UNITED STATES
ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE ADMINISTRATOR

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

BUSINESS CONFIDENTIALITY ASSERTED

Complainant's Initial Post-Hearing Brief (the "Brief") contains material claimed to be confidential business information ("CBI") pursuant to 40 C.F.R. § 2.203(b). The material claimed as CBI includes financial information submitted to Complainant by Taotao USA, Inc., Taotao Group Co., Ltd., and Jinyun County Xiangyuan Industry Co., Ltd. (collectively, "Respondents"), as well as financial information about Respondents obtained through the United States Customs and Border Protection's Automated Commercial Environment database. A complete version of the Brief has been filed with the Hearing Clerk, together with a version in which the CBI has been redacted. If you have any questions, please contact Edward Kulschinsky at (202) 564-4133, or at kulschinsky.edward@epa.gov.

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COMPLAINANT'S INITIAL POST-HEARING BRIEF

Complainant files this Initial Post-Hearing Brief (the "Brief") concerning the appropriate penalties to be assessed against Taotao USA, Inc. ("Taotao USA"), Taotao Group Co., Ltd. ("Taotao Group"), and Jinyun County Xiangyuan Industry Co., Ltd. ("JCXI") (collectively "Taotao" or "Respondents"), for the 109,964 violations of Clean Air Act (the "Act") sections 203(a)(1) and 213(d), 42 U.S.C. §§ 7522(a)(1), 7547(d), established by the May 3, 2017 Order on Partial Accelerated Decision and Related Motions ("AD Order").

I. Background on Respondents and Related Business Entities

Respondents in this matter are the vehicle manufacturers, Taotao Group and JCXI, and the vehicle importer, Taotao USA. Yuejin Cao is the owner and president of Taotao Group, which is located in Zhejiang, China. Am. Answers ¶¶ 6, 14; CX216 at 89, 105; Tr. 100, 155. Taotao Group is a "large group enterprise" that "integrates R&D, manufacturing and sales." CX191 at EPA-002520; *see* CX168 at EPA-002296 (profile page with similar description). Taotao Group claims to have multiple subsidiary corporations (including Respondent JCXI) in and outside of China, and annual sales volume of more than $80 million as of October 2016. CX168 at EPA-002296. Taotao Group and its subsidiaries produce a wide array of products which are sold around the world. CX168 at EPA-002296–97; CX191 at EPA-002520. Taotao

Group manufactured the vehicles identified in Counts 1 through 4 of the Amended Complaint, all of which bear the Taotao name and logo. *E.g.,* CX001 at EPA-000010.

JCXI is a subsidiary of Taotao Group. CX168 at EPA-002296; CX191 at EPA-002522; CX216 at 105. Yuejin Cao is the president of JCXI, which is located in Zhejiang, China. Am. Answer ¶¶ 5, 15. JCXI manufactured the vehicles identified in Counts 5 through 10 of the Amended Complaint, all of which bear the Taotao name and logo. *E.g.*, CX005 at EPA-000160.

Taotao USA is a Texas corporation with an office at 2201 Luna Road, Carrollton, Texas. Am. Answer ¶ 4. Yuejin Cao's son, Matao Cao, is the owner and president of Taotao USA. *Id.* ¶ 12; CX171 at EPA-002294; CX191 at EPA-002522; CX216 at 22. Taotao USA is the exclusive importer of vehicles manufactured by Taotao Group and JCXI, and it sells these vehicles to dealers throughout the United States. CX095 at EPA-001212–13; CX216 at 10–11, 26–30, 44, 46; *e.g.* CX001 at EPA-000018; CX005 at EPA-000171. Taotao USA does not purchase vehicles from any other manufacturers. CX216 at 46. Taotao USA imported every vehicle in the Amended Complaint. Am. Answer ¶¶ 45, 55, 65, 74, 84, 94, 104, 114, 122, 130.

Taotao USA and its owner, Matao Cao, are closely related to several other entities that, while not named as respondents in this matter, are relevant to Taotao USA's claimed inability to pay the proposed penalty. 2201 Luna Road, LLC ("Luna LLC"), was formed on September 14, 2015, shortly before the Complaint was filed, with Matao Cao named as the initial registered agent and manager. Tr. 663–64; CX205 at EPA-002651; CX217 at 117–18. Luna LLC owns a facility at 2201 Luna Rd., Carrollton, Texas, which it purchased on or around December 11, 2015, shortly after the Complaint was filed, for not less than $11,361,500. CX206 at EPA-002655–57; CX208 at EPA-002751. Luna LLC purchased the property using two loans including a Small Business Administration 504 loan obtained with the assistance of Taotao USA

and Daction Trading, Inc. ("Daction"). *See* CX206 at EPA-002686–2703 (deed of trust from Luna LLC to North Texas Certified Development Corporation ("CDC") securing loan), 2706–16 (lender agreement between CDC and East West Bank naming loan to Luna LLC as "SBA Loan Name: Taotao USA, Inc." and naming the business operating company as "Taotao USA, Inc. and Daction Trading, Inc."); 2719–23 ("Assignment and Subordination of Leases" between Luna LLC, Taotao USA, Daction, and CDC, securing $5,000,000 loan, and describing Luna LLC as the "Eligible Passive Company" and Taotao USA and Daction as the "Operating Company").

