UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE ADMINISTRATOR

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

RESPONDENTS' INITIAL POST-HEARING BRIEF

Respondents Taotao USA, Inc. ("Taotao USA"), Taotao Group Co. Ltd. ("Taotao Group"), and Jinyun County Xiangyuan Industry Co., LTD. ("JCXI") respectfully file their Initial Post-Hearing Brief consistent with 40 CFR § 22.26, and with the Order on Motion to Extend Post-Hearing Brief Deadlines issued on December 14, 2017.

INTRODUCTION

Complainant has brought this administrative action against Taotao USA, Taotao Group and JCXI alleging violations of the Clean Air Act ("CAA" or "Act"). Although the Complaint encompasses 109,964 vehicles, the violation alleged is the same: the catalytic converters on all 109,964 vehicles do not conform to the design specifications described in relevant Certificate of Conformity ("COC") applications.

From the initiation of this administrative action until the close of the evidentiary hearing, the only evidence Complainant set forth was to show that Respondent Taotao USA, when completing its COC applications, listed the wrong catalytic converter precious metal concentrations.

Complainant claimed, and the Tribunal agreed, that Respondents were liable for failing to accurately specify the catalytic converter concentrations, even if the failure was inadvertent and a

result of Taotao USA's reliance on its suppliers' representations, because the "[t]HE Clean Air Act is a strict liability statute," to which, even "impossibility of compliance is no defense." Because respondents can be held liable for their wrongly-described catalytic converters even if they are "manufactured by a different person and . . . cannot be tested to ensure 100% accuracy, the Presiding Officer advised that Respondents must decide the extent to which they will rely on their suppliers' statements about their catalytic converters and whether to test or verify those statements.

Having proven liability, Complainant thereafter failed to meet its burden of proof to establish a reasonable penalty. Basically, Complainant's testimony and evidence at the hearing only seems to show that because Respondents are liable, they must pay a penalty pursuant to a policy that incorporates all possible violations. But whereas good faith reliance or impossibility is not a defense to the CAA's strict liability, it is surely a defense to an arbitrary and excessive proposed penalty.

Complainant seeks a penalty based on the same method of calculations that a respondent would pay if it had intentionally provided false information; imported vehicles that actually harmed the environment; failed to obtain any certificates of conformity; and/or gained a large economic benefit from committing such violations. However, Respondents did none of the above-mentioned acts. While Complainant's proposed penalty makes all possible upward adjustments that the policy allows, Complainant has made none of the permissible downward adjustments or accounted for the specific act Respondents are held liable for. Why should Respondents be subjected to the same penalty calculations that would be assessed against a manufacturer that is liable for intentional conduct, opposed to a manufacturer who is held strictly liable for inadvertent conduct based on good faith reliance that caused no harm to the environment?

Even if Complainant could show that the proposed penalty is appropriate pursuant to the Clean Air Act Mobile Source Civil Penalty Policy ("Penalty Policy"), or that the penalty is appropriate because similar penalties have been assessed against respondents in other cases, the proposed penalty would still not be appropriate here because in this particular matter Complainant can only seek a penalty that complies with the waiver of the CAA jurisdictional limitations obtained from the Department of Justice ("DOJ"). In this action, the DOJ waiver expressly prohibits penalty assessment for violations that go beyond mere harm to the regulatory scheme. Therefore, regardless of whether or not the proposed penalty would be appropriate in other similar circumstances, the proposed penalty in this case is in fact inappropriate because it is based not only on harm to the regulatory program, but also actual or potential harm to the environment and includes a portion attributable to willful and knowing conduct, in direct violation of the DOJ waiver.

Furthermore, Complainant failed to show that the proposed penalty was restricted to harm to the regulatory scheme pursuant to the waiver of jurisdictional limitations obtained from the Department of Justice ("DOJ"). In fact, Complainant admitted that the proposed penalty went beyond harm to the regulatory scheme, therefore falling outside the scope of the DOJ's waiver of statutory limitations.

The proposed penalty is also unreasonable and excessive because it does not take into consideration all the statutory penalty factors, and goes beyond Respondents' ability to pay.

At the evidentiary hearing, Respondents presented evidence showing that their reliance on their supplier's statements was in good faith, and Respondents did test and verify those statements to a large extent. Respondents also fully cooperated with the agency in submitting samples and conducting extensive tests, at their own expense, after being notified for the first time on December

24, 2013. Although Complainant failed to put forth any evidence showing that the full useful life emission tests presented with each COC application were based on different catalytic converters than the ones equipped onto the non-compliant vehicles, the only harm to the regulatory scheme that Complainant claimed was an absence of accurate full useful life emission tests for said non-compliant vehicles. Complainant's entire proof of harm to the regulatory scheme relies on an assumption that Respondents somehow acquired catalytic converters with the same design specifications as those listed on the relevant COC applications and then later changed the design. But said assumption fails logic because the catalytic converter specifications were never Respondents' design but rather the design Respondents' suppliers provided and Respondents' submitted. Whereas the CAA does impose strict liability, the Act does not allow excessive penalties for inadvertent good-faith mistakes.

