

October 26, 2018

To: EPA & NHTSA

From: Jason A. Schwartz, Former Consultant to the Administrative Conference of the United States on the Marketable Permit Project & Adjunct Professor at New York University School of Law

Dockets: NHTSA-2018-0067 & EPA-HQ-OAR-2018-0283

Subject: Flexible Compliance Options under the Safer Affordable Fuel-Efficient Vehicles Rule

I recently served as the consultant to the Administrative Conference of the United States (ACUS) on its recommendations to federal agencies on marketable permits.<sup>1</sup> EPA and NHTSA now seek comments on elements of their market-based compliance flexibilities under the Safer Affordable Fuel-Efficient Vehicles Rule. I submit these comments based on ACUS's recommendations and my research in my role as ACUS consultant. These comments are my own and do not necessarily reflect the views of ACUS members or staff.<sup>2</sup>

### ***The Administrative Conference Recommends More Transparency for Credit Markets***

The agencies ask whether to require more information disclosure around trades, including price information, noting that neither the public, shareholders, competitors, nor even the agencies themselves know the price of credit transactions.<sup>3</sup> The agencies can assume that credits may be traded at prices similar to the civil penalty rate for non-compliance under the CAFE standards, but not knowing the actual prices greatly complicates the agencies' estimations of the costs of complying with the standards.<sup>4</sup>

The agencies propose requiring trading parties to submit information that discloses the identities of the parties to credit trades, the number of credits traded, and the amount of compensation exchanged for credits. The proposed regulations would also permit NHTSA to publish information about specific transactions.<sup>5</sup> This proposal is consistent with recommendations from the Administrative Conference of the United States.

The Administrative Conference is an independent federal agency that issues recommendations to other agencies on best regulatory practices, as part of its mandate to study "the efficiency, adequacy, and fairness" of administrative procedures.<sup>6</sup> In December 2017, the Administrative Conference adopted Recommendation 2017-4 on Marketable Permits.<sup>7</sup> The Recommendations included these best practice guidelines on information disclosure:

10. Subject to other agency priorities and applicable legal requirements, including the Paperwork Reduction Act (PRA) and e-Government Act, agencies should collect data on the

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<sup>1</sup> ACUS, Adoption of Recommendations, 82 Fed. Reg. 61,728 (Dec. 29, 2017). *Also available* at ACUS, Recommendation 2017-4, Dec. 14, 2017, <https://www.acus.gov/sites/default/files/documents/Recommendation%202017-4%20%28Marketable%20Permits%29.pdf> (hereinafter "ACUS Recommendations"). *See also* Jason A. Schwartz, *Final Report on Marketable Permits: Recommendations on Applications and Management* (Dec. 11, 2017), <https://www.acus.gov/sites/default/files/documents/Marketable%20Permits%20Report-final.pdf> (hereinafter "ACUS Consultant's Report").

<sup>2</sup> My other titles include adjunct professor and legal director at the Institute for Policy Integrity at New York University School of Law. These comments do not necessarily reflect the views, if any, of New York University. However, the comments are consistent with the views of the Institute for Policy Integrity.

<sup>3</sup> 83 Fed. Reg. at 42,999 (Aug. 24, 2018); Preliminary Regulatory Impact Analysis at 108 (Oct. 16, 2018).

<sup>4</sup> 83 Fed. Reg. at 43,179.

<sup>5</sup> 83 Fed. Reg. at 43,449-50

<sup>6</sup> 5 U.S.C. § 594.

<sup>7</sup> 82 Fed. Reg. 61,728 (Dec. 14, 2017).

operation of marketable permitting programs and consider periodically assessing both the policy effectiveness and economic efficiency of existing marketable permitting programs. Agencies should be cognizant that some of the data collected may be confidential and protected against disclosure by law.

