

ORAL ARGUMENT NOT YET SCHEDULED
No. 09-1318

United States Court of Appeals for the D.C. Circuit

ARKEMA INC.,

Petitioner,

v.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY,

Respondent.

**JOINT BRIEF OF PETITIONERS ARKEMA INC.,
SOLVAY FLUORIDES, LLC, AND SOLVAY SOLEXIS, INC.**

On Petition for Review from the United States
Environmental Protection Agency

Consolidated with No. 09-1335

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**CERTIFICATE OF PARTIES, RULINGS UNDER REVIEW,
AND RELATED CASES PURSUANT TO CIRCUIT RULE 28(a)(1)**

1. Parties. The parties to this proceeding are, in No. 09-1318, petitioner Arkema Inc. (“Arkema”) and respondent United States Environmental Protection Agency (“EPA” or the “Agency”) and, in No. 09-1335, petitioners Solvay Fluorides, LLC, and Solvay Solexis, Inc. (collectively, “Solvay”), and respondent EPA. Pursuant to Federal Rule of Appellate Procedure 26.1 and Circuit Rule 26.1, petitioner Arkema certifies that it is a wholly owned subsidiary of Arkema Delaware, Inc. There are no publicly held companies that own 10% or more of the stock of Arkema; however, Arkema is indirectly owned by Arkema, S.A., a French public company. Petitioner Solvay Fluorides, LLC certifies that it is a wholly owned subsidiary of Solvay Chemicals, Inc., and petitioner Solvay Solexis, Inc. certifies that it is a wholly owned subsidiary of Ausimont Industries, Inc. No publicly held corporation owns 10% or more of the membership interests of Solvay Fluorides, LLC or 10% or more of the stock of Solvay Solexis, Inc.; however, Solvay Fluorides, LLC and Solvay Solexis, Inc. are indirectly owned by Solvay, S.A., a Belgian public company.

2. Rulings Under Review. The petition for review challenges EPA's final rule entitled "Protection of Stratospheric Ozone: Adjustments to the Allowance System for Controlling HCFC Production, Import, and Export," which appears in the Federal Register at 74 Fed. Reg. 66,412 (Dec. 15, 2009) ("Final Rule").

3. Related Cases. Petitioners are unaware of any additional cases that are related to the cases that have been consolidated.

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GLOSSARY OF ABBREVIATIONS

CAA	Clean Air Act
CFC	chlorofluorocarbon
EPA	U.S. Environmental Protection Agency
HCFC	hydrochlorofluorocarbon
HCFC-22	chlorodifluoromethane
HCFC-141b	1,1-dichloro-1-fluoroethane
HCFC-142b	1-chloro-1,1-difluoroethane

JURISDICTIONAL STATEMENT

This is a petition for review of a final regulation promulgated by EPA. EPA was authorized to conduct the rulemaking pursuant to sections 605 and 606 of the Clean Air Act, 42 U.S.C. §§ 7671d, 7671e. Because EPA's rule has nationwide applicability, this Court has jurisdiction under 42 U.S.C. § 7607(b)(1).

STATEMENT OF ISSUES

1. Whether the Final Rule is arbitrary and capricious because it reverses EPA's prior policy of recognizing inter-pollutant trades of baseline hydrochlorofluorocarbon production and consumption allowances without providing a reasoned analysis therefor.

2. Whether the Final Rule is contrary to law because EPA wrongly based its action on the conclusion that Section 607 of the Clean Air Act prohibits baseline inter-pollutant trades.

3. Whether the Final Rule is impermissibly retroactive because it invalidates previously approved baseline inter-pollutant trades.

INTRODUCTION

In 2003, EPA established a cap-and-trade allowance system, pursuant to the Clean Air Act ("CAA" or the "Act"), to help fulfill the obligations of the United States under the Montreal Protocol on Substances

that Deplete the Ozone Layer, Sept. 16, 1987, S. TREATY DOC. NO. 100-10, 1522 U.N.T.S. 29 (“Montreal Protocol” or the “Protocol”). *See* Final Rule, Protection of Stratospheric Ozone: Allowance System for Controlling HCFC Production, Import and Export, 68 Fed. Reg. 2820 (Jan. 21, 2003) (“2003 Rule”). That system capped hydrochlorofluorocarbon (“HCFC”) production and consumption by making a one-time assignment of “baseline” allowances for certain HCFCs and authorizing allowance-holders to expend a fixed percentage of that baseline each year. Consistent with the CAA, EPA allowed “trades of annual *and* permanent allowances between HCFCs *and* between companies.” JA 146 (emphasis added). In so doing, EPA emphasized that its system permitted trades with “maximum flexibility” to facilitate changes in the HCFC marketplace. 2003 Rule, 68 Fed. Reg. at 2833.

Because the Montreal Protocol required a further step-down in overall HCFC production and consumption effective January 1, 2010, EPA initiated rulemaking proceedings in late 2008. *See* Proposed Rule, Protection of Stratospheric Ozone: Adjustments to the Allowance System for Controlling HCFC Production, Import, and Export, 73 Fed. Reg. 78,680 (Dec. 23, 2008) (“Proposed Rule”). EPA proposed to continue the

existing cap-and-trade system, meeting the step-down obligations by reducing the caps *pro rata*. In the Final Rule, however, the Agency repudiated a key component of the existing cap-and-trade system. EPA announced that the CAA prevented it from honoring Arkema's and Solvay's trades of permanent allowances between HCFCs that already had taken place, notwithstanding the Agency's previous written approvals of those transfers and even though Arkema and Solvay had planned their future businesses with the legitimate expectation that EPA's approvals were meaningful. Rather than try to justify this abrupt change of course, EPA denied that it had changed its policy at all, even though the Agency itself had explained to stakeholders that such trades were available, had approved such trades, had provided for them in its regulations, and had proposed in the notice of proposed rulemaking to continue using baselines that reflected these trades. The result of this decision is to take allowances away from Arkema and Solvay and gift those allowances (and the corresponding market share) to their competitors.

The Agency's action violates fundamental principles of administrative law and must be vacated. The Final Rule is arbitrary and capri-

cious because it represents a severe change of policy without even an acknowledgment that a change was taking place, let alone sufficient notice or a suitable justification. In the process, EPA wrongly interpreted the CAA as requiring the result. Further, legislative rules cannot work a retroactive effect, but that is just what EPA has done by using the Final Rule to reject petitioners' baseline allowance transfers after they already had been approved. As a consequence, EPA has dictated market shares that bear no resemblance to underlying market realities.

STATEMENT OF FACTS

A. The Montreal Protocol

In the mid-1970s, scientists discovered that certain man-made chemicals were contributing to the depletion of stratospheric ozone in the Earth's atmosphere. *See NRDC v. EPA*, 464 F.3d 1, 3 (D.C. Cir. 2006). As a result, the United States and other nations entered into the Montreal Protocol, which was incorporated into domestic law through the Clean Air Act Amendments of 1990, Pub. L. No. 101-549, tit. VI, 104 Stat. 2399, 2648 (codified at 42 U.S.C. §§ 7671-7671q).

The Protocol, as amended, called for an end to the production and consumption¹ of ozone-depleting chlorofluorocarbons (“CFCs”) by 1996. In 1990, the London Amendment to the Protocol identified a related class of compounds, HCFCs, as “transitional substances” that could be used in place of CFCs. Art. I, § B.3. Because HCFCs also deplete ozone (albeit to a considerably lesser extent), the parties to the Protocol further agreed (as part of the 1992 Copenhagen Amendment) to cap HCFC consumption and production in 1996 and to phase out HCFCs by 2030, with intermediate step-downs set for 2004, 2010, 2015, and 2020. Art. I, § G. Market allocations associated with the 2010 step-down are the subject of this dispute.

B. The Clean Air Act

The CAA authorizes the Administrator of EPA to direct, within the limits of her statutory authority, the program of stepping-down and ultimately eliminating the production and consumption of HCFCs. 42 U.S.C. § 7671d(e).² For both CFCs and HCFCs, the Act creates a cap-

¹ Under the Protocol and the CAA, “consumption” means “production plus imports minus exports.” Final Rule, 74 Fed. Reg. at 66,414.

² The CAA limits HCFC production as of 2015, 42 U.S.C. § 7671d(b)(1), but authorizes EPA to accelerate the schedule under various circumstances, including when the Montreal Protocol is modified, *id.* §

and-trade system under which EPA issues production and consumption allowances based on a “baseline year,” which for HCFCs is defined to mean “a representative calendar year.” *Id.* § 7671(2).

Section 607 of the CAA, 42 U.S.C. § 7671f, governs the trading of allowances. The Act expressly requires EPA to permit two types of transfers—“[i]nterpollutant transfers” and “[t]rades with other persons.” *Id.* § 7671f(b), (c). An inter-pollutant transfer—sometimes called an “intracompany transfer”—is a transfer by an allowance-holder from one substance to another: “The rules under this section shall permit a production allowance for a substance for any year to be transferred for a production allowance for another substance for the same year on an ozone depletion weighted basis.” *Id.* § 7671f(b)(1).³ A trade with another person—typically called an “inter-company transfer”—is a transfer from an allowance-holder to another party:

7671e(a)(3). Following the adoption of the Copenhagen Amendments, EPA invoked the acceleration authority as to the HCFCs at issue here. Final Rule, Protection of Stratospheric Ozone, 58 Fed. Reg. 65,018, 65,025 (Dec. 10, 1993) (“1993 Rule”).

³ Some substances are more destructive of ozone than others. The relative amount of such degradation attributed to any substance is known as its ozone depletion potential.

The rules under this section shall permit 2 or more persons to transfer production allowances (including inter-pollutant transfers * * *) if the transferor of such allowances will be subject, under such rules, to an enforceable and quantifiable reduction in annual production which * * * exceeds the reduction otherwise applicable to the transferor * * *.

Id. § 7671f(c).⁴

C. The 2003 Rule

Using its CFC phase-out system adopted in the early 1990s as a model, EPA established a cap-and-trade allowance system for HCFCs in 2003 to ensure that the United States would meet the January 1, 2004, step-down under the Montreal Protocol. 2003 Rule, 68 Fed. Reg. 2820. EPA determined that it could produce the necessary reductions by setting baseline levels for just three HCFCs, known as HCFC-141b, HCFC-22, and HCFC-142b.

Although the Agency set a baseline for HCFC-141b,⁵ it essentially banned its production effective January 1, 2003, “except for use in a process resulting in its transformation or its destruction.” 40 C.F.R.

⁴ Pursuant to CAA § 607(d), 42 U.S.C. § 7671f(d), consumption allowances are traded on the same basis as production allowances.

⁵ HCFC-141b (1,1-dichloro-1-fluoroethane) had been used as a solvent and foam-blowing agent.

§ 82.16(b). The elimination of HCFC-141b was alone sufficient to reduce overall United States HCFC production and consumption, as required by the Protocol, so long as supplies of other HCFCs did not increase. *See* Proposed Rule, Protection of Stratospheric Ozone: Allowance System for Controlling HCFC Production, Import and Export, 66 Fed. Reg. 38,064, 38,070 (July 21, 2001) (“2001 Proposed Rule”).

Accordingly, EPA identified baseline levels for the two other widely used HCFCs—HCFC-22⁶ and HCFC-142b⁷—and capped their annual production and consumption at 100% of the baseline levels. 40 C.F.R. § 82.16(a). The baselines were set “on a one-time basis,” such that the allowances would change only if “the percentage of baseline allowances is reduced to ensure compliance with the Protocol cap” or if the baseline itself was adjusted “through permanent transfers of allowances” undertaken at the election of market participants. 2003 Rule, 68 Fed. Reg. at 2823. Otherwise, the baseline would “remain the same from control pe-

⁶ HCFC-22 (chlorodifluoromethane) has been the refrigerant of choice for a wide range of applications such as comfort air-conditioning systems used to cool homes and office buildings.

