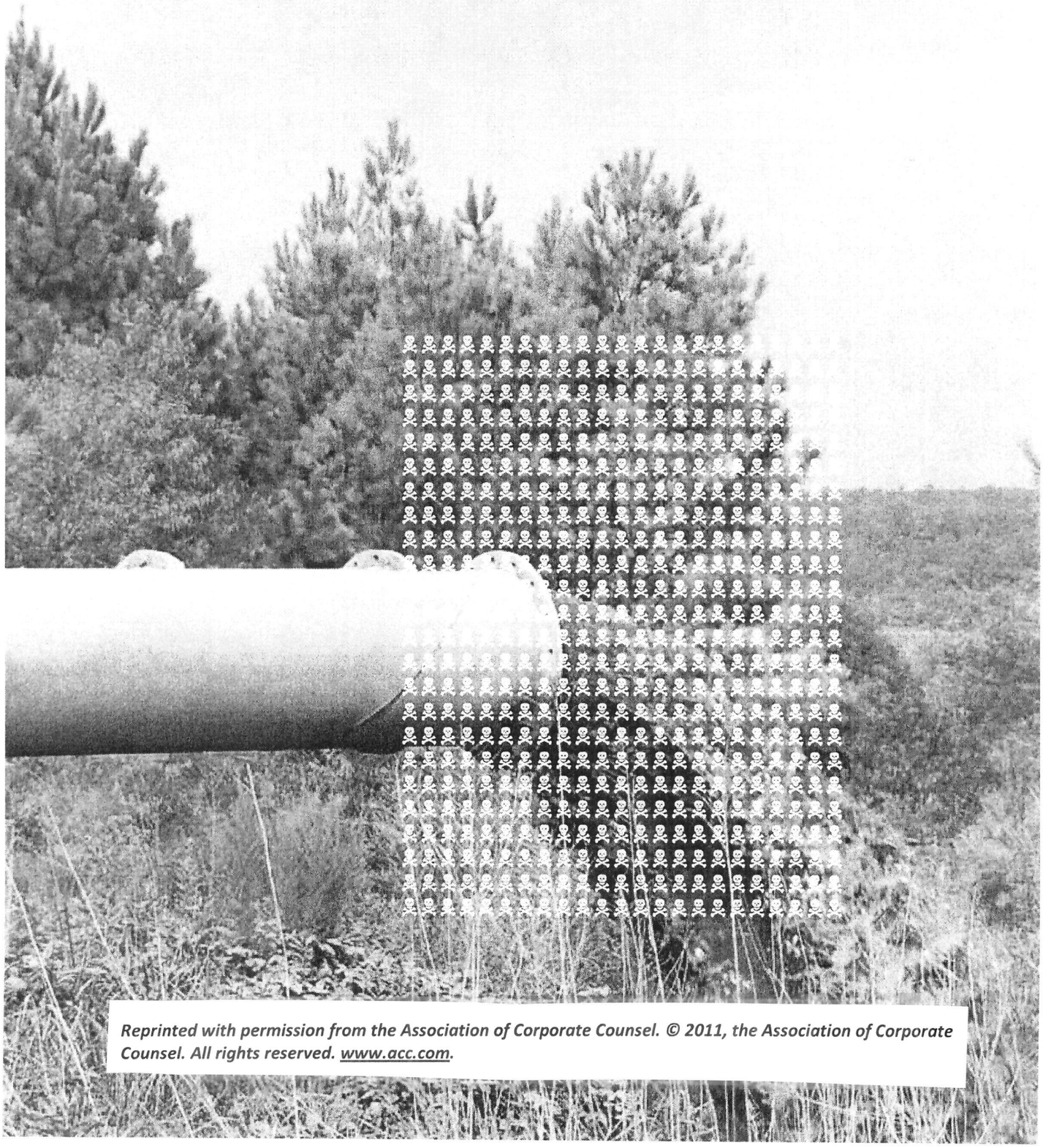

Recent Criminal Actions Involving Wastewater Treatment Facilities

BY JULIE A. BELL AND JOHN S. IRVING

Your company just closed its acquisition of a smaller company that engages in manufacturing activities during which hazardous substances are generated and then disposed. During due diligence, you learned that your new subsidiary's financial performance had improved greatly over the past year. During this period, the company made significant cuts in its EHS expenditures. The target had, in fact, terminated its contract with one of its largest disposal contractors, and internal reports showed a steep decline in the number of pounds of waste generated and hauled away. Should the investigation of possible environmental compliance violations and consideration of voluntary disclosure to EPA move to the top of your "to do" list?