Here, Respondents reasonably relied on their supplier's statements because the statements were largely backed by laboratory test results, and then further verified the statements by equipping a sample catalytic converter on each emission test vehicles to test the performance of the catalytic converter for full useful life emissions. Only after the catalytic converters passed the full useful life testing, by generating emissions well-below the agency's standards, did Respondent Taotao USA submit its COC application relying on the suppliers' statements regarding their designs. Complainant on the other hand failed to meet their burden of proof to establish that Respondents gained any benefit from the violation that they are being held strictly liable for, nor did Complainant meet its burden to show the harm Respondents conduct caused to the regulatory scheme and how such conduct is so serious that it necessitates a gravity adjustment of over $1 million.

ARGUMENT

The Clean Air Act ("CAA or the "Act") unambiguously limits the amount of penalty that may be sought against a violator in a penalty assessment proceeding. CAA § 205(c)(1). The language of the Act makes clear that the limitation is not only on the amount recovered, but the amount "sought" in an administrative proceeding. *Id.* Here, Complainant seeks a proposed penalty of $1,601,149.95. *See* Complainant's Exhibit ("Ex." Or "CX") 213 at EPA-002808–11.

Complainant could only bring this action against Respondents if the Administrator and the Attorney General jointly determined that larger penalty amount in this matter was appropriate for administrative penalty assessment. CAA § 205(c)(1). During the prehearing stage of this action, Complainant presented evidence to show that the DOJ had agreed to waive the CAA jurisdictional limits. *See* CX028 at EPA-000546-47. However, said waiver of the CAA's jurisdictional limitations is not unconditional. *Id.* In fact, the DOJ waiver expressly limits the penalty assessment in this matter to violations "that harm the regulatory scheme, but do not cause excess emissions;" and violations of "provisions on certification, labeling, incorrect information in manuals, or warranty information violations." *See* CX028 at EPA-000546-47. The DOJ waiver explicitly excluded 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."

Id. (emphasis added). The statute governing administrative assessment of penalties does not use the term "regulatory scheme", instead the foregoing language likely comes from the Clean Air Act Mobile Source Civil Penalty Policy ("Penalty Policy"). *See* Complainant's Ex. 22 at EPA-000465.

Complainant bears the burden of presentation and persuasion that the relief sought is appropriate. 40 C.F.R. § 22.24(a); In re New Waterbury, Ltd., 5 E.A.D. 529, 537 (EAB 1994)

(Complainant bears both the burden of production and the burden of persuasion that the penalty proposed is reasonable in the light of all the statutory factors, including ability to pay.). In this case, Complainant has the burden of proving that the proposed penalty of $1.6 million is reasonable in light of all the CAA's penalty assessment factors, ***and*** that it is within the scope of the DOJ's waiver of the CAA's jurisdictional limitations. *See* CAA § 205(c)(1), (2); Complainant's Ex. 28 at EPA-000546-47; *see also* Order Denying Respondents' Motion to Dismiss for Lack of Subject Matter Jurisdiction at 19, n.21 ("…CX 28 does suggest that such penalty cannot be based upon the violations causing "excess emissions," any harm beyond that to the "regulatory scheme," or being undertaken willfully, knowingly, or intentionally."). Complainant has failed to meet this burden, and the proposed penalty is unreasonable, arbitrary, and exceeds the Act's jurisdictional limits.

I. The proposed penalty is exceeds the Clean Air Act's jurisdictional limitations.

The $1,601,149.95 proposed penalty sought is larger than statutory maximum permitted in administrative proceedings, and exceeds the bounds of the waiver of the statutory limits in this action.

At the evidentiary hearing, Complainant presented Ms. Isin, who calculated the proposed penalty in this matter. *See* Transcript of Proceedings (Tr.) at 556-57. Complainant attempted to satisfy the agency's burden of proving the reasonableness of the proposed penalty through Ms. Isin's testimony on how she applied the Penalty Policy to come up with the relief sought. *Id.* Ms. Isin's testimony, however, entirely defeats Complainant's claim that the penalty sought is appropriate. Ms. Isin admitted at the hearing that the proposed penalty is not solely based on harm to the regulatory scheme, but instead includes amounts attributable to actual or potential harm to the environment. *See* Tr. at 841. Ms. Isin further testified that the proposed penalty includes amounts attributable to willfulness and negligence. *See* Tr. at 601 ("We adjusted the penalty by 20

percent upward for willfulness ***and*** negligence.") (emphasis added). Ms. Isin testified that when she speaks of "willfulness or negligence" she is "describing something that could have been prevented…something the Respondent knew or should have known to prevent." *See* Tr. at 706.

