ORAL ARGUMENT SCHEDULED FOR MAY 10, 2010
No. 09-1318

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

ARKEMA INC.,

Petitioner,

v.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY,

Respondent.

JOINT REPLY 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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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

INTRODUCTION AND SUMMARY OF ARGUMENT

When EPA created its cap-and-trade system for managing the production and importation of HCFCs, the Agency explained that it had designed the program to last until HCFCs were eliminated. As a key component of that framework, EPA crafted rules that allowed market participants to trade allowances, either between companies or between pollutants, on a single-year or permanent basis. So situated, the cap-and-trade system guaranteed compliance with the Montreal Protocol while facilitating a flexible marketplace for HCFCs.

In its brief defending the Final Rule, EPA paints a far different picture of its HCFC program. In its present view, the Agency did not mean that "permanent" transfers would really be permanent; rather, its role was to grant "privileges" to market participants that could be revoked at the Agency's will.

EPA's defense of its Final Rule rests on mischaracterizations of petitioners' arguments, the Agency's prior positions, and the governing legal standards. To begin with, the Agency denies ever having changed its position on the permanence of baseline inter-pollutant transfers. The Agency can reach that result only by ignoring its explicit past

statements and sustained conduct that comported with those statements. The Agency also insists that its denial of past practices is cured because its new policy is defensible. But the law requires an agency to acknowledge contrary past practices before imposing inconsistent regulatory requirements.

In a similar vein, the Agency attempts to side-step its sudden and silent abandonment of market principles by arguing that such principles are not required by statute. But our argument here is not that the statute imposes such a requirement; we rely instead upon EPA's own statements and actions, which the Agency cannot disregard without providing a reasoned analysis.

Likewise, EPA contends that it discharged its obligation to subject its major legal interpretations to notice and comment by implying that legal interpretations might be implicated. But the law requires that the interpretation *itself* be subjected to notice and comment, not just the possibility that a statute might be interpreted.

On the substance, EPA's brief abandons the Agency's position in the Final Rule that Section 607 of the CAA forbids inter-pollutant transfers of baseline allowances. Based solely upon "the language of

section 607 and the legislative history," EPA concluded in the Final Rule that Section 607(b) "permit[s] only year-by-year inter-pollutant transfers." 74 Fed. Reg. at 66,421. Now, the Agency argues that the statute "does not expressly address" these issues, EPA Br. 48, and that the "sparse" legislative history "cannot be interpreted to *require* EPA to recognize previously executed inter-pollutant transfers in setting [future] baselines," *id.* at 55. But the Agency may defend its Final Rule only on the basis of its *findings* in the Final Rule. Its errant conclusion that it was bound by statute renders *Chevron* inapplicable and requires that the Final Rule be vacated and the matter remanded.

Finally, EPA denies that its Final Rule has a retroactive effect, based on its views that the effects are only prospective and that its 2003 Rule granted "privileges" rather than vested "rights." The first point disregards the continuing nature of the HCFC step-down program—and EPA's cancellation of past transfers within the confines of that program. The second point draws a distinction that the law does not recognize.

For any and all of these reasons, the petition for review should be granted.

ARGUMENT

I. THE FINAL RULE FAILED TO PROVIDE A REASONED ANALYSIS OR ADEQUATE NOTICE OF EPA'S POLICY CHANGE.

The Final Rule changed two Agency policies without even acknowledging that they previously existed. Those policies were replaced, moreover, because the Agency adopted a new interpretation of CAA § 607 that had not been subjected to a full course of notice and comment. EPA's brief does not provide any suitable explanations for these shortcomings, each of which requires vacatur.

A. The Final Rule Abandoned EPA's Previous Policy Of Permitting And Approving Permanent Inter-Pollutant Transfers.

As we explained in our opening brief (at 31-40), the Final Rule should be vacated because EPA abandoned, *sub silentio*, its past practice of authorizing and approving permanent inter-pollutant transfers of baseline allowances. EPA offers two responses, both of which lack merit.