⁷ HCFC-142b (1-chloro-1,1-difluoroethane) is used in refrigerant blends and traditionally has been used to make plastic foam products like insulation and food trays.

riod to control period (one calendar year to the next).” *Id.* This approach was consistent with EPA’s stated goal of “providing certainty and predictability to allowance holders.” 2001 Proposed Rule, 66 Fed. Reg. at 38,064.

The preamble to the 2003 Rule emphasized that companies were entitled to change their baseline mix of chemicals through inter-pollutant transfers of allowances. The initial baseline had been selected by identifying a year, between 1994 and 1997, during which the company had consumed and produced the greatest amount of HCFCs on an ozone-depletion-weighted basis.⁸ EPA then distributed baseline allowances on a chemical-by-chemical basis that reflected the company’s priorities during that particular year. But EPA explained that “companies * * * wish[ing] to obtain allowances for different HCFCs [could] take advantage of the transfer provisions.” 68 Fed. Reg. at 2832; *accord* 40 C.F.R. § 82.3 (“A person’s consumption allowances * * * are the total of the allowances obtained under §§ 82.19 and 82.20, as may be modified under § 82.23.”). Likewise, by “incorporating a high degree of flex-

⁸ Pursuant to the CAA, EPA was required to identify a “representative calendar year” as the HCFC baseline. CAA § 601(2), 42 U.S.C. § 7671(2).

ibility in the transfers of allowances,” EPA was helping companies “in responding to market decisions and trends.” 68 Fed. Reg. at 2832. Commenters had contended that maximizing “flexibility was considered imperative if tracking were done on the proposed chemical-by-chemical basis,” as opposed to providing a total ozone-depletion allowance to each company. *Id.* at 2833. EPA “agree[d]” with these commenters and announced that it was “establishing procedures for transfers with *maximum* flexibility within the constraints of the allowance system.” *Id.* (emphasis added).

The Agency gave two examples of the baseline trades that it incorporated into its system. *First*, one company could transfer baseline allowances to another company. *Id.* at 2835. *Second*, the preamble explained that “inter-pollutant transfers of * * * baseline allowances would * * * be permitted.” *Id.* What distinguished inter-company and inter-pollutant *baseline* trades from *annual* trades was that baseline trades were “permanent.” *See id.* (“The permanent nature of the [baseline] transfer is what makes it different from the transfer of current-year allowances.”).

Accordingly, as the CAA mandated, the 2003 Rule established regulations governing inter-company and inter-pollutant trades. In 40 C.F.R. § 82.3, the Agency defined “consumption allowances” and “production allowances” as each company’s baseline amount of allowances, as modified through trading (and through other mechanisms for extra allowances and exports, which are not at issue here). In § 82.23(a), EPA set out the procedures for “[i]nter-company transfers.” The procedures for “[i]nter-pollutant transfers” appear in § 82.23(b).⁹ Although an allowance holder cannot trade allowances from one year to another, § 82.23(d) of EPA’s regulation contemplates that baseline allowances—*i.e.*, the baseline levels from which calendar-year allowances are distributed each year—can be transferred on a permanent basis, in accordance with § 82.23(a), (b), or (c), in which case “[a] person receiving a permanent transfer of baseline production allowances or baseline consumption allowances (the transferee) for a specific class II controlled substance will be the person who has their baseline allowances adjusted in accordance with the phaseout schedules in this section.” Under the

⁹ Section 82.23(c) authorizes trades that are simultaneously inter-company and inter-pollutant.

2003 Rule, EPA thus expressly allowed permanent inter-pollutant trades of consumption allowances and production allowances.¹⁰

EPA's authorization of permanent baseline transfers is confirmed by its official form for reporting HCFC allowance transfers, which was developed through notice and comment procedures. *See* Reporting and Recordkeeping Requirements of the HCFC Allowance System, 71 Fed. Reg. 30,675 (May 30, 2006); Reporting and Recordkeeping Requirements of the HCFC Allowance System, 70 Fed. Reg. 75,458 (Dec. 20, 2005).¹¹ A company submitting a transfer claim to EPA is required to designate the "Type of Allowance Transferred." According to EPA's official guidance for completing the form, "[a] transfer of current year allowances is only for the current control period[,while a] transfer of baseline allowances *permanently* reduces the number of allowances that the

¹⁰ The same document is used to report both inter-company and inter-pollutant trades. *E.g.*, JA 4-6. In addition, to comport with the Act's requirement that trades *reduce* HCFC production and consumption, any trades between substances would proceed on an ozone-depletion-adjusted basis, and the amount traded would be reduced by a 0.1% transfer offset. 40 C.F.R. § 82.23(a)(i)(G), (b)(3)(v).

¹¹ The basic structure of the transfer form predates the HCFC cap-and-trade system. The 1993 form for transferring CFC allowances used identical language to permit baseline inter-pollutant transfers. EPA, Guidance for the Stratospheric Ozone Protection Program (July 1992).

transferor will receive in future allocations,” and “[o]nly one box should be checked.” EPA, Guidance Document for the Stratospheric Ozone Protection Program After January 1, 2005, part 4, at 19, *available at* <http://www.docstoc.com/docs/7832523/Guidance-Document-for-the-Stratospheric-Ozone-Protection-Program> (emphasis in original) [hereinafter Guidance Document].

Significantly, the 2003 Rule also confirmed that, in anticipation of the 2010 step-down, production of HCFC-22 and HCFC-142b for domestic use in new equipment would be prohibited effective January 1, 2010. 40 C.F.R. § 82.16(c). That deadline had been established in 1993, *see* 1993 Rule, 58 Fed. Reg. at 65,025, so the refrigeration industry has long understood that beginning in 2010 only aftermarket sales of HCFC-22 and HCFC-142b (*i.e.*, sales for use in existing equipment) would be permitted.

D. Petitioners’ Inter-Pollutant Baseline Trades

Arkema is a major participant in the market for HCFCs and employs more than 1900 people at 15 sites throughout the United States. JA 154. Arkema has chosen to focus its business on supplying refrigerant needs in the aftermarket, where Arkema is the leading U.S. sup-

plier of HCFC-22. *Id.* In 2008, Arkema estimated its share of the U.S. HCFC-22 aftermarket at 33%. *Werkema Dec.* ¶ 7.

As the January 1, 2010, ban on the use of HCFC-22 in new equipment grew closer, Arkema decided that to maintain its pre-2010 position in the HCFC-22 aftermarket it needed to convert HCFC-142b allowances to HCFC-22. Accordingly, on April 18, 2008, Arkema filed with EPA Form 2014.03, through which Arkema elected to transfer substantial quantities of “Baseline Year Allowances” from HCFC-142b to HCFC-22. *JA 26-32.*¹²

EPA confirmed these baseline transfers at least three times. *First*, immediately after Arkema filed Form 2014.03, EPA responded with “non objection notices” authorizing Arkema to “proceed” with the “baseline” transfers. *JA 33-34.* *Second*, in anticipation of the Proposed Rule, EPA sent Arkema confirmation of its baseline allocations that reflected the 2008 transfers. *JA 88-92.* *Third*, in January 2009, EPA sent

¹² In particular, Arkema filed applications to transfer 16,173 metric tons of HCFC-142b consumption baseline allowances and 15,631 metric tons of HCFC-142b production baseline allowances, which, after deduction of the 0.1% transfer offsets and conversion based on ozone-depletion factors, resulted in a new HCFC-22 consumption baseline allocation of 19,113 metric tons and a new HCFC-22 production baseline allocation of 18,473 metric tons.

Arkema a letter informing it of its available 2009 allowance. JA 145. That confirmation also reflected the 2008 baseline transfers, thereby confirming, once again, that EPA was treating the transfers as permanent and having effect beyond the 2008 control period.

Solvay likewise is a producer, exporter, and importer of refrigerants, including HCFC-22 and HCFC-142b. JA 149. Soon after the 2003 Rule was promulgated, Solvay determined that its business interests required conversion of the majority of its HCFC-142b allowances to HCFC-22. Magid Dec. ¶¶ 5-7. In 2006, for example, Solvay consumed 96% of its HCFC-142b allowances as HCFC-22, primarily to service the refrigeration aftermarket. JA 197. After conducting annual trades from 2004 to 2007, Solvay decided to make its transfer permanent in 2008. Accordingly, Solvay Solexis submitted a “transfer claim” to convert 2,852 metric tons of baseline HCFC-142b consumption into 3,368 metric tons of baseline HCFC-22 consumption, which were transferred in turn to Solvay Fluorides. JA 3-6, 11-14. Like Arkema, Solvay specified its intent to complete a transfer of “Baseline Year Allowances” on EPA Form 2014.03. *Id.* Similarly, EPA confirmed that Solvay had ef-

fecting a baseline transfer in “non objection notices” authorizing Solvay to proceed with a “baseline” transfer, JA 9-10, 24-25.

E. Proceedings Before EPA

In anticipation of the 2010 step-down, EPA solicited feedback from major stakeholders and held a public meeting on June 16, 2008. At that meeting, EPA explained the current system and introduced the options moving forward. JA 35-75. In explaining the current system to stakeholders, EPA stated that “[t]rades of allowances” were “[a]llowed between entities [or] between HCFCs * * * [f]or baseline and calendar year allowances.” JA 47. Arkema responded to the public meeting by supporting the “known and proven methodology” of the existing cap-and-trade system. JA 87.

On December 23, 2008, EPA formally initiated a rulemaking proceeding for the promulgation of regulations necessary for the 2010 HCFC step-down, which required the United States to reduce HCFC production and consumption to 25% of its national baseline under the Montreal Protocol. *See* Proposed Rule, 73 Fed. Reg. 78,680.

The Proposed Rule’s “preferred” option for achieving that reduction was “to continue [EPA’s] past practice of apportioning company-

specific production and consumption baselines for individual HCFCs, and granting a certain percent of that baseline as necessary to achieve compliance with the cap.” *Id.* at 78,686. To that end, EPA proposed “to apportion company-specific baselines in amounts that are equivalent to those currently published at [40 C.F.R.] § 82.17 (for production) and § 82.19 (for consumption), *adjusted as necessary to reflect permanent transfers of baseline allowances.*” *Id.* (emphasis added).

EPA said that it was “not proposing to revisit decisions made in the 2003 allocation rule,” *id.* at 78,687; rather, it anticipated that “the continued availability of inter-pollutant transfers w[ould] permit the market to self-correct for unforeseen changes in demand and allow individuals to consider a range of options for their allowances,” *id.* at 78,689. Through the inter-pollutant transfer process, “EPA s[ought] to avoid unnecessary disruptions in the marketplace,” consistent with its goal “to promote a smooth transition for industry.” *Id.* EPA specifically emphasized that “[b]oth inter-pollutant and inter-company transfers of allowances are possible, either on a calendar-year or permanent basis.” *Id.* at 78,701.

Accordingly, EPA proposed company-specific baselines that “reflect adjustments resulting from approved inter-pollutant and/or inter-company transfers of baseline allowances (*i.e.*, permanent rather than calendar-year allowances) through the process described in [40 C.F.R.] § 82.23.” 73 Fed. Reg. at 78,693. The baseline production and consumption allowance allocations proposed by EPA appropriately reflected Arkema’s and Solvay’s 2008 permanent baseline transfers, which EPA had already reviewed and approved. *Id.* at 78,694. EPA requested public comments on the Proposed Rule (and five alternatives) by March 9, 2009. *Id.* at 78,680.

Shortly after the Proposed Rule was introduced, EPA released a fact sheet explaining the proposal. With respect to baseline trades, the fact sheet explained the Agency’s existing practices by saying that “EPA ha[d] proposed to * * * *continue* to provide flexibility by allowing EPA-approved trades of annual *and* permanent allowances between HCFCs *and* between companies.” JA 146 (emphasis added).

