Texas Commission on Environmental Quality

INTEROFFICE MEMORANDUM

To: Commissioners' Work Session **Date:** September 7, 2007

Thru: John Sadlier, Deputy Director, Office of Compliance and Enforcement

From: Matthew R. Baker, P.E., Director, Enforcement Division

Subject: Enforcement Process Review Implementation Regarding the Compliance History and Administrative Penalty Policy Projects

Issue Consideration of the Enforcement Process Review Implementation status, including potential rulemaking for Compliance History and implementation of the Administrative Penalty Policy Changes

Background and Current Practice

The TCEQ has implemented approximately 61% of the Enforcement Process Review (EPR) recommendations. The remaining 39% relate to changes to the compliance history rule or the penalty policy. The Executive Director is seeking direction from the Commission on the outstanding issues in order to complete implementation of the EPR recommendations.

Compliance History issues were presented before the Commission at the August 12, 2005, September 16, 2005, and March 10, 2006 Commission Work Sessions. At the direction of the Commission, informal discussions with interested parties were held. At the March 10, 2006 Commission Work Session, the Commission provided the Executive Director with direction on the issues and instructions to proceed with formal rulemaking. The draft rule changes are summarized below and the Executive Director is asking for consideration of these changes and whether the Commission would like to go forward with the formal rulemaking process.

Administrative Penalty Policy and Rule issues were presented before the Commission at the January 14, 2005, August 12, 2005, and September 16, 2005 Commission Work Sessions and the March 29, 2006 Commission Agenda. At the September 16, 2005 Commission Work Session, the Commission directed the Executive Director to conduct a series of stakeholder meetings on key issues related to the calculation of administrative penalties. These stakeholder meetings were held at six locations across the State in November and December of 2005. Information on, and summaries of, the stakeholder meetings have been posted on the TCEQ website. At the March 29, 2006 Agenda meeting, the Commission gave the Executive Director direction on some of the issues and took others under advisement. The issues and their current status are described below for consideration by the Commission and direction for implementation.

Issues for Consideration:

Compliance History

The Executive Director is recommending that the following changes be made to the current rule:

- **Site rating formula:** exclude violations cited in federal orders from the numerator, exclude self-reported violations from the numerator until addressed in an enforcement order, add complexity to the denominator of the formula, and include early compliance with a rule or participation in an agency-supported voluntary pollution reduction program.
- **Repeat Violator:** redefine repeat violator as having more than one of the "same" major violation.
- **Nomenclature of classification:** change "Average by Default" to "Unclassified".
- **Change of ownership:** add requirement that, as part of a due diligence performed, compliance history information is disclosed by the seller to the buyer prior to a change of ownership.
- **Review of data:** add language that allows a regulated entity access to its compliance history information prior to publication on the agency's Web site.
- **Appeal of classification:** revise the appeal of classification language to allow all average performers the opportunity to appeal.

The Executive Director is seeking concurrence from the Commission to go forward with a draft rule package to address these issues.

Administrative Penalty Policy

Administrative Penalty Policy/Rule Question 1 Should the Commission convert the Penalty Policy into a rule?

Option 1: Take some items in the policy and convert them to rule. Leave other items as policy and supplement the policy and rule with guidance documentation.

Pros:

- This option may address some of the concern raised by SOAH. SOAH has indicated that a rule will be easier to enforce than a policy in an evidentiary hearing.
- This option may address some of the issues raised by stakeholders. Some of the stakeholders have indicated that they would like to see the policy enacted as a rule to make it less subjective.

Cons: To make changes to the parts of the policy that are converted to rules would require a full rulemaking process which can take up to a year to implement.

Option 2: Convert the entire policy into a rule.

Pros:

- SOAH has indicated that a rule will be easier to enforce than a policy in an evidentiary hearing.

- Some of the stakeholders have indicated that they would like to see the policy enacted as a rule to make it less subjective.

Cons:

- A rule may not give the Commission the flexibility that may be desired for unusual or extraordinary circumstances that may warrant higher or lower penalties.
- When changes are necessary to the policy a full rulemaking effort will need to be implemented which can take up to a year to accomplish.

