



ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 82

[EPA-HQ-OAR-2011-0354; FRL-9614-5]

RIN 2060-AQ98

Protection of Stratospheric Ozone: Adjustments to the Allowance System for Controlling HCFC Production, Import, and Export

AGENCY: Environmental Protection Agency [EPA].

ACTION: Proposed rule.

SUMMARY: EPA is proposing to adjust the allowance system controlling U.S. consumption and production of hydrochlorofluorocarbons (HCFCs) as a result of a recent court decision vacating a portion of the rule titled “Protection of Stratospheric Ozone: Adjustments to the Allowance System for Controlling HCFC Production, Import, and Export; Final Rule.” EPA interprets the court’s vacatur as applying to the part of the rule that establishes the company-by-company baselines and calendar-year allowances for HCFC-22 and HCFC-142b. Following the August 5, 2011 interim final rule allocating allowances for 2011, this action proposes to relieve the regulatory ban on production and consumption of these two chemicals following the court’s vacatur by establishing company-by-company HCFC-22 and HCFC-142b baselines and allocating production and consumption allowances for 2012-2014.

DATES: Written comments on this proposed rule must be received by the EPA Docket on or before **[INSERT DATE 30 DAYS AFTER PUBLICATION IN FEDERAL REGISTER]**, unless a public hearing is requested. Any party requesting a public hearing must notify the contact listed below under FOR FURTHER INFORMATION CONTACT by 5 p.m. Eastern Standard Time on **[INSERT DATE 7 DAYS AFTER PUBLICATION IN FEDERAL REGISTER]**. If a public hearing is requested, the hearing would be held on **[INSERT DATE**

15 DAYS AFTER PUBLICATION IN FEDERAL REGISTER] and commenters will have until **[INSERT DATE 45 DAYS AFTER PUBLICATION IN FEDERAL REGISTER]** to submit comments before the close of the comment period. If a hearing is held, it will take place at EPA headquarters in Washington, DC. EPA will post a notice on our website, <http://www.epa.gov/ozone/strathome.html>, announcing further information should a hearing take place.

ADDRESSES: Submit your comments, identified by Docket ID No. **EPA-HQ-OAR-2011-0354**, by one of the following methods:

- www.regulations.gov: Follow the on-line instructions for submitting comments.
- Email: a-and-r-docket@epa.gov
- Mail: Docket # EPA-HQ-OAR-2011-0354, Air and Radiation Docket and Information Center, U.S. Environmental Protection Agency, Mail code: 6102T, 1200 Pennsylvania Ave., NW, Washington, DC 20460.
- Hand Delivery: Docket #EPA-HQ-OAR-2011-0354 Air and Radiation Docket at EPA West, 1301 Constitution Avenue NW, Room B108, Mail Code 6102T, Washington, D.C. 20004. Such deliveries are only accepted during the Docket's normal hours of operation, and special arrangements should be made for deliveries of boxed information.

Instructions: Direct your comments to Docket ID No. **EPA-HQ-OAR-2011-0354**. EPA's policy is that all comments received will be included in the public docket without change and may be made available online at www.regulations.gov, including any personal information provided, unless the comment includes information claimed to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Do not submit information that you consider to be CBI or otherwise protected through www.regulations.gov or e-mail. The www.regulations.gov website is an “anonymous access” system, which means EPA will not

know your identity or contact information unless you provide it in the body of your comment. If you send an e-mail comment directly to EPA without going through www.regulations.gov, your e-mail address will be automatically captured and included as part of the comment that is placed in the public docket and made available on the Internet. If you submit an electronic comment, EPA recommends that you include your name and other contact information in the body of your comment and with any disk or CD-ROM you submit. If EPA cannot read your comment due to technical difficulties and cannot contact you for clarification, EPA may not be able to consider your comment. Electronic files should avoid the use of special characters, any form of encryption, and be free of any defects or viruses. For additional information about EPA's public docket, visit the EPA Docket Center homepage at www.epa.gov/epahome/dockets.htm.

FOR FURTHER INFORMATION CONTACT: Luke H. Hall-Jordan by telephone at (202) 343-9591, or by e-mail at hall-jordan.luke@epa.gov, or by mail at U.S. Environmental Protection Agency, Stratospheric Protection Division, Stratospheric Program Implementation Branch (6205J), 1200 Pennsylvania Avenue, NW, Washington, D.C., 20460. You may also visit the Ozone Protection website of EPA's Stratospheric Protection Division at www.epa.gov/ozone/strathome.html for further information about EPA's Stratospheric Ozone Protection regulations, the science of ozone layer depletion, and related topics.

SUPPLEMENTARY INFORMATION:

Acronyms and Abbreviations. The following acronyms and abbreviations are used in this document.

CAA – Clean Air Act

CAAA – Clean Air Act Amendments of 1990

CFC – Chlorofluorocarbon

CFR – Code of Federal Regulations

EPA – Environmental Protection Agency

FR – Federal Register

HCFC – Hydrochlorofluorocarbon

HVAC – Heating, Ventilating, and Air Conditioning

Montreal Protocol – *Montreal Protocol on Substances that Deplete the Ozone Layer*

MOP – Meeting of the Parties

MT – Metric Ton

ODP – Ozone Depletion Potential

ODS – Ozone-Depleting Substances

Party – States and regional economic integration organizations that have consented to be bound by the *Montreal Protocol on Substances that Deplete the Ozone Layer*

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I. General Information

A. Does This Action Apply to Me?

This rule will affect the following categories:

- Industrial Gas Manufacturing entities (NAICS code 325120), including fluorinated hydrocarbon gases manufacturers and reclaimers;
- Other Chemical and Allied Products Merchant Wholesalers (NAICS code 422690), including chemical gases and compressed gases merchant wholesalers;
- Air-Conditioning and Warm Air Heating Equipment and Commercial and Industrial Refrigeration Equipment Manufacturing entities (NAICS code 333415), including air-conditioning equipment and commercial and industrial refrigeration equipment manufacturers;
- Air-Conditioning Equipment and Supplies Merchant Wholesalers (NAICS code 423730) , including air-conditioning (condensing unit, compressors) merchant wholesalers;
- Electrical and Electronic Appliance, Television, and Radio Set Merchant Wholesalers (NAICS code 423620), including air-conditioning (room units) merchant wholesalers; and
- Plumbing, Heating, and Air-Conditioning Contractors (NAICS code 238220), including Central air-conditioning system and commercial refrigeration installation; HVAC contractors.

This list is not intended to be exhaustive, but rather provides a guide for readers regarding entities likely to be regulated by this action. This table lists the types of entities that could potentially be regulated by this action. Other types of entities not listed in this table could also be affected. To determine whether your facility, company, business organization, or other entity is regulated by this action, you should carefully examine these regulations. If you have questions regarding the applicability of this action to a particular entity, consult the person listed in the **“FOR FURTHER INFORMATION CONTACT”** section.

B. What Should I Consider as I Prepare My Comments for EPA?

1. Confidential Business Information (CBI)

Do not submit confidential business information (CBI) to EPA through www.regulations.gov or e-mail. Clearly mark the part or all of the information that you claim to be CBI. For CBI information in a disk or CD-ROM that you mail to EPA, mark the outside of the disk or CD-ROM as CBI and then identify electronically within the disk or CD-ROM the specific information that is claimed as CBI. In addition to one complete version of the comment that includes information claimed as CBI, a copy of the comment that does not contain the information claimed as CBI must be submitted for inclusion in the public docket. Information so marked will not be disclosed except in accordance with procedures set forth in 40 CFR 2.2.

2. Tips for Preparing Your Comments

When submitting comments, remember to do the following:

- Identify the rulemaking by docket number and other identifying information (subject heading, **Federal Register** date and page number).
- Follow directions. The Agency may ask you to respond to specific questions or organize comments by referencing a Code of Federal Regulations (CFR) part or section number.
- Explain why you agree or disagree with the proposal; suggest alternatives and substitute language for your requested changes.
- Describe any assumptions and provide any technical information and/or data that you used in preparing your comments.
- If you estimate potential costs or burdens, explain how you arrived at your estimate in sufficient detail to allow for it to be reproduced.
- Provide specific examples to illustrate your concerns, and suggest alternatives.

- Explain your views as clearly as possible, avoiding the use of profanity or personal threats.
- Make sure to submit your comments by the comment period deadline identified.

II. Background

EPA is undertaking this rulemaking as a result of the decision issued by the U.S. Court of Appeals for the District of Columbia Circuit (Court) in *Arkema v. EPA* (618 F.3d 1, D.C. Cir. 2010) regarding the December 15, 2009 final rule titled “Protection of Stratospheric Ozone: Adjustments to the Allowance System for Controlling HCFC Production, Import, and Export,” published at 74 FR 66413 (2009 Final Rule). Certain allowance holders affected by the 2009 Final Rule filed petitions for judicial review of the rule under section 307(b) of the Clean Air Act. Among other arguments, the petitioners contended that the rule was impermissibly retroactive because in setting the baselines for the new regulatory period, EPA did not take into account certain inter-pollutant baseline transfers that petitioners had performed during the prior regulatory period.

The Court issued a decision on August 27, 2010, agreeing with petitioners that “the [2009] Final Rule unacceptably alters transactions the EPA approved under the 2003 Rule,” (*Arkema v. EPA*, 618 F.3d at 3). The Court vacated the rule in part, “insofar as it operates retroactively,” and remanded to EPA “for prompt resolution,” (618 F.3d at 10). The Court withheld the mandate for the decision pending the disposition of any petition for rehearing. EPA’s petition for rehearing was denied on January 21, 2011. The mandate issued on February 4, 2011. More detail is provided on the case and EPA’s interpretation of the Court’s decision in section II.D. of this preamble.

EPA addressed the Court’s partial vacatur as it relates to 2011 in an August 5, 2011 interim final rule, “Protection of Stratospheric Ozone: Adjustments to the Allowance System for

Controlling HCFC Production, Import, and Export,” (2011 Interim Final Rule). This proposed rule is a follow-on to that action, and proposes a path forward for the remainder of the regulatory period ending on December 31, 2014.

A. How Does the Montreal Protocol Phase Out HCFCs?

The *Montreal Protocol on Substances that Deplete the Ozone Layer* is the international agreement aimed at reducing and eventually eliminating the production and consumption of stratospheric ozone-depleting substances (ODS). The U.S. was one of the original signatories to the 1987 Montreal Protocol and the U.S. ratified the Protocol on April 12, 1988. Congress then enacted, and President George H.W. Bush signed into law, the Clean Air Act Amendments of 1990 (CAAA), which included Title VI on Stratospheric Ozone Protection, codified as 42 U.S.C. Chapter 85, Subchapter VI, to ensure that the U.S. could satisfy its obligations under the Montreal Protocol. Title VI includes restrictions on production, consumption, and use of ODS that are subject to acceleration if “the Montreal Protocol is modified to include a schedule to control or reduce production, consumption, or use . . . more rapidly than the applicable schedule” prescribed by the statute (CAA §606). Both the Montreal Protocol and the Clean Air Act (CAA) define consumption as production plus imports minus exports.

In 1990, as part of the London Amendment to the Montreal Protocol, the Parties identified HCFCs as “transitional substances” to serve as temporary, lower ozone depletion potential (ODP) substitutes for CFCs and other ODS. EPA similarly viewed HCFCs as “important interim substitutes that will allow for the earliest possible phaseout of CFCs and other Class I substances¹” (58 FR 65026). In 1992, through the Copenhagen Amendment to the Montreal Protocol, the Parties created a detailed phaseout schedule for HCFCs beginning with a cap on consumption for developed countries not operating under Article 5 of the Montreal Protocol (non-Article 5 Parties), a schedule to which the U.S. adheres. The consumption cap for

¹ Class I refers to the controlled substances listed in appendix A to 40 CFR part 82 subpart A. Class II refers to the controlled substances listed in appendix B to 40 CFR part 82 subpart A.

each non-Article 5 Party was set at 3.1 percent (later tightened to 2.8 percent) of a Party's CFC consumption in 1989, plus a Party's consumption of HCFCs in 1989 (weighted on an ODP basis). Based on this formula, the HCFC consumption cap for the U.S. was 15,240 ODP-weighted metric tons (MT), effective January 1, 1996. This became the U.S. consumption baseline for HCFCs.

The 1992 Copenhagen Amendment created a schedule with graduated reductions and the eventual phaseout of HCFC consumption (Copenhagen, 23-25 November, 1992, Decision IV/4). Prior to a later adjustment in 2007, the schedule initially called for a 35 percent reduction of the consumption cap in 2004, followed by a 65 percent reduction in 2010, a 90 percent reduction in 2015, a 99.5 percent reduction in 2020 (restricting the remaining 0.5 percent of baseline to the servicing of existing refrigeration and air-conditioning equipment), with a total phaseout in 2030.

The Copenhagen Amendment did not cap HCFC production. In 1999, the Parties created a cap on production for Non-Article 5 Parties through an amendment to the Montreal Protocol agreed by the Eleventh Meeting of the Parties (Beijing, 29 November – 3 December 1999, Decision XI/5). The cap on production was set at the average of: (a) 1989 HCFC production plus 2.8 percent of 1989 CFC production, and (b) 1989 HCFC consumption plus 2.8 percent of 1989 CFC consumption. Based on this formula, the HCFC production cap for the U.S. was 15,537 ODP-weighted MT, effective January 1, 2004. This became the U.S. production baseline for HCFCs.

To further protect human health and the environment, the Parties to the Montreal Protocol adjusted the Montreal Protocol's phaseout schedule for HCFCs at the 19th Meeting of the Parties in September 2007. In accordance with Article 2(9)(d) of the Montreal Protocol, the adjustment to the phaseout schedule was effective on May 14, 2008.²

² Under Article 2(9)(d) of the Montreal Protocol, an adjustment enters into force six months from the date the depositary (the Ozone Secretariat) circulates it to the Parties. The depositary accepts all notifications and documents related to the Protocol and examines whether all formal requirements are met. In accordance with the procedure in

As a result of the 2007 Montreal Adjustment (reflected in Decision XIX/6), the U.S. and other developed countries are obligated to reduce HCFC production and consumption 75 percent below the established baseline by 2010, rather than 65 percent as previously required. The other milestones remain the same. The adjustment also resulted in a phaseout schedule for HCFC production that parallels the consumption phaseout schedule. All production and consumption for Non-Article 5 Parties is phased out by 2030.

Decision XIX/6 also adjusted the provisions for Parties operating under paragraph 1 of Article 5 (developing countries): (1) to set HCFC production and consumption baselines based on the average 2009-2010 production and consumption, respectively; (2) to freeze HCFC production and consumption at those baselines in 2013; and (3) to add stepwise reductions of 10 percent below baselines by 2015, 35 percent by 2020, 67.5 percent by 2025, and 97.5 percent by 2030 – allowing, between 2030 and 2040, an annual average of no more than 2.5 percent to be produced or imported solely for servicing existing air-conditioning and refrigeration equipment. All production and consumption for Article 5 Parties will be phased out by 2040.

In addition, Decision XIX/6 adjusted Article 2F to allow developed countries to produce “up to 10 percent of baseline levels” for export to Article 5 countries “in order to satisfy basic domestic needs” until 2020.³ Paragraph 14 of Decision XIX/6 notes that no later than 2015, the

Article 2(9)(d), the depositary communicated the adjustment to all Parties on November 14, 2007. The adjustment entered into force and became binding for all Parties on May 14, 2008.