Arkema submitted comments endorsing the Proposed Rule because it (1) maintained EPA’s past treatment of allowance transfers; (2) permitted market participants to adapt to changes in HCFC demand

such that the allowance system reflected the market; (3) was consistent with Arkema's expectations when it paid an "offset" as a fee for completing the baseline transfer; and (4) avoided the pitfalls of alternatives, chief of which was giving an increased share of the HCFC-22 aftermarket to companies that had chosen to sell to original equipment manufacturers rather than focus on the aftermarket. JA 154-62.

Solvay likewise endorsed the Proposed Rule. It explained that the transfer mechanisms had "provided critical flexibility to meet marketplace demands" and that any change from the 2003 Rule would "undermine confidence in all future phaseout programs." JA 149-51. Moreover, Solvay explained that reverting to the 1994-1997 baseline allowance levels without recognizing already approved inter-pollutant baseline transfers would "disrupt [Solvay's] many years of sales to the refrigerants aftermarket," because Solvay had converted at least 95% of HCFC-142b allowances to HCFC-22 for the past four years. JA 197.

Several commenters objected to the Proposed Rule's recognition of past transfers. For example, DuPont Fluoroproducts commented that, under the Proposed Rule, "[o]nly two companies would receive increases in HCFC-22 consumption baseline allowances * * *: Arkema and the

Solvay Group.” JA 170. Meanwhile, “[t]hose increases would adversely affect the nineteen other HCFC-22 allowance holders.” *Id.* Likewise, Honeywell Specialty Materials (“Honeywell”) commented that the Proposed Rule would benefit “just two * * * companies, Arkema and Solvay.” JA 185. Honeywell advocated disregarding Arkema’s and Solvay’s baseline trades—which would result in an increase of its own and DuPont’s market shares. For the very first time, some 19 years after Congress enacted CAA § 607, Honeywell’s comments suggested a theory that the Act somehow prohibited EPA from recognizing baseline inter-pollutant trades. JA 185-87. Such a legal theory appeared nowhere in EPA’s Proposed Rule or in any of its prior regulatory actions on HCFCs or CFCs.

EPA waited until December 15, 2009, just 17 days before the step-down date required by the Montreal Protocol, to publish its Final Rule. The Final Rule completely reversed EPA’s prior position on permanent baseline transfers. *See* 74 Fed. Reg. at 66,419. Contrary to its existing HCFC allowance system rules, EPA adopted Honeywell’s unprecedented theory that EPA was *prohibited* from allowing permanent baseline transfers because “section 607(b) [of the CAA] is best read as permitting

only year-by-year inter-pollutant transfers.” *Id.* at 66,421. Rather than acknowledge that this was a new interpretation of its CAA authority, EPA claimed that its past statements were “consistent with this interpretation.” *Id.* at 66,422. In response to Arkema’s objection that neither EPA nor any commenter had ever before taken the position that Section 607 of the CAA limited the availability of baseline inter-pollutant transfers, EPA asserted that it “disagree[d] that it has been interpreting the Clean Air Act as allowing permanent inter-pollutant baseline trades.” JA 259. Instead, EPA claimed that in its past practice it “ha[d] allowed for permanent inter-company transfers but noted that any inter-pollutant transfers are not carried forward into the future.” *Id.*

F. Effects Of The Final Rule

If permitted to remain in force, the Final Rule will dramatically and arbitrarily rearrange the U.S. refrigerant marketplace. Rather than honoring the original baselines (as modified by approved transfers), market participants will be assigned artificial market shares for the HCFC-22 *aftermarket* equal to their 1994-1997 market shares for the total HCFC-22 market, which then included sales for manufactur-

ing original equipment. This action ignores the fundamental shift in the market since 1997 and overrides the resulting changes in business strategy that Arkema and Solvay took in response. For petitioners, the Proposed Rule would have provided aggregate allowances for HCFC-22 consistent with their pre-2010 shares of the HCFC-22 aftermarket. In short, by canceling Arkema's and Solvay's past transfers, EPA unwound market decisions and awarded non-representative market shares unrelated to business practices—all in contravention of its own cap-and-trade system.

STATUTES AND REGULATIONS

Pursuant to Circuit Rule 28(a)(5), relevant statutes and regulations are printed in a separately bound addendum, which has been filed alongside this brief.

SUMMARY OF ARGUMENT

The Final Rule promulgated by EPA is unsustainable for three independent reasons.

I. When an agency reverses a previous position or policy, it must acknowledge the change of course and supply a reasoned analysis explaining its deviation from precedent. Any reversal of policy without such a reasoned analysis is arbitrary and capricious. The Final Rule

promulgated by EPA contains two sharp breaks with past Agency practice, but EPA did not provide a reasoned analysis for the departure from precedent in either case.

First, the Final Rule invalidates inter-pollutant trades of baseline HCFC allowances, even though EPA previously had authorized and approved such transfers. In providing for baseline transfers, the 2003 regulations did not distinguish between inter-pollutant and inter-company transfers. To the contrary, EPA imposed materially indistinguishable criteria on the two kinds of transfers and structured the regulations such that the baseline transfer provision applied to both inter-pollutant and inter-company trades. In implementing those regulations, EPA promulgated a regulatory form, through notice-and-comment procedures, that allowed companies to request and receive authorization for baseline inter-pollutant transfers. Arkema and Solvay filed this form and requested baseline inter-pollutant transfers. Those requests were approved and EPA confirmed twice more that those baseline transfers had taken place. EPA recognized this past practice in a meeting with stakeholders before the publication of the Proposed Rule; in the Proposed Rule itself, in which the Agency proposed to honor these

baseline inter-pollutant trades; and in a fact sheet explaining the Proposed Rule. Ignoring these contradictions, EPA nevertheless claimed in the Final Rule that baseline inter-pollutant trades were unavailable under the Act and had, in fact, never been authorized. Past practice demonstrates otherwise, and EPA's failure to acknowledge its past practice renders the Final Rule arbitrary and capricious. Moreover, because the Final Rule rested on a novel interpretation of the Act, EPA was required to subject the theory to notice and comment. Its failure to do so independently requires that the Final Rule be vacated.

Second, the Final Rule abandons EPA's longstanding recognition that competitive forces must be permitted to govern the market for HCFCs. In previous rulemakings, EPA insisted that promoting the market was necessary and that inter-pollutant transfers were essential to achieving that end because they facilitated companies' responses to market conditions. The Final Rule silently abandons those practices, replacing market-based allowances with fiat allocations that arbitrarily give market share to certain companies at the expense of others.

II. Agency action must be vacated when the agency wrongly concludes that its conduct is mandated by statute. In the Final Rule,

EPA concluded that the legislative history and text of the CAA prohibit baseline inter-pollutant transfers; however, neither imposes any such limitation.

EPA's reliance on the CAA's legislative history is misplaced. EPA apparently decided that Congress did not intend to permit baseline inter-pollutant transfers because neither the House bill nor the Senate bill contemplated them. EPA overlooked the fact that the Conference Committee endorsed a third approach that neither Chamber had proposed. Given that baseline inter-pollutant transfers would have served no function in either of the unenacted bills, it was illogical for EPA to rely upon those bills as evidence of what the House and Senate intended in their Conference Committee compromise.

Likewise, EPA's construction of the statutory text is incorrect. EPA concluded that Congress intended to permit baseline transfers between companies but to prohibit baseline transfers between HCFCs. The provision relied upon by EPA, however, merely states that allowances cannot be transferred from one year to a different year. And the inference employed by EPA to conclude that inter-pollutant transfers

can only be annual would apply equally to inter-company transfers, which indisputably can be permanent.

III. An agency is not permitted to engage in retroactive rulemaking unless Congress has explicitly so authorized. In the case of the CAA, this Court has held that EPA lacks the authority to regulate retroactively. Yet the Final Rule operates retroactively to cancel inter-pollutant trades that EPA already approved.

A regulation is retroactive if it changes the legal consequences of a past action. Here, EPA established a cap-and-trade system in 2003 that was designed to survive all subsequent step-downs until the phase-out of HCFCs was complete. Baselines were set on a one-time basis, and allocations could change only through permanent transfers of those baselines or percentage reductions during HCFC step-downs. In the Final Rule, EPA left the cap-and-trade system intact in all respects except for recalculating Arkema's and Solvay's baselines to reverse their baseline inter-pollutant trades. Although the Agency approved those trades in 2008, it now insists that they never existed. EPA cannot use a rule-making proceeding to change its past decisions in such an ongoing system.

STANDING

Arkema and Solvay have standing to challenge the Final Rule because they are “object[s] of the action * * * at issue.” *Sierra Club v. EPA*, 292 F.3d 895, 900 (D.C. Cir. 2002) (quoting *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992)). The Proposed Rule would have provided Arkema and Solvay with larger HCFC production and consumption allowances than the Final Rule. The loss of those marketable allowances has resulted in serious economic consequences for both companies. *See* Werkema Dec. ¶ 10; Magid Dec. ¶ 18.¹³ Accordingly, Arkema and Solvay are aggrieved by the Final Rule. Their injuries can be redressed by an order vacating the Final Rule and directing EPA to promulgate a new rule consistent with its legal obligations.

ARGUMENT

The Final Rule must be vacated because it is “arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law.” CAA § 307(d)(9)(A), 42 U.S.C. § 7607(d)(9)(A). This Court’s precedents require vacatur when an agency changes course without so acknowledging, when it operates under the mistaken belief that a certain conclu-

¹³ The declarations of Thomas Werkema and Sheldon B. Magid appear in the Standing Addendum, *infra*.

sion is required by statute, or when it promulgates regulations that reach into the past to change the legal effect of completed acts. Each of those fundamental flaws is present in the Final Rule, which rearranges the HCFC marketplace in a manner that contravenes, rather than reinforces, the existing market. Any of these reasons is sufficient for granting the petition for review.

I. THE FINAL RULE MUST BE VACATED BECAUSE EPA CHANGED ITS PRIOR PRACTICE WITHOUT PROVIDING A REASONED ANALYSIS OR ADEQUATE NOTICE.

When an agency reverses its past practice without providing a reasoned basis therefor, the agency action is arbitrary and capricious and must be vacated. Here, EPA's Final Rule reversed its approach on two matters of crucial importance. *First*, EPA repudiated its previous approval—and endorsement—of inter-pollutant baseline transfers. But rather than explain its deviation from precedent, EPA denied its past practices. Moreover, although a change in statutory interpretation must be preceded by notice and comment, EPA impermissibly announced its interpretation of the CAA for the first time in the Final Rule. The lack of sufficient notice is an alternative basis for vacating the Final Rule. *Second*, notwithstanding decades of emphasizing the

importance of facilitating a well-functioning market for HCFCs and repeatedly recognizing that inter-pollutant transfers are necessary to allow the market to self-correct, EPA has now abandoned these core market principles without a rational explanation for the change. As a result, the HCFC allowances in the Final Rule are neither a product of competitive forces nor a reasonable representation of the marketplace. They are, instead, a function of regulatory grace. Because EPA failed even to acknowledge that it was changing its practices with respect to baseline inter-pollutant transfers and the importance of relying upon market forces, the Final Rule is unsustainable.

A. The Agency Must Provide A Reasoned Analysis Of Its Change In Position.

Although an agency is free to change its policies and statutory interpretations, it must first “supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored.” *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970). Absent such scrutiny by the agency, “abrupt shifts in policy * * * constitute ‘danger signals’ that the [agency] may be acting inconsistently with its statutory mandate” and constitute arbitrary and

capricious rulemaking. *Office of Comm'n of United Church of Christ v. FCC*, 707 F.2d 1413, 1425 (D.C. Cir. 1983).

