

**A Review of Texas' and Other States' Policies on  
Recovery of Economic Benefit Through  
Administrative Penalties in Environmental  
Enforcement**

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Luke Metzger

In December 2003, the Texas Commission on Environmental Quality (TCEQ) launched a year-long, comprehensive review of its enforcement program and practices. The review comes after a string of reports by state and federal auditors, non-profits and academics that document that the agency's "enforcement process does not consistently ensure that violators are held accountable".<sup>1</sup>

These studies detail the vast majority of illegal polluters who escape any kind of punishment, the many large polluting facilities which go years without inspections, and the lack of sufficient resources and political will to enforce the law aggressively and provide a credible deterrent against illegal pollution.

No issue is perhaps more illustrative of TCEQ's failures in enforcement than that of its penalty policy. While few violators ever reach the penalty stage in the enforcement process, those who do routinely face low fines. And thanks to an explicit TCEQ policy, many facilities actually profit from non-compliance, even after being assessed an administrative penalty.

A cornerstone of environmental enforcement is recapturing the economic benefit that a violator may have gained from illegal activity (known as the economic benefit of non-compliance or EBN). According to the U.S. EPA, "recapture helps level the economic playing field, preventing violators from obtaining an unfair financial advantage over their competitors who timely made the necessary investment in environmental compliance. Generically, penalties serve as incentives to protection of the environment and public health by encouraging the adoption of pollution prevention and recycling practices that limit exposure to liability for pollutant discharges. Finally, appropriate penalties help deter future violations by the violator and by others similarly situated."<sup>2</sup>

In Texas, however, TCEQ's penalty policies allow many of the entities that violated Texas law to escape re-payment of all or part of EBN. According to a review of eighty enforcement cases over three years by the Texas State Auditor, TCEQ staff estimated that violators enjoyed an economic benefit of \$8,647,005 through non-compliance. However, the fines assessed by TCEQ amounted to only \$1,683,635, approximately 19 per cent of the violators' economic benefit. The Auditor attributed this failure to TCEQ's penalty policy.<sup>3</sup>

A more recent review by TexPIRG confirms that this TCEQ practice continues. For example, a review of a number of enforcement cases since September 1, 2003 reveal that many of the EBNs calculated by TCEQ were not collected as penalties (Figures are from TCEQ Penalty Worksheets).

<sup>1</sup> State Auditor's Office, State of Texas. *An Audit Report on the Commission on Environmental Quality's Enforcement and Permitting Functions for Selected Programs*. December 2003

<sup>2</sup> Environmental Protection Agency, Office of Enforcement and Compliance Assurance. *Identifying and Calculating Economic Benefit That Goes Beyond Avoided And/Or Delayed Costs*. May 25, 2003

<sup>3</sup> State Auditor's Office, State of Texas. *An Audit Report on the Commission on Environmental Quality's Enforcement and Permitting Functions for Selected Programs*. December 2003

| <b>FACILITY</b>                    | <b>County</b> | <b>ORDER DATE</b> | <b>MEDIA</b>                 | <b>ECONOMIC BENEFIT</b> | <b>PENALTY IMPOSED</b> |
|------------------------------------|---------------|-------------------|------------------------------|-------------------------|------------------------|
| Equistar Chemicals, LP             | Harris        | 4/5/04            | Water Quality                | \$494,946               | \$54,725               |
| City of Trenton                    | Fannin        | 10/10/03          | Water Quality                | \$653,589               | \$6120                 |
| Harris County WCID No. 1           | Harris        | 11/16/03          | Water Quality                | \$630,604               | \$66,000               |
| City of Whitehouse                 | Brazoria      | 12/21/03          | Water Quality                | \$606,456               | \$24,890               |
| Pilgrim Poultry, G.P.              | Camp          | 4/19/04           | WWA                          | \$449,177               | \$200,000              |
| Galveston Environmental Services   | Galveston     | 3/22/04           | Industrial & Hazardous Waste | \$82,462                | \$48,125               |
| Luce Bayou Public Utility District | Harris        | 9/25/03           | Water Quality                | \$76,542                | \$19,475               |
| Thousand Trails, Incl              | Rains         | 3/22/04           | Water Quality                | \$14,026                | \$10,800               |
| Calidad Environmental Services     | Bexar         | 3/14/04           | Industrial & Hazardous Waste | \$11,049                | \$4080                 |