First, the Agency contends that "it did not express any policy sanctioning the conversion of baseline allowances for one pollutant into baseline allowances for a different pollutant." EPA Br. 24. That contention is belied by the record. The Agency explicitly guaranteed in the

2003 Rule that "inter-pollutant transfers of * * * baseline allowances would * * * be permitted." 68 Fed. Reg. at 2835. The Agency also developed official forms that explicitly permitted such trades, then approved and confirmed such trades, and explained to market participants that such trades were available.

Second, EPA argues that even if it had changed its policy, *acknowledging* the policy change was unnecessary because the Agency had sufficient reasons for implementing the new policy. EPA Br. 24-25, 29-37. But the prohibition on unacknowledged policy reversals is a bulwark against agency caprice; when an agency reverses course, it must be mindful of the costs of undermining industry expectations. EPA identifies no legal authority that allows it to disregard this longstanding requirement.

1. EPA had a preexisting policy of permitting and approving inter-pollutant transfers of baseline allowances.

The record shows that, prior to the promulgation of the Final Rule, EPA had a policy of authorizing and approving baseline inter-pollutant trades. In particular, the text and structure of the 2003 Rule, the administrative form promulgated by EPA to implement the 2003

Rule, the Agency's approvals of baseline inter-pollutant trades under the 2003 Rule, and the Agency's confirmations of those baseline trades in subsequent years all demonstrate the existence of this policy. *See* Pet. Br. 31-37. EPA ignores most of this evidence and offers unpersuasive responses to the rest.

When EPA implemented the HCFC phaseout, it created a system to transition the industry from the first step-down in 2003 to the ultimate elimination of HCFCs. Consistent with that approach, EPA decided to set baseline allowance levels "on a one-time basis," subject to change only as EPA periodically reduced the allowance percentage to satisfy obligations under the Montreal Protocol or if parties engaged in "permanent transfers of allowances." 68 Fed. Reg. at 2823.[1]

As we explained in our opening brief (at 12-13, 33-35), having made the decision to allow inter-pollutant baseline transfers, EPA

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[1] EPA's explanation of the mathematics behind annual allowances is inaccurate. The Agency says that "[a]n allowance under Title VI is simply a percentage of a baseline: the percentage being the numerator and the baseline being the denominator." EPA Br. 50. In reality, the number of allowances available in any calendar year results from *multiplying* the quantity of baseline allowances (with any changes due to trading) by EPA's designated percentage for that year. *See* 40 C.F.R. § 82.16(a).

promulgated Form 2014.03 to permit allowance-holders to complete such transfers. *See, e.g.*, JA 5. That form required transferors to select whether they would transfer "Baseline Year Allowances" or "Current Year Allowances." The record demonstrates that based upon that election, EPA approved petitioners' baseline trades and confirmed their lasting effect. *See, e.g.*, JA 9.

Ignoring its express endorsements of petitioners' baseline trades, EPA now tries to minimize the significance of these required elections as "nothing more than a check-mark in the box." EPA Br. 26. But the form developed by EPA reflects its policies and procedures. And EPA induced reliance when both Arkema and Solvay filed the forms—according to the Agency's published instructions—to request baseline inter-pollutant transfers, JA 3-6, 11-14, 26-32, and when EPA approved and confirmed those transfers, JA 9-10, 24-25, 33-34, 88-92, 145; *see also* Magid Decl. ¶ 10 (SA 9).

Beyond its criticism of its own form, EPA's argument appears to be that the Agency never authorized or approved inter-pollutant transfers that were intended to last beyond the 2003-2009 regulatory period. In support, EPA contends that "baseline" transfers were not intended to

be "permanent," and that "permanent" does not mean "in perpetuity." Both of these defenses are mistaken.

EPA first argues that we have misunderstood the term "baseline." The Agency contends that the approvals merely characterize the transfers as affecting "Baseline Year Allowances," and that "merely label[ing] the allowance type as 'baseline'" does not mean that "inter-pollutant transfers marked as 'baseline' will be treated as permanent transfers of a company's baseline allowances." EPA Br. 26. This effort to distinguish between a "baseline" transfer and a "permanent" transfer is baffling. In the 2003 Rule, the Agency explained that "[t]he permanent nature of the transfer is what makes [a baseline transfer] different from the transfer of current-year allowances." 68 Fed. Reg. at 2835. Likewise, EPA's official guidance that accompanied the regulatory form explained that a "transfer of baseline allowances *permanently* reduces the number of allowances that the transferor will receive in future allocations." 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).

