported by Taotao USA for Taotao and Jinyun was $[redacted]. At hearing, Mr. Jackson testified that Respondents were "the number [redacted] from a production volume perspective" in [redacted], and "[l]ast year [2016] they [were] number [redacted], and they're in the top [redacted] for production volume." Tr. at 96-97; *see also* 40 C.F.R. § 86.419-2006(b)(1) (providing for the division of motorcycles into classes based on engine displacement). Between 2009 and 2016, Taotao USA was "consistently ranked between [redacted] and [redacted] of the top importers of recreational vehicles and motorcycles made in China into the United States." Tr. at 635-37, 844; *see also* CX 190A. The total declared value of Taotao USA's imports during those years was more than $[redacted]. CX 190A; Tr. at 637-38. The Penalty Policy suggests that an upward adjustment of at least $100,000 could have been appropriately made in light of the size of Respondents' businesses, in an effort to reach a sum that would sufficiently deter businesses of their size from further violations. CX 22 at EPA-000469, 000475. EPA chose to exercise its discretion and not add this additional sum, presumably because it had already dramatically scaled back the penalty based upon the large number of violations to what it deemed an amount likely to deter future violations. In that this was the premise on which the case was tried, and therefore, Respondents made no arguments in

regard thereto, I exercise my discretion and too make no further adjustment to the gravity penalty amount for the size of Respondents' business.

C. Adjustments

Under the Penalty Policy, once the economic benefit and gravity calculations have been added together to create the preliminary deterrence amount, several additional factors call for increasing or decreasing that figure to be equitable to the regulated community. CX 22 at EPA-000477. It is the burden of the violator to justify any mitigation adjustments. CX 22 at EPA-000477. Some of these factors, such as history of compliance, as specifically enumerated statutory penalty factors, others would fall under the catchall statutory phrase of "other matters as just may require." 42 U.S.C. § 7524(c)(2).

1. Degree of Willfulness, Cooperation, and History of Noncompliance

Although the CAA is a strict liability statute, the penalty policy calculation methodology still considers the violator's state of mind. CX 22 at EPA-000477. Specifically, the policy takes into account the violator's control over events, the foreseeability of events constituting the violation, whether the violator took reasonable precautions to prevent the violation, whether the violator knew or should have known of the possibility of violating, the sophistication level within the industry in dealing with compliance issues, and whether the violator knew of the legal requirement that was violated. CX 22 at EPA-000478.

Next, the degree to which a violator does or does not "cooperate" also may affect the penalty amount based on the Agency "goals of equitable treatment and swift resolution of environmental problems." CX 22 at EPA-000478. At the outset, cooperation may be assessed based on whether the violator promptly reported its noncompliance to the Agency. CX 22 at EPA-000478. Voluntary and prompt disclosure will mitigate the gravity-based portion of the penalty. CX 22 at EPA-000478. On the other hand, the penalty may be increased if the violator knew of the violation but did not report it. CX 22 at EPA-000478-000479.

Third, the policy provides that if a party has violated a similar environmental regulation in the past, then the penalty should be adjusted upward because the prior enforcement response was not a sufficient deterrent. CX 22 at EPA-000479. The factors that should be considered include the degree of similarity of the prior violation; how recent it was; how many previous violations have occurred; and the violator's efforts to remedy previous violations. CX 22 at EPA-000479. A prior violation may be a notice of violation, settlement agreement, warning letter, complaint, consent decree, or consent agreement and final order. CX 22 at EPA-000479. It is generally considered "similar" if a previous enforcement response should have alerted the party to a specific type of compliance problem. CX 22 at EPA-000479. For uncertified vehicle violations, "a 'similar' violation is one that involves any violation of the vehicle and engine requirements under Title II of the [CAA] or the regulations implementing [CAA] requirements." CX 22 at EPA-000480. The penalty may be increased by 35 percent for one prior violation, and up to 70 percent for multiple prior violations. CX 22 at EPA-000480.

In this case, the Agency added 20 percent to the gravity amount for Respondents' willfulness and negligence. Tr. at 601, 763. This increase was based on the fact that Taotao

USA was operating under the ASA compliance plan that required pre-import catalyst testing, and "if the company had been doing what it should have been doing under the compliance plan . . . we wouldn't have this case right now." Tr. at 601-02; *see also* Tr. at 604 ("[W]e gave them . . . these detailed instructions on what we would do, you know, were we to be running a company like Taotao USA."). That is, according to Ms. Isin, "[t]he basis for the adjustment [was] Taotao's continuing lack of interest in catalyst testing, in preventing the types of violations that we saw here, despite our repeated efforts to get them to perform catalyst testing." Tr. at 632, 706.

The Agency made no adjustment in either direction (up or down) to the gravity penalty amount for Respondents' cooperation because the violations were not self-reported, but Respondents still complied with Agency inspections. Tr. at 632-33.

Finally, the Agency increased the penalty by an additional 20 percent based on Taotao USA's history of noncompliance – specifically, its carburetor violations that led to the 2010 ASA. Tr. at 598-600, 807, 809. Even though Taotao China and Jinyun were not parties to the ASA, the increase was applied to all of the vehicles in this proceeding because Taotao USA held the COCs for each vehicle. Tr. at 812-13.

2. Agency's Arguments

The Agency argues it properly increased the penalty by 20 percent based on Respondents' degree of willfulness "with respect to Respondents' failure to conduct routine catalytic converter screening that might have prevented the violations from occurring." AB at 13. Even though the ASA demanded Respondents adhere to a compliance plan that included pre-import catalyst testing, they failed to follow that plan. AB at 13. "Respondents' failure to conduct tests that might have detected problems with the catalytic converters in this matter was willful or negligent," the Agency argues. AB at 15.

As for Respondents' cooperation, the Agency asserts no upward adjustment is needed because Respondents cooperated during the investigation, and no downward adjustment is warranted because Respondents did not self-report their non-compliance. AB at 15.

Finally, the Agency asserts it appropriately increased the penalty by 20 percent for Respondents' history of noncompliance based on the 2010 ASA. The certification violations that prompted the ASA "were similar to the violations at issue in this case and should have alerted Respondents to the importance of ensuring that their vehicles match the designs described in the COC applications," the Agency contends. AB at 13. Even so, "problems with Respondents' catalytic converters appeared in [model year] 2012, not two years after date of ASA, suggesting the ASA did not achieve deterrence," the Agency states. AB at 13.