### **Texas Economic Benefit Policy Allows Many Polluters to Profit from Violations**

Polluters gain an economic benefit by delaying or avoiding legally required pollution control measures. Money not spent on compliance measures is then available for other profit-making activities. Alternately, polluters may gain an illegal competitive advantage through non-compliance. For example, if a company sells its products at a lower cost than its law-abiding competitors.

The State Auditor was not the first to encourage the agency to recover the EBN. In 1993, the Comptroller of Texas issued a Performance Review of the Texas Air Control Board (one of three agencies merged into what is now TCEQ) documented the failures of the agency to assess fines that recovered the EBN.

The report pointed out that several states, including Florida, Illinois, Minnesota, and Virginia were recovering the EBN in the early 90s. While Texas statutes already gave regulators the authority to recover the full EBN, the Performance Review recommended that legislation be passed that explicitly directed agency staff to recover EBN.

In 1994, the newly formed TNRCC adopted this approach in their enforcement philosophy:

*Some entities may – consciously or unconsciously – decide that the costs of compliance are just too great when considered against the likelihood of being caught and substantially penalized... If non-compliance yields considerable cost savings, and there is little expectation of enforcement... being accompanied by substantial monetary consequences beyond the costs of coming into compliance at that later date, then an entity driven primarily by economic considerations will choose to pollute and take the consequences later.*

*To offset the advantages of non-compliance for entities driven primarily by such economic considerations, enforcement penalties must at least exceed the costs saved by a company operating in violation of environmental laws before any real deterrent effect is achieved. This requires recovering economic benefits of non-compliance plus a penalty component designed to achieve deterrence in appropriate cases.<sup>4</sup>*

By 1997, however, TNRCC moved away from this philosophy and developed new policies that did not seek to ensure recovery of the EBN. Thus, in approving the state's application for authorization to implement the federal NPDES program on September 14, 1998, EPA wrote:

Although EPA urges states to implement penalty authority in a manner equivalent to EPA's, it is not required... While authority to collect economic benefit exists, TNRCC's policy allows for mitigation of penalties to zero in some instances. Therefore, there is no guarantee that economic benefit, at a minimum, will be collected by TNRCC in all cases.<sup>5</sup>

The new policy directed TCEQ staff to calculate what, if any, economic benefit a violator gained through non-compliance. If the benefit was less than \$25,000, there was no attempt to either recover the economic benefit or increase the base penalty by some amount. This gave polluters a \$25,000 'free-ride' on economic benefit. If the benefit was over \$25,000, then TCEQ staff were to increase the base penalty by 10 to 50%, depending on 'culpability'. Later, the threshold was lowered to \$15,000. Under either formula, polluters often realized economic benefits that exceeded their penalties.<sup>6</sup>

For example, if a violator was found to have gained an economic benefit of \$100,000 through non-compliance, but their base penalty was only \$1000 (which was the average TCEQ penalty for clean water violations in 2001), the penalty enhancement for economic benefit could only be as much as \$500. The total penalty would amount to only \$1500, for a net savings of \$98,500.

<sup>4</sup> Texas Commission on Environmental Quality 1994 Enforcement Policy

<sup>5</sup> 63 Fed. Reg. 51164, 51174 (Sept. 24, 1999). EPA added, "Through its oversight role, EPA will work with TNRCC to ensure that the penalties collected under the TPDES program are consistent with those required by the NPDES program including, where appropriate, the collection of economic benefit.

<sup>6</sup> This current policy is found in the agency's penalty policy, found in TCEQ Publication RG 253, dated September 2002, and available on TCEQ's website.

## Other States' Policies Provide Better Model for Texas

In early 2004, TexPIRG performed a survey of states to determine how EBN was handled in other states. Most states responding to a TexPIRG survey list recovery of EBN as one of several factors to be "considered" when calculating penalties. A number of states, however, require full recovery of EBN.

