UNITED STATES
ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE ADMINISTRATOR

In the Matter of:	)	
	)	
Borla Performance Industries, Inc.,	)	**Docket No. CAA-R9-2020-0044**
	)	
Respondent.	)	

COMPLAINANT'S REBUTTAL PREHEARING EXCHANGE

The Director of the Enforcement and Compliance Assurance Division ("ECAD") of the U.S. Environmental Protection Agency's Region 9 Office ("Complainant") files this Rebuttal Prehearing Exchange, consistent with section 22.19 of the Consolidated Rules of Practice Governing the Administrative Assessment of Civil Penalties and the Revocation/Termination or Suspension of Permits ("Consolidated Rules"), and with the Prehearing Order issued by this Tribunal on October 19, 2020, as amended by the Order on Join Motion for Extension of Time filed February 5, 2021. Complainant may amend or supplement this Prehearing Exchange as provided by sections 22.19(f) and 22.22(a)(1) of the Consolidated Rules.

The Prehearing Order directs Complainant to provide in its Rebuttal Prehearing Exchange: (I) a detailed explanation of the factors considered and methodology utilized in calculating the amount of the proposed penalty, in accordance with the criteria set forth in the particular statute authorizing this proceeding and as referenced in the proposed civil penalty section of the Complaint; and (II) a statement and/or any documents in response to Respondent's Prehearing Exchange as to provisions 3(A) through 3(D) of the Prehearing Order.

I. Complainant's Proposed Penalty and Penalty Calculation Explanation.

Complainant proposes an assessment of an administrative civil penalty of **$1,272,126** against Respondent for the 5,338 violations alleged in Count 1 of the Amended Complaint for violations of section 203(a)(3)(B) of the Clean Air Act ("CAA" or the "Act"), 42 U.S.C. § 7522(a)(3)(B).

Any person violating sections 203(a)(3)(B) of the CAA, 42 U.S.C. § 7522(a)(3)(B), is subject to a civil penalty of up to $3,750 for each for each violation that occurred on or before November 2, 2015, and up to $4,876 for each violation that occurred after November 2, 2015, where penalties are assessed on or after December 23, 2020. CAA § 205(a), 42 U.S.C. § 7524(a); 40 C.F.R. § 19.4; Civil Monetary Penalty Inflation Adjustment Rule, 85 Fed. Reg. 83818, 83821 (Dec 23, 2020). Any such violation with respect to section 203(a)(3)(B) of the CAA, 42 U.S.C.

§ 7522(a)(3)(B) shall constitute a separate offense with respect to each part or component. CAA § 205(a), 42 U.S.C. § 7524(a).

In determining the amount of the civil penalty in this matter, the CAA requires that the EPA take into account certain statutory penalty factors, namely "the gravity of the violation, the economic benefit or savings (if any) resulting from the violation, the size of [Respondent's] business, [Respondent's] history of compliance with this subchapter, action taken to remedy the violation, the effect of the penalty on [Respondent's] ability to continue in business, and such other matters as justice may require." CAA § 205(c)(2), 42 U.S.C. § 7524(c)(2).

Complainant calculated the proposed penalty according to EPA's Clean Air Act Title II Vehicle and Engine Civil Penalty Policy, issued in January 2021, and available to the public at https://www.epa.gov/sites/production/files/2021-01/documents/caatitleiivehicleenginepenaltypolicy011821.pdf (last visited February 1, 2021) (hereinafter the "Penalty Policy"). The Penalty Policy sets forth the policy of the EPA for assessing administrative civil penalties for violations of certain CAA provisions concerning motor vehicles and motor vehicle engines, and nonroad vehicles, engines, or equipment, including violations of Section 203(a)(3)(B) of the CAA. Penalty Policy at 1.

The purpose of the Penalty Policy is to ensure that: (1) civil administrative penalties are assessed in accordance with the CAA in a fair and consistent manner; (2) penalties are appropriate for the gravity of the violation; (3) penalties are sufficient to deter both individual violators and the regulated community as a whole from committing violations; (4) economic incentives for noncompliance are eliminated; and (5) compliance is expeditiously achieved or maintained. Penalty Policy at 1. The Penalty Policy considers and is grounded upon the statutory penalty factors set forth in Section 205(c)(2) of the CAA. The EPA states in the Penalty Policy that it should be used to calculate administrative penalties assessed under Section 205(c) of the CAA in a proceeding under the Consolidated Rules of Practice of 40 C.F.R. Part 22. Penalty Policy at 1-2.

When calculating the penalty, the Complainant rounded all monetary figures to the nearest dollar. As described below, consistent with the Penalty Policy, the proposed penalty consists of two fundamental components: the economic benefit penalty component, and the gravity penalty component. Penalty Policy at 4.

A. Economic Benefit.

The economic benefit component accounts for the economic benefit or savings resulting from the violation. Consistent with the Penalty Policy, Complainant assessed Respondent's economic benefit from the violations based upon the illegal or wrongful profits from Respondent's sale of illegal defeat devices, otherwise referred to under the Penalty Policy as "beyond BEN benefits" (or "BBBs"). Penalty Policy at 5-8.

To determine the illegal or wrongful profits from Respondent's illegal sales of defeat devices that are alleged in the Second Amended Complaint, Complainant's expert Gail Coad assessed the profits Respondent incurred from these sales. For purposes of calculating economic benefit based on profits,

Ms. Coad's approach is to subtract all direct costs of the sale[1] from the sale price, reduce that amount by the estimated income taxes paid by Respondent, and then adjust the amount to present value by applying an appropriate discount rate.[2]

Ms. Coad reviewed financial information that Respondent submitted to Complainant on November 14, 2019. See CX022 and CX023. Ms. Coad's spreadsheet workbook pages showing the detail and results of her calculations are included at CX019. Ms. Coad applied Complainant's information to calculate the Gross Profits ("GP"), Gross Profits Less Variable Costs ("GP-VC"), and Gross Profits Less Variable Costs Less Allocated Costs (GP-VC-AC).[3] Ms. Coad then reduced the values to after-tax terms, using the top federal and state (California) marginal income tax rates for pass-through entities, as taken from EPA's BEN model 2020.0.0.[4,5] Finally, Ms. Coad applied year-by-year discount rates included in the EPA's BEN model 2020.0.0[6] to determine the present value of the illegal profits as of March 31, 2021. A summary of the results of Ms. Coad's calculations are at CX019 at 3.