To satisfy the “reasoned analysis” standard, an agency first must “display awareness that it *is* changing position.” *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1811 (2009) (emphasis in original). “An agency may not, for example, depart from a prior policy *sub silentio* or simply disregard rules that are still on the books.” *Id.* Otherwise, it will have no ability to grapple with the past policy to determine whether a course correction is authorized and appropriate. This Court must enforce the agency’s obligation to change course only “conscious[ly]” and must ensure that the agency has addressed the “serious reliance interests that must be taken into account” when an agency is not creating its policies “on a blank slate.” *Id.*

An agency’s obligation to supply a reasoned analysis for upsetting its past practices applies regardless of whether the practice is codified in regulations. This Court has enforced the “reasoned analysis” requirement whenever an agency changes its “policies,” “standards,” and “precedents,” and has applied the requirement to a range of past agency conduct. *See, e.g., Bush-Quayle '92 Primary Comm., Inc. v. FEC*, 104

F.3d 448, 453 (D.C. Cir. 1997) (requiring consistency with audit report from previous election); *Action for Children's Television v. FCC*, 821 F.2d 741, 743-46 (D.C. Cir. 1987) (requiring consistency with agency report).

Once the agency has identified a conflicting past practice, it must suitably justify any deviation. “[I]f an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.” *Greater Boston Television Corp.*, 444 F.2d at 852. If an agency fails to supply its own “reasoned analysis” to justify its action, the separation of powers prevents this Court from developing one independently. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947).

B. The Final Rule Changed EPA's Position On Inter-Pollutant Baseline Trades Without Addressing EPA's Past Practice.

1. EPA's position on inter-pollutant transfers of baseline allowances changed in the Final Rule. Whereas EPA previously had acknowledged that baseline inter-pollutant transfers were available and had approved such transfers for Arkema and Solvay, the Final Rule ar-

ticulated a conflicting policy forbidding those same transfers. The previous policy is evident from the 2003 regulations; from EPA's practice in applying those regulations, including the forms it promulgated thereunder; from the way EPA explained its past practice, in plain language, in publications issued before and after the Proposed Rule; and from the Proposed Rule itself.

a. The 2003 regulations set forth explicit procedures for transferring allowances in 40 C.F.R. § 82.23. Subsection (b) governed all inter-pollutant transfers: "a person (transferor) may convert consumption allowances or production allowances for one [HCFC] to the same type of allowance for another [HCFC]." In a similar fashion, subsection (a) authorized inter-company transfers and subsection (c) authorized transfers that are simultaneously inter-company and inter-pollutant. Under these regulations, the procedures for inter-company and inter-pollutant transfers under 40 C.F.R. § 82.23 were materially indistinguishable.

Baseline transfers were explicitly referenced by subsection (d), which provided that after such a transfer, any adjustment at the time of an eventual phaseout would be made from the transferee's account. On its face, § 82.23(d) made no distinction between inter-pollutant trans-

fers and inter-company transfers and thus applied equally to both types of trades.

Notwithstanding this regulatory framework, EPA now asserts that baseline trades are merely a subset of inter-company trades and that baseline inter-pollutant trades do not exist. However, the structure of § 82.23 compels the contrary conclusion. If baseline trades were a subset just of inter-company trades, then the discussion of baseline trades would have been placed in § 82.23(a), the subsection dealing exclusively with inter-company trading. At the very least, the provision addressing baseline trades would have indicated that it applied only to the inter-company trades authorized by § 82.23(a). But the 2003 Rule did no such thing because EPA intended to facilitate baseline trades both between companies and between chemicals. Indeed, the preamble to the 2003 Rule specifically recognized that baseline trades could result in “a lasting shift of a company’s allowances to another company” *and* that “inter-pollutant transfers of * * * baseline allowances would also be permitted.” 68 Fed. Reg. at 2835.

b. Consistent with the 2003 regulations, EPA created an administrative system in which inter-pollutant and inter-company trans-

fers are treated identically. Indeed, employing notice-and-comment procedures, EPA promulgated a form for use in completing inter-pollutant and inter-company baseline transfers. See 71 Fed. Reg. 30,675; 70 Fed. Reg. 75,458. The same form is used for each type of transfer and requires a company completing a transfer to specify whether its trade is for “Current Year Allowances” or “Baseline Year Allowances.” *E.g.*, JA 5, 13, 28. Transferors are admonished that “[o]nly one box should be checked,” with no distinction drawn between inter-pollutant and inter-company transfers. Guidance Document, *supra*, part 4, at 19. Consistent with this approach, the instructions for this official form explain that “[a] transfer of current year allowances is only for the current control period[, while a] transfer of baseline allowances *permanently* reduces the number of allowances that the transferor will receive in future allocations.” *Id.* (emphasis in original). As with the regulatory language, no distinction is made between inter-pollutant and inter-company trades.

In administering the cap-and-trade system under the 2003 regulations and the accompanying forms, EPA confirmed the existence of permanent baseline inter-pollutant transfers by approving such trans-

actions. Both Arkema and Solvay filed EPA's regulatory claim notice form to transfer consumption and production baseline allowances from HCFC-142b to HCFC-22 in 2008. JA 3-6, 11-14, 26-32. EPA approved these transfers and unambiguously confirmed that it was approving permanent, *baseline* transfers in the process. *First*, EPA sent "non objection notices" to each petitioner instructing the companies to "proceed" with their "baseline" transfers. JA 9-10, 24-25, 33-34.¹⁴ *Second*, in anticipation of the rulemaking proceedings now at issue, EPA sent petitioners confirmations of their baseline allowances that reflected the 2008 baseline trades. *E.g.*, JA 88-92. *Third*, after single-year transfers for 2008 would have expired, EPA sent petitioners confirmations of their 2009 allowance balances that reflected the 2008 baseline transfers. *E.g.*, JA 145. EPA's conduct thus consistently and unambiguously reinforced the Agency's practice of approving baseline inter-pollutant transfers.

¹⁴ There can be no doubt that a "baseline" transfer and a permanent transfer are synonymous. In the 2003 Rule, EPA explained that "[t]he permanent nature of the [baseline] transfer is what makes it different from the transfer of current-year allowances." 68 Fed. Reg. at 2835.

c. If there were any doubt that EPA believed that market participants could complete inter-pollutant baseline trades, the Agency dispelled it by explicitly and repeatedly stating that they could. In a meeting with stakeholders before the Proposed Rule was issued, for example, EPA described the system in place “[t]oday” as allowing “[t]rades of allowances” that could be “[f]or baseline and calendar-year allowances” and that were “[a]llowed between entities [and] between HCFCs.” JA 47.

EPA confirmed this policy in the Proposed Rule itself. As the Agency explained, “[b]oth inter-pollutant and inter-company transfers of allowances are possible, either on a calendar-year or permanent basis.” 73 Fed. Reg. at 78,701. Accordingly, under EPA’s preferred approach for implementing the 2010 stepdown, “[t]he proposed company-specific baselines * * * reflect[ed] adjustments resulting from approved inter-pollutant and/or inter-company transfers of baseline allowances (*i.e.*, permanent rather than calendar-year allowances) through the process described in § 82.23.” *Id.* at 78,693.

In describing the proposal in a fact sheet released the next month, EPA explained once more that its proposal was merely to “*continue to*

provide flexibility by allowing EPA-approved trades of annual *and* permanent allowances between HCFCs *and* between companies.” JA 146 (emphasis added).¹⁵ This repetition of EPA’s understanding of its practices forecloses the possibility that EPA forbade inter-pollutant transfers of baseline allowances before the Final Rule—let alone that EPA interpreted the CAA as requiring that result. Yet EPA insisted in the Final Rule that its position was unwavering.

2. Notwithstanding the Agency’s regulations authorizing baseline inter-pollutant trades, its forms for recording such trades, its explicit pronouncements that such trades were available, and its past approvals of such trades, EPA failed in its Final Rule to provide a “reasoned analysis” for its new interpretation of the legal requirements. To the contrary, EPA announced that it “disagree[d] that it ha[d] been interpreting the Clean Air Act as allowing permanent inter-pollutant baseline trades.” JA 259. Accordingly, EPA made no attempt to recon-

¹⁵ An internal communication between EPA and the Office of Management and Budget also revealed the Agency’s understanding that inter-pollutant baseline transfers were possible until the issuance of the Final Rule. EPA wrote that “Solvay’s allowance of [HCFC-]22 [had] changed because the final rule does not account for permanent inter-pollutant trades (whereas the proposal did * * *).” Docket No. 150.14.

cile the Final Rule with its past approvals of baseline inter-pollutant transfers or to assess whether it was appropriate to upset petitioners' reliance on those approvals. Because EPA failed to supply the required reasoned analysis for changing its position, it acted arbitrarily and capriciously. *See Fox Television Stations*, 129 S. Ct. at 1811.

In defense of its claim that it had not changed position, EPA insisted in the Final Rule that it “ha[d] made past statements that are consistent with [its] interpretation.” 74 Fed. Reg. at 66,422. In particular, EPA cited three statements from the preamble to the 2003 Rule. But those supposedly consistent statements do not withstand scrutiny, and they could not, in any event, override EPA’s actual practices in administering the HCFC cap-and-trade system.

First, EPA relies upon the preamble’s statement that “[t]he permanent transfer of baseline allowances is a lasting shift of a company’s allowances to another company.” 68 Fed. Reg. at 2835. In context, EPA was merely providing an *example* of a permanent transfer, not imposing an implicit limitation. This must be so, because in the same paragraph EPA noted that “[s]ubsequent inter-pollutant transfers of these baseline allowances would also be permitted.” *Id.* Because a baseline transfer

is, by its very definition, permanent, *see id.* (“The permanent nature of the [baseline] transfer is what makes it different from the transfer of current-year allowances.”), this concession undermines any claim that only inter-company trades are permanent. As discussed above, the structure and language of the 2003 regulations reinforce this conclusion, because they authorize inter-company and inter-pollutant transfers of baseline allowances on the same terms without imposing any expiration date on inter-pollutant trades. *See* 40 C.F.R. § 82.23.

Second, EPA cites the preamble’s comment that “at the time of a reduction step or a phaseout of the substance, the current holder of baseline allowances that were received in a permanent transfer would be the person who would have them deducted.” 68 Fed. Reg. at 2835. This statement has no bearing on the propriety of inter-pollutant transfers. Petitioners do not dispute that their transferred baseline allowances are subject to the stepdown or that baseline allowances could be set to zero when a substance is phased out, as was done for HCFC-141b. Thus, EPA’s statement simply describes the functioning of the allowance system as both EPA and petitioners understood it prior to the Final Rule.

Third, EPA relies on the preamble’s observation that EPA would “allow permanent transfers of baseline allowances with those allowances disappearing at the phaseout date for the specific HCFC, regardless of what inter-pollutant transfers had taken place.” *Id.* Again, because no “phaseout” of HCFC-22 or HCFC-142b has taken place, this assertion does not bear on the propriety of inter-pollutant baseline transfers. EPA defined a “phaseout” as when “the consumption and production allowances for a specific HCFC disappear.” *Id.* at 2833. That plainly has not happened for HCFC-22 or HCFC-142b.

Thus, none of EPA’s prior statements—particularly when considered in light of its consistent pattern of conduct—justifies the Agency’s claim that it was merely following its past practice. Because EPA failed to provide a “reasoned analysis” for changing its approach—indeed, because it failed even to *acknowledge* that it had changed its approach—the Agency acted arbitrarily and capriciously. The Final Rule must be vacated and the matter remanded.

3. EPA’s failure to provide a reasoned analysis is compounded by its failure to subject its new interpretation of the CAA to the procedures of notice and comment.

The CAA sets forth strict notice requirements that require EPA to identify the “basis and purpose” of a proposed rule, including “the major legal interpretations and policy considerations underlying the proposed rule.” 42 U.S.C. § 7607(d)(3). Providing public notice serves three essential purposes:

(1) to ensure that agency regulations are tested via exposure to diverse public comment, (2) to ensure fairness to affected parties, and (3) to give affected parties an opportunity to develop evidence in the record to support their objections to the rule and thereby enhance the quality of judicial review.

Int’l Union, United Mine Workers of Am. v. Mine Safety & Health Admin., 407 F.3d 1250, 1259 (D.C. Cir. 2005). Here, those purposes were skirted by EPA’s failure to provide any notice that it was considering reinterpreting the CAA to forbid baseline inter-pollutant transfers.

