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Articles of Note

Department of Justice Restricts Supplemental Environmental Projects in Civil Enforcement Settlements

by Kim Bick

The Department of Justice issued a new civil enforcement settlement policy in June that may negatively impact the regulated community's ability to settle civil enforcement actions. Before this new policy, settlements with defendants in civil environmental enforcement actions could include a component paying for private party Supplemental Environmental Projects (SEPs).

SEPs require a defendant to undertake environmental projects that result in significant reductions in pollution or reduce risks to public health in the impacted community. The June 5 directive to restrict SEPs would remove a powerful tool that helped achieve settlements. It would eliminate tens of millions of dollars of annual funding of projects that historically have benefitted local communities on the wrong side of environmental justice, and niche environmental projects that would otherwise go unfunded. Prior Justice Department policies precluded *requiring* parties to include SEPs in settlements, but SEPs have been routinely used by Justice as an optional tool to achieve settlements by reducing the total penalty amount by incorporating environmental projects that benefit the impacted community. Eliminating SEPs as an optional tool to assist in the resolution of civil environmental enforcement actions could disincentive defendants from settling, leaving the Justice Department to litigate.

On June 5, Attorney General Sessions issued a memorandum, Prohibition on Settlement Payments to Third Parties, to all component heads and US Attorneys at Justice, including the Environment and Natural Resources Division. (https://www.justice.gov/opa/press-release/file/971826/download). In the memorandum, the Attorney General notes that certain prior settlement agreements included "payments to various non-governmental, third-party organizations as condition of settlement with the United States. These third-party organizations were neither victims nor parties to the lawsuits. The Department will no longer engage in this practice. Effective immediately, Department attorneys may not enter into any agreement on behalf of the United States in settlement of federal claims or charges, including agreements settling civil litigation … that directs or provides for a payment or loan to any non-governmental person or entity that is not a party to the dispute."

SEPs have been employed as optional settlement components since February 1991, when the US Environmental Protection Agency issued formal guidance allowing the use of SEPs in the settlement of civil environmental actions. In the past, EPA took position that SEPs further the federal goal of protecting and enhancing public health and the environment. EPA updated its policy recently in 2015 in a memo titled *Issuance of the 2015 Update to the 1998 U.S. Environmental Protection Agency Supplemental Environmental Projects Policy* (SEP Policy). (https://www.epa.gov/sites/production/files/2015-04/documents/sepupdatedpolicy15.pdf). Under EPA's 2015 policy, a defendant could agree to undertake an environmentally beneficial project related to the alleged violation in exchange for significantly reducing the penalty paid to the US Treasury. Typically, the cost to fund the SEP would be more than the mitigated amount of the penalty; therefore, the total cost to the settling defendant would be greater than a non-SEP penalty-only settlement. The settling defendant would be motivated, however, to settle under these

circumstances because the total "penalty" portion of the settlement reported to the public and shareholders would be significantly reduced. In fiscal year 2016, EPA civil settlements included approximately $32 million for the performance of SEPs. (See https://www.epa.gov/enforcement/enforcement-annual-results-numbers-glance-fiscal-year-2016).

The prior EPA SEP Policy prohibited any SEPs that were merely for cash donations in lieu of penalty funds, which would be in violation of the Miscellaneous Receipts Act, 33 U.S.C. § 3302(b). The June 5 Memo includes that prohibition, but also prohibits funding projects, such as SEPs, for any third-party entity that is not a party to the enforcement action. Under the new policy, the only SEPs that could be funded in a settlement are projects by government entities (including local and state entities), or additional projects at the defendant's facilities beyond those already required for compliance.

The June 5 Memo precludes the following types of SEPs that involved cash payments to uninvolved third parties:

- Purchasing renewable energy credits;
- Purchasing and preserving watersheds;
- Paying for repairs and removal of contamination or asbestos in communities impacted by environmental justice;
- Funding community projects implemented by nongovernmental organizations.

Following the June 5 Memo, the Acting Assistant Attorney General of ENRD has been pressured for detailed guidance on how the new policy will impact the use of SEPs in the settlement of civil environmental enforcement matters. At a minimum, the use of SEPs in civil settlements will face new scrutiny and additional limitations. It is likely that SEPs will not be entertained at all by ENRD lawyers attempting to settle such matters.

