United States
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EPA

# Report of Audit

OFFICE OF MOBILE SOURCES'

ESTABLISHMENT, MITIGATION, AND

COLLECTION OF PENALTIES

E1G16-05-0058-61560

SEPTEMBER 30, 1986

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

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OFFICE OF
INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Audit Report No. E1G16-05-0058-61560
Report on Office of Mobile Sources'
Establishment, Mitigation, and
Collection of Penalties

FROM: Ernest E. Bradley III
Assistant Inspector General for Audit

TO: J. Craig Potter
Assistant Administrator for Air and Radiation

## SCOPE AND OBJECTIVES

This report is the first of three reports on the results of our audit of the Office of Mobile Sources' (OMS) enforcement program. This report covers our audit of OMS' establishment, mitigation and collection of penalties.

The objectives of this audit were to: (1) evaluate the appropriateness of proposed penalties; (2) evaluate the reasons for the disparity between proposed penalties and the final mitigated amounts; and (3) determine that the final mitigated penalties are collected where cash is involved and that the violator complied with other conditions in the settlement agreement. We performed the audit in accordance with the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions issued by the Comptroller General of the United States.

Our audit generally covered OMS enforcement activities for FYs 1983 - 1985. In order to accomplish our objectives, we interviewed OMS officials, reviewed and evaluated OMS' policies, procedures and practices, and evaluated 106 enforcement cases. We included open, settled and dropped cases that involved fuel and tampering violations. We identified and reviewed OMS' internal control systems. The weaknesses we found are included in this report. Our field work was conducted from October 4, 1985 to May 13, 1986.

## SUMMARY OF FINDINGS

Over the last three years, OMS has initiated significant enforcement cases against violators of the Clean Air Act. During this period, OMS has proposed penalties of over $46 million and issued over 2,000 Notices of Violation. To improve their fuels enforcement program, OMS officials have:

-- Developed a short form procedure to expedite minor violations to reduce case processing time. Currently, settlement agreements are reached in an average of 104 days from the date of the Notice of Violation.

-- Negotiated public information programs into settlement agreements to dissuade the public from violating the regulations.

Our review disclosed, however, that OMS can improve procedures for administering its enforcement program. In response to our review, OMS has already taken action to implement several of our recommendations and we cite its actions in our report.

### 1. PROPOSED PENALTY AMOUNTS NEED REVIEW

The penalties proposed by OMS on violators of EPA's unleaded gasoline regulations have not changed since 1975 and may need revision. Proposed penalties are in some cases only 5 to 10 percent of the amount allowed by the Clean Air Act. The effectiveness of EPA's unleaded gasoline regulations and future enforcement efforts against fuel additive violations could be improved by a formal periodic review of the proposed penalty tables to ensure penalties are large enough to encourage compliance. The effects of noncompliance with EPA's unleaded gasoline regulations are significant. For example, two to four tankfuls of leaded gasoline can permanently disable a catalytic converter which can increase emissions of harmful pollutants by as much as 800 percent.

OMS officials had also not made a decision regarding an increase in lead phasedown penalties. Unless these penalties are sufficient to deter violations, a refiner may violate the revised lead in gasoline standard because a penalty is cheaper than complying with the standard. Subsequent to the completion of our field work, OMS took action to raise the per gram proposed penalties in phasedown cases by 666 percent.

In addition, OMS has not finalized its draft February 1985 Civil Penalty Policy for fuel and tampering violations. Each EPA program office, in a joint effort with the Office of Enforcement and Compliance Monitoring (OECM), is to revise existing policies or write new policies to ensure conformance with the Agency's February 1984 Policy On Civil Penalties. However, OMS has not submitted its policy to OECM for review.

In reply to our draft report, the Assistant Administrator for Air and Radiation disagreed that current FOSD proposed penalties are too low, but he agreed to review the current penalty schedule. He also will re-examine OMS' draft penalty policy to determine whether it should be finalized.

If a penalty is to achieve deterrence, both the violator and the general public must be convinced that the penalty places the violator in a worse position than those who have complied in a timely fashion. The penalties used by OMS are over 10 years old, thus the regulated petroleum marketing industry has had ample time to comply with EPA's rules. OMS needs to coordinate its draft penalty policy with OECM to assure its enforcement program is consistent with the Agency's Policy On Civil Penalties.

We recommend that the Assistant Administrator for Air and Radiation work closely with OECM to revise the "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act" to raise the penalty amounts for the different types of violations. Also, consideration should be given to (1) raising the size of business criteria for assessing the penalty amount in order to penalize large-size businesses by a larger monetary amount, (2) placing more emphasis on whether the defendant willfully or purposely violated EPA's unleaded gasoline regulations, and not on whether it was a first time violation, and (3) consider a higher penalty if the violation occurred in an area with significant pollution problems. We further recommend that simultaneous with the above action and coordinated with OECM, OMS' Civil Penalty Policy be issued in final form.

2. OMS' EFFORTS TO RESOLVE CASES NEED BETTER SUPPORT AND TRACKING

Case files did not always contain sufficient documentation to assure that reductions of proposed penalties were warranted. Consequently, EPA cannot be assured that all settlements were the best the Federal government could obtain. Summaries of negotiations with appropriate evidence for penalty reductions are required by the Agency guidelines and would help support final settlement agreements between OMS and the violator.