3. Respondents' Arguments

Respondents again contend the DOJ waiver precludes the 20 percent upward adjustment for willfulness and negligence, and assert that the Agency has failed to explain why the adjustment was reasonable under factors outlined in the Penalty Policy. RB at 15; RRB at 4-5. Specifically, Respondents claim that the evidence shows they were not aware of the inaccurate reporting of their catalyst designs until the end of 2015, and the design specifications were not

theirs. RB at 16. That is, Respondents attempt to shift the blame for the violations to Beijing ENTE and Nanjing Enserver, the manufacturers of the catalysts. RB at 16. Respondents argue they could not have foreseen that false information would be provided by such manufacturers. RB at 16. Further, Respondents point out they had three of the five different types of catalysts involved in the vehicles at issue tested at Chinese laboratories and submitted the results to the Agency. RB at 16-17. They also note their retention of an engineering consulting firm. RB at 17. To that extent, Respondents say, there is evidence they took appropriate precautions to prevent their violations. RB at 17-18. Respondents also state they did not have knowledge of the legal requirements they violated.[43] RB at 17.

Next, Respondents complain that the Agency ignored their level of cooperation. RB at 17-18. They specifically point to their retention of an engineering consultant and payment of a penalty to settle their violation of the 2010 ASA. RB at 17-18. As such, they assert they are entitled to a decrease in the penalty in recognition of their cooperation. RB at 17-18.

Finally, as for their alleged history of noncompliance, Respondents state "there is no evidence" that Taotao China or Jinyun previously violated any environmental requirement. RB at 18; RRB at 6. They also assert the Agency made the upward adjustment without regard to factors specified in the Penalty Policy, and they suggest Taotao USA's prior violations that led to the 2010 ASA are too minor to warrant a penalty increase. RB at 18-19.

4. Analysis

I am unpersuaded by Respondents' argument that the Agency's upward adjustments for willful and knowing conduct is prohibited by the terms of the DOJ waiver. As indicated above, in June 2016 DOJ further extended its waiver and grant of permission to the Agency to pursue an administrative penalty above the statutory limit for the additional recreational vehicles in Counts 9 and 10 that had been later found to violate CAA certification requirements. CX 28. This

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[43] At hearing, Mr. Jackson testified that the GECC engages in extensive educational outreach to the industry, including vehicle and engine manufacturers, through videos, meetings, conferences, regulatory guidance, webinars, and workshops. *See, e.g.*, CX 12-CX 17; RX 33; Tr. at 44-45, 48, 225-27, 233, 235-36, 278-79, Tr. At 80-81, 317. Consistent therewith, Mr. Jackson himself met two or three times in person with Matao Cao and Yuejin Cao, including a meeting held in May 2017 at their manufacturing facilities in China. Tr. at 67, 80-81, 99-100. His impression from those meetings was "that they weren't fully aware of some of the provisions and were asking for our help in identifying the provisions or understanding the provisions" to which they were subject. Tr. at 82. That is, "they were not as aware of the regulatory requirements as they felt they should have been. And so my impression from that is that they weren't engaged as maybe they could have been." Tr. at 95. Mr. Jackson drew this impression of Matao Cao because the questions he asked were "superficial or seemed to indicate that they haven't actually looked at the regulations in some cases." Tr. at 96; *see also* Tr. at 292-93. Compared to other large manufacturers similar in size to Respondents, Respondents appeared to have spent less effort in developing systems to ensure their products complied with applicable regulations, Mr. Jackson observed. Tr. at 98-99. "Someone who applies for a certificate of conformity should be familiar with the regulations because they're applying for a certificate that indicates that they are complying with the regulations," he explained. Tr. at 277.

second document also granted to EPA a "waiver for certain potential additional violations that may occur in the future" "as long as such violations are *substantially similar* to those covered under" the waivers already issued. CX 28 at EPA-000546. The waiver goes on to define "violations that are *not substantially similar*" to include "any future violations . . . that are willful, knowing, *or otherwise* potentially criminal." CX 28 at EPA-000547 (Emphasis added).

It is clear from the context of the DOJ authorization and use of the phrase "or otherwise potentially criminal" that the "willful" or "knowing" prohibition applies to enforcement actions arising in a criminal context, or to violations requiring a scienter element. *See* CX 28 at EPA-000547. That is, the waiver withholds authorization for a criminal proceeding against the Respondents which DOJ could initiate in a federal district court based upon their mental culpability. Again, the only allegations described in this *administrative* proceeding are certification violations under the Clean Air Act, a strict liability statute with no scienter element. To the extent willfulness and negligence were considered, it was only for purposes of calculating an appropriate administrative penalty, not for assessing criminal, civil, or administrative liability. The DOJ waiver contains no stipulation as to Respondents' state of mind within an administrative civil enforcement proceeding, and the Agency has not alleged any potentially criminal violations. Consequently, Respondents have presented no viable argument based on the DOJ waiver and 42 U.S.C. § 7524(c). The Agency and the DOJ jointly determined that the proposed penalty amount is appropriate.

Further, I find Respondents' negligence in this case justifies the 20 percent penalty increase applied by the Agency. Given the regulatory and certification requirements that apply to their industry, it is puzzling that Respondents did not employ routine testing of the catalytic converters they purchased. As Mr. Jackson testified, manufacturers typically engage in quality control processes as frequently as every quarter to ensure production consistency, both internally and externally with their supplier base. *See* Tr. at 65-66. That their suppliers might deliver to them a cheaper non-compliant product that did not actually contain precious metals in the quantity and concentration that Respondents specified in their COC applications is entirely foreseeable. It was particularly foreseeable since the price Respondents were paying for these converters was substantially less than what catalytic converters having such metals as identified in the COC applications cost, at least according to Respondents' own spreadsheet. Yet Respondents were not engaged with the regulatory requirements at the level they should have been, and they made less effort than a typical manufacturer would to ensure their products complied with applicable regulations. *See* Tr. at 95-96, 98-99, 277, 292-93. The "precautions" that Respondents allege they took in this case – testing certain catalysts in Chinese laboratories, briefly hiring an engineering consultant – were inconsistent and performed in a way that was unlikely to prevent the violations in this case, and the Agency repeatedly told Respondents their efforts did not measure up. *See* CX 69-CX 74; CX 76; CX 78-CX 79; CX 81; CX 215; RX 10 at 1 and 2.

Most notably, the 2010 ASA that Taotao USA executed with the Agency included a compliance plan that mandated pre-import testing of Respondents' catalytic converters. As Ms. Isin observed, the Agency provided a roadmap for compliance that Respondents could have followed. *See* CX 67; Tr. at 599, 603-04, 710-11. Had they done so, the violations in this case would not have occurred, as Respondents would have discovered the catalytic converters they purchased were not as described. Although Taotao China and Jinyun were not parties to the ASA, given the familial relationship among the Respondents and their principals, the ASA's

application to the vehicles they manufactured, and that Taotao USA was the exclusive importer of their vehicles, it is fair to infer that they were on notice of the pre-import testing requirements and their obligation to manufacture compliant engines. To that extent, Respondents violations were entirely foreseeable.

With respect to Respondents' cooperation, no adjustment was made by the Agency and none is needed. Respondents may have cooperated with the Agency's investigation, but they did not volunteer or self-report their violations. They deserve no reward for this behavior.