The Trump Justice Department has been critical of the agency's past settlements that included supplemental environmental projects and appears to be concerned about the diversion of penalty funds from the US Treasury to uninvolved third parties. SEPs also were criticized by the Obama Justice Department because of the appearance of leniency on large corporations. In 2016, Attorney General Brad Schimel in the Justice Department allowed 3M to make upgrades to a facility and avoid paying a financial penalty as part of the settlement, which was viewed critically. However, in 2016, EPA's enforcement efforts resulted in nearly $6 billion in civil penalties and required companies to fund over $13.7 billion for pollution control. (https://www.epa.gov/enforcement/enforcement-annual-results-numbers-glance-fiscal-year-2016). Contributing to this significant number was BP's $5.6 billion penalty for the Deepwater Horizon oil spill. The total penalty number does not, however, include the Clean Air Act settlement agreement with Volkswagen, which would have added nearly $15 billion to that figure. The Volkswagen settlement will be included in EPA’s fiscal year 2017 numbers.

Importantly, SEPs went hand in hand with the increase in self-reporting and volunteer stewardship by businesses. And, although total penalty amounts decreased, settlements increased with the use of SEPs. Under the June 5 policy, DOJ may be less likely to reach settlements unless they have very strong cases against alleged violators. Defendant companies may be unwilling to agree to a significant penalty to avoid the risk of litigation if the risk is not significant. Previously, a defendant company may settle to avoid litigation costs and negative press during litigation. Now, a defendant company may choose to litigate if their case is strong, weighing the cost of negative press during litigation against the cost of negative press related to a significantly high penalty amount in a settlement.

It appears that the goal of the June 5 Memo is to see penalty amounts increase and not be substituted for SEPs. However, eliminating SEPs may not result in an increase in penalties deposited to the US Treasury coffers. The Justice Department could end up with fewer cases settled, lower penalty totals collected annually, increased litigation costs to the taxpayer, and no guarantee of success in litigation. Under the prior EPA policy, SEPs were a win-win-win. The alleged violator could achieve a settlement with a lower "penalty" to report to shareholders, the Department of Justice would get a “W” and penalty

funds to the US Treasury (albeit less than without SEPs), and the local community would get an environmental project.

The Securities and Exchange Commission (SEC) mandates disclosure of certain types of legal proceedings in which a company or its property is involved. Specifically, Item 103 of Regulation S-K12 requires disclosure of actions that have actually been brought or that are known by the company to be contemplated by governmental authorities or private parties. (7 C.F.R. § 229.103 (2008)). Instruction 5(C) to Item 103 includes a "reasonable belief" standard under which there is no disclosure duty if the company reasonably believes that the action will result in monetary sanctions of less than $100,000. Importantly, in the past, an alleged violator could settle for less than $100,000 in penalties and fund a SEP, potentially avoiding reporting of the legal action, although there may be SEC reporting obligations for the SEP depending on the materiality of the cost. The $100,000 SEC reporting limit may still drive some penalties to be less than $100,000 in settlements offered by the Justice Department. If so, the Justice Department's June 5 Memo may serve only to eliminate environmental projects, and not to increase penalty funds accruing to the US Treasury. Time will tell if the ultimate result is lower overall penalty totals through government settlements, or if the Justice Department will seek greater penalties, either through settlement or litigation.

Although the June 5 Memo did not include citizens' suits in the policy, it is possible that the policy against SEPs will be extended to settlement of citizens' suits that must be approved by the Department of Justice. It is possible that private citizens and non-governmental organization plaintiffs will be incentivized to settle privately, out of court, instead of through a judicially approved settlement. There is already a cadre of plaintiffs who use citizens' suits for the main purpose of gaining attorneys' fees, not to achieve the goal and purpose of the citizens' suit provisions -- compliance with the underlying statute. Some of these plaintiffs' lawyers prefer out of court private settlements to avoid oversight by the Department of Justice. Without such oversight, there is no way to ensure that settlements achieve the goals of citizens' suit provisions. If 100% of the penalty in a citizens' suit settlement must be paid to the U.S. Treasury, and no funds will be allowed to pay for SEPs, then plaintiffs' counsel in citizens' suits will be incentivized to avoid a judicially approved settlement.

The elimination of private third-party SEPs from settlements will likely have far-reaching effects that should be monitored closely by corporations defending alleged violations of environmental regulations. Companies will need to carefully review litigation risk assessment if the Justice Department seeks heightened penalties in lieu of SEPs in settlements.

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