³ Paragraphs 4-6 of adjusted Article 2F read as follows:

“4. Each Party shall ensure that for the twelve-month period commencing on 1 January 2010, and in each twelve-month period thereafter, its calculated level of consumption of the controlled substances in Group I of Annex C does not exceed, annually, twenty-five per cent of the sum referred to in paragraph 1 of this Article. Each Party producing one or more of these substances shall, for the same periods, ensure that its calculated level of production of the controlled substances in Group I of Annex C does not exceed, annually, twenty-five per cent of the calculated level referred to in paragraph 2 of this Article. However, in order to satisfy the basic domestic needs of the Parties operating under paragraph 1 of Article 5, its calculated level of production may exceed that limit by up to ten per cent of its calculated level of production of the controlled substances in Group I of Annex C as referred to in paragraph 2.

5. Each Party shall ensure that for the twelve-month period commencing on 1 January 2015, and in each twelve-month period thereafter, its calculated level of consumption of the controlled substances in Group I of Annex C does not exceed, annually, ten per cent of the sum referred to in paragraph 1 of this Article. Each Party producing one or more of these substances shall, for the same periods, ensure that its calculated level of production of the controlled substances in Group I of Annex C does not exceed, annually, ten per cent of the calculated level referred to in paragraph 2 of this Article. However, in order to satisfy the basic domestic needs of the Parties operating under paragraph 1 of Article 5, its calculated level of production may exceed that limit by up to ten per cent of its calculated level of production of the controlled substances in Group I of Annex C as referred to in paragraph 2.

Parties would consider “further reduction of production for basic domestic needs” in 2020 and beyond. Under paragraph 13 of Decision XIX/6, the Parties will review in 2015 and 2025, respectively, the need for the “servicing tails” for developed and developing countries. The term “servicing tail” refers to an amount of HCFCs used to service existing equipment, such as certain types of air-conditioning and refrigeration appliances.

B. How Does the Clean Air Act Phase Out HCFCs?

The U.S. has chosen to implement the Montreal Protocol phaseout schedule on a chemical-by-chemical basis. In 1992, environmental and industry groups petitioned EPA to implement the required phaseout by eliminating the most ozone-depleting HCFCs first. Based on the available data at that time, EPA believed the U.S. could meet, and possibly exceed, the required Montreal Protocol reductions through a chemical-by-chemical phaseout that employed a “worst-first” approach focusing on certain chemicals earlier than others. In 1993, as authorized by section 606 of the CAA, the U.S. established a phaseout schedule that eliminated HCFC-141b first and would greatly restrict HCFC-142b and HCFC-22 next, followed by restrictions on all other HCFCs and ultimately a complete phaseout (58 FR 15014, March 18, 1993; 58 FR 65018, December 10, 1993).

On January 21, 2003 (68 FR 2820), EPA promulgated regulations (2003 Final Rule) to ensure compliance with the first reduction milestone in the HCFC phaseout: the requirement that by January 1, 2004, the U.S. reduce HCFC consumption by 35 percent and freeze HCFC production. In the 2003 Final Rule, EPA established chemical-specific consumption and production baselines for HCFC-141b, HCFC-22, and HCFC-142b for the initial regulatory

6. Each Party shall ensure that for the twelve-month period commencing on 1 January 2020, and in each twelve-month period thereafter, its calculated level of consumption of the controlled substances in Group I of Annex C does not exceed zero. Each Party producing one or more of these substances shall, for the same periods, ensure that its calculated level of production of the controlled substances in Group I of Annex C does not exceed zero. However:

i. each Party may exceed that limit on consumption by up to zero point five per cent of the sum referred to in paragraph 1 of this Article in any such twelve-month period ending before 1 January 2030, provided that such consumption shall be restricted to the servicing of refrigeration and air conditioning equipment existing on 1 January 2020;

ii. each Party may exceed that limit on production by up to zero point five per cent of the average referred to in paragraph 2 of this Article in any such twelve-month period ending before 1 January 2030, provided that such production shall be restricted to the servicing of refrigeration and air conditioning equipment existing on 1 January 2020.”

period ending December 31, 2009. Section 601(2) states that EPA may select “a representative calendar year” to serve as the company baseline for HCFCs. In the 2003 Final Rule, EPA concluded that because the entities eligible for allowances had differing production and import histories, no single year was representative for all companies. Therefore, EPA assigned an individual consumption baseline year to each company by selecting its highest ODP-weighted consumption year from among the years 1994 through 1997. EPA assigned individual production baseline years in the same manner. EPA also provided for new entrants that began importing after the end of 1997 but before April 5, 1999, the date the advanced notice of proposed rulemaking was published. EPA took this action to ensure that small businesses that might not have been aware of the impending rulemaking would be able to continue in the HCFC market.

The 2003 Final Rule apportioned production and consumption baselines to each company in amounts equal to the amounts in the company’s highest “production year” or “consumption year,” as described above. It completely phased out the production and import of HCFC-141b by granting 0 percent of that substance’s baseline for production and consumption in the table at 40 CFR 82.16. EPA did, however, create a petition process to allow applicants to request small amounts of HCFC-141b beyond the phaseout. The 2003 Final Rule also granted 100 percent of the baselines for production and consumption of HCFC-22 and HCFC-142b for each of the years 2003 through 2009. EPA was able to allocate allowances for HCFC-22 and HCFC-142b at 100 percent of baseline because, in light of the concurrent complete phaseout of HCFC-141b, the allocations for HCFC-22 and HCFC-142b, combined with projections for consumption of all other HCFCs, remained below the 2004 cap of 65 percent of the U.S. baseline.

EPA allocates allowances for specific years; they are valid between January 1 and December 31 of a given control period (i.e., calendar year). Prior to December 15, 2009, EPA had not allocated any HCFC allowances for year 2010 or beyond. The regulations at section 82.15(a) and (b) only addressed the production and import of HCFC-22 and HCFC-142b for the

years 2003-2009. Through the 2009 Final Rule (74 FR 66412), EPA addressed the production and import of HCFC-22 and HCFC-142b for the 2010-2014 control periods. Absent the granting of calendar-year allowances, section 82.15 would have prohibited the production and import of HCFC-22 and HCFC-142b after December 31, 2009. The 2009 Final Rule allowed for continued production and consumption, at specified amounts, of HCFC-142b, HCFC-22, and other HCFCs not previously included in the allowance system, for the 2010-2014 control periods.

In the U.S., an allowance is the unit of measure that controls production and consumption of ODS. EPA establishes company-by-company baselines (also known as “baseline allowances”) and allocates calendar-year allowances equal to a percentage of the baseline for specified control periods. A calendar-year allowance represents the privilege granted to a company to produce or import one kilogram (not ODP-weighted) of the specific substance. EPA allocates two types of calendar-year allowances – production allowances and consumption allowances. “Production allowance” and “consumption allowance” are defined at section 82.3. To produce an HCFC for which allowances have been allocated, an allowance holder must expend both production and consumption allowances. To import an HCFC for which allowances have been allocated, an allowance holder must expend consumption allowances. An allowance holder exporting HCFCs for which it has expended consumption allowances may obtain a refund of those consumption allowances upon submittal of proper documentation to EPA.

Since EPA is implementing the phaseout on a chemical-by-chemical basis, it allocates and tracks production and consumption allowances on an absolute kilogram basis for each chemical. Upon EPA approval, an allowance holder may transfer calendar-year allowances of one type of HCFC for calendar-year allowances of another type of HCFC, with transactions weighted according to the ODP of the chemicals involved. Pursuant to section 607 of the CAA, EPA applies an offset to each HCFC transfer by deducting 0.1 percent from the transferor’s allowance balance. The offset benefits the ozone layer since it “results in greater total reductions

in the production in each year of . . . class II substances than would occur in that year in the absence of such transactions” (42 U.S.C. 7671f).

The U.S. remained comfortably below the aggregate HCFC cap through 2009. The 2003 Final Rule announced that EPA would allocate allowances for 2010-2014 in a subsequent action and that those allowances would be lower in aggregate than for 2003-2009, consistent with the next stepwise reduction for HCFCs under the Montreal Protocol. EPA stated its intention to determine the number of allowances that would be needed for HCFC-22 and HCFC-142b, bearing in mind that other HCFCs would also contribute to total HCFC consumption. EPA noted that it would likely achieve the 2010 reduction step by applying a percentage reduction to the HCFC-22 and HCFC-142b baselines. EPA subsequently monitored the market to estimate servicing needs and market adjustments in the use of HCFCs, including HCFCs for which EPA did not establish baselines in the 2003 Final Rule.

In the 2009 Final Rule, EPA determined both the estimated demand for HCFC-22 during the 2010-2014 regulatory period and the percentage of that estimated demand for which it was appropriate to allocate allowances. As described in section III.B. of this action, EPA determined that the percentage of the estimated demand allocated in the form of allowances should not remain constant from year to year but rather should decline on an annual basis. For 2010, EPA allocated allowances equal to 80 percent of the estimated demand for HCFC-22, concluding that reused, recycled, and reclaimed material could meet the remaining 20 percent. Under the 2009 Final Rule, the percentage of estimated demand for which there was no allocation, and therefore would need to be met through recycling and reclamation, rose from 20 percent in 2010 to 29 percent in 2014 to ensure the U.S. market would have a viable reclamation industry and could meet the 2015 stepwise reduction under the Montreal Protocol.

The determinations EPA made in the 2009 Final Rule regarding (1) the total estimated demand for HCFC-22 in 2010-2014 and (2) the percentage of that estimated demand that EPA

would address through an allowance allocation were not at issue in the litigation and are unaffected by the Court's decision. As such, EPA did not revisit either determination with respect to 2011 in the 2011 Interim Final Rule (76 FR 47451), but rather relied on the existing record from the 2009 Final Rule (74 FR 66412). The 2011 Interim Final Rule established new baselines that (1) credited the 2008 inter-pollutant trades at issue in *Arkema v. EPA* based on the Court's decision and (2) reflected inter-company, single-pollutant baseline transfers that occurred since the 2009 Final Rule was signed. The 2011 Interim Final Rule also (3) allocated HCFC-22 and HCFC-142b allowances for 2011, (4) clarified EPA's policy on all future inter-pollutant transfers, and (5) updated company names.

C. What Sections of the Clean Air Act Apply to This Rulemaking?

Several sections of the CAA apply to this rulemaking. Section 605 of the CAA phases out production and consumption and restricts the use of HCFCs in accordance with the schedule set forth in that section. As discussed in the 2009 Final Rule (74 FR 66416), section 606 provides EPA authority to set a more stringent phaseout schedule than the schedule in section 605 based on an EPA determination regarding current scientific information or the availability of substitutes, or to conform to any acceleration under the Montreal Protocol. EPA previously set a more stringent schedule than the section 605 schedule through a rule published December 10, 1993 (58 FR 65018). Through the 2009 Final Rule, EPA made a further adjustment to the section 605 schedule based on the acceleration under the Montreal Protocol as agreed to at the Meeting of the Parties in September 2007. The more stringent schedule established in that rule is unaffected by the recent Court decision and is therefore still in effect.

Section 606 provides authority for EPA to promulgate regulations that establish a schedule for production and consumption that is more stringent than what is set forth in section 605 if: "(1) based on an assessment of credible current scientific information (including any assessment under the Montreal Protocol) regarding harmful effects on the stratospheric ozone

layer associated with a class I or class II substance, the Administrator determines that such more stringent schedule may be necessary to protect human health and the environment against such effects, (2) based on the availability of substitutes for listed substances, the Administrator determines that such more stringent schedule is practicable, taking into account technological achievability, safety, and other relevant factors, or (3) the Montreal Protocol is modified to include a schedule to control or reduce production, consumption, or use of any substance more rapidly than the applicable schedule under this title.” It is only necessary to meet one of the three criteria. In the 2009 Final Rule, EPA determined that all three criteria had been met with respect to the schedule for phasing out production and consumption of HCFC-22 and HCFC-142b.

As noted in the 2009 Final Rule, while section 606 is sufficient authority for establishing a more stringent schedule than the section 605 phaseout schedule, section 614(b) of the CAA provides that in the case of a conflict between the CAA and the Montreal Protocol, the more stringent provision shall govern. Thus, section 614(b) requires the Agency to establish phaseout schedules at least as stringent as the schedules contained in the Montreal Protocol. To meet the 2010 stepdown requirement, EPA is continuing to allocate HCFC allowances at a level that will ensure the aggregate HCFC production and consumption will not exceed 25 percent of the U.S. baselines. For more discussion of this point, see 74 FR 66416.

Finally, section 607 addresses transfers of allowances both between companies and chemicals. EPA is further clarifying the policy and procedures applicable to permanent inter-pollutant transfers in this action, and is proposing a minor change to the regulations governing inter-pollutant transfers to provide additional clarity to stakeholders.

D. How Does This Action Relate to the Recent Court Decision?

Certain allowance holders affected by the 2009 Final Rule filed petitions for review in the U.S. Court of Appeals for the District of Columbia Circuit. Among other arguments, the petitioners, Arkema, Inc., Solvay Fluorides, LLC, and Solvay Solexis, Inc., contended that the

rule was impermissibly retroactive because in setting the baselines for the new regulatory period, EPA did not take into account certain inter-pollutant baseline transfers that petitioners had performed during the prior regulatory period. The 2011 Interim Final Rule contained a description of those transfers and the EPA approvals of those transfers. As explained in the 2011 Interim Final Rule, the transfers at issue occurred in 2008. Solvay Solexis, Inc. submitted two Class II Controlled Substance Transfer Forms for consumption allowance transfers to Solvay Fluorides, LLC on February 15, 2008, and March 4, 2008. Arkema, Inc. submitted two Class II Controlled Substance Transfer Forms for consumption and production allowance transfers on April 18, 2008. Each company requested EPA's approval to convert HCFC-142b allowances to HCFC-22 allowances, and checked a box on the EPA transfer form indicating that "baseline" allowances would be transferred. EPA sent non-objection notices to both Solvay Solexis, Inc. and Solvay Fluorides, LLC on February 21, 2008 and March 20, 2008 and to Arkema, Inc. in April 2008. The transfer requests and EPA's approvals were attached to petitioners' court filings and are available in the docket for this action.

In the Notice of Proposed Rulemaking titled "Protection of Stratospheric Ozone: Adjustments to the Allowance System for Controlling HCFC Production, Import, and Export," published in the Federal Register at 73 FR 78680 on December 23, 2008 (2008 Proposed Rule), EPA requested comments on establishing baselines for the 2010-2014 regulatory period "with or without" taking into account baseline inter-pollutant transfers made during the 2003-2009 regulatory period (73 FR 78687). The proposed regulatory text accounted for the inter-pollutant transfers discussed above. The increase in HCFC-22 baseline allowances for Arkema, Inc. and Solvay Fluorides, LLC presented in the 2008 Proposed Rule resulted in a larger amount of HCFC-22 baseline allowances overall and therefore a lower percentage of HCFC-22 baselines allocated across the board in each control period. Specifically, the proposed shift resulted in a 16 percent decrease in allocation share for all other HCFC-22 allowance holders, and increases for

the petitioners: Arkema and Solvay. For more detail on the effect of these transfers, see section III.C. of this preamble.

In the 2009 Final Rule, after considering comments, EPA determined that allowing inter-pollutant transfers from one regulatory period to become a part of the baseline in the next regulatory period could undermine the Agency's chemical-by-chemical phaseout approach and could encourage market manipulation. EPA also concluded that section 607 of the CAA was best read as limiting inter-pollutant transfers to those conducted on an annual basis. For these reasons, EPA did not take the 2008 inter-pollutant transfers into account in establishing the baselines for the 2009 Final Rule covering 2010-2014.