Ms. Coad's opinion is that the GP-VC present value after-tax profit from Respondent's violations of $592,654 is a reasonable approximation of Respondent's economic benefit from the violations. Ms. Coad selected this value (GP-VC) rather than the GP amount because it is appropriate to include costs that can be directly attributed to the production and sale of the violative products. Ms. Coad opinion is not based on the GP-VC-AC present value after-tax profit because the annual sale of the violative products is a small percentage of the Respondent's overall annual sales activity, currently

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[1] "Direct costs of the sale" means the "cost of goods sold" (i.e. costs of manufacturing a product, including labor, input materials or manufacturing expense) plus any other costs that can be directly attributable to the product (i.e., freight, warranties, interest).

[2] "Discount rate" is a value representing the company's cost of capital, a value that it must return on its investments at a minimum. In this case we apply the discount rate to take into account the benefit that Borla gained as a result of the profits from the illegal products.

[3] GP equals sales price minus costs of goods sold (i.e., standard costs plus other manufacturing costs). Variable Costs reflect costs for outbound freight, warranties and interest that contribute to the direct costs of a sale and can be attributed to an individual product. Allocated costs reflect a share of fixed overhead costs (i.e., research and development costs, administrative costs, and sales and marketing costs) that Borla had applied in its economic benefit calculations included in CX023.

[4] EPA's BEN model is used by EPA enforcement staff to estimate the economic benefit a violator may have gained from delayed or avoided compliance costs. The BEN model is available at: https://www.epa.gov/enforcement/penalty-and-financial-models (last visited March 16, 2020). Under EPA contract, Ms. Coad and her staff provide support to EPA in maintaining and updating the BEN model, as well as training EPA staff in the use of the model.

[5] The top marginal income tax rates for S-Corporations that Ms. Coad applied are provided at CX019 at 6. Use of the top marginal income tax rates, and use of the higher marginal state tax rates for California rather than Tennessee, are conservative assumptions, as Borla has not provided any evidence of its actual marginal tax rates, which could be lower.

[6] The year-by-year discount rates for S-Corporations that Ms. Coad applied are provided at CX019 at 6. Ms. Coad applied the year-by-year discount rates for S-Corporations used in the BEN model to calculate the Present Value Adjustment Factor for each year 2014 through 2018, and these adjustment factors are multiplied with after-tax profit values to adjust the profits to present value. Under contract to EPA, Ms. Coad and her staff update the discount rate values in the BEN model annually. The Present Value Adjustment Factors Ms. Coad applied are provided at CX019 at 6. Ms. Coad's use of the BEN model's discount rates for S-Corporations is reasonable given that Borla has not provided any alternative discount rate specific to the company.

estimated to be $22.8 million.[7] The "AC" costs, which are not directly relatable to a specific product sale, and which are applicable to the sales of all products, do not vary with each unit of production, although they may vary in a step-wise manner depending on overall company sales activities.

To assess how Borla's reported financial information and Ms. Coad's estimated profits compare with industry benchmarks for profit margins, Ms. Coad obtained relevant industry-reported data from the Risk Management Association ("RMA"), Annual Statement Studies, Financial Ratio Benchmarks[8] for NAICS 336390 – Other Motor Vehicle Parts Manufacturing and NAICS 423120 – Motor Vehicle Supplies and New Parts Merchant Wholesalers, which are the NAICS codes most relevant to Respondent's business. The relevant data considered is provided at CX019 at 39-40. A summary table of Ms. Coad's assessment is provided at CX019 at 40. Ms. Coad's assessment is that Respondent's reported financial information concerning profits is roughly similar to the industry benchmarks for profit margins.

B. Gravity Component.

The gravity component accounts for the potential harm the violation poses, the likelihood of harm or extent of harm that occurred, the effectiveness of efforts to correct the violation, the size of the violator, the violator's culpability, the violator's degree of cooperation, and the violator's compliance history. Penalty Policy at 9. As stated in the Penalty Policy:

> Violations of the Act undercut Title II's comprehensive program for emissions control and reduction, increasing the risk to human health and the environment. Harm is thus inherent in each violation, though the precise nature and degree of harm may vary depending upon the circumstances of the case. Proof that violation resulted in actual harm to human health is not necessary; it is sufficient to demonstrate the potential for harm.

Penalty Policy at 9.

Consistent with the Penalty Policy, the first part of the gravity component assessed was the egregiousness of each violation. The egregiousness of the violation refers to the likelihood that the violation will result in harm to the regulatory scheme, harm to human health and the environment in the form of excess emissions, or both. The most egregious violations include those where the EPA's ability to administer the regulatory program is significantly impaired, excess emissions are likely to occur, or where there is no reliable information about vehicle or engine emissions. Penalty Policy at 10. In this matter, the violative parts identified in the Second Amended Complaint remove emission-related elements of design in motor vehicles. Particularly, the violative parts eliminate catalytic converters, which are key aftertreatment emission control devices, from the exhaust system from any motor vehicle

[7] This annual revenue estimate is from a D&B Hoovers OneStop Report for the "Borla Performance Industries, Inc." location in Johnson City, Tennessee. CX020 at 15. Borla has not provided any information on the company's total annual sales for the violative period or more recently. Annual violative product sales averaged about $767,000, which is about 3.4% of the company's estimated annual sales. Therefore, it is unlikely that the violative sales had any significant or material impact on the company's overhead or "Allocated Costs."