Because the proposed penalty is based on harm to the environment, in addition to any harm to the regulatory scheme, and makes adjustments for conduct that Complainant deems willful and "knowing," it directly violates the express conditions of the DOJ's waiver. *See* CX28 at EPA-000546-47. Complainant has therefore exceeded the CAA's jurisdictional limitations on seeking penalties in administrative actions. Complainant is therefore barred from recovering the proposed penalty, or any penalty in this action.

II. The proposed penalty is excessive and inappropriate

Complainant has failed to meet its burden in proving that the proposed penalty is appropriate. The proposed penalty is inappropriate because Complainant (1) did not consider all the necessary statutory factors; (2) arbitrarily adjusted the gravity component for all three Respondents regardless of whether or not the facts support such adjustments; (3) failed to prove that Respondents gained any economic benefit from the violations; and (4) failed to prove that Respondents have an ability to pay the proposed penalty.

Complainant's proposed penalty relies entirely on upward adjustments allowed under the Penalty Policy, ignoring anything factors that would warrant a downward adjustment. Complainant has also scaled counts 9 and 10 separately thereby increasing the penalty two-fold.

A. The Penalty Policy

The Penalty Policy establishes two bases for calculating a penalty amount in EPA administrative actions: (1) a minimum deterrence amount, which in turn consists of (a) a gravity

component, and (b) an economic benefit component; and (2) a set of adjustment factors to modify the gravity component upwards or downwards. *Id.* at EPA000457

1. Economic benefit

Complainant originally applied the rule of thumb calculations to calculate economic benefits. Tr. at 583. After applying the rule of thumb method, Complainant initially proposed an economic benefit derived from the violations of approximately $1.65 million. *See* Respondent's Ex. 1 at 1. Respondents presented evidence showing that because the allegations for which Respondents have been held strictly liable for were inadvertent and correcting the violations simply required accurately describing the design specifications in on the COC applications, Respondents derived no benefit from the violations. *Id.*; Complainant's Ex. 216 at 132.

Respondents expert witness, Jonathan Shefftz testified at the hearing that all Respondents had to do was list the correct catalytic converter design specifications on each COC application. Tr. at 867. However, if an economic benefit were to be assessed against Respondents, then the cost of hiring additional staff for the relevant time period would have ensured that COC applications were fully and accurately completed. Tr. at 895. The economic benefit in that instance would be $105,000. Mr. Shefftz also provided three additional scenarios in which case, the economic benefits would be higher, but these scenarios rely on facts that Complainant was unable to prove at the hearing. *See* Respondent's Exhibit 1 at 1-3.

Without proving the necessary facts, Complainant selected scenario four from Mr. Shefftz report and used that as the economic benefit in the agency's proposed penalty. Scenario four is based on the net present value of the cost of purchasing different catalytic converters that conform to the descriptions of composition in the COC applications and the net present value of additional staffing and/or consultants to ensure accurate reporting. *Id.* However, as previously stated,

Respondents did not have to purchase the catalytic converters with the precious metal concentrations described in the COC applications, they merely had to submit COC applications that accurately reflected the actual precious metals composition of the their catalytic converters.

Complainant's witness, Cleophas Jackson testified at the hearing that the agency does not set design standards for catalytic converters. Tr. at 74. Mr. Jackson stated that manufacturers are free to set their own design standards, so long as the design meets emission standards. *Id.* Because liability was assessed on the basis that none of the catalytic converters on Respondents vehicles matched the design specifications on the COC applications, and the evidence shows that all vehicles passed emission tests, there is no reason to hold that Respondents needed to purchase catalytic converters with the precise precious metal concentrations specified on their COC applications ***and*** hire additional staff to ensure accurate reporting. 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. Complainant has not proven its burden of showing why Respondents needed to incur both of the foregoing additional costs to achieve compliance. Therefore, the economic benefit, if any, should either be $105,000 (the after-tax net present values of additional costs for staffing and/or consultants) ***or*** $114,000 (the after-tax net present values of the price differentials of the catalytic converters specified in the COC applications, without the additional costs for staffing and/or consultants). *See* Respondents' Ex. 1 AT 1-3. An economic benefit based on the unnecessary costs of both additional staffing and additional value of price differentials, without proving the facts necessary to show why both costs are needed to ensure compliance is arbitrary and excessive.

2. <u>Gravity Component</u>

The Penalty Policy establishes a method that quantifies the gravity component of the penalty. *See generally* CX022. The gravity component is divided into four subcomponents to measure the seriousness or harm, only one of these four components consider whether, and to what extent, the violation harms the regulatory scheme. *Id.* at 000465-69.