In a second layer of semantics, EPA argues that a "'permanent' transfer of baseline allowances was meant to apply only to the existing step-down period." EPA Br. 28. But such a limited definition of "permanent" is inconsistent with the ordinary meaning of the term and the context in which it appeared. "Permanent" means "[c]ontinuing or designed to continue indefinitely without change." COMPACT OXFORD ENGLISH DICTIONARY 1313 (2d ed. 2000). If EPA had intended to mean "for the duration of the current allowance period," it would not have used the term "permanent." Moreover, the notion of "permanent" transfers that would expire in 2009 would have been inconsistent with the Agency's decision to allocate baseline allowances "on a one-time basis." 68 Fed. Reg. at 2823. To the contrary, it is evident from the context of the 2003 Rule that EPA created a system designed to extend past the 2003-2009 regulatory period. Otherwise, it would have made no sense for EPA to provide that annual allowances would be decreased if "the percentage of baseline allowances is reduced to ensure compliance with the Protocol cap," 68 Fed. Reg. at 2823, given that the allowance percentages during the 2003-2009 period were to be a constant 100% of the baseline for HCFC-22 and HCFC-142b, *see* 40 C.F.R. § 82.16(a) (2004).

Indeed, notwithstanding EPA's suggestions (at 15, 27) that all allowances would have disappeared after 2009 but for its intervention, the Agency is *required* to "promulgate rules * * * providing for the issuance of allowances" until each HCFC is phased out. CAA § 607(a), 42 U.S.C. § 7671f(a).[2]

EPA criticizes petitioners for failing to identify explicit Agency statements that "permanent" transfers would survive after 2009, but in light of the plain meaning of the word "permanent" and the context in which it was used, it is incumbent upon EPA to identify evidence that EPA did *not* mean what it said. Absent any such evidence—and EPA has proffered none—the conclusion can only be that EPA's policy under the 2003 Rule was to authorize and approve permanent inter-pollutant transfers of baseline allowances.

[2] The Agency casts its argument in terms of what "Petitioners knew" the term "permanent" to mean. EPA Br. 28. But their only evidence is an ambiguous phrase in a cover letter used by Solvay, the intended meaning of which has not been established. EPA did not rely upon that document in the proceedings below, and it cannot use this litigation to introduce a *post hoc* rationalization. *See SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947). Even if that cover letter could be used to override the Agency's actual policies as to Solvay, it certainly cannot be imputed to Arkema, which had no prior knowledge of Solvay's filings.

2. An agency cannot supply a reasoned analysis for abandoning a preexisting policy if it does not acknowledge the preexisting policy.

It is a fundamental tenet of administrative law that "agency action is arbitrary and capricious if it departs from agency precedent without explanation." *Ramaprakash v. FAA*, 346 F.3d 1121, 1124 (D.C. Cir. 2003). EPA responds by arguing that it "adequately explained the reasons for choosing not to recognize past inter-pollutant transfers." EPA Br. 30. But that argument is not responsive to the "reasoned analysis" requirement. When an agency seeks to write on a blank slate, it might be able to justify several different policies, but this Court has never found that the availability of multiple options allows an agency to disregard its existing policies at will. To the contrary, in the face of a preexisting policy, an agency must begin by acknowledging and addressing the current state of the law. *See, e.g.*, *U.S. Air Tour Ass'n v. FAA*, 298 F.3d 997, 1006 (D.C. Cir. 2002) (holding that although a preexisting policy "does not preclude a new standard, promulgated pursuant to notice and comment as this one was, from being reasonable as well," the agency must "justify the change in course with a 'reasoned analysis'").