[8] The Risk Management Association (RMA) is a not-for-profit professional association that has 1,900 institutional members across the banking and financial services industries. The RMA, Annual Statement Studies, Financial Ratio Benchmarks provide "industry benchmark data that comes directly from the financial statements of small and medium-size business clients of RMA's member institutions." More information on RMA is available at: https://www.rmahq.org/annual-statement-studies/ (last visited March 16, 2020).

on which they are installed. Catalytic converters are a critical emissions-related element of design in gasoline-fueled motor vehicles, installed by original manufacturers of motor vehicles and motor vehicle engines to meet emission standards in order to obtain a certificate of conformity in compliance with Title II of the CAA. Therefore, the manufacture and sale of this violative parts constitute Tier 2 egregiousness under the Penalty Policy. Penalty Policy at 28 (violations that remove aftertreatment systems are Tier 2 violations unless reliable emissions testing shows that the violations do not increase tailpipe emissions).

Once the violations were determined to be Tier 2 egregiousness, the category of the affected vehicles was determined based on the type of motor vehicles or motor vehicle engines for which the parts or components are intended to be installed. In this matter, the parts are intended to be installed into gasoline light-duty vehicles which fall into Size Category B of Table C1. Penalty Policy at 30. The penalty for each Tier 2 violation under Size Category B is $1,500.

Under the Penalty Policy, the Complainant has discretion when calculating the total gravity penalty to apply a scaling equation which incrementally reduces the per-violation penalty starting with the 51st violation. The Complainant has chosen to do so in this case. The equation to calculate the gravity portion of the penalty is below with P_1 being the "per violation" amount, $1,500, that was found using Table C1.

$$(49*P_1) + [\ (\#\ \text{of Violations} - 49)^{0.7} * P_1] = \text{Gravity Penalty}$$

Inserting the number of alleged violations found in the Second Amended Complaint (5,338) into "# of Violations", and the $1,500 amount found in Table C1 into "P_1", results in the below equation and a gravity penalty of $679,472.

$$(49 * \$1{,}500) + [(5{,}338 - 49)^{0.7} * \$1{,}500] = \$679{,}472$$

The next step in calculating the gravity penalty component is to account for the remediation of the alleged violations. Penalty Policy at 12-13. In this matter, no reduction was included since Respondent provided no substantiated information to the EPA concerning remediation.

Pursuant to the Federal Civil Penalty Inflation Adjustment Act, 40 C.F.R Part 19, and the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, the gravity component of the penalty must be further adjusted to account for inflation. EPA periodically issues civil monetary penalty inflation adjustment rules to account for inflation. The most recent Civil Monetary Penalty Inflation Adjustment Rule was issued on December 23, 2020 at 85 Fed. Reg. 83818.[9] This Rule precedes the issuance of the Penalty Policy which became effective on January 18, 2021. At this time, no inflation guidance memos have been issued adjusting the Penalty Policy, so no inflation adjustments to the gravity component have been made.

In calculating the proposed penalty, Complainant did not adjust the penalty to reflect the size of Respondent's business. The D&B Hoovers OneStop Report for the "Borla Performance Industries, Inc." location in Johnson City, Tennessee provides a modelled estimate of Respondent's annual sales for 2020 as approximately $22.8 million. CX020 at 15. Per the Penalty Policy, if a violator's most recently

[9] Available at https://www.govinfo.gov/content/pkg/FR-2020-12-23/pdf/2020-26997.pdf.

complete year of revenue is $30 million or more, the gravity would be increased by an amount equal to 0.15 percent of the violator's annual revenue. Penalty Policy at 13-14. Since information available to Complainant indicates that Borla's revenue was less than $30 million, Complainant did not adjust the penalty due to business size.

That being said, Complainant did seek information from Respondent concerning annual revenue in its Information Request to Respondent issued pursuant to Section 208 of the CAA, and Respondent declined to respond. See CX 6 at 16. Complainant reserves the right to amend its proposed penalty if information comes available indicating Respondent's most recently complete year of revenue is $30 million or more.

Under the Penalty Policy, additional adjustment factors may be applied to the gravity penalty amount to promote flexibility and consistency in the gravity penalty policy component. These factors include the violator's culpability, degree of cooperation or noncooperation, and history of noncompliance. Penalty Policy at 14-17. No additional adjustments were made to the gravity penalty component for culpability, cooperation, and history of noncompliance. With respect to cooperation, Complainant considered both Respondent's statements that it has stopped the sale of the violative parts at issue in this Proceeding, as well as Respondent's noncooperation with fully responding to the EPA's initial Information Request issued pursuant to Section 208 of the CAA, which necessitated Complainant to issue a second Section 208 Information Request, as documented in CX 4, CX 299, CX 300, and CX 322. Based on these considerations, Complainant made no gravity adjustment either positive or negative based on cooperation.

The combined economic benefit of $592,654 and total gravity penalty component of $679,472 arrives at the final penalty figure of $1,272,126. Penalty Policy at 17.

For the foregoing reasons, the Complainant respectfully requests that the Tribunal assess a civil penalty of $1,272,126 against Respondent for the 5,338 violations of Title II of the Clean Air Act identified in the Second Amended Complaint.

II. Complainant's Rebuttal Prehearing Exchange.

A. Statement in Response to Respondent's Prehearing Exchange.

Complainant makes the following statement in response to Respondent's Prehearing Exchange. This statement is a summary of the responses Complainant intends to provide in this Proceeding and is not intended to be a complete response. Complainant further reserves the right to amend or supplement its response.

Defense 1-- *EPA Lacks Statutory Authority*.

Respondent claims that the EPA lacks statutory authority to pursue the alleged violations in this case because the exhaust parts and components at issue were intended for use in motor vehicles that had been "redesigned" as vehicles used solely for competition. According to Respondent, motor vehicles used solely for competition or redesigned for such use are not subject to the defeat device prohibitions contained in the CAA. Respondent's claims are without merit. The CAA's tampering and defeat device

prohibitions regarding motor vehicles do not have a "competition-conversion" or "competition use" exemption. Rather, the evidence clearly shows Respondent's exhaust aftertreatment delete pipes at issue in this Proceeding are intended for use with, or as part of, a motor vehicle or motor vehicle engines, have a principal effect to bypass, defeat, or render inoperative a device or element of design installed in such motor vehicle or motor vehicle engine in compliance with CAA Title II regulations (namely, catalytic converters), and Respondent knew or should have known that such parts were being offered for sale or installed for such use or put to such use. Notably, Respondent has provided no evidence to date that any of its exhaust aftertreatment delete pipes that are among the alleged violations of this Proceeding were installed in a vehicle permanently converted for competition use or never used on the public roads. Thus, Respondent's arguments concerning competition purely speculative and legally irrelevant.