However, I find Taotao USA's history of noncompliance justifies the 20 percent penalty increase applied by the Agency. The 2010 ASA was executed to resolve 3,768 CAA violations for Taotao USA's importation of uncertified vehicles manufactured with undisclosed adjustable parameters and emissions-related parts different from those described in the COC applications. *See* CX 67; Tr. at 140-42, 598-600. As the Penalty Policy notes, for uncertified vehicle violations, "a 'similar' violation is one that involves any violation of the vehicle and engine requirements under Title II of the [CAA] or the regulations implementing [CAA] requirements." CX 22 at EPA-000480. Clearly, the violations in this case are similar to the violations resolved by the 2010 ASA, as they all involved the CAA's vehicle and engine requirements. As to the history of noncompliance of Taotao China and Jinyun, the Agency presented sufficient evidence to tie them to the prior violations outlined by the 2010 ASA.[44] Specifically, the evidence discussed above and below joins all three Respondents in serving the same business enterprise under the ownership and control of the Cao family. *See supra* pp. 10-11, 14-15; *infra* p. 41-42. Additionally, the Chinese catalyst testing conducted in August 2011 in response to the 2010 ASA was ordered by Taotao China, and Matao Cao in his deposition reported discussing the impact of the 2010 ASA violations with his father. CX 216 at 129-30, 135. In the absence of evidence to the contrary, this is sufficient to implicate Taotao China and Jinyun in the prior violations that were the subject of the 2010 ASA.

In sum, I conclude the Agency's proposed penalty adjustments for willfulness and negligence, degree of cooperation, and history of noncompliance are reasonable and appropriate. *See* CX 213.

D. Ability to Pay

"[A] respondent's ability to pay may be presumed until it is put at issue by a respondent." *JHNY, Inc.*, 12 E.A.D. 372, 397 (EAB 2005) (quoting *Spitzer Great Lakes, Ltd.*, 9 E.A.D. 302, 321 (EAB 2000)). If a respondent claims an inability to pay, the Agency "is required to present some evidence to show that it *considered* the respondent's ability to pay a penalty as part of [the Agency's] prima facie case that a proposed penalty is appropriate taking all penalty criteria into consideration." *Id.* at 398. That is, there is no specific burden of proof with respect to an ability to pay factor; so long as the respondent's ability to pay is considered and "touched upon[,] and the overall penalty is supported by the analysis[,] a prima facie case can be made." *CDT Landfill Corp.*, 11 E.A.D. 88, 121 (EAB 2003) (quoting *New Waterbury Ltd.*, 5 E.A.D. at 538). "The

[44] Ms. Isin testified the manufacturer of the vehicles involved in those violations was Zhejiang Taotao Industry Co., a predecessor company of Taotao China or Jinyun that was "most likely the same company" as Respondents but with a different name. *See* Tr. at 812.

[Agency] need not present any *specific* evidence to show that the respondent *can pay* or obtain funds to pay the assessed penalty, but can simply rely on some *general* financial information regarding the respondent's financial status which can support the *inference* that the penalty assessment need not be reduced." *JHNY, Inc.*, 12 E.A.D. at 398 (quoting *New Waterbury Ltd.*, 5 E.A.D. at 542-43).

After the Agency makes out its prima facie case, the respondent must rebut "with detailed evidence demonstrating it could not afford the penalty." *Id.* at 399 (citing *New Waterbury Ltd.*, 5 E.A.D. at 542). If the respondent presents

> *specific* evidence to show that despite its sales volume or apparent solvency it cannot pay any penalty, the [Agency] as part of its burden of proof in demonstrating the "appropriateness" of the penalty must respond either with the introduction of additional evidence to rebut the respondent's claim or through cross examination it must discredit the respondent's contentions.

Id. at 398 (quoting *New Waterbury Ltd.*, 5 E.A.D. at 542-43). That is, a respondent must explain how the proposed penalty would cause it to suffer undue financial hardship and prevent it from paying ordinary and necessary business expenses. *See Bil-Dry Corp.*, 9 E.A.D. 575, 614 (EAB 2001). "[I]f the respondent does not offer 'sufficient, specific evidence as to its inability to continue in business to rebut the [Agency's] prima facie showing,' the ALJ may decide that the penalty is appropriate, at least with respect to the ability to pay issue." *CDT Landfill Corp.*, 11 E.A.D. at 122 (quoting *Lin*, 5 E.A.D. 595, 599 (EAB 1994)). Significantly, tax returns are sufficient to show how much of a respondent's income is subject to federal corporate taxation, but they are insufficient to establish any hardship that would render the respondent unable to pay a penalty. *See Bil-Dry*, 9 E.A.D. at 614 (financial statements would have provided a detailed picture of the respondent's financial state and showed whether it could pay the proposed penalty, but respondent chose not to provide such documents and did not offer an explanation for withholding them).

1. Evidence of Respondents' Ability to Pay

The Agency specifically considered Respondents' ability to pay, Ms. Isin testified. Tr. at 634, 845-46. She reviewed Respondents' import history, descriptions of the companies on the Internet, financial documents the companies provided, and hired Mr. Carroll to analyze available information about Respondents and provide an opinion on their ability to pay the penalty. Tr. at 634. Using information retrieved from U.S. Customs and Border Protection, she determined that between 2009 and 2016, Taotao USA was "consistently ranked between [redacted] and [redacted] of the top importers of recreational vehicles and motorcycles made in China into the United States." Tr. at 635-37, 844; *see also* CX 190A. The total declared value of Taotao USA's imports during those years was more than $[redacted]. CX 190A; Tr. at 637-38. "It doesn't look like a company that's about to fold," Ms. Isin noted. Tr. at 638. On Taotao China's Alibaba.com[45] profile, Ms.

[45] Alibaba.com is China's largest global online wholesale marketplace, according to U.S. Securities and Exchange Commission filings by the website's owner, Alibaba Group Holding Ltd. *See, e.g.*,

Isin discovered the company boasts more than 1,000 employees, total revenue of more than $100 million, and owns several subsidiary companies. CX 35; Tr. at 639-640; *see also* CX 168. On the website Dealernews.com, Ms. Isin found an article published in 2014 reporting that Taotao China has a 30 percent market share in the United States for ATVs and motorcycles.[46] CX 42; Tr. at 639-640. Additionally, Ms. Isin reviewed literature that Respondents provided to Mr. Jackson and the Agency delegation during the audit in China. CX 191; Tr. at 641. From those documents, she further concluded that Taotao China makes "all kinds of products," that it owns Jinyun, that Taotao China and Jinyun both produce vehicles for Taotao USA, that Matao Cao owns [redacted] percent of Taotao USA, and that a new factory is being built for Taotao China. Tr. at CX 191; 641-43, 789-790. "To me, [Respondents are] all kind of intertwined. You know, the manufacturer and the importer of the same vehicles," Ms. Isin testified. Tr. at 643. Based on the upward trend of imports, descriptions of Respondents on the Internet, and Respondents' presentation about their current organization and future expansion plans, "it showed that the company looks like it can pay a penalty," she added. Tr. at 644.