Option 3: Leave the Penalty Policy as an Agency policy formally approved by Commission Action.

Pros:

- This option provides the most flexibility for the Commission. Some circumstances, that cannot all be anticipated in a rulemaking process, may warrant higher or lower penalties that a rule may not give the Commission the flexibility to act upon.
- This option allows for more timely changes to the policy. A rulemaking process can take up to a year to accomplish whereas policy changes can occur by direction of the Commission.
- The Agency has been operating under the auspices of an administrative penalty policy since 1985 and the policy has been effective.

Cons:

- The State Office of Administrative Hearings (SOAH) has indicated that a policy is more difficult to enforce than a rule.
- Some of the stakeholders have indicated that they would like to see the policy enacted as a rule to make it less subjective.

Administrative Penalty Policy/Rule Question 2 What should the Commission consider when calculating the penalty adjustment for Economic Benefit?

Option 1: Change the threshold of the dollar range of the economic benefit in the economic benefit matrix from $15,000 to $5,000, $7,500, or $10,000. The current penalty policy makes no penalty adjustment for economic benefit if the economic benefit gained is below $15,000. If greater than or equal to $15,000 the base penalty is increased by 50%. The table below demonstrates how orders might be affected by economic benefit adjustments for the suggested possible thresholds.

FISCAL YEAR (2007 DATA IS FOR ORDERS EFFECTIVE THRU JULY)	TOTAL ORDERS ISSUED	ORDERS WITH ECONOMIC BENEFIT INCLUDED AT $15,000 THRESHOLD	ORDERS WITH ECONOMIC BENEFIT INCLUDED AT $10,000 THRESHOLD	ORDERS WITH ECONOMIC BENEFIT INCLUDED AT $7,500 THRESHOLD	ORDERS WITH ECONOMIC BENEFIT INCLUDED AT $5,000 THRESHOLD
FY2005	1,159	28 (2.4%)	49 (4.2%)	60 (5.2%)	93 (8.0%)
FY2006	1,531	29 (2.0%)	60 (3.9%)	73 (4.8%)	105 (6.9%)
FY2007	1,171	22 (1.9%)	40 (3.4%)	48 (4.1%)	61 (5.2%)

Pros:

- Lowering the threshold would increase the number of orders with economic benefit adjustments and would alleviate some concerns voiced by stakeholders who commented that the economic benefit adjustment is not high enough.
- This would alleviate some concerns voiced by stakeholders who believe that recovery of the full economic benefit is not a feasible option.

Cons:

- Some stakeholders may not support this option because it would result in increasing the number of orders with economic benefit adjustments.
- This option would not alleviate concerns voiced by stakeholders who believe that the full economic benefit should be recovered.

Option 2: For this option, the Executive Director would evaluate avoided costs separately from delayed costs to determine the total economic benefit adjustment.

Recovery of Avoided Costs: If the economic benefit gained from a violation is determined by the Executive Director to be derived from an avoided cost of compliance then 100% of the economic benefit related to the violation will be included in the proposed administrative penalty.

Recovery of Delayed Costs: If the economic benefit from a violation is determined by the Executive Director to be derived from a delayed cost of compliance, the delayed cost would be calculated using a similar theory as in the current policy, basing the amount of penalty enhancement on a threshold value which could be $15,000, $10,000, $7,500, or $5,000.

If the violations included in an order involve both avoided and delayed costs, the values from the calculations for each would be added together for the final enhancement.

Pros: This option is a hybrid of the current policy and the concept of recovery of the full economic benefit value and may be a good compromise between opposing viewpoints. Environmental groups commented in support of recovery of the full economic benefit and regulated entities and small businesses commented on either maintaining the current policy or deferring some or all of the economic benefit gained in lieu of corrective action.

Cons: Some comments received from representatives of the regulated community argue that calculation of the economic benefit gained cannot be fairly applied across the board because the methodology to determine economic benefit is so complex.