Defense 2 -- *EPA's interpretation of the statutory provisions on which it bases its allegations is incorrect as a matter of law and is not entitled to any deference*.

Respondent asserts that the definition of "motor vehicle" in the CAA "must be interpreted without *Chevron* deference and under the rule of lenity to resolve ambiguity in the law." In response, Complainant asserts that the CAA is clear on its face and the EPA's interpretation and application has been in line with the statute and consistent for many years. The assertion regarding lenity ignores a long line of cases holding that lenity applies only where there is "grievous ambiguity" that leaves a court guessing what Congress intended. That is not the case here. In addition, courts have held that lenity does not foreclose *Chevron* deference.

Defense 3 -- *EPA has not demonstrated the subject sales violate Section 203(a)(3)(B)*.

To prove a violation of section 203(a)(3)(B), Respondent asserts that "EPA must prove that Borla intended the challenged parts to be used on a motor vehicle (not a racing vehicle) or that they were so used." In addition, Respondent has created a hypothetical. Respondent asserts that its exhaust part and components at issue in this case, which are designed to fit specific models of motor vehicles, are interchangeable with "purpose-built [racing] vehicles based on the same models of car." Under these circumstances, Respondent claims that the EPA bears the burden of proving "that any challenged parts were used on motor vehicles rather than purpose-built racers."

Respondent's assertions are legally incorrect in many ways. In its Complaint, as amended, the EPA has alleged every element needed to state a valid claim for relief. The language of section 203(a)(3)(B), the legislative history, and the entire regulatory scheme make clear that part of the test for determining whether a part of component is a defeat device is the design, not the use, of those parts and components. Moreover, the evidence in this matter clearly show that Respondent designed, marketed, and intended its parts for installation in EPA-certified motor vehicles. Finally, Respondent has failed to provide adequate evidence showing its hypothetical is anything more than speculative. Respondent has not provided any evidence showing that the parts at issue in this matter are indeed interchangeable with a purpose-built vehicle used solely for competition and were indeed installed in such vehicle.

Defense 4 -- *EPA's actions in assessing a penalty are inconsistent with Executive Order 13924*.

Executive Order 13924 is revoked, and when it was effective it clearly stated that the Executive Order provides no rights or benefits to any person against the United States. As stated in Sec. 9(d):

> This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person.

Moreover, the November 25, 2020 EPA Memorandum re Implementation of Executive Order 13924 explicitly states that it does not create any rights or benefits enforceable against the United States. Finally, Respondent provides no specifics of how Complainant is not acting in accord with either Executive Order 13924 or the November 25, 2020 memorandum.

Defense 5 -- S*tatute of Limitations*.

Respondent has neither asserted nor demonstrated that the violations alleged by Complainant fall outside the Statute of Limitations as extended by the tolling agreement executed by the Parties.

Defense 6 -- *Violation of Separation of Powers*.

Respondent asserts a violation of the separation of powers on two bases. First, Respondent claims that if the CAA provides EPA with expansive authority to interpret "motor vehicle" or adopt a penalty policy applicable to violations with "little or no demonstrated harm," such a delegation would lack an intelligible principle, as established by case law, and violate the non-delegation doctrine. Second, Respondent challenges the legitimacy of the non-delegation doctrine and "intelligible principle" jurisprudence as a whole.

Notwithstanding the established case law that bars constitutional challenges to statutes in an administrative proceeding, Respondent's defense must fail because (1) its non-delegation challenge is refuted by the CAA's plain language and (2) its constitutional challenge to the non-delegation doctrine flies in the face of settled jurisprudence.

Defense 7 -- *EPA's newly formed interpretation of the CAA lacks adequate notice*.

Respondent asserts that the EPA has held inconsistent interpretations of what is a "motor vehicle," the option of converting such vehicles to being solely used for competition, and the applicability of the defeat device prohibition in section 203(a)(3)(B) of the CAA. Respondent asserts that by using its enforcement discretion to not pursue defeat device violations in some circumstances that involved dedicated competition-only vehicles and allegedly developing a newly formed interpretation of the defeat device prohibition, EPA "affirmatively misled Borla and the public."

Respondent's assertion that EPA has a "newly formed" interpretation of the defeat device prohibition is factually incorrect. The EPA has long held a consistent public position regarding competition and defeat devices since many years before the initiation of this matter. In addition, the clear statutory language in Section 203(a)(3)(B) of the CAA regarding defeat devices precludes any legitimate assertion of a lack of fair notice.

Defense 8 -- *Violation of Due Process and Sixth Amendment Rights*.

While acknowledging that EPA has not yet set forth the specific civil penalty amount it seeks in the case, Borla states that, "to the extent EPA seeks penalties that are punitive in nature or designed to deter others rather than compensate for any harms or costs caused by Borla, this case should properly be viewed as a criminal enforcement matter and lacks the procedural safeguards for such matters." Although Borla recognizes that current jurisprudence might not view this as a criminal matter, it intends to challenge such jurisprudence and thus sets forth the basic argument in order to preserve it and because the general principles at least inform broader notions of due process in how we should approach punitive penalties even in a nominally "civil" context.

Complainant agrees with the "current jurisprudence" that does not view this administrative enforcement action as a criminal enforcement action and, therefore, that the Sixth Amendment does not apply to this case.

Defense 9 -- *Violation of the Ex Post Facto Clause*.

Respondent's claim that this case might violate the Ex Post Facto clause in the Constitution rests on both treating this case as a criminal matter and viewing EPA's alleged change in interpretation of "motor vehicle" as both a change in the law and retroactively applied. None of these claims are correct. First, this is a civil administrative enforcement case. No authority in the CAA allows for criminal cases to be brought in an administrative forum. Second, the EPA has not changed its interpretation of "motor vehicle" under the CAA. Finally, since the EPA has not changed its interpretation, it neither can be a change in the law nor retroactively applied.