For example, Oklahoma's Department of Environmental Quality (ODEQ) has the policy that uses economic benefit of non-compliance as the floor for its penalties.

In determining an appropriate fine, the starting point is to estimate, in so far as possible, the economic benefit (if any) which has accrued to the respondent by virtue of the noncompliance...the assessed fine should at least recover the economic benefit of noncompliance.<sup>7</sup>

Illinois law requires that:

In determining the appropriate civil penalty to be imposed...the Board shall ensure, in all cases, that the penalty is at least as great as the amount of economic benefits, if any, accrued by the respondent as a result of the violation, unless the Board finds that imposition of such penalty would result in an arbitrary or unreasonable hardship.<sup>8</sup>

Tennessee's Department of Environment and Conservation indicates that it uses EPA's penalty policies, at least for hazardous waste violations, and references EPA guidelines<sup>9</sup> that requires for the recapture of

significant economic benefit of noncompliance that occurs to a violator from noncompliance with the law. It is incumbent on all enforcement personnel to calculate economic benefit. An economic benefit should be calculated and added to the gravity-based penalty component when a violation results in significant economic benefit to the violator.

South Dakota's Department of Environmental and Natural Resources responded to TexPIRG's survey with a letter from its Surface Water Quality Program that stated the state's policy

requires a penalty to include that amount which will offset any advantage to the entity for non-compliance. It does not prescribe a process to calculate that penalty but requires that a reasonable method be used...The policy...specifies that the EPA computer program BEN...can be used...<sup>10</sup>

<sup>7</sup> ODEQ Administrative Procedures Manual, Enforcement Section, page 6, revised 12/26/01.

<sup>8</sup> 415 ILL. COMP. STAT. 5/42 (Civil Penalties at § 42(h)(5)(7), (2003).

<sup>9</sup> Letter of February 20, 2004 from Tennessee Dept. of Envi. And Cons. to Luke Metzger, TexPIRG, in file of author

<sup>10</sup> Letter of February 20, 2004 from South Dakota Dept. of Envi and Nat. Res. To Luke Metzger, TexPIRG in the files of the author.

Moreover, even in the other twenty states that responded to TexPIRG's survey and that do not explicitly require recovery of the EBN, none provide for the type of limited recovery in TCEQ's penalty policy. Instead, these states' policies largely direct enforcement staff to attempt to recover any economic benefit.

### **Case Study**

Pilgrim's Pride is the second-largest chicken producer in the United States, with sales of over \$2.6 billion in 2003. The East Texas company has a long history of violations of environmental laws, stemming from improper treatment and illegal discharges of animal waste.

On April 19, 2004, TCEQ finalized an enforcement order for Pilgrim's failure to properly maintain its waste lagoons. TCEQ staff estimated the company saved \$449,177 by failing to comply with the law. Yet, Pilgrim was only ordered to pay only \$200,000, for a net savings of \$249,177. For this multi-million dollar company, it paid to pollute.

### **Calculation of Economic Benefit**

Understandably, regulated industries, which oppose the recovery of economic benefit in general or for their violations, question how economic benefit is calculated. The courts that have reviewed the standard models, however, have upheld them. The Third Circuit ruled:

Precise economic benefit to a polluter may be difficult to prove. The Senate Report accompanying the 1987 amendment that added the economic benefit factor to section 309(d) recognized that a reasonable approximation of economic benefit is sufficient to meet plaintiff's burden for this factor. . . . The determination of economic benefit or other factors will not require an elaborate or burdensome evidentiary showing. Reasonable approximations of economic benefit will suffice.<sup>11</sup>

In the mid-1980s, EPA developed a computer model to assist enforcement officials in making this 'reasonable approximation'. This 'BEN model' quantifies a company's economic savings that result from delaying capital investments in pollution control equipment and avoiding related operations and maintenance expenses. The model seeks

