October 22, 2020

James Owens. Esq.
Deputy Administrator
National Highway Traffic Safety Administration
1200 New Jersey Avenue, S.E.
Washington, D.C. 20590

RE: Support for Petition for Rulemaking – 49 C.F.R. Part 578

Dear Mr. Owens:

On October 2, 2020, the Alliance for Automotive Innovation (Auto Innovators) petitioned the National Highway Traffic Safety Administration (NHTSA) for rulemaking to amend 49 C.F.R. Part 578 to clarify and establish that the first model year to which a civil penalty rate[1] of $14 will apply to automobile manufacturers for failure to meet a fuel economy standard prescribed under 49 U.S.C. 32902 is Model Year (MY) 2022.[2] This petition asserts that retroactive application of increased civil penalties is strictly punitive, because automakers are not able to make changes to existing or completed model years to avoid paying increased penalties. This additional economic harm would further magnify the ongoing negative economic impacts caused by the COVID pandemic.

Here, we are supplementing our petition with additional information for your consideration based on publicly available data. This public information illustrates the immense challenges facing manufacturers if NHTSA imposes a retroactive $14 civil penalty rate. The challenges are even further amplified by constraints in compliance mechanisms. We understand that manufacturers have and/or will provide additional information in support of this petition, including confidential business information; we encourage NHTSA to use the company-specific confidential business information to further refine its understanding of the impact described below.

Credit Shortfalls. Based on the most recent publicly available data, NHTSA projects total MY 2019 shortfalls to be 288 million credits.[3] If the associated civil penalty is $5.50 per 0.1 mile per gallon per vehicle,[4] the total estimated civil penalty liability for the industry could be as much as $1.59 billion for a single model year, depending on automakers' abilities to offset these deficits. Based on the same NHTSA data, a civil penalty rate increase to $14 in MY 2019 nearly triples the potential civil penalty

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[1] The use of the term "civil penalty" in the submitted petition and in this letter, which mirrors the wording used in the Energy Policy & Conservation Act (EPCA), 49 U.S.C. § 32912, should not be read as an admission that penalties under EPCA qualify as "civil monetary penalties" under the Federal Civil Penalties Inflation Adjustment Act Improvements Act, which is a defined term in that Act.
[2] Auto Innovators is still evaluating its options for further judicial review of the Second Circuit decision. The submitted petition and this subsequent letter are filed without any prejudice to, or waiver of, the rights of Auto Innovators to seek subsequent judicial review.
[3] *MY 2011-2019 Industry CAFE Compliance*, NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION (Oct. 15, 2019), *available at* https://one.nhtsa.gov/cafe_pic/AdditionalInfo.htm (see "MY 2011-2019 Credit Shortfall Report) (hereinafter *Credit Shortfall Report*).
[4] CAFE civil penalty rates will be expressed as their monetary component (e.g., $5.50) hereafter.

liability to $4.04 billion, an increase of $2.45 billion. Given the reduced level of credits being generated by industry, and the constraints in credit banking, transfer, and trading further discussed below, it is more likely that increasing levels of fines will be paid. As Auto Innovators noted in its petition, motor vehicle manufacturing is capital-intensive and company product plans are set many years before the model year begins.

Credit Banking, Transfer, and Trading. Although credit banking, transfer, and trading mechanisms[5] may lower the potential civil penalty liability, such actions are subject to significant statutory and regulatory constraints, as well as market conditions.

Minimum Domestic Passenger Car Standard (MDPCS). The MDPCS cannot be satisfied with transferred or traded credits. The only compliance flexibility that can be applied to the MDPCS is carry-forward or carry-back of surplus credits from a manufacturer's own domestic passenger car fleet. Additionally, at least one manufacturer has already begun paying civil penalties for failure to meet the MDPCS,[6] likely indicating exhaustion of previously banked domestic passenger car surpluses and no expectation for near-term credit surpluses in the upcoming model years. In fact, NHTSA has noted that in MY 2018, two manufacturers project that they will fail to meet the MDPCS, and in MY 2019, five manufacturers project that they will fail to meet the MDPCS.[7] Further, only four manufacturers project earning domestic passenger car credits (and one of these is an all-electric vehicle manufacturer who will never have need for these credits). The remaining domestic manufacturers will presumably use credits, to the extent available, to comply in MY 2019.