Complainant first learned of Daction when, in response to a request for financial documents supporting their claimed inability to pay, Respondents submitted Daction's tax returns and financial statements. Tr. at 648–49, 658–59. Daction's tax returns describe it as an ATV wholesaler, like Taotao USA. CX171 at EPA-002289; CX199 at EPA-002624; CX216 at 108–09. Matao Cao explained in his deposition that Taotao USA and Daction shared office and warehouse space, and Taotao USA would transfer some of its sales with dealers to Daction. CX216 at 109. Though Matao Cao does not own Daction, evidence such as Daction's participation in the purchase of the 2201 Luna Rd. property, Respondents' access to Daction's financial documents, and Taotao USA's sharing of office and warehouse space with Daction all demonstrate that Respondents and Daction have close business and ownership connections.

Tao Motor, Inc. ("Tao Motor") was formed on January 6, 2016, with a registered business address of 2201 Luna Rd. and with Matao Cao named as the registered agent, sole director, and organizer of the company. Tr. 661–62; CX207 at EPA-002737–39. Tao Motor is owned by a Chinese manufacturing company, Zhejiang Taotao Vehicles Co., Ltd. ("Zhejiang Taotao"), which is owned 90% by Matao Cao and 10% by Yuejin Cao. CX191 at EPA-002523; CX216 at 25, 86–87, 97–98. Both Taotao USA and Tao Motor sell on-road and nonroad

vehicles, and both sell parts through EagleATVParts.com, a division of Taotao USA. CX216 at 26, 61–63, 85–86, 107–08, 111–12; CX217 at 7–8, 17–19. Taotao USA imports some of Tao Motors' vehicles, selling them to Tao Motor at cost (declared value/FOB plus shipping), and the two companies do not compete. CX216 at 60–65, 85–88, 106–08; CX217 at 18–20, 33–34, 41–42. After Tao Motor was incorporated, all of the employees in Taotao USA's California branch office became Tao Motor employees, except for the individual responsible for EPA compliance who left the company. CX217 at 38–41, 62. Now a Tao Motor official handles EPA compliance for both Tao Motor and Taotao USA. CX217 at 62. Zhejiang Taotao, which owns Tao Motor and is controlled by Matao Cao, owns the factory that produces Taotao Group and JCXI vehicles; Taotao Group and JCXI rent Zhejiang Taotao's production lines. CX216 at 93–95, 105–06.

In sum, Yuejin Cao directly owns Taotao Group, which in turn owns JCXI. Yuejin Cao's son, Matao Cao, directly owns Taotao USA and Zhejiang Taotao, and the latter in turn owns Tao Motor. Matao Cao also exerts control over Luna LLC. CX206 at EPA-002722. Taotao USA and Daction helped Luna LLC purchase a warehouse at 2201 Luna Rd. Taotao USA, Tao Motor, and Daction are all located at 2201 Luna Rd., where they pay rent to Luna LLC. Tr. 675–77; CX216 at 117–18. They all sell motorcycles and ATVs, but do not compete with one another. Taotao Group and JCXI rent manufacturing facilities from Zhejiang Taotao, which they use to produce vehicles sold to Taotao USA. Taotao USA is the exclusive United States importer of Taotao Group and JCXI vehicles. Taotao USA sells vehicles to Tao Motor at cost, and transfers sales to Daction. While the entities may appear separate on paper, the unified control over, and close business dealings between, the entities show they are part of a financially-intertwined family enterprise that manufactures vehicles in China and sells them in the United States. Indeed, Matao and Yuejin Cao consulted with each other regarding the payment of penalties to EPA, both in

2010 and in the current administrative penalty case. CX216 at 129–30, 134–35.

This is consistent with representations made to an EPA official who visited Respondents' manufacturing facility in China in 2016. At a meeting with Yuejin Cao, Matao Cao, and other Taotao representatives, EPA was provided a PowerPoint presentation showing the inter-connections between Taotao Group, JCXI, Taotao USA, Zhejiang Taotao, and Tao Motors. Tr. 143–44, 148–49, 154–55; CX191 at EPA-002520–25, CX216 at 89–93, 96–97. Respondents' representatives told EPA that the companies were all related, that Yuejin Cao had the responsibility for the overall company, and Matao Cao had specific responsibility for the United States entities. Tr. at 155. They further indicated that they were planning to transition more to the use of Tao Motors in the United States rather than Taotao USA. *Id.* at 157–58.

