July 12, 2019

The Honorable Elaine L. Chao
United States Department of Transportation
1200 New Jersey Ave. SE
Washington, D.C. 20590

Dear Secretary Chao:

The Department of Transportation ("DOT") and the National Highway Traffic Safety Administration ("NHTSA") administer the civil penalty rate at 49 U.S.C. § 32912(b). The Civil Monetary Penalties Inflation Adjustment Act of 1990, as amended, ("Inflation Adjustment Act” or "Act") requires agencies, including DOT and NHTSA, to adjust covered civil monetary penalties for inflation regularly, including by making an initial adjustment to account for inflation. An agency need not initially adjust a civil monetary penalty by the otherwise required amount if an agency determines and the Director of the Office of Management and Budget ("OMB") concurs that such an adjustment would constitute a “negative economic impact.” Recently, DOT and NHTSA determined that adjusting the civil penalty rate at 49 U.S.C. § 32912(b) from $5.50 to $14 constitutes a “negative economic impact” under the Inflation Adjustment Act and sought OMB’s concurrence. As explained below, OMB concurs with the determination.

I. Background

The Inflation Adjustment Act requires agencies, including DOT and NHTSA, to adjust covered civil monetary penalties for inflation to account for inflation since the penalty was established or last adjusted for inflation, and regularly thereafter. The Act caps the initial adjustment at 150% of the penalty amount and permits an initial adjustment "by less than the otherwise required amount if" the agency and OMB satisfy certain statutory requirements. First, the head of the agency must, “after publishing a notice of proposed rulemaking and providing an opportunity for comment, determine[] in a final rule that ... increasing the civil monetary penalty by the otherwise required amount will have a negative economic impact.” Second, the Director of OMB must concur with the head of the agency’s determination.

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2 Id. § 4(c)(1)(A).
3 Id. § 4(b)(1).
4 Id. § 4(c)(1).
5 Id.
6 Id. § 4(c)(2).
In a notice of proposed rulemaking and subsequent final rule entitled “Civil Penalties,” the Secretary of Transportation determined that an increase in the Corporate Average Fuel Economy (“CAFE”) civil penalty rate from $5.50 to $14 constitutes a "negative economic impact" under the Inflation Adjustment Act. After careful review of DOT and NHTSA’s arguments, analysis, and determination, the Director of OMB concurs with the determination that adjusting the CAFE civil penalty rate from $5.50 to $14 would have a "negative economic impact" under the Inflation Adjustment Act.

II. Rationale for Concurrence


The Inflation Adjustment Act does not clearly explain what constitutes a “negative economic impact.” The Act does not define the term “negative economic impact,” in contrast to other operative terms such as “civil monetary penalty” and “agency.” We are also not aware of an accepted definition in the economic literature that the term impliedly references or legislative history that sheds light on the issue. The ambiguous statute identifies only the direction (negative) and general nature (economic) of the impact the head of the agency should consider. While the Act does not explicitly cover other important interpretive issues, including whether an agency may consider distributional consequences as it makes a determination about impact and whether there exists a threshold for the magnitude of an impact, the Act’s structure and purpose provide some interpretive assistance.

By implication, the Act provides some insight about the term “negative economic impact.” Section 4(c) of the Act permits the agency to make one of two different determinations to satisfy the Act’s requirement. Under § 4(c)(1)(A), the agency may consider the negative economic impact of an adjustment. Under a different provision of the Act, § 4(c)(1)(B), the agency may instead determine that “the social costs of increasing the civil monetary penalty by the otherwise required amount outweighs the benefits.” The presence of a cost-benefit test in a separate provision and its absence in the parallel provision at issue suggests the agency is not limited to a cost-benefit examination as it determines whether an adjustment would result in a negative economic impact. Instead, an agency may consider the magnitude and some or all of the distributional consequences of an adjustment of a civil monetary penalty, including concentrated

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7 Like DOT and NHTSA, OMB does not believe the CAFE civil penalty rate is a civil monetary penalty under the Inflation Adjustment Act, which we explain in our associated legal determination. Nevertheless, DOT and NHTSA’s final rule in the alternative determines that, were the civil penalty rate at issue a civil monetary penalty under the Act, the adjustment of the rate to $14 would have a negative economic impact. Our concurrence applies to the determination made in the alternative.


9 Id. § 3.

10 Id. § 4(c)(1)(B).
significant negative impacts that an adjustment would cause, e.g., significant costs placed on a group of entities, such as firms in a particular industry.