<sup>11</sup> *Public Interest Research Group of New Jersey, Inc. v. Powell Duffryn Terminals, Inc.* 913 F. 2d 64 (3d Cir. 1990), cert. Denied, 498 U.S. 1109 (1991). The Fifth Circuit also holds that reasonable approximations of economic benefit will suffice, stating:

"Finally, and most importantly, we note that a court need only make a "reasonable approximation" of economic benefit when calculating a penalty under the CWA." *Sierra Club, Lone Star Chapter v. Cedar Point Oil Co.*, 73 F. 3d 546, 576 (5<sup>th</sup> Cir. 1996), cert. Denied, 519 U.S. 811 (1996), citing A survey of twenty-seven states found that over 50% of the respondents currently use the BEN model. Other states, including Texas, use their own matrices to calculate EBN. *Powell Duffryn* at 80.

to use standard financial cash flow and net present value analysis techniques, based on generally accepted financial principles. The model attempts to calculate the costs of complying on-time and of complying late, adjusted for inflation and tax deductibility. However, the BEN model for calculating economic benefit is not all that needs to be examined.<sup>12</sup>

In 1999, EPA conducted a public review of the model. In addition to improving BEN's precision and user-friendliness, EPA developed a separate model to calculate any competitive advantage gained by a violator through increased market share or sale of products containing banned materials.<sup>13</sup>

## **Conclusion**

The issue of recovery of economic benefit is gaining attention from decision-makers, the media, and the public.

On March 11, 2003, Attorney General John Ashcroft announced that the number one priority for the Department of Justice's Environment and Natural Resources Division was to "Level the playing field" and "focus on bringing recalcitrant members of a regulated industry into compliance with applicable laws and on recovering the economic benefit gained by recalcitrants when they avoid compliance costs."<sup>14</sup>

A July 2003 EPA review of TCEQ's management of the National Pollution Discharge Elimination System (NPDES) also found significant enforcement problems. EPA recommended TCEQ change their penalty policy to "Collect at least the economic benefit of noncompliance and the gravity portion for the actual time period of noncompliance. This practice would serve to "level the playing field" and make it economically impractical to violate the permit requirements".<sup>15</sup>

In the 78<sup>th</sup> regular session of the Texas Legislature, Representative Eddie Rodriguez filed HB 877 and Senator Juan Hinojosa filed SB 1878. The bills would have required the TCEQ, to the extent practicable, recover in administrative penalties the full economic benefit of non-compliance. TCEQ is also considering making this change administratively, as they have the authority to do.

<sup>12</sup> For example, in *U.S. v. Municipal Authority of Union Township*, 150 F.3d 259 (3d Cir. 1998), the court affirmed the right of enforcement officials to calculate economic from wrongful profits. The case examined penalties assessed by EPA for illegal discharges to a township's POTW. The increased volume of discharges led to higher usage fees from the POTW in excess of the cost of compliance. EPA calculated that the company gained wrongful profits from the violation. The court stated "it is significant that neither the statute nor the case law supports the contention that the cost-avoidance method is the only permissible method of determining the amount the polluter has gained from violating the law." *Id.* At 266. In this case, use of the BEN model would not have adequately penalized the company for the violation.

<sup>13</sup> Federal Register: July 21, 1999 (Volume 64, Number 139)[Notices][Page 39135-39136]

<sup>14</sup> U.S. Department of Justice Environment and Natural Resources Division. Factsheet on Environmental Enforcement Accomplishments. July 31, 2003. Available at <http://japan.usembassy.gov/e/p/tp-20030805b2.html>

<sup>15</sup> Environmental Protection Agency Region 6. Audit of Texas management of NPDES program. 2003

TCEQ penalty policy currently disadvantages law-abiding businesses, deprives the state of critical revenue and creates a perverse incentive to pollute. Whether legislatively or administratively, Texas needs to follow the recommendation of EPA and require full recovery of the economic benefit of non-compliance.

This change will help improve deterrence efforts by TCEQ, eliminate the competitive disadvantage law-abiding businesses are currently subject to, will likely initially increase fines put into the General Revenue, and will help restore the public faith in TCEQ.