The Court issued a decision on August 27, 2010, agreeing with petitioners that “the [2009] Final Rule unacceptably alters transactions the EPA approved under the 2003 Rule” (*Arkema v. EPA*, 618 F.3d at 3). The Court vacated the rule in part, “insofar as it operates retroactively,” and remanded to EPA “for prompt resolution,” (618 F.3d at 10). The Court withheld the mandate for the decision pending the disposition of any petition for rehearing. On November 12, 2010, EPA filed a petition for rehearing, which was denied on January 21, 2011. The mandate issued on February 4, 2011.

Because the Court vacated the rule only in part, without specifying which part or parts were vacated, EPA may adopt a reasonable interpretation of the vacatur's extent. In doing so, EPA is relying on its expertise in administering the HCFC phaseout regulations under Title VI of the CAA. First, EPA notes that the rule contains elements that were not at issue in the litigation. EPA concludes that the vacatur has no effect on allowances for any substances other than HCFC-142b and HCFC-22, since the petitioners' claims and the opinion itself discuss only those two substances. Similarly, EPA concludes that other discrete portions of the rule, such as the provisions on use and introduction into interstate commerce, are unaffected by the vacatur.

The baselines for HCFC-142b and HCFC-22 were clearly at issue in the litigation and indeed are the focus of the Court’s opinion. The Court found that “the Agency’s refusal to account for the Petitioners’ baseline transfers of inter-pollutant allowances in the Final Rule is impermissibly retroactive,” (618 F.3d at 9). Because baseline and calendar year allowances are inextricably linked⁴, EPA has determined that the Court’s vacatur voided the HCFC-22 and HCFC-142b baselines in 40 CFR 82.17 and 82.19 as well as the percentage of baseline allocated for those specific substances in 40 CFR 82.16 for all companies listed in those sections.⁵ This means that until EPA establishes new baselines and allocates new calendar-year allowances, production and import of these two substances is prohibited under 40 CFR 82.15. Recognizing this scenario, on January 28, 2011, EPA sent letters to affected stakeholders informing them that the Agency would exercise enforcement discretion for a limited period provided their production and import did not exceed specified levels and provided that they adhered to additional conditions.

In determining the meaning of the Court’s vacatur, EPA considered whether this interpretation was consistent with what the Court intended and a good fit for the specific circumstances, which include the goals and design of the HCFC allowance program and the basic structure of the 2009 Final Rule. While this interpretation is appropriate in this instance, it is possible that another interpretation would be more appropriate in a case involving a program with different goals, design, or structure.

⁴ The reason baseline and calendar-year allocations are inextricable is because calendar-year allocations are expressed as a percentage of baseline, and the percentage of baseline allocated for a specific substance varies depending on the sum of all company baselines for that substance. The process works as follows for each specific HCFC: First, all the company-specific baselines listed in the tables at 40 CFR 82.17 and 82.19 are added to determine the aggregate amount of baseline production and consumption, respectively. Second, EPA determines how many consumption allowances the market needs for a given year, taking into account recycled, reused, and reclaimed material, and divides that amount by the aggregate amount of baseline allowances. The resulting percentage listed in the table at section 82.16 becomes what each company is allowed to consume in a given control period. For example, a company with 100,000 kg of HCFC-22 baseline allowances would multiply that number by the percentage allowed for 2011 (for example, 32 percent) to determine its calendar-year allowance is 32,000 kg. Historically and in this proposed rule, EPA has allocated the same percentage of baseline allowances for production as it does for consumption.

⁵ The companies’ allocations are inter-related because, as noted in footnote 4, the percentage of baseline allocated varies according to the sum of the company-specific baselines.

EPA's initial response to the Court's partial vacatur was to issue the 2011 Interim Final Rule (76 FR 47451). Through today's notice, EPA is proposing a way to address the Court's decision as it relates to the remainder of the regulatory period ending December 31, 2014. In addition, the Agency is taking comment on whether the vacatur and remand should be interpreted as applying to the 2010 allocations, and if so, how allowances might be adjusted to reflect this. See section III.B.4. for EPA's proposed approach to address 2010 allowances.

E. Comments Relevant to Recovery and Reclamation Issues in This Rulemaking Submitted in Response to the 2011 Interim Final Rule Allocating HCFC Allowances

The EPA received 15 submissions from 13 commenters in response to the 2011 interim final rule. Three comments were received late. Specifically, the Agency had asked for comment on several issues relevant to HCFC-22 supply and the status of recovery and reclamation, including: (1) previous estimates of HCFC-22 demand; (2) the amount of virgin HCFC-22 currently in inventory, available for reuse and/or waiting for import from abroad; and (3) whether there is an overall surplus of the gas. The Agency received comments directly answering these questions, along with other comments that are of relevance to this proposed rulemaking.

EPA is not providing a complete response to comments on the 2011 interim final rule in this preamble; however, EPA is acknowledging the most relevant comments here in order to highlight certain stakeholder concerns regarding the future implementation of the HCFC phaseout program. It is the Agency's responsibility to implement Title VI of the CAA, and its policy objective is to do so in a way that smoothly transitions the U.S. away from HCFCs to non-ODS alternatives. Therefore, EPA is particularly interested in stakeholder input regarding the status of HCFC-22 recovery and reclamation, because this information applies directly to previously-stated policy goals. This section notes the following three issues discussed in comments to the 2011 Interim Final Rule.

1. Supply of HCFC-22

- a. Economic feasibility of reclamation
 - b. Economic incentives for recovery and emissions prevention
 - c. Effect of virgin gas supplies on dry-shipped condensing units
2. Providing Allowances to Reclaimers
3. Providing Allowances to Manufacturers of HCFC Blends

1. Supply of HCFC-22

Nine commenters submitted comments requesting that EPA decrease consumption allowances for 2012-2014. Another company also supported such a decrease, as long as updated market conditions indicate there is a need to do so and all allowance holders are affected proportionally. Commenters suggested that excess supply was due to several factors. Additionally, commenters stated the price of HCFC-22 is low, indicating that virgin supplies are not constrained to the extent that the Agency had anticipated. Some commenters pointed to the unused consumption allowances for 2010 as evidence of over-supply and the need for decreasing the total number of consumption allowances.

- a) *Economic feasibility of reclamation*: Most commenters, many of whom are reclaimers, are concerned about the excess supply and low price of virgin HCFC-22 because this situation makes reclaim financially unfeasible. EPA understands that reclaimers can stay in business only if reclaimed gas can be profitably sold for a price that does not exceed the price of virgin gas, and the price of virgin gas will increase only when the supply has contracted. The Agency promotes reclamation via separation and distillation, which requires very little virgin gas, and recognizes that reclaiming without significant blending further increases the costs of reclamation.
- b) *Economic incentives for recovery and emissions prevention*: Commenters also pointed out that the excess supply and low price of HCFC-22 do not incentivize recovery in general, and likely promote venting and poor maintenance practices. EPA agrees that if

the gas is not valuable then there will be little incentive to reuse it or proactively prevent leaks, in addition to increasing the likelihood of venting (which is illegal under section 608 of the CAA).

- c) *Effect of virgin gas supplies on dry-shipped condensing units*: Two commenters also specifically mention the increased popularity in dry-shipped condensing units that are eventually charged with HCFC-22 as a symptom of this over-supply. The Agency recognizes that the majority of commenters believe that there is an excess of HCFC-22 on the market, which has direct negative consequence for reclaim and recovery, and thus overall ODS emissions. Additionally, EPA has received a petition (included in the docket) from the Carrier Corporation, dated February 3, 2011, concerning dry-shipped HCFC-22 condensing units. EPA is taking comment on whether the installation of dry-shipped HCFC-22 condensing units will affect the phaseout of virgin HCFC-22 production and import.

EPA undertook an analysis to gauge whether there is a surplus of HCFC-22 and, if so, how large the surplus is. A memo in the docket for this rulemaking details EPA's analysis of the HCFC-22 market. The results indicate EPA should consider allocating between 11 to 47 percent less per year between 2012 and 2014 relative to the amounts that appeared in the 2009 Final Rule. Consequently, EPA is proposing in this rulemaking to allocate fewer HCFC-22 consumption allowances than contemplated in the 2009 Final Rule for 2012-2014 in order to promote recovery and reclamation and encourage transition to non-ODS alternatives (see section III.B. and III.C.). As stated in the 2009 Final Rule, "The Agency strongly encourages increased recovery and either recycling or reclamation of HCFC-22...Recovery becomes even more important in light of the 2015 Montreal Protocol phasedown step, when the U.S. HCFC consumption cap is reduced from 3,810 ODP-weighted metric tons to 1,524 ODP-weighted metric tons," (74 FR 66422).

2. Providing Allowances to Reclaimers

Two commenters requested that EPA provide HCFC allowances to certified reclaimers. As explained in the report titled “Analysis of Equipment and Practices in the Reclamation Industry,” which is included in the docket for this rulemaking, “refrigerant reclamation refers to the reprocessing and upgrading of recovered refrigerant through such mechanisms as filtering, drying, distillation and chemical treatment in order to restore the substance to specifications outlined in the Air-Conditioning, Heating, and Refrigeration Institute (AHRI)’s Standard 700-1995.” The commenters argue increasing allocations to reclaimers would increase the amount of reclaimed HCFCs available for purchase. The comments are similar to those submitted prior to the finalization of the 2009 Final Rule, which allocated HCFC allowances for 2010-2014. EPA responded to this request at the time (74 FR 66422; Response to Comments document for the 2008 NPRM), but discusses the issue further here.

The Agency’s primary concern is that providing reclaimers with allowances could foster unsustainable reclamation practices that rely on blending instead of investing in the technology to fully reclaim HCFCs. Based on the phaseout schedule and the decrease in annual allocations, reclamation through separation and distillation will be more important in 2015 when the HCFC-22 allocation must drop by at least 45 percent from 2010 levels and absolutely necessary by 2020, by which time import and production of HCFC-22 must be phased out entirely. In addition, many businesses have either found a way to secure reliable access to virgin HCFCs or have made investments to reclaim HCFCs in a sustainable way, without a direct allocation of allowances.

EPA is also concerned that providing allowances to reclaimers does not address the key structural issue that the industry and the HCFC transition are facing: the price of HCFC-22 is too low to foster reclamation and is not sending the necessary signal to move consumers to non-ODS alternatives. While providing allowances to reclaimers would likely decrease the cost to recover

and reclaim HCFCs, EPA is concerned about what effect providing allowances to reclaimers would have on the market price of HCFC-22. EPA is seeking comment on whether providing allowances to reclaimers would affect the market price of HCFC-22, and what effect that price change would have on the transition away from ODS and the sustainability of the reclamation industry.

EPA continues to believe that allocating fewer allowances is the best way to foster reclamation and recovery. Thus, this proposal does not include an allocation for reclaimers. However, the Agency has included the relevant comments on the Interim Final Rule in the docket for this rulemaking and welcomes further comment on this issue from all interested parties.

3. Providing Allowances to Manufacturers of HCFC Blends

One small business has informed EPA that it cannot acquire either HCFC allowances or the HCFCs it needs to manufacture its HCFC blend (see the letters from ICOR dated May 17, 2011 and September 6, 2011). The company asserts that the cap and trade system is in practice “cap and no trade,” where companies hold onto their allowances, even if they have no intention of using them. The commenter argues that this leads to artificially high prices for HCFCs and HCFC allowances. To remedy this situation, the commenter requests that EPA take unused allowances and provide those allowances to companies that either purchased HCFCs or HCFC consumption allowances in 2008 and 2009. EPA notes that the inability to acquire allowances and/or HCFCs themselves does not appear to be a widespread problem, as numerous companies have made a significant number of transfers over the last year alone, and no other company has indicated it cannot acquire HCFCs. However, EPA is taking comment on whether other companies are having difficulty acquiring HCFCs or HCFC allowances.

Some historical background may help to provide context on how EPA provided flexibility for small businesses when establishing the HCFC allocation system. In the 2003 Final

Rule, published January 21, 2003, EPA assigned individual company baselines by considering the highest production and consumption years for every company between the years 1994-1997—a four year period preceding regulation of the production and import of HCFCs.

“Consumption” is defined by the Clean Air Act as “the amount of that substance produced in the United States, plus the amount imported, minus the amount exported,” (42 USC § 7671). A company had to be manufacturing or importing HCFCs at that time in order to be assigned a baseline. In addition, the EPA provided an exception allowing new entrants provided that they began importing after the end of 1997, but before April 5, 1999, the date the EPA published the advanced notice of proposed rulemaking for the regulatory period 2003-2009. The Agency believed that such small businesses might not have been aware of the impending rulemaking that would affect their ability to continue in the HCFC market.

In addition to the exception for late entrants made in the 2003 Final Rule, there is significant flexibility in the types of transfers companies can conduct. Companies can transfer allowances between companies and, on a temporary basis, between chemicals. A guidance memo, titled “Flexibility in the HCFC Allowance System,” describing this flexibility further is available in the docket and on EPA’s website. Companies can also purchase HCFCs at the wholesale price, which, according to comments on the 2011 Interim Final Rule, has been decreasing. The allocation system in part was established to discourage the use of HCFCs and companies’ continuation in the HCFC market. As stated in the 2003 Final Rule, “businesses that desired an allocation of HCFC allowances would have known the risks of jumping into the business at this juncture” (66 FR 38073). Since that statement more than nine years ago, access to information and knowledge of the risks regarding entering or continuing in the HCFC market have only increased. Furthermore, new entrants have entered the market by purchasing consumption allowances, as EPA predicted they could back in 2003. All entities wishing to enter the HCFC import or production market can continue to purchase allowances for HCFCs.

As the market continues to decrease in size, EPA does not believe that expanding the pool of allowance holders is necessary to prevent disruption of the continued servicing of existing equipment. EPA explored several options that would have expanded the number of allowance holders in the 2008 NPRM (73 FR 78867) and determined the current approach with adjustment for transfers of baseline allowances was appropriate (74 FR 66419; Response to Comments for the 2008 NPRM). Given EPA's intent to phase down, and ultimately phase out, the use of HCFCs, consistent with the requirements of the CAA and obligations under the Montreal Protocol, EPA believes it is justified in continuing to allocate only to those entities who participated in the market at the initial stages, as well as those that have entered the market by purchasing HCFC baseline allowances in accordance with the established practices. EPA does not believe that providing allowances to companies that were not importing or producing HCFCs prior to EPA regulation is appropriate at this time given the disruption it would create to the existing regulatory framework. However, in light of the large number of HCFC allowances that were not used in 2010 and the difficulty at least one company is having in getting HCFCs, EPA welcomes comments on whether an allocation to manufacturers of HCFC blends who are having difficulty acquiring HCFCs or HCFC allowances would be appropriate. Commenters supporting such an allocation should consider (1) how EPA might determine the total amount of such an allocation, (2) how EPA might determine which companies should receive allowances, (3) how EPA would verify that allowance holders are refusing to sell HCFCs and HCFC allowances, (4) how EPA might set baselines for these companies, (5) whether EPA should provide allowances in addition to the amount proposed in this rule, or as part of the amount proposed in this rule, and (6) how providing allowances to an additional set of companies would affect the U.S. transition away from HCFCs.

III. How Does EPA Propose to Allocate HCFC-22 and HCFC-142b Allowances for 2012-2014?

EPA is proposing to continue the system established in previous rulemakings (68 FR 2820, 74 FR 66412, 76 FR 47451) to address HCFC production and import in the U.S. The process works as follows for each specific HCFC: First, all the company-specific baselines listed in the tables at 40 CFR 82.17 and 82.19 are added to determine the aggregate amount of baseline production and consumption, respectively. Second, EPA determines how many consumption allowances the market needs for a given year, taking into account recycled, reused, and reclaimed material, and divides that amount by the aggregate amount of baseline allowances. The resulting percentage listed in the table at section 82.16 becomes what each company is allowed to consume in a given control period. For example, a company with 100,000 kg of HCFC-22 baseline allowances would multiply that number by the percentage allowed for the year (for example, 32 percent in 2011) to determine its calendar-year allowance is 32,000 kg. Historically, EPA has allocated the same percentage of baseline allowances for production as it does for consumption.