II. Penalty Policy Provides Appropriate Framework to Determine Penalty Amount

This Tribunal resolved all questions of liability in this matter in the May 3, 2017 AD Order, leaving only the issue of penalty to be decided. Tr. 7; Hearing Notice & Order at 1 (May 9, 2017). When determining the amount of a civil penalty, the Act requires EPA to consider "the gravity of the violation, the economic benefit . . . resulting from the violation, the size of the violator's business, the violator's history of compliance . . . , action taken to remedy the violation, the effect of the penalty on the violator's ability to continue in business, and such other matters as justice may require." 42 U.S.C. § 7524(c)(2). EPA penalty guidelines or policies "create a framework whereby the decisionmaker can apply [her] discretion to the statutorily-prescribed penalty factors, thus facilitating the uniform application of these factors." *Chem Lab Prods., Inc.*, 10 E.A.D. 711, 725 (EAB 2002) (quoting *Great Lakes Div. of Nat'l Steel Corp.*, 5 E.A.D. 355, 374 (EAB 1994)). The Consolidated Rules require penalties to be determined "based on the evidence in the record and in accordance with any penalty criteria set forth in the

act," and in consideration of "any civil penalty guidelines issued under the Act." 40 C.F.R. § 22.27(b).

Complainant calculated the proposed penalty using the Clean Air Act Mobile Source Civil Penalty Policy ("Penalty Policy"). CX022; Tr. 553–54. The Penalty Policy divides civil penalties into two components, economic benefit and gravity. CX022 at EPA-000457–58.

III. Respondents Obtained an Economic Benefit from the Violations

Complainant accepts $219,299 as the measure of economic benefit, as calculated by Respondents' expert witness, Mr. Jonathan Shefftz, and described as scenario 4 on pages 18 to 21 of his expert report, and which 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 exercising additional staffing effort to ensure compliance. Tr. 583–84; RX001 at 14, 18–21; Tr. 867–68, 871–74; CX218 at 94; *see* RX001 at 8–12 (describing present value calculation). The Penalty Policy states that where violations arise from missing or nonconforming catalysts, as in this case, "the cost of purchasing and installing the catalytic converter" is an appropriate measure of the violator's economic benefit. CX022 at EPA-000462.

Mr. Shefftz calculated scenario 4 using information provided to him by Respondents that he understood to represent "the cost for the actual catalytic converters that were used . . . and the cost for catalytic converters that would have met the COC compositions." Tr. 871–72; *see* CX218 at 90–92, 94 (describing information provided by Respondents). Mr. Shefftz also included in his scenario the cost of additional compliance measures, estimated as the cost of paying a quarter-time environmental engineer for four years. RX001 at 14. Mr. Shefftz explained that additional staffing would be a necessary component for measuring Respondents' economic benefit as the avoided cost of using catalytic converters that conformed to the certified

specifications. *Id.*; Tr. 867–69; 894–95, 897–98 (explaining need for additional staffing); CX218 at 44–45, 94 (describing calculation of additional staffing effort).

Mr. Shefftz's scenario 4 represents the most comprehensive and accurate approach to calculating Respondents' economic benefit in this matter based on available information and consistent with the Penalty Policy because it measures avoided cost by using actual catalytic converter prices rather than constituent precious metal prices, and includes costs for additional staffing, supervision, and testing necessary to ensure compliance. *See* Tr. 584 (describing basis for accepting scenario 4); Tr. 867, 871, 898 (describing calculation). Complainant therefore accepts $219,299, scenario 4 offered by Respondents, as Respondents' economic benefit.

IV. The Violations Warrant a Significant Gravity Penalty

The Penalty Policy provides a method for calculating the gravity component using specific, objective factors "designed to measure the seriousness of the violations and reflect" the violations' actual or potential harm and importance to the regulatory scheme. CX022 at EPA-000465. The potential for harm is inherent in a violation, and exists regardless of whether a violation results in actual harm to human health or the environment. *See* CX022 at EPA-000465 (actual or potential harm "focuses on whether (and to what extent) the activity . . . *was likely to result in*, the emission of a pollutant"); *Carroll Oil Co.*, 10 E.A.D. 635, 658 (EAB 2001) (explaining that potential for harm was inherent in respondent's failure to monitor for releases from underground storage tank "regardless of the time such releases first occurred"); *Everwood Treatment Co., Inc.*, 6 E.A.D. 589, 603 (EAB 1996) (citing 1990 RCRA Penalty Policy) ("certain violations may have 'serious implications' for the RCRA program and can have a 'major' potential for harm regardless of their actual impact on humans and the environment"). "[I]t is the potential in each situation that is important, not solely whether harm has actually occurred."