OMS' draft Civil Penalty Policy states ". . . a maximum of 40 percent of the proposed penalty may be deducted if the violator promptly corrects the violation and where appropriate established a program designed to effectively prevent recurrence of the violations." However, case files did not always contain sufficient documentation for the Agency to assure that the reductions were warranted. In addition, settlement agreements contained clauses requiring the violator to correct the deficiencies which the violator should have corrected promptly after the Notice of Violation (NOV), i.e., before the settlement agreement. This suggests the violator did not promptly correct the violation, yet the violator was judged as qualifying for a reduction of the proposed penalty.

Our draft report outlined several steps that would increase management's assurance that reductions of proposed penalties were warranted and to improve the tracking of cases. As a result of our review, officials have acted to improve procedures to ensure all mitigations are supported and to improve their tracking of case file development. The Assistant Administrator, while he did not see a need for an independent review of case files, did not object to such a review. Accordingly, we recommend he (1) ensure that OMS completes its actions to correct the cited weaknesses and (2) coordinate with OECM to implement an independent periodic review of a representative sample of case files to ensure that case files contain sufficient documentation to support settlement conditions made by OMS attorneys.

## 3. SETTLEMENTS WOULD BENEFIT FROM ADDITIONAL GUIDANCE ON ALTERNATIVES TO CASH PENALTY PAYMENTS

OMS policy allows a violator to undertake an OMS approved project as an alternative to a cash penalty. However, the impact of some alternatives is speculative because the environmental benefits are unclear. OMS attorneys do not have specific criteria on acceptable projects and they do not have adequate criteria for determining how much credit should be given to alternative payments. Consequently, the Agency's goal of acceptable environmentally beneficial projects may not be achieved in all cases, and the deterrent value of the final settlement may not be accomplished.

The types of alternative payments negotiated by OMS, for example, have included:

-- Purchase of a $20,000 van for a rehabilitation center which would have the slogan "Breathe Clean Air . . . Use Unleaded Gas" on the van.

-- A $25,000 donation to two colleges for purposes of sponsoring environmental internships, scholarships and research on topics of environmental law.

Our draft report recommended that OMS develop criteria and examples for attorneys to follow when assigning credit to alternative payments and that case files show how the attorney calculated the credit for alternative payments. In response to our draft report, officials provided us a 1980 memorandum that allowed attorneys to mitigate proposed penalties at a rate of two dollars for each dollar spent by the violator on an alternative project. Officials believed that to quantify the credit or environmental benefit for alternative projects would be unending, arbitrary and unnecessary.

We believe there is a need for OMS to reasonably determine the value of alternative projects. The 1980 memorandum stated that a primary reason for the two for one credit is that it will generally take more than a one dollar reduction of the penalty for each dollar spent by the respondent in order to encourage the respondent to undertake these activities. We believe this basis is inadequate for mitigating millions in proposed penalties, and additional criteria are needed. In this regard, the Agency stated in its February 1984 Policy On Civil Penalties that in some cases the Agency has accepted for credit certain expenditures whose actual environmental benefit has been somewhat speculative. OECM reviewed the Agency Policy on Civil Penalties and likewise found a need for additional clarification regarding alternative payments. Accordingly, we recommend the Assistant Administrator coordinate with OECM and develop clearer criteria for alternative projects.

## 4. CONTROLS OVER PENALTIES HAVE IMPROVED BUT FURTHER IMPROVEMENTS CAN BE MADE

OMS' controls over cash penalties owed to the Federal government and controls over other settlement conditions were not completely adequate. Consequently, we found instances where Agency employees lost penalty payments. OMS also needs formal procedures to ensure that collection of the entire civil penalty occurs when violators (1) do not comply with all settlement agreement conditions or (2) do not comply in a timely manner.

OMS and Financial Management Division (FMD) officials have initiated some steps and our draft report recommended additional actions to improve collection procedures and controls over cash penalties. In addition, OMS officials are improving their oversight function of other settlement conditions in order to maximize their enforcement of the Clean Air Act. Further, FMD plans to forward information on penalty payments to the Internal Revenue Service. We are recommending that the Assistant Administrator ensure that OMS complete its actions to correct the cited weaknesses.

## 5. OMS SHOULD ENSURE CLEAR PROCEDURES FOR PURSUING VIOLATIONS AGAINST SMALL REFINERIES

OMS did not pursue several violations of the lead phasedown regulations. As a result, cumulative proposed penalties of $1,765,000 were not negotiated for collection. Our draft report recommended that the Assistant Administrator for Air and Radiation (1) establish clear procedures for attorneys to follow in lead phasedown violations and (2) initiate an independent periodic review of a representative sample of enforcement cases to ensure all Agency requirements are met.

OMS officials agreed with our recommendation concerning the necessity for establishing clear procedures for attorneys to follow in lead phasedown violations and stated they would not object to an independent review of cases. Accordingly, we recommend that the Assistant Administrator take appropriate action to implement our draft report's recommendations.

## 6. FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT NOT FULLY IMPLEMENTED

Field Operations and Support Division (FOSD) officials did not fully participate in the Federal Managers' Financial Integrity Act (FMFIA) process. Consequently, officials did not document specific internal control procedures and techniques to show that their programs and activities were carried out in accordance with Agency directives. Unless officials document specific internal control procedures and techniques, there is a risk that FOSD's activities, if performed improperly, will not be detected. For example, Finding No. 4 of our report describes instances where Agency employees lost penalty payments. Agency officials have acted to strengthen this year's FMFIA process. We believe their actions provide FOSD officials the opportunity to fully participate in the FMFIA process and to adequately document and evaluate their internal control procedures and techniques.