Credit Transfer Caps. In MY 2019 and later years, manufacturers can transfer only up to 2.0 miles per gallon (MPG) of credit into a compliance fleet from a different compliance fleet to satisfy a credit shortfall.[8] In MY 2019, manufacturers project that 20 of their compliance fleets will have a shortfall that exceeds the 2.0 MPG limit.[9] As CAFE standards increase pursuant to the year-over-year increases established in both the 2012[10] and the 2020[11] Final Rules for CAFE standards, the fuel savings represented by a MPG become less, making the cap more restrictive over time when credits are adjusted. Finally, credit transfers are further constrained in that (by our present understanding) a manufacturer cannot transfer credit up to the cap over multiple years for use that exceeds the applicable cap in a single year.[12]

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[5] "Banking" refers to the generation of surplus credits which may be used to satisfy a future or past shortfall. "Transfer" refers to moving surplus credits from one compliance fleet (e.g., domestic passenger car) to another compliance fleet (e.g., light truck). "Trading" refers to the movement of credits between manufacturers (i.e., a credit sale or purchase).
[6] *Credit Shortfall Report.*
[7] *Manufacturer Projected Fuel Economy Performance Report*, NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION (Oct. 11, 2019), https://one.nhtsa.gov/cafe_pic/AdditionalInfo.htm (see "MYs 2018 and 2019 Projected Fuel Economy Performance") (hereinafter *Manufacturer Projected Fuel Economy Performance Report*). Comparison of reported CAFE projections to standards at 49 C.F.R. § 531.5(d).
[8] *See* 49 U.S.C. § 32903(g).
[9] *See Credit Shortfall Report* (calculation by Auto Innovators).
[10] 77 Fed. Reg. 62,623 (Oct. 15, 2020).
[11] The Safer Affordable Fuel-Efficient Vehicles Rule for Model Years 2021-2026 Passenger Cars and Light Trucks, 85 Fed. Reg. 24,174 (Apr. 30, 2020).
[12] *See* Letter from O. Kevin Vincent, Chief Counsel, National Highway Traffic Safety Administration, to Tom Stricker, Toyota, "Toyota CAFE Credit Transfer Banking" (July 5, 2011), No. 10-004142, https://www.nhtsa.gov/interpretations/10-004142-toyota-cafe-credit-transfer-banking-5-jul-11-final-signature.

Credit Adjustment Factors. When a manufacturer uses a transferred or traded credit for compliance, it is subject to an adjustment factor.[13] The adjustment factor makes a credit sold by a manufacturer worth as little as 1/10 of a credit to the purchasing manufacturer who would apply it to satisfy a shortfall.[14] It is reasonable to assume that a large portion of the surplus credits earned in MY 2019 are attributable to pure electric vehicle manufacturers. Manufacturers collectively project approximately 969 million surplus credits will be earned in MY 2019.[15] Of these, 926 million (96%) are domestic passenger car credits.[16] Only four manufacturers project earning domestic passenger car credits, and of these, an all-electric manufacturer projects the greatest degree of over-compliance by far (762.7 MPG performance relative to a standard of 39.7 MPG).[17] Therefore, to the degree that a particular manufacturer chooses to sell this surplus credit, and other manufacturers choose to purchase from it, those credits could be subject to an adjustment factor where manufacturers receive only 1 credit for approximately every 10 credits purchased.[18]

Availability and Price of Tradeable Credits. Credit surpluses are concentrated in just a few fleets. In MY 2017, 40% of compliance fleets generated credits; in 2018, 34% of compliance fleets are projected to generate credit; in 2019, only 24% of compliance fleets are projected to generate credits.[19] Virtually all of the fleets expected to generate credits are those of full-line manufacturers, who may need such credit surpluses to cover their own shortfalls, or those of pure electric vehicle manufacturers whose credits will be greatly discounted when traded (see above).[20] Only one manufacturer has no general need to preserve credit surpluses for its own use before considering sales to other manufacturers. Given the current uncertain economic conditions, full-line manufacturers can generally be expected to retain surplus credits. There is no regulatory requirement for manufacturers to sell credits. As more fleets experience credit shortfalls, demand for purchased credits is likely to increase, thereby raising prices. Finally, a tripling of the civil penalty rate would have a direct impact on the price of credits, which has a material impact on any automaker seeking to buy or sell those credits—the ceiling price for a purchased credit is likely the civil penalty rate, else the purchased credit would represent a less valuable business proposition. In addition, the cost of purchasing such credits would be a direct economic cost to manufacturers this calendar year (2020) as NHTSA works to finalize MY 2018 compliance, which then impacts subsequent model year compliance costs as changes occur with respect to the availability of surplus credits.