Euclid of Virginia, Inc., 13 E.A.D. 616, 694 (EAB 2008) (quoting *Penalty Guidance for Violations of UST Regulations* § 3.1.2 (Nov. 14, 1990)). "It is a well-settled principle that that proof of actual harm to the environment need not be proven to assess a substantial penalty." *Id.*

The risk of excess pollutant emissions is inherent in the act of importing and selling uncertified vehicles, particularly where the violations arise from the use of non-conforming catalytic converters. *See* CX022 at EPA-000467 ("[E]ngines with missing or defective catalytic converters would be expected to have emissions that are greater than those on which proper catalytic converters had been installed."); Tr. 75–78, 114–15, 135–36 (describing how provision of inaccurate data prevents accurate assessment of compliance). The Act's certification program is a pre-importation, pre-sale program that prevents air pollution by prohibiting the importation or sale of any engine or vehicle unless its design is reviewed, tested, and found to not exceed emissions standards throughout its useful life. 42 U.S.C. §§ 7401(c), 7521(a)(1)–(a)(3)(A), 7522(a)(1), 7525(a)(1); Tr. 44–65, 67–71, 73–78, 114–17, 132–36, 545–46; *see United States v. Chrysler Corp.*, 591 F.2d 958, 960–61 (D.C. Cir. 1979) (finding "clear congressional intent . . . that vehicles pass emission tests before they may be sold to the public"); *see also* Tr. 82–85 (describing health effects of regulated pollutants). The program relies on manufacturers providing EPA with complete, accurate information and test data for review before the vehicles and engines are sold and put into use. Tr. 56, 65, 75–78, 109, 116–17; 140–41, 545–46, 551. Respondents imported or sold 109,964 vehicles that were not covered by certificates of conformity because they were built using untested catalytic converters different from those described in COC applications submitted to the EPA. AD Order at 31. The violations caused significant harm to the Act's certification program and created the potential for environmental harm in the form of excess emissions of pollutants. *See Woodcrest Mfg.*, 7 E.A.D. 757, 781

(EAB 1998) (failure to register can cause significant harm and warrant substantial penalty).

Low-hour emissions tests were conducted on vehicles identified in Counts 1 through 8, and all but one of the tested vehicles passed. Tr. 587; *see* CX099–CX122 (low-hour test reports); Tr. 61–63, 120–22 (describing low-hour testing and deterioration factors). These test results do not mean there was no potential for harm, rather, they only suggest the vehicles produced might not have exceeded standards at the low-hour service level. Mr. Jackson testified that low-hour testing has limits both generally and in this case given the tests' reliance on deterioration factors derived from full-useful life testing conducted on vehicles other than those identified in the Amended Complaint. Tr. 61–63, 120–22, 132–36; *see* Tr. 587–88 (Ms. Isin testifying about concerns that low-hour tests may not accurately reflect full-useful life emissions). Mr. Jackson also testified about particular concerns he had with the use of palladium-only catalytic converters in low-hour testing, due to concerns about palladium's durability at higher mileage and service hours. Tr. at 136. While the low-hour test results do suggest that vehicles in Counts 1 through 8 are not likely to exceed standards at the low-hour service point, those tests also do not establish that the vehicles will in fact meet end-of-life emissions standards.

No emissions tests were conducted on vehicles identified in Counts 9 and 10. Tr. 588. Though vehicles in Counts 9 and 10 were *certified* to the same design as the vehicles in Count 6, this Tribunal has already established that the vehicles in this matter were not built to the certified design. Tr. 594. There is no evidence the emissions from vehicles identified in Counts 9 and 10, either at low-hour or end of useful life, comply with emissions standards. We simply don't know, which is precisely what the certification program is designed to prevent.

Respondents caused the program significant harm by circumventing the pre-import, pre-sale certification process, rendering the program unable to perform its function of protecting

human health and the environment. As a consequence, 109,964 vehicles with untested useful life emissions are operating in the United States. A significant gravity penalty is warranted.

V. The "Preliminary Deterrence Amount"

The "preliminary deterrence amount" is the sum of the economic benefit and base gravity components, the latter adjusted to reflect egregiousness, the number of violations, the number of violations remediated, and the size of the violator's business. CX022 at EPA-000470–76. The first step in calculating base gravity is to determine the base per-vehicle/engine penalty using the horsepower of the vehicle or engine in violation, which is a measure of the engine's size and correlates to its potential emissions. *Id.* at EPA-000466, 470. Complainant calculated the vehicles' horsepower by multiplying the power rating listed in kilowatts in each COC application by a standard factor to convert kilowatts into horsepower. Tr. at 558–59; Response to Complainant's Requests for Admissions ("RFA Response") at ¶¶ 6–11, 14, 17, 20, 23–24. Where a COC application identified multiple power ratings, Complainant took the average of the two numbers. Tr. 558. Complainant then calculated the base per-vehicle penalty for each count using Table 1 on page 16 of the Penalty Policy, CX022 at EPA-000470. Tr. 559.