Pursuant to the Penalty Policy, a gravity component is added to the economic benefit to reflect the seriousness of the offense. *Id.* This seriousness determination depends on two factors: (1) Actual or Potential Harm; and (2) Importance to the Regulatory Scheme. *Id.* at 000465. The penalty policy defines *Actual or Potential Harm* as the factor that is based on whether (and to what extent) the activity of the violator actually resulted in, or was likely to result in, the emission of a pollutant in violation of the standards specified for the particular vehicles or engines at issue. *Id. Id.* In the absence of actual emission information, the Penalty Policy provides an objective method of determining potential emissions released by the "violative engines or vehicles." *Id.* Such a method involves a rule of thumb calculation of excess emissions that depends on (a) the size of the engine; (b) the egregiousness of the violation, meaning the likelihood that vehicles will exceed emission standards; and (c) effectiveness of actions to remedy or mitigate the violations. *Id.* The foregoing three considerations are provided by the Penalty Policy for determining the actual or potential harm to the environment from excess emissions, not harm to the regulatory scheme. Therefore, the consideration of the foregoing factors is not permitted in this action, pursuant to the DOJ waiver. *See* Complainant's Ex. 28 at EPA-000546-47 (expressly limiting violations to those that harm the regulatory scheme and do not cause excess emissions).

. Unable to pursue penalty for violations that harm the environment, Complainant is therefore restricted to calculating the gravity component based on the next subcomponent which considers the violations' effect on the regulatory scheme. Subcomponent number two is referred

to in the Penalty Policy as "[i]mportance to the regulatory scheme." *See* CX22 at EPA-000469. In assessing the penalty in this action, a consideration of all other components or subcomponents, other than the violation's effect on the regulatory scheme, in the absence of harm to the environment, is expressly prohibited by the CAA because such a consideration falls outside the scope of the DOJ waiver.

Importance to the regulatory scheme is defined as the "importance of the requirement to achieving the goals of the Clean Air Act and its implementing regulations." *Id.* at EPA000465. The Penalty Policy provides under the foregoing gravity subcomponent that "[e]ven in the absence of harm in the form of excess emissions, the gravity component of the penalty should reflect the seriousness of the violation in terms of its effect on the regulatory program. *Id.* at EPA-000469. Because the gravity in this case cannot be based on violations that cause excess emissions and harm, or potentially harm, the environment; in determining whether reliance on the Penalty Policy is appropriate in this action, the focus should be on subcomponent number two in the Penalty Policy.

The only evidence presented on whether the violation harms the regulatory scheme was through the expert testimony of Complainant's witness, Cleophas Jackson. *See* Tr. at 28. Mr. Jackson's entire testimony on whether the violation harmed the regulatory scheme consisted of his 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. Tr. at 76-77. While Mr. Jackson's opinion might be correct in certain cases, this is not such a case.

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 different from the catalytic converters on all other vehicles in each

engine family. In fact, the Complainant's evidence on liability relies on a conclusion that each and every vehicles produced by Respondents did not conform to the design specifications in the COC application because they were all identical and shipped in an unaltered condition. *See* 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 ("Combined Response") at 18. If that were true, then the catalytic converters on the emission data vehicles belonging to each engine family would also be identical to the non-conforming vehicles because an emission data vehicle is the same vehicle as the vehicles that "were not unaltered and identical." *Id.* Complainant cannot on one hand argue that all 109,964 vehicles did not conform to the COC application because they underwent the same manufacturing process, and then on the other hand argue that the emission data vehicles that are representative of all these 109,964 vehicles did conform to the COC application. Not only does such an argument strain credibility, Complainant has not set forth any evidence to prove the foregoing premise of their regulatory harm argument.

Second, 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. For example, the full useful life emission test on the emission data vehicle for engine family DTAOC.049MC2 submitted to the agency with the COC application shows that when tested at 2564.482km, the vehicle generated CO emissions of 6.144g/km (nearly half the allowable amount) and when the vehicle was tested at 6030.06km, it generated CO emissions of 2.098g/km. *See* CX003 at EPA-000108-11. When a vehicle belonging to the same engine family, determined to not match the catalytic converter specified in the COC application was tested at low mileage pursuant to the

agency's test order in 2014, the vehicle tested at 2528.8k likewise passed emission standards, generating CO emissions of 6.621g/km. *See* CX102 at EPA-001320.

For the foregoing reason, 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.

Finally, even if the Presiding Officer does find that the violations in this action do harm the regulatory scheme, Complainant's proposed policy is still inappropriate for the following reason: 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. CX22 at EPA-000469. 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. Had the violations in this Complaint been construed "labeling violations," the Penalty Policy may have been helpful, but the Penalty policy clearly does not provide guidance for calculating a penalty that is based on violations (1) that merely harm the regulatory scheme; and (2) that are not labeling violations. The inappropriateness of the Penalty Policy in this action is further exemplified by Ms. Isin's testimony.