Pour yourself a strong cup of coffee — your decision might well determine whether your company will face a criminal indictment. In two recent criminal actions, the US Department of Justice, working with the EPA and other investigative agencies, brought charges involving unpermitted discharges from wastewater treatment facilities. A comparison of the two cases provides some helpful insight into business decisions and practices that can determine whether a company is charged as a defendant in a criminal case.

The cases

On Dec. 8, 2010, a grand jury in the Northern District of Indiana indicted United Water Services, Inc., which operated the Gary Sanitary District (GSD) water treatment plant, and its two highest-ranking employees at that plant. All three are charged with Conspiracy (18 U.S.C. § 371) and a substantive count of Tampering with a Monitoring Method in violation of the Clean Water Act (33 U.S.C. § 1319(c)(4)). The indictment alleges that the United Water Services, Inc., employees engaged in a scheme, whereby they increased the quantity of chlorine used to disinfect effluent flowing to the Grand Calumet River shortly before required samples were taken, and then decreased the chlorine level shortly afterward. The indictment lists 78 occurrences of chlorine level manipulation, along with some other egregious allegations, including: (1) terminating and paying a year's salary to a plant supervisor who refused to comply with orders to manipulate chlorine levels (on the condition that the plant supervisor agreed "not to make any negative or disparaging remarks"); (2) instructing plant employees "that the chlorine dosing method would involve increasing the chlorine dosing level prior to taking the daily *E. coli* sample for testing, and then decreasing the chlorine level after the sample had been taken;" and (3) ignoring an email from a different company facility about a decrease in chlorine consumption from approximately 689 to 285 gallons. The indictment also notes that the annual performance review for the facility's highest-ranking employee "gave substantially greater weight to improving the financial performance of United Water's GSD operation than to compliance with environmental requirements."

On Feb. 24, 2011, a grand jury in the Western District of Louisiana indicted two senior employees of a company that operated an industrial wastewater treatment facility that discharged to the City of Shreveport's publicly owned treatment works (POTW) and to the Red River. The company was Arkla Disposal Services, Inc. (Arkla), which was purchased by Canada-based CCS in the third quarter of 2006.[1] The indictment charges the president of Arkla, the general manager of its Shreveport facility, and the facility's night shift supervisor with Conspiracy; Discharging to the POTW in Violation of a Requirement of the Approved Pretreatment Program (33 U.S.C. § 1319(c)(2)(A)); two counts of Discharging to the Red River Without a Permit (33 U.S.C. §§ 1311(a) & 1319(c)(2)(A)); and Obstruction (18 U.S.C. § 1505). The charged conduct occurred from July 2006 through at least October 2007 — notably, much of the charged behavior occurred after Arkla reportedly was purchased by CCS. The indictment alleges conduct at least as egregious as, and certainly more complicated than, that alleged in the Indiana case, including: (1) inspecting a pipeline to the Red River to see whether a monitoring device had been placed on the line; (2) replacing the effluent in a sampler with fresh water; (3) fabricating new pipe connections to bypass the facility's effluent flow meter; (4) replacing tank sampling lines with fresh water lines and extending the facility's outfall line into the river and underwater; (5) instructing an employee to spray detergent over the surface of the Red River if the employee saw oil sheens caused by the facility's outfall; and (6) obstructing an EPA inspection by staging a pump failure and making it look as though a valve had been left open that would have contaminated tanks from which the EPA inspector was trying to collect effluent samples.

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The differences

In situations like these, the government can charge companies through the doctrine of *respondeat superior*, which holds that corporations may be liable for the acts of their directors, officers, employees and agents, where their actions were within the scope of their duties and intended, at least in part, to benefit the corporation.[2] Department of Justice policy also states that, "in all cases involving wrongdoing by corporate agents, prosecutors should not limit their focus solely to individuals or the corporation, but should consider both as potential targets."[3] Why, then, was United Water Services, Inc., charged in Indiana, while Arkla/CCS was not charged in Louisiana?