Specifically, EPA is proposing to (1) establish 2012-2014 company-by-company consumption and production baselines for HCFC-22 and HCFC-142b in the tables at 40 CFR 82.17 and 82.19 identical to the baselines established in the 2011 Interim Final Rule (76 FR 47468), (2) allocate company-by-company production and consumption allowances for these substances for 2012-2014 by establishing percentages of production and consumption baselines in the table at section 82.16 and (3) revise the regulatory text at 40 CFR 82.23 to make the procedure for all future inter-pollutant transfers clear. EPA will address the allocations for the control periods beyond 2014 at a later date. All aspects of the 2009 Final Rule promulgated on December 15, 2009 (74 FR 66412) that are not addressed in this proposed rule are unchanged.

Additionally, EPA notes that beginning January 1, 2015, section 605 of the CAA prohibits the use and introduction into interstate commerce of any HCFC unless it “(1) has been used, recovered and recycled; (2) is used and entirely consumed (except for trace quantities) in

the production of other chemicals; or (3) is used as a refrigerant in appliances manufactured prior to January 1, 2020.” In addition, EPA’s regulations at 40 CFR 82.15 restrict use and introduction into interstate commerce of HCFC-141b, HCFC-142b, and HCFC-22 beginning in 2010, with limited exceptions. If entities will need HCFCs in 2015 and beyond for uses other than the exemptions contained in section 605, they should contact EPA prior to 2013. Entities should understand that the statutory prohibition in section 605 generally will prevent EPA from accommodating such needs, with the possible exception of de minimis quantities.

A. What Baselines Does EPA Propose to Use for HCFC-22 and HCFC-142b Allowances?

In the 2009 Final Rule, EPA presented the allocation structure for HCFC-22 and HCFC-142b for the control periods 2010-2014: allocating a percentage of the baseline production and consumption allowances. The rationale for this system is discussed further at 74 FR 66412. The Court found no fault with EPA’s framework for allocating HCFCs in the 2009 Final Rule, except the aspects of the rule deemed to be retroactive, i.e., not taking into account inter-pollutant baseline transfers that occurred in the prior regulatory period in establishing company-specific baseline allowances. To address this, EPA is proposing to establish baselines for 2012-2014 identical to the HCFC-22 and HCFC-142b baselines established in the 2011 Interim Final Rule (76 FR 47451) that reflect past inter-pollutant baseline transfers deemed permanent by the Court.

EPA cited several reasons why it would prefer to set baselines without taking into account inter-pollutant transfers in the 2009 Final Rule (74 FR 66420), the Response to Comments document included in the record for that rulemaking, and the 2011 Interim Final Rule (76 FR 47451). However, EPA is recognizing the 2008 transfers in establishing the baselines through 2014 in accordance with the Court’s decision. The Agency is providing advance notice that for the 2015-2019 regulatory period, it would consider using more recent production and import data than the 1994-1997 data used to set baselines for the first time in the 2003 Final

Rule. The Agency is particularly interested in stakeholders' views on whether there would be an environmental benefit to doing so.

B. What Factors Did EPA Consider in Proposing Allocation Amounts for HCFC-22 and HCFC-142b?

In the 2009 Final Rule, EPA decided to allocate HCFC-22 and HCFC-142b allowances based on the projected servicing needs for those compounds, taking into account the amount of those needs that can be met through recycling and reclamation. EPA is not changing that approach in this proposed rulemaking and continues to believe it is necessary to promote use of reused, recycled, and reclaimed material in anticipation of the 2015 phasedown step. However, EPA is proposing to allocate fewer consumption allowances for HCFC-22 relative to the 2009 Final Rule based on analysis of updated market conditions. The proposed allocation and the supporting documentation are discussed in section III.B.2. Regardless of the extent to which the total number of consumption allowances differs from the total number allocated in the 2009 Final Rule, the specific amounts allocated per company will be different than the 2009 Final Rule. In accordance with the Court's decision in *Arkema v. EPA*, the Agency is proposing to reflect the 2008 inter-pollutant transfers in companies' baselines, and EPA therefore needs to allocate a different percentage of company baselines in order for the aggregate number of annual HCFC consumption allowances to be less than (or equal to) the 2009 Final Rule. EPA is also proposing to allocate different percentages of baseline for annual consumption than for annual production (described in the rest of the preamble as "decoupling").

Separate from the proposed allocation change, EPA is taking comment on whether or not to provide more HCFC-22 and/or HCFC-142b consumption and/or production through this rulemaking than it did in the 2009 Final Rule as a result of the unforeseen circumstances presented by the Court's decision in *Arkema v. EPA*. While the Agency's preference is not to provide recoupment, EPA is considering an approach to the 2013 allocation or 2013 and 2014

allocations that could allocate allowances to account for lost opportunities to produce and consume in 2010, given that 2010 allowance levels were based on baselines that are inconsistent with the Court's finding (section III.B.4. discusses this in more depth).

1. How Important is HCFC-22 Relative to HCFC-142b for Servicing Existing Equipment?

HCFC-22 is the most widely-used HCFC. The demand for its use in servicing existing equipment was the primary factor affecting EPA's allocation of production and consumption allowances of HCFCs for the current regulatory period. Prior to issuing the 2009 Final Rule and the 2009 *Servicing Tail Report*, EPA issued and sought comment on three versions of a draft report analyzing servicing demand for the HCFC appliances in the U.S. refrigeration and air-conditioning sector projected to be in service from 2010-2019 (all versions available at Docket EPA-HQ-OAR-2008-0496: published November 4, 2005 at 70 FR 67172; released at a stakeholder meeting on September 29, 2006; published December 23, 2008, with 2008 Proposed Rule). The *Servicing Tail Report* focuses on air-conditioning and refrigeration appliances because such equipment represents the bulk of the servicing need. In addition, the servicing exception to the use ban for HCFC-22 and HCFC-142b pertains only to use as a refrigerant in such equipment. Under 40 CFR 82.15(g) nearly all other uses of newly produced material for these two HCFCs were banned effective January 1, 2010. HCFC-142b has primarily been used as a foam blowing agent, a use that was prohibited beginning in 2010 (40 CFR 82.15(g)). The projected servicing demand for existing refrigeration equipment containing HCFC-142b is extremely low: approximately 100 MT. EPA therefore focused the analysis on HCFC-22 because that compound is the predominant HCFC in the installed base of air-conditioning and refrigerant equipment for which servicing in the U.S. will likely continue.

As discussed in the 2009 Final Rule, the majority of HCFC-22 equipment that is projected to be in use from this point onward will be air-conditioning applications, including

window units, packaged terminal units, unitary air-conditioning, chillers, dehumidifiers, water and ground source heat pumps, and motor vehicle air-conditioning in buses and trains. The report projected that approximately 145.6 million units of all such types of HCFC-22 air-conditioning equipment were in use in 2010, decreasing by about 41 percent in 2015 and 86 percent in 2020. In addition, approximately 3.8 million units of HCFC-22 refrigeration equipment were in use in 2010. The installed base of HCFC-22 refrigeration equipment is projected to decrease from 2010 levels by about 44 percent in 2015 and 75 percent in 2020. For more on the *Servicing Tail Report*, see 74 FR 66424 and the *Servicing Tail Report* included in the docket.

EPA estimates that the servicing need for HCFC-22 will continue to decrease each year, and consistent with the 2009 Final Rule, EPA proposes to account for this by allocating a smaller amount for 2012 than was allocated for 2011. This approach is described in section III.B.3. of this action, along with more recent market data on the need for, and availability of, HCFC-22.

2. Can Servicing Needs be Met with Virgin and Recovered Material?

In the 2009 Final Rule, the Agency recognized that servicing demand can be met with a combination of newly-manufactured or imported HCFCs (virgin HCFCs) and HCFCs that have been recovered and either reused, recycled or reclaimed. Therefore, EPA did not anticipate that virgin HCFC-22 would need to be produced or imported to meet the entire HCFC-22 servicing demand in each year between 2010 and 2014. The *Servicing Tail Report* analyzes various scenarios regarding reclamation. EPA continues to believe that reused, recycled, and reclaimed material can help meet HCFC-22 servicing needs and is therefore proposing to maintain the same approach to meeting servicing needs at this time. While the Agency is not changing its approach, EPA believes that the percentage of overall demand that can be met by reclaimed material is higher than originally projected. EPA is taking comment on the new projections of reclaim capabilities outlined in the memo included in the docket for this rulemaking titled, “Analysis of

HCFC-22 Servicing Needs in the U.S. Air Conditioning and Refrigeration Sector: Additional Considerations for Estimating Virgin Demand,” (Adjustment Memo).

3. How Would the Allocation Decline?

As explained in the preamble to the 2009 Final Rule, without year-to-year reductions in the allocations for virgin HCFC-22, the HCFC-22 market could be oversaturated, and the contribution of reused, recycled, and reclaimed refrigerant would decrease, both in the total number of kilograms and as the proportion of overall need.

EPA is particularly concerned with encouraging a smooth transition to the 2015 stepdown. At that date, the U.S. must meet a 90 percent reduction below the baseline for all HCFCs. EPA’s *Servicing Tail Report* shows that even a 20 percent recovery rate would be insufficient to meet the demand for HCFC-22 in 2015. As shown in Table 4-5 in the report, demand for HCFC-22 in 2015 was projected to be 38,800 MT while the cap for all HCFCs equates to 27,709 MT of HCFC-22 (assuming no allocation for any other HCFCs). In developing the 2009 Final Rule, EPA calculated that to meet the total demand in 2015, the recovery rate would have to increase to 26 percent (representing 29 percent of total servicing demand).

EPA determined in the 2009 Final Rule a level of allocation projected to meet the servicing demand over 2010-2014. In addition to EPA’s request for comment on whether to address or not address 2010 allowances (see section III.B.4.), the Agency is proposing to establish lower overall HCFC-22 consumption allocation levels for 2012-2014 than those the Agency determined were appropriate in the 2009 Final Rule. The Adjustment Memo in the docket to this rulemaking discusses recent data and stakeholder feedback that indicate that demand for virgin HCFC-22 is lower than originally projected, and that the number of consumption allowances should be 11 to 47 percent lower relative to the 2009 Final Rule. Specifically, the memo examines (1) surplus inventory of HCFC-22 from past years, (2) reclaimer capacity, and (3) increased recovery and re-use of HCFC-22 from the large retail food

sector. EPA is taking comment on the analysis, supporting data, and assumptions presented in the Adjustment Memo.

Since EPA is continuing to allow the use of existing HCFC-22 appliances manufactured prior to January 1, 2010, reused, recycled, and reclaimed HCFC-22 will become more valuable as the phaseout progresses. The demand for HCFC-22 to service existing equipment will provide an economic incentive to increase the quantities of recovered HCFC-22 available for reuse, recycling, and reclamation. Therefore, the Agency believes that establishing a lower aggregate HCFC-22 consumption allocation for 2012-2014 than in the 2009 Final Rule is not only justified by decreased demand and the availability of surplus inventory from past years, but also because a lower virgin supply will further incentivize recovery and reclamation. The docket for the 2009 Final Rule (EPA-HQ-OAR-2008-0496) provides information on EPA's past assumptions regarding the availability of reused, recycled and reclaimed HCFC-22 to meet servicing demand, while the Adjustment Memo to this docket discusses recent changes in the HCFC-22 market.

In the 2009 Final Rule, EPA determined it was appropriate to establish an annual step-down with the assumption that the total demand to be met from recovered HCFC-22 would equal 12,500 MT each year. This is approximately the amount EPA projected would be needed to meet the servicing demand in 2015. Using this approach, the aggregate allocation for consumption would equal approximately 40,700 MT in 2012, and decrease each year after, as shown in Table 1. These values are derived by subtracting 12,500 MT from the estimated servicing demand each year. However, in light of changes to both virgin demand and reclaimer capabilities, EPA believes that the portion of demand met by recovered HCFC-22 could range from 12,500 MT to 19,700 MT each year (see the Adjustment Memo), and that reduced demand, along with surplus inventory estimates, warrant a significantly lower total allocation for 2012, 2013 and 2014. While Table 1 shows how the total allocation in the 2009 Final Rule was determined, the Agency is now proposing to allocate between 11 and 47 percent fewer consumption allowances for 2012

to 2014. EPA will not issue HCFC-22 and HCFC-142b allowances for 2015 or later until a future rulemaking.

Table 1 –2009 Final Rule Projection of Amount of Annual HCFC-22 Demand to be Met by Allocated and Recovered Material

	2012	2013	2014
Estimated Demand (MT)	53,200	48,400	43,600
Recovered Amount (MT)	12,500	12,500	12,500
Total Allocation (MT)	40,700	35,900	31,100

As the total servicing demand decreases, assuming the supply of recovered HCFCs stays at a constant level results in recovered material comprising a greater proportion of the total demand each year. Using this assumption and the projected demand level from the 2009 Final Rule, the percentage of the total servicing demand to be met with recovered material would rise from 21.6 percent of total demand in 2011 to 28.7 percent in 2014, though the total amount of recovered material needed would remain at 12,500 MT for each year. In the Adjustment Memo, EPA considers two HCFC-22 allocation scenarios for each year. The larger allocation scenario considers: (1) an annual surplus inventory drawdown of 6,000 MT; (2) the same 12,500 MT of annual recovery and reclamation used in the 2009 Final Rule and (3) a minimum expected recovery and reuse rate of 20 percent of total demand in the large retail food sector each year. The smaller allocation scenario considers: (1) the same surplus inventory drawdown of 6,000 MT; (2) an annual reclamation amount of 19,700 MT, or 35 percent of estimated servicing demand in 2012, and (3) a maximum expected recovery and reuse rate of 70 percent of total demand in the large retail food sector. These two scenarios indicate that EPA should decrease annual allocations relative to the 2009 Final Rule by between 11 and 47 percent each year—with the exact range varying slightly year by year. As summarized in Table 4 of the Adjustment Memo, the Agency is proposing to issue HCFC-22 consumption allowances as follows: between 25,100 and 36,200 MT in 2012 (a decrease of 11 to 38 percent); between 20,800 and 31,400 MT in 2013 (a decrease of 13 to 42 percent) and between 16,400 and 26,300 MT in 2014 (a decrease

of 15 to 47 percent). As percentages of baseline, these proposed amounts correspond to allocations of 17.7 to 25.5 percent in 2012, 14.7 to 22.1 percent in 2013, and 11.6 to 18.5 percent in 2014.

In summary, the Agency is proposing to reduce consumption allowances relative to the 2009 Final Rule. The Agency is also proposing to decouple production allowances and allocate either the same amount of production as in the 2009 Final Rule or the same percentage of baseline as in the 2009 Final Rule. A memo included in the docket for this rulemaking provides an overview of the various scenarios (see the Overview Memo).

4. How Will EPA Address the Court's Decision with Regard to 2010 HCFC Allowances?

EPA's first step in addressing the Court's decision was to establish baselines for 2011 that reflected the 2008 inter-pollutant transfers that were at issue in the litigation and to allocate allowances for 2011 as a percentage of those baselines. As noted in the Interim Final Rule (76 FR 47451), EPA interprets the Court's decision as applying, at a minimum, to the baseline and calendar-year allowances for 2011-2014. The Agency is taking comment on whether to interpret the decision as applying to the 2010 allocation, and if so, how allowances in future control periods might be adjusted to reflect this. The petitioners in the case, Arkema and Solvay, have stated that EPA should "restore the allowances of which Arkema and Solvay were deprived unlawfully in 2010," or "provide a method to compensate Arkema and Solvay for year 2010 allowances that rightfully should have been available" (February 4, 2011 letter to Drusilla Hufford, EPA, from William Hamel, Arkema, and March 7, 2011 letter to Drusilla Hufford, EPA, from Don Magid, Solvay, both available in the docket for this rulemaking). As a result of these requests, EPA is considering whether to grant additional allowances for all companies that would have received higher allocations in 2010 if the 2008 inter-pollutant transfers had been reflected in the baselines published in the 2009 Final Rule. The companies affected, and the

additional allowances they would have received (hereinafter described as “recoupment allowances”), are included in Table 2, below.

