Case No. VEE-0079

March 2, 2001

DECISION AND ORDER

OF THE DEPARTMENT OF ENERGY

Application for Exception

Name of Petitioner: Diversified Refrigeration, Inc.

Date of Filing: February 1, 2001

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Diversified Refrigeration, Inc. (DRI) requests a six-month exception from the 2001 energy appliance efficiency standards for built-in refrigerators that become effective July 1, 2001. As explained below, we are granting DRI a six-month exception - from July 1, 2001 to December 31, 2001 - that permits the firm to produce a specific number of non-compliant refrigerators per month and requires DRI to submit monthly reports on the number of each model produced.

I. Background

The Energy Policy and Conservation Act (EPCA) directed the DOE to review and revise the 1989 energy conservation standards applicable to refrigerators. See EPCA §325(b)(3)(B), 42 U.S.C. § 6295(b)(3)(B); 54 Fed. Reg. 47916 (November 17, 1989). Pursuant to that direction, in 1997, the DOE finalized new standards that become effective on July 1, 2001. 62 Fed. Reg. 23101 (April 28, 1997).

The DOE Organization Act (DOEOA) authorizes the DOE to grant exceptions to EPCA standards. DOEOA § 504(a), 42 U.S.C. 7194(a). The DOEOA permits adjustments "consistent with the purposes" of EPCA, "as may be necessary to prevent special hardship, inequity, or unfair distribution of burdens." The preamble to the notice promulgating the new refrigerator efficiency standards specifically refers to this provision. 62 Fed. Reg. at 23,108-09. As the preamble indicates, the DOE may grant an exception for a limited time and may place other conditions on the grant of relief, including conditions related to the effects of the relief on competition. Id. at 23,109.

The DOE's procedural regulations set forth the procedures applicable to exception applications. 10 C.F.R. Part 1003, Subparts B and C. Subpart B provides the procedures for considering an exception request. Subpart C provides the procedures for an appeal of an exception decision.

DRI's sole operation is a manufacturing facility, in which it builds built-in refrigerators for sale to GE Appliances (GE). DRI is located in Selmer, Tennessee, a town of approximately 4600 residents, in southwestern Tennessee. DRI employs a significant number of Selmer's 4600 residents.

DRI is one of four firms that manufacture built-in refrigerators. The other three are Viking Range Corporation (Viking), Whirlpool Corporation (Whirlpool), and Sub-Zero Freezer Co. (Sub-Zero). Both Viking and DRI applied for exception relief.

In June 2000, Viking filed its application for exception, requesting that OHA grant it an exception from the new refrigerator efficiency standards. Specifically, Viking requested a 12-month extension to comply with the standards.

Viking's three competitors - Sub-Zero, Whirlpool, and GE - filed comments in opposition to Viking's request.(4) The competitors did not challenge Viking's contention that it was unable to meet the deadline; instead, the competitors argued that Viking's inability to meet the deadline was the result of its own discretionary business decisions and that an exception would cause them competitive harm.

In a November 3 decision, we granted Viking's request in part. Viking Range Corp., 28 DOE ¶ 81,002 (2000). Specifically, we granted Viking a six-month extension to meet the new standards, based on our conclusion that the application of the July 1, 2001 effective date to Viking would create an unfair distribution of burdens.

Sub-Zero, Whirlpool, and GE appealed the November 3 decision. In their appeals, Sub-Zero and Whirlpool opposed the relief granted. GE, on the other hand, abandoned its opposition to the request and merely requested a technical modification, i.e., that the

exception relief be expressly limited to the refrigerator models for which Viking sought relief.

By separate order issued today, we are affirming our grant of exception relief to Viking, except that during each of the six months of exception relief, from July 1, 2001 to December 31, 2001, the exception relief is limited to a total production of 475 refrigerators. See Sub-Zero Freezer Co., 28 DOE ____ (March 2, 2001).

During the pendency of the appeals of the Viking exception, DRI filed its exception request. DRI contends that it is unable to meet the deadline because of a loss of engineering staff due to high turnover and difficulty in recruiting new hires. DRI contends that, in the absence of relief, it will have to shut-down its factory.

All five parties - DRI, its customer GE, Viking, Sub-Zero and Whirlpool were involved in our consideration of the DRI exception application. In considering the DRI application and the Viking appeals, we requested various types of information.

First, we requested that DRI identify the models for which it sought relief and its sales of those models during each month in 1999 and 2000. DRI provided this information, which indicated that it seeks relief for its side-by-side built-in refrigerators.

Second, we requested that the parties comment on a possible limitation on the exception relief to avoid giving the recipient of exception relief a competitive advantage. We proposed to limit the number of units produced during the period of exception relief, and we requested the parties' views on such a limitation. Viking and GE disagreed with such a limitation, arguing that such a limitation was anti-competitive. Sub-Zero and Whirlpool viewed such a limitation as an improvement over an unlimited grant of relief but nonetheless as inadequate to address their concern of competitive harm.

