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## Expanding the Use of Supplemental Environmental Projects

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# EXPANDING THE USE OF SUPPLEMENTAL ENVIRONMENTAL PROJECTS

## INTRODUCTION

On June 11, 2003, the Environmental Protection Agency (EPA) released a memorandum announcing its goal to encourage and expand the use of Supplemental Environmental Projects (SEPs) in settlements.<sup>1</sup> SEPs are “environmentally beneficial projects which a defendant . . . agrees to undertake in settlement of an enforcement action, but which the defendant . . . is not otherwise legally required to perform.”<sup>2</sup> In settlements of environmental enforcement actions, the EPA generally requires alleged violators to comply with federal environmental regulations and to pay a monetary penalty.<sup>3</sup> The EPA will reduce the required payment in certain enforcement actions if the alleged violator agrees to perform a Supplemental Environmental Project as part of the settlement.<sup>4</sup> The inclusion of SEPs in settlements furthers the “EPA’s goals to protect and enhance public health and the environment.”<sup>5</sup> In its June 2003 memorandum, the EPA noted that SEPs are being underutilized<sup>6</sup> and that there is tremendous potential to achieve even greater benefits for the environment with the increased use of SEPs in settlements.<sup>7</sup>

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1. “The purpose of this memorandum, therefore, is to summarize the foundation underlying our SEP Policy and to announce the actions we are taking to encourage and expand the use of SEPs in the settlement of enforcement actions.” Memorandum from John Peter Suarez, Assistant Adm’r, Env’tl. Prot. Agency, to Assistant Adm’rs et al. 1 (June 11, 2003), *available at* <http://www.epa.gov/compliance/resources/policies/civil/seps/seps-expandinguse.pdf> [hereinafter Expanding the Use of SEPs Memo].

2. Final EPA Supplemental Environmental Projects Policy Issued, 63 Fed. Reg. 24,796, 24,797–98 (May 5, 1998) [hereinafter 1998 SEP Policy] (typeface altered) (emphasis omitted).

3. *Id.* at 24,796.

4. *Id.* at 24,797.

5. *Id.* at 24,796.

6. *See* Expanding the Use of SEPs Memo, *supra* note 1, at 1.

7.

During FY2002, 10% of our civil judicial and administrative penalty settlements included SEPs valued at a total of \$56.5 million dollars. While we should be proud of these figures, I believe that we have a tremendous opportunity to achieve greater benefits for the environment and communities affected by violations. Through settlements containing SEPs, we have the opportunity to not only bring regulated entities into compliance, but to secure public health and environmental benefits in addition to those achieved by compliance with applicable laws. As such, all enforcement staff should consider every opportunity to increase our use of SEPs and include more environmentally significant SEPs wherever possible.

*Id.*

In order for an SEP to be included as part of the settlement, the defendant must propose and agree to carry out a project that the EPA determines qualifies as an SEP.<sup>8</sup> The project must meet several requirements to qualify.<sup>9</sup> One of the most limiting of these requirements is the nexus requirement, which states that there must be an adequate “relationship between the violation and the proposed project.”<sup>10</sup> In some situations, there is simply no feasible project that meets this nexus requirement; therefore, an SEP cannot be included in the settlement. After the EPA accepts the proposed project, it determines the appropriate percentage to lower the penalty.<sup>11</sup> The current SEP policy does not allow the mitigation percentage to exceed 80% of the SEP cost;<sup>12</sup> therefore, a defendant who agrees to perform an SEP will end up paying more than it would have if it had simply paid the penalty.<sup>13</sup> The EPA’s current SEP policy fails to maximize the benefits that could be realized from the use of SEPs in settlements. This Note argues that the EPA’s current SEP policy could be improved by creating and managing an Environmental Trust that would be used to complete SEPs, increasing the mitigation percentage to 100% and relaxing the nexus requirement, and allowing third-party contractors to bid on and carry out SEP contracts.

This Note consists of five parts. Part I provides a brief historical overview of SEPs and explains the current SEP policy in greater detail.<sup>14</sup> Part II explores the reasons for the underutilization of SEPs in settlements

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8. See 1998 SEP Policy, *supra* note 2, at 24,797.

9. *Id.*

10. *Id.* at 24,798.

[All SEPs] must have adequate nexus. Nexus is the relationship between the violation and the proposed project. This relationship exists only if: a. The project is designed to reduce the likelihood that similar violations will occur in the future; or b. The project reduces the adverse impact to public health or the environment to which the violation at issue contributes; or c. The project reduces the overall risk to public health or the environment potentially affected by the violation at issue.

*Id.*

11. *Id.* at 24,797.

12. *Id.* at 24,802.

13. There are two exceptions to the 80% ceiling on the mitigation percentage.

(1) For small businesses, government agencies or entities, and non-profit organizations, this mitigation percentage of the SEP COST may be set as high as 100 percent if the defendant/respondent can demonstrate the project is of outstanding quality. (2) For any defendant/respondent, if the SEP implements pollution prevention, the mitigation percentage of the SEP COST may be set as high as 100 percent if the defendant/respondent can demonstrate that the project is of outstanding quality.

*Id.*

14. See *infra* Part I.

despite the EPA's policy on expanding the use of SEPs.<sup>15</sup> Part III suggests that the EPA should alter the SEP policy by creating an Environmental Trust, increasing the mitigation percentage, relaxing the nexus requirement, and allowing third-party contractors to bid on SEP contracts in order to increase the utilization of SEPs.<sup>16</sup> Part IV focuses on whether or not the EPA has the authority to make the alterations suggested in Part III.<sup>17</sup> Part V of this Note highlights how creation of the Environmental Trust, changes to the mitigation percentage and nexus requirement, and use of third-party contractors improve the EPA's current SEP policy and discusses some of the weaknesses of the proposal.<sup>18</sup>

## I. THE DEVELOPMENT OF SEPS

### A. *Historical Overview of SEPs*

SEPs were first used in the settlement of environmental enforcement actions in the 1980s.<sup>19</sup> The first written reference to SEPs was in the EPA's 1980 Penalty Policy.<sup>20</sup> From the beginning, the EPA has been cautious with the use of SEPs and has placed several restrictions on their use.<sup>21</sup> The Department of Justice (DOJ) objected to the EPA's use of SEPs.<sup>22</sup> The DOJ claimed, among other things, that the use of SEPs violated the appropriations process by allowing penalties that should be paid into the United States Treasury to be used by defendants to carry out SEPs.<sup>23</sup> The United States Comptroller General, head of the General Accounting Office (GAO), has also been an outspoken opponent of

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15. See *infra* Part II.

16. See *infra* Part III.

17. See *infra* Part IV.

18. See *infra* Part V.

19. Edward Lloyd, *Supplemental Environmental Projects Have Been Effectively Used in Citizen Suits to Deter Future Violations as well as to Achieve Significant Additional Environmental Benefits*, 10 WIDENER L. REV. 413, 415 (2004).

20. *Id.*

21. See Kenneth T. Kristl, *Making a Good Idea Even Better: Rethinking the Limits on Supplemental Environmental Projects*, 31 VT. L. REV. 217, 222–24 (2006); Leslie J. Kaschak, Note, *Supplemental Environmental Projects: Evolution of a Policy*, 2 ENVTL. LAW. 465, 467–73 (1996).

22. See *Environmental Credit Projects Under Clean Water Act: Hearing on H.R. 3411 Before the Subcomm. on Fisheries and Wildlife Conservation and the Environment and the Subcomm. on Oceanography of the H. Comm. on Merchant Marine and Fisheries*, 100th Cong. 61–62 (1987) (statement of Raymond Ludwizewski, Associate Deputy Attorney General, U.S. Department of Justice) [hereinafter DOJ Statement].

23. Quan B. Nghiem, Comment, *Using Equitable Discretion to Impose Supplemental Environmental Projects Under the Clean Water Act*, 24 B.C. ENVTL. AFF. L. REV. 561, 568 (1997).

SEPs.<sup>24</sup> In 1992, the Comptroller General issued an opinion stating that the EPA did not have the authority to use SEPs in settlements,<sup>25</sup> because this practice violated the Miscellaneous Receipts Act (MRA).<sup>26</sup>

Despite the opposition by the DOJ and GAO, courts have found that payments do not have to be paid to the Treasury as long as they are not defined as “penalties” and are made before the defendant is found liable.<sup>27</sup> Settlements are made before a finding of liability; therefore, SEP payments do not fall under the MRA.<sup>28</sup> The Clean Air Act is the only environmental statute in which Congress has explicitly mentioned the use of SEPs.<sup>29</sup> However, SEPs have been used extensively and Congress has not imposed any restrictions on the EPA’s use of SEPs.<sup>30</sup> “Congress is aware of the use of SEPs by the EPA, and has, through legislative history and proposed bills,” displayed congressional acquiescence to the EPA’s use of SEPs.<sup>31</sup>

The EPA created the first SEP policy in 1991.<sup>32</sup> The 1991 SEP Policy identified five categories that a proposed project could fall under to qualify as an SEP; it also contained a requirement that the SEP be related to the violation (nexus requirement) and allowed the cost of the SEP to mitigate the monetary penalty by 100%.<sup>33</sup> In 1995, the EPA revised the SEP

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24. Lloyd, *supra* note 19, at 426.