11. To the extent practicable, agencies should release data on permit transactions, prices, holdings, compliance rates, and other data to help the public gauge a market's policy effectiveness and to help parties make efficient decisions in the market.<sup>8</sup>

The preamble to the recommendations explained why more transparency about marketable permits is desirable:

Because permit markets rely heavily on the decisions of both the agency and permit buyers, facilitating the flow of information is an extremely important part of a marketable permitting program. Making data on permit transactions, prices, and holdings publicly available can help the agency and the public access the efficacy of the program. It also enables smooth operation of the permit markets by enabling permit buyers to better evaluate the value of the permits. Having clear communication policies for announcing policy changes or enforcement actions that could influence the market prevents prepublication leaks and information asymmetries that could unjustly benefit some parties and undermine the permit market.<sup>9</sup>

As my consultant report to the Administrative Conference elaborated, price disclosure places all players on equal informational footing, facilitates price discovery, and assists buyers and sellers in reaching terms.<sup>10</sup> Without reliable, transparent information on prices, buyers and sellers have more difficulty reaching terms, resulting in fewer trades and market inefficiency. Moreover, regulators require greater transparency to facilitate oversight. Greater transparency in tracking transactions and credits helps regulators "detect fraud, manipulation, market power, and abuse, and to enforce compliance."<sup>11</sup>

The agencies should require manufactures to report more information about their credit transactions and should regularly make that information public.

### ***A Cost-Benefit Framework, not "Harmonization," Should Inform the Agencies' Choice of Compliance Flexibilities***

The agencies propose eliminating or altering various compliance flexibilities. EPA proposes eliminating offset credits for air conditioning leakage and for emissions of methane and nitrous oxide, in the vague pursuit of "harmonizing with the CAFE program."<sup>12</sup> NHTSA proposes perhaps eliminating credit trading in the CAFE program because it is not statutorily required.<sup>13</sup> The agencies more broadly suggest that other credits, adjustments, and economic incentives may be distorting the market and should perhaps be eliminated.<sup>14</sup>

Yet the agencies have not proposed any framework for evaluating which compliance flexibilities to retain, alter, expand, or eliminate. The Administrative Conference recommends that agencies should evaluate whether compliance flexibilities will best achieve policy objectives, as set by statute.<sup>15</sup> EPA's policy objective is to protect public health and welfare, after "giving appropriate consideration to the

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<sup>8</sup> 82 Fed. Reg. at 61,734.

<sup>9</sup> 82 Fed. Reg. at 61,733.

<sup>10</sup> Schwartz, Final Report, *supra*, at 86-87.

<sup>11</sup> *Id.* at 84.

<sup>12</sup> 83 Fed. Reg. at 42,988.

<sup>13</sup> 83 Fed. Reg. at 42,999.

<sup>14</sup> PRIA at 108.

<sup>15</sup> ACUS Recommendation #1 on Marketable Permits.

cost of compliance.”<sup>16</sup> NHTSA’s policy objective is to set the “maximum feasible average fuel economy” standard after considering “technological feasibility, economic practicability, the effect of other motor vehicle standards . . . and the need of the United States to conserve energy.”<sup>17</sup>

Those are the criteria by which the agencies should evaluate the flexible compliance options. The goal of harmonizing EPA’s standards with the CAFE program does not justify overriding all other costs and benefits and statutory responsibilities, and it is not necessarily a reason for EPA to eliminate some of its offset credit options. It is possible that lack of harmonization could cause costs, such as redundant paperwork and administrative costs—although EPA does not assess the existence or magnitude of such effects. On the other hand, harmonization can also carry costs. If EPA eliminates cost-saving flexibilities and so inflates the cost of complying with standards, the agency will fail to set standards that actually maximize net social welfare. The resulting forgone emissions reductions and consumer savings from sub-optimal standards carry very real costs to public health and welfare. EPA should evaluate the costs and benefits of various compliance flexibilities and, consistent with its statutory mandate, continue to offer the flexibilities that will help maximize net social welfare.

Similarly, NHTSA should not eliminate credit trading just because it is not statutorily required. Credit trading and other compliance flexibilities have a proven track record of lowering costs without undermining policy objectives.<sup>18</sup> It is true that, in some contexts and without proper design and oversight, some market-based flexibilities can result in distortions. But the agency should not presume that to be true of any existing flexibilities without doing the proper analysis.

The information disclosures recommended above will assist the agencies in analyzing the policy effect, economic efficiency, and management challenges of their existing compliance flexibilities. Armed with such an analysis, the agencies can engage in a holistic review of whether their existing compliance flexibilities help maximize net social benefits. In the meantime, though, the agencies should exercise caution before acting on any self-interested petitions from regulated entities seeking changes to the existing compliance flexibilities.<sup>19</sup>

Sincerely,

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<sup>16</sup> 42 U.S.C. § 7521.

<sup>17</sup> 49 U.S.C. § 32902.

<sup>18</sup> See generally Schwartz, Final Report, *supra*.

<sup>19</sup> *E.g.*, 83 Fed. Reg. at 43,452.