In addition, the structure and purpose of the Act and our initial implementation guidance inform the magnitude of impacts that would satisfy the negative economic impact test. The Act’s scope is broad and applies to every civil monetary penalty under a covered agency’s jurisdiction. Under this regime, initial adjustments vary significantly from no adjustment to fairly substantial inflation adjustments (limited only by the statutory 150% cap on a civil monetary penalty’s increase), such as the adjustment at issue here. Read literally, “negative economic impact” could apply to every such adjustment. This is because increasing the magnitude of a civil monetary penalty has some financial cost on entities subject to the civil monetary penalty in comparison to the lower penalty those entities would otherwise face or faced. Obviously, such an application enervates the Act by providing a loophole that could be abused to avoid any initial inflation adjustment. Congress could not have intended to include a loophole that would render the Act wholly ineffective, and we decline to adopt such an interpretation.

The precise boundary of the magnitude of impacts that satisfy the negative economic impact test, however, is more difficult to establish. Below, we provide benchmarks for magnitude, all of which the initial adjustment of the civil penalty rate implicates. While we do not endorse a specific dollar threshold, we recognize that the magnitude of the impact must be significant. The adjustment satisfying the below benchmarks is evidence of significant impact. In addition, the magnitude must be great enough that § 4(c)(1)(A) cannot be used systematically to undermine the purposes of the Act. Such a view is consistent with OMB’s initial guidance on the issue in which we explained “OMB expects determination concurrences to be rare.”

The preceding statutory analysis frames the negative economic impact discussion below, which focuses on the distributional question—significant costs placed on a group of entities—and the magnitude of those costs.

2. Negative Economic Impacts Analysis – Magnitude

The strongest evidence that NHTSA presents of the negative economic impact associated with the initial adjustment of the CAFE civil penalty rate is the sheer magnitude of the incremental penalties on automobile manufacturers that the agency projects will result from an increase in the penalty to $14 as well as other direct costs in the automobile manufacturing industry.

Significantly increased penalties are an important negative impact of an increase of the civil penalty rate to $14. In its analysis, NHTSA estimated incremental penalties using both the proposed standards and the augural standards. The lower estimate assumed the proposed standards, which a proposal from the Environmental Protection Agency (“EPA”) and DOT

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issued in August 2018 about new standards for Model Years 2021–2026 outlines. The upper estimate assumed the augural standards, which are the current CO2/GHG emissions standards for Model Years 2022–2025 that the EPA and DOT established in 2012. These two estimates help identify incremental penalties that adjusting to $14 would create.

Based on the above two standards and NHTSA’s CAFE Compliance and Effects Model (commonly called the “CAFE Model”), NHTSA projects an increase in penalties of approximately $2.8 billion and $7.2 billion over the 2019 through 2026 period, which is equivalent to $350 million and $900 million per year on average. The projected penalties at the $14 penalty level are 2.3 and 2.6 times as large as the projected penalties at the $5.50 level.

While the application of accrued credits could offset the projected incremental penalties, a manufacturer applying those credits foregoes their benefits—namely sale in the private market. Moreover, the application of those credits to projected incremental penalties decreases credit supply in the market, likely increasing the price of those credits. The use of credits, worth more by their removal from the market, means automakers incur a higher opportunity cost when applying credits to incremental penalties, so it is not clear that application of credits would mitigate the overall economic cost created by the increase in penalty level.

We considered several benchmarks to assess the magnitude of the penalty payment increase. One benchmark that agencies have used for decades is the $100 million annual threshold for when a regulatory action is “economically significant” and thus subject to strengthened analytic and interagency review requirements. As applied by the Office of

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14 NHTSA used the CAFE Model to develop the projected penalty payments used in its determination about negative economic impact. DOT’s Volpe National Transportation Systems Center developed the model to support NHTSA’s CAFE rulemakings, and NHTSA has used the CAFE Model’s results for all CAFE rulemakings since 2003. In addition, the model was peer-reviewed in 2016 leading to the implementation of many recommended updates to the model, inputs, outputs, and documentation. NHTSA uses the model as a tool to estimate how manufacturers could attempt to comply with a given CAFE standard by adding technology to anticipate future vehicle fleets, and to estimate impacts of that additional technology on fuel consumption, greenhouse gas emissions, and economic costs and benefits to vehicle owners and society. Like every model, the CAFE Model has strengths and weaknesses, but it is overall the best publicly available model for purposes of evaluating impacts of CAFE civil penalties.