25.

The Environmental Protection Agency lacks authority to settle mobile source air pollution enforcement actions brought pursuant to section 205 of the Clean Air Act . . . by entering into settlement agreements that allow alleged violators to fund public awareness and other projects relating to automobile air pollution in exchange for reductions of the civil penalties assessed against them.

Opinion of Comptroller General of the United States, GAO No. B-247155 (July 7, 1992), *available at* 1992 WL 726317 [hereinafter 1992 GAO Opinion].

26. The Miscellaneous Receipts Act requires money received by federal agents to be deposited into the United States Treasury. 31 U.S.C. § 3302 (2000).

27. *See* Pub. Interest Research Group of New Jersey, Inc. v. Powell Duffryn Terminals, Inc., 913 F.2d 64 (3d Cir. 1990) (indicating that although money that the court has labeled as civil penalties must be paid into the Treasury, money that has not been labeled as civil penalties, such as SEP money in a settlement, does not have to be paid into the Treasury); *Sierra Club, Inc. v. Elec. Controls Design, Inc.*, 909 F.2d 1350 (9th Cir. 1990) (holding that in a settlement agreement where there is no finding of liability, the prohibition against requiring the defendant to make payments to any organization other than the Treasury is lifted).

28. *Sierra Club*, 909 F.2d at 1355–56.

29. 42 U.S.C. § 7604(g)(2) (2000). *See also* Lloyd, *supra* note 19, at 423.

30. Lloyd, *supra* note 19, at 425.

31. Laurie Droughton, *Supplemental Environmental Projects: A Bargain for the Environment*, 12 PACE ENVTL. L. REV. 789, 822–23 (1995).

32. Env’tl. Prot. Agency, Policy on the Use of Supplemental Environmental Projects in EPA Settlements, 25 Env’tl. L. Rep. (Env’tl. Law Inst.) 35,607 (Feb. 12, 1991) [hereinafter 1991 SEP Policy].

33. *Id.*

policy.<sup>34</sup> The 1995 SEP Policy created a five-step process, which is still used today, for EPA officials to use in determining whether a proposed project qualifies as an SEP.<sup>35</sup> The 1995 SEP Policy created a more strict nexus requirement and placed a ceiling on the mitigation percentage at 80%.<sup>36</sup> The EPA again revised the SEP policy in 1998 and deemed it the final SEP policy.<sup>37</sup>

### *B. EPA's 1998 Final SEP Policy*

On May 5, 1998, the EPA issued the Final EPA Supplement Environmental Projects Policy.<sup>38</sup> The stated purpose of the policy "is to encourage and obtain environmental and public health protection and improvements that may not otherwise have occurred without the settlement incentives provided by this Policy."<sup>39</sup> The policy explains a five-step process that agency officials should use to determine if a proposed project qualifies as an SEP and to determine the appropriate mitigation percentage.<sup>40</sup> The five-step process is:

- (1) Ensure that the project meets the basic definition of a SEP.
- (2) Ensure that all legal guidelines, including nexus, are satisfied.
- (3) Ensure that the project fits within one (or more) of the designated categories of SEPs.
- (4) Determine the appropriate amount of penalty mitigation.
- (5) Ensure that the project satisfies all of the implementation and other criteria.<sup>41</sup>

#### *1. Ensure the Project Meets the Definition of an SEP*

In order for a proposed project to qualify as an SEP, it must meet the basic definition of an SEP.<sup>42</sup> The current SEP policy defines SEPs as

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34. Interim Revised EPA Supplemental Environmental Projects Policy Issued, 60 Fed. Reg. 24,856 (May 10, 1995) [hereinafter 1995 SEP Policy].

35. *Id.*

36. *Id.*

37. 1998 SEP Policy, *supra* note 2.

38. *Id.* at 24,796.

39. *Id.*

40. *Id.* at 24,797.

41. *Id.* (section references omitted).

42. *Id.*

“*environmentally beneficial* projects which a defendant/respondent agrees to undertake *in settlement of an enforcement action*, but which the defendant/respondent is *not otherwise legally required to perform*.”<sup>43</sup> The SEP policy breaks this definition down into three parts and gives further explanation as to what each part means.<sup>44</sup> The SEP policy explains that an SEP must “improve, protect, or reduce risks to public health, or the environment at large” in order to be characterized as “environmentally beneficial.”<sup>45</sup> “In settlement of an enforcement action” means that the EPA helps “shape the scope of the project before it is implemented,” and the project is not commenced until after the EPA has issued a notice of violation.<sup>46</sup> Lastly, “not otherwise legally required to perform” means that the defendant cannot be “required by any federal, state, or local law or regulation” to complete the project.<sup>47</sup> If the proposed project meets this basic definition, the agency official proceeds to step two.

## 2. *Ensure that All Legal Guidelines Are Satisfied*

The 1998 SEP Policy uses five legal guidelines to ensure that the SEPs are within the EPA’s authority and do not conflict with any statutory or constitutional requirements.<sup>48</sup> First, a project must be consistent with the provisions of the statute forming the basis for the enforcement action.<sup>49</sup> Second, a project must meet at least one of the stated goals of the environmental statutes that the enforcement action is based on, and the project must have adequate nexus.<sup>50</sup> Third, the EPA may not manage or control funds that will be used to carry out the performance of an SEP.<sup>51</sup>

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43. *Id.* at 24,797–98 (typeface altered).

44. *See id.* at 24,798.

45. *Id.*

46. *Id.*

47. *Id.* This includes projects that the defendant will probably be required to perform “(1) as injunctive relief in the instant case; (2) as injunctive relief in another legal action U.S. EPA, or another regulatory agency could bring; (3) as part of an existing settlement or order in another legal action; or (4) by a state or local requirement.” OFFICE OF SITE REMEDIATION ENFORCEMENT, ENVTL. PROT. AGENCY, BROWNFIELD SITES AND SUPPLEMENTAL ENVIRONMENTAL PROJECTS (SEPs) 2 (Nov. 2006), available at <http://www.epa.gov/compliance/resources/publications/cleanup/brownfields/brownfields-seps.pdf>.

48. The EPA recognizes that it has been given broad discretion to settle cases. “Accordingly, this Policy uses five legal guidelines to ensure that our SEPs are within the Agency’s and a federal court’s authority, and do not run afoul of any Constitutional or statutory requirements.” 1998 SEP Policy, *supra* note 2, at 24,798.

49. *Id.*

50. *Id.* For a discussion of the nexus requirement, see *supra* note 10.

51. *Id.* This Note will argue that the third guideline should be abandoned, and the EPA should create and manage an environmental trust to perform SEPs.

The EPA may monitor the performance of the project and take legal action if the SEP is not adequately implemented.<sup>52</sup> Fourth, the type and scope of the SEP must be explained in the settlement agreement.<sup>53</sup> Lastly, the SEP cannot be used to satisfy any federal agency's statutory obligation, nor can an SEP give any federal agency resources to perform a project for which Congress has specifically appropriated funds.<sup>54</sup>

### 3. *Ensure that the Project Fits Within One of the Categories of SEPs*

The 1998 SEP Policy includes seven specific categories under which a proposed project must fall in order to qualify as an SEP.<sup>55</sup> The Policy also includes an eighth category for projects that do not fall under one of the seven specific categories but have been determined to have environmental merit and meet the other provisions of the SEP policy.<sup>56</sup> The seven specific categories are as follows: public health,<sup>57</sup> pollution prevention,<sup>58</sup> pollution reduction,<sup>59</sup> environmental restoration and protection,<sup>60</sup>

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52. *Id.*

53.

This means the "what, where and when" of a project are defined by the settlement agreement. Settlements in which the defendant/respondent agrees to spend a certain sum of money on a project(s) to be defined later (after EPA or the Department of Justice signs the settlement agreement) are not allowed.

*Id.*

54. *Id.*

55. *Id.* at 24,799.

56. *Id.* at 24,801.