Option 3: Include 100% of the economic benefit related to the violation for all proposed administrative penalties with the exception of small municipalities (i.e., cities with < 5,000 in population and counties with < 25,000 in population, etc.). In this scenario, the entire economic benefit from both the avoided and delayed costs would be added to the base penalty calculation.[1]

Pros:

- This would alleviate some concerns voiced by small municipalities with limited assets.
- Representatives from several school districts testified at the stakeholder meetings and stated that they are normally not in a position to have staff that are soley dedicated to environmental issues and they do not have the sophistication of larger businesses or governments, stressing compliance assistance over enforcement.
- Environmental groups have expressed a desire for the full economic benefit to be recovered.

Cons: Some comments received from representatives of the regulated community argue that this cannot be fairly applied across the board because the methodology to calculate economic benefit is so complex.

Option 4: No change from the current practice.

Pros:

- Status quo. No rule or policy change would be necessary.
- Some stakeholders have advocated maintaining the current policy because of the complexity of determining the true economic benefit from any given violation.

Cons:

- During the Enforcement Process Review the Commission directed staff to change the current policy after receiving stakeholder comments.
- Some stakeholders have commented that the economic benefit calculation currently in use is not high enough to deter future violations.

Administrative Penalty Policy/Rule Question 3 Should the Commission provide additional decreases to the base penalty based upon whether or not a regulated entity is a small business or small local government?

Currently, the penalty policy takes into account the size of a Respondent's site and designates whether or not a site is a major or minor source. These designations are different for each program

[1] Inclusion of economic benefit cannot result in a final assessed administrative penalty that exceeds the statutorily mandated maximums.

area and is based upon the potential for harm to human health or the environment based upon the amount or type of regulated activities at a site. This designation does not take into account the size of a business (number of employees or assets) or the population of a municipality.

Option 1: Retain the current policy and continue to designate major/minor sources.

Pros: By focusing on the potential for harm, this option addresses environmental concerns in a more direct manner. The fact that a business or government is "small" does not mean that they do not have a high potential to cause harm.

Cons: This option would not address stakeholder issues received from small businesses, municipalities, and school districts who stated that their financial resources are severely restricted and that in many situations they may not be able to afford to achieve compliance as well as pay a penalty.

Option 2: Allow an additional reduction to the base penalty for small businesses and small local governments.

Pros: This option would address stakeholder issues received from small businesses, municipalities, and school districts who stated that their financial resources are severely restricted and that in many situations they may not be able to afford to achieve compliance as well as pay a penalty.

Cons: This option results in treating small businesses and small local governments differently than large businesses and local governments.

Administrative Penalty Policy/Rule Question 4 What should the Commission consider when calculating the penalty adjustment related to Culpability?

Option 1: Permittees, Registrants, and Licensees should be deemed "culpable" unless the alleged violation is truly something that they could not have foreseen.

Pros: Environmental groups felt that an upward adjustment of the penalty for culpability should occur if the entity is permitted, registered, or has received a previous Notice of Violation (NOV), Notice of Enforcement (NOE), or Commission Order.

Cons: Small business groups felt that an upward adjustment of the penalty for culpability should occur if the entity has received a previous NOV, NOE, or Commission Order but not just because an entity is permitted or registered.

Option 2: Culpability should be determined on a case-by-case basis regardless of status of authorization.

Pros:

- Status quo. No changes to rule or policy necessary.
- The comments received from large businesses varied but most favored a case-by-case determination.

Cons: Environmental groups commented that the use of a case-by-case scenario could result in the policy being inconsistently applied.

Administrative Penalty Policy/Rule Question 5 What should the Commission consider in using standard penalties for violations that the current penalty policy classifies as "potential" or "programmatic"?

At the March 29, 2006 Agenda meeting, the Commission gave the following direction to the Executive Director:

> Standard base penalties should be developed for most violations with the exception of the following situations:
>
> - where an actual discharge or emission has occurred; and/or
> - environmental or human health effects have been documented; and/or
> - where regulatory authorization has not been obtained; and/or
> - where there has been an impairment of water rights.
>
> Factors such as good faith efforts, economic benefit, culpability, and compliance history will continue to affect the final penalty.