Defense 10 --*The Rule of Lenity*.

See statement regarding Defense No. 2, above.

Defense 11 -- *Violation of Due Process and of the Seventh Amendment Right to a Jury Trial*.

Respondent asserts this proceeding violates its Seventh Amendment right to a trial by jury. While making this assertion, Respondent acknowledges the line of cases that conclusively reject Respondent's assertion. Notwithstanding this legal authority, Respondent complains that it "makes little sense given that one of the very purposes of a jury is to provide a check on the government and a check on oppressive laws."

Complainant agrees with the well-settled legal authority holding that the Seventh Amendment does not apply to an administrative enforcement action such as this one.

Defense 12 -- *Violation of the Excessive Fines Clause*.

Respondent gives no specifics concerning how Complainant is violating the Excessive Fines Clause of the Constitution.

Defense 13 -- *Arbitrary and Capricious Penalties*.

Respondent asserts that EPA's new tampering penalty policy is arbitrary and capricious because it "is not based on scientific data regarding relative emission impacts and does not produce fair or equitable penalty assessments."

The two main thrusts of Respondent's argument in this regard is as follows. First, Respondent asserts that some of Respondent's exhaust aftertreatment delete pipes are not as polluting as other defeat devices because they only remove the "secondary catalyst" from a vehicle and do not affect a vehicle's ability to meet emission standards. Second, Respondent argues that defeat devices that remove the emission controls from gasoline vehicles are not as polluting as those defeat devices affecting diesel vehicles. Respondent claims that the Penalty Policy does not appropriately account for these factors.

Respondent's first assertion is not factually supported. Respondent has submitted documents concerning emission testing Respondent asserts that has been conducted. RX 21. EPA regulations establish a performance-based emission standard requirement. The automobile original equipment manufacturer determines the hardware and control strategy needed for vehicles to meet those standards. The EPA issues a certificate of conformity when the manufacturer has demonstrated successfully that a vehicle has been designed so that, when properly built, maintained, and operated, it will meet emission standards throughout its statutorily defined useful life. Borla's experiment documented in RX 21 with part number 60547 depicts an altered emission control configuration that has been decoupled from the terms under which the certificate of conformity was issued.

The regulations at 40 C.F.R. Part 86 subpart S provides the criteria for conducting emission test and specifies which test are applicable to the 2016 Chevrolet Corvette. Borla did not provide verifiable documentation that its limited in scope experiment adhered to the test validity criteria as outlined in 40 C.F.R. Part 86. Borla's experiment appears to show the catalytic converter system on the 2016 Chevrolet Corvette being substantially reduced from its certified volume. Borla did not provide information that showed a 2016 Chevrolet Corvette equipped with a reduced catalytic converter system will meet emission standards throughout its statutorily defined useful life. The deterioration factor documented in the 2016 Chevrolet Corvette application for certification is predicated on the vehicle being equipped with certain hardware and software. Borla has altered the hardware and has not provided verifiable information about the software the vehicle is running during its experiment.

Moreover, Borla's reconfiguration of the 2016 Chevrolet Corvette catalytic converter system raises questions about non-methane hydrocarbon emission control. Vehicle manufacturers are required to demonstrate proportional hydrocarbon control at 20 degrees Fahrenheit. EPA's 2007 Control of Hazardous Air Pollutants from Mobile Sources; Final Rule, 72 Fed. Reg. 8428 (Feb. 26, 2007), provides the reasons why non-methane hydrocarbons need to be controlled. Borla did not provide information about whether cold testing experiments were conducted as part of its evaluation process. EPA's cold testing procedures can be found in 40 C.F.R. Part 86 subpart C. Suppositions about degrees of deleteriousness should be based on the reconfigured catalytic converter system being subjected to the same regulatory environment as the original certified configuration. The newly configured system may or may not be susceptible to in-use control issues and degradation. Sound engineering judgement dictates that Borla needs to demonstrate prolonged sustainability over the statutorily defined useful life for the reconfigured catalytic converter system.

With respect to Respondent's second assertion, Respondent provides no convincing evidence to support its contention that a defeat device affecting gasoline vehicles should be considered less egregious under the CAA's penalty factors than a defeat device affecting diesel vehicles. Further, the Penalty Policy assigns gravity penalties in part based upon vehicle size, and Complainant has utilized Size Category B for calculating a penalty in this matter, which is a small size category than those size categories that typically apply to diesel motor vehicles, thus a corresponding smaller penalty has been calculated per violation than would have been calculated had the affected vehicles been diesel vehicles. Respondent fails to explain why its penalty should be calculated any lower than similarly situated respondents who sell defeat devices affect Size Category B vehicles.

Defense 14 -- *Estoppel*

As recognized in the cases cited by Respondent, a claim of estoppel against the U.S. Government faces a very high threshold. None of the criteria which might justify estoppel are present in this case.

Defense 15 -- *Compliance with Laws/*

See statements regarding Defenses No. 1, No. 2, No. 3, and No.7, above.

Defense 16 -- *Good Faith*.

Respondent asserts that it acted in good faith in manufacturing, selling, and offering for sale the exhaust parts and components at issue in this case. This assertion is largely based upon issues Respondent has discussed in its Defenses No. 1, No. 2, No. 3, No. 7, and its position that placing a "race-only" tag on each part before making its exhaust parts indiscriminately available to the general public was sufficient to comply with the CAA.

Respondent's assertion ignores the clear language of the defeat device prohibition in section 203(a)(3)(B) of the CAA, the EPA's consistent position with regard to the scope of the defeat device prohibition, and the EPA's outreach to the regulated community regarding the defeat device prohibition which occurred years before the violations at issue in this case.