57. "A public health project provides diagnostic, preventative, and/or remedial components of human health care which is related to the actual or potential damage to human health caused by the violation." *Id.* at 24,799. Examples of public health projects include: "epidemiological data collection and analysis, medical examinations of potentially affected persons, collection and analysis of blood/fluid/tissue samples, medical treatment and rehabilitation therapy." *Id.*

58. "A pollution prevention project is one which reduces the generation of pollution through 'source reduction,' i.e., any practice which reduces the amount of any hazardous substance, pollutant or contaminant entering any waste stream or otherwise being released into the environment, prior to recycling, treatment, or disposal." *Id.* "Source reduction may include equipment or technology modifications, process or procedure modifications, reformulation or redesign of products, substitution of raw materials, and improvements in housekeeping, maintenance, training, inventory control, or other operation and maintenance procedures." *Id.*

59.

A pollution reduction project is one which results in a decrease in the amount and/or toxicity of any hazardous substance, pollutant or contaminant entering any waste stream or otherwise being released into the environment by an operating business or facility by a means which does not qualify as "pollution prevention."

*Id.* Pollution reduction projects include: "the installation of more effective end-of-process control or treatment technology, or improved containment, or safer disposal of an existing pollutant source." *Id.*

60. "An environmental restoration and protection project is one which enhances the condition of the ecosystem or immediate geographic area adversely affected." *Id.* These types of projects include:



assessments and audits,<sup>61</sup> environmental compliance promotion,<sup>62</sup> and emergency planning and preparedness.<sup>63</sup>

#### 4. *Determine the Amount of Penalty Mitigation*

When an environmental regulation is violated, the EPA uses monetary penalties to deter future violations and ensure that violators are not able to “obtain an economic advantage over their competitors who complied” with the regulations.<sup>64</sup> Defendants agree to undertake an SEP in exchange for a reduction in their settlement penalty.<sup>65</sup> The EPA has developed another five-step process to calculate the final settlement penalty.<sup>66</sup>

First, the settlement penalty without the SEP is calculated.<sup>67</sup> This is calculated by adding the dollar value of the economic benefit the defendant gained from noncompliance<sup>68</sup> with the EPA regulation to an

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Restoration of a wetland in the same ecosystem along the same avian flyway in which the facility is located; or purchase and management of a watershed area by the defendant/respondent to protect a drinking water supply where the violation . . . did not directly damage the watershed but potentially could lead to damage due to unreported discharges.

*Id.*

61. “There are three types of projects in this category: a. Pollution prevention assessments; b. environmental quality assessments; and c. compliance audits.” *Id.* at 24,799–800.

62. “An environmental compliance promotion project provides training or technical support to *other members* of the regulated community to: (1) Identify, achieve, and maintain compliance with applicable statutory and regulatory requirements or (2) go beyond compliance by reducing the generation, release, or disposal of pollutants beyond legal requirements.” *Id.* at 24,800. For example, an environmental compliance promotion project could involve: “producing a seminar directly related to correcting widespread or prevalent violations within the defendant/respondent’s economic sector.” *Id.* “Environmental compliance promotion SEPs are acceptable only where the primary impact of the project is focused on the same regulatory program requirements which were violated and where EPA has reason to believe that compliance in the sector would be significantly advanced by the proposed project.” *Id.*

63. “An emergency planning and preparedness project provides assistance—such as computers and software, communication systems, chemical emission detection and inactivation equipment, HAZMAT equipment, or training—to a responsible state or local emergency response or planning entity.” *Id.* “Emergency planning and preparedness SEPs are acceptable where the primary impact of the project is within the same emergency planning district or state affected by the violations and EPA has not previously provided the entity with financial assistance for the same purposes as the proposed SEP.” *Id.*

64. Penalties provide regulated entities with incentives to comply with the EPA’s regulations. They also level the playing field among violators and their competitors who have complied. The penalties prevent the violators from gaining an economic advantage through noncompliance. *Id.* at 24,801.

65. *See id.*

66. *Id.*

67. *Id.*

68. The step where the economic benefit is calculated is labeled Step 1.a. *Id.*

amount that reflects the gravity<sup>69</sup> of the violation.<sup>70</sup> “The gravity component is all of the penalty other than the identifiable economic benefit amount . . . .”<sup>71</sup> The EPA has developed a penalty policy to calculate this gravity component.<sup>72</sup>

Second, the minimum penalty amount with an SEP is calculated.<sup>73</sup> “The minimum penalty amount must equal or exceed the economic benefit of noncompliance plus 10 percent of the gravity component, or 25 percent of the gravity component only, whichever is greater.”<sup>74</sup>

Third, the net present after-tax cost of the SEP is calculated.<sup>75</sup> The EPA has developed a computer model, PROJECT, to aid in the calculation of the SEP cost.<sup>76</sup> Three costs are entered into the computer model to determine the cost of the SEP: capital costs, one-time nondepreciable costs, and annual operation costs and savings.<sup>77</sup> The SEP cost calculated by PROJECT is not exact; it is simply a reasonable estimate.<sup>78</sup>

Fourth, the mitigation percentage is determined, and the mitigation amount is calculated.<sup>79</sup> The mitigation percentage is determined by the SEP’s performance on the following six factors: benefits to the public or environment at large,<sup>80</sup> innovativeness,<sup>81</sup> environmental justice,<sup>82</sup>

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69. The step where the gravity component is calculated is labeled Step 1.b. *Id.*

70. The step where the economic benefit and the gravity component are added is labeled Step 1.c. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 24,801 n.15.

79. *Id.* at 24,802.

80. “While all SEPs benefit public health or the environment, SEPs which perform well on this factor will result in significant and quantifiable reduction in discharges of pollutants to the environment and the reduction in risk to the general public.” *Id.*

81. “SEPs which perform well on this factor will further the development, implementation, or dissemination of innovative processes, technologies, or methods which more effectively: reduce the generation, release or disposal of pollutants; conserve natural resources; restore and protect ecosystems; protect endangered species; or promote compliance.” *Id.*

82. “SEPs which perform well on this factor will mitigate damage or reduce risk to minority or low income populations which may have been disproportionately exposed to pollution or are at environmental risk.” *Id.*

community input,<sup>83</sup> multimedia impacts,<sup>84</sup> and pollution prevention.<sup>85</sup> The 1998 SEP Policy restricts the mitigation percentage of the SEP cost from exceeding 80%.<sup>86</sup> This means that for every one dollar a defendant spends on the SEP, that defendant only receives an eighty cent penalty reduction. Defendants who opt to simply pay the settlement penalty rather than complete an SEP end up paying less in total. The SEP cost (calculated in step three) is then multiplied by the mitigation percentage to obtain the mitigation amount.<sup>87</sup>

Finally, the mitigation amount (calculated in step four) is subtracted from the settlement amount without an SEP (calculated in step one).<sup>88</sup> The remainder is compared with the minimum penalty amount (calculated in step two) and whichever amount is greater is adopted as the final settlement penalty.<sup>89</sup>

#### 5. *Ensure that the Project Satisfies All the Implementation and Other Criteria*

The final step is to make sure that the project complies with all of the implementation and other criteria.<sup>90</sup> This includes ensuring that the defendants are legally liable for the satisfactory completion of the SEP.<sup>91</sup> In addition, the EPA has the responsibility of overseeing the implementation of the SEP and taking legal action if the SEP is not satisfactorily completed by the defendant.<sup>92</sup>

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83. "SEPs which perform well on this factor will have been developed taking into consideration input received from the affected community." *Id.* The community input factor has recently been emphasized by the EPA. *Id.* at 24,803 ("In appropriate cases, EPA should make special efforts to seek input on project proposals from the local community that may have been adversely impacted by the violations."). Gathering community input when developing the SEP can "[r]esult in SEPs that better address the needs of the impacted community; promote environmental justice; produce better community understanding of EPA enforcement; and improve relations between the community and the violating facility." *Id.*

84. "SEPs which perform well on this factor will reduce emissions to more than one medium." *Id.* at 24,802.

85. "SEPs which perform well on this factor will develop and *implement* pollution prevention techniques and practices." *Id.* (emphasis added).

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. The defendant is allowed to use contractors to complete the SEP, but the defendant may not transfer the legal liability for ensuring the SEP's completion to the contractors. *Id.*

92. *Id.* at 24,803.