Ms. Isin also requested financial information from Respondents in 2015 in response to their inability to pay claim. Tr. at 649. Respondents submitted financial statements and U.S. tax returns filed by Taotao USA; Taotao China and Jinyun did not provide tax returns. CX 161-CX 163; CX 171; Tr. at 649-651, 846. Ms. Isin entered information from Taotao USA's tax returns into ABEL, the Agency computer program that performs certain computations to produce a list of probabilities that a Respondent can pay a penalty.[47] Tr. at 651-52. The ABEL analysis indicated there was a 70 percent probability that Taotao USA could pay a penalty of $[redacted]. Tr. at 652. Ms. Isin found this amount inconsistent with the import data she had reviewed. Tr. at 652.

Ms. Isin requested additional financial information from Respondents "several times," but they did not provide any. Tr. at 654, 800, 846. On October 13, 2016, the Agency requested specific financial information about Respondents and related entities that would enable a more thorough evaluation of Respondents' ability to pay a penalty. CX 169; Tr. at 654-56. Respondents provided limited information in response. CX 170; CX 197-CX 203; Tr. at 656-661. Ms. Isin further perused public records of Respondents and their related entities. She

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https://www.sec.gov/Archives/edgar/data/1577552/000119312514184994/d709111df1.htm. As Ms. Isin testified, the company is similar to Amazon.com. Tr. at 639.

[46] Respondents complain the information about them that the Agency obtained from the Internet is unreliable. *See, e.g.*, ARB at 14. There is no question that these sources are of limited reliability on their own, and they are most useful when considered in the totality of evidence related to Respondents' financial viability. Moreover, Respondents have offered no evidence to disprove the accuracy of the claims made on these websites or to otherwise show they are not credible.

[47] Generally, "ABEL estimates a company's future cash flow based on past performance," and its primary purpose is to inform settlement discussions by providing "a quick estimate of ability to pay." CX 25 at EPA-000525. The model does not capture potential sources of funds beyond the reported financial data, nor does it recognize that a respondent may obtain money to pay the penalty by liquidating nonessential assets, calling in loans made to officers, acquiring additional loans, or borrowing from parent or subsidiary companies. CX 25 at EPA-000526-000527.

discovered that Matao Cao was also the registered agent, director, and organizer of a company called Tao Motor, Inc., which formed January 6, 2016, and shared a business address with Taotao USA at 2201 Luna Road, Carrollton, Texas. Tr. 661-62; CX 207 at EPA-002737-39. The sole owner of Tao Motor is a Chinese company called Zhejiang Taotao Vehicles Co., Ltd. ("Zhejiang Taotao"), which is owned by both Matao and Yuejin Cao.[48] CX 191 at EPA-002523; CX 216 at 25, 86-88, 97-98. In her public records search, Ms. Isin additionally discovered that a company called 2201 Luna Road, LLC shared the same business address with Taotao USA and Tao Motor, and that Matao Cao was the manager of that company. CX 205; Tr. at 663. In reviewing property records and information about the interrelated companies, Ms. Isin determined the companies coordinated to obtain a more than $11 million Small Business Administration loan to purchase the property they shared. CX 206; CX 208; CX 209; Tr. at 665-681. "How is it they were able to obtain such a large loan? How did they qualify for that? [W]hy, if they can qualify for that, why can't they pay a $1.6 million penalty?" Ms. Isin testified. Tr. at 681.

According to Mr. Carroll, based on its federal tax returns and other selected data, Taotao USA is able to pay a penalty of at least $3.295 million and continue in business. CX 192 at EPA-002576, 002578; Tr. at 395-96. Mr. Carroll came to this conclusion after reviewing federal income tax returns filed by Taotao USA for tax years 2012 through 2015.[49] CX 161-CX 163; CX 171; CX 192; Tr. at 396-97. Mr. Carroll specifically focused on the company's receivables – shipments or sales for which it had not yet been paid – and the company's accounts payable – expenses that have been incurred but not paid. CX 192 at EPA-002578, 002582-002586; Tr. at 397. Mr. Carroll also looked at industry-specific characteristics, i.e., those possessed by "motor vehicle, motor vehicle parts, and supplie[s] merchant wholesalers," based on the North American Industry Classification System ("NAICS").[50] Tr. at 399-401, 480-81. He compared numbers

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[48] Matao Cao owns [redacted] percent of Zhejiang Taotao, and his father Yuejin Cao owns [redacted] percent. CX 191 at EPA-002523; CX 216 at 97. Taotao China and Jinyun manufacture vehicles on production lines they rent from Zhejiang Taotao's factory in China. CX 216 at 93-95, 105-06.

[49] Mr. Carroll also considered the Amended Complaint, the dollar value of Taotao USA's imports in recent years, Agency guidance documents on evaluating a violator's ability to pay a penalty, RMA Annual Statement Studies, IRS Instructions for Form 1120, Investopedia.com, and the text Intermediate Accounting by Keiso Weygandt (15th ed.). CX 192 at EPA-002580-002581; Tr. at 439-442. Additionally, Mr. Carroll compared the value of purchases Taotao USA reported on its tax returns, about $[redacted], with the value of imports it reported to U.S. Customs and Border Protection, about $[redacted]. CX 194; Tr. at 435-36. "Unless there is something unexplained happening, for an import business such as Taotao USA, these numbers should be similar in size," Mr. Carroll wrote in his report. CX 194 at EPA-002592. Without further information, Mr. Carroll could not explain the reason for the differences in the numbers, but he noted that "a big red flag goes up." Tr. at 436, 489.

[50] Mr. Carroll obtained a NAICS code from Taotao USA's tax returns but discovered the number the company reported was incomplete and not an existing NAICS number. Consequently, Mr. Carroll extrapolated to "the next logical" number – 423110 – that best describes the industry in which Taotao USA is engaged. CX 192 at EPA-002580; Tr. at 399-401, 483, 496-98, 501, 505. He used that NAICS number to identify the appropriate RMA data to review. Using RMA data

reported by Taotao USA to industry-specific information from other similarly-situated companies compiled by the Risk Management Association ("RMA"), a non-profit association of bank lenders that collects data from financial statements of privately-held companies and publishes the information in composite form annually. CX 167; CX 192 at EPA-002578; Tr. at 401-02, 429-432, 477, 498. He further adjusted Taotao USA's reported numbers to comply with Generally Accepted Accounting Principles ("GAAP").[51] CX 192 at EPA-002578, 002580, 002582-002584; Tr. at 403, 414, 417-18, 426-27.