Third, we requested information on the parties' ability and intent to stockpile non-compliant refrigerators(3) prior to the July 1, 2001 effective date. To the extent that manufacturers are able to stockpile, such stockpiling would ameliorate the impact of an exception granted a competitor; similarly, to the extent that an exception applicant is able to stockpile, its need for exception relief is reduced. Diversified, Viking, and Whirlpool responded, but Sub-Zero did not.

Fourth, we gave Sub-Zero and Whirlpool the opportunity to submit information to support their claim that the relief put them at a cost disadvantage, i.e., their expected change in marginal cost related to out-of-pocket manufacturing costs. Sub-Zero declined this opportunity, but Whirlpool submitted the information.

Finally, all parties agreed that the built-in refrigerator market comprises a very small segment of the domestic refrigerator market. In 1999, over 9 million refrigerators were produced, of which approximately 140,000 were built-in refrigerators. It is also agreed that Sub-Zero has over half of the built-in refrigerator market, that Viking has roughly three percent, and that the remainder is divided between Whirlpool and GE, DRI's customer.

We held a hearing on the DRI exception application on February 27. The hearing panel included an economist.

II. Analysis

It is undisputed that DRI cannot produce compliant refrigerators by the July 1, 2001 deadline. Sub-Zero and Whirlpool argue, however, that had DRI been more diligent in its efforts to comply, it would be able to do so. Thus, they argue, DRI's inability to comply results from "discretionary business decisions" rather than an unfair distribution of burdens.

Our review of the information submitted by DRI indicates that had DRI begun its compliance efforts earlier, DRI might have been able to meet the deadline. We do not believe, however, that DRI's failure to begin compliance efforts earlier or to undertake more aggressive compliance efforts later are "discretionary business decisions" that preclude the grant of relief.

As an initial matter, we observe that the characterization of a decision as "discretionary" does not preclude the grant of exception relief. In one sense, every decision is "discretionary": the word "decision" denotes the making of a choice. Under that use of the word "discretionary," any need for relief could be traced to the discretionary decision to begin the business for which an exception is sought. Accordingly, the mere fact that a firm would not need exception relief had it made a different choice or a different set of choices does not preclude exception relief. Instead, exception relief is not appropriate where a firm makes a choice that does not reasonably take into account its regulatory obligations. In such cases, we refer to the choice as the "primary" cause for the firm's difficulty. See, e.g., Ince Minerals Corp., 3 DOE ¶ 81,136 at 83,498 (1979) (firm's financial difficulties attributable to its incorrect assessment of quality of reserves rather than DOE regulations).

From hindsight, it is clear that DRI should have begun its efforts to produce compliant refrigerators earlier than it did. It is also possible that DRI, and its customer GE, could have taken more aggressive steps to comply. On the other hand, all parties agree that developing compliant refrigerators involves significant engineering effort, and the record indicates that DRI encountered significant difficulties hiring and retaining, either as employees or on a contract basis, the number of engineers that it needed. DRI attributes these problems to the competitive environment for engineers, which was exacerbated in the refrigeration industry by the approaching effective date of the new standards. Accordingly, it appears to us that the primary cause of DRI's inability to meet the deadline was its failure to anticipate the unusual degree of difficulty it would encounter in obtaining sufficient engineering staff.

Based on the foregoing, we do not believe that DRI's various choices along the way preclude a grant of exception relief. Accordingly, we proceed to consider the Sub-Zero and Whirlpool arguments that the burden to DRI of not meeting the deadline does not outweigh the burden to them if exception relief is granted.

Sub-Zero and Whirlpool argue that DRI has not established that the burden to DRI of a six-month suspension of its refrigerator sales outweighs the competitive harm that Sub-Zero and Whirlpool would suffer if we grant DRI a six-month extension in which to sell non- compliant refrigerators.(4)

We believe that it is clear that, in the absence of relief, DRI would suffer a significant burden. DRI's only operation at its Tennessee plant is to produce built-in refrigerators. Accordingly, in the absence of relief, it will not be able to operate. The inability to operate will result in the loss of six months of income, necessitate a lay-off of workers, disrupt its relations with suppliers and with GE, and have serious consequences on its long-term ability to be competitive. Thus, in the absence of exception relief, the impact of the new standards on DRI would be draconian.

In contrast, we find that Sub-Zero and Whirlpool have not shown that they would experience real harm from the grant of exception relief. Their primary concern is that DRI, and its customer GE, could use the lower production cost of the non-compliant refrigerators to gain market share. Sub-Zero and Whirlpool argue that an exception relief recipient will not pass through its design and retooling cost during the relief period. We do not agree. As we indicated in a prior decision, firms pass through costs unless precluded by market conditions or a desire to increase market share. See Sub-Zero Freezer Co., 28 DOE ¶ _____ (January 31, 2001) (slip op. at 5-6). The exception relief will not change market conditions, which will apply to all the manufacturers of built-in refrigerators. Moreover, we believe that a limit or "cap" on the number of units that can be produced pursuant to the exception relief largely ameliorates the concern about loss of market share. Indeed, Sub-Zero and Whirlpool concede that a such limitation would mitigate their concern. Tr. at 24-25. On the other hand, DRI and GE vehemently oppose such a limit, arguing that a cap would be anti-competitive.