## II. WHY ARE SEPs UNDERUTILIZED?

### A. *The EPA's Policy Encouraging the Use of SEPs*

The EPA has announced a clear policy on encouraging and expanding the use of SEPs in the settlement of enforcement actions.<sup>93</sup> On June 11, 2003, the EPA released a memorandum to encourage EPA enforcement staff to include SEPs in the settlement of enforcement actions whenever possible.<sup>94</sup> In an effort to increase the use of SEPs in settlements, the EPA attempted to simplify SEP policy and created an SEP library, which includes potential project ideas generated by EPA staff.<sup>95</sup> The EPA promotes the use of SEPs because they further the objectives of the environmental statutes and the policy goals of the EPA.<sup>96</sup> SEPs “protect and enhance public health and the environment,”<sup>97</sup> and provide a means for the settlement penalties to be used to correct environmental damage rather than being placed in the general treasury fund.<sup>98</sup>

### B. *The Underutilization of SEPs*

Despite the EPA's policy on encouraging the use of SEPs in settlements, only a small percentage of settlements of enforcement actions actually include SEPs.<sup>99</sup> From 1992 to 2006, less than twelve percent of the settlements contained SEPs.<sup>100</sup> The annual SEP utilization rate has

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93. Expanding the Use of SEPs Memo, *supra* note 1, at 1.

94. *Id.*

95. The EPA is “launching an effort to simplify the SEP Policy, and [is] piloting a SEP library which will serve as a clearinghouse for possible SEPs.” *Id.* at 2. An SEP library will provide many benefits. “First, [it will] ensure that projects actually redound to the benefit of local communities by soliciting community group proposals.” Steven Bonorris et al., *Environmental Enforcement in the Fifty States: The Promise and Pitfalls of Supplemental Environmental Projects*, 11 HASTINGS W.-Nw. J. ENVTL. L. & POL’Y 185, 214 (2005). An SEP library will allow community groups to identify environmental projects that the community most needs and the benefits they offer. “Second, the proposals reduce transaction costs for all parties, as there is no need to make under-informed and uncertain predictions about the risks and benefits of projects as they arise in the course of settlement negotiations.” *Id.* Violators may select a project from the library without having to expend the resources to come up with an SEP idea on their own.

96. See 1998 SEP Policy, *supra* note 2, at 24,797.

97. *Id.* at 24,796.

98. In *United States v. Smithfield Foods, Inc.*, 982 F. Supp. 373, 375 (E.D. Va. 1997), one court opined, “as a matter of public policy, simply depositing civil penalties into the vast reaches of the United States Treasury does not seem to be the most effective way of combating environmental problems caused by a specific polluter.” However, the court went on to hold that the court must enforce the law as it was passed by Congress, which required the monetary penalty to be paid into the Treasury once it had been deemed a penalty by the court. *Id.* at 375–76.

99. Kristl, *supra* note 21, at 219.

100. *Id.* at 243.

been declining since 1995,<sup>101</sup> which is when the EPA amended the SEP policy to tighten the nexus requirement and reduced the mitigation percentage ceiling to 80%.<sup>102</sup> The full potential of SEPs has yet to be realized.<sup>103</sup> There are several factors that have led to this underutilization of SEPs. In recent article, Professor Kenneth Kristl suggests that the two most important factors that have led to underutilization are the nexus requirement and the mitigation percentage.<sup>104</sup>

The 1998 SEP Policy's strict nexus requirement prevents the use of SEPs in several settlements. Nexus is the relationship between the SEP and the violation.<sup>105</sup> Fewer projects meet this requirement as the EPA requires a closer relationship between the SEP and the violation.<sup>106</sup> In some situations, there is simply no feasible project that will meet the narrow nexus requirement of the SEP policy. The EPA issued a memorandum in 2002 emphasizing the importance of the nexus requirement;<sup>107</sup> however, the concept of nexus was not adequately explained.<sup>108</sup> The enforcement staff continued to have difficulty applying the nexus concept to proposed projects.<sup>109</sup>

In 2002, the EPA released a memo on the "Importance of the Nexus Requirement in Supplemental Environmental Projects."<sup>110</sup> The memo warns agency officials that an adequate nexus is important because it ensures that the EPA is in compliance with the MRA. The memo goes on

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101.

[T]he annual utilization rate [of SEPs] has been steadily declining since 1995, with only a temporary stabilization in the 8% range during FY 2004–2005. This decline has occurred despite the consistent pronouncements of EPA since the 1995 SEP Policy that the agency wants to encourage and increase the use of SEPs. The data clearly show that ten years of these pronouncements have had no apparent effect on SEP utilization.

*Id.* at 245.

102. 1995 SEP Policy, *supra* note 34, at 24,858, 24,861.

103. See Expanding the Use of SEPs Memo, *supra* note 1, at 1.

104. Kristl, *supra* note 21, at 220. This Note agrees with Professor Kristl's argument that the nexus requirement should be relaxed and the mitigation percentage increased. It expands on these ideas by proposing the creation of an Environmental Trust and permitting the use of third-party contractors.

105. 1998 SEP Policy, *supra* note 2, at 24,798.

106. Kristl, *supra* note 21, at 220.

107. Memorandum from Walker B. Smith, Director, Office of Regulatory Enforcement, Env'tl. Prot. Agency, to Reg'l Counsel et al. 1 (Oct. 31, 2002), available at <http://www.epa.gov/compliance/resources/policies/civil/seps/sepnexus-mem.pdf> [hereinafter Nexus Memo].

108. In its June 2003 memo, the EPA noted that "several Regional and Headquarters offices raised questions about the complexity of the existing SEP Policy. Specifically, [they] heard a number of questions concerning how to define an appropriate nexus in certain situations . . ." Expanding the Use of SEPs Memo, *supra* note 1, at 3.

109. See *id.*

110. Nexus Memo, *supra* note 107, at 2.

to explain the penalties for violating the MRA.<sup>111</sup> They include “removal from office and, in some cases, personal liability for the amount of money misappropriated.”<sup>112</sup> If there is a relationship between the SEP and the violation, the memo states that the EPA can reduce the penalty.<sup>113</sup> If the nexus requirement is not met, then the memo claims that the EPA does not have the discretion to reduce the penalty.<sup>114</sup> These types of warnings likely cause EPA officials to enforce a strict nexus requirement which discourages the use of SEPs. The risks of removal from their position and personal liability for the money misappropriated are severe and probably encourage EPA officials to be very cautious with their approval of SEPs. In order to avoid failing to comply with the nexus requirement, EPA officials and defendants are likely inclined to undertake projects that have been completed by other defendants, or worse, steer clear of utilizing SEPs altogether.<sup>115</sup> This stifles the creation of new forms of SEPs that could potentially lead to increased environmental benefits.

The 80% ceiling the SEP policy places on the mitigation percentage is perhaps the largest contributor to the underutilization of SEPs.<sup>116</sup> If the EPA calculates a \$100 settlement penalty for a violation, the defendant is presented with two options. The defendant can agree to perform an SEP that will cost \$100 and pay a \$20 settlement penalty (since only 80% of the SEP cost can be used to mitigate the settlement penalty).<sup>117</sup> Alternatively, the defendant can simply pay the \$100 settlement penalty.<sup>118</sup> Thus, the defendant must pay a total of \$120 when the SEP is included in the settlement, but must only pay a total of \$100 if the SEP is not included. Assuming most defendants are rational economic actors, they will choose the less expensive option. The SEP policy creates “a built-in economic disincentive to undertake SEPs by making the dollars spent on SEPs less valuable than dollars simply paid as penalties.”<sup>119</sup>

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111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. Kristl, *supra* note 21, at 241.

Without clear guidance on what nexus really is, Agency personnel and defendants are likely to “play it safe” and choose projects that have been approved before or simply avoid SEPs altogether instead of exploring new ways of utilizing SEPs that might in fact be at the outer limits of nexus.

*Id.*

116. *See id.* at 220.

117. *See* 1998 SEP Policy, *supra* note 2, at 24,801.

118. *See id.*

119. *See* Kristl, *supra* note 21, at 262.

Another reason a settlement may not include an SEP is that it may not be feasible. The settlement amount may be too small to develop and carry out an SEP in some cases.<sup>120</sup> The current SEP policy requires the defendant to propose a project that meets all the SEP requirements and to be responsible for implementing the SEP.<sup>121</sup> Some defendants may be unable to identify a project that meets the SEP policy requirements or may not have the expertise and resources necessary to implement an SEP.

### III. CREATION OF AN ENVIRONMENTAL TRUST, ALTERATION OF MITIGATION PERCENTAGE AND NEXUS, AND UTILIZATION OF THIRD-PARTY CONTRACTORS

The EPA's current SEP policy could be improved by taking three steps: creating and managing an Environmental Trust that would be used to complete SEPs, increasing the mitigation percentage to 100% and relaxing the nexus requirement, and allowing third-party contractors to bid on and carry out SEP contracts. These changes would likely lead to an increase in the use of SEPs in the settlement of enforcement actions, higher quality SEPs, and the more efficient use of SEP dollars. The EPA's goals to "protect and enhance public health and the environment"<sup>122</sup> would be better served by implementing these changes.

Although the EPA explicitly states that it cannot establish SEP accounts in order to hold or manage SEP funds,<sup>123</sup> this Note contends that the EPA should abandon this policy and create an Environmental Trust.<sup>124</sup> The Environmental Trust would accept the settlement penalty agreed upon

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120. *Id.* at 244.