Next, Complainant adjusted the base per-vehicle penalty for egregiousness. Tr. 559. Violations are of "Major" egregiousness if "excess emissions are likely to occur," or the violations involve uncertified vehicles "and there is no information about the emission from these vehicles . . . ." CX022 at EPA-000467. The Policy states that "engines with missing or defective catalytic converters would be expected to have emissions that are greater than those on which proper catalytic converters had been installed." *Id.* Violations are "Moderate" if they involve uncertified vehicles, and "the emissions from the vehicles . . . are likely to be similar to emissions from certified vehicles." *Id.* When "there is uncertainty about the proper egregiousness

classification, a violation should be classified as Major." *Id.* Complainant categorized Counts 1 through 8 as "Moderate," because the vehicles identified in those counts passed low-hour emissions tests ordered by Complainant. Tr. 587–88. The low-hour test results suggest the emissions from the vehicles in Counts 1 through 8 may be similar to emissions from certified vehicles. *Id.* The base per-vehicle penalties for violations in Counts 1 through 8 were therefore multiplied by a factor of 3.25. *Id.* at 559; CX022 at EPA-000471. Complainant categorized the violations in and Counts 9 and 10 as "Major" because the violations in this matter relate to the vehicles' catalytic converters, and none of the vehicles identified in Counts 9 and 10 have undergone emissions testing. Tr. 588, 768–70. The penalties in those counts were therefore multiplied by 6.5.[1] Tr. 559, 588; CX022 at EPA-000467, 471.

Complainant then applied scaling factors to the adjusted per-vehicle penalties to reflect the number of violations. Tr. 585–86. The Penalty Policy uses tiered multipliers to decreases the per-vehicle penalty as the number of violations increases. CX022 at EPA-000472. Violations may be grouped together for scaling, or scaled separately. *Id.* Where vehicles of different sizes are scaled together, the violations with the largest per-vehicle penalty are treated first, and the lowest per-vehicle penalty last. *Id.* Complainant scaled the violations identified in Counts 1 through 8, and then restarted the scaling for violations in Counts 9 and 10 because those violations were discovered after the Complaint had been filed. Tr. 585–86, 832–33; *see* Mot. for

[1] Complainant does not allege that evidence in this matter shows the violations caused excess emissions, and does not seek any increase of penalty on that basis. Counts 1 through 8 are Moderate because evidence suggests the vehicles in those Counts may not exceed emissions standards, while Counts 9 and 10 are Major because there is no information regarding those vehicles' emissions. Complainant's penalty calculation thus squarely fits within the bounds stated in the June 2, 2016 letter from the Department of Justice. *See* CX028 at EPA-000546–47.

Leave to Am. Compl. at 2 (Jun. 14, 2016) (describing discovery of new violations). The decision to restart scaling for Counts 9 and 10 also reflects the longevity of the violations in this case, which span model years ("MYs") 2012 through 2016.[2] Tr. 586.

After scaling, the Penalty Policy requires the "multiple-vehicle gravity" to be increased by 30% "in the case of vehicles or engines for which no remedial action is taken, or where the action is ineffective." CX022 at EPA-000468, EPA-000474. Respondents did not remediate any of the violations except for 66 vehicles in Counts 9 and 10. Tr. 596–97, 847; RFA Response ¶¶ 25–26. Complainant increased the gravity component attributable to all but the 66 remediated vehicles upward 30% by determining the average per-vehicle gravity for each count after scaling, multiplying the average per-vehicle gravity by the number of unremediated vehicles, and then adding 30% of that result to the total gravity component. Tr. 596–97; CX022 at EPA-000474.

Complainant did not adjust the penalty to reflect the size of Respondents' business due to uncertainty about Respondents' net worth. Tr. 600. Complainant did adjust the penalties for Counts 9 and 10 to account for inflation using Penalty Policy inflation amendments issued in 2013 and 2016. *Id. see* CX023 at EPA-000485–89 (instructions for applying 2013 inflation amendments); CX024 at EPA-000505, 510 (instructions for applying 2016 inflation amendments); RFA Response ¶¶ 27–30 (establishing dates of importation).

VI. History of Violation, Culpability, and Cooperativeness

After calculation of the "preliminary deterrence amount," the gravity component may be further adjusted to reflect a violator's history of noncompliance, degree of willfulness or

[2] Complainant issued the Notice of Violation on December 24, 2013, notifying Respondents of concerns regarding their catalytic converters. CX092 at EPA-001112. The EPA issued a COC for the vehicles in Count 9 eight months later on August 11, 2014, and issued a COC for the vehicles in Count 10 on October 7, 2015. CX051 at EPA-000648; CX052 at EPA-000649. Respondents' thus knew of EPA's concerns before they began manufacturing the vehicles in Counts 9 and 10.

negligence, and degree of cooperation. CX022 at EPA-000477.