The RMA suggested a company like Taotao USA typically has receivables that are 10.3 percent of the company's total assets. Tr. at 402-03. Taotao USA's tax returns report that its receivables are [redacted]; however, if Taotao USA were in line with the industry average, Mr. Carroll calculated that during the years he reviewed, the company would have had actual receivables between $[redacted] and $[redacted]. CX 161-CX 163; CX 171; CX 192 at EPA-002582-002583; Tr. at 399, 403. Mr. Carroll acknowledged that if Taotao USA were paid in advance for its products, it would be accurate to report [redacted] accounts receivable. However, he further indicated that would be an unusual business practice. Tr. at 403-06, 418-420.

Similarly, Taotao USA on its tax returns reported an average ratio of cost of goods sold to accounts payable of [redacted]. CX 161-CX 163; CX 171; CX 192 at EPA-002585; Tr. at 408-410. According to the RMA data that Mr. Carroll used, the average ratio of companies similar to Taotao USA is 32.6; if Taotao USA is actually consistent with other companies in its industry, then nearly [redacted] percent of its reported accounts payable – $[redacted] to $[redacted] in each of the years examined – should be recharacterized, according to Mr. Carroll. CX 161-CX 163; CX 171; CX 192 at EPA-002585; Tr. at 409-411. In Mr. Carroll's view, this [redacted] percent of reported accounts payable is in fact equity investment by Taotao China in Taotao USA based on the duration, consistency, and growth of Taotao USA's accounts payable during the reviewed tax years as well as the fact that Taotao USA's accounts payable largely reflect money owed to Taotao China. CX 192 at EPA-002585; Tr. at 411-12, 423-24, 518, 522. That is, Taotao China invested money in Taotao USA and has continued to invest by [redacted] "on a regular basis for a great number of years." Tr. at 527.

Further, in Taotao USA's industry, it would be "quite extraordinary" to have accounts payable that are [redacted], Mr. Carroll testified. Tr. at 521. "Typical terms would be 30 to 60 days, not [redacted]," he said. Tr. at 534. Notably, it's a "related party transaction," he pointed out, which raises a red flag. Tr. at 426, 511-16, 533-34. "There's a father and son here. And I'm not sure who works for who, but they're all one, big, happy family," Mr. Carroll testified. "We have to look at it, what's the reality here. It reminds me of the story about did you ever buy a car from your father. Did you really pay a dollar for the car? That's a related-party transaction. We have related-party transactions here. I don't trust them."

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was appropriate, he testified, because it would be "spurious" to compare Taotao USA, a small, privately-owned company, to large, publicly-traded multinational companies like Kawasaki or Yamaha that file information with the U.S. Securities and Exchange Commission. Tr. at 497-99, 529.

[51] GAAP is a body of systems, procedures, and common definitions used in accounting, similar to the Uniform Commercial Code, according to Mr. Carroll. Tr. at 417-18. Mr. Carroll was not familiar with the accounting standards used in China. Tr. at 476.

Tr. at 426. Mr. Carroll further described Taotao USA as a healthy business with "[redacted]." Tr. at 427-28. In that sense, he said, Taotao USA serves as a "piggy bank that the money flows in and out of" due to the familial relationship between Taotao USA, Taotao China, Matao Cao, and Yuejin Cao. Tr. at 428. "It doesn't sound like an ordinary business transaction," Mr. Carroll observed. Tr. at 428.

Mr. Carroll's calculations led him to make a significant shift in the apparent net worth of Taotao USA. The company's tax returns report a net worth ranging from $[redacted] to $[redacted]; after the recharacterizations discussed above, Mr. Carroll's calculated net worth of the company ranges from $[redacted] to $[redacted].[52] CX 161-CX 163; CX 171; CX 192 at EPA-002586, Tr. at 423-24. "[T]he value of the company, because it's now equity as opposed to debt, jumps by the amount of the recharacterization, and it recognizes the risk return relationship of the Chinese company based on their continued investment in this particular business," Mr. Carroll testified. Tr. at 526. Consequently, Mr. Carroll opines that the company could pay the fine sought by the Agency by collecting loans made to shareholders; from financing based on accounts receivable; from financing based on inventories; by liquidating other assets; or from a loan based on equity. CX 192 at EPA-002586; Tr. at 413-17, 423.

At hearing, Mr. Shefftz testified that he also considered ability to pay on behalf of the Respondents, although his analysis was limited. Tr. at 899. For Taotao China and Jinyun, Mr. Shefftz reviewed "what appeared to be financial statements, or at least components of financial statements," although a lot of the documents were in Chinese so he did not understand them. Tr. at 875-76. Consequently, he produced no expert report about the two companies' ability to pay a penalty. Tr. at 877. However, he did create a spreadsheet from data in the financial statements he received and ran his own "ABEL-like" analysis. Tr. at 877, 901-02. His analysis showed that one of the Chinese companies "could afford to pay the entire amount of the proposed penalty," which at that time was $3.2 million, "and one company could pay only a portion." Tr. at 902-04.

As for Taotao USA, Mr. Shefftz was provided copies of the company's tax returns, although he did not further investigate the reliability of the underlying numbers. Tr. at 877, 899-900. He used information from those tax returns to run an ABEL analysis, which, based on projections of the company's internal cash flow, concluded, like Ms. Isin, that there was a 70 percent chance that Taotao USA could pay a penalty of $[redacted]. RX 1 at 22, 32; Tr. at 877-81.

Mr. Shefftz also disputed aspects of Mr. Carroll's testimony about the sources from which Taotao USA could pay a penalty. As for collecting loans made to shareholders, Mr. Shefftz characterized that "as a relatively small amount, about $[redacted]" according to the

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[52] As a result of extracting numbers from an adjacent column of data in the RMA text that applied to businesses larger than Taotao USA, Mr. Carroll stated that his final numerical calculation of accounts receivable is incorrect. However, he testified, the difference is immaterial and does not change his overall opinion on Taotao USA's ability to pay the penalty. Tr. at 432-33. The Agency sought to file a corrected expert's report immediately prior to the hearing but was denied because the request was made too late. *See* n.6; Complainant's Motion for Leave to File Out of Time & Motion to Correct Expert Report (Oct. 16, 2017); Tr. at 373, 394, 445.

company's most recent tax return. Tr. at 884. Further, he said, there are questions about that figure, as shareholders may have been foregoing returns from the company in exchange for the loan. Tr. at 884. With respect to liquidating "other assets," an amount Mr. Carroll pinned at $[redacted] in the 2015 tax return, Mr. Shefftz said he did not know whether other assets could be a source of cash to pay the penalty because "I just don't know what the composition of those other assets are." CX 192 at EPA-002586-002587; Tr. at 885. Such assets may or may not be related to Taotao USA's line of business, so it is unclear whether liquidating them would impact the company's ability to continue in business, he testified. Tr. at 885. Regarding the other penalty payment sources Mr. Carroll identified, Mr. Shefftz expressed skepticism as to their usefulness. Taotao USA could secure a loan with its existing inventory of vehicles, he suggested, but it could not realistically liquidate that inventory to pay the loan because "its business is importing these vehicles and then selling them . . . . [I]t's not really a source of paying a penalty unless we're talking about shutting down and liquidating the business." Tr. at 886. Similarly, he added, Taotao USA could not really obtain financing based on its accounts receivable because that is money based on past sales, "[a]nd that's how the company stays in business is by getting money for what it sold previously." Tr. at 886. Yet he also acknowledged that his own ABEL analysis relies on money coming in from vehicle sales, "[s]o in some ways I'm saying yes, that money should be used to pay the penalty[.]" Tr. at 886. Regarding a loan based on equity, it requires the company's assets "either being regenerated through cash flow or that are somehow not related to the ability to continue in business," Mr. Shefftz states. Tr. at 886.