B. The Testimony of Amelie Isin

1. <u>The gravity component of the proposed penalty</u>

Ms. Isin testified that she calculated the gravity in this case by first considering the number of vehicles and engines in violation, the engine size of those vehicles and engines, and the egregiousness of the violation. *See* Tr. at 558. The Penalty Policy clearly states that the foregoing considerations are made under the subcomponent of actual or potential harm, which "focuses on

whether and to what extent excess emissions result from the violations." Complainant's Ex. 22 at EPA-000466-67. The Penalty Policy states that:

> "Excess emissions are a function of at least two considerations, and possibly others depending on the facts of the case: (1) the number of violative engines or vehicles; and (2) the amount of excess emissions that will be emitted from each uncertified vehicle or engine over the vehicle's or engine's useful life."

Id.

The Penalty Policy further states that while he first consideration can be quantified in a straightforward and objective manner, the second consideration - the amount of excess emissions attributable to the violations can be estimated in an objective manner by considering" the engine size; emission control devices that are missing or defective; and the effectiveness of actions taken to remedy or mitigate the violation." *Id.* The Penalty Policy provides a "rule of thumb" for nonroad engines, recreational vehicles and heavy-duty highway vehicles, similar to the economic benefit rule of thumb, where the amount of emissions from such engines or vehicles is proportional to the engine's size. The economic benefit rule of thumb for engines under 15 horse power is $15 per engine regardless of the engine size. *See* Complainant's Ex. 22 at EPA-000462.

Compare the foregoing language of the Penalty Policy to excerpts from Ms. Isin's testimony below:

> "And in this case, you know, we know the number of vehicles and engines in violation. That's already been decided. The horsepower was obtained from the applications for certification for each engine family…then we took the horsepower multiplier from Table 1 of the vehicle -- of the EPA Mobile Source Civil Penalty Policy, and I believe the applicable multiplier for vehicles in this power range is about $15 per vehicle, so we multiplied that by the horsepower and that gave us the base per vehicle penalty."

Tr. at 558-59.

Because Ms. Isin's calculation of the base-per-vehicle calculation relies entirely on the method for calculating the harm from excess emissions, instead of harm to the regulatory scheme, the entire base-per-vehicle amount from the proposed penalty must be removed. Notably, even though Ms. Isin testified that the applicable multiplier in this power range is about $15 per vehicle, and that Complainant multiplied the horsepower by that multiplier, the base-per-vehicle in Complainant's proposed penalty is not horsepower times 15. On the contrary, the horsepower of each vehicle in this case is multiplied by 80. *See* Complainant's Ex. 213 at EPA- EPA-002808–11.[1]

Under this Penalty Policy, the egregiousness of a violation refers to the likelihood that the emissions from the vehicles or engines in violation may exceed certified levels or applicable standards. Complainant's Ex. 22 at EPA-000467. As previously stated, the only examples provided by the Penalty Policy on violations that harm the regulatory scheme involve labeling violations. The Penalty Policy recognizes that while violations that harm the regulatory scheme but do not exceed emissions, e.g. labeling violations, are "minor" egregiousness violations, engines or vehicles that are labeled as legal for sale in the United States, meaning they do not harm the regulatory scheme, but that "in fact do not meet applicable emissions and other standards," should be considered a more egregious violation (Moderate or Major, depending on the facts of the particular case. *Id.* at EPA-000468. In this action, the violations may only be those that violate the regulatory scheme, but do not cause excess emissions, therefore, the violations are of minor egregiousness. *See* Complainant's Ex. 28.

However, Ms. Isin testified that after getting the base-per-vehicle penalty in this case, [Complainant] took the number and used a "moderate" egregiousness multiplier of 3.25 for counts

[1] For e.g. count 1 has a horsepower of 2.94, which if multiplied by a multiplier of 15 would make the base-per-vehicle gravity of $44.1. The base-per-vehicle gravity for count one in Complainant's proposed penalty worksheet is $235.20.

and a "major egregiousness multiplier of 6.5 for counts 9 and 10. *See* Tr. at 559. When asked "if there is no actual or potential harm from excess emissions," what egregiousness multiplier, is applied under the Penalty Policy, Ms. Isin responded: "I suppose minor." Tr. at 839. Minor egregiousness has a multiplier of 1.

After applying the egregiousness multiplier to the base-per-vehile, Ms. Isin testified that the gravity was scaled to reflect the number of vehicles. Tr. at 585. Because the egregiousness multiplier and the base-per-vehicle were both calculated relying on harm from actual or potential excess emissions, the entire adjusted bas- per-vehicle amount in the proposed penalty is inappropriate because it goes beyond mere harm to the regulatory scheme.