For history of noncompliance, a penalty may be increased by up to 35% for one prior similar violation, and up to 70% for multiple prior violations. *Id.* at EPA-000479–80. Violations are "similar" if previous enforcement "should have alerted the party to a particular type of compliance problem," and "[i]n the case of violations involving uncertified vehicles . . . a 'similar' violation is one that involves any violation of the vehicle and engine requirements under Title II of the Act or the regulations implementing those requirements." *Id.*

Here, Respondent Taotao USA entered into an administrative settlement agreement with the EPA in 2010 (the "ASA") to resolve 3,768 violations of 42 U.S.C. § 7522(a)(1), arising from the importation of vehicles that were not covered by COCs because they were manufactured with adjustable parameters and emissions-related parts different from those described in the COC applications. CX067 at EPA-000810–12; Tr. 598–600; *see* Tr. 140–42 (describing carburetors and adjustable parameters). The certification violations in the ASA were similar to the violations at issue in this case and should have alerted Respondents to the importance of ensuring that their vehicles match the designs described in the COC applications. Yet, problems with Respondents catalytic converters appeared in MY 2012, not two years after date of ASA, suggesting the ASA did not achieve deterrence. Complainant thus increased the gravity component by 20%. Tr. 598.

Complainant also increased the gravity component by 20% due to willfulness or negligence with respect to Respondents' failure to conduct routine catalytic converter screening that might have prevented the violations from occurring. Tr. 601–02, 604, 630–32; 706. The ASA included a compliance plan designed to help Taotao USA comply with the Act. Tr. 602–04; CX067 at EPA-000828–46. The plan in part required Taotao USA to, prior to importation, analyze the composition of a sample catalytic converter from each engine family to confirm that

the vehicles matched the certified design specifications. CX067 at EPA-000828–30. Tr. 602–05. The results were to be reported to EPA annually. CX067 at EPA-000832; Tr. 605–06.

Between 2011 and 2012, Taotao USA provided the EPA with 14 pre-importation catalytic converter test reports purportedly for MY 2010 and 2011 engine families, 7 of which had internal inconsistencies suggesting that the catalytic converters tested were actually taken from different vehicles than the reports claimed. *See* CX073 at EPA-000880–81, 883 (emails transmitting 14 reports and response noting 16 reports required); CX215 at 548–77 (pre-import test reports ordered by Taotao Group and provided by Taotao USA on February 24, 2012); Tr. 613, 618–22, 735, 741–43 (describing emails and discrepancies in reports). Taotao USA also submitted results of *post-importation* tests conducted on catalytic converters taken from three MY 2012 engine families, including a vehicle identified in Count 4. CX077 at EPA-000912–37; Tr. 625–26, 816–18. The three tests were conducted late in the year, after the vehicles had already been imported, and showed that the catalytic converter taken from the vehicle identified in Count 4 had a precious metals ratio different from that described in the corresponding COC application. Tr. 821, 823; *compare* CX077 at EPA-000935–37 (test results) *with* CX004 at EPA-000126 (catalytic converter description in COC application); *see* Reply in Supp. of Complainant's Mot. for Part. Accel. Dec. at 5 n.3 (Jan. 13, 2017) (describing test results).

Despite repeated demands from the EPA, Taotao USA did not submit complete test reports for MYs 2010 through 2012, and did not submit any pre-importation test reports in 2013, 2014, or 2015. Tr. 630–31; *see* CX069 at EPA-000854, 856, 858 (identifying deficiencies in submissions and requesting reports); CX070 at EPA-000863–64 (documenting missing catalyst test reports); CX072 at EPA-000866–67 (demanding stipulated penalties for label violations and missing test reports); CX073 at EPA-000869–70, 881, 884 (email documenting missing and

overdue information); CX074 at EPA-000888–89 (documenting missing and overdue information); CX078 at EPA-000979–81 (documenting missing and overdue information); CX081 at EPA-000989–91 (documenting missing and overdue information).

Respondents' failure to conduct tests that might have detected problems with the catalytic converters in this matter was willful or negligent. Matao Cao, president of Taotao USA, admitted as much in his deposition when he indicated that he signed the ASA without understanding it and handed responsibility for compliance to Taotao USA's general manager, and that the outcome might have been different if he had personally overseen compliance. CX216 at 35, 69–73, 77–79, 132–35. Respondents stopped conducting pre-importation catalyst tests in 2012, and nonconforming catalytic converters were subsequently found on MY 2012, 2013, 2014, 2015, and 2016 vehicles. Tr. 626, 630–31. The compliance plan required catalyst testing precisely to ensure that catalytic converters on Respondents' vehicles matched the certified specifications *before* the vehicles were imported and sold, and thus prevent the violations in this case from occurring. Complainant therefore increased the gravity component by 20% to account for willfulness or negligence. Tr. 601–02, 632.

Complainant did not adjust the penalty for cooperation. An upward adjustment was not warranted for this factor because Respondents were cooperative during Complainant's investigation. Tr. 632–33, 754. A downward adjustment was also not warranted because Respondents did not self-report their noncompliance. *Id.*; CX022 at EPA-000478–79.