Additionally, Mr. Shefftz rebutted the adjustments Mr. Carroll made to Taotao USA's net worth. It might be reasonable to adjust the accounts receivable if the purpose was "trying to come up with a more complete balance sheet for the company, and we just wanted to have some rough idea of what it would be if the company's accounts receivable looked like other companies in this industry." Tr. at 887. But that approach does not work for penalty purposes because "bigger net worth based on the book value does not mean somehow the company has a greater ability to pay a penalty, because that's just a number on paper. It doesn't represent actual cash the company has that can pay a penalty," Mr. Shefftz testified. Tr. at 888. He did agree with Mr. Carroll, however, that "[i]t would be very odd for a company like [Taotao USA] to have [redacted]. So to that extent, I questioned that aspect of it." Tr. at 900 Still, Mr. Shefftz added, relying on RMA data for that purpose is "essentially just saying in that case that the company's financial health is typical financial health, at least for some of its components, as other companies in its industry," when the point is "to know specifically what is the financial condition of this actual company in reality." Tr. at 888. Mr. Shefftz called Mr. Carroll's adjustments based on Taotao USA's accounts payable "even more speculative." Tr. at 888. Having a large accounts payable "could mean the company is having trouble paying its suppliers in a prompt way and that the bills are essentially piling up over time." Tr. at 888. Or, Mr. Shefftz added, the numbers could be "an accounting convention carried over from prior years and they have no real financial meaning anymore." Tr. at 889. Additionlly, Mr. Shefftz testified that the trend in the accounts payable numbers from 2012 to 2015, with a $[redacted] between 2013 and 2014, may reflect that something is being paid off or "that Taotao USA is having so much trouble paying its suppliers that it's essentially been written off as debt by its suppliers." Tr. at 889-890. Mr. Shefftz professed to not understand Mr. Carroll's conclusion that the accounts payable actually represent an equity stake in Taotao USA by Taotao China and Jinyun. Tr. at 890. "That strikes me as entirely speculative and not supported by . . . anything in the documentary record in this case," Mr. Shefftz contended. Tr. at 890. And, he added, even if

it were true, that does not represent a cash source from which Taotao USA could pay a penalty. Tr. at 890.

2. Agency Argument

The Agency did not adjust the penalty downward based on any of the Respondents' having a limited ability to pay. AB at 16, 20. The Agency asserts it met its burden of showing that it considered this factor in calculating a penalty that is appropriate overall, and that none of the Respondents met their burden to produce specific evidence demonstrating that they cannot pay and that the proposed penalty is inappropriate. AB at 16; ARB at 12-13.

In general, the Agency contends, "substantial evidence" shows that Taotao China and Jinyun are able to pay the penalty "because the financial condition of a parent is highly relevant to assessing a subsidiary's ability to pay, and JCXI is a subsidiary of Taotao Group." AB at 16. In particular, the evidence suggests Taotao China "controls a large, profitable, multi-faceted business enterprise with a sales presence in many parts of the world," the Agency argues. AB at 16. And in addition to asserting that neither Taotao China nor Jinyun put forth evidence that they lack an ability to pay, the Agency points to Mr. Shefftz's testimony that the companies could pay a $3.2 million penalty. AB at 16-17; ARB at 13.

As for Taotao USA, the Agency seeks to undercut Mr. Shefftz's opinion that the company can pay only $[redacted] by noting that his ABEL analysis "used inputs solely derived from Taotao USA's tax returns, and assessed only predicted future cash flow." AB at 17. He did not review other financial documents or consider Taotao USA within the context of "the broader family-owned business enterprise," the Agency notes. AB at 17. Thus, the Agency contends, his analysis does not provide a complete picture of Taotao USA's business size or financial resources. AB at 17; ARB at 13.

According to the Agency, the evidence reveals Taotao USA to be a mere pass-through entity "that allows [Taotao China] and [Jinyun] to move Taotao vehicles into the United States market, and depends on this broader business enterprise to exist." AB at 17. The Agency states that Taotao USA's tax returns, particularly as described by Mr. Carroll, paint this broader picture even as they appear on their face to portray a company that is "thinly financed and unstable." AB at 19. To that end, "[a]ny consideration of Taotao USA's ability to pay must account for its ability to obtain support from its owner and other entities in the Taotao family enterprise," the Agency argues. AB at 18; ARB at 14.

In response to the allegations against them, the Agency notes, Respondents did not put forth specific evidence of an inability to pay the penalty. AB 20. Mr. Shefftz's testimony and analysis was limited and relied on the face value of Taotao USA's tax returns, the Agency asserts, and he further testified that Taotao China and Jinyun could pay the penalty. AB at 20.

3. Respondents' Argument

Respondents contend it is the Agency's burden to prove they "have an ability to pay the proposed penalty." RB at 19. They further state that the ABEL model is the most appropriate way to measure ability to pay, and ABEL analysis revealed that Taotao USA can pay a penalty of only $700,000. RB at 19.

Respondents further assert that Mr. Carroll's analysis was based merely on a "smell test" and that he arbitrarily compared Taotao USA to other businesses presumed to be similar "without considering the unique facts of this case, and whether or not what's typical in the United States is typical in foreign corporations or domestic corporations run by foreign nationals." RB at 20.

Additionally, Respondents contend that the information regarding their imports and gross revenue which the Agency obtained from the Internet is unreliable and "meaningless because gross revenue that does not account for manufacturing costs, expenses, loan payments, interests, et cetera cannot establish an ability to pay." RB at 20; *see also* ARB at 13-14 (arguing such evidence does not satisfy the low threshold of showing a reasonable inference of financial ability). Respondents also contend that Mr. Shefftz's testimony that Taotao Group or Jinyun could pay a $3.2 million penalty is "entirely irrelevant." ARB at 14-15. Finally, Respondents argue the Agency failed to present compelling evidence of Respondents' relationships to other parties that impacts their ability to pay the penalty. RB at 20; ARB at 15.