121. 1998 SEP Policy, *supra* note 2.

122. *Id.* at 24,796.

123.

[The Office of Enforcement and Compliance Assurance] has had several inquiries into the feasibility of establishing SEP "banks" or accounts for pooling the funds applied towards SEPs. Specifically, the question is whether EPA may hold and manage, in one account, SEP funds from several settlements that would otherwise have been used by defendants/respondents for SEP projects in each individual enforcement settlement. While the aggregation of SEP funds may result in a SEP with greater public health or environmental benefits than several smaller funds, we have been advised by OGC that the MRA prohibits EPA from managing SEP funds.

Memorandum from John Peter Suarez, Assistant Adm'r, Env'tl. Prot. Agency, to Reg'l Counsels (Region 1-x) et al. 3 (Dec. 15, 2003), <http://www.epa.gov/compliance/resources/policies/civil/seps/seps-thirdparties.pdf> [hereinafter Third Party and Aggregation Memo].

124. See Executive Office of Energy and Environmental Affairs, MET Overview, <http://www.mass.gov/eea/met> (follow "MET Overview" hyperlink) (last visited Nov. 15, 2008) for an explanation of how the Massachusetts Environmental Trust operates and a potential model for the EPA's Environmental Trust.

by the EPA and the violator. In addition, the Environmental Trust could accept voluntary contributions from the public. The settlement penalty should continue to be determined just as explained by the 1998 SEP Policy—adding the dollar value of the economic benefit the defendant gained from noncompliance and an amount based on the gravity of the violation.<sup>125</sup> The defendant would simply pay the settlement amount directly into the EPA's Environmental Trust; the EPA would never be given the payment. The EPA would manage the Environmental Trust for the public. The EPA or a third-party contractor would then come up with an SEP for that specific settlement, and the money in the Environmental Trust would be used to carry out the SEP. In the event that an SEP is not feasible (e.g., if the settlement amount is too small), the money would be left in the Environmental Trust and would be used for future projects.

The mitigation percentage should be increased to 100%. With the creation of the Environmental Trust, there is no justification for a mitigation percentage below 100%. The defendant no longer carries out the SEP. The defendant simply pays the settlement penalty directly into the Environmental Trust as opposed to the Treasury. In order to increase the use of SEPs in settlements, the mitigation percentage must be 100%. Any lower percentage creates an economic disincentive to choose the SEP option. Assuming defendants behave rationally, they will choose the least costly option.

There are several reasons that may explain why the EPA has placed an 80% ceiling on the mitigation percentage.<sup>126</sup> However, these reasons are no longer justified under this new proposal. The EPA may believe the defendant receives some economic benefit from doing an SEP (e.g., the SEP actually costs the defendant less to complete than the defendant reports that it will cost).<sup>127</sup> If the suggested changes are implemented, this problem no longer justifies the 80% cap. If a third-party contractor carries out the SEP instead of the defendant, this eliminates the risk that the SEP will end up costing the defendant less than the reported cost. The defendant loses the power to overstate the costs if a third-party contractor proposes and carries out the SEP.

The EPA may also believe that the defendant benefits from implementing the SEP by gaining goodwill and creating a positive public image.<sup>128</sup> However, the 1998 SEP Policy addresses this concern by

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125. 1998 SEP Policy, *supra* note 2, at 24,801.

126. *Id.* at 24,802.

127. Bonorris et al., *supra* note 95, at 206.

128. Kristl, *supra* note 21, at 263; DOJ Statement, *supra* note 22, at 30.



requiring that whenever a defendant “publicizes a SEP or the results of a SEP, it will state in a prominent manner that the project is being undertaken as part of the settlement of an enforcement action.”<sup>129</sup> Therefore any benefit is likely minimal. Furthermore, if the changes proposed above are implemented, the EPA (or possibly the third-party contractor) will get the public image benefit. The defendant is taken out of the picture and will no longer stand to benefit from any goodwill that is created from implementing the SEP.

It is also possible that the EPA believes that “SEP dollars simply do not have the same deterrent effect as penalty dollars.”<sup>130</sup> Most defendants are rational economic actors and will choose the option that is least costly to them. It does not matter whether the dollar is spent on an SEP or paid directly to the Treasury. If there is any truth to this idea that money spent by defendants to implement an SEP does not have the same deterrent effect, it is remedied by requiring the defendants to pay the settlement amount directly into the Environmental Trust instead of allowing them to keep the money and spend it to implement the project themselves.

Finally, the EPA currently uses the mitigation percentage to encourage and reward projects of outstanding quality.<sup>131</sup> There is a policy exception that allows the mitigation percentage to be 100% if the SEP implements pollution prevention and the defendant can demonstrate that the project is of outstanding quality.<sup>132</sup> Under the new changes, there is no need to require a mitigation percentage of less than 100% for each project, since there is no longer a need to encourage or reward a defendant who develops a project of outstanding quality. The EPA or third-party contractors will be in charge of developing the projects. The third-party contractor with the best project idea will be chosen by the EPA to carry out the SEP; therefore, the market will create the incentive to develop projects of outstanding quality.

In addition, the nexus requirement should be eliminated, or at least relaxed, in order to expand the use of SEPs.<sup>133</sup> If the EPA continues to require a strict relationship between the violation and the SEP, then an exception should be created for violations where an SEP is not feasible. If an SEP is not viable (e.g., the settlement penalty is too small or the EPA

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129. See 1998 SEP Policy, *supra* note 2, at 24,803.

130. Kristl, *supra* note 21, at 263.

131. See 1998 SEP Policy, *supra* note 2, at 24,802.

132. *Id.*

133. See Bonorris et al., *supra* note 95, at 212 (arguing that some commentators advise that the EPA should relax the nexus requirement so as not to impede SEPs that could promote environmental justice).

could not come up with a suitable project), then the nexus requirement should be dropped, and the payments should simply be placed in the Environmental Trust.

Finally, the EPA should utilize third-party contractors.<sup>134</sup> The defendant would pay the settlement penalty directly into the Environmental Trust. The EPA would then match the violation with one of its project ideas and announce the project to the public. Third-party contractors could then bid against each other in an effort to secure the contract to carry out the SEP (much like other government contracts) with the lowest bidder securing the contract. If the EPA is unable to come up with a suitable project idea, third-party organizations would be allowed to come forward with proposals.

#### IV. EPA'S AUTHORITY TO IMPLEMENT PROPOSED CHANGES

The EPA has the authority to create an Environmental Trust, increase the mitigation percentage, relax the nexus requirement, and use third-party contractors to carry out SEPs. The following sections will explain why the EPA has the authority to make each of these changes. In addition, even if the EPA does not have the authority to make these changes, Congress should expressly authorize these changes to the 1998 SEP Policy. The changes will improve the SEP policy and will lead to the greater use of SEPs in the settlement of enforcement actions. This will in turn lead to more environmental benefits.

##### A. *Creating an Environmental Trust*

The EPA has issued a memorandum stating that it cannot hold and manage SEP funds in one account, because according to the Office of General Counsel (OGC), this practice would violate the MRA and appropriations laws.<sup>135</sup> Therefore, the creation of an Environmental Trust is prohibited.<sup>136</sup> This Note contends that the OGC incorrectly interpreted

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134. The EPA addressed the use of third-party contractors in the December 2003 memorandum.

An alleged violator could use a private organization to recommend SEPs to it during negotiations with the Agency, and then to manage a SEP, as long as (1) the defendant/respondent is obligated under the settlement document to complete the project satisfactorily, (2) the defendant/respondent fully expends the amount of funds agreed to be spent in the performance of the SEP, and (3) the project meets all of the conditions and requirements of the SEP Policy.

Third Party and Aggregation Memo, *supra* note 123, at 4.

135. *Id.* at 3.

136. *See id.*

the Miscellaneous Receipts Act and appropriations laws and incorrectly advised the EPA that they prohibited the EPA from managing SEP funds.

The MRA provides that “an official or agent of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim.”<sup>137</sup> In order to trigger the MRA, a government agent must receive money for the government. The current SEP policy does not violate the MRA, because the SEP funds are never received by any EPA agent.<sup>138</sup> The funds stay with the defendant who agrees to use the money to implement the SEP agreed upon in the settlement.<sup>139</sup> Similarly, the Environmental Trust does not violate the MRA. In the Environmental Trust situation, the EPA agent never actually receives the SEP funds either; the funds go directly from the defendant to the Environmental Trust, which the EPA manages for the public. In addition, the funds cannot be considered “money for the government”; the funds are for the SEP and are held in the Environmental Trust until the SEP is carried out.<sup>140</sup> If the current SEP policy does not violate the MRA, then the Environmental Trust does not either.<sup>141</sup>

The Office of Legal Counsel issued an opinion on the proposed settlement of *In re Complaint of Steuart Transportation Co.*, which further clarified the type of settlement that violates the MRA.<sup>142</sup> In *Steuart*, a claim was brought against an oil company for an oil spill that occurred in the Chesapeake Bay.<sup>143</sup> The claim was settled.<sup>144</sup> One of the terms of the

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137. 31 U.S.C. § 3302 (b) (2000).