In the Proposed Rule, EPA indicated its preference to continue using the existing baselines, which reflected inter-pollutant trades. 73 Fed. Reg. at 78,687. The Agency said that it was “not proposing to revisit decisions made in the 2003 allocation rule,” *id.*, because “the continued availability of inter-pollutant transfers w[ould] permit the market to self-correct for unforeseen changes in demand and allow individuals

to consider a range of options for their allowances,” *id.* at 78,689. Although the Agency invited comment on five regulatory options, which included setting baselines “with or without considering any permanent baseline transfers and/or inter-pollutant transfers,” *id.* at 78,687, it nowhere hinted that it might view the CAA as *requiring* it to disregard inter-pollutant transfers that had already been finalized.

The leap from soliciting comments on a policy choice to reinterpreting the authorizing statute to require the ultimate result is substantial. But a final rule must be the “logical outgrowth” of an agency’s proposals. *Shell Oil Co. v. EPA*, 950 F.2d 741, 750-51 (D.C. Cir. 1991). As this Court has explained, “[s]omething is not a logical outgrowth of nothing,” *Kooritzky v. Reich*, 17 F.3d 1509, 1513 (D.C. Cir. 1994), and interested parties cannot be expected to “divine the EPA’s unspoken thoughts,” *Ariz. Pub. Serv. Co. v. EPA*, 211 F.3d 1280, 1299 (D.C. Cir. 2000) (quoting *Shell Oil*, 950 F.2d at 751). This is especially crucial where an agency has an established policy, proposes to maintain its policy, and then “repudiate[s] its proposed interpretation and adopt[s] its inverse” in the final rule. Such was the case in *Environmental Integrity Project v. EPA*, 425 F.3d 992 (D.C. Cir. 2005), where this Court vacated

a final rule that would have changed an existing policy because “an interpretation of a legislative rule cannot be modified without the notice and comment procedures that would be required to change the underlying regulation.” *Id.* at 997.

Here, EPA’s ultimate legal interpretation represented an about-face from the Agency’s past policies, which EPA announced it was “not proposing to revisit.” Proposed Rule, 73 Fed. Reg. at 78,687. Its interpretive approach appeared nowhere in the Proposed Rule because it was invented by commenter Honeywell, which advanced its theory on the last day of the comment period. JA 185-87. An agency “cannot bootstrap notice from comment.” *Fertilizer Inst. v. EPA*, 935 F.2d 1303, 1312 (D.C. Cir. 1991). Neither Arkema nor Solvay had the opportunity to develop evidence or legal arguments in response (although Arkema submitted a comment after the comments period had closed urging EPA not to consider Honeywell’s novel interpretation of the CAA, JA 194-96). This procedural shortcoming deprived petitioners of an effort to “persuade” the agency that its interpretation was misguided and inequitable. *CSX Transp., Inc. v. Surface Transp. Board*, 584 F.3d 1076, 1083 (D.C. Cir. 2009) (holding, in a case addressing baselines for setting rail-

road rates, that the “mere mention” of an issue in the proposed rule was insufficient notice that the agency was considering a different approach to that issue to invite comments).

Before EPA announced a major new legal interpretation, it was required to subject that interpretation to a full course of notice and comment. Its failure to do so requires the Final Rule to be vacated.

C. The Final Rule Abandoned EPA’s Reliance On Inter-Pollutant Baseline Trades To Facilitate A Well-Functioning Market Without Addressing Its Past Practice.

On a broader level, EPA’s cancellation of baseline inter-pollutant transfers reflects a repudiation of the engine EPA has used to drive the cap-and-trade programs under the Montreal Protocol for decades. EPA has long insisted that its cap-and-trade system should facilitate a well-functioning market and that inter-pollutant trades are essential to achieving that end. In displacing inter-pollutant trades, EPA has failed to explain either why the goal of facilitating an efficient market is no longer important or why inter-pollutant trades are no longer needed to achieve that objective. Accordingly, this change of course is a further, independent, ground for vacating the Final Rule.

EPA's departure from market principles is particularly damaging. Despite its past understanding that market mechanisms must govern corporate decisions about which chemicals to produce and sell, and in which quantities, EPA has replaced that competition with market shares devised by regulatory fiat that bear no resemblance to the evolving market for HCFCs. This edict bequeaths additional market share to some companies at the expense of others, for no apparent reason. The consequences of this caprice are particularly significant here, where EPA has taken market share from companies that specialized in the HCFC-22 *aftermarket*—the only market that now survives—and gifted it to those that did not.¹⁶ Because EPA has abandoned, without explanation, its position that transfers are necessary to allow a market to evolve naturally, its rule must be vacated.

1. EPA has long maintained that allowance transfers are necessary to maintain the proper relationship between cap-and-trade al-

¹⁶ Indeed, EPA acknowledged that, by changing course, it was choosing to favor certain market participants who had not taken advantage of trading opportunities by “negatively affect[ing]” companies, such as Arkema and Solvay, that did exercise such rights. 74 Fed. Reg. at 66,421. For Solvay, which consistently utilized inter-pollutant transfers under the 2003 Rule to participate in the HCFC-22 market, the Final Rule strips virtually all of its market share.

allowances and market conditions. Soon after the Montreal Protocol was signed (and before Congress amended the CAA to incorporate Title VI), EPA implemented an “allocated quota” system that “grandfather[ed] past market shares” for CFCs. Final Rule, Protection of Stratospheric Ozone, 53 Fed. Reg. 30,566, 30,586 (Aug. 12, 1988). To allow market shares to remain dynamic, however, the rule permitted the trading of allowances. *Id.* After the CAA was amended to incorporate Title VI, EPA recognized that “Congress provided for trading primarily to afford industry flexibility in meeting the required reduction requirements.” Final Rule, Protection of Stratospheric Ozone, 56 Fed. Reg. 49,548, 49,561 (Sept. 30, 1991).

In particular, EPA emphasized that “inter-pollutant trades are vital if companies, assigned [CFC] allowances according to their 1986 production mix, are to reallocate allowances among chemicals to reflect changes in market demand for individual chemicals based on technological developments in substitutes for each listed chemical.” *Id.* EPA considered inter-pollutant trading to be the primary means by which allowance holders could “shift among themselves the production and import of various chemicals as the market demands.” *Id.* at 49,562.

When HCFCs were added to the Title VI cap-and-trade program, EPA heeded the CAA and continued to rely on inter-pollutant trades to keep the system up to date. EPA considered, and rejected, a “rolling baseline” that “would essentially move the baseline forward in time so that the baseline would always be the most accurate reflection of the current HCFC market.” Advanced Notice of Proposed Rulemaking, Protection of Stratospheric Ozone: Allowance System for Controlling HCFC Production, Import and Export, 64 Fed. Reg. 16,373, 16,377 (Apr. 5, 1999). According to EPA, inter-pollutant trading made a rolling baseline unnecessary: “[I]f the regulatory system includes smooth procedures for trading allowances, shifts in demand and changes in market share could be addressed by individual companies, thus obviating the need to re-allocate allowances.” *Id.* The flexible trading system was specifically designed to “assist in responding to market decisions and trends.” 2003 Rule, 68 Fed. Reg. at 2832.

EPA’s 2008 Proposed Rule continued to recognize the importance of inter-pollutant trades to its HCFC allowance system. EPA explained that the “continued availability of inter-pollutant transfers will permit the market to self-correct for unforeseen changes in demand and allow

individuals to consider a range of options for their allowances.” 73 Fed. Reg. at 78,689. EPA deemed such an approach essential “to avoid unnecessary disruptions in the marketplace” and “to promote a smooth transition for industry.” *Id.*

Arkema’s comments on the Proposed Rule highlighted the importance of maintaining a baseline that was representative of the HCFC market. In supporting EPA’s preferred approach, which recognized baseline inter-pollutant transfers, Arkema noted the benefits of “[m]arket adjustment through allowance trading” and cautioned EPA that “[h]aving created a highly successful system in 2003, the Agency should avoid any temptation to switch horses in mid-stream.” JA 156, 158. Arkema stressed that “it would make no sense to unwind or to ignore those market activities [reflected in allowance trades] over the past five years,” JA 158, and pointed out that “[r]etaining the existing baselines, with full recognition of trades, is the surest way for the final rule to maintain market continuity and satisfy market expectations,” JA 159. Likewise, Solvay explained that the “transfer mechanism has become an important medium for trade and meeting marketplace de-

mands,” JA 198, and that it “provide[s] critical flexibility * * * and allow[s] appropriate responses to shifts in marketplace demand,” JA 150.

In evaluating EPA’s other proposed options, Arkema noted that the crucial criterion was whether an approach “could result in a representative baseline.” JA 87, 160. Both Arkema and Solvay warned that an allowance system that failed to account for the ban on use of HCFC-22 and HCFC-142b in new equipment would fail to be “representative” if it gave business after 2010 to entities that had been supplying refrigerant for use in new equipment as opposed to the aftermarket.

With the Final Rule, EPA acknowledged the need to “reflect[] the changes in the marketplace that have occurred since the last time EPA addressed these baselines.” JA 258. Further, EPA recognized that while it was not the *only* goal, “trying to most closely match the aftermarket” was a goal of the final rule. JA 260; *see also* JA 269 (rejecting a system based on sales because EPA was “not convinced that 2004-2006 sales data would more accurately reflect the marketplace in 2010 than the original 1994-1997 baselines” given that “[s]tarting in 2010, the only use of virgin HCFC-22 will be for servicing existing equipment.”); JA 271 (rejecting a system that capped companies’ total ozone depletion po-

tential because it would “not reflect the market decisions made between 2003 and 2009”).¹⁷

2. Notwithstanding EPA’s past dedication to maintaining an efficient marketplace for HCFCs and petitioners’ comments emphasizing the importance of an effective market, the Final Rule is divorced from current market realities. The bottom line is that after years of encouraging market participants to adapt to changes in relative demand among HCFCs by trading allowances between pollutants, and professing concern about “prevent[ing] disruption” to market demand, JA 272, EPA has triggered a reset button that returns the market to how it appeared in the years 1994-1997. But the market has changed significantly in the ensuing 13 years—not the least because only the HCFC-22 aftermarket survives. By pegging 2010 aftermarket allowances to 1994-1997 market shares, and by willfully ignoring the decisions of market participants to adjust their focus in the interim, EPA has abandoned its

¹⁷ In setting baselines for new HCFCs that came on the market after 2003, EPA “us[ed] recent data,” thereby “ensur[ing] that the baseline reflects the current market as closely as possible.” 74 Fed. Reg. at 66,432. The Agency further noted that if additional amounts are needed, “inter-pollutant transfers could be used to make adjustments.” *Id.* at 66,433.

past insistence that market reliance is imperative.¹⁸ The legal infirmity in the Final Rule is that EPA has articulated no rational justification for this policy, which results in an allocation scheme that is arbitrary in the purest sense of the term.

EPA nowhere addressed its past statements regarding the importance of allowing HCFC allocations to be determined by market forces and inter-pollutant transfers to reflect changes in the HCFC marketplace. EPA thus could not have supplied a reasoned analysis for its departure from precedent. The Final Rule must therefore be vacated and the matter remanded for further consideration.

II. THE FINAL RULE MUST BE VACATED BECAUSE EPA MISTAKENLY CONCLUDED THAT ITS POSITION IS COMPELLED BY THE CLEAN AIR ACT.

Even if EPA had not changed its interpretation of the CAA without acknowledging its past interpretation, the Final Rule still would be unsustainable. The Final Rule expresses EPA's opinion that "[CAA] section 607(b) is best read as permitting only year-by-year inter-pollutant transfers," rather than permitting baseline inter-pollutant

¹⁸ Moreover, EPA has failed to demonstrate how its new system of a baseline *without* inter-pollutant trading satisfies the Act's requirement that the baseline reflect a "representative calendar year." CAA § 601(2)(C), 42 U.S.C. § 7671(2)(C).

transfers. 74 Fed. Reg. at 66,421. The CAA imposes no such limitation, however, and EPA erred in deciding it was so bound.