EPA suggests that the Supreme Court held otherwise in *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1811 (2009). *See* EPA Br. 35-36. But *Fox* addressed a different point—whether an agency faces a higher burden in justifying policy changes. *See* 129 S. Ct. at 1810. At the same time, *Fox* reaffirmed the longstanding requirement that an agency acknowledge that it is displacing an existing policy and thereby upsetting expectations. *See id.* at 1811. Following *Fox*, this Court has thus held that "[r]easoned decision making * * * necessarily requires the agency to *acknowledge* and provide an adequate explanation for its departure from established precedent." *Dillmon v. NTSB*, 588 F.3d 1085, 1089-90 (D.C. Cir. 2009) (emphasis added); *accord id.* at 1089 ("we do require the agency to 'display awareness that it *is* changing position'") (quoting *Fox*, 129 S. Ct. at 1811).

As we explained in our opening brief (at 21), EPA not only failed to acknowledge its prior policies, it insisted that it had always had the same policy. 74 Fed. Reg. at 66,422. In such a circumstance, the Agen-

cy cannot have satisfied its obligation to supply a "reasoned analysis" justifying its change in policy.[3]

B. The Final Rule Abandoned EPA's Previous Reliance On Market Mechanisms.

As we explained in our opening brief (at 44-51), the Final Rule is untenable for the independent reason that it abandons EPA's professed reliance on competitive mechanisms to regulate the HCFC marketplace. EPA offers three responses, but none explains away the deficiency.

First, EPA argues that it was not "required to eliminate offending chemicals in a manner that either promotes maximum market flexibility for affected companies or rewards companies for their past service to particular segments of the market." EPA Br. 38. This argument misstates petitioners' position. Our position is not that EPA was *required* to rely upon certain market mechanisms but that once EPA announced that it *would* rely upon them, it could not abandon the mechanisms *sub silentio*. In our opening brief (at 45-50), we described EPA's lengthy history of reliance on market mechanisms. The Agency simply ignores

[3] The policies underlying an agency's obligation to supply a "reasoned analysis" before it changes course are particularly apt in this case, in light of the questionable basis for the policy arguments now asserted by EPA, none of which formed the basis for the Final Rule. *See infra* Part II.A.

that history. Whether or not a market-based allowance system was required, EPA cannot lawfully promulgate regulations that disregard the Agency's prior policy.

Second, EPA claims that petitioners are mistaken in contending that the Final Rule "bequeaths additional market share to some companies at the expense of others." EPA Br. 39. In EPA's current view, market shares are enshrined in the quantity of baseline allowances apportioned in 2003, based on 1994-1997 data. But as a factual matter, market shares are reflected in the quantity of baseline allowances in 2009, which resulted from baseline trading by industry participants to adapt to the evolving marketplace in accordance with EPA's regulations.[4] This dispute underscores the importance to EPA's decision-making of correctly identifying the meaning of the 2003 Rule—and the likelihood that, if the Agency had acknowledged its actual practice un-

[4] In the context of the CFC phase-out, EPA recognized the foolishness of hewing to past market shares in an evolving market. *See* 56 Fed. Reg. at 9518. The Agency observed that "Congress did not intend the production limits to take effect without provision for producers to change their mix of chemicals," and noted that the "market dynamic" encouraged companies to produce regulated chemicals in 1991 "in different relative amounts then they were in 1986." *Id.* at 9521-22.

der the 2003 Rule, it would have reached a different outcome on inter-pollutant trades.

Third, EPA contends that it *did*, in fact, craft the Final Rule by using market data. EPA Br. 40. EPA's sole argument is that, by commissioning a "Servicing Tail Report," the agency was able to "assess market factors." *Id.* at 15-16, 40. But that report addresses only the *total* amount of HCFC-22 and HCFC-142b needed to satisfy market demands; it does not discuss the *allocation* of that total amount among producers and importers, let alone the effect of any allocation on customers, distributors, or market participants. *See, e.g.*, Final Rule, 74 Fed. Reg. at 66,415. It is thus difficult to understand how the Servicing Tail Report could justify EPA's new policy on inter-pollutant trades.