The Executive Director is looking for concurrence from the Commission that this is still the direction to take.

Pros:

- Small business representatives were supportive of standardized penalties because they felt that it would help to clearly define penalty amounts.
- Standardized penalties will help streamline the enforcement process.

Cons:

- Environmental groups were concerned about the lack of consideration for the duration of the violation and that the percentages in the examples provided during the stakeholder meetings and EPR appeared to be too low.
- Several concerns were raised by stakeholders about which violations would qualify for standard penalties and the lack of flexibility to consider all circumstances of a violation.

Administrative Penalty Policy/Rule Question 6 Are there better means of determining the number of events for a given violation than the methodology expressed in the Commission's current penalty policy?

Option 1: Devise a clearer method for determining the number of penalty events that takes the duration of the violation into account, as well as the level of impact to human health and the environment.

Pros: There was consensus from stakeholders regarding a need for a better method for determining the number of penalty events.

Cons: No dissenting comments were received.

Option 2: Leave the policy as is, where the number of events is based upon level of impact of the violation to human health or the environment.

Pros: Status Quo. No change to policy or rule would be needed.

Cons: Stakeholders expressed displeasure with the current practice of determining the number of penalty events.

Administrative Penalty Policy/Rule Question 7 Should the Commission change how the compliance history component is used in calculating administrative penalties?

Option 1: Escalate the penalty using only previously issued orders that fall within the five year compliance period. This method would escalate a penatly by a certain percentage per order. For example, each previously order could result in escalating the base penalty by 25%. If this option is chosen, the Executive Director seeks direction from the Commission on the appropriate percentage to use and if there should be a ceiling on that percentage (i.e., 25% per order with a ceiling of 500%).

Pros: This option would alleviate the concerns regarding double-counting NOVs in the penalty calculation and simplify the use of compliance history in escalating a penalty.

Cons: This option might (at the discretion of the Commission) make more entities "culpable" because NOVs would no longer be used for the Complaince History enhancement and might therefore be used in the determination regarding culpability. This option may also reduce the overall effect of compliance history on the final penalty.

Option 2: Escalate the penalty using issued orders and NOVs that are not associated to violations that have been referred for enforcement. Base penalties would be escalated by a certain percentage per order and a certain percentage for the NOVs. For example, each order could result in escalating the base penalty by 25% and each NOV that is not related to the pending allegations could result in escalating the penalty by 3%. If this option is chosen, the Executive Director would seek direction from the Commission on the appropriate percentages to use and if there should be a ceiling on the combined percentage.

Pros: This option would alleviate the concerns regarding double-counting compliance history in the penalty calculation and simplify the use of compliance history in escalating a penalty.

Cons: This option may reduce the overall effect of compliance history on the final penalty.

Option 3: Leave the policy as is.

Pros: Status Quo. No changes would be necessary to the policy.

Cons: This option would not alleviate the concerns regarding double-counting compliance history in the penalty calculation.

Administrative Penalty Policy/Rule Question 8

Under what circumstances when a respondent fails to answer and a Default Order is issued, should the fuel delivery certificate be revoked?

Scenario 1: Corrective action is required (as well as the payment of a penalty and/or fees).

Pros: The use of fuel delivery certificate revocation is an effective compliance incentive, and an effective means of bringing noncomplying facilities into compliance in an expedient manner.

Cons: Prohibiting the delivery and/or sale of fuel may limit the regulated entity's ability to generate income thereby limiting its ability to pay overdue fees, satisfy administrative penalties, and/or cover expenses associated with the cost of compliance and remediation.

Scenario 2: No corrective action is required, only the payment of a penalty and/or payment of fees.

Pros: The use of fuel delivery certificate revocation is an effective means of making facilities pay past due penalties and/or fees.

Cons:

- Prohibiting the delivery and/or sale of fuel may limit the regulated entity's ability to generate income thereby limiting its ability to pay overdue fees, satisfy administrative penalties, and/or cover expenses associated with the cost of compliance and remediation.
- Revoking the delivery certificate in this situation may lead to respondents not correcting violations in the future.