4. Analysis

To the extent Respondents placed their ability to pay at issue in this proceeding, the Agency presented sufficient evidence, as outlined above, to show that it considered this as part of its prima facie case. Specifically, the Agency reviewed Respondents' import history, publicly-available descriptions of their businesses, and limited financial documents the companies provided or that were obtained elsewhere. The Agency also sought additional information from Respondents and hired an expert to evaluate the documents. *See* Tr. at 634, 845-46. Based on the general financial information gathered by the Agency, there is sufficient evidence to support an inference that the proposed penalty need not be reduced based upon any inability to pay.

Consequently, the burden shifted to Respondents to provide detailed evidence demonstrating they cannot afford to pay the penalty. But Respondents produced almost no evidence at hearing, let alone *specific* evidence, of their inability to pay.

With respect to Taotao China and Jinyun, the Agency admitted into the record evidence demonstrating the companies' general financial health and that their ability to pay could be inferred through publicly available information about the scope of their operation and common ownership. That is, Taotao China has 2,000 employees, 200 staff members, and owns multiple subsidiary companies. It makes ATVs, motorcycles, electric vehicles, electric bicycles, wooden doors, steel doors, running machines, fitness equipment, and garden tools. *See, e.g.*, CX 35 at EPA-000607; CX 168 at EPA-002296; CX 191 at EPA-002520. The company boasts annual revenues of $80 to $100 million. *See* CX 35; CX 168 at EPA-002296; Tr. at 639-640. Jinyun is one of six subsidiary corporations that Taotao China owns. *See* CX 35; CX 168 at EPA-002296; CX 191 at EPA-002522; CX 216 at 105; Tr. at 639, 695. Yuejin Cao is the owner of Taotao China and the president of both Taotao China and Jinyun. *See* Am. Compl., ¶¶ 14-15; Resp'ts Am. Answers, ¶¶ 14-15; Tr. at 100, 155; CX 216 at 105. Considering only the vehicles at issue in this case, the companies together manufactured an inventory valued at $[redacted] at the time it was imported into the United States. *See* CX 61; CX 64; CX 140; CX 148; CX 183-CX 189; Tr. at 565-68. And notably, "the Agency may look at the financial condition of a related company to determine whether the related company may be a legitimate source of funds

affecting the respondent's ability to pay or the economic impact of the penalty." *Carroll Oil Co.*, 10 E.A.D. 635, 665 (EAB, July 2002) (citing *New Waterbury*, 5 E.A.D. at 549). *See also United States v. Mun. Auth. of Union Township*, 150 F.3d 259, 268-69 (3rd Cir. 1998) (observing that financial condition of defendant's parent corporation is relevant consideration in assessing a company's ability to pay).

On the other hand, Respondents did not introduce any evidence to rebut or discredit the Agency's evidence of the financial health of the Chinese companies, nor did they undermine any of the Agency witnesses' testimony on these issues. Respondents had ample opportunity at hearing to introduce additional financial information about Taotao China and Jinyun to support their inability to pay claim, but they did not. Respondents could have provided financial statements and company executives to explain them, but did not. Moreover, Respondents' own expert witness testified that either Taotao China or Jinyun "could afford to pay the entire amount of the proposed penalty," which at the time of his analysis was $3.2 million, and the other company could pay a portion of that amount.[53] Tr. at 902-04. Given the intimate relationship between these companies and the individual who controls them, it is not relevant *which* one can afford to pay a $3.2 million penalty, which is double the total penalty proposed in this case. Rather, it is reasonable to infer that resources can be shifted from one company to the other and that both have the ability to pay.

As for Taotao USA, the Agency has carried its burden of putting forth *general* information regarding Taotao USA's financial status sufficient to support an inference that the penalty need not be reduced, and Taotao USA has not presented *specific* evidence showing that it cannot pay the penalty. Most persuasively, the Agency has shown that for purposes of assessing Taotao USA's ability to pay, the company should be viewed not as an isolated entity but as part of a global corporate enterprise controlled by a father and son. This corporate enterprise includes Respondents as well as related companies such as Tao Motor, Zhejiang Taotao, and 2201 Luna Road, LLC. The evidence shows that an overall aim of this corporate enterprise is to manufacture, import, and sell motorcycles and offroad vehicles in the United States. Taotao USA's role in this enterprise, as shown by the evidence, has been to import these vehicles, apply for and hold their COCs, and sell the vehicles to dealers. To that end, inventory and cash pass freely through Taotao USA. What this shows is not that Taotao USA lacks the ability to pay a penalty, but rather the depth of resources it can tap for this purpose: Taotao USA is controlled by Matao Cao, whose father, Yuejin Cao, controls Taotao China, which in turn owns Jinyun. That is, Respondents are all related; Yuejin Cao has responsibility for the overall enterprise, and Matao Cao has specific responsibility for the U.S. entities. *See* CX 191 at EPA-002522-002523; Tr. at 155-58, 213-15, 367. Thus, Taotao China and Jinyun manufacture vehicles on production lines they rent from Zhejiang Taotao's factory in China. *See* CX 216 at 93-95, 105-06. Zhejiang Taotao is wholly owned by Matao Cao and Yuejin Cao. *See* CX 191 at EPA-002523; CX 216 at 97. Taotao USA is the exclusive importer into the United States of Taotao China and Jinyun

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[53] Although Mr. Shefftz did not include this testimony in his report, apparently because he "did not have enough confidence that the financial statements represented what I would like them to represent," his opinion is probative of Taotao China's and Jinyun's ability to pay because it represents his conclusion after reviewing documents the companies provided him for the specific purpose of making an ability to pay assessment. *See* Tr. at 875-877. Moreover, Respondents produced no evidence at hearing that would undermine or contradict their expert's testimony.

vehicles, which were manufactured in Zhejiang Taotao's factory, and Taotao USA does not purchase vehicles from any suppliers other than Taotao China and Jinyun. *See* CX 1 at EPA-000018; CX 5 at EPA-000171; CX 95 at EPA-001212-13; CX 216 at 10-11, 25-30, 44-46; Tr. at 308. In fact, between 2009 and 2016, Taotao USA was among the top [redacted] importers of Chinese-made motorcycles and recreational vehicles, and the value of these imports during those years exceeded $[redacted] while the value of the vehicles imported in this case tops $[redacted]. *See* CX 189; CX 190A; Tr. at 565-66, 571, 635-38, 844. Moreover, either Taotao China or Jinyun have the ability to pay a penalty that is nearly twice the amount the Agency proposes to assess in this case.