138.

Use of SEPs is acceptable since they are provided for within the substantive statutes, outside the requirements of the MRA and the ADA, legal as an out-of-court agreement incorporated into a consent decree, simply a consideration in the application of the EPA Civil Penalty Policy, and accepted by Congress through its acquiescence and support.

Droughton, *supra* note 31, at 812.

139. Kristl, *supra* note 21, at 255.

140. “[W]here a governmental body holds money in trusteeship for a class of persons affected by the statutory or regulatory violations, it need not deposit such money into the Treasury.” Droughton, *supra* note 31, at 816–17.

141. Congress is well aware of the EPA’s use of SEPs and has displayed congressional acquiescence for their use. *Id.* at 822. It could be argued that since the Environmental Trust is set up by the EPA, it is as though the money went through the EPA’s hands. In addition, since the EPA would manage the Trust, it could be argued that the EPA would, in effect, be directing the funds in violation of the MRA. If there is still doubt as to whether the Environmental Trust would violate the MRA, Congress should draft a statute that authorizes the EPA to use the Environmental Trust. “[W]here specific statutory authority exists to retain collected funds or to hand such funds differently, the MRA is inapplicable.” *Id.* at 817.

142. 4 Op. Off. Legal Counsel 684 (1980).

143. *Id.* at 685.

144. *Id.*

settlement required the oil company to give money to a waterfowl preservation organization.<sup>145</sup> The Office of Legal Counsel found that this settlement term violated the MRA.<sup>146</sup> This was its conclusion, despite the fact that no money was ever received by a government agent.<sup>147</sup> “[I]f a federal agency could have accepted possession and retains discretion to direct the use of the money,” it does not matter if any money is received by a federal official.<sup>148</sup> This is still a violation of the MRA.<sup>149</sup>

Even though this opinion broadens the reach of the MRA, the Environmental Trust is still compatible with the MRA. First, the settlement money goes directly into the Environmental Trust; the EPA cannot accept possession of the money. Second, the EPA retains no more discretion to direct the use of the money after it is placed in the Environmental Trust than it does when the money is held by the defendant. Currently, the defendant uses the money to perform an SEP. The EPA oversees this performance and can take action if the SEP is not satisfactorily performed. Under the proposal, the money would go directly to the Environmental Trust, a project would be chosen, and the EPA would ensure that the project is satisfactorily performed. Neither the current policy nor the proposed change in policy violates the MRA.

Courts have held that that the MRA requires all penalties to be paid into the Treasury.<sup>150</sup> However, payments involved in a settlement are not delineated as penalties. “It is precisely before liability is determined that most settlements take place, and thus the caselaw exempts SEP payments from the category of penalties and thus from the purview of the MRA.”<sup>151</sup> In the same way, the Environmental Trust payments would be exempted from the category of penalties. The settlements out of which Trust

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145. *Id.* A number of migratory waterfowl were killed in the oil spill. One part of the claim that the federal government brought against the oil company was for the death of these waterfowl.

146. *Id.* at 684.

147. *Id.* at 688.

148. *Id.*

149. *Id.*

150. Kristl, *supra* note 21, at n.212. See *Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found.*, 484 U.S. 49, 53 (1987) (“If the citizen prevails in such an action, the court may order injunctive relief and/or impose civil penalties payable to the United States Treasury.”); *Pub. Interest Research Group of New Jersey, Inc. v. Powell Duffryn Terminals, Inc.*, 913 F.2d 64, 81 (3d Cir. 1990) (“Congress intended that any penalties assessed in a citizen suit be treated as ‘miscellaneous receipts.’ Under the Miscellaneous Receipts Act, any person having custody of such public funds must deposit them in the Treasury within three days of receipt.”); *Sierra Club, Inc. v. Elec. Controls Design, Inc.*, 909 F.2d 1350, 1354 (9th Cir. 1990) (“We agree with the district court that if the payments required under the proposed consent decree are civil penalties within the meaning of the Clean Water Act, they may be paid only to the U.S. treasury.”).

151. Kristl, *supra* note 21, at 257.

payments would come would take place before liability is determined; thus the payments would not be considered penalties.

The Appropriations Clause of the Constitution provides that only Congress can appropriate funds for a federal agency.<sup>152</sup> Again, if the current SEP policy does not violate this provision, then the Environmental Trust does not either. There is no difference between the EPA determining that the settlement money can be spent on the implementation of an approved SEP instead of being paid to the Treasury, and the EPA determining that the settlement money can be placed in an Environmental Trust that will later be used to implement an approved SEP.

### *B. Increasing the Mitigation Percentage*

It is clear that the EPA has the authority to allow any mitigation percentage that it chooses. Currently, the EPA only allows 80% of the penalty to be offset by the SEP cost.<sup>153</sup> In the past, the EPA has allowed for the entire penalty to be offset by the SEP cost.<sup>154</sup> Since the EPA has previously allowed a 100% mitigation percentage and its authority has not been diminished, it follows that it still has the authority to increase the mitigation percentage to 100%.

### *C. Relaxing the Nexus Requirement*

In its 2002 memo, the EPA states that the nexus requirement must be met to avoid violating the MRA: “If there is a relationship between the alleged violation and the SEP, then it is within the Agency’s discretion to take the SEP into account as a mitigating factor when determining the amount” of the settlement penalty.<sup>155</sup> “If there is no nexus,” the memo claims, “then the Agency does not have that discretion.”<sup>156</sup> This interpretation of the MRA is incorrect. The nexus requirement is not needed to avoid violating the MRA. The necessary requirement is that the money for the project is never given to the EPA; it is simply spent on the SEP. It does not matter whether the SEP has a strict nexus requirement or no nexus requirement at all. In both situations, the money for the SEP

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152. “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.” U.S. CONST. art. I, § 9, cl. 7.

153. 1998 SEP Policy, *supra* note 2.

154. 1991 SEP Policy, *supra* note 32.

155. Nexus Memo, *supra* note 107, at 2.

156. *Id.*

never falls into the hands of the EPA. The MRA never comes into play in either situation.<sup>157</sup>

There is also no statutory source of the nexus requirement. There are no federal environmental statutes that expressly contain a nexus requirement for SEPs.<sup>158</sup> The Clean Air Act is the only environmental statute that even mentions SEPs in general.<sup>159</sup> In addition, SEPs are “parts of settlements, and the strictures of the statute involved do not limit the terms of a settlement under the statute.”<sup>160</sup> Professor Kristl notes that “[n]othing in the settlement context gives rise to a legal requirement of nexus.”<sup>161</sup>

#### *D. Utilizing Third-Party Contractors*

The EPA also prohibits defendants from simply making cash payments to third-party contractors “conducting a project without retaining full responsibility for the implementation or completion of the project, as this appears to violate the MRA.”<sup>162</sup> The creation of the Environmental Trust keeps the defendant from simply making a cash payment to a third-party contractor. Instead, the defendant makes a payment directly into the Environmental Trust, which is then used to pay the contractor.

The EPA notes that allowing third-party contractors to implement the SEPs creates some legal difficulties.<sup>163</sup> First, the EPA is concerned that working closely with a third-party contractor to carry out an SEP might “create the appearance that EPA is using the organization as a means to indirectly manage or direct SEP funds.”<sup>164</sup> Under the proposal, this concern is no longer relevant. The money goes directly into the Environmental Trust, which is used to carry out the SEPs. The EPA never receives or directs the funds; it simply manages the Environmental Trust.

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157. 31 U.S.C. § 3302 (2000).

158. Kristl, *supra* note 21, at 247.

159. *Id.*

160. *Id.* at 248 (emphasis omitted).

161. *Id.* at 249.

162. Third Party and Aggregation Memo, *supra* note 123, at 4. The current policy regarding the use of third-party organizations to manage SEPs or SEP funds is very strict. The EPA acknowledges that “[p]rivate organizations that are developing libraries of projects and offering project and funds management, project implementation, and oversight services can play a valuable role in SEPs.” *Id.* (emphasis omitted). However, a defendant can only use third-party contractors to assist in carrying out SEPs. A defendant can utilize a third-party contractor as long as the defendant retains the responsibility of ensuring the project is satisfactorily completed, the defendant spends the agreed upon amount of funds to carry out the SEP, and the SEP meets all of the requirements of the SEP policy. *Id.*

163. *Id.* at 5.