Moreover, Respondent's conduct with respect to the violations alleged represent at best willful blindness as to who their exhaust aftertreatment delete pipes went to, what vehicles they were installed on, and how such vehicles were used. Respondent's disclaimers on their products and marketing show that Respondent clearly understood that its products removed emission controls required under the CAA. Nonetheless, the evidence shows that Borla marketed its violative parts to the public at large and sold their products to automotive parts distributors without restrictions on who those distributors could sell to. Respondent has put forth no evidence showing it undertook any affirmative effort to effectively ensure their products only were installed on vehicles permanent converted for racing and not used on the public roads, nor have they provided any evidence the exhaust aftertreatment delete pipes Respondent manufactured and sold actually were installed in such vehicles.

Defense 17 -- *EPA cannot demonstrate a legal or equitable basis for imposing civil penalties*.

See statements regarding Defenses No. 1, No. 2, No. 3, and No. 7, above.

Defense 18 -- *EPA cannot utilize the penalty policy because it is not listed in EPA's Guidance Document Portal.*

Respondent's asserts that EPA cannot use the Penalty Policy to calculate any civil penalty in this Proceeding because it is not listed in EPA's Guidance Document Portal. Borla cites the Federal Register preamble to a recently finalized rule rather than the rule itself, as set forth at 40 C.F.R. Part 2, Subpart D ("Subpart D").

The provisions of Subpart D do not support Borla's assertion. First, no provision of Subpart D bars EPA from using guidance that is not listed in EPA's Guidance Document Portal. Second, the Penalty Policy is not "guidance" under the definition set forth in Subpart D since the New Tampering Policy is primarily "directed to the EPA or its components" rather than the regulated community. Finally, section 2.502(c) makes clear that Borla cannot enforce any aspect of Subpart D:

> This subpart is intended to improve the internal management of the EPA. As such, it is for the use of EPA personnel only and is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its agencies or other entities, its officers or employees, or any other person.

Defense 19 -- *EPA's adjudicatory structure and procedures violate the appointments clause and the separation of powers.*

ALJ Biro was constitutionally appointed by former EPA Administrator Carol Browner on November 24, 1996 and later constitutionally appointed Chief Administrative Law Judge by Administrator Browner on May 23, 1997. See CX 345.

Other Defenses.

In addition, Complainant hereby provides a statement in response to two other major aspects of Respondent's prehearing exchange.

Number of Violations

Respondent claims that it has reviewed sales records and has determined that the number of parts within the 57 part numbers identified by EPA in its Amended Complaint that were sold and shipped to United States customers during the period of January 15, 2015, through September 26, 2018 is 4,787 parts. However, Respondent fails to explain or account for why its revised number of parts is so much less than what it originally reported in its response to the EPA's Section 208 Information Request. Further, Respondent claims that 102 parts in Complainant's count really went to someone outside the United States, notwithstanding the fact that the relevant invoices state the parts were purchased by a buyer in the United States and shipped to an address within the United States. Respondent's screen shots of a database listing are not credible evidence to refute what is stated plainly on the sales invoices. Finally, such parts nonetheless were manufactured by Respondent in violation of the manufacturing prohibition of Section 203(a)(3)(B) of the CAA, and therefore still in violation regardless of where the parts ultimately went.

Respondent's "Lost Opportunity Cost" Economic Benefit Calculation.

Respondent challenges Complainant's economic benefit calculation by posing a "lost opportunity cost" theory in which Respondent claims to has incurred a significant opportunity cost by manufacturing and selling the parts alleged to be in violation in this matter and therefore should not be assessed any economic benefit penalty.

Respondent's prehearing exchange fails to explain what alternative product would have been built and sold if Respondent had not manufactured the violative products. Regardless, Borla's construct is purely hypothetical and speculative. If the alternative product was financially preferable, and Borla was a rational decision-maker, then it would have made more of the alternative product. The evidence is that Borla chose not to do so, indicating that either the presented analysis is flawed or that continued production of the violative products was viewed to be financially advantageous for reasons not evident in the numbers presented. For example, sales of the violative products may have been done for reasons for building Respondent's overall business, such as improving Respondent's brand reputation and overall position in the market.

Further, Respondent may have had excess production capacity during this period, and may have been able to produce the hypothetical alternative product if it wanted to. Respondent does not provide evidence or data that its manufacturing facility was operating at full capacity. Nor does Respondent provide evidence of orders or demand for products that it was unable to fulfill due to its production of violative products.

Finally, Respondent does not adjust its calculations to account for "other operational activity expenses" and income taxes as it does for the net profits analysis it performs. If Respondent's net profits analysis was consistent with its "lost opportunity cost" methodology, the net profits result would be considerable larger.

B. Revised Witness Summaries in Response to Respondent's Prehearing Exchange**.**

In response to Respondent's Prehearing Exchange, Complainant revises certain of the Complainant's witness summaries submitted as part of its Initial Prehearing Exchange. The witness summaries for Andrew Chew, Jason Gumbs, and Gail Coad as revised are provided as follows:

1. Andrew Chew, EPA Region 9, Enforcement and Compliance Assurance Division. Mr. Chew is an Environmental Engineer with EPA's Enforcement and Compliance Assurance Division in Region 9. Mr. Chew served as the EPA's lead investigator in this matter, was lead inspector of Borla's facility in California, and may testify as a fact witness. Mr. Chew received, reviewed, and is the custodian of Borla's responses to information requests issued to Borla by the EPA concerning the alleged violations at issue in this case. Mr. Chew also gathered together EPA documents concerning the makes, models, and model years of motor vehicles relevant to this case. Mr. Chew is expected to testify regarding the EPA's investigation of Borla and the inspection of Borla's facility, the EPA's review of Borla's responses to information requests and identification and tabulation of violations documented in Borla's responses, and the compilation of documents and evidence demonstrating that Borla's parts and components are designed to fit and remove exhaust

emission controls on EPA-certified motor vehicles. Mr. Chew is also expected to testify regarding the collection of certain YouTube videos regarding the use of certain of Respondent's products alleged to be violative in this Proceeding.