Table 2 – Proposed Recoupment Allowances

Company	Chemical	Consumption (kg)	Production (kg)
Arkema	HCFC-22	4,749,692	4,611,848
DuPont	HCFC-142b	2,339	0
Honeywell	HCFC-142b	58,291	107,097
Solvay Fluorides	HCFC-22	1,157,895	0
Solvay Solexis	HCFC-142b	0	289,800

EPA is taking comment on four possible options with regard to this issue: (1) providing recoupment allowances in 2013 *in addition* to the aggregate level of production and consumption specified in the 2009 Final Rule; (2) allocating recoupment allowances over two years (2013-2014) *in addition* to the aggregate level of production and consumption specified in the 2009 Final Rule; (3) allocating recoupment allowances *from* the aggregate level of production and consumption specified in the 2009 Final Rule over two years (2013-2014); and (4) treating missed allowances from 2010 as impossible to recoup. EPA is also taking comment on (1) whether it should provide recoupment for HCFC-22 and HCFC-142b, or just HCFC-22 allowances, and (2) whether it should provide recoupment for production and consumption, or just consumption allowances. EPA is seeking comment on these two points because (1) the Court’s decision only addresses the losses of the petitioners Arkema and Solvay, who appear to be most concerned with recoupment for HCFC-22 allowances, (2) neither of the petitioners has specifically requested recoupment for production allowances, and (3) while Solvay Solexis could receive recoupment allowances for HCFC-142b production (see Table 2), it would receive nearly ten times more HCFC-142b production allowances under this proposed rule absent recoupment than the 2009 Final Rule, which could avoid the need for HCFC-142b production allowance recoupment. When considering the options included in this section, commenters should consider options 1-4 providing or not providing recoupment for HCFC-142b and providing or not

providing recoupment for production allowances. Additionally, EPA recognizes that any option to provide recoupment in addition to the aggregate level of consumption is, to some extent, in tension with the proposal to decrease the aggregate allocation and might impede the intended effects of allocating fewer HCFC-22 allowances.

If EPA provides recoupment, the Agency is proposing to address this issue *in addition to* the proposed establishment of baselines reflecting the Court's decision on past inter-pollutant transfers, and the proposed allocation of HCFC-22 production and consumption allowances. Under each of these approaches, the U.S. would still be well below its HCFC cap under the Montreal Protocol. EPA is not proposing a recoupment option that would begin in 2012 because waiting until 2013 provides companies that may receive recoupment allowances time to prepare for the increase in calendar-year allowances.

Under option 1, each company would get the percentage of baseline listed in proposed section 82.16(a)(1). The companies listed in Table 2 would receive an additional one-time allocation in 2013 of the amount specified in the table. Granting recoupment allowances under option 1 would add 329 ODP-weighted MT of allowed HCFC consumption and 280 ODP-weighted MT of allowed HCFC production in 2013. The result is an increase in allowed HCFC consumption and production (ODP-weighted) by 17 percent and 15 percent, respectively, beyond that allowed in the 2009 Final Rule, assuming constant levels of overall consumption and production. While the number of allowances would be higher in 2013 than envisioned in the 2009 Final Rule, it would not increase environmental damage during the regulatory period from 2010-2014 relative to the projections in the 2009 Final Rule: approximately 425 ODP-weighted MT of HCFC consumption allowances and approximately 930 ODP-weighted MT of HCFC production allowances were not used by allowance holders in 2010 (source: EPA's ODS Tracking System). This one-year increase in allowances in 2013 would keep the aggregate level of consumption and production for 2010-2014 below the level envisioned in the 2009 Final Rule.

Since the 2014 allocation would be unchanged from (or less than) the 2009 Final Rule level, option 1 could be preferable to a two-year recoupment option because it could smooth the transition to the 2015 stepdown under the Montreal Protocol. Option 1 would also restore the companies' lost opportunity to produce or consume in 2010 without reducing the amount of allowances other companies receive further.

Option 1 is not without disadvantages. First, it would increase the number of allowances available for use in 2013, which might impede the development of a viable reclamation industry and hamper the transition to the 2015 stepdown. Second, this option significantly increases the number of allowances in 2013 for certain companies receiving recoupment, meaning that those companies arguably could have difficulty selling the full amount of HCFC-22 produced or imported with allowances that year. However, if companies receiving extra allowances all in one year cannot sell the full amount in that year, they may store produced and/or imported material for sale or use in later years, or sell the allowances to other producers or importers for use in that same year. Third, companies not receiving recoupment would have the same number of allowances as they would under a no-recoupment scenario, but they would have a smaller share of all allowances allocated under this option compared to a no recoupment scenario.

Under the second option, recoupment allowances would be provided over two years (2013-2014) instead of one year as in option 1. Each entity listed in Table 2 would receive half of the amount listed in the table in 2013 and 2014 in addition to the percentage of baseline as listed in proposed section 82.16(a)(1). Option 2 would increase allowed consumption and production relative to the 2009 Final Rule levels by 8 percent in 2013 and by 10 percent and 9 percent, respectively, in 2014. This options shares some of the advantages of option 1: (1) the amount allocated between 2010 and 2014 is still below the amount envisioned as total usage during that period in the 2009 Final Rule when taking into consideration the number of allowances not used in 2010, and (2) it restores the companies' lost opportunity to produce or

consume in 2010 without reducing the amount of allowances other companies would receive under no recoupment.

A significant downside to this option is that it increases the number of allowances available in 2013 *and* 2014, and may hamper the smooth transition in 2015 to 10 percent of baseline under the Montreal Protocol, since the decrease between the 2014 allocation and 2015 allocation for HCFC-22 would be larger under this option than in option 1. Also, like option 1, companies who would not receive recoupment would have a smaller share of all allowances compared to a no recoupment scenario.

Under option 3, EPA could provide recoupment allowances as part of the aggregate allocation level. The letters included in the docket from Don Magid, Solvay Fluorides, to Drusilla Hufford, EPA, dated March 7, 2011, and from William Hamel, Arkema, to Drusilla Hufford, EPA, dated February 4, 2011, express support for this option. One way to do this would be to allocate HCFC-22 allowances (both recoupment for 2010 and their allotted percentage of baseline for 2013 and 2014) to the companies listed in Table 2, and then allocate the remainder to all other allowance holders by revising the percentage of baseline allocated. A memo to the docket explains this approach in more detail (see “Memo: Recoupment Options”). Providing all recoupment from the allocated level in the 2009 Final Rule (or a lesser amount) in one year is not possible because there are too few allowances to provide recoupment and regular allowances for HCFC-142b. Additionally, the memo explains that if the Agency provides recoupment for HCFC-142b production allowances, the Agency will have no choice but to increase the aggregate number of production allowances.

The primary benefit of option 3 is that it keeps the overall consumption allocation at the same level (or less) as that in the 2009 Final Rule, and should therefore not negatively affect the transition to the 2015 stepdown or recovery and reclamation. However, for the years during which recoupment occurred, companies not receiving recoupment under this option would

receive fewer allowances, and a smaller share of overall allowances, than under the other recoupment scenarios. The amount of allowances received by these companies also would be smaller than the amount they would have received under the 2008 Proposed Rule, and would decrease further if EPA decides to allocate less than the amounts in the 2009 Final Rule.

EPA is also considering option 4, under which the Agency would not provide recoupment allowances. As part of the evaluation of this option, EPA is considering the effect of the Court's partial vacatur and remand on the 2010 allocation. The Court issued its decision on August 27, 2010, but stayed the mandate pending resolution of any petition for rehearing. The 2009 Final Rule remained in effect during 2010. EPA's petition for rehearing was denied on January 21, 2011, and the mandate issued on February 4, 2011. While EPA has not interpreted the vacatur as nullifying 2010 allowances, EPA is considering whether to address the 2010 allocation on remand even if the partial vacatur does not apply to 2010.

EPA notes that all 2010 allowances expired on December 31, 2010 and therefore have no value in later years. See 74 FR 66415 ("EPA allocates allowances for specific years; they are valid between January 1 and December 31 of a given control period (*i.e.*, calendar year)"). 40 CFR Part 82 also makes it clear that allowances are tied to a specified control period. Section 82.16(a) states that "In each control period...each person is granted the specified percentage of baseline production allowances and baseline consumption allowances for the specified class II controlled substances apportioned under §§82.17 and 82.19." Furthermore, the definitions of unexpended allowances in section 82.3 specify that allowances are valid for specific control periods. The protection of stratospheric ozone allowance system at 40 CFR Part 82 does not allow banking or borrowing of allowances. Since the Court's mandate issued on February 4, 2011, no company could have possessed 2010 allowances on the date the mandate issued, because all unexpended 2010 allowances had already expired.

EPA seeks comment on whether it is possible to put the petitioners in *Arkema v. EPA* in the position they would have been in had they received the full amount of 2010 allowances to which they believed they were entitled. If EPA were to grant the petitioners additional 2010 allowances now, those allowances would have no value, as 2010 allowances can be expended only in 2010. The three recoupment options discussed above assume that by providing recoupment allowances in 2013, or 2013-2014, EPA can make up for the lost opportunity to provide or consume a specific amount of HCFC, which might either have been sold during 2010 or placed in inventory for sale during a subsequent year. Advantages of not providing recoupment allowances include (1) not increasing the amount of HCFC-22 on the market, which has advantages for the environment, public health, and for fostering a viable reclamation industry in advance of the 2015 stepdown, and (2) not decreasing the actual number or share of allowances for other allowance holders. Given the considerations above, including the structure of the program and the policy advantages noted, EPA's preference is not to provide recoupment allowances.

If EPA decides to provide recoupment, the Agency prefers option 1 because it has a minimal impact on the 2015 stepdown to 10 percent of baseline, addresses the Court's decision in the simplest manner, and does not further decrease the number of allowances companies would have received had EPA taken the 2008 inter-pollutant transfers into account in its 2009 Final Rule. EPA welcomes comment on the matter. A memo in the docket for this rulemaking shows how EPA would effectuate each of the options in the regulatory text at 40 CFR Part 82 (see "Memo: Recoupment Options"). To effectuate this option, the regulatory text at 40 CFR 82.16(a) would be amended to add paragraph (a)(2) as set forth in the regulatory text of this proposed rule.

Any recoupment allowances allocated for 2013 or 2014 would function in the same way as other calendar-year allowances: for example, they could be used only in the calendar year for which they were issued and would expire at the end of that calendar year.

C. How Much HCFC-22 and HCFC-142b Would be Allocated in 2012-2014?

As discussed previously, EPA is proposing to revise the tables in 40 CFR 82 that together specify the production and consumption allowances available during specified control periods. The tables at sections 82.17 and 82.19 apportion baseline production allowances and baseline consumption allowances, respectively, to individual companies for specific HCFCs during a particular regulatory period. Complementing these tables, the table at section 82.16 lists the percentage of baseline allocated to allowance holders for specific control periods. EPA is proposing to (1) retain this framework of complementary tables, (2) respond to the Court's remand by establishing baselines for 2012-2014 identical to those established in the 2011 Interim Final Rule (76 FR 47451), and (3) grant allowances based on percentages of baselines in a manner that achieves the 2010 phaseout step and lays the groundwork for the next phaseout step in 2015 (which could mean fewer 2012-2014 consumption allowances with or without fewer 2012-2014 production allowances as compared to the 2009 Final Rule). EPA has published an Overview Memo in the docket clarifying how the various options presented in this proposed rule might work separately or in combination.

In the 2009 Final Rule, 34.1 percent, 30.1 percent, and 26.1 percent of each company's HCFC-22 baselines were allocated for 2012, 2013, and 2014, respectively. As discussed above, EPA interprets the Court's vacatur as applying to the HCFC-22 and HCFC-142b allocations for each of these years. EPA intends to put in place new allocations through this rulemaking. EPA is proposing, at maximum, to allocate 28.7 percent, 25.3 percent and 21.9 percent of the HCFC-22 baseline for 2012, 2013 and 2014 consumption, respectively. EPA is also proposing an 11 to 47 percent reduction to this maximum amount for each year, which would correspond to annual

consumption allowances of 17.7 to 25.5 percent of baseline in 2012, 14.7 to 22.1 percent in 2013, and 11.6 to 18.5 percent in 2014. The reduction could apply to consumption only or to consumption and production, if EPA chooses not to decouple consumption and production allowances.

The percent allocation for HCFC-142b was 0.47 percent of baseline in the 2009 Final Rule for 2012-2014. EPA is proposing to allocate 4.9 percent of HCFC-142b baseline for 2012-2014. As a reminder, the percentages allocated for 2013 and 2014 could be different if EPA decides to provide recoupment.

The 2009 Final Rule, which did not include the 2008 transfers of HCFC-142b to HCFC-22 baseline allowances in the baselines for the next regulatory period, had a total HCFC-22 consumption baseline of 119,384 MT. EPA is reflecting the baseline transfers in section 82.17 and 82.19 in accordance with the Court's decision. As a result, the aggregate HCFC-22 consumption baseline has increased to 141,865 MT. Since the aggregate HCFC-22 baseline is now higher due to the increase in the number of HCFC-22 baseline allowances for Arkema, Inc. and Solvay Fluorides, LLC, EPA is allocating a smaller percentage of the company-specific baselines (even without the proposed decrease in allocation) than in the 2009 Final Rule to achieve the same total number of HCFC-22 allowances. Thus, 40,700 MT of HCFC-22 consumption (the aggregate allocation amount for 2012 in the 2009 Final Rule) is equal to 34.1 percent of 119,384 MT (baseline) of HCFC-22 in the 2009 Final Rule, and 28.7 percent of 141,865 MT (baseline) for 2012 in this proposed rule. An 11 to 47 percent reduction in consumption allowances would change the percentage of baseline allocated to between 17.7 and 25.5 percent for 2012. The aggregate HCFC-22 production baseline is also increasing, from 110,619 MT in the 2009 Final Rule to 129,093 MT, to reflect Arkema, Inc.'s transfer of HCFC-142b baseline production allowances to HCFC-22 baseline production allowances.

The opposite is true for HCFC-142b, which had a larger aggregate consumption baseline in the proposed rule (21,089 MT), but now has a smaller consumption baseline (2,047 MT) since EPA is accounting for inter-pollutant transfers from HCFC-142b to HCFC-22. Thus, 100 MT of HCFC-142b consumption allowances (the aggregate allocation amount in each year between 2012 and 2014) is equal to 0.47 percent of 21,089 MT of HCFC-142b in the 2009 Final Rule, and 4.9 percent of 2,047 MT in this proposed rule. Aggregate HCFC-142b baseline production allowances are decreasing from 25,090 MT in the 2009 Final Rule to 9,444 MT in this proposed rule to reflect Arkema, Inc.'s transfer of HCFC-142b baseline production allowances.