Part of the answer is likely because of the acquisition of Arkla by CCS, presumably meaning that CCS had nothing to do with the earlier violations. Given, however, that Arkla was part of CCS for the majority of the 15 months of charged conduct, the acquisition alone cannot explain why neither entity's name appears in the heading of the indictment.

The Department's apparent decision to forego a criminal case against Arkla/CCS is better explained in a November 2008 newspaper article about the investigation.[4] The article states that according to CCS spokesmen, the company conducted an internal investigation after an April 2007 EPA inspection, terminated the now-indicted general manager of the Shreveport facility, self-reported potential violations to the EPA under the EPA's voluntary disclosure policy, and cooperated with investigators.

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EPA policies

In 2000, the EPA published notice of its *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations* ("Audit Policy").[5] The Audit Policy provides certain incentives for companies that self-report violations, provided that certain conditions are met. In August 2008, EPA published notice of its *Interim Approach to Applying the Audit Policy to New Owners* ("Interim Approach").[6] By relaxing many of the conditions of the Audit Policy, the Interim Approach provides additional incentives for new owners of facilities to perform environmental audits, and report and correct violations. It is limited to new owners that promptly disclose violations to EPA or enter into an audit agreement within nine months of transaction closing; to new owners who were not responsible for environmental compliance at the facility, did not cause the violation, and could not have prevented it; to violations that originated with the prior owner; and to buyers and sellers that do not share a common corporate parent or own majority shares of each other.

The following summaries describe the Audit Policy conditions and the additional incentives provided by the Interim Approach:

- **Audit Policy Condition One:** The violation was discovered through an environmental audit or through a compliance management system that reflects due diligence in preventing, detecting and correcting violations.
  - Interim Approach Modifications: This condition is waived for violations discovered through pre-acquisition due diligence.
- **Audit Policy Condition Two:** The violation was identified voluntarily, and (with some exceptions for Clean Air Act violations) not through a monitoring, sampling or audit procedure that is required by statute, regulation, permit, judicial or administrative order, or consent agreement.
  - Interim Approach Modifications: Violations are not disqualified on the basis that they are discovered through legally required monitoring, sampling or audit procedures.
- **Audit Policy Condition Three:** The company must disclose the violation in writing to the EPA within 21 calendar days of discovery.
  - Interim Approach Modifications: New owners must disclose violations within 21 days of discovery or within 45 days of closing, whichever is longer.
- **Audit Policy Condition Four:** The company must discover the violation independently, i.e., before EPA or another government agency likely would have identified the problem through its own investigation or from information received through a third party.
  - Interim Approach Modifications: No modification.
- **Audit Policy Condition Five:** The company must remedy any harm caused by the violation and expeditiously certify in writing to appropriate Federal, State, and local authorities that it has corrected the violation.
  - Interim Approach Modifications: No modification.
- **Audit Policy Condition Six:** The entity must agree to take steps to prevent a recurrence of the violation.
  - Interim Approach Modifications: No modification.
- **Audit Policy Condition Seven:** Same or similar violations must not have occurred at the same facility within the past three years (or at one or more facilities owned by a multi-facility organization within the past five years).
  - Interim Approach Modifications: No modification.
- **Audit Policy Condition Eight:** The violations must not have resulted in serious actual harm to the environment, or presented an imminent and substantial endangerment to public health or the environment.
  - Interim Approach Modifications: All violations qualify, so long as they did not result in a fatality, community evacuation, or other seriously injurious or catastrophic event.
- **Audit Policy Condition Nine:** The company must cooperate with the EPA and provide the information it needs to determine policy applicability (e.g., there must be no hiding, destruction or tampering with possible evidence after discovering potential environmental violations).
  - Interim Approach Modifications: Cooperation means assisting EPA in determining whether the Audit Policy, as modified by the Interim Approach, is met (not whether the unmodified Audit Policy conditions are met).