Credit Banking. Despite being earned for fuel savings, credit banking is limited to five years carry-forward and three years carry-back. There is a limited timeframe in which a credit surplus may be used to satisfy a credit shortfall. Over time, the number of compliance fleets with a credit surplus has shrunk (17 fleets in MY 2017, 14 fleets projected in MY 2018, and 10 fleets projected in MY 2019).[21] On the whole, industry has been using credits since MY 2015.[22] Therefore, fewer

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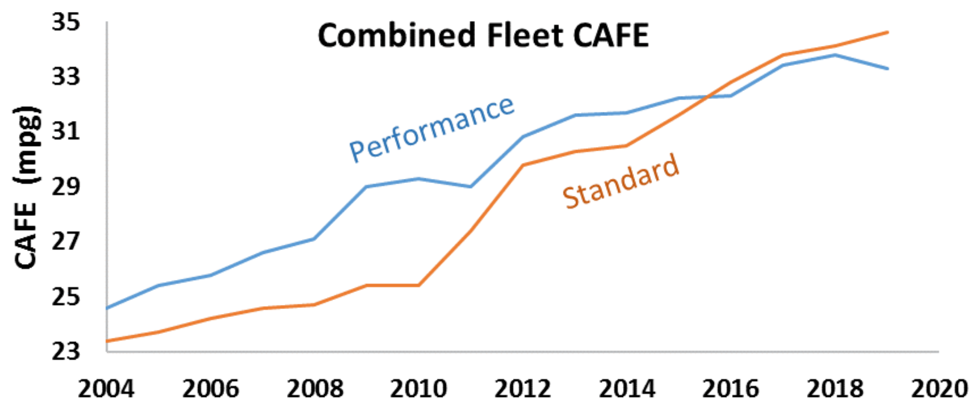
[13] *See* 49 C.F.R. § 536.4(c).
[14] 85 Fed. Reg. at 24,305 (Apr. 30, 2020) ("For example, a manufacturer that buys 40 million credits from [a pure electric vehicle manufacturer] may show a credit balance in excess of 40 million. However, when those credits are applied, they may be worth only 1/10 as much—making that manufacturer's true credit closer to 4 million than 40 million").
[15] *Credit Shortfall Report*.
[16] *Id.*
[17] *Manufacturer Projected Fuel Economy Performance Report.*
[18] *See* 85 Fed. Reg. at 24,305, *supra* note 12; *see also* 49 C.F.R. § 536.4(c).
[19] *See Credit Shortfall Report* (calculation by Auto Innovators).
[20] *See* 85 Fed. Reg. at 24,305, *supra* note 12.
[21] *Credit Shortfall Report*.
[22] *NHTSA CAFE Public Information Center*, NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION, https://one.nhtsa.gov/cafe_pic/CAFE_PIC_home.htm (last visited Oct. 21, 2020).

manufacturers are generating credit surpluses that can be carried forward and previous surpluses (to the extent not expired) are expected to be drawn down due to annual increases in CAFE standards (MYs 2019-2026). Reliance on future surplus credit generation is questionable at best. Current trends suggest that fewer, not more, manufacturers are generating surplus credits. Also, a credit shortfall is indicative of a fleet that is lagging the standard. In order to generate a surplus in the future, that compliance fleet would need to not only catch up to the standard, but also exceed it. Given the uncertainties involved in assessing future compliance, reliance on planned future credit surpluses carries significant risks.



Source: Derived from *CAFE Public Information Center: Fleet Performance,* NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION,https://one.nhtsa.gov/cafe_pic/CAFE_PIC_fleet_LIVE.html and the NOVATION ANALYTICS MODEL YEARS 2012-2019 BASELINE STUDIES REPORT, *available at* Regulations.gov (Docket ID EPA-HQ-OAR-2018-0283-7635).

Conclusion and Request for Relief. In Auto Innovators' October 2 petition, we explain that applying the increased civil penalty retroactively to model years that already have been produced and sold, or are already in the final production process, has no corresponding fuel economy or environmental benefit and is strictly punitive. A recent NHTSA rulemaking should serve as a guide in this matter. In 2016 NHTSA granted the industry's request to apply the anticipated increase starting with a model year in the future. NHTSA applied increased civil penalties in a future model year in recognition that automakers could not make changes to existing or completed model years to avoid paying increased penalties. The same reasoning applies at present. The data discussed in this letter shows the magnitude of the potential economic harm that would be created due not only to the structure of the credit mechanisms in the CAFE program, which limit a manufacturer's ability to address CAFE shortfalls after the fact, but how such economic harm would be magnified by the impacts of the COVID pandemic on the auto sector. Auto Innovators therefore reaffirms its request that NHTSA amend Part 578 to provide that the $14 civil penalty rate will not apply before MY 2022.

Sincerely,

Julia M. Rege
Vice President, Energy & Environment