After considering this matter carefully, we have concluded that it is appropriate to place a cap on the relief. A cap on the relief accomplishes two important objectives. First, as indicated above, a cap addresses Sub-Zero's and Whirlpool's concerns about competitive harm. Second, a cap helps to assure that, in the future, firms will not view exception relief as a short term alternative to compliance and that recipients of relief will expeditiously bring themselves into compliance. Thus, the purpose of a cap is not to "punish" the recipient of exception relief, as suggested by GE, see Tr. at 35. Rather, the purpose of a cap is to avoid creating an advantage to the recipient during the pendency of the relief and to provide a fixed limit on any incentive for non- compliance with the efficiency regulations.

In choosing the number for the cap, we believe that the number should permit the firm to operate normally but should be designed to assure competitors that the recipient of relief is not at a competitive advantage. If we must err, we believe that it should be on the side of caution in order to recognize that competitors are the ones that took all the necessary steps to comply with the standards. This is an important matter, particularly given the recent promulgation of new efficiency standards for other appliances. See 66 Fed. Reg. 3312 (January 12, 2001), amended 66 Fed. Reg. 8745 (February 2, 2001) (clothes washers); 66 Fed. Reg. 3335 (January 12, 2001), amended 66 Fed. Reg. 8745 (February 2, 2001) (commercial heating, air conditioning and water heating equipment); 66 Fed. Reg. 7169 (January 22, 2001), amended 66 Fed. Reg. 8745 (February 2, 2001) (central air conditioners and heat pumps). We do not want this decision to have the effect of inviting non-meritorious applications for exception from those new standards. In this increasingly important area of appliance energy efficiency, we realize that the changes required for manufacturers are substantial. The availability of exception relief to adjust for serious mis-steps toward compliance helps to make the system work properly.(4) Nevertheless, an exception should be framed in a way that allows a manufacturer only to get back on schedule towards compliance without serious interruptions, not to gain advantage over its competitors. Accordingly, although we believe that DRI is entitled to six months of exception relief, from July 1, 2001 to December 31, 2001, we are limiting the relief as follows: (i) the relief is limited to DRI's side-by-side refrigerators, (ii) the relief during the period July 2001 through November 2001 for all models combined is limited to a maximum production of 1600 refrigerators in any given month, (iii) the relief for the month of December 2001 is limited to a maximum production of 800 refrigerators,(5) and (iv) the relief is contingent upon the filing of subject to monthly reports, due by the 15th of the month after the reporting month, listing the number of each model produced in the reporting month and showing DRI's progress in achieving compliance.

III. Conclusion

As the foregoing indicates, we have concluded that, in the absence of exception relief, DRI would suffer an unfair distribution of burdens. For that reason, we have concluded that DRI's exception should be granted with the limitations specified above.

It Is Therefore Ordered That:

(1) The Application for Exception filed by Diversified Refrigeration, Inc. (DRI) be and hereby is granted in part as set forth in Paragraphs 2, 3, and 4 below.

(2) The deadline for DRI's compliance with the July 1, 2001 refrigeration efficiency standards is extended from July 1, 2001 to December 31, 2001.

(3) The exception relief is limited to DRI's side-by-side refrigerators; the relief for the months during the period July 2001 through November 2001 for all models combined is limited to a maximum production of 1600 refrigerators in any given month; and the relief for the month of December 2001 for all models combined is limited to a maximum production of 800 refrigerators.

(4) For each month of the exception relief, DRI shall file a report showing (i) the number of non-compliant refrigerators produced that month, broken down by model number, and (ii) DRI's progress in achieving compliance with the new standards. The report shall be due by the 15th of the month immediately following the reporting month.

(5) This is a final order of the Department of Energy.

George B. Breznay

Director

Office of Hearings and Appeals

Date: March 2, 2001

(4)Sub-Zero comments dated August 7, 2000; Whirlpool comments dated August 10, 2000; GE comments dated August 10, 2000.

(3)We use the term “non-compliant refrigerators” to refer to those that comply with existing standards but will not comply with the new standards.

(4)No one disputes that the impact of the requested exception on energy conservation goals is de minimis. Over 9 million refrigerators are sold each year; as explained below, we are granting a six-month exception for a maximum of 8800 refrigerators.

(4)Scholars have recognized the important “safety valve” function that the exceptions process provides. See, e.g., Alfred C. Aman, Jr., “Administrative Equity: An Analysis to Administrative Rules,” 1982 Duke L.J. 277.

(5)The lower limit for December 2001 is based on DRI’s submissions in this proceeding, indicating that DRI will be ramping up production of compliant models during this month.