164. *Id.*

A second concern is that “there are ethical restrictions on endorsing or otherwise providing private organizations with unfair competitive advantages in selling their SEP management and implementation services to defendants/respondents.”<sup>165</sup> Again, this is not an issue under the proposal. The third-party contractors would bid against each other to receive the contract. This removes any concerns regarding unfair competitive advantages.

#### V. IMPLEMENTING CHANGES WILL IMPROVE THE EPA’S CURRENT SEP POLICY

Although the current SEP policy has led to substantial environmental benefits, it is underutilized and could be improved.<sup>166</sup> The EPA should create an Environmental Trust and use it to complete SEPs. It should increase the mitigation percentage to 100% and relax the nexus requirement. Finally, the EPA should allow third-party contractors to bid on and complete SEP contracts. These changes would make SEPs a viable option for more defendants, thus increasing their usage.<sup>167</sup> The proposal would also allow SEPs to be conducted more efficiently and utilized to address the most pressing environmental problems. In addition, many of the problems experienced under the current SEP policy would be remedied by adopting the proposed changes.

##### A. *Increased Utilization of SEPs*

The EPA’s current SEP policy contains a nexus requirement that creates an impediment for many possible SEPs.<sup>168</sup> Eliminating or at least relaxing the nexus requirement<sup>169</sup> would make SEPs an acceptable option

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165. *Id.*

166. See Expanding the Use of SEPs Memo, *supra* note 1, at 1.

167. An alternative to this proposal is the use of environmental grants to encourage environmentally beneficial projects. Some opponents of SEPs “argue that government grants (financed out of an environmental penalty fund, as in Delaware) to regulated entities for environmentally beneficial projects would be a better means of promoting environmentally beneficial projects and would not weaken deterrence.” Bonorris et al., *supra* note 95, at 208. The grant program would allow agency officials to screen out projects that would not maximize environmental benefit per dollar. “By only accepting projects that offer a higher rate of environmental return, ‘regulators conserve resources in their limited grant budget for more promising projects’ and help ensure that SEPs redound to the public benefit.” *Id.* (quoting David Dana, *The Uncertain Merits of Environmental Enforcement Reform: The Case of SEPs*, 1998 WIS. L. REV. 1181, 1216).

168. 1998 SEP Policy, *supra* note 2, at 24,798.

169. Although this Note argues that the nexus requirement should be reduced or eliminated, there are arguments in favor of keeping the nexus requirement that must be noted. Professor Kristl suggests that there may be political reasons for requiring that the SEP be related to the violation. “From a

for a greater number of settlements.<sup>170</sup> This would lead to greater environmental benefits. The 80% cap on the allowable mitigation percentage also reduces the number of SEPs used in settlements.<sup>171</sup> Increasing the mitigation percentage to 100% would eliminate the economic disincentive to defendants to include SEPs in their settlements and would also lead to greater environmental benefits.<sup>172</sup>

### *B. Aggregation of Funds*

Under the current SEP policy, funds from different settlements cannot be aggregated and used to complete larger environmental projects.<sup>173</sup> The creation of the Environmental Trust and the reduction of the nexus requirement would allow for aggregation of funds. This would allow companies with violations that only require a small settlement amount to still choose the SEP option, even though the amount could not fund a

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political perspective, an affected population is the most likely to react positively or negatively to the settlement of a violation, and a SEP that adequately addresses that population's injuries or interests no doubt increases the chance of a positive reaction." Kristl, *supra* note 21, at 259. However, Professor Kristl argues that this is a political reason, not a legal one, and there is no legal requirement of nexus. *Id.*

In addition, there are fairness concerns associated with the nexus requirement. By requiring that SEPs be connected to the violation, the ecosystem and community that was harmed are restored. *Id.* Low-income and minority populations are disproportionately affected by pollution. 1998 SEP Policy, *supra* note 2, at 24,797. Environmental violations often occur in communities where these segments of the nation's population reside. "Emphasizing SEPs in communities where environmental justice concerns are present helps ensure that persons who spend significant portions of their time in areas, or depend on food and water sources located near, where the violations occur would be protected." *Id.* Eliminating nexus may reduce the restorative justice benefits of SEPs.

In response to these concerns, projects will be created to address the injuries that resulted from the violation when possible. It is only in situations where the amount of the penalty is too small to carry out an SEP or no project is able to be generated that meets the nexus requirement that the funds will be spent on other environmental problems. Under the current SEP policy, when the penalty amount is too small or no project meets the SEP requirements, the money is not used to address the injuries of the population affected either. Currently, the money is placed into the Treasury. Therefore, eliminating the nexus requirement will not cause fewer projects to be devoted to restoring those affected by the violation. The only difference between the current SEP policy and the proposal is that when a project is unable to meet the nexus requirement under the proposal, the money will be used on another environmental project instead of being placed into the Treasury. In cases where the money is aggregated and a project of pressing importance is implemented instead, it is likely that the affected citizens will still react favorably to the EPA's project decision.

170. Kristl, *supra* note 21, at 220 ("[T]he nexus requirement is a restraint on SEP utilization . . .").

171. 1998 SEP Policy, *supra* note 2, at 24,802.

172. Kristl, *supra* note 21, at 220 ("[O]fficial EPA policy requires a defendant who wants to perform [an] SEP to pay more than the defendant would if it were simply paying a penalty alone. This economic disincentive likely creates a restraint on SEP utilization.").

173. Third Party and Aggregation Memo, *supra* note 123, at 2.



project on its own.<sup>174</sup> Aggregation would also allow the EPA to undertake larger and more beneficial projects. Instead of using the funds in a piecemeal fashion, the EPA could opt to aggregate the funds and undertake a project “on a regional or national basis.”<sup>175</sup> This could lead to more environmental benefit per SEP dollar. In addition, there may be environmental projects of pressing importance at various times. The creation of the Environmental Trust and elimination of the nexus requirement would allow the EPA to address the most important environmental concerns first.<sup>176</sup> This could prevent more costly environmental harm in the future.

### C. Improved Project Ideas

The defendants have the responsibility to come up with their project ideas under the current SEP policy.<sup>177</sup> Allowing the EPA or third-party contractors to develop the project ideas will be more efficient than allowing the defendants to come up with their own ideas in most situations.<sup>178</sup> Defendants are motivated by their own self-interest, and their goal in coming up with a project is likely to minimize the detriment to themselves instead of maximizing environmental benefit. The EPA already has a library of ideas; therefore, having the EPA instead of the defendants come up with the ideas would not require an unreasonable amount of resources to be expended by the EPA.<sup>179</sup> The EPA will likely come up with better ideas, because it is more aware of possible options for

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174. Kristl, *supra* note 21, at 260 (“[A]ggregation can produce additional benefits by providing ‘increased leverage’ for larger environmental benefits and the opportunity for defendants ‘in smaller cases to take advantage of the SEP Policy.’”) (quoting Third Party and Aggregation Memo, *supra* note 123, at 2).

175. *Id.* at 261.

176. *Id.* at 260 (“The broader range of possibilities would also give EPA planning or administrative options that could result in coordinated . . . benefits in areas needing assistance. For example, one could envision a coordinated effort to use SEP aggregation in an area devastated by a natural disaster.”).

177. 1998 SEP Policy, *supra* note 2.

178. See Lloyd, *supra* note 19, at 433.

179. See Memorandum from Granta Y. Nakayama, Assistant Adm’r, Env’tl. Prot. Agency, to Assistant Adm’rs et al. (July 20, 2006), available at <http://www.epa.gov/oecaerth/resources/policies/civil/seps/potentialproject-seps0607.pdf> [hereinafter Project Ideas Memo]. The following are some examples of EPA project ideas: “[o]perate and maintain health clinics serving low income and minority communities and sensitive populations;” conduct lead-based paint abatement for low income housing; purchase emissions credits and retire them; purchase and install fuel cells; pave roads to reduce “dust and particulate matter from unpaved” surfaces; replace gasoline-powered vehicles with alternative fuel or hybrid vehicles; restore migratory bird or endangered species habitat; purchase land and maintain it as a green buffer or conservation easement; implement green engineering methods, create recycling centers; and install “water systems that reuse wastewater or greywater.” *Id.* at 3–9.

projects. It knows the areas of environmental concern that are the most pressing, and the EPA has more expertise and experience in environmental issues than most defendants will have. In addition, allowing third-party organizations, who specialize in environmental projects, to come up with ideas will likely lead to increased idea generation as well as higher quality projects.<sup>180</sup>

#### *D. Deprivation of Goodwill and Interest*

This proposal also leads to the deprivation of goodwill for the defendant that might result from carrying out an SEP, and eliminates the possible accumulation of interest that would be put toward additional environmental projects. If the EPA or a third-party contractor implements the SEPs, then the EPA or third-party contractor will derive any goodwill or public image boost that may result from the project being carried out. Another obvious benefit that would result from the Environmental Trust would be the interest that accrues (assuming some of the funds were left in the Trust instead of being used to fund a project right away). The current SEP policy leaves the money in the hands of the defendant. This reduces the amount of the penalty by the interest earned over the period of time the SEP is implemented. The defendant should not get this benefit.