After all adjustments, Complainant calculated a gravity component of $1,381,850 for the violations identified in the Amended Complaint, which combined with the economic benefit component of $219,299, yields a total civil penalty against Taotao USA of $1,601,149. Taotao Group is jointly and severally liable for $225,473, attributable to Counts 1 through 4, and JCXI

is jointly and severally liable for $1,375,676, attributable to Counts 5 through 10. Complainant's proposed penalty calculation is shown in CX213, EPA-002808–11. Tr. 683

VII. Adjustment for Ability to Pay

Complainant did not adjust the penalty for Respondents' ability to pay. In this proceeding, Complainant has the burden of showing it considered Respondent's ability to pay, and that the proposed penalty is appropriate, while Respondents have the burden of producing specific evidence showing they cannot pay and the proposed penalty is inappropriate. *Order on Respondents' Second Motion in Limine*, at 6–7 (Oct. 2, 2017) (quoting *New Waterbury, Ltd.*, 5 E.A.D. 529, 542–43 (EAB 1994)). Complainant has adequately considered each Respondent's ability to pay their respective proposed penalties, and the Respondents have failed to provide convincing specific evidence that the proposed penalty is excessive or inappropriate.

Substantial evidence supports the inference that Taotao Group and JCXI have the ability to pay the proposed penalty. The two entities are considered together because the financial condition of a parent is highly relevant to assessing a subsidiary's ability to pay, and JCXI is a subsidiary of Taotao Group. *Supra* at 2; *United States v. Muni. Auth. of Union Twp.*, 150 F.3d 259, 268–69 (3d Cir. 1998); *see Atlantic States Legal Found., Inc. v. Universal Tool & Stamping Co., Inc.*, 786 F. Supp. 743, 753 (N.D. Ind. 1992) (considering financial statements of parent and subsidiary). Taotao Group's statements suggest it controls a large, profitable, multi-faceted business enterprise with a sales presence in many parts of the world. CX168 at EPA-002295–2303; CX191 at EPA-002520–2573; Tr. 638–44. Importantly, at hearing Respondents put forth no evidence or testimony to support an ability to pay claim for either Taotao Group or JCXI. In fact, Respondent's expert, Mr. Shefftz, testified that based on the limited information about Taotao Group and JCXI available to him, it appeared one company could pay all and one

company could pay part of the original proposed penalty of $3.295 million. Tr. at 875–77, 903–04; CX218 at 62–63. Where Respondents' own expert testifies they can afford to pay the penalty, their ability to pay may be presumed. *New Waterbury,* 5 E.A.D. at 538–39, 541–43.

With regard to Taotao USA, Mr. Shefftz testified that the EPA's ABEL computer model predicts Taotao USA has a 70% probability of being able to pay [redacted] Tr. at 877–79, 881, 899–900. His ABEL analysis used inputs solely derived from Taotao USA's tax returns, and assessed only predicted future cash flow. *Id.* He did not review any other financial documents, attempt to validate any of the information included in the Taotao USA's tax returns, or consider Taotao USA's place within the broader family-owned business enterprise.[3] Tr. at 877, 899–900; RX001 at 32–35. In fact, he has written that he has only done a "limited" analysis for this case. RX001 at 2, 22; *see* Tr. 878–79 (does not use ABEL in court as a rule); *see also* Tr. 652–53 (ABEL not intended to be definitive)

Mr. Shefftz's ABEL analysis and accompanying testimony does not provide a complete picture of Taotao USA's business size or financial resources. Taotao USA is essentially a pass-through entity that allows Taotao Group and JCXI to move Taotao vehicles into the United States market, and depends on this broader business enterprise to exist. Tr. 155–58; *see supra* at 2 (Taotao USA deals exclusively with Taotao Group and JCXI). The enterprise is clearly successful. Taotao USA is [redacted]. Tr. 97. In 2016 Taotao USA was also [redacted] *Id.* Between 2009 and 2016, the total declared value of Taotao USA's entries into the

[3] Complainant requested additional financial information about Daction and Tao Motor during the course of this litigation, which Respondents refused to provide. Tr. 653–54; CX169 at EPA-002265–68; CX170 at EPA-002271–86.

United States [redacted] with a total declared value for those years of [redacted]. CX190A at EPA-002517A; Tr. 571, 635–38. For the vehicles in violation in this case alone, the approximate declared value is $43,052,543. CX189 at EPA-002516; Tr. 565–66. The enterprise is building a new factory in China,[4] recently purchased a warehouse in Texas, and is starting a new business in the United States (Tao Motor). *See supra* 2–5 (cataloging relationships between companies). The enterprise has been successful enough to allow Matao Cao to purchase a second, million-dollar home during this litigation, even as Respondents claimed to be unable to pay.[5] Considered as a whole, the enterprise revealed by the evidence is incompatible with the depiction of Taotao USA as a struggling business. Any consideration of Taotao USA's ability to pay must account for its ability to obtain support from its owner and other entities in the Taotao family enterprise. CX025 at EPA-000527. An inference can be made that Taotao USA has the means to continue in business notwithstanding imposition of a $1.6 million penalty. *See* Tr. 643–44, 653–54, 678–82 (considering related companies).