C. The Final Rule Was Promulgated Without Notice-And-Comment For EPA's New Interpretation of Section 607.

Petitioners were denied a meaningful opportunity to comment on EPA's new legal interpretation of CAA § 607. As we explained in our opening brief (at 40-44), CAA § 307(d)(3)(C) requires EPA to provide a statement of the "major legal interpretations * * * underlying the proposed rule." 42 U.S.C. § 7607(d)(3)(C). The 2008 Proposed Rule con-

tained no indication that EPA was considering a reinterpretation of Section 607, let alone a particular interpretation thereof. Nonetheless, the Agency contends that its obligation to expose its "major legal interpretations" to comment was satisfied by its proposal to set baseline allowances "*with or without* considering any permanent baseline transfers *and/or* inter-pollutant transfers." EPA Br. 43 (internal quotation marks omitted). EPA asserts that "[t]his statement is a clear indication that EPA would be considering both 'legal interpretations and policy considerations' on the issue of the permanence of inter-pollutant transfers." *Id.*

The Agency's *Federal Register* notice cannot reasonably be read to imply that the Agency was considering a reinterpretation of its statutory authority under CAA § 607. But even if the notice implied that CAA § 607 was in play, CAA § 307(d)(3) requires more than that EPA disclose *the fact* that the Agency is considering an unidentified legal interpretation. By its plain text, this provision requires the Agency to identify the legal interpretation *itself*.

EPA claims that any error was harmless because petitioner Arkema submitted a post-deadline comment that the Agency "included in

the Docket and Administrative Record." EPA Br. 44-45. But Arkema's comment responds only to another commenter, not to a proposal from the Agency itself. In any event, EPA does not claim that petitioner Solvay was offered the opportunity to comment on Honeywell's new interpretation of CAA § 607, and it does not claim that a comment by Arkema could have discharged Solvay's substantial rights. Arkema's comment therefore has no bearing on the resolution of this issue.

II. EPA MISTAKENLY CONCLUDED IN THE FINAL RULE THAT ITS POSITION IS COMPELLED BY THE CLEAN AIR ACT.

When an agency wrongly concludes that a statute compels a particular action, *Chevron* deference is unavailable and the agency action must be vacated. That is what happened here.

A. EPA's Conclusion That The Clean Air Act Forbids Baseline Inter-Pollutant Transfers Is Not Entitled To Deference.

As we explained in our opening brief (at 51-53), *Chevron* deference applies only when an agency makes a policy judgment based on an acknowledged gap in a statute. Where, as here, an agency claims that Congress has decided the issue, that legal conclusion is due no deference. And if this Court finds that the statute is ambiguous, it cannot "choose between competing meanings," *Alarm Indus. Commc'ns Comm.*

v. FCC, 131 F.3d 1066, 1072 (D.C. Cir. 1997), but instead must remand to allow the agency to "bring its experience and expertise to bear," *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 797-98 (D.C. Cir. 2004).

EPA now takes the position that the statute is ambiguous after all and that it *can* be interpreted to preclude permanent intra-company transfers. *See* EPA Br. 48 ("It is quite evident that CAA §607, the provision dealing with transfers of allowances, does not expressly address whether inter-pollutant transfers characterized as 'baseline' are to be deemed 'permanent' and reflected in subsequent regulatory periods."). But in the Final Rule, the Agency took the position that the statute is *un*ambiguous and that it *must* be interpreted to preclude such transfers. At that time, the Agency announced that "[a]fter considering the language of section 607 and the legislative history"—but not any policy considerations—"EPA believes that section 607(b) is best read as *permitting only* year-to-year inter-pollutant transfers." 74 Fed. Reg. at 66,421 (emphasis added). Likewise, EPA interpreted Section 607 as "*requiring* that all inter-pollutant transfers, whether occurring between companies or within a single company, be conducted on a yearly—and thus temporary—basis." *Id.* at 66,422 (emphasis added). The terms

"requiring" and "permitting only" indicate that EPA saw itself as bound by Section 607, not that the Agency was making a policy judgment between competing interpretations of the statute.[5]

EPA's brief nonetheless identifies a list of policy concerns that the Agency claims to have "detailed" in its proceedings. EPA Br. 30-32. The Agency argues that "Petitioners do *not* challenge the substantive bases for EPA's decision," and suggests that this omission is significant. EPA Br. 4. This is misleading. Our position is that the Final Rule relied *only* on EPA's incorrect statutory interpretation. This Court "do[es] not ordinarily consider agency reasoning that 'appears nowhere in the [agency's] order.'" *PanAmSat Corp. v. FCC*, 198 F.3d 890, 897 (D.C. Cir. 1999) (quoting *Graceba Total Commc'ns, Inc. v. FCC*, 115 F.3d