A description of the modeling assumptions and parameters for the CAFE Model and the data supporting the calculations are publicly available. Technical Foundations for the NPRM Analysis, 83 Fed. Reg. 43,000 (Aug. 24, 2018) (describing modeling assumptions and parameters); Compliance and Effects Modeling System, 2018 NPRM for Model Years 2021–2026 Passenger Cars and Light Trucks CAFE Model Run, Central Analysis and Sensitivity Analysis Links, https://www.nhtsa.gov/corporate-average-fuel-economy/compliance-and-effects-modeling-system (underlying data). The analysis incorporates assumptions, which have been peer reviewed, about CAFE standards and other regulatory alternatives, the future of the vehicle market, the applicability and impacts of fuel-saving technologies, and other economic inputs. Even though peer reviewers have questioned some model inputs, all inputs besides the penalty rate are held constant across model runs under a set of CAFE standards. Using the above resources, it is possible to recreate the analysis and projected penalties.
Information and Regulatory Affairs, a regulatory action is economically significant if costs, benefits, or transfers exceed $100 million in any one year. Year-by-year projected penalties are displayed in Tables 1 and 2. Under the augural standards, annual costs in the form of increases in penalties range from a low of $562 million in 2021 to a high of $1.7 billion in 2025. Under the proposed standards, penalty payment increases range from a low of $85 million in 2026 to a high of $764 million in 2019. Thus, by either standard, the size of the average annual projected penalty increase exceeds the benchmark for economic significance, and in nearly every case exceeds the benchmark on an actual yearly basis.

Another benchmark we considered is the Congressional Budget Office’s (“CBO”) total estimated revenues of the Inflation Adjustment Act. The Inflation Adjustment Act applied to hundreds of civil monetary penalties and CBO estimated a total increase in revenues from these penalties of $1.310 billion over 10 years, or $131 million per year. The annual average of approximately $350 to $900 million in projected incremental penalties under this action far exceed the revenue all adjusted penalties would provide per CBO projections. While some of the projected incremental penalties could be offset by credits and therefore not result in additional Federal government revenue, the foregone credits used in the offset represent real economic cost incurred by the manufacturers. Therefore, relative to the projected revenue effects of other civil monetary penalties, the projected incremental penalties under either standard are significant.

We are not aware of any other civil monetary penalty having the same or greater magnitude of impact as the initial adjustment to the CAFE penalty rate would have. In fact, we are aware of only one other rule adjusting civil monetary penalties that is economically significant. That Department of Labor initial adjustment rule adjusted over sixty civil monetary penalties for inflation. Thus, we believe determining that adjusting the penalty rate to $14 is a negative economic impact could not be used to systematically undermine the purposes of the Act. Projected incremental penalties, however, are not the only negative impacts associated with the penalty rate increase to $14. The CAFE Model assumes that the penalty rate increase will cause manufacturers to upgrade their technology over time more than they would without the penalty. Those technology costs, which NHTSA discusses generally, over and above what the market would ordinarily generate, represent further negative impacts to manufacturers (and consumers to the extent that these costs are passed on in higher prices) beyond the projected incremental penalties.

"has resulted in or is likely to result in... an annual effect on the economy of $100,000,000 or more’’); Unfunded Mandates Reform Act, 2 U.S.C. § 1532(a) (establishing additional procedures for notices of proposed rulemaking that “include[] any Federal mandate that may result in the expenditure... of $100,000,000 or more (adjusted annually for inflation’’)).


3. **Negative Economic Impacts – Distributional and Other Analysis**

The projected incremental penalties are not only significant in magnitude, but would be concentrated in automobile manufacturing, an important domestic industry. As recognized above, NHTSA may consider concentration of negative impacts in the analysis of whether an adjustment constitutes a negative economic impact. The CAFE statute only applies to automobile manufacturers and thus any penalty adjustment would be highly concentrated, in contrast to other penalties with a broader scope.

In addition, as NHTSA has explained in its final rule, the determination of a manufacturer’s CAFE penalties is complex. NHTSA determines any potential civil penalties for failing to meet fuel economy standards after the application of a complex formula, credit-earning arrangement, and credit transfer and trading program. It is difficult to predict how individual manufacturers will react to the penalty rate adjustment, which would likely have varying impacts across models and manufacturers. It is therefore exceptionally difficult to predict the potential myriad effects on the industry. For example, NHTSA discusses potential effects on the competitiveness of domestic manufacturers and employment losses concentrated in particular geographic areas, such as areas of significant domestic automobile manufacturing. Those potential concentrated economic consequences as well as significant uncertainty about the adjustment’s consequences in an industry of vital national importance further supports NHTSA’s determination that the initial adjustment would result in a negative economic impact.