2. Jason Gumbs, EPA, Office of Enforcement and Compliance Assurance ("OECA"), Office of Civil Enforcement ("OCE"), Air Enforcement Division ("AED"), Vehicle & Engine Enforcement Branch ("VEEB"). Mr. Gumbs hold a B.S. in Mechanical Engineering Technology from the States University of New York – Utica, NY. Mr. Gumbs is an Environmental Engineer and may be qualified to testify as an expert in the EPA's Clean Air Act vehicle and engine regulatory program, motor vehicle exhaust systems, the emission control devices and elements of design installed in those systems, and the effects of the exhaust system parts or components manufactured and sold by Borla on the motor vehicles relevant to this case. Mr. Gumbs is expected to testify regarding the function and importance of catalytic converter exhaust emission control devices in a motor vehicle's capability to meet emission standards, the compilation of vehicle manufacturer diagrams and other documentation showing where catalytic converters are located in the exhaust system of the motor vehicles at issue int this case, and his review of the Borla parts and components at issue in this case and their fitment and function to remove catalytic converters on EPA-certified motor vehicles. In addition, Mr. Gumbs is expected to testify about his review of and opinion regarding the information Respondent has provided regarding its emission testing of its products, including the information provided in RX 21. Mr. Gumbs's resume is included among Complainant's exhibits and is marked as CX 2.

3. Gail Coad, Industrial Economics ("IEc"). Ms. Coad holds a B.A. in Economics from Connecticut College, and an M.B.A. from the Graduate School of Business at Stanford University. Ms. Coad has held managerial positions in the U.S. Office of Management and Budget's Office of Information and Regulatory Affairs, and the U.S. EPA's Office of Water Regulation and Standards. Ms. Coad is a member of the National Association of Business Economists and an Associate of the Certified Fraud Examiners Association, and has extensive experience analyzing the economic benefit financial condition of businesses, individuals, and not-for-profit organizations. Ms. Coad may be called to testify about research conducted to assess Borla's financial condition and size of its business. Ms. Coad may also be called to testify about research concerning the typical profits and expenses of businesses similar to Borla. Ms. Coad may be qualified to testify as an expert on the economic benefit or savings resulting from the violations identified in the Amended Complaint. Ms. Coad may also be called to testify to provide an opinion regarding Respondent's estimate of economic benefit and its "lost opportunity cost" theory of economic benefit as identified in Respondent's prehearing exchange. Ms. Coad may also be qualified to testify as an expert on the financial condition of Borla and other related persons or entities, and about the impact of a penalty on Borla's ability to continue in business. Ms. Coad's resume is included in Complainant's exhibits and is marked as CX 1.

C. **Additional Witness and Witness Summary in Response to Respondent's Prehearing Exchange**.

In rebuttal of Respondent's Prehearing Exchange, Complainant may call the following additional witness.

1. Brent Ruminski, Eastern Research Group, Inc. Mr Ruminski is an engineer at the Eastern Research Group, Inc. ("ERG"), a contractor for the U.S. EPA, and has been employed by ERG since 2011. Mr. Ruminski has performed or otherwise participated in inspection or enforcement investigations for the U.S. EPA to investigate potential violations of the tampering and aftermarket defeat device prohibitions under the CAA. Mr. Ruminski may be called to testify concerning his participation in EPA's enforcement investigation of Respondent, including, but not limited to, review and collection of webpage advertisements made by Respondent and third-party distributors of Respondent's product.

C. Documents and Exhibits

As part of its Rebuttal Prehearing Exchange, Complainant is adding additional exhibits, and is filing a revised Exhibit CX 0, titled "Complainant's Prehearing Exchange Exhibits," for a list of the exhibits (including exhibits not previously provided) that Complainant may introduce at hearing. Copies of the additional exhibits are provided in tandem with this Rebuttal Prehearing Exchange. Each exhibit is labeled as prescribed by the Prehearing Order, and the pages of each exhibit are numbered in the manner prescribed by the Prehearing Order.

In summary, in response to Respondent's arguments and assertions concerning its liability, competition, fair notice, estoppel, and penalty defenses, and assertions Respondent has made concerning good faith efforts to comply and cooperation in the EPA's enforcement action, Complainant is submitting as part of its Rebuttal prehearing exchange:

1. Legislative and regulatory history documents, EPA guidance and policy statements, and public presentation materials concerning the Defeat Device and Tampering Prohibition of Section 203(a)(3) of the CAA.

2. Product listings, catalogues, and advertisements published on the internet by Respondent or third-party distributors regarding the products alleged as violative in this Proceeding.

3. YouTube videos regarding the use of certain of Respondent's products alleged as violative in this Proceeding.

4. Correspondence concerning Respondent's deficient and dilatory responses to the EPA Information Request issued pursuant to Section 208 of the CAA.

D. Information and Policy/Guidance Relied Upon in Calculating a Proposed Penalty

The Prehearing Order at 2(C) states that Complainant shall submit as part of its Initial Prehearing Exchange all factual information and supporting documentation relevant to the assessment of a penalty, and a copy, or a statement of the internet address (URL), of any policy or guidance intended to be relied upon by Complainant in calculating a proposed penalty.

Complainant indicated in its Initial Prehearing Exchange that it was going to apply a penalty policy that has been superseded by the Penalty Policy discussed in Complainant's penalty explanation above. Complainant clarifies that it is applying the Penalty Policy, which can be found at the following

URL: https://www.epa.gov/sites/production/files/2021-01/documents/caatitleiivehicleenginepenaltypolicy011821.pdf.

Complainant also indicated in its Initial Prehearing Exchange that a Civil Penalty Inflation Rule applied to this proceeding that has now been superseded by a new Civil Penalty Inflation Rule, which can be found at https://www.govinfo.gov/content/pkg/FR-2020-12-23/pdf/2020-26997.pdf.

Also, in response to Respondent's use of emission testing to challenge the harm and egregiousness consideration in Complainant's proposed penalty, Complainant may refer to the following rulemaking: Control of Hazardous Air Pollutants From Mobile Sources; Final Rule, published February 26, 2007, 72 Fed. Reg. 8428. See https://www.govinfo.gov/content/pkg/FR-2007-02-26/pdf/E7-2667.pdf. Among other things, the preamble to the rulemaking discusses non-methane hydrocarbon cold temperature emission standards, which is not addressed in Respondent's emission testing material submitted in its prehearing exchange.