[5] Even if EPA *were* filling a legislative gap through agency policymaking, it would not be entitled to the "extreme degree of deference" the Agency now seeks. EPA Br. 48 (quoting *Huls Am. Inc. v. Browner*, 83 F.3d 445, 452 (D.C. Cir. 1996)). This Court accords such deference only when an Agency "is evaluating scientific data within its technical expertise." *Huls Am.*, 83 F.3d at 452 (quoting *Int'l Fabricare Inst. v. EPA*, 972 F.2d 384, 389 (D.C. Cir. 1992) (per curiam)). EPA did not consider *any* data in deciding that baseline inter-pollutant transfers should be outlawed, and to the extent that it engaged in any independent reasoning, it makes claims about "market expectations," *e.g.*, EPA Br. 31, that are far outside its environmental ken. Thus, even if this Court's precedent did not preclude *any* deference, there would certainly be no basis for taking deference to the "extreme."

1038, 1041 (D.C. Cir. 1997)) (second alteration in original). In the Final Rule, the Agency acknowledged that *commenters* had made certain policy arguments but did not indicate that those policies formed the basis for the Final Rule. The Agency now tries to rely upon its responses to those comments, which appeared in a separate document, as if the responses can *amend* the basis for the regulation that is set out in the Final Rule itself. But EPA cannot change its position in litigation now that it has identified flaws in the actual basis for its decision.

In any event, the policy arguments identified in EPA's brief are seriously flawed, and once EPA is compelled to address those arguments unburdened by the mistaken assumption that the statute left it with no choice, there is a substantial likelihood that the Agency will adopt the policy it implemented in 2003 and proposed again in 2008. A brief review of the Agency's assertions shows that it is a thin reed upon which the Agency seeks to support itself:

1. EPA claims that "market manipulation could effectively destroy EPA's worst-first regulatory regime by perpetuating allowances that were intended to be abolished." EPA Br. 52; *accord id.* at 30-31. But that cannot be true. The "worst-first" system allows EPA to ban

the use of certain HCFCs before all HCFCs are phased out in 2030. Inter-pollutant trades have no bearing on which *HCFCs* remain in the marketplace; they bear only on which *companies* have the right to produce and import the remaining refrigerants. Nothing about the system could be manipulated to bring back HCFCs that EPA had designated for phaseout.[6]

2. EPA alleges that inter-pollutant trades "[h]ave an outsized impact on small companies." EPA Br. 31. But the evidence identified by EPA establishes only that the policy will have a *proportional* effect on *all* companies.

3. EPA contends that inter-pollutant trades "[i]nterfere with market expectations" and create "market distortion" and "market disruption." EPA Br. 31, 42 n.10. But these assertions are not backed by evidence or analysis; rather, EPA assumes its conclusion by characteriz-

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[6] Nor, for that matter, is there any evidence that the market has, in fact, been manipulated. To the contrary, baseline inter-pollutant transfers enabled petitioners to adapt their businesses to respond to the market. Using these regulatory tools, petitioner Solvay restructured its business from HCFC-142b to HCFC-22 to serve the refrigeration aftermarket, which is entirely consistent with an HCFC phaseout that contemplates an aftermarket that survives the end of original equipment manufacturing. *See, e.g.*, Magid Decl. ¶¶ 5-6, 8 (SA 7-8).

ing the market as what existed before the inter-pollutant baseline trades that the Agency authorized and approved. When that assumption is removed, market disruption could arise only from the defeat of petitioners' legitimate expectations that past approvals would not be rescinded. *See, e.g.*, Magid Decl. ¶¶ 5-7, 16-20 (SA 7-8, 12-13); Werkema Decl. ¶¶ 10-12 (SA 3-4). There is a substantial likelihood that the Agency would reverse its position on the market effects of baseline inter-pollutant transfers once it acknowledges that the 2003 Rule permitted such transactions.