Although this Court must defer to an agency's policy-driven interpretation of an ambiguous statute under *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837 (1984), the Court does not defer "when the agency wrongly believes that interpretation is compelled by Congress," *Peter Pan Bus Lines, Inc. v. Fed. Motor Carrier Safety Admin.*, 471 F.3d 1350, 1354 (D.C. Cir. 2006) (internal quotation marks omitted). In such a circumstance, the Court cannot "choose between competing meanings," *Alarm Indus. Commc'ns Comm. v. FCC*, 131 F.3d 1066, 1072 (D.C. Cir. 1997), and remand is necessary so that the agency can "bring its experience and expertise to bear in light of competing interests at stake," *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 797-98 (D.C. Cir. 2004).

While the interpretation of ambiguous statutes falls within the discretionary powers of executive agencies, judicial review is limited to the interpretive justifications actually provided by the agency. *See State Farm*, 463 U.S. at 43; *Chenery*, 332 U.S. at 196. Thus, this Court's role is limited to considering whether EPA was correct in concluding that "the language of section 607 and the legislative history"

compelled the treatment of inter-pollutant transfers in the Final Rule. 74 Fed. Reg. at 66,421. Because neither the legislative history nor the statutory text supports EPA's interpretation, the Court must vacate the Final Rule and remand the matter to EPA for further proceedings.

A. EPA Has Misinterpreted The Legislative History Of CAA Section 607.

EPA's reliance on the legislative history of CAA § 607 to distinguish between inter-pollutant and inter-company transfers is misplaced. Although EPA never before had relied upon the legislative history of the Act to interpret Section 607 and never indicated in its Proposed Rule that it was considering such an approach, the Final Rule apparently adopts the interpretation advanced by Honeywell at the close of the comment period. *See* JA 185-87, 263-64. EPA concluded that the legislative history foreclosed the possibility of baseline inter-pollutant transfers because "neither the House nor the Senate bill contemplated permanent inter-pollutant transfers." JA 264. But this reading is incorrect in light of how Section 607 came to be.

The House and Senate initially passed very different bills. The Senate bill took a "basket" approach that provided each company with a cap on its chemical production and consumption measured in ozone-

depleting potential. Under the Senate approach, a market participant was free to decide which chemicals to produce, and to switch freely between different chemicals, so long as the “combined ozone depletion weighted amount of such substances” did not exceed the maximum allotted to that company. S. 1630, 101st Cong. § 702 (proposed CAA § 506) (as passed by Senate Apr. 3, 1990), *reprinted in* 3 STAFF OF S. COMM. ON ENV’T & PUB. WORKS, 103D CONG., A LEGISLATIVE HISTORY OF THE CLEAN AIR ACT AMENDMENTS OF 1990, at 4119, 4760 (Comm. Print 1993) [hereinafter LEGISLATIVE HISTORY]. As a necessary aspect of such a program, any company could increase its consumption of one chemical if it offset that increase by a proportionate decrease in another ozone-depleting substance. Because the Senate bill thus built inter-pollutant transfers into the system, there was no need for separate chemical-specific baselines.

The House amendment would have ensured compliance with the Montreal Protocol by employing a “worst-first” phase-out that eliminated chemicals one by one. S. 1630, 101st Cong. § 711 (proposed CAA § 154) (as passed by House May 23, 1990), *reprinted in* 2 LEGISLATIVE HISTORY, *supra*, at 1809, 2389. The House’s approach would have

created distinct cap-and-trade systems for each ozone-depleting substance, and because the House bill did not permit trading of allowances between substances, it did not incorporate any provision for baseline inter-pollutant transfers. *See, e.g.*, Chafee-Baucus Statement of Senate Managers, 1 LEGISLATIVE HISTORY, *supra*, at 731, 880, 927.

The Conference Committee melded key aspects of each bill to produce CAA § 607. Baselines were to be set on a chemical-by-chemical basis, as per the House bill. *See id.* At the same time, the final legislation permitted free transfers of allowances between chemicals, following the approach of the Senate bill, in order to maximize industry flexibility. *See id.* (explaining that the Conference bill directed EPA “to promulgate regulations that will authorize inter-pollutant transfers, as in the Senate bill, and trades with other persons, as in the House amendment”). Nothing in the subsequent debates on the Conference bill suggested that inter-pollutant transfers were subject to additional restrictions. *See, e.g.*, 1 *id.* at 1334.

EPA erred by relying upon the Chambers’ pre-Conference bills to conclude that both Chambers intended to prohibit such transfers in the final legislation reflecting the Conference compromise. Although the

House bill did not contemplate inter-pollutant trading, the House ultimately agreed to the Senate's approach. *See* 1 *id.* at 927. Free trading of HCFCs was inherent in that approach, under which market participants could decide how to allocate a cumulative HCFC allowance. *See id.* Under the Senate's approach, a market participant plainly could have shifted its priorities between 1997 and 2010 without having its actions nullified when a step-down occurred.

In short, because the Senate view on inter-pollutant flexibility prevailed, the relevant legislative history shows that Congress understood that inter-pollutant transfers would be allowed freely. EPA thus erred in uncritically adopting Honeywell's misguided view of the legislative history as the foundation for its newly announced interpretation of Section 607.

B. EPA Has Misinterpreted The Text Of CAA Section 607.

Likewise, EPA's construction of the statute itself is mistaken. The Final Rule takes the position that Congress unambiguously intended to prohibit baseline transfers between pollutants, because it authorized "a production allowance for a substance for *any* year to be transferred for a production allowance for another substance for the *same* year on an

ozone depletion weighted basis.” CAA § 607(b), 42 U.S.C. § 7671f(b) (emphasis added); *see* 74 Fed. Reg. at 66,421. In EPA’s view, “[t]his language emphasizes the year-by-year nature of such transactions,” whereas the CAA’s provision governing inter-company transfers has no such language.

EPA’s construction of the statute is incorrect. Section 607(b) prohibits only the transfer of an allowance for a particular control period to a *different* control period. The reasons for such a requirement track the Montreal Protocol, which imposes annual limits; if market participants were allowed to transfer allowances from one control period to a different control period, then the United States could exceed its maximum allocation in years to which allowances were transferred. Baseline transfers introduce no such concern, as allowances are distributed each year on the basis of the baseline (as adjusted through inter-pollutant transfers), and the allowances thus distributed can only be used during that calendar year.¹⁹

¹⁹ To the contrary, a baseline inter-pollutant trade differs from a single-year inter-pollutant trade in that the former survives from control period to control period. Thus, in the year following a baseline trade, the allowances for that year will reflect the prior transfer. But such a me-

Nor can the inter-company provisions of Section 607(c) be used to limit the inter-pollutant provisions of Section 607(b). Section 607(c) permits inter-company transfers of baseline allowances, but requires “an enforceable and quantifiable reduction in *annual* production which * * * exceeds the reduction otherwise applicable to the transferor.” Thus, if Congress had intended to prohibit permanent, inter-pollutant transfers by emphasizing the annual nature of such trades, it likewise emphasized the annual nature of *inter-company* trades. But EPA acknowledges that Congress authorized baseline inter-company trades. Accordingly, EPA’s construction requires similar language within the same statutory provision to take on different meanings. Because that result has no basis in the statutory text, EPA misconstrued Congress’s intent.

Because EPA wrongly believed that CAA § 607 forbids it from recognizing inter-pollutant baseline trades, its interpretation warrants no *Chevron* deference. See *Peter Pan Bus Lines*, 471 F.3d at 1354 (“[D]eference to an agency’s interpretation of a statute is not appropri-

chanism does nothing to move allowances from one year into another, so baseline trades are entirely consistent with CAA § 607(b).

ate when the agency wrongly believes that interpretation is compelled by Congress.”) (internal quotation marks omitted); *accord Transitional Hosps. Corp. v. Shalala*, 222 F.3d 1019, 1029 (D.C. Cir. 2000) (“While the Secretary has discretion * * *, that discretion must be exercised through the eyes of one who realizes she possesses it.”). The matter must be remanded so that EPA can interpret the statute anew.²⁰

²⁰ While EPA relied on the CAA to conclude that it was prohibited from recognizing permanent inter-pollutant trades, 74 Fed. Reg. at 66,421-22, it also adverted to a number of policy justifications for that conclusion that were offered by commenters, *id.* at 66,421. But even if EPA had issued the Final Rule on the basis of those policy justifications rather than its flawed statutory interpretation, remand would still be required. Before an agency may exercise its policymaking discretion, “it necessarily ha[s] to decide what [the statute] mean[s].” *PDK Labs.*, 362 F.3d at 798.

In any event, none of the supposed justifications for dishonoring past baseline transfers holds water. For example, some commenters stated that inter-pollutant transfers “could create incentives for future manipulation of the allocation system in anticipation of the future control periods.” 74 Fed. Reg. at 66,421. But EPA did not consider any evidence of manipulation, nor does it appear to have considered the simple expedient of creating future subclasses of HCFCs between which allowances could not be transferred. *See* CAA § 607(b)(3), 42 U.S.C. § 7671f(b)(3). Commenters also suggested that inter-pollutant trades would result in a system based on capping total ozone depletion potential, rather than the chemical-by-chemical phaseout adopted in 1993. 74 Fed. Reg. at 66,421. However, inter-pollutant trades adjust only the relative market shares of chemicals that have *not* been phased out and do not have the potential to revive chemicals that have already been retired. In any event, CAA § 607(b), 42 U.S.C. § 7671f(b), specifically con-

III. THE FINAL RULE MUST BE VACATED BECAUSE IT IS IMPERMISSIBLY RETROACTIVE.

Although EPA is authorized to promulgate rules under the CAA, it may not issue a regulation that is retroactive. But that is what it has done here. The Final Rule must be vacated, and the matter remanded, because the Final Rule has an impermissible retroactive effect.

A. Legislative Rules Cannot Have A Retroactive Effect.

Retroactivity is “disfavored in the law,” *Eastern Enters. v. Apfel*, 524 U.S. 498, 532 (1998) (plurality op.), because “[e]lementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly,” *Landgraf v. USI Film Products, Inc.*, 511 U.S. 244, 265 (1994). Retroactive laws are particularly problematic because of the possibility that a legislature or agency will “sweep away settled expectations suddenly and without individualized consideration.” *Landgraf*, 511 U.S. at 266. Retroactive actions raise concerns that a decisionmaker is responding to “political pressures” to make decisions adversely affecting “unpopular groups or individuals.” *Id.*

templates the transfer of allowances “on an ozone depletion weighted basis,” so this concern is misplaced.

An agency’s “power to promulgate legislative regulations is limited to the authority delegated by Congress,” *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988); accordingly, regulations cannot be retrospective “unless that power is conveyed by Congress in express terms,” *id.* As this Court has explained, “[t]he relevant provisions of the Clean Air Act contain no language suggesting that Congress intended to give EPA the unusual ability to implement rules retroactively.” *Sierra Club v. Whitman*, 285 F.3d 63, 68 (D.C. Cir. 2002). Thus, if the Final Rule has a retroactive effect, it cannot be sustained.²¹

B. The Final Rule Has A Retroactive Effect.

1. To determine whether a legislative rule is retroactive, this Court examines whether the regulation “takes away or impairs vested rights acquired under existing law, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations already past.” *Ass’n of Accredited Cosmetology Schools v. Alexander*, 979 F.2d 859, 864 (D.C. Cir. 1992) (quoting *Neild v. District of Columbia*, 110 F.2d 246, 254 (D.C. Cir. 1940), in turn quoting *Soc’y for Propagating the Gospel v. Wheeler*, 22 F. Cas. 756, 767 (C.C.D.N.H.

²¹ This Court’s authority to vacate a rule issued without proper statutory authority stems from CAA § 307(d)(9), 42 U.S.C. § 7607(d)(9).