Among the benefits for voluntarily disclosing violations consistent with the Audit Policy (as applied to new owners through the Interim Approach) is that EPA agrees not to refer the company to the Justice Department for criminal prosecution, so long as the violation was not part of a pattern or practice that demonstrates or involves (1) a prevalent management philosophy that conceals or condones environmental violations; or (2) high-level corporate officials' or managers' conscious involvement in, or willful blindness to, violations of federal environmental law. EPA reserves the right to recommend criminal prosecution of individual managers and employees, and it notes that the Justice Department retains the ultimate authority to make criminal charging decisions.

Justice Department policies

The Justice Department considers EPA's policies when deciding whether to bring environmental criminal cases. The US Attorney's Manual states:

> EPA has adopted a policy that may affect cases involving voluntary disclosure, cooperation, and compliance by potential defendants. During their decision-making process in environmental cases prosecutors should take into account that policy and any departmental policy or policies that may be relevant.[7]

That US Attorney's Manual provision is consistent with the Department's 1991 policy entitled *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator* ("DOJ 1991 Policy").[8] The factors used in the Department's exercise of prosecutorial discretion include: (1) whether a disclosure is voluntary, timely and complete; (2) whether full and timely cooperation is provided; and (3) the existence and scope of any regularized, intensive and comprehensive environmental compliance program. Additional factors that the policy states may be relevant are: (1) the pervasiveness of noncompliance; (2) the extent to which a company had an effective system of discipline for employees who violated company environmental policies; and (3) prompt efforts to remove the source of non-compliance and lessen the environmental harm resulting from it.

In deciding whether to criminally charge corporations, the Justice Department also considers the factors detailed in its *Principles of Federal Prosecution of Business Organizations*, the most recent version of which was issued by Deputy Attorney General Mark Filip[9] in August 2008 and is found at US Attorney's Manual § 9-28.[10] Those principles largely echo the EPA and Justice Department policies discussed above, and list the following general factors to be considered:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management;
3. the corporation's history of similar misconduct, including prior criminal, civil and regulatory enforcement actions against it;
4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents;
5. the existence and effectiveness of the corporation's pre-existing compliance program;
6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution and to cooperate with the relevant government agencies;
7. collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees and others not proven personally culpable, and impact on the public arising from the prosecution;
8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
9. the adequacy of remedies, such as civil or regulatory enforcement actions.

Application of the policies to the recent cases

As always, there surely is more to the story in both the Indiana and Louisiana cases than is in the public record. That said, some logical inferences can be made.

Consider for yourself, for example, how well CCS in the Louisiana case measures up to "Company A" in the following hypothetical identified in the DOJ 1991 Policy as "the ideal case in terms of criteria satisfaction and consequent prosecution leniency":

1. Company A regularly conducts a comprehensive audit of its compliance with environmental requirements.
2. The audit uncovers information about employees disposing of hazardous wastes by dumping them in an unpermitted location.
3. An internal company investigation confirms the audit information. (Depending upon the nature of the audit, this follow-up investigation may be unnecessary.)

4. Prior to the violations, the company had a sound compliance program, which included clear policies, employee training and a hotline for suspected violations.
5. As soon as the company confirms the violations, it discloses all pertinent information to the appropriate government agency; it undertakes compliance planning with that agency; and it carries out satisfactory remediation measures.
6. The company also undertakes to correct any false information previously submitted to the government in relation to the violations.
7. Internally, the company disciplines the employees actually involved in the violations, including any supervisor who was lax in preventing or detecting the activity. Also, the company reviews its compliance program to determine how the violations slipped by and corrects the weaknesses found by that review.
8. The company discloses to the government the names of the employees actually responsible for the violations, and it cooperates with the government by providing documentation necessary to the investigation of those persons.

While the exact timing of CCS's discovery of violations and reported disclosures to the government are unclear, CCS likely also fell under the EPA's relaxed disclosure standards for new owners. It is unclear whether the Justice Department declined to prosecute CCS altogether, or whether CCS and the Department entered into a non-prosecution or deferred prosecution agreement. It is also possible that the story is not yet over for CCS — but the fact that there is no case involving CCS listed in the court records of the US District Court for the Western District of Louisiana suggests that the company might have dodged a bullet.

