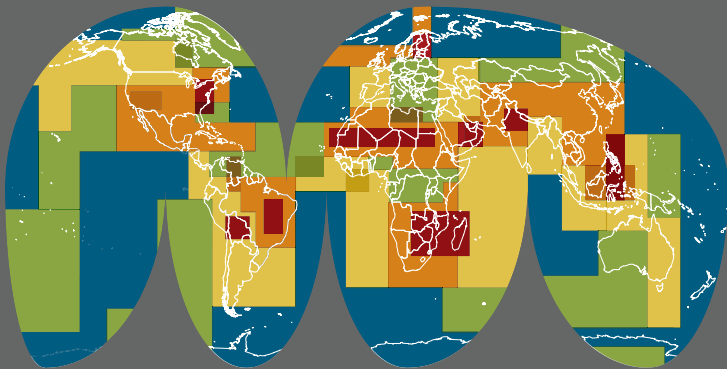


Bigger Environmental Issues – Tougher Regulatory Responses



A SPECIAL FOCUS PRESENTED BY
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Since the fall, 2005, Executive Counsel special focus on climate change, the debate has intensified. In New York and Mississippi, pending lawsuits claim that greenhouse gases cause hurricanes and rising sea levels. International tribunals have been asked to find the United States in violation of treaty obligations for failing to regulate greenhouse gases.

Litigation in the Supreme Court seeks to force EPA to regulate those gases under the Clean Air Act. And this says nothing of the layers of activity involving state, national and international regulatory bodies.

The three climate change articles in this year's special edition frame the policy debate. While there are striking differences in perspective, what is most interesting is the degree of convergence.

- None disputes that the atmosphere is warming, or that human activity is a contributing factor. The debate is over how much warming will occur and how fast, and the relative human contribution.
- There is no dispute that any regulatory response should be national or international. As one writer comments, a patchwork of state and regional programs could spell confusion and bureaucracy.
- There is no dispute that technology and corporate ingenuity are the keys to a meaningful response.

At this point, the policy debate becomes more nuanced. Efficiency improvements and wind power can satisfy demand and carry the economy only so far. How can incentives for technologies that will make a difference be created? To some, the answer is a cap-and-trade

program modeled on the Kyoto experiment, whose results to date are decidedly mixed. To others, it is a broad-based carbon tax. To still others, it is a system of incentives for research to improve existing technologies and develop new ones, and for technology transfer combined with intellectual property rights protection.

The question that arises in all three articles – how to create incentives for transforming technologies that will move us beyond carbon dependence – will dominate the climate change debate in the coming years.

One aspect of policy that is unlikely to change is discussed in the articles concerning environmental enforcement. The perception about which environmental issues require the most immediate attention varies from one region to another, but the trend is toward more regulation and tougher enforcement. The three articles on environmental enforcement make clear that the criminal enforcement option is receiving increased attention in the United States and abroad. Companies have no choice but to update environmental management programs in light of the domestic and international legal and policy considerations that are reviewed in these articles.

Table of Contents

- | | | | |
|-----------|--|-----------|---|
| 30 | New EPA Enforcement Chief Promises Criminal Prosecutions By F. William Brownell and David C. Lashway | 38 | Iowa's Solution To Foreign Oil Dilemma By Governor Tom Vilsack |
| 34 | Environmental Violations Can Lead to Criminal Charges Abroad By Turner T. Smith, Jr., David J. van Hoogstraten and Lucas Bergkamp | 40 | Board Oversight of Environmental Management After Sarbanes-Oxley By Steven P. Solow and Karl Richard Heisler |

New EPA Enforcement Chief Promises Criminal Prosecutions

Challenge for Corporate Managers

By F. William Brownell and David C. Lashway

In July 2005, the new head of EPA's enforcement office, Granta Nakayama, announced his intention to strengthen criminal enforcement of environmental laws. According to Nakayama, "use of criminal enforcement helps ensure that

those ... whose actions cause or threaten harm for the sake of profit ... will put both their fortune and liberty at risk."

In commenting on sentences for company officials in a recent Clean Air Act criminal case, Nakayama added: "Prosecutions will go as high up the corporate hierarchy as the evidence permits ... We will hold senior managers of corporations accountable."

In pursuit of stronger criminal enforcement, Nakayama has promised that cooperation between the civil and criminal enforcement programs at EPA will increase. Among other things, Nakayama has said that EPA will pursue criminal prosecutions for egregious environmental violations even if the matter originates as a civil investigation. EPA is considering co-locating the civil and criminal investigative offices around the country, despite concerns about the possible use (or misuse) of civil process in aid of criminal investigations.