In summary, EPA is proposing (1) to establish production and consumption baselines for 2012-2014 identical to those established in the 2011 Interim Final Rule (76 FR 47451) for HCFC-22 and HCFC-142b in the tables at sections 82.17 and 82.19. EPA is also proposing (2) to add new specified percentages of baseline for those substances to the table in section 82.16 for the 2012-2014 control periods. Without recoupment, the maximum proposed allocation amounts for consumption are specified in Table 1. Relative to the 2009 Final Rule, EPA is proposing to (3) allocate fewer HCFC-22 consumption allowances, the same amount or more HCFC-22 production allowances, and the same amount of HCFC-142b production and consumption allowances. If EPA chooses to provide recoupment allowances, the percentage of HCFC-22 baseline allocated to consumption could be 3.3 percent lower if EPA decides to provide recoupment from the total allocation in 2013 and 2014—regardless of the total allocation. The percentage of HCFC-22 baseline allocated to production could be 2.8 percent lower. The percentage of HCFC-142b baseline allocated to production and consumption could be 4.5 percent lower. Table 3 reflects the range of allocation percentages, including recoupment.

Table 3 - Proposed Phaseout Schedule for HCFC-22 and HCFC-142b between 2012 and 2014⁶

Control Period	HCFC-22 Consumption		HCFC-22 Production		HCFC-142b Consumption and Production	
	High	Low	High	Low	High	Low
2012	28.7%	17.7%	34.1%	17.7%	4.9%	4.9%
2013	25.3%	11.4%	30.1%	11.4%	4.9%	0.4%
2014	21.9%	8.3%	26.1%	8.3%	4.9%	0.4%

Consistent with the 2009 Final Rule, EPA is allocating different baseline percentages for HCFC-22 and HCFC-142b because EPA projects that the needs will differ for servicing air-conditioning and refrigeration appliances during the 2012-2014 control periods.

1. How Does EPA Propose to Allocate HCFC-22 Consumption Allowances for 2012-2014?

For 2012, the 2009 Final Rule allocated HCFC-22 consumption allowances to meet about 76.5 percent of the servicing need, which translated into approximately 40,700 MT, or 59 percent of the total HCFC consumption cap for the 2012 control period. In this rulemaking, EPA is proposing to allocate 11 to 47 percent less for 2012 relative to the 2009 Final Rule; see the Adjustment Memo in the docket for a discussion of recent updates to estimated servicing demand and how much of that demand could reasonably be met by recovered or reclaimed refrigerant. In the 2009 Final Rule, 2013 and 2014 consumption allocations were 35,900 MT and 31,100 MT, respectively. The Agency is proposing to allocate 11 to 47 percent less for those years as well. Along with any reduction in consumption allowances, the final allocations in 2013 and 2014 will

⁶ Table 3 shows the highest and lowest percentage of baseline allocated being proposed in this rule. The high HCFC-22 consumption scenario shows the percentage allocated if EPA provides the same number of allowances relative to the 2009 Final Rule. The high HCFC-22 production scenario shows an increase in overall production allowances if EPA allocates the same percentage of baseline as in the 2009 Final Rule. The low HCFC-22 production and consumption scenarios take into consideration a reduction in allowances relative to the 2009 Final Rule and recoupment from the aggregate allocation in 2013 and 2014. Additionally, the low scenario for HCFC-22 production shows the percentage allocated if EPA does not decouple production and consumption. For HCFC-142b, the high percentage reflects the same thinking used in the 2011 Interim Final Rule. The low scenario incorporates consumption recoupment from the aggregate amount for 2013 and 2014.

depend on which recoupment option the Agency chooses (including no recoupment). If the Agency issues recoupment, its preferred option is to allocate all recoupment (5,907 MT) in 2013 and do so in addition to the overall consumption allocation—regardless of whether the annual allocations are decreased relative to the 2009 Final Rule or not. In each year between 2012 and 2014, EPA’s total HCFC consumption allocation including recoupment would be at least 36 percent below the Montreal Protocol cap, and would be below servicing demand as estimated in the *Servicing Tail Report*. Section III.B.4. of this preamble also discusses other recoupment options.

2. How Does EPA Propose to Allocate HCFC-22 Production Allowances for 2012-2014?

In the 2009 Final Rule, EPA decided to use the same percentages for production and consumption allocations – deriving the percentages based on estimated need for each individual HCFC. In this rulemaking, EPA is proposing to decouple the percentage of baseline allocated for production and consumption allowances. The Agency is taking comment on two options with regard to decoupling production allowances: (1) allocating the same aggregate number of HCFC-22 production allowances as in the 2009 Final Rule for 2012-2014, and (2) using the same baseline percentages as in the 2009 Final Rule to allocate HCFC-22 production allowances in 2012-2014. The proposal to decrease consumption allowances by 11 to 47 percent relative to the 2009 Final Rule would also apply to production allowances should the Agency decide not to decouple production allowances from consumption allowances.

Under option 1, EPA would decouple the percentage of baseline allocated for production from the percentage of baseline allocated for consumption. A range of percentages is provided in Table 3. EPA would effectuate this change in its regulations by replacing the table at 40 CFR 82.16 with two tables. One would allocate a percent of baseline for consumption allowances. In the other, EPA would allocate 28.7 percent of production baseline in 2012, 25.3 percent in 2013, and 21.9 percent in 2014. The resulting allocation would provide 37,050 MT of HCFC-22

production allowances in 2012. This aggregate allocation in 2012 is approximately two percent lower than the amount allocated in the 2009 Final Rule (37,050 MT in this proposed rule vs. 37,721 MT in the 2009 Final Rule) because the aggregate amount of baseline production allowances in this rulemaking did not increase by the same relative amount as aggregate baseline consumption allowances. Because Solvay did not transfer its HCFC-142b production allowances to HCFC-22 production allowances, HCFC-22 baseline consumption allowances are 18.8 percent higher in this rule, while baseline production allowances are only 16.7 percent higher. The memo to the docket for this rulemaking titled “Effects of HCFC-22 and HCFC-142b Baseline Changes: 2009 Final Rule vs. 2011 Proposed Rule,” (Baseline Memo) discusses the slight differences in allocation amounts in more detail. Absent recoupment, EPA would allocate 32,660 MT of HCFC-22 production allowances in 2013, and 28,271 MT of HCFC-22 production allowances in 2014 under option 1.

Under option 2, EPA would also decouple the percentage of baseline allocated for production from the percentage of baseline allocated for consumption. EPA would effectuate this change in its regulations by replacing the table at 40 CFR 82.16 with two tables. One would allocate a percentage of baseline for consumption allowances. The other would allocate 34.1 percent, 30.1 percent and 26.1 percent of baseline for production allowances in 2012, 2013, and 2014, respectively, consistent with the 2009 Final Rule. This approach would still provide the petitioners in *Arkema v. EPA* the benefit of their 2008 baseline transfers while giving other companies with production baselines approximately the same number of production allowances as they received in the 2009 Final Rule. Compared to the 2009 Final Rule, the net result of this option would increase allowed production by 6,299 MT in 2012, 5,560 MT in 2013, and 4,821 MT in 2014.

EPA is interested in comments on a number of issues with regard to these two options. From a policy perspective, EPA is interested in comments on whether an increase in the total

number of HCFC-22 production allowances would result in greater total HCFC production, either in the U.S. or globally. EPA notes that production of 1 kilogram of an HCFC requires both a production allowance and a consumption allowance (82.15(a)(1),(2)). Thus, an increase in production allowances without a corresponding increase in consumption allowances does not automatically result in greater production. The most likely scenario is that an increase in production allowances would result in greater U.S. production for export. This is because as stated in 82.20(a), “A person may obtain at any time during the control period...consumption allowances equivalent to the quantity of class II controlled substances that the person exported from the U.S. and its territories to a foreign state...when that quantity of class II controlled substance was produced in the U.S. ...with expended consumption allowances.” In effect, current EPA regulations allow exporters to receive a refund of one consumption allowance for each kilogram they export if they show one consumption and one production allowance were expended for the material exported. Therefore, an increase in production allowances would not be expected to result in greater HCFC consumption in the U.S. As an aside, the Agency also allows for additional production for export to Article 5 countries under the Montreal Protocol through its allotment of Article 5 allowances. Until December 31, 2019, companies are allowed to produce up to 10 percent of their HCFC-22, HCFC-141b and HCFC-142b production baselines annually so long as the produced material is exported to an Article 5 country. Article 5 allowances and their proper use are described in more detail at 82.18(a)(2).

EPA welcomes comment on whether, relative to the 2009 Final Rule, an increase in the total number of production allowances, as proposed under option 2, would result in (1) an increase in U.S. consumption, (2) an increase in U.S. production, either for domestic use or for export, and/or (3) an increase in worldwide production and/or consumption of HCFCs. Moreover, given that one potential outcome might be an increase in U.S. exports of HCFC-22,

EPA invites comment on the implications of such an increase for the U.S. economy and the global environment, particularly as it relates to the smooth U.S. phaseout of HCFC-22.

EPA also requests comments on whether section 605(c) would preclude allocating a different percentage of baseline for production than for consumption. Section 605(c) states that EPA must “promulgate regulations phasing out the production . . . of class II substances in accordance with [section 605],” subject to any acceleration under section 606. It further states that EPA must “promulgate regulations to insure that the consumption of class II substances in the United States is phased out and terminated in accordance with the same schedule . . . as is applicable to the phase-out and termination of production of class II substances under [Title VI].” EPA is considering three possible interpretations of the term “schedule” as referenced in section 605(c): (1) the schedule that appears on the face of section 605, which contains no deadlines until 2015; (2) the schedule that appears on the face of section 605, as accelerated under section 606; and (3) the specific allocation percentages or amounts established by EPA through rulemaking for each control period. EPA believes that the second interpretation is the most consistent with the statutory language and purpose. The Agency requested comment on this issue in the 2011 Interim Final Rule (76 FR 47451) and received four comments in favor of increasing production allowances, and two comments in opposition. Only one commenter responded specifically to EPA’s interpretation of section 605, and the commenter agreed with the second interpretation presented.

In past actions, the Agency has made the initial schedule in section 605 more stringent to reflect modifications to the Montreal Protocol phaseout schedule for HCFCs. Under the 2007 Montreal Adjustment (reflected in Decision XIX/6), the U.S. is obligated to reduce HCFC production and consumption 75 percent below its aggregate baseline by 2010. EPA is not proposing to increase production to an amount that would be inconsistent with that obligation.

Instead, EPA is taking comment on whether to allow production to increase relative to consumption, without encroaching on the cap.

Under option 2, the U.S. would still be below the Montreal Protocol's production cap (when all HCFCs are included) by at least 33 percent in each year, even when including recoupment (the memo to the docket entitled, "Montreal Protocol Compliance," contains more detailed information on the implications of each option relative to the Montreal Protocol cap).

In summary, EPA seeks comment on whether to decouple production from consumption, and if so, which decoupling option to choose. EPA is also seeking comment on whether increasing production allowances above the 2009 Final Rule level, as in option 2, would negatively affect the transition to the 2015 phaseout step, under which the U.S. is obligated to reduce HCFC production and consumption 90 percent below its aggregate baseline.

3. How Does EPA Propose to Allocate HCFC-142b Allowances for 2012-2014?

Establishing HCFC-142b baseline allowances that take into account the 2008 inter-pollutant transfers discussed in section II.D. results in 2,047 MT of aggregate baseline consumption allowances and 9,444 MT of aggregate baseline production allowances. Consistent with the 2009 Final Rule, EPA is proposing to allocate 100 percent of the projected servicing need for HCFC-142b identified in that rule: 100 MT of consumption. To get to that level of consumption, EPA is proposing to allocate 4.9 percent of the aggregate consumption baseline, as reflected in the table at section 82.16. The aggregate allocation number for consumption is the same as in the 2009 Final Rule.

Using the same percentage (4.9 percent), EPA is proposing to allocate 463 MT of HCFC-142b production allowances for each control period between 2012 and 2014. The aggregate allocation for production is higher than the amount allocated in the 2009 Final Rule (463 MT in this proposed rule vs. 118 MT in the 2009 Final Rule). The proposed allocation is 292 percent higher than in the 2009 Final Rule because the aggregate amount of baseline HCFC-142b

consumption allowances in this rulemaking decreased by a significantly larger amount than aggregate baseline HCFC-142b production allowances. HCFC-142b baseline consumption allowances are 90.3 percent lower in this rule, while baseline production allowances are only 62.4 percent lower. The difference between the change in production and consumption baselines is a result of Arkema trading most of its HCFC-142b production allowances, while Solvay did not. This higher amount of calendar-year production does not affect the U.S.'s ability to meet its obligations under the Montreal Protocol. The Baseline Memo in the docket for this rulemaking discusses the differences in more detail.

As discussed in section III.B.4. of this preamble, EPA is considering options to allocate recoupment allowances in 2013 or 2013-2014 in addition to the 4.9 percent of baseline described above. If finalized, the 2013 option would result in an additional 61 MT of HCFC-142b consumption allowances and 397 MT of HCFC-142b production allowances. The 2013-2014 option would result in 30 MT of additional HCFC-142b consumption allowances and 198 MT of HCFC-142b production allowances each year.

4. How Would the Aggregate for HCFC-22 and HCFC-142b Translate Entity-by-Entity?

For 2012, EPA is proposing to allocate (1) at maximum, approximately 40,700 MT of HCFC-22 consumption allowances, (2) 37,050 MT of HCFC-22 production allowances (with possible adjustments), (3) approximately 100 MT of HCFC-142b consumption allowances and (4) 463 MT of HCFC-142b production allowances. However, EPA actually allocates allowances to individual companies (i.e., legal entities). Company-specific production and consumption baselines (also referred to as “baseline allowances”) for HCFC-142b and HCFC-22 are listed at sections 82.17 and 82.19, respectively. The range of percentages of baseline each entity would receive for HCFC-22 and HCFC-142b in 2012 through 2014 is shown in Table 3 above. For the low percentage of baseline allocated, Table 3 shows how the proposed allocation combined with recoupment option 3 (recoupment provided from the total allocation, not in addition to the

allocation) would affect allowances. For the high percentage of baseline allocated, Table 3 shows no change relative to the 2009 Final Rule on the consumption side and an increase in allowances on the production side. The percentages included in the proposed regulatory text at the end of this preamble are at the lower end of the range EPA is proposing to allocate.

Allowances allocated for individual control periods are called “calendar-year allowances” to distinguish them from the baseline production or consumption allowances. For 2012-2014, EPA is proposing to apportion production and consumption baselines for HCFC-22 and HCFC-142b on the same basis as in the 2009 Final Rule, except that EPA is making adjustments to reflect (1) the 2008 inter-pollutant transfers of baseline allowances deemed permanent by the Court, (2) inter-company, single-pollutant transfers of baseline allowances that occurred in 2010, and (3) changes in company names that occurred after the 2009 Final Rule was signed. All of these changes were made in the 2011 Interim Final Rule (76 FR 47451), and EPA is proposing to do the same for 2012-2014. Applying the approach described above, EPA would apportion production and consumption baselines for HCFC-22 and HCFC-142b to the following entities in the following amounts:

Table 4: Baseline Production Allowances of HCFC-22 and HCFC-142b in 40 CFR 82.17

Person	Controlled Substance	Allowances (kg)
Arkema	HCFC-22	46,692,336
	HCFC-142b	484,369
DuPont	HCFC-22	42,638,049
Honeywell	HCFC-22	37,378,252
	HCFC-142b	2,417,534
MDA Manufacturing	HCFC-22	2,383,835
Solvay Solexis	HCFC-142b	6,541,764

Table 5: Baseline Consumption Allowances of HCFC-22 and HCFC-142b in 40 CFR 82.19

Person	Controlled Substance	Allowances (kg)
ABCO Refrigeration Supply	HCFC-22	279,366
Altair Partners	HCFC-22	302,011
Arkema	HCFC-22	48,637,642

	HCFC-142b	483,827
Carrier Corporation	HCFC-22	54,088
Coolgas Investment Property	HCFC-22	1,040,458
DuPont	HCFC-22	38,814,862
	HCFC-142b	52,797
H.G. Refrigeration Supply	HCFC-22	40,068
Honeywell	HCFC-22	35,392,492
	HCFC-142b	1,315,819
Mexichem Fluor Inc.	HCFC-22	2,546,305
Kivlan & Company	HCFC-22	2,081,018
MDA Manufacturing	HCFC-22	2,541,545
Mondy Global	HCFC-22	281,824
National Refrigerants	HCFC-22	5,528,316
Refricenter of Miami	HCFC-22	381,293
Refricentro	HCFC-22	45,979
R-Lines	HCFC-22	63,172
Saez Distributors	HCFC-22	37,936
Solvay Fluorides	HCFC-22	3,781,691
Solvay Solexis	HCFC-142b	194,536
USA Refrigerants	HCFC-22	14,865

The proposed baselines listed above are identical to the tables presented in the 2011 Interim Final Rule (76 FR 47451).