By contrast — at least as alleged in the indictment — United Water Services, Inc., in the Indianapolis case instructed employees to manipulate chlorine levels; terminated an employee who refused to do so (stating, as part of his refusal, that "he ... did not want to go to jail"); paid that employee a year's salary not to make "negative or disparaging remarks" about the company; gave substantially greater weight in the annual performance review for the facility's highest-ranking employee to improving the financial performance than to environmental compliance; ignored concerns expressed by another company employee about a significant drop in the amount of chlorine being used; and made a false statement to the Contract Compliance Officer about the level of free chlorine residual at the time of a sampling. The alleged violations include 68 instances of chlorine level manipulation over more than a four-year period, suggesting that the violations were continuous and pervasive. There is no indication that United Water Services, Inc., was in a position to avail itself of the EPA's relaxed new owner disclosure standards. There appears to be no publicly available information about United Water Service's compliance efforts, efforts to detect or remediate violations, or efforts to disclose violations to the government — but the fact that the company is a named defendant in the indictment suggests that the situation was different from that of CCS in Louisiana. Shortly after the indictment was returned, the company refuted the allegations against it, stating in part that "[t]he government's claim is, at best, a disagreement about operating and monitoring methods, with no allegation of environmental harm." "Trying to make a crime out of this disagreement," the company continued, "is an abuse of prosecutorial discretion."[11]

Post-acquisition due diligence is also important, because new owners **only have nine months** to "promptly" make disclosures **or enter into an audit agreement.**

Lessons learned

It obviously would be preferable not to have employees manipulating chlorine levels or grafting pipes to circumvent monitoring devices in the first place. Companies should have strong compliance policies and procedures in place to prevent, detect and/or correct that kind of conduct. The CCS case in Louisiana also demonstrates the importance of pre-acquisition due diligence. Post-acquisition due diligence is also important, because new owners only have nine months to "promptly" make disclosures or enter into an audit agreement. Even there, "prompt" disclosure still means disclosure within 21 calendar days of the discovery of the violation.

Environmental due diligence typically follows standards set by the American Society of Testing and Materials (ASTM) for Phase I and Phase II Environmental Site Assessments (ESA) for purposes of demonstrating that a landowner (or occupant) carried out "all appropriate inquiries" in the land's prior use. That is required to qualify for the "innocent landowner," "contiguous property owner," and "prospective purchaser" defenses to liability under the Com-

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prehensive Environmental Response, Compensation, and Liability Act (CERCLA). A Phase I ESA is an assessment of a property's environmental conditions for contamination. A Phase II ESA further evaluates environmental conditions identified in the Phase I ESA in order to better define the nature and extent of contamination. Bear in mind, though, that these assessments focus on the land itself and might not identify other environmental conditions related to air and water pollution, and proper storage and disposal of hazardous wastes. It also might be particularly difficult to identify purposeful wrongdoing by the current landowner and its employees. Particular attention should be paid to the types of potential pollution unique to the site — air pollution, for example, for power generation facilities.

Counsel conducting pre-acquisition due diligence should evaluate the target's environmental reporting, paying particular attention to disclosures made to regulatory or law enforcement agencies in the past seven years. If the target company is publicly traded, review its disclosures in its public filings relating to environmental risks and liabilities. To the extent possible, counsel should interview the target's chief environmental, health and safety officer — or at least a member of senior management to whom the function ultimately reports — in order to understand and evaluate the strength of the company's attention to waste handling, storage and disposal, permitting, auditing, reporting, policy and employee discipline.

Compliance policies and procedures are only worthwhile if they are "effective." The government will not be impressed with a set of binders that sit on a shelf in a compliance officer's office and that employees know nothing about. US Sentencing Guideline §8B2.1 lists the essential elements of an effective compliance and ethics program, which include:

- exercising due diligence to prevent and detect criminal conduct;
- promoting an organizational culture that encourages ethical conduct and compliance with the law ("Tone at the Top");
- establishing standards and procedures;
- ensuring that the company's governing authority is knowledgeable about the content and operation of the compliance program;
- assigning responsibility for the compliance program to specific high-level personnel and delegating day-to-day operational responsibility to other specific personnel;
- providing those administering the compliance program with adequate resources, authority and access to the company's governing authority;
- training employees and agents;
- monitoring and auditing;
- providing and publicizing a system for employees to anonymously or confidentially report violations without fear of retaliation;
- providing incentives for performing in accordance with the compliance program and disciplining those who fail to do so; and
- periodically reassessing risks and modifying policies and procedures as necessary.