Nakayama is not writing on a clean slate. Criminal enforcement of environmental laws has been on the rise over the past decade. EPA's criminal enforcement program achieved near record levels of fines and jail time in

2005 – including total sentences of almost 200 years and \$100 million in fines and restitution. In addition, EPA initiated almost 400 environmental crime investigations, and more than 300 defendants were charged with environmental crimes.

In addition, Congress in 2005 increased EPA's budget for criminal enforcement. Among other things, EPA is moving to hire new criminal investigators, and they will be looking for things to do.

Recent cases suggest areas of possible emphasis, as well as steps that companies might take to manage and to mitigate increased criminal enforcement risks.

NEW AREAS FOR CRIMINAL ENFORCEMENT

Historically, criminal enforcement of environmental laws has focused on narrowly drawn programs that address immediate threats to public health or welfare, and where knowledge and culpability are easily established. Prime examples include programs governing the use and disposal of asbestos-containing materials, oil spills, ocean dumping, and use or importation of ozone-depleting chemicals.

EPA



In each of these areas, prosecutors can identify a person or entity directly responsible for the alleged environmental threat. The nature of the compliance obligation is sufficiently simple that proof of knowledge or guilty intent may not be difficult, and given the nature of the substances at issue, the consequences of the alleged violation for public health and the environment can be severe.

During 2005, violations of asbestos regulations resulted in fines and prison sentences in federal jurisdictions ranging from Pennsylvania (*U.S. v. Kay*) to Colorado (*U.S. v. Backus*) and Arizona (*U.S. v. Springer*). In one case, *U.S. v. Thorn*, the defendant received a sentence of 168 months. Indictments were returned for violations of the asbestos program in Montana (*U.S. v. W.R. Grace*) and Utah (*U.S. v. Young*). During 2005, cases involving ocean dumping and oil spills led to fines of up to \$25 million in one case and substantial prison sentences of up to 33 months in others, in Alaska, Oregon, California, Massachusetts, New York and Florida.

The narrow focus of these environmental programs has meant that criminal enforcement of environmental law has been of interest to relatively narrow segments of corporate America.

This is changing. With the maturing of environmental regulatory programs and the additional resources available for criminal enforcement, the government is now in a position to apply what it has learned in this early round of prosecutions to more broadly-applicable environmental programs, including environmental permitting, reporting and compliance certification obligations.

During 2005, for example, the government successfully prosecuted the first criminal case under the Clean Air Act "new source review" program, for failure to obtain pre-construction permits for modification of an existing furnace (*U.S. v. Tyler Pipe Co.*, in the eastern district of Texas). Acting without necessary environmental permits led to criminal convictions under the Resource Conservation and Recovery Act in cases in Minnesota, Texas and Pennsylvania.

During 2005, EPA also used its criminal enforcement authorities to prosecute discharges of pollutants without permits under the Clean Water Act in Virginia, Delaware, Florida, Alabama, North Carolina, California and Missouri. The incorrect delineation of wetlands to avoid wetland permitting gave rise to criminal prosecution in *U.S. v. Ball*. In these cases, prison sentences ranged up to 24 months, with fines in excess of \$5 million.

Extensive monitoring and reporting requirements under the traditional environmental regulatory programs are generating vast amounts of data. These data and reports are the raw materials that the new

criminal investigators will use in coming years. Managing this information to ensure that it is handled properly, and that its implications are understood and acted upon by corporate managers, is more important than ever.

OMISSIONS A RED FLAG

In preparing for increased criminal enforcement, it's important to understand what makes a case criminal. Recent enforcement actions shed light on what draws the prosecutor's attention.

First, given the complexity of environmental regulation, prosecutors are more comfortable with cases that have traditional criminal law aspects, including false statements to the government. Because environmental regulatory programs require frequent submission of reports and documents – including monitoring data, permit applications, and supporting materials – inaccuracies in such documents can give rise to enforcement scrutiny. Not surprisingly, many recent criminal enforcement cases involve allegations of false statements or the omission of critical information.

During 2005, for example, the defendants in *U.S. v. McWane, Inc.* were charged with falsifying air pollution tests, and the defendants in *U.S. v. Tyler Pipe Co.* pled guilty to false statements made in a Clean Air Act Title V operating permit. In *U.S. v. Kellogg*, in the eastern district of Pennsylvania, defendants were charged with or convicted of falsifying water quality tests under the Clean Water Act.