The Penalty Policy recognizes that if a per-horsepower or per-engine gravity amount is used that results in penalties of an appropriate size for cases involving a small number and/or small size engines, this same per-horsepower or per-engine gravity amount may result in penalties that are inappropriately or unreasonably large, beyond what could reasonably be obtained in court, in cases where the number of uncertified engines and/or engine size is very large. Complainant's Ex. 22 at EPA-000469. The Penalty Policy includes scaling factors for both numbers of vehicles or engines, and for engine size in the case of non-road engines to compensate for the policy's potential for yielding unreasonably large penalties. *Id.* Clearly, the potential risk of assessing unreasonably large penalties is high in this matter, where there are 109,964 vehicles. The necessity for scaling is therefore indisputable. However, Complainant decided that it would not scale all violations in accordance with the scaling table in the penalty policy but rather by grouping counts 1-8 together and then restart scaling for counts 9-10. The reason:

> Amelie Isin: We did that because Counts 9 and 10 we discovered after filing the complaint, the initial complaint in this case. We felt typically the penalty policy allows the litigation

team to decide whether to -- how to group the violations for a penalty calculation. And we typically restart scaling when -- in cases where we have a number of model years, and we do it to reflect the longevity of the violations.

Tr. at 586. Ms. Isin's testimony fails to consider that even though the Penalty Policy gives the litigation team the discretion to group all violations together or group them separately, such discretion depends on the facts of the particular case. *See* CX022 at EPA-000472. The foregoing discretion is likely provided because not all cases involve large numbers of vehicles. The example the Penalty Policy provides to illustrate when the discretion is appropriate only involves 120 total vehicles. *Id.*

In this case, however, regardless of whether or not the Penalty Policy "allows the litigation team to decide" how to group the violations, the separate grouping of counts 9 and 10 has resulted in precisely what the Penalty Policy sought to prevent through scaling. The unreasonableness is evident in Complainant's proposed penalty worksheet. *See* CX213 at EPA-002808–11. The grouping of counts 1 through 8 for scaling resulted in a total gravity of $983,539.42 for 108,283 of the 109,964 total violations. *Id.* While the total gravity for the remaining 1,681 violations alone is $508,744.86. *Id.* 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. This is precisely what the scaling factor seeks to prevent.

On the other hand if all vehicles were grouped together, which makes sense given that liability for all vehicles is based on the exact same "certification" violation, the total gravity for all 109,964 vehicles would be significantly lower. *See* CX022 at EPA-000472.

The separate grouping of counts 9 and 10 is also inappropriate because Complainant is only considering facts that allow for upward adjustments while ignoring facts that may reflect a

downward adjustment. For example, Complainant has grouped counts 9 and 10 separately because these violations were discovered after the initial Complaint. Tr. at 586. The only plausible justification would then be that Respondents had knowledge of the violation but failed to correct it. However, the foregoing premise fails to take into account the penalty in this matter is being assessed against Response for the violation of which Respondents had no knowledge until the notice of violation in this case was issued on December 24, 2013, notifying Respondents that their catalytic converters may not have been accurately described in the relevant COC applications. Tr. at 589. When the notice of violation was issued in the very end of 2013, all vehicles belonging to counts 2, 3, 4, 6. 7, and 8 had already been manufactured, and possibly sold under the then-existing COCs. *See* CX002-CX004; CX006-8; *see also* Tr. at 577. Because all vehicles belonging to counts 2, 3, 6, 7, and 8 are model year 2013, while vehicles belonging to count 4 are model year 2012. *Id.* Complainant seeks to punish Respondent for importing vehicles after the initial Complaint was filed, but seeks to mitigate the gravity for vehicles that were manufactured, and possibly imported, well before the first notice of violation was issued.

2. <u>Adjustments</u>

The Penalty Policy allows the following adjustments: degree of willfulness and/or negligence, degree of cooperation/non-cooperation, history of noncompliance, ability to pay, litigation risk and other unique factors. *See* CX022 at EPA-000477-82. Whereas most of these factors permit upward and downward adjustments, Complainant only adjusted the penalty upwards, without even considering all the relevant factors provided in the Penalty Policy.

(a) Willfulness and/or Negligence

Ms. Isin testified that the penalty was adjusted upwards by 20% for "willfulness and negligence. Tr. at 601. A 20% adjustment for willfulness and/or negligence is the maximum

permitted under the Penalty Policy. *See* CX022 at EPA-000478. As stated previously, such an adjustment was specifically prohibited by the DOJ's waiver. Additionally, Complainant failed to explain why the maximum upward adjustment was reasonable in this case.

The Penalty Policy provides the following factors for determining the appropriate adjustment for willfulness and/or negligence. (1) How much control the violator had over the events constituting the violation; (2) The foreseeability of the events constituting the violation; (3) Whether the violator took reasonable precautions against the events constituting the violation; (4) Whether the violator knew or should have known of the possibility violations would occur; (5) The level of sophistication within the industry in dealing with compliance issues and the availability of fully compliant vehicles or engines of the type at issue in the case being evaluated; and (6) Whether the violator in fact knew of the legal requirement that was violated. Complainant failed to show evidence that the 20% upward adjustment was reasonable pursuant to the foregoing factors. *Id.*