#### *E. Increased Efficiency of SEPs*

Currently, defendant companies implement their own SEPs.<sup>181</sup> Allowing third-party organizations to bid against each other to carry out the SEPs ensures that the maximum amount of environmental benefit is realized from every SEP dollar. The third-party organizations will be specialized in implementing SEPs and will likely be able to carry out the projects for a lower price than the defendant may have been able to.<sup>182</sup>

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180. There is a possible counterargument to this statement. The defendant company will likely have more knowledge about its unique operations and about the violation that occurred. This intimate knowledge might place defendants in a better position to come up with project ideas and to implement the SEP. This proposal is not suggesting that the defendant should be prohibited from offering project ideas. In addition, the third-party contractors would be able to gather information about the operations and violation of the defendant company. If a defendant company is uniquely suited to implement its SEP, it is possible that the defendant could bid on its own SEP contract. The details of this arrangement are beyond the scope of this Note; however, the defendant company would presumably have to pay some neutral third party (such as the EPA or a third-party contractor) to oversee the implementation of the SEP.

181. 1998 SEP Policy, *supra* note 2.

182. That is unless the defendant company's intimate knowledge of their operations and violation allow it to complete the project at a lower price. *See supra* note 180.

This will also increase the likelihood that the projects are carried out in the most efficient manner possible. There are already “[p]rivate organizations that are developing libraries of projects and offering project . . . management, project implementation, and oversight services.”<sup>183</sup> In addition, the EPA has already acquiesced to defendants’ use of third-party organizations as contractors or consultants to assist in the implementation of an SEP.<sup>184</sup> This shows that the EPA recognizes the benefits that third-party contractors can offer to the SEP program.

#### *F. Strengthen Current SEP Policy*

Several weaknesses of the current SEP policy could be strengthened by this proposal. Under the current SEP policy, a defendant company could simply carry out an environmental project they had already intended to carry out before the violation.<sup>185</sup> This would mean that the defendant would be able to side step the punishment for the violation altogether. Requiring the defendant to pay the settlement amount into the Environmental Trust, and then having the EPA or a third-party organization come up with an SEP to spend it on eliminates this possibility. The creation of an Environmental Trust and use of third-party contractors also eliminates the risk that “[o]pportunistic violators may overestimate SEP costs in order to receive greater relief from the calculated penalty, or they may underreport the business benefits of SEPs.”<sup>186</sup> It may be difficult for EPA officials in charge of overseeing the implementation of the SEP to correctly value the costs and benefits of an SEP.<sup>187</sup> A defendant company could intentionally overestimate the implementation cost of an SEP in order to reduce the actual cost of the violation.<sup>188</sup> Similarly, a defendant company could intentionally

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183. Third Party and Aggregation Memo, *supra* note 123, at 4.

184. *Id.*

185. The current SEP policy states that the purpose of the SEP policy is to “obtain environmental or public health benefits that may not have occurred ‘but for’ the settlement.” 1998 SEP Policy, *supra* note 2, at 24,798 n.2. Therefore, the policy makes projects which the “defendant has previously committed to perform or have been started before the Agency has identified a violation” not eligible as SEPs. *Id.* Despite this provision in the SEP policy, defendants may still propose projects that they have previously intended to implement without the EPA’s knowledge.

186. Bonorris et al., *supra* note 95, at 206.

187. As mentioned briefly above, the EPA calculates the cost of an SEP using a computer model called PROJECT. The EPA admits that the computer model produces an estimate, not an exact cost. 1998 SEP Policy, *supra* note 2, at 24,801 n.15.

188. “To use PROJECT, the Agency needs reliable estimates of the costs associated with a defendant/respondent’s performance of a SEP . . .” *Id.* at 24,801. If the defendant gives unreliable

underestimate the economic benefits received<sup>189</sup> from the implementation of an SEP in order to reduce the actual cost of the violation.<sup>190</sup> If a third-party contractor, who obtains the contract by placing the lowest bid, is in charge of providing the cost and savings estimates, the potential for overestimating costs and underestimating savings is eliminated.

### CONCLUSION

The use of SEPs in settlements provides significant environmental benefits.<sup>191</sup> The EPA recognizes these benefits and has announced a clear policy of encouraging the use of SEPs.<sup>192</sup> Despite this clear support, SEPs are being underutilized.<sup>193</sup> This underutilization can be attributed to the strict nexus requirement, the 80% ceiling on the mitigation percentage,

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estimates of the SEP costs, then the EPA will be unable to get a reasonable estimate of the SEP cost.  
*Id.*

189. In 2003, the EPA issued a memo explaining that EPA officials could approve profitable SEPs. This means that even though the violator may receive an economic benefit from the SEP, the EPA could approve it as an SEP. The EPA recommended no more than an 80% mitigation credit for profitable pollution prevention SEPs and no more than a 60% mitigation credit for all other profitable SEPs. In order to be accepted, a profitable SEP must meet a higher standard. This high standard can be met if the project demonstrates:

- (1) a high degree of innovation . . . with the potential for widespread application; (2) technology that is transferable to other facilities or industries, and the defendant/respondent will share information about the technology; (3) extraordinary environmental benefits that are quantifiable . . . ; (4) exceptional environmental or public health benefits to an Environmental Justice community; and/or (5) a high degree of economic risk for the alleged violator.

Memorandum from John Peter Suarez, Assistant Adm'r, Env'tl. Prot. Agency, to Reg'l Counsel et al. 6 (Dec. 5, 2003), *available at* <http://www.epa.gov/compliance/resources/policies/civil/seps/seps-profitableprojects.pdf>.

190. Defendant companies can experience savings with the implementation of an SEP. For example: "energy efficiency gains, reduced materials costs, reduced waste disposal costs, or increases in productivity." 1998 SEP Policy, *supra* note 2, at 24,801.

191. SEPs provide many benefits for not only the environment but also the regulators, industry, and the community. "SEPs promote a cooperative relationship between the regulator and the violator, to the benefit of both." Bonorris et al., *supra* note 95, at 203. SEPs also foster innovation in compliance and pollution prevention techniques. Defendants might attempt to use a new pollution prevention technology as an SEP. If the new technology is shown to be cost-effective, the EPA might encourage all members of the industry to adopt the technology. *Id.* at 203-05. "[R]egulators often lack resources to pursue cutting edge environmentally beneficial projects, . . . SEP programs provide a laboratory for innovation." *Id.* at 204. SEPs also clearly benefit the ecosystems and communities in which they are undertaken. *Id.* at 204-05. "SEPs also provide certain corporations with opportunities to re-evaluate and improve upon inefficiencies in production processes." Nghiem, *supra* note 23, at 566. Companies that implement SEPs "often can improve competitive efficiency by lowering future compliance costs while simultaneously fulfilling their legal obligations." *Id.* Lastly, some defendants "simply may derive greater satisfaction from having their money directed towards some tangible, environmentally beneficial purpose instead of having the same funds deposited into a general federal pool." *Id.*

192. Expanding the Use of SEPs Memo, *supra* note 1, at 1.

193. *Id.*

and the fact that some cases are not conducive to the use of SEPs. This Note argues that the EPA's current SEP policy could be improved upon by taking three steps. First, the EPA should create and manage an Environmental Trust and use it to implement SEPs. Second, the mitigation percentage should be increased to 100% and the nexus requirement eliminated or relaxed. Third, the EPA should allow third-party contractors to bid on and carry out SEP contracts. This proposal would make SEPs a viable option for a greater number of violators and would lead to an increase in their use. It would also maximize the environmental benefit per SEP dollar by allowing the SEP money to be used in the most efficient manner possible. It is important to improve the current SEP policy and encourage the use of SEPs in settlements, because SEPs provide more environmental benefits than simply paying the penalties directly into the Treasury. Like penalties that are paid directly into the Treasury, SEPs serve a deterrent function. However, unlike penalties paid to the Treasury, SEPs also promote the EPA's goals of protecting and enhancing public health and the environment.<sup>194</sup> The full potential of SEPs has yet to be realized. If the SEP policy is not updated, this potential is likely to remain unrealized.

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194. 1998 SEP Policy, *supra* note 2, at 24,796.

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