To that end, Taotao USA's ability to pay is demonstrated through its relationship to other companies if not by the limited financial documents it produced – in this case, its tax returns.[54] Importantly, recognizing Taotao USA's ability to pay the penalty levied against it in this matter does not set aside the company's corporate form or suggest that another company is liable for its transgressions. Rather, it merely reflects the extensive resources from which Taotao USA can draw to meet the costs of business, which in this case include a penalty for violating the CAA. Of further significance is Taotao USA's failure to submit sufficient financial documentation beyond its tax returns. As the EAB indicated in *Bil-Dry*, Taotao USA succeeded only in offering evidence of its income that is subject to federal corporate taxation. It did not offer adequate evidence that would explain how the proposed penalty would cause it to suffer undue financial hardship or prevent it from paying ordinary and necessary business expenses.

Moreover, Respondents did not rebut the Agency's evidence of Taotao USA's ability to pay nor the inferences that can be drawn from that evidence. Respondents only produced direct evidence from Mr. Shefftz that, based on its self-reported cash flow, the company can pay a penalty of at least $[redacted] *See* RX 1 at 22, 32; Tr. at 651-52, 877-81. But to be clear, his analysis relies only on cashflow that Taotao USA reported on its income tax returns. It does not consider the company's broader assets or assets that might be available to it through related companies. *See* RX 1 at 2, 22, 32-35; Tr. at 877–79, 881, 899–900. Consequently, Mr. Shefftz's analysis establishes the minimum penalty amount Taotao USA could pay; it does not place any ceiling on that amount. And as demonstrated through Mr. Carroll's testimony, there is evidence that Taotao USA's tax returns do not paint a full picture of the company's financial health or the depth of its resources. Mr. Shefftz did not conduct any investigation behind the numbers reported on the tax returns that he then relied on for his ABEL analysis, Mr. Carroll noted. "If you don't investigate the number, the conclusions are not reliable," Mr. Carroll testified. Tr. at 437, 445-46.

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[54] To that extent, Mr. Carroll's analysis of Taotao USA's tax returns is persuasive to the overall conclusion that the company can afford to pay the penalty even if his recharacterization of the company's overall net worth relies to some extent on conjecture. He too notes the circumstantial evidence – the Cao family relationship, abnormal treatment of accounts payable and receivable, lack of bank loans, inconsistent reporting of the declared value of its imports – that Taotao USA has significant resources available to it that are not immediately apparent on the face of its tax documents.

For these reasons, the penalty the Agency has proposed is appropriate taking into account the evidence as it relates to Respondents' ability to pay, and Respondents did not meet their burdens of production or persuasion that they are unable to pay the penalty.

E. Penalty Conclusion

After considering the statutory penalty factors as well as the various relevant components of the Penalty Policy and applying them to the facts of this case, I find the penalty proposed by the Agency appropriate and consistent with the evidence and the CAA. I assess a total civil penalty of $1,601,149.95 against Taotao USA for violations alleged in Counts 1 through 10. Of that total, I assess against Taotao China, jointly and severally, a penalty of $247,982.55 based on violations alleged in Counts 1 through 4. Also of the total civil penalty, I assess against Jinyun, jointly and severally, a penalty of $1,353,167.40 based on violations alleged in Counts 5 through 10.[55]

DECISION AND ORDER

1. Respondents are jointly and severally liable for the total civil penalty as discussed above, and they are ordered to pay that amount in the manner directed below.

2. Taotao USA is jointly and severally liable for the total penalty assessed in this case, in the amount of **$1,601,149.95**.

3. Of the total penalty amount, Taotao China is jointly and severally liable for **$247,982.55**.

4. Of the total penalty amount, Jinyun is jointly and severally liable for **$1,353,167.40**.

5. Payment of the full amount of this civil penalty shall be made within **30 days** after this Initial Decision becomes a final order under 40 C.F.R. § 22.27(c), as provided below:

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[55] I reached these penalty amounts by using most of the same calculations presented by the Agency in its Revised Penalty Calculation Worksheet. *See* CX 213. However, in light of the Agency's acceptance of Respondents' economic benefit calculation, I too followed Mr. Shefftz's calculation as he presented them for each count. *See, e.g.*, RX 1 at 21 (Row 4); RX 1 at 28, 29 ("Economic Benefit; Total = $219,299" Row). The economic benefit Mr. Shefftz attributed to each count conflicted with the per-count allocation the Agency reported in its worksheet. Relying on Mr. Shefftz's calculation leads to a slightly larger share of the penalty for Taotao China than what the Agency proposed, and a slightly smaller share for Jinyun. *See* CX 213. However, it does not alter the total penalty or the total economic benefit calculation that the Agency sought and accepted, and the Agency offered no explanation to support deviating from Mr. Shefftz's allocation.

Payment shall be made by submitting a certified or cashier's check(s)[56] in the requisite amount, payable to "Treasurer, United States of America," and mailed to:

U.S. Environmental Protection Agency
Fines and Penalties
Cincinnati Finance Center
P.O. Box 979077
St. Louis, MO 63197-9000

A transmittal letter identifying the subject case and EPA docket number (CAA-HQ-2015-8065), as well as the Respondents' names and addresses, must accompany the check.

If Respondents fail to pay the penalty within the prescribed statutory period after entry of this Initial Decision, interest on the penalty may be assessed. *See* 31 U.S.C. § 3717; 40 C.F.R. § 13.11.

6. Pursuant to 40 C.F.R. § 22.27(c), this Initial Decision shall become a final order **45 days** after its service upon the parties and without further proceedings unless: (1) a party moves to reopen the hearing within **20 days** after service of this Initial Decision, pursuant to 40 C.F.R. § 22.28(a); (2) an appeal to the Environmental Appeals Board is taken within **30 days** after this Initial Decision is served upon the parties pursuant to 40 C.F.R. § 22.30(a); or (3) the Environmental Appeals Board elects, upon its own initiative, to review this Initial Decision, under 40 C.F.R. § 22.30(b).

SO ORDERED.

Susan L. Biro
Chief Administrative Law Judge

Dated: August 7, 2018
Washington, D.C.

[56] Respondents may also pay by one of the electronic methods described at the following Agency website: https://www.epa.gov/financial/additional-instructions-making-payments-epa

In the Matter of *Taotao USA, Inc., Taotao Group Co., Ltd., and Jinyun County Xiangyuan Industry Co., Ltd.,* Respondents. Docket No. CAA-HQ-2015-8065

CERTIFICATE OF SERVICE

I certify the foregoing **Initial Decision**, dated August 7, 2018, and issued by Chief Administrative Law Judge Susan L. Biro, was sent this day to the following parties in the manner indicated below.

Matt Barnwell
Attorney Advisor

Original by Hand Delivery To:

Mary Angeles
Headquarters Hearing Clerk
U.S. Environmental Protection Agency
Office of Administrative Law Judges
Room M1200
1300 Pennsylvania Avenue, N.W.
Washington, DC 20004

Copies by E-Mail To:

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Dated: August 7, 2018
Washington, D.C.