D. Are HCFC-141b, HCFC-123, HCFC-124, HCFC-225ca, and HCFC-225cb Allowances Affected by this Rulemaking?

Since the Court's decision did not vacate this portion of the 2009 Final Rule, EPA is not proposing to change baselines and percentages of baseline allocated as calendar-year allowances for HCFC-141b, HCFC-123, HCFC-124, HCFC-225ca, and HCFC-225cb, except to make adjustments for inter-company, single-pollutant transfers of baseline allowances, as reflected in the 2011 Interim Final Rule (76 FR 47451). In the case of HCFC-141b, EPA is continuing to allocate 0 percent of baseline for U.S. consumption and production, consistent with 40 CFR 82.16(b).

E. How Will EPA Allocate Other HCFCs?

As a result of EPA's allocation process, which is largely based on projected demand for HCFC-22 and HCFC-142b, minus an amount of HCFC-22 that is assumed to be reused,

recycled, or reclaimed, the total allocation is lower than the aggregate HCFC cap under the Montreal Protocol. EPA recognizes that there could be some additional need for HCFCs not specifically included in this rule. While some niche applications in the U.S. use other HCFCs, such as HCFC-21, EPA is not aware of additional need for production or import of these substances at this time, as adequate amounts appear to be in inventory. However, EPA is not foreclosing the possibility of additional production or import for these niche uses. Also, some amount of HCFC-141b will likely continue to be produced or imported via the petition process during 2012-2014. EPA believes there is sufficient room under the cap for such continued production and import. The current regulations at 40 CFR 82.15 ban the production and import of class II substances for which EPA has apportioned baseline production and consumption allowances in excess of allowances held by the producer or importer, but do not ban the production and import of class II substances for which EPA has not apportioned baseline production and consumption allowances. This rule does not alter the current regulations in that respect. The producer or importer of an HCFC that is not subject to the allowance system would be required to report to EPA consistent with the existing recordkeeping and reporting requirements. If necessary, EPA could amend the regulations to set and apportion baselines and issue allowances for these HCFCs. Therefore, retaining room under the cap could provide the benefit of accounting for unanticipated growth in HCFCs that do not have allocations or other unforeseen events. However, EPA is not reserving room under the cap for the above-described reasons. EPA is allocating allowances based on modeled demand for virgin and recovered material in preparation for the next major stepdown period under the Montreal Protocol in 2015.

IV. How Does EPA Propose to Change the Regulations Governing Allowance Transfers of Class II Controlled Substances?

The Agency is concerned about the possibility of companies undermining the HCFC chemical-by-chemical phaseout by performing inter-pollutant transfers in advance of future

phaseout steps. EPA interprets the 2003 Final Rule, which established the transfer provisions at 40 CFR 82.23, as allowing only single-pollutant, inter-company transfers to be made on a permanent basis. Nevertheless, EPA recognizes that in *Arkema v. EPA*, the Court found that “EPA’s practice under the 2003 Rule was to allow petitioners’ baseline transfers of inter-pollutant allowances” (618 F.3d at 8). Therefore, EPA clarified its current policy on inter-pollutant transfers in the 2011 Interim Final Rule (76 FR 47459) and is repeating that clarification in this action. EPA is also proposing to modify the regulatory text in order to dispel any possibility of confusion in the future. In addition to modifying the regulatory text to address the duration of inter-pollutant transfers, EPA is also proposing to revise the regulatory text to reflect prior Agency statements pertaining to inter-pollutant transfers of Article 5 allowances.

A. How Does EPA Propose to Change the Regulations Governing Permanent Transfers of Class II Allowances?

Sections 607(b) and (c) of the CAA address inter-pollutant and inter-company transfers of allowances, respectively. Inter-pollutant transfers are the transfer of an allowance of one substance to an allowance of another substance on an ODP-weighted basis. Inter-company transfers are transfers of allowances for the same ODS from one company to another company. Section 607(c) also authorizes inter-company transfers combined with inter-pollutant transfers, so long as the requirements of both are met. The corresponding regulatory provisions for HCFCs appear at 40 CFR 82.23.

The 2009 Final Rule updated the baselines for HCFC-22 and HCFC-142b to reflect name changes and inter-company baseline transfers, *i.e.*, transfers of baseline for a specific type of HCFC from one company to another. Doing so reflected the changes in the marketplace that had occurred since EPA promulgated the 2003 Final Rule. Inter-company baseline transfers provide a mechanism for new entrants to join the HCFC market and for other companies to expand their business. EPA recognizes that in some cases, entities are no longer actively involved in HCFC

production, import, and/or export activities. EPA retained the baseline for such entities, noting that this had been a mechanism by which new entrants had entered the HCFC allowance system in the past.

The 2009 Final Rule also addressed four inter-pollutant baseline transfers made during the prior regulatory period (see section II.D. and the transfer forms in the docket for this action for more detail). EPA had proposed to adjust the company baselines to reflect these four inter-pollutant baseline transfers in the 2008 Proposed Rule. Eight commenters opposed, and two commenters supported, these proposed adjustments. At issue was whether the inter-pollutant baseline transfers should be part of the companies' baseline allowances in the next regulatory period.

After reviewing the comments, EPA concluded that adjusting the baselines to reflect inter-pollutant baseline transfers could create incentives for future manipulation of the allocation system in anticipation of future control periods. EPA remains concerned about the potential for such future manipulation if inter-pollutant baseline transfers during the current regulatory period change a company's baseline for future regulatory periods. For example, in 2020 EPA will no longer be issuing HCFC-22 production or consumption allowances (see section 82.16(e)). EPA expects that companies with HCFC-22 allowances would no longer be in the HCFC market at that date if they did not hold allowances for other HCFCs that may still be produced after 2020. If EPA were to allow inter-pollutant baseline transfers that carried forward into the new regulatory period, companies with HCFC-22 baselines in 2019 could convert them all to baselines for HCFC-123. Perpetuating the HCFC-22 baselines in a new form would be counter to the design of the chemical-by-chemical phaseout, under which the baseline allowances for a particular chemical are intended to drop out of the system upon the phase-out of that chemical.

As another example, in 2015, a producer or importer that previously had not participated in the HCFC-123 market could dominate that market by converting its HCFC-22 baseline in

2014 to HCFC-123 baseline. Given the different ODPs of HCFC-22 and HCFC-123 (0.055 and 0.02, respectively), converting one baseline allowance of HCFC-22 would result in 2.75 baseline allowances of HCFC-123. Also, since companies hold many more HCFC-22 baseline allowances than HCFC-123 baseline allowances, converting those HCFC-22 baseline allowances would have an overwhelming effect on the current HCFC-123 baseline allowance holders and the overall market. EPA agrees with commenters on the 2008 Proposed Rule that taking inter-pollutant baseline transfers into account in setting baselines could have the effect of moving the U.S. HCFC phasedown from a chemical-by-chemical phaseout, as established under the “worst-first” approach in the 1993 Final Rule, towards an ODP-weighted phasedown. Thus, there are important policy reasons going forward for not taking inter-pollutant transfers into account in establishing baselines for new regulatory periods.

Some commenters on the 2008 Proposed Rule stated that modifying the baselines by taking into account inter-pollutant transfers would be contrary to the CAA. One commenter argued that section 607 of the CAA allows EPA to approve inter-pollutant transfers of allowances only on a year-to-year basis. That commenter pointed to language in section 607(b) stating that EPA regulations are to 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.” The commenter also discussed the legislative history of the 1990 CAA Amendments.

EPA does not agree with the commenter that the language of section 607(b) is clear on its face. However, where the statutory language is ambiguous, EPA has discretion to choose a reasonable interpretation of that language. EPA determined in the 2009 Final Rule that section 607(b) is best read as permitting only year-by-year inter-pollutant transfers. EPA continues to believe that this is the best interpretation of the statutory language. Section 607(b) states that EPA’s rules are to permit “a production allowance for a substance for any year to be transferred

for a production allowance for another substance for the same year.” This language emphasizes the year-by-year nature of such transactions. No parallel language appears in section 607(c). That section does, however, provide that any inter-pollutant transfers between two or more persons must meet the requirements of section 607(b).

As the Court noted, “the Agency is certainly entitled to . . . institute a program that forbids baseline inter-pollutant transfers in the future,” (*Arkema v. EPA*, 618 F.3d at 9). Hence, EPA concludes that requiring all inter-pollutant transfers to be conducted on a yearly – and thus temporary – basis going forward is the approach most consistent with the wording of section 607(b). Further discussion of the reasons for limiting inter-pollutant transfers to those conducted on a calendar-year basis is available in the Response to Comments on the 2008 Proposed Rule (included in the docket for this rulemaking).

Consistent with the Court’s decision regarding *past* inter-pollutant transfers (those conducted during the prior regulatory period), the baselines established in this action for 2012-2014 take into account the 2008 inter-pollutant baseline transfers. EPA is clarifying, however, that it has not approved any inter-pollutant transfers of baseline allowances in the current regulatory period, and for the reasons given in the 2009 Final Rule and in this action, in the future, EPA intends to approve inter-pollutant transfers only on a year-by-year basis. Thus, in the context of the allowance system for protection of stratospheric ozone, companies should not expect that any inter-pollutant transfers they conduct will affect their baselines either in the current regulatory period or any future regulatory period.

EPA proposes to revise the regulations to avoid any further dispute about the Agency’s position on this issue. In addition, EPA is proposing to clarify the procedures that apply to permanent, single-pollutant transfers. Specifically, EPA proposes to add a sentence at the beginning and end of section 82.23(d) of 40 CFR Part 82, so the text reads:

“(d) Permanent transfers. The procedures in paragraph (a) of this section apply to permanent inter-company transfers of baseline production allowances or baseline consumption allowances. 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 phaseout schedules in this subpart. No person may conduct permanent inter-pollutant transfers of baseline production allowances or baseline consumption allowances.”

B. How Does EPA Propose to Change the Regulations Governing Transfers of Article 5 HCFC Allowances?

Article 5 allowances for Class II substances are the privileges granted under 40 CFR 82.18(a) to produce the specified HCFC for export only to countries listed in 40 CFR Subpart A, Appendix C, Annex 4. The countries listed in that annex are developing countries whose control obligations under the Montreal Protocol are addressed in Article 5 of the treaty and hence are referred to as “Article 5 Parties.” EPA is proposing to revise the regulations at 40 CFR 82.23(b) to reflect its previously stated intent to allow inter-pollutant transfers of Article 5 allowances. The regulations currently provide clarity on inter-company (single-pollutant) transfers of Article 5 allowances in section 82.23(a) by stating “a person...may transfer to any other person...any quantity of the transferor’s class II...Article 5 allowances for the same type of allowances...” While 82.23(a) specifically includes Article 5 allowances in the list of allowances that may be transferred to another entity, 82.23(b), which governs inter-pollutant transfers, makes no mention of Article 5 allowances.

Section 82.23 was promulgated as part of the 2003 Final Rule (68 FR 2820). EPA specifically discussed the inter-pollutant transfer of Article 5 allowances at 68 FR 2834 stating, “For example, after the 2003 phaseout of HCFC-141b and before 2010, a company receiving...Article 5 allowances for HCFC-141b could engage in inter-company transfers of

those allowances, but not in inter-pollutant transfers [because no other HCFC Article 5 allowances would be available during that period]. In 2010, when...Article 5 allowances for HCFC-22 and HCFC-142b become available, these allowances will be transferable with the ones for HCFC-141b.” These statements indicate that the Agency intended for companies to be able to perform inter-pollutant transfers of Article 5 allowances. The omission of Article 5 allowances from section 82.23(b) appears to have been an oversight. Therefore, EPA is proposing to revise the regulations to specifically provide for the inter-pollutant transfers of Article 5 allowances through this rulemaking. As with other types of inter-pollutant transfers, these transfers would be limited in duration to a single year.

EPA is also proposing to change the text at 82.23(a)(ii) for consistency with its previously stated policy on offsets for transfers of Article 5 allowances. Section 607(a) requires that transfers of production allowances “will result in greater total reductions in the production in each year of . . . class II substances than would occur in that year in the absence of such transactions.” In a November 10, 1994, Federal Register notice, EPA stated its interpretation that the section 607 offset requirement applies to Article 5 allowance transfers (59 FR 56287): “Inter-pollutant transfers of Article 5 allowances will continue to require a one percent offset, as required by section 607 of the CAA...” In the May 10, 1995 final rule at 60 FR 24980, EPA stated that “With today's action, EPA permits inter-pollutant and inter-company transfers of Article 5 allowances as proposed...” meaning EPA intended to require an offset for transfers of Article 5 allowances in the class I allowance system.

This intent to require an offset is also reflected in certain provisions of the class II allowance system in 40 CFR 82. Section 82.23(a)(i)(G) specifically requires an offset for Article 5 allowance inter-company transfers, stating that the transfer claim must set forth: “For trades of consumption allowances, production allowances, export production allowances, or Article 5 allowances, the quantity of the 0.1 percent offset applied to the unweighted quantity traded that

will be deducted from the transferor's allowance balance.” The offset is also mentioned at section 82.23(a)(iii): “In the case of transfers of . . . Article 5 allowances, EPA will reduce the transferor's balance of unexpended allowances by the quantity (in kilograms) to be converted plus 0.1 percent of that quantity.” This contrasts with section 82.23(a)(ii)(A), which states that in the case of Article 5 allowances, “EPA will reduce the transferor’s balance of unexpended allowances . . . by the quantity to be transferred,” with no mention of an offset. In addition, in the introductory text for 82.23(a)(ii), Article 5 allowances are not mentioned: “The transfer claim is the quantity (in kilograms) to be transferred plus, in the case of transfers of production or consumption allowances, 0.1 percent of that quantity;” EPA is proposing to amend 82.23(a)(ii) and 82.23(a)(ii)(A) to require an offset for transfers of Article 5 allowances. This will make section 82.23(a) consistent throughout. Section 82.23(b) currently requires an offset of 0.1 percent for all inter-pollutant transfers. Thus, if EPA adds Article 5 allowances to section 82.23(b), an offset will automatically apply.

To reflect EPA’s intent to allow inter-pollutant transfers of Article 5 allowances, and the requirement that an offset be deducted when an entity is transferring Article 5 allowances, the Agency is proposing to modify the regulatory text. EPA is proposing to modify the text at 40 CFR 82.23(a)(ii) to read as set forth in the regulatory text of this proposed rule.

The Agency is also proposing to modify the text at 40 CFR 82.23(b) by adding Article 5 allowances to the list of allowances that can be traded between pollutants. The text would read as set forth in the regulatory text of this proposed rule.