In response to Respondent's fair notice, estoppel, and fairness defenses made in its prehearing exchange, Complainant may refer in this Proceeding to the following EPA settlements regarding the aftermarket defeat device prohibition under Section 203(a)(3)(B):

United States v. Casper's Electronics, Inc., Consent Decree Lodged July 10, 2007, https://www.epa.gov/enforcement/caspers-electronics-inc-clean-air-act#:~:text=WASHINGTON%20%2D%20The%20Department%20of%20Justice,in%20violation%20of%20the%20Clean/.

United States v Edge Products, LLC, Consent Decree Lodged January 17, 2013, https://www.epa.gov/sites/production/files/documents/edgeproducts-cd.pdf.

H&S Performance, LLC, Consent Agreement and Final Order (CAFO), Effective Dec. 17, 2015, at https://www.epa.gov/sites/production/files/2016-01/documents/hscafo.pdf.

Frederick Truck & Auto Accessories, Inc., dba Trick Trucks IV, Expedited Settlement Agreement, Effective, Sept. 21, 2017, at https://www.epa.gov/sites/production/files/2017-09/documents/fredericktrucksandautoaccessoriesinc17.pdf.

Spartan Diesel Technologies, LLC, Administrative Complaint, Filed Oct. 19, 2017, at https://yosemite.epa.gov/oarm/alj/ALJ_Web_Docket.nsf/Filings-and-Attachments/DF5D27CB9C74E890852581C30052D157/$File/2017-10-19%20-%20spartan%20diesel%20-%20complaint.pdf; EPA Office of Administrative Law Judges (OALJ) Initial Decision and Order on Default, Issued Oct. 30, 2018, at https://www.epa.gov/sites/production/files/2018-12/documents/spartandiesel-initialdecisionandorder.pdf.

Adrenaline Truck Performance, LLC, CAFO, Effective Mar. 29, 2018, at https://www.epa.gov/sites/production/files/2018-04/documents/adrenalinetruckperformancellc18.pdf.

KT Performance, Inc. Administrative Complaint, Filed Apr. 30, 2018, at https://yosemite.epa.gov/oarm/alj/ALJ_Web_Docket.nsf/Filings-and-Attachments/5E13E39F28077DAE852582820052C9B6/$File/2018-04-30%20-%20kt%20performance%20-

%20complaint%20(redacted).pdf; CAFO, Effective Jul. 03, 2018, at https://www.epa.gov/sites/production/files/2018-07/documents/ktperformanceinc-cafo.pdf.

Justin Holder, Battlefield Automotive, LLC, and Enhanced Alternatives, LLC, dba Battlefield Automotive and Confederate Diesel, Administrative Complaint filed Jun. 14, 2018, at https://yosemite.epa.gov/oarm/alj/ALJ_Web_Docket.nsf/Filings-and-Attachments/0F11BBB5B4DFC9AF852582AC007991AB?OpenDocument; CAFO, Effective Sept. 4, 2018, at https://www.epa.gov/sites/production/files/2018-09/documents/justinholderbattlefieldautomotivellccafo18.pdf.

United States v. Derive Systems, Inc., SCT Holdings, Inc. and Sect Delaware Holdings, Inc; Derive Power, LLC; SCT Performance, LLC and Bully Dog Acquisition, LLC, and Derive Efficiency, LLC, Consent Decree, Lodged Sept. 24, 2018, at https://www.epa.gov/sites/production/files/2018-09/documents/derive-cd.pdf.

Car Sound Exhaust System, Inc., dba MagnaFlow, CAFO, Effective Dec. 21, 2018, at https://www.epa.gov/sites/production/files/2019-02/documents/carsoundexhaustsystem.pdf.

Flowmaster, Inc., CAFO, Effective Feb. 25, 2019, at https://www.epa.gov/sites/production/files/2019-02/documents/flowmasterinccafo.pdf.

Freedom Performance, LLC, Administrative Complaint, Filed Mar. 18, 2019, at https://yosemite.epa.gov/oarm/alj/ALJ_Web_Docket.nsf/Filings-and-Attachments/3833943FB455F6A7852583C3005DCF29/$File/2019-03-18%20-%20freedom%20-%20complaint%20(redacted).pdf; EPA OALJ Initial Decision and Penalty Order, Issued Feb. 24, 2020, at https://www.epa.gov/sites/production/files/2020-03/documents/freedomperformance-initialdecisionandpenaltyorder.pdf.

United States v. Performance Diesel, Inc., Consent Decree, Lodged Sept. 12, 2019 (Notice of Violation issued 2015), at https://www.epa.gov/sites/production/files/2019-09/documents/pdi-cd.pdf.

United States v. Punch It Performance and Tuning LLC, D N S Enterprises of Florida, Inc., REI Research Group, Inc., Michael Paul Schimmack, Vanessa Schmimack, and Lori Brown, Consent Decree, Lodged Jan. 10, 2020 (Notice of Violation issued 2016), at https://www.epa.gov/sites/production/files/2020-01/documents/punchit-cd.pdf.

Also, Complainant may refer in this Proceeding to the EPA Kit Car Policy, July 8, 1994, published at https://www.epa.gov/importing-vehicles-and-engines/kit-car-policy (last visited March 19, 2021).

Respectfully Submitted,

ALLAN ZABEL

Digitally signed by ALLAN ZABEL
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CERTIFICATE OF SERVICE

I certify that an electronic copy of the foregoing Complainant's Rebuttal Prehearing Exchange *In the Matter of Borla Performance Industries, Inc.*, Docket No. CAA-R9-2020-0044, was filed and served on the Presiding Officer this day through the Office of Administrative Law Judges' E-Filing System, with the exception of certain exhibits that have been filed via a file-share system established by the O. the Office of Administrative Law Judges for handling large files. I certify that an electronic copy of this Prehearing Exchange was sent this day by e-mail and links to a file transfer system to the following e-mail addresses for service on Respondent's counsel: Erik S. Jaffe at ejaffe@schaerr-jaffe.com; Kent Mayo at kent.mayo@bakerbotts.com; Julie Cress at Julie.cress@bakerbotts.com.

March 19, 2021

Date

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