The evidence shows that Respondents were not aware of the inaccurate reporting of design specifications until December 24, 2015. Tr. at 590. The evidence shows that the catalytic converter design specifications were not Respondents'. *See generally*CX001-CX010. The catalytic converters were manufactured by Beijing ENTE and Nanjing Enserver, from whom Respondents purchased the catalytic converters. *Id.* Therefore there is no evidence showing that Respondents could have foreseen that the suppliers would give inaccurate information, especially because Respondents had no motive for providing false information. Tr. at 831. Because 69,071 vehicles in this Complaint are model years 2012 and 2013, Respondents, could not have foreseen the events constituting the violations. *See* CX213 at EPA-002808–11. The evidence also shows that Respondents had a sample of at least three of the five different types of catalytic converter involved

in the 109,964 vehicles, tested at Chinese laboratories, the results of which were submitted to the agency. Tr. at 607; Respondents' Ex. 18A. Respondents even retained an engineering consultant, pursuant to the agency's suggestion, who conducted catalytic converter tests on a sample vehicle belonging to count four in accordance with Complainant's instructions. Tr. at 816; CX077 at EPA-000936. Therefore, there is evidence that Respondents did take precautions against the events constituting the violation. There is no evidence that Respondents knew or should have known of the possibility that violations would occur. Again, the evidence shows that Respondents had no knowledge of the possibility that violations would occur in regards to the 21,275 vehicles belonging to count four because Respondents did precisely what the agency asked them to. *See* id; *see also* Tr. at 836-39. The evidence shows that it is unlikely that Respondents had known of a possibility that violations would occur in regards to vehicles belonging to counts 2, 3, 6, 7 and 8 because those vehicles are model year 2013. The evidence only shows some knowledge of a possibility that violations would occur in regards to counts 9 and 10 because those were discovered after the initial complaint was filed. Tr. at 586. Finally, the evidence also shows that the Respondents did not have knowledge of the legal requirement that was violated because as Matao Cao stated in his deposition, Respondents believed that the agency was only concerned with emissions and if the vehicles passed emissions, then they were compliant. CX216 at 128-137.

Without regard to any of the foregoing, and without regard to the DOJ's waiver, Complainant adjusted the penalty by the maximum percentage permitted. However, the evidence shows that a downward adjustment was likely appropriate pursuant to the Penalty Policy factors.

(b) Degree of Cooperation/Non-Cooperation

The Penalty Policy allows for a 10% upward or downward adjustment for cooperation/non-cooperation. *See* CX022 at EPA-000478-79. Ms. Isin testified that Complainant did not increase the proposed penalty in this case because:

> "Taotao USA has actually been cooperative with our --all our inspections. You know, I went to Taotao USA's warehouse in Dallas, Texas, and they complied with the inspection, and they provided samples here in this case that we were just talking about where we sent them a letter requesting two additional exhaust systems for testing. They promptly provided those."

Tr. at 632-33. Ms. Isin testified that the penalty was not adjusted downwards because such adjustments are "typically for cases where there's a swift resolution, or there's self-reporting of violations, that neither of those situations occurred here."

However, contrary to Ms. Isin's testimony, the Penalty Policy states that there may be other indicia or facts indicating a violator's degree of cooperation other than prompt or delayed reporting of the violation. CX at EPA-000479. Here Respondents retained an engineering consultant on the agency's suggestion, paid a penalty of $160,000 for failing to provide the catalytic converter test reports for 2012, and still provided reports for vehicles in count 4; and made all reasonable efforts to comply with emission standards. Tr. at 816-22. Regardless, in calculating the proposed penalty, Complainant ignored the foregoing efforts.

(c) History of Non-Compliance

Pursuant to the Penalty Policy, when a party has violated a similar environmental requirement before, unless the previous violation was caused by factors entirely out of the control of the violator, the gravity-based portion of the penalty should be adjusted upward. CX22 at EPA-000479. In this case, there is no evidence that Respondents Taotao Group and JCXI violated any environmental requirement before this case. But Complainant assessed a 20% upward adjustment, and applied it towards both Taotao Group and JCXI.

Additionally, the evidence shows that Complainant assessed the maximum permissible adjustment for a history of noncompliance without regard to the factors specified in the Penalty Policy. These factors are (1) how similar the previous violation was (more similar prior violations should result in a larger penalty increase); (2) how recent the previous violation was (more recent prior violations should result in a larger penalty increase); (3) the number of previous violations (more prior violations should result in a larger penalty increase); and (4) he violator's efforts to remedy previous violations(s) (prior violations that were not corrected should result in a larger penalty increase). CX022 at EPA-000479. Pursuant to the Penalty Policy the maximum upward adjustment where like here, there is one prior occurrence of a violation, is 35%. *Id.*

The prior violation for which Complainant increased the gravity component by 20% for all vehicles in this matter occurred in 2010. Tr. at 812-14. Said prior violation consisted of certain non-road vehicles where Respondent Taotao USA failed to specify in the COC application that the vehicles had adjustable parameters. *Id.* The testimony at the hearing shows that failing to indicate the presence of adjustable parameters could be accounted to something as small as failing to check a box in the application. Tr. at 281. The evidence also showed that Respondent Taotao USA remedied all previous violations in accordance with the agency's plan. Tr. at 810. Regardless, Complainant adjusted the gravity component upwards by 20%.