We found NHTSA’s arguments regarding the size and concentration of negative impacts persuasive given the accompanying analytical support, and several other qualitative arguments NHTSA presents further support its argument. NHTSA discusses potential effects on regional employment, identifying studies with conflicting conclusions about national employment. The studies suggest a potential effect on regional employment. NHTSA also discusses potential effects on competition in the automobile market through limits on consumer choice created by production decisions as a result of the higher penalty rate. This, too, is a potential result. Finally, NHTSA discusses potential effects on imports and domestic competitiveness. NHTSA concludes that domestic producers would need to charge higher prices to cope with increased compliance efforts, reducing the competitiveness of domestic fleets compared to already relatively cheaper imported vehicles. Higher prices could also disproportionately harm lower-income consumers. While NHTSA does not provide quantitative analysis, these important qualitative arguments further support NHTSA’s analysis.

In sum, OMB agrees with DOT and NHTSA’s analysis about the consequences of adjusting the CAFE civil penalty rate that otherwise would be required under the Inflation Adjustment Act. The negative impact would be significant and concentrated on an important American industry, with possible further concentrated negative impacts on domestic competitiveness, regional employment, and lower income consumers. Therefore, the Acting

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18 For the reasons stated above, we would conclude that the penalty would result in a “negative economic impact” regardless of the distributional effects.

Director of OMB concurs with the Secretary’s determination that an increase in the CAFE penalty rate from $5.50 to $14 would result in a negative economic impact and may be adjusted by less than the otherwise required amount under the Act.

Sincerely,

Russell T. Vought
Acting Director
Table 1: Projected Additional Penalties under Augural Standards If Rate Is Increased

<table>
<thead>
<tr>
<th>Model Year</th>
<th>Projected Penalties Under $5.50 Rate, Central Analysis (Augural Standards)</th>
<th>Projected Penalties Under $14 Rate, Sensitivity Analysis (Augural Standards)</th>
<th>Difference (Projected Additional Penalties If Rate is Increased)</th>
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<tbody>
<tr>
<td>2019</td>
<td>$402,661,295.97</td>
<td>$979,857,995.69</td>
<td>$577,196,699.71</td>
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<td>2020</td>
<td>$424,626,535.48</td>
<td>$1,074,571,984.97</td>
<td>$649,945,449.49</td>
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<td>2021</td>
<td>$296,664,715.42</td>
<td>$858,535,520.00</td>
<td>$561,870,804.58</td>
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<td>2022</td>
<td>$435,761,242.00</td>
<td>$1,161,920,853.58</td>
<td>$726,159,611.58</td>
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<td>2023</td>
<td>$493,426,421.72</td>
<td>$1,323,396,714.35</td>
<td>$829,970,292.63</td>
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<td>2024</td>
<td>$806,729,507.15</td>
<td>$2,108,481,177.18</td>
<td>$1,301,751,670.03</td>
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<td>2025</td>
<td>$1,038,128,818.83</td>
<td>$2,695,259,330.77</td>
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<td>2026</td>
<td>$674,517,279.88</td>
<td>$1,541,685,503.03</td>
<td>$867,168,223.15</td>
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<td>TOTAL</td>
<td>$4,572,515,816.46</td>
<td>$11,743,709,079.56</td>
<td>$7,171,193,263.09</td>
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Note: projected penalties could be offset by the application of credits.

Table 2: Projected Additional Penalties under Proposed Standards If Rate Is Increased

<table>
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<tr>
<th>Model Year</th>
<th>Projected Penalties Under $5.50 Rate, Central Analysis (Proposed Standards)</th>
<th>Projected Penalties Under $14 Rate, Sensitivity Analysis (Proposed Standards)</th>
<th>Difference (Projected Additional Penalties If Rate is Increased)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>$505,612,917.19</td>
<td>$1,269,742,039.02</td>
<td>$764,129,121.83</td>
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<td>2020</td>
<td>$455,216,572.77</td>
<td>$1,131,135,706.97</td>
<td>$675,919,134.20</td>
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<td>2021</td>
<td>$302,262,154.89</td>
<td>$704,833,149.24</td>
<td>$402,570,994.35</td>
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<td>2022</td>
<td>$257,659,098.79</td>
<td>$575,460,915.48</td>
<td>$317,801,816.69</td>
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<td>2023</td>
<td>$188,672,069.76</td>
<td>$384,423,537.48</td>
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<td>2024</td>
<td>$183,904,369.42</td>
<td>$355,182,994.82</td>
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<td>2025</td>
<td>$165,483,877.30</td>
<td>$312,608,273.21</td>
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<td>2026</td>
<td>$103,265,737.66</td>
<td>$188,049,420.14</td>
<td>$84,783,682.48</td>
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<td>TOTAL</td>
<td>$2,162,076,797.79</td>
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<td>$2,759,359,238.58</td>
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Note: projected penalties could be offset by the application of credits.