1814) (Story, J.)). This inquiry “is not always a simple or mechanical task,” *Landgraf*, 511 U.S. at 268, because the Court must engage in a “commonsense, functional judgment about ‘whether the new provision attaches new legal consequences to events completed before its enactment,’” *Martin v. Hadix*, 527 U.S. 343, 357-58 (1999) (quoting *Landgraf*, 511 U.S. at 270).

In the regulatory context, the same standard governs whether a rule is retroactive. See *Nat’l Mining Ass’n v. Dep’t of Labor*, 292 F.3d 849, 859-60 (D.C. Cir. 2002). In the course of this inquiry, “[t]he critical question is whether a challenged rule establishes an interpretation that ‘changes the legal landscape.’” *Id.* (quoting *Health Ins. Ass’n of Am., Inc. v. Shalala*, 23 F.3d 412, 423 (D.C. Cir. 1994)). Thus, an agency cannot use a rulemaking to change the rules of a game already in progress.

2. The Final Rule has just such a retroactive effect. When EPA created the cap-and-trade system for HCFCs in 2003, it set a baseline for each market participant “on a one-time basis.” 68 Fed. Reg. at

2823.²² The Agency announced that the baseline could change, but only through baseline transfers of allowances and that “allocations would remain the same from control period to control period (one calendar year to the next) until each chemical is phased out or until the percentage of baseline allowances is reduced to ensure compliance with the Protocol cap.” *Id.* Such a system was necessary to effectuate the Agency’s goal of “providing certainty and predictability to allowance holders.” 2001 Proposed Rule, 66 Fed. Reg. at 38,064.

Based on those representations, market participants such as Arkema and Solvay planned their HCFC operations and production investment decisions on the understanding that allocations could change only through baseline transfers and percentage reductions. In 2008, both Arkema and Solvay elected to pay a fee—the required allowance

²² Congress intended the starting baseline to be determined on a one-time basis. The statute defines “baseline year” to mean “a representative calendar year” for HCFCs, which did not have a developed market when the CAA was amended. CAA § 601(2)(C)(ii), 42 U.S.C. § 7671(2)(C)(ii). For CFCs, which did have a developed market, Congress chose a particular year—either 1986 or 1989, depending on the substance. CAA § 601(2)(A), (B), 42 U.S.C. § 7671(2)(A), (B). The fixing of a single year for CFCs implies the same intent for HCFCs, and prevents EPA from scrapping the baseline system it selected in 2003 as long as it is representative.

offset that accompanies a transfer—to obtain the benefits they foresaw in transferring their allowances.

The cap-and-trade system created in 2003 remains ongoing. Just as EPA announced it would do at the outset, the Final Rule carries forward baseline allowances from the 2003 cap-and-trade system already in place. However, notwithstanding the Agency's prior position that limited the ways in which baselines could be changed, EPA reached back into the past to change the effect of Arkema's and Solvay's baseline transfers, even though the Agency previously had confirmed—on at least three occasions—that the inter-pollutant trades had changed Arkema's and Solvay's baseline allowances. *See supra* pp. 14-16.

This is precisely the type of retroactivity that cannot be accomplished through rulemaking. EPA cannot use a legislative rule to “prescribe[] what the law *was* at an earlier time.” *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 225 (1995). Although the cap-and-trade system continues and all other transfers continue to be recognized, EPA now seeks to change the terms of the transactions it authorized for Arkema and Solvay. Because the Final Rule cannot permissibly change

the legal consequences of actions that took place in 2008 and were approved by the Agency at that time, the Final Rule must be vacated.

CONCLUSION

For the above-stated reasons, the petition for review should be granted, the Final Rule vacated, and the matter remanded to the EPA.

Dated: February 16, 2010

Respectfully submitted.

/s/ David M. Williamson
(with permission)

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CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to Fed. R. App. P. 32(a)(5) and (7)(B), that the foregoing brief was prepared in 14-point Century Schoolbook font, and contains 12,336 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Cir. R. 32(a)(1).

Dated: February 16, 2010

/s/ Brian D. Netter
Brian D. Netter

CERTIFICATE OF SERVICE

I hereby certify, pursuant to Fed. R. App. P. 25(c), that on February 16, 2010, the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send a notification to the attorneys of record in this matter, who are registered with the Court's CM/ECF system.

Dated: February 16, 2010

/s/ Brian D. Netter
Brian D. Netter

STANDING ADDENDUM

DECLARATION OF THOMAS WERKEMA

I, Thomas Werkema, hereby declare under penalty of perjury as follows:

1. I currently am the Director of Regulatory Activities of Arkema Inc. ("Arkema").

My responsibilities include government advocacy and working with regulatory agencies to create meaningful and successful regulations. I have been in that position with Arkema since January, 1993 and have worked for Arkema and its predecessor companies since June, 1987. This declaration is based on my personal knowledge, and I am authorized to provide this declaration on Arkema's behalf.

2. Arkema is one of the world's top suppliers of refrigerants. Several of our refrigerant products are part of a chemical family called hydrochlorofluorocarbons, or HCFCs. One of these is known as HCFC-22 and sometimes as R-22, where the "R" stands for refrigerant. For many years, HCFC-22 has been the refrigerant of choice around the world in numerous applications, including especially comfort air-conditioning systems that are used to cool homes and office buildings. Another Arkema product is HCFC-142b, which is used in refrigerant blends and traditionally has been used to make plastic foam products like insulation and food trays.

3. U.S. Environmental Protection Agency ("EPA") regulations promulgated in 2003 set up an allowance system to regulate the production and consumption of HCFC-22 and HCFC-142b. The Agency selected as the "baseline" for each company that produced or imported those two compounds its highest one-year historical production and consumption, weighted according to the potential to destroy ozone, from 1994 through 1997. Allowances were allocated through 2009. For each calendar year, EPA allowed a percentage of the baseline to be produced or imported.

4. In addition, the 2003 rules restricted production and import of both HCFC-22 and HCFC-142b after January 1, 2010 to only a few designated uses. Of greatest importance to Arkema, EPA's rules allow those compounds to continue to be used in servicing equipment manufactured prior to January 1, 2010. For HCFC-142b, only small quantities are needed in the aftermarket for supplying equipment manufactured prior to that date. On the other hand, substantial amounts of HCFC-22 still will be needed in the after-market. EPA has estimated that an aggregate of 50,000 metric tons of virgin HCFC-22 will need to be supplied in just 2010 for servicing equipment manufactured prior to January 1 of that year.

5. In the United States, Arkema is the leading supplier of HCFC-22 for servicing equipment. This is referred to as after-market sales. It is broadly understood that original equipment and aftermarket uses of HCFC-22 represent distinct markets with different competitors and different pricing mechanisms.

6. With notice to EPA, in April 2008 Arkema transferred baseline allowances from its account for HCFC-142b to baseline allowances in its account for HCFC-22. Those transfers are described more fully in the December 28, 2009 Declaration of Michael Brubaker. Arkema executed those transfers with the understanding that it was effecting a permanent change in its baseline allowance accounts. Arkema set its business plans for its after-market refrigerant sales in 2009 and beyond in accordance with that expectation.

7. On May 12, 2008, I met with EPA staff who work on development of HCFC rules. Among other things, I informed them that Arkema estimated its share of the United States HCFC-22 after-market to be approximately 33%.

8. On December 23, 2008, EPA proposed to allocate baseline allowances for the years 2010 to 2014 in order to further limit production and use of HCFCs pursuant to United

States treaty obligations imposed by the Montreal Protocol. The Agency's preferred alternative for the proposed allocations was based on the pre-2010 baseline allowance accounts, as they existed on June 16, 2008. For HCFC-22, EPA proposed to allocate to Arkema approximately 36% of the total aggregate production baselines, and about 35% of the total aggregate consumption baselines. These proposed allocations included Arkema's April 2008 baseline transfers. Under the proposed allocation, Arkema would have been able to sell approximately 17,120 metric tons of HCFC-22 in 2010.

9. In its December 15, 2009 final rule, however, EPA allocated to Arkema HCFC-22 allowances that represent only approximately 25% of the total aggregate production baselines and only approximately 26% of the total aggregate consumption baselines. In the final allocation, EPA changed its previous decision to allow Arkema's permanent baseline transfers, and instead decided that it could not recognize Arkema's inter-pollutant baseline trades. Under the Final Rule, Arkema has the ability to sell only 12,370 metric tons of HCFC-22 in 2010, or 4750 fewer tons than under the Proposed Rule.

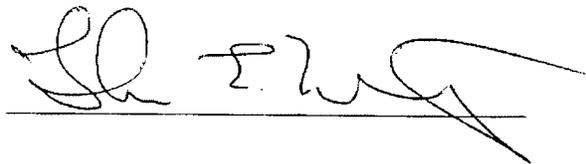
10. The effect of withdrawing approval of Arkema's baseline trades is that Arkema will lose a significant part of the share of after-market sales which it had developed and held prior to EPA's promulgation of the final HCFC allocation rule. Specifically, EPA's change in allocation methods means that Arkema will have approximately 18,300 fewer metric tons of HCFC-22 for sale from 2010 to 2014 in the United States after-market. I estimate that the associated loss to Arkema over that time will be at least \$217 million, with approximately \$44 million of that loss incurred in 2010.

11. While Arkema will suffer immediate injury for the 2010 control period, its injuries will increase markedly if its baseline transfers are not reinstated before contracts are

negotiated for the 2011 refrigerant season. Consistent with market practice, those contracts will be negotiated in the fall of 2010.

12. Many purchasers of aftermarket refrigerants buy multiple refrigerants and wish to deal with one supplier who can meet all their needs. If Arkema is unable to supply sufficient quantities of HCFC-22, then a number of its “one-stop” customers will obtain all of their refrigerants from Arkema’s competitors. I estimate that the reduction in Arkema’s HCFC-22 baseline allowances from EPA means that Arkema will lose an additional \$54 million in sales of other refrigerants from 2010 to 2014.

13. Under the Montreal Protocol, the aggregate allowances for all U.S. HCFC consumption each year from 2010 to 2014 may not exceed 3,810 ozone depletion potential-weighted metric tons. I have calculated that EPA’s December 15, 2009 final rule allocates for 2010 only 2,894 ozone depletion potential-weighted metric tons of HCFC consumption allowances for 2010. This means that the Agency has established an unallocated reserve—below the U.S. Montreal Protocol cap— of 916 ozone depletion potential-weighted metric tons. That is the equivalent of 16,654 metric tons of HCFC-22. Thus, Arkema could be allocated an additional 4750 metric tons of HCFC-22 consumption allowances in 2010, which would enable Arkema to compete for its existing after-market customers, without compromising U.S. compliance with the Montreal Protocol.

A handwritten signature in black ink, appearing to be "S. E. Wang", written over a horizontal line.

Dated: December 28, 2009

**UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

Solvay Fluorides, LLC and)	
Solvay Solexis, Inc.,)	
)	
Petitioners,)	
)	
v.)	Case No. 09-1335
)	
United States Environmental Protection)	
Agency,)	
)	
Respondent.)	

DECLARATION OF SHELDON B. MAGID

I, Sheldon B. Magid, hereby declare under penalty of perjury as follows:

1. I am a Sales and Marketing Manager at Solvay Fluorides, LLC (“Solvay Fluorides”) and my responsibilities include the sales, marketing and management of the fluorocarbon business in North America for Solvay Fluorides. I have been in that position with Solvay Fluorides since November 2004. I am also familiar with the actions relevant to this matter undertaken by Solvay Fluorides’ affiliate Solvay Solexis, Inc. (“Solvay Solexis”). This declaration is based on my personal knowledge, and I am authorized to provide this declaration on behalf of both Solvay Fluorides and Solvay Solexis (collectively “Solvay”).

2. Solvay Fluorides and Solvay Solexis are producers, importers and distributors of hydrochlorofluorocarbons (“HCFCs”), including HCFC-22 which is

used in refrigeration and air-conditioning systems, and HCFC-142b, which is used in refrigerant blends and typically has been used as a blowing agent to make foam products such as insulation and food trays.