To establish criminal liability for false statements, the government must show that the person signing the report knew that the facts were false at the time it was signed. Under the "responsible corporate officer" doctrine, however, any person who is in a position to prevent the wrong and fails to act, or who shields himself from knowledge of wrongdoing, may face liability. Under environmental laws, management's obligation to certify compliance or completeness of reports and applications ensures additional scrutiny.

Under the Clean Air Act, for example, permit applications must contain "certification of compliance with all applicable requirements by a responsible official." Responsible officials also have a duty to certify the completeness of permit applications. Among other corporate officials, officers in charge of a principal business function or responsible for operation of one or more facilities in a corporation are considered "responsible" for purposes of the Act.

Scrutiny of permit applications and reports may focus on omission as well as commission, or even on a failure to inquire further where warning signals exist that would have led a reasonable person to ask questions.

In commenting on a recent criminal prosecution under the Clean Air Act, the Chief of the Justice Depart-

ment's Environmental Crimes Section observed that "protecting local communities from harmful air pollution depends upon honest reporting by regulated companies." That is, fulfilling reporting and investigation responsibilities established by environmental programs promptly and accurately is viewed as critical to the effective functioning of those programs.

Underscoring the importance of accurate and timely reporting, the failure to investigate has been a focus of recent criminal prosecution. In *U.S. v. Royal Canin USA, Inc.*, although the company officials discovered a spill and took some measures to mitigate it, they did not investigate its full extent or report it to the authorities. Their failure to act resulted in criminal enforcement.

The operation of any industrial facility requires a variety of environmental permits and notifications, and these permits have become the repository of most environmental compliance obligations. As a result, it isn't surprising that recent criminal enforcement cases have focused on the failure to obtain necessary permits, including permits for the construction, modification or operation of industrial facilities, and for the release or disposal of pollutants.

During 2005, failure to obtain necessary permits led to indictments, guilty pleas and convictions under the Clean Air Act for failure to obtain pre-construction permits; under the Clean Water Act for failure to obtain permits to discharge or to dredge and fill in wetlands; and under the Resource Conservation and Recovery Act, for failure to obtain necessary treatment, storage or disposal permits.

Criminal enforcement is a more likely result where the substance released is hazardous, or its impact on public health or welfare is immediate. In such cases, a prosecutor can be expected to argue that the company has a higher duty of care, and that knowledge of the unlawful activity should be attributed to the company and its management. During 2005, criminal sentences under the Clean Air Act and Clean Water Act included fines and prison time for violations relating to the release of hazardous substances from a tank explosion, and the discharge of untreated industrial wastewater to navigable waters.

Finally, while "culpable conduct" will draw a prosecutor's attention, some environmental statutes now criminalize ordinary negligence. Under the Clean Air Act, for example, it is a crime to "negligently release" hazardous substances, so as to "negligently place another person in imminent danger" of serious injury.

In a recent Clean Air Act case, a company paid a \$10 million criminal fine for negligently endangering the lives of workers by improper storage of hazardous substances, which resulted in uncon-

trolled releases into the air and an adjacent river (*U.S. v. Motiva Enterprises*).

In a recent Clean Water Act case, an "act of ordinary negligence" that led to the discharge of a pollutant into a river resulted in criminal enforcement (*U.S. v. Ortiz*). In this case, the court of appeals explained that the Clean Water Act does not require a defendant to know that a discharge will enter "waters of the United States." Rather, an individual or corporation can be liable for failing to exercise reasonable care regarding how the substances have been managed or treated.

UPDATE MANAGEMENT PRACTICES

If recent remarks by government officials are taken at face value, there will be greater use of criminal enforcement as a compliance tool in coming years. This will include an increase in criminal prosecutions under traditional environmental regulatory programs, increased scrutiny of discharge reports and compliance certifications, and perhaps even a blurring of the line between civil and criminal enforcement. Fines and prison terms can be significant.

Absent a clearly constituted theory of enforcement, how does a company mitigate the risks that environmental violations will be viewed as criminal behavior?

A first step is to be alert to what the government says it will do, and then to track what it actually does. What is learned can then be reflected in a company's environmental management program. Such programs must be periodically updated, tested and audited if they are to provide needed protections.

Beyond the mere existence of an environmental management program, a corporate culture that includes a commitment to compliance and appropriate rewards for promoting compliance, or sanctions for conduct that does not, is critical. Companies with such programs should have little to fear from EPA's increased focus on criminal enforcement.



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