In the event that a potential violation is discovered, a company must quickly evaluate whether the discovery qualifies as "voluntary" and "independent" under EPA policy, i.e., whether the discovery was because of an existing legal obligation and whether it was discovered before EPA or another government agency likely would have identified the problem through its own investigation or from information received through a third party. Particularly, where those criteria are met (and even more

> Companies should **be prepared to cooperate fully** with the government; to explain **how their compliance policies and procedures are effective**, or have been made effective in **response to the discovery.**

so where it is likely that the government might learn of the violation from a disgruntled employee or elsewhere), companies should strongly consider making a full written disclosure to the government within the 21-day time limit. Companies should be prepared to cooperate fully with the government; to explain how their compliance policies and procedures are effective, or have been made effective in response to the discovery; to discuss disciplinary action taken against employees responsible for the violations; and to discuss the company's plans to remediate the environmental harm caused by the violation. Further, as advised by the US Sentencing Commission in its guidance on effective compliance and ethics programs,[12] personnel evaluations should include an ethical behavior and compliance component. This is particularly important in companies governed by extensive or comprehensive regulatory schemes, as was the case here.

Companies must also act quickly to investigate the extent to which management ordered, condoned or should have been aware of the violation. Internal investigations bring their own set of unique issues. Missteps can lead to serious problems, including potential obstruction of justice charges for altering documents and electronic information, providing incomplete or inaccurate information to investigators, instructing witnesses not to speak with investigators, or telling them what to say to investigators. The investigation process must protect the company's attorney-client privilege, e.g., by having attorneys conduct employee interviews and by not disclosing privileged information to third parties. This complicates how disclosures are made to the government. Employees must also understand that company attorneys do not represent them personally, an issue that has led to considerable litigation and attorney referrals to bar counsel. Electronic evidence, including emails, must be carefully preserved, collected and reviewed.

There are strong reasons to ensure that a company's compliance program is effective, and not simply a collection of papers that employees have not been trained on. There are equally strong reasons to engage in meaningful environmental due diligence — ideally prior to a transaction, but also afterward. If trouble strikes, there will not be much time to properly investigate potential violations or to evaluate whether disclosure and cooperation with the government is the appropriate course of action.

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NOTES

1 See *www.ccscorporation.ca/company/Corporate%20Profile/history.html.*
2 See US Attorney's Manual § 9-28.200 (available at *www.justice.gov/usao/eousa/foia_reading_ room/usam/*).
3 Id.
4 Alison Bath, "Dumping in Red River Investigated," *Shreveport Times*, Nov. 9, 2008 (*www.shreveporttimes.com/article/99999999/SPECIALPROJECTS05/809280341/Dumping-Red-River-investigated*).
5 See *www.epa.gov/oecaerth/resources/policies/incentives/auditing/auditpolicy51100.pdf; www.epa.gov/oecaerth/incentives/auditing/auditpolicy.html.* See also EPA's 1997 Interpretive Guidance at *www.epa.gov/oecaerth/resources/policies/civil/rcra/audpolintepgui-mem.pdf.*
6 See *http://edocket.access.gpo.gov/2008/pdf/E8-17715.pdf; www.epa.gov/oecaerth/incentives/ auditing/newowners-incentives.html.*
7 US Attorney's Manual at § 5-11.114(C).
8 *www.justice.gov/enrd/3058.htm.*
9 *www.justice.gov/dag/readingroom/dag-memo-08282008.pdf.*
10 *www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm.*
11 "United Water Refutes DOJ Charges," *Business Wire*, Dec. 8, 2010 (*www.allbusiness.com/government/government-bodies-offices/15348574-1.html*).
12 US Sentencing Guidelines Manual § 8B2.1 (*www.ussc.gov/Guidelines/2010_guidelines/ Manual_HTML/8b2_1.htm*).