V. Statutory and Executive Order Reviews

A. Executive Order 12866: Regulatory Planning and Review and Executive Order 13563: Improving Regulation and Regulatory Review

Under Executive Order (EO) 12866 (58 FR 51735, October 4, 1993), this action is a "significant regulatory action" since it raises “novel legal or policy issues.” Accordingly, EPA

submitted this action to the Office of Management and Budget (OMB) for review under Executive Orders 12866 and 13563 (76 FR 3821, January 21, 2011) and any changes made in response to OMB recommendations have been documented in the docket for this action.

EPA did not conduct a specific analysis of the benefits and costs associated with this action. Many previous analyses provide a wealth of information on the costs and benefits of the U.S. HCFC phaseout including:

- The 1993 *Addendum to the 1992 Phaseout Regulatory Impact Analysis: Accelerating the Phaseout of CFCs, Halons, Methyl Chloroform, Carbon Tetrachloride, and HCFCs*.
- The 1999 Report *Costs and Benefits of the HCFC Allowance Allocation System*.
- The 2000 Memorandum *Cost/Benefit Comparison of the HCFC Allowance Allocation System*.
- The 2005 Memorandum *Recommended Scenarios for HCFC Phaseout Costs Estimation*.
- The 2006 ICR *Reporting and Recordkeeping Requirements of the HCFC Allowance System*.
- The 2007 Memorandum *Preliminary Estimates of the Incremental Cost of the HCFC Phaseout in Article 5 Countries*.
- The 2007 Memorandum *Revised Ozone and Climate Benefits Associated with the 2010 HCFC Production and Consumption Stepwise Reductions and a Ban on HCFC Pre-charged Imports*.

A memorandum summarizing these analyses is available in the docket.

B. Paperwork Reduction Act

This action does not impose any new information collection burden. EPA already requires recordkeeping and reporting for HCFCs, and this action does not amend those provisions. The Office of Management and Budget (OMB) has previously approved the information collection requirements contained in the existing regulations at 40 CFR part 82, subpart A under the provisions of the Paperwork Reduction Act, 44 U.S.C. 3501 et seq. and has assigned OMB control number 2060-0498. The OMB control numbers for EPA's regulations in 40 CFR are listed in 40 CFR part 9.

C. Regulatory Flexibility Act (RFA)

The Regulatory Flexibility Act (RFA) generally requires an agency to prepare a regulatory flexibility analysis of any rule subject to notice-and-comment rulemaking requirements under the Administrative Procedure Act or any other statute, unless the Agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. Small entities include small businesses, small organizations, and small governmental jurisdictions. We have considered the economic impacts of this proposed rule on small entities. For purposes of assessing the impacts of this rule on small entities, a small entity is defined as: (1) a small business as defined by the Small Business Administration's (SBA) regulations at 13 CFR 121.201; (2) a small governmental jurisdiction that is a government of a city, county, town, school district or special district with a population of less than 50,000; and (3) a small organization that is any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.

This action will affect the following categories:

- Industrial Gas Manufacturing entities (NAICS code 325120), including fluorinated hydrocarbon gases manufacturers and reclaimers;

- Other Chemical and Allied Products Merchant Wholesalers (NAICS code 422690), including chemical gases and compressed gases merchant wholesalers;
- Air-Conditioning and Warm Air Heating Equipment and Commercial and Industrial Refrigeration Equipment Manufacturing entities (NAICS code 333415), including air-conditioning equipment and commercial and industrial refrigeration equipment manufacturers;
- Air-Conditioning Equipment and Supplies Merchant Wholesalers (NAICS code 423730) , including air-conditioning (condensing unit, compressors) merchant wholesalers;
- Electrical and Electronic Appliance, Television, and Radio Set Merchant Wholesalers (NAICS code 423620), including air-conditioning (room units) merchant wholesalers; and
- Plumbing, Heating, and Air-Conditioning Contractors (NAICS code 238220), including Central air-conditioning system and commercial refrigeration installation; HVAC contractors.

After considering the economic impacts of this proposed rule on small entities, I certify this action will not have a significant economic impact on a substantial number of small entities as it relieves a regulatory ban on production and consumption that would otherwise apply in the wake of the Court's vacatur. EPA is continuing to allocate production and consumption allowances using the same approach described in the 2009 Final Rule with adjustments to reflect (1) 2008 inter-pollutant transfers of baseline allowances deemed permanent by the Court, (2) inter-company, single-pollutant transfers of baseline allowances that occurred in 2010, (3) changes in company names that occurred after the 2009 Final Rule was signed and (4) an updated picture on the demand for HCFC-22. EPA is not modifying the recordkeeping or

reporting provisions and thus is not increasing the burden to small businesses. EPA's HCFC Phaseout Benefits and Costs Memo, included in this docket, provides a summary of previous small business analyses, as well as the most recent cost and benefit data used for the 2009 Final Rule. We continue to be interested in the potential impacts of the proposed rule on small entities and welcome comments on issues related to such impacts.

D. Unfunded Mandates Reform Act

This action contains no Federal mandates under the provisions of Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), 2 U.S.C. 1531-1538 for State, local, or tribal governments or the private sector. UMRA does not apply to rules that are necessary for the national security or the ratification or implementation of international treaty obligations. This rule implements the 2010 milestone for the phase-out of HCFCs under the Montreal Protocol. Therefore, this action is not subject to the requirements of sections 202 or 205 of the UMRA.

This action is also not subject to the requirements of section 203 of UMRA because it contains no regulatory requirements that might significantly or uniquely affect small governments. This action apportions production and consumption allowances and establishes baselines for private entities, not small governments.

E. Executive Order 13132: Federalism

Executive Order 13132, titled "Federalism" (64 FR 43255, August 10, 1999), requires EPA to develop an accountable process to ensure "meaningful and timely input by State and local officials in the development of regulatory policies that have federalism implications." "Policies that have federalism implications" is defined in the Executive Order to include regulations that have "substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government."

This action does not have federalism implications. It does not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government, as specified in Executive Order 13132. This action is expected to primarily affect producers, importers, and exporters of HCFCs. Thus, the requirements of section 6 of the Executive Order do not apply.

F. Executive Order 13175: Consultation and Coordination with Indian Tribal Governments

This action does not have tribal implications, as specified in Executive Order 13175 (65 FR 67249, November 9, 2000). This action does not significantly or uniquely affect the communities of Indian tribal governments. It does not impose any enforceable duties on communities of Indian tribal governments. Thus, Executive Order 13175 does not apply to this action.

G. Executive Order 13045: Protection of Children from Environmental Health and Safety Risks

This action is not subject to EO 13045 (62 F.R. 19885, April 23, 1997) because it is not economically significant as defined in EO 12866. The Agency nonetheless has reason to believe that the environmental health or safety risk addressed by this action may have a disproportionate effect on children. Depletion of stratospheric ozone results in greater transmission of the sun's ultraviolet (UV) radiation to the earth's surface. The following studies describe the effects of excessive exposure to UV radiation on children: (1) Westerdahl J, Olsson H, Ingvar C. "At what age do sunburn episodes play a crucial role for the development of malignant melanoma," *Eur J Cancer* 1994; 30A: 1647-54; (2) Elwood JM Japson J. "Melanoma and sun exposure: an overview of published studies," *Int J Cancer* 1997; 73:198-203; (3) Armstrong BK, "Melanoma: childhood or lifelong sun exposure," In: Grobb JJ, Stern RS Mackie RM, Weinstock WA, eds. "Epidemiology, causes and prevention of skin diseases," 1st ed. London, England: Blackwell

Science, 1997: 63-6; (4) Whiteman D., Green A. "Melanoma and Sunburn," Cancer Causes Control, 1994: 5:564-72; (5) Heenan, PJ. "Does intermittent sun exposure cause basal cell carcinoma? A case control study in Western Australia," Int J Cancer 1995; 60: 489-94; (6) Gallagher, RP, Hill, GB, Bajdik, CD, et. al. "Sunlight exposure, pigmentary factors, and risk of nonmelanocytic skin cancer I, Basal cell carcinoma," Arch Dermatol 1995; 131: 157-63; (7) Armstrong, DK. "How sun exposure causes skin cancer: an epidemiological perspective," Prevention of Skin Cancer. 2004. 89-116.

This action implements the U.S. commitment to reduce the total basket of HCFCs produced and imported to a level that is 75 percent below the respective baselines. While on an ODP-weighted basis, this is not as large a step as previous actions, such as the 1996 Class I phaseout, it is one of the most significant remaining actions the U.S. can take to complete the overall phaseout of ODS and further decrease impacts on children's health from stratospheric ozone depletion.

H. Executive Order 13211: Actions that Significantly Affect Energy Supply, Distribution, or Use

This action is not a "significant energy action" as defined in Executive Order 13211 (66 FR 28355 (May 22, 2001)), because it is not likely to have a significant adverse effect on the supply, distribution, or use of energy. The rule issues allowances for the production and consumption of HCFCs.

I. National Technology Transfer and Advancement Act

Section 12(d) of the National Technology Transfer and Advancement Act of 1995 ("NTTAA"), Public Law No. 104-113, 12(d) (15 U.S.C. 272 note) directs EPA to use voluntary consensus standards in its regulatory activities unless to do so would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards are technical standards (e.g., materials specifications, test methods, sampling procedures, and business practices) that are

developed or adopted by voluntary consensus standards bodies. The NTTAA directs EPA to provide Congress, through OMB, explanations when the Agency decides not to use available and applicable voluntary consensus standards. This action does not involve technical standards.

Therefore, EPA did not consider the use of any voluntary consensus standards.

I. Executive Order 12898: Federal Actions to Address Environmental Justice in Minority Populations and Low-Income Populations

Executive Order (EO) 12898 (59 FR 7629 (Feb. 16, 1994)) establishes federal executive policy on environmental justice. Its main provision directs federal agencies, to the greatest extent practicable and permitted by law, to make environmental justice part of their mission by identifying and addressing, as appropriate, disproportionately high and adverse human health or environmental effects of their programs, policies, and activities on minority populations and low-income populations in the U.S.

EPA has determined that this action will not have disproportionately high and adverse human health or environmental effects on minority or low-income populations because the 2010 phaseout step increases the level of environmental protection for all affected populations without having any disproportionately high and adverse human health or environmental effects on any population, including any minority or low-income population. This action continues the implementation of the U.S. commitment to reduce the total basket of HCFCs produced and imported to a level that is 75 percent below the respective baselines. While on an ODP-weighted basis, this is not as large a step as previous actions, such as the 1996 Class I phaseout, it is one of the most significant remaining actions the U.S. can take to complete the overall phaseout of ODS and further lessen the adverse human health effects for the entire population.

List of Subjects in 40 CFR Part 82

Environmental protection, Administrative practice and procedure, Air pollution control,
Chemicals, Exports, Hydrochlorofluorocarbons, Imports

DATED: December 22, 2011.

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Administrator.

40 CFR part 82 is proposed to be amended to read as follows:

PART 82-PROTECTION OF STRATOSPHERIC OZONE

1. The authority citation for part 82 continues to read as follows:

Authority: 42 U.S.C. 7414, 7601, 7671– 7671q.

2. Amend §82.16 by revising paragraph (a) to read as follows:

§82.16 Phaseout schedule of class II controlled substances.

(a) *Calendar-year Allowances.* (1) In each control period as indicated in the following tables, each person is granted the specified percentage of baseline production allowances and baseline consumption allowances for the specified class II controlled substances apportioned under §§82.17 and 82.19:

Calendar-year HCFC Production Allowances

Control Period	Percent of HCFC-141b	Percent of HCFC-22	Percent of HCFC-142b	Percent of HCFC-123	Percent of HCFC-124	Percent of HCFC-225ca	Percent of HCFC-225cb
2003	0	100	100	--	--	--	--
2004	0	100	100	--	--	--	--
2005	0	100	100	--	--	--	--
2006	0	100	100	--	--	--	--
2007	0	100	100	--	--	--	--
2008	0	100	100	--	--	--	--
2009	0	100	100	--	--	--	--
2010	0	41.9	0.47	125	125	125	125
2011	0	32.0	4.9	125	125	125	125
2012	0	17.7	4.9	125	125	125	125
2013	0	14.7	4.9	125	125	125	125
2014	0	11.6	4.9	125	125	125	125

Calendar-year HCFC Consumption Allowances

Control Period	Percent of HCFC-141b	Percent of HCFC-22	Percent of HCFC-142b	Percent of HCFC-123	Percent of HCFC-124	Percent of HCFC-225ca	Percent of HCFC-225cb
2003	0	100	100	--	--	--	--
2004	0	100	100	--	--	--	--
2005	0	100	100	--	--	--	--
2006	0	100	100	--	--	--	--
2007	0	100	100	--	--	--	--
2008	0	100	100	--	--	--	--
2009	0	100	100	--	--	--	--
2010	0	41.9	0.47	125	125	125	125
2011	0	32.0	4.9	125	125	125	125
2012	0	17.7	4.9	125	125	125	125
2013	0	14.7	4.9	125	125	125	125
2014	0	11.6	4.9	125	125	125	125

(2) *Recoupment allowances.* In the control period beginning January 1, 2013 and ending December 31, 2013, the following companies are granted a one-time amount of HCFC consumption and production allowances in addition to the percentage of baseline listed in the

table at paragraph (a)(1) of this section: 4,749,692 kg of HCFC-22 consumption allowances and 4,611,848 kg of HCFC-22 production allowances to Arkema; 2,339 kg of HCFC-142b consumption allowances to DuPont; 58,291 kg of HCFC-142b consumption allowances and 107,097 kg of production allowances to Honeywell; 1,157,895 kg of HCFC-22 consumption allowances to Solvay Fluorides; and 289,800 kg of HCFC-142b production allowances to Solvay Solexis.

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3. Amend §82.23 by revising paragraphs (a)(ii) introductory text, (a)(ii)(A), (b)(1), and (d) to read as follows:

§82.23 Transfers of allowances of class II controlled substances.

(a) * * * (ii) The Administrator will determine whether the records maintained by EPA indicate that the transferor possesses unexpended allowances sufficient to cover the transfer claim on the date the transfer claim is processed. The transfer claim is the quantity (in kilograms) to be transferred plus 0.1 percent of that quantity. The Administrator will take into account any previous transfers, any production, and allowable imports and exports of class II controlled substances reported by the transferor. Within three working days of receiving a complete transfer claim, the Administrator will take action to notify the transferor and transferee as follows:

(A) The Administrator will issue a notice indicating that EPA does not object to the transfer if EPA's records show that the transferor has sufficient unexpended allowances to cover the transfer claim. In the case of transfers of production or consumption allowances, EPA will reduce the transferor's balance of unexpended allowances by the quantity to be transferred plus 0.1 percent of that quantity. In the case of transfers of export production or Article 5 allowances, EPA will reduce the transferor's balance of unexpended allowances, respectively, by the quantity to be transferred plus 0.1 percent of that quantity. The transferor and the transferee may proceed

with the transfer when EPA issues a no objection notice. However, if EPA ultimately finds that the transferor did not have sufficient unexpended allowances to cover the claim, the transferor and transferee, where applicable, will be held liable for any knowing violations of the regulations of this subpart that occur as a result of, or in conjunction with, the improper transfer.

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(b) *Inter-pollutant transfers.* (1) Effective January 1, 2003, a person (transferor) may convert consumption allowances, production allowances or Article 5 allowances for one class II controlled substance to the same type of allowance for another class II controlled substance listed in Appendix B of this subpart, following the procedures described in paragraph (b)(3) of this section.

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(d) *Permanent transfers.* The procedures in paragraph (a) of this section apply to permanent inter-company transfers of baseline production allowances or baseline consumption allowances. 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 phaseout schedules in this subpart. No person may conduct permanent inter-pollutant transfers of baseline production allowances or baseline consumption allowances.

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