4. EPA argues that 19 of 21 companies must "relinquish" baseline allowances. EPA Br. 31. To be sure, the allotment of the Montreal Protocol quota is a zero-sum game. But EPA's approach begs the question of whether other companies were *entitled* to a greater share of allowances—notwithstanding that original-equipment uses of HCFC-22 were phased out—or whether inter-pollutant baseline trades created flexibility.

5. EPA suggests that permitting inter-pollutant trades would result in "increased emissions of HCFCs." EPA Br. 32; *accord id.* at 10, 17. To the contrary, inter-pollutant trades have the effect of increasing

the production or consumption of one HCFC while reducing the production or consumption of another. *See* CAA § 607(a), 42 U.S.C. § 7671f(a). And because EPA requires a 0.1% allowance offset whenever a transfer is completed, inter-pollutant transfers necessarily result in a net environmental *benefit*. *See id.*; 40 C.F.R. § 82.23(b)(3)(v). The only difference between our approach and the Agency's is who produces or imports the HCFCs, not the total quantity. Indeed, EPA's assertion is disproven by the Proposed Rule, which recognized permanent inter-pollutant trades but would not have driven the United States out of compliance with the Montreal Protocol.

In sum, this Court should not credit the Agency's *post hoc* identification of baseless policy arguments in its effort to defend a flawed regulation.

B. EPA's Interpretation Of Section 607 Is Incorrect.

As we explained in our opening brief (at 53-59), neither the text nor the legislative history of the CAA compel the Agency to invalidate previously-approved inter-pollutant transfers of baseline allowances. In its brief, EPA essentially agrees. The Agency now concedes that "the legislative history is sparse" and that the statute "does not expressly

address whether inter-pollutant transfers characterized as 'baseline' are to be deemed 'permanent' and reflected in subsequent regulatory periods." EPA Br. 48, 55. Thus, if the Court agrees that EPA's Final Rule was not an exercise of statutory gap-filling, remand is necessary.

Having conceded that the statute is ambiguous, EPA nonetheless attempts to defend its interpretation of the text and history of Section 607. *First*, the Agency states that "the intent of the inter-pollutant transfer provision, section 607(b), is to prohibit a company from engaging in trades that will allow it to use allowances in a subsequent year." EPA Br. 50. The Agency then contends that inter-pollutant baseline transfers somehow violate that principle, because "recognition of baseline transfers from the years 2008 and 2009 would allow Arkema to produce [more] HCFC-22 in 2010 than under the 2010 Regulation as currently promulgated." EPA Br. 51. This reasoning does not comport with the purposes of CAA § 607. As we explained in our opening brief (at 57), Title VI of the CAA ensures compliance with quotas imposed by the Montreal Protocol by preventing a company from transferring allowances from one calendar year to another, which could result in the United States exceeding its quota in the latter year. But a baseline

transfer poses no threat to this obligation, because each company is issued an annual allotment of allowances on the basis of its baseline. Even though a particular company's baseline can be shifted from one HCFC to another (through an inter-pollutant baseline transfer), the transfer system guarantees that *total* production and importation—the only concern of the Protocol—remain within the Protocol's ozone-depletion-based limits. Inter-pollutant baseline transfers do not change the fact that calendar-year 2008 allowances had to be used in 2008, and calendar-year 2009 allowances in 2009, and that to the extent they were not, those calendar-year allowances expired.

Second, the Agency defends its conclusion that inter-pollutant trades are prohibited on the ground that the "Conference Agreement addressed differences in the two bills by combining the two separate concepts, *not* by adding the concept of inter-pollutant transfers to occur over multiple years." EPA Br. 53-54. But the "concept[]" from the Senate bill presupposed that market participants could make lasting shifts of their HCFC priorities.[7] Because the Agency ignores the Senate

[7] Under the Senate bill, parties would have been assigned a baseline (on a one-time basis) based on production and consumption data from 1986. Participants would have been free to allocate their baseline among

"concept[]," its interpretation cannot be correct. We made this point in our opening brief (at 53-56), but EPA has chosen to ignore it.