3. In 2003, under the federal Clean Air Act and the Montreal Protocol, the U.S. Environmental Protection Agency (“EPA”) established an allowance system to limit the production and consumption of HCFC-22 and HCFC-142b. EPA established a “baseline” for each company that produced or imported HCFCs based on its historical production and consumption, weighted according to the potential to destroy ozone, during the years 1994 through 1997. For each calendar year since 2004, EPA has distributed allowances according to a percentage of each company’s baseline.

4. The 2003 EPA rules also restricted production and import of both HCFC-22 and HCFC-142b after January 1, 2010 to only a few designated uses, primarily servicing refrigeration equipment manufactured prior to January 1, 2010 (known as “aftermarket servicing”). Because of this limit on authorized use, only small quantities HCFC-142b are needed in the aftermarket for supplying equipment; however, substantial amounts of HCFC-22 will still be needed. EPA has estimated that 50,000 metric tons of HCFC-22 will be needed from suppliers in 2010 with generally decreasing amounts for subsequent years. EPA’s 2003 rules also established procedures for transferring HCFC allowances between companies and

among pollutants subsequent to the initial baseline determination. These rules are set out in various Federal Register notices and codified in EPA's regulations at 40 C.F.R. § 82.23.

5. Beginning in 2003, anticipating the shift in market demand for HCFCs, Solvay has converted the majority (>70%) of its HCFC-142b allowances into HCFC-22 allowances to reflect its sales and market share in the HCFC-22 refrigerant aftermarket (that is, sales of HCFC-22 to clients that service existing refrigeration equipment, as opposed to sales to companies that manufacture new equipment, referred to as original equipment manufacturers or "OEM").

6. Consistent with its position in the HCFC-22 aftermarket, in each of the years 2006 to 2009, Solvay converted at least 95% of its HCFC-142b allowances into HCFC-22 allowances, which were then consumed to meet the needs of Solvay's U.S. customers engaged primarily in supplying the aftermarket service of refrigeration equipment.

7. In February and March 2008, Solvay Solexis acted in reliance on EPA's "inter-pollutant" transfer regulations and requested the conversion of a total of 2,852,850 kg of baseline HCFC-142b consumption allowances (i.e., its baseline market share) into 3,368,181 kg of baseline consumption allowances for HCFC-22, which it then transferred to Solvay Fluorides. *See* Ex. 1 (Letter from C. Jones, Solvay Solexis, to M. James, U.S. EPA, dated Feb. 15, 2008); Ex. 2 (Letter from C.

Jones, Solvay Solexis, to M. James, U.S. EPA, dated Mar. 4, 2008). The request was submitted on EPA Form 2014.03, which required Solvay to specify whether its transfer was for "Current Year Allowances" or "Baseline Year Allowances." Solvay chose to transfer baseline allowances and specified its intent to make the transfer "on a permanent basis." I have attached hereto as Exhibits 1 and 2 true and complete copies of the transaction records for those two transfers.

8. EPA approved this transaction via non-objection notices authorizing Solvay to proceed with the baseline transfer, noting "transferor and transferee may proceed with the transfer." *See* Ex. 3 (Letter from R. Brennan, U.S. EPA, to C. Jones, Solvay Solexis, dated Feb. 21, 2008); Ex. 4 (Letter from R. Brennan, U.S. EPA, to C. Jones, Solvay Solexis, dated Mar. 20, 2008). I have attached hereto as Exhibits 3 and 4 true and complete copies of the transaction records for those two transfers.

9. By letter dated December 29, 2008, EPA notified Solvay of its distribution of HCFC-22 allowances for 2009 in the amount of 3,781,690 allowances. *See* Ex. 5. By letter dated December 29, 2008, EPA notified Solvay Solexis of its distribution of HCFC-142b allowances for 2009 in the amount of 194,536 allowances. *See* Ex. 6. The totals in that letter show that EPA was continuing to recognize Solvay's 2008 inter-pollutant conversions of HCFC-142b allowances to

HCFC-22 allowances. I have attached hereto as Exhibits 5 and 6 true and complete copies of EPA's letters.

10. Solvay's transfer of its HCFC-142b baseline in 2008 and previous yearly transfers reflected its business planning for the HCFC market as it had developed, taking into account market demand and the needs of its customers for the period after 2010. Solvay executed those transfers with the understanding that it was effecting a permanent change in its baseline allowance accounts, and that future allocations of allowances for the 2010-2014 time period would be based on a percentage of this baseline, consistent with EPA regulations. Solvay set its business plans for its after-market refrigerant sales in 2009 and beyond in accordance with that expectation.

11. At various times in 2007, 2008 and 2009, Solvay had telephone conversations with representatives of EPA. At no time did EPA indicate that Solvay's permanent inter-pollutant baseline transfers would not be credited as permanent adjustments to its HCFC-142b and HCFC-22 baselines.

12. On December 23, 2008, EPA initiated rulemaking for issuance of allowances for the 2010-2014 time period. In the proposed rule, EPA proposed company-specific baselines that "reflect adjustments resulting from approved inter-pollutant and/or inter-company transfers of baseline allowances (*i.e.*, permanent rather than calendar-year allowances) through the process described in § 82.23." 73

Fed. Reg. at 78,693. The allowance allocations proposed by EPA naturally reflected Solvay's permanent baseline transfers, which had been approved and confirmed by EPA. Solvay submitted comments encouraging EPA to adopt the Proposed Rule.

13. Unlike Solvay, which focused on the aftermarket, other HCFC market participants such as Honeywell and DuPont, have also focused on OEM sales. However, under EPA rules, HCFC-22 may no longer be used in OEM refrigeration equipment as of January 1, 2010, and thus the market for OEM sales has been phased-out. Therefore, Honeywell and DuPont are now seeking to convert their OEM sales into aftermarket sales, and submitted comments to EPA suggesting that EPA effectively take aftermarket share from Solvay by giving other market participants a larger distribution of HCFC-22 allowances from EPA. As described below, this was in fact done in the 2009 EPA final rule.

14. In December 2009, EPA issued new rules in the Federal Register which, for the first time, refused to credit the permanent inter-pollutant transfer of HCFC-142b baseline allowances into HCFC-22 baseline allowances that Solvay had completed (and which EPA had approved) in 2008. EPA's decision to exclude permanent baseline transfers will disrupt many years of Solvay's sales to the refrigerants aftermarket and will unfairly disadvantage Solvay's customers by reducing competition in the marketplace, forcing Solvay's customers to look

elsewhere for supply, and likely raising prices by restricting the number of market participants with a significant number of allowances.

15. EPA's 2009 final rule allocates to Solvay HCFC-22 allowances that represent only approximately 0.8% of the total HCFC-22 consumption baselines. In contrast, based on Solvay's market share and taking into account Solvay's conversion of baseline HCFC allowances in 2008, Solvay expected to receive 7.5% of the total HCFC-22 consumption baselines under the EPA rules in place at that time. Compared to EPA's previous rules, the new allocation approach leaves Solvay short in the amount of 2,749,973 kgs of HCFC-22 baseline consumption allowances for each year during the period 2010 to 2014. This number is computed by comparing Solvay's aggregate baseline allowances of HCFC-142b and HCFC-22 for the Proposed Rule to the baseline allowances of HCFC-142b and HCFC-22 in the Final Rule on an HCFC-22 ODP (ozone depleting potential) equivalency basis, after applying the respective percentage of the baseline that is to be issued in 2010. The following chart illustrates the discrepancy between the baseline allowances that Solvay was expecting, based on EPA's approval of its 2008 inter-pollutant transfers, and what Solvay actually received under the 2009 EPA rule:

Table A

Person	Substance	Baseline Allocation (Proposed)	%	Allowances Issued (1/1/2010)	Baseline Allocation (Final Rule)	%	Allowances Issued (1/1/2010)	Gain/Loss
Solvay Solexis	HCFC-142b	194,536 Consumption	4.9%	9,532 kg	3,047,386 Consumption	0.47%	14,323 kg	4,790 [5,656 HCFC-22 equiv]
Solvay Fluorides	HCFC-22	3,781,690 Consumption	35.2%	1,331,155 kg	413,509 Consumption	41.9%	173,260 kg	-1,157,895
TOTAL (HCFC-22 equivalent)								-1,152,239
								Baseline adjustment needed (divide by 0.419):*
								2,749,974

* The shortage of 1,152,239 represents the additional consumption allowances needed to match Solvay's appropriate market share of 3,781,690 HCFC-22 baseline.

16. The effect of withdrawing approval of Solvay's baseline trades is that Solvay will lose a significant part of the share of after-market sales which it had developed and held prior to the challenged changes in EPA's HCFC allocation rule.

17. EPA's new 2009 regulation affects and aggrieves Solvay by limiting the amount and kinds of HCFC it can produce, import and sell. Solvay will suffer economic and commercial injury by being unable to fill its customers' needs through allowances to which it was entitled from its baseline allocation, and instead will have to purchase allowances from other sources or lose customers and business.

18. I estimate that the associated loss to Solvay will be at least \$15 million in 2010 and at least \$80 million over the period 2010 through 2014.

19. While Solvay will suffer immediate injury for the 2010 control period, its injuries will increase markedly if its baseline transfers are not reinstated before commercial agreements are negotiated for the 2011 refrigerant season. Consistent with market practice, those commercial agreements will be negotiated in the fall of 2010.

20. In addition, many purchasers of aftermarket refrigerants buy multiple refrigerants and wish to deal with one supplier who can meet all their needs. If Solvay is unable to supply sufficient quantities of HCFC-22, then its "one-stop" customers could end up obtaining all of their refrigerants from Solvay's competitors. Similarly, without a supply of allowances commensurate with its previous market share in the refrigerant aftermarket (EPA has allocated Solvay only a trivial number of allowances compared to its customer's needs), Solvay's ability to bid on large contracts will be substantially limited. In fact, customers have already contacted Solvay to question whether it has enough allowances to fulfill their purchasing needs, indicating that they will need to look elsewhere for refrigerant supply. I estimate that the shortfall in Solvay's HCFC-22 baseline allowances could cause additional millions of dollars in lost sales of other refrigerants from 2010 to 2014.

21. Under the Montreal Protocol, the allowances for all U.S. HCFC consumption during the period 2010 to 2014 may not exceed 3,810 ODP-weighted metric tons annually, or 19,050 ODP-weighted metric tons over the five control periods. EPA's 2009 final rule allocates 12,335.5 ODP-weighted metric tons, or 2,467.1 ODP-weighted tons on average for each of the five control periods -- which represents 65% of the consumption control cap. This leaves an unallocated reserve of 6,714.5 ODP-weighted metric tons below the U.S. Montreal Protocol cap for the 5 years control period, or on average 1,349.2 ODP-weighted metric tons per year for

each of the five years. This 1,349.2 ODP-weighted metric tons is the equivalent to 24,531 metric tons of HCFC-22 per year (1349.2 / 0.055 ODP), which represents the amount of undistributed HCFC-22 in EPA's reserve.

22. In summary, Solvay Fluorides could be allocated an additional 2,750 metric tons (2,749,974 kg) of HCFC-22 baseline consumption allowances for each year of the period 2010 through 2014, which would enable Solvay to compete for its existing after-market customers, without compromising U.S. compliance with the Montreal Protocol. This equates to the issuance each year of the following number of HCFC-22 consumption allowances, in addition to those that EPA has already issued, using EPA's declining percentages for each vintage year during the control period:

Year	2010	2011	2012	2013	2014
Requested Adjustment to Baseline (MT)	2,749.974	2,749.974	2,749.974	2,749.974	2,749.974
(% baseline to be allocated)	(41.9%)	(38.0%)	(34.1%)	(30.1%)	(26.1%)
Additional HCFC-22 Allowances due Solvay Fluorides	1,152,239	1,044,990	937,741	827,742	717,743

Sheldon B Magid

 1/8/2010

Dated: January 8, 2010