III. The evidence fails to establish that Respondents have an ability to pay the proposed penalty.

It is Complainant's burden to prove that Respondents have an ability to pay the proposed penalty of $1,601,149.95. Just like the agency has drafted a guidance on the assessment of civil penalties, the agency also has a guidance on a violator's ability to pay. *See* CX025. This guidance was introduced into evidence by Complainant. EPA has developed three financial computer models

to assess a violator's ability to pay. *Id.* at EPA-000525. Therefore, pursuant to the guidance document, the agency must at the minimum prove that Respondents have an ability to pay the proposed penalty, before the burden shifts to Respondents. Pursuant to the guidance document, the most appropriate model in this case would be the ABEL model. *Id.* Ms. Isin testified at the hearing that according to the ABEL model Respondents Taotao USA have an ability to pay a penalty of approximately $700,000. Regardless, Complainant seeks a larger proposed penalty.

To satisfy its burden, Complainant presented the expert testimony of Dr. James Carroll. Mr. Carroll submitted two reports to the agency, each showing that Respondents had an ability to pay over $3 million in penalties. Tr. at 404. Dr. Carroll later amended the reports at least twice in this matter. Dr. Carroll's opinion was not based on any of EPA financial models, nor the financial documents available to him. Tr. at 438. Instead, Dr. Carroll based his opinion entirely on his assumptions and estimations pursuant to the "smell test." Tr. at 406. Dr. Carroll arbitrarily selected an NAICS code number to include an additional digit based on his assumption that a company should have accounts receivable; and he redistributed all or most of Respondent Taotao USA's account payables because in his opinion a company only has payables if they are payable in 30 to 60 days. Tr. at 400, Tr. at 880-86. The foregoing conclusion was made without considering the unique facts of this case, and whether or not what's typical in the United States is typical in foreign corporations of domestic corporations run by foreign nationals. The testimony of Dr. Carroll is clearly unreliable.

In addition to Dr. Carroll's testimony, Complainant presented highly unreliable and meaningless evidence to support an ability to pay. Said evidence included statements from unreliable sources such as unreliable news publications and websites including Alibaba and those of unrelated parties. Tr. at 783. Complainant also proceeded to show that Respondents had a large

gross revenue based on their imports and claimed value. Tr. at 565. The foregoing evidence is entirely meaningless because gross revenue that does not account for manufacturing costs, expenses, loan payments, interests, et cetera cannot establish an ability to pay.

Without establishing an ability to pay, and in light of Respondents' credible evidence of an inability to pay, Complainant proceeded to present evidence attempting to show a relation between Respondents and other companies. Tr. at 661; CX206 at EPA-002655–57; CX208 at EPA-002751; See CX206 at EPA-002686–2703; Tr. 661–62; CX207 at EPA-002737–39. Complainant did not show that said other companies had an ability to pay, but merely that the companies may be related parties based on certain transactions. Clearly, Complainant has failed to satisfy its burden of proving an ability to pay.

CONCLUSION

Complainant failed to meet its burden of proving that the proposed penalty accounted for all statutory factors and that it was reasonable and appropriate in this action. The evidence clearly shows that Complainant's proposed penalty exceeds the scope of the CAA. Complainant failed to prove that the proposed penalty is assessed for harm to the regulatory scheme and not harm to the environment. In the absence of proving any amount solely based on "harm to the regulatory program," Complainant has no available means of recovering a penalty because Complainant sought a penalty outside the scope of the waiver of CAA jurisdictional limitations. However, if the Presiding Officer finds that Complainant may still recover a penalty, such penalty would have to be limited to the statutory maximum permitted by the CAA, provided it is reasonable, not excessive and arbitrary, given the particular facts of this case. For these reasons, Respondents request that this Tribunal find that Complainant had failed to establish the relief sought.

Respectfully Submitted,

Date: 12/22/2017

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CERTIFICATE OF SERVICE

This is to certify that the foregoing instrument in the Matter of Taotao USA, Inc., et al., Docket No. CAA-HQ-2015-8065, was filed and served on the Presiding Officer this day through the Office of Administrative Law Judge's E-Filing System.

I certify that a copy of the foregoing instrument was sent this day via electronic mail to the following e-mail addresses for service on Complainant's counsel: Edward Kulschinsky at Kulschinsky.Edward@epa.gov, Robert Klepp at Klepp.Robert@epa.gov, and Mark Palermo at Palermo.Mark@epa.gov.

Respectfully Submitted,

Date:12/22/2017

William Chu