Third, EPA contends that 40 C.F.R. § 82.23 should not be read to contradict the Agency's interpretation of the statute. As we explained in our opening brief (at 33), the structure of § 82.23 suggests that baseline inter-pollutant transfers are available, because that provision appears in a separate subsection of § 82.23, rather than within the subsection dealing with inter-company transfers. EPA criticizes this reasoning as "pure supposition," but the structure of a statute or regulation is an important interpretive tool. *See, e.g.*, *Pharm. Research & Mfrs. of Am. v. Thompson*, 251 F.3d 219, 224 (D.C. Cir. 2001). EPA also claims that 40 C.F.R. § 82.23(d) cannot apply to inter-pollutant transfers because it refers to the "transferee." EPA Br. 55. But this cannot be a meaningful distinction, because EPA's form for allowance transfers requires the transferor to specify the transferee, even for inter-pollutant

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HCFCs as they saw fit, and no mechanism would have existed for the Agency to roll-back previous strategic decisions by individual market participants when the baseline percentages were reduced to satisfy Protocol obligations. *See* 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).

transfers. As the official instructions explain, "[i]f a person is conducting an inter-pollutant transfer * * * the transferee company will be the same company [as the transferor]." Guidance Document, *supra*, part 4, at 19.

III. THE FINAL RULE IS IMPERMISSIBLY RETROACTIVE.

By invalidating past trades in an ongoing cap-and-trade system, EPA acted retroactively, which is forbidden in a rulemaking proceeding under the CAA. *See* Pet. Br. 60-65. EPA does not deny that there is a bar on retroactive rulemaking, but it claims that the Final Rule is not, in fact, retroactive. EPA Br. 57-60. In EPA's view, because the Final Rule concerns only future allowances, it cannot be retroactive. EPA also contends that no rule concerning HCFC allocations could be retroactive because "permission to produce and consume HCFCs (through the grant of allowances) is not a right but a 'privilege' granted by EPA under the terms of its own regulations." EPA Br. 58.

EPA's first point is another version of its claim that the HCFC allowance system in effect from 2010-2014 is divorced from the allowance system in effect from 2003-2009. As we have explained, *see* Pet. Br. 2, 8-9, 26, 62, that is not so. In 2003, EPA created a lasting system for the

step-down and ultimate phaseout of HCFCs. When the Agency described inter-pollutant trades as "permanent," therefore, the approved trades were intended to last until the applicable HCFC phaseout date. The Final Rule reached back into the past to invalidate the effect of trades that already had occurred.

As to EPA's second point, the principle against retroactivity does not embrace the rights-versus-privileges distinction. To the contrary, the Supreme Court has explained that the standard set out in *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), embraces a "functional," or interest-based, conception of retroactivity. *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 947 (1997). *Landgraf* enumerates three categories of retroactivity—when a new legal requirement "would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." 511 U.S. at 280. Rather than adopting a formalistic distinction between rights and privileges, "retroactivity law is concerned with the protection of reasonable reliance." *Bergerco Canada v. U.S. Treas. Dep't*, 129 F.3d 189, 193 (D.C. Cir. 1997).

The Agency's contrary approach is manifestly incorrect. EPA contends that "a regulation can only be impermissibly retroactive if it impairs *vested rights* acquired under existing law." EPA Br. 58. As the Agency sees it, permission to produce and consume HCFCs "is not a right but a 'privilege' granted by EPA." *Id.* But this distinction would entitle the Agency to promulgate the most brazenly retroactive rules without recourse. For example, if past privileges could be freely revoked, EPA could pass a new rule in 2010 that eliminated HCFC allowances for the year 2005 and imposed penalties on parties that exercised their 2005 privileges. Such a rule would fall squarely within the prohibition against retroactivity, which is further confirmation that the rights-versus-privileges distinction cannot be meaningful.

CONCLUSION

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

Dated: April 9, 2010

Respectfully submitted.

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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 5815 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Cir. R. 32(a)(1).

Dated: April 9, 2010

/s/ Brian D. Netter
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CERTIFICATE OF SERVICE

I hereby certify, pursuant to Fed. R. App. P. 25(c), that on April 9, 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: April 9, 2010

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