More specifically, Complainant's financial expert, Dr. James Carroll, testified there were anomalies in Taotao USA's tax returns, such as high accounts payable and a lack of bank loans, suggesting Taotao USA is an extension of the larger enterprise rather than an independent entity. Tr. 397, 406–14, 421–23, 427–28, 511–12, 521, 526–28, 533–34. From 2012 to 2015, Taotao USA's reported accounts payable show [redacted], making it an industry outlier. Tr. 407–10, 521, 524; CX192 at EPA-002584–86. Reported

[4] Yuejin and Matao Cao told EPA of their plans to build a new, much bigger factory in China to expand their motorcycle and ATV business, and took the EPA officials on a tour of the construction site. Tr. at 157–58; CX216 at 92–93.

[5] [redacted] CX209 at EPA-002759–85. [redacted]. *Id.* at EPA-002784–92.

payables suggest Taotao USA is thinly financed and unstable. Tr. 413, 422–23. However, by other measures Taotao USA is a stable, growing business. Tr. 411–12, 427–28; *supra* 17–18.

The mystery is solved if the payables are viewed not as a debt owed to arms-length suppliers, but are instead recharacterized as an equity investment from the father's businesses (Taotao Group and JCXI) in the son's (Taotao USA), in the form of vehicles rather than cash. Treating the payables as equity would explain why Taotao USA has no bank loans, and such treatment is supported by the companies' close familial relationship, mutual dependence, history of high payables, and Matao Cao's testimony about the lack of payment terms between the companies. Tr. 411–13, 425–28, 511–12, 515–16, 526–28, 533–34; CX216 at 41–43. A consequence of this is that Taotao USA is healthier than its tax returns would suggest, and could finance the payment of a penalty using the equity as collateral if it corrected its financial reports. Tr. 414–17, 422, 427–28, 526. Taotao USA could also obtain "spontaneous financing" from Taotao Group and JCXI by delaying payments and increasing the payables, i.e., obtaining additional investment from those entities. Tr. 422, 527–28. Taotao USA had reduced its accounts payable between 2013 and 2015; increasing them back to 2013 levels would provide Taotao USA with sufficient funds to pay the proposed penalty. Tr. 422, 425–26, 507, 509, 527–28, 889.

Dr. Carroll identified another anomaly that suggests Taotao USA's tax returns do not accurately portray its financial condition, and that Taotao USA can pay the proposed penalty. Declared value represents the amount Taotao USA paid for the goods imported, and should correspond to purchases reported in its tax returns. Tr. 435–36, 571; CX194 at EPA-002592–93. In fact, for the years 2012 to 2015, the average declared value of Taotao USA's imports was [redacted] than the reported value of purchases. Tr. 435–36; CX194 at EPA-002592–93. This indicates that the value of about 2 of every 3 vehicles purchased and imported by Taotao USA

are not reported in Taotao USA's federal tax returns. Mr. Cao could not directly explain the cause for the discrepancy, CX216 at 84–85, but he may have given a partial answer when he explained that Taotao USA transfers some sales to Daction. *Id.* at 108–09. Regardless of its cause, the discrepancy supports the inference that Taotao USA's tax returns are not reliable, that Taotao USA is financially intertwined with other closely-related entities, and that Taotao USA has significantly more resources than the tax returns might suggest.

Respondents have not put forth specific evidence to adequately support their claimed inability to pay. Mr. Shefftz testified that two of the three Respondents, Taotao Group and JCXI, could pay the penalty, and that Taotao USA could pay a large portion of it. Mr. Shefftz's analysis of Taotao USA was limited, and relied exclusively on Taotao USA's tax returns which he took at face value. Dr. Carroll testified that the record suggests Taotao USA's tax returns should not be taken at face value because they understate its business activity and ability to obtain funds, and further explained how Taotao USA could independently acquire funds to pay the penalty. Also, Taotao USA is part of a large, successful family enterprise with related entities and owners that could provide financial assistance. For these reasons, Complainant, after considering Respondents' ability to pay, did not reduce the penalty. Tr. 638–44, 652–54, 681–82.

Conclusion

For the foregoing reasons, Complainant requests an order assessing a joint and several civil penalties of $225,473 against Taotao USA and Taotao Group for Counts 1 to 4, and of $1,375,676 against Taotao USA and JCXI for Counts 5 through 10, for a total civil penalty of $1,601,149, approximately $14.56 per violation. Tr. 683.

Respectfully Submitted,

12/21/2017
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CERTIFICATE OF SERVICE

I certify that the original and two copies of the foregoing Complainant's Initial Post-Hearing Brief ("Brief") in the Matter of Taotao USA, Inc., et al., Docket No. CAA-HQ-2015-8065, and a copy of the foregoing Brief from which CBI has been redacted, were filed this day by hand delivery to the Headquarters Hearing Clerk in the EPA Office of the Headquarters Hearing Clerk at the address listed below:

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I certify that an encrypted electronic copy of the foregoing Brief was sent this day by e-mail to the following e-mail addresses for service on Respondents' counsel: William Chu at wmchulaw@aol.com; and Salina Tariq at stariq.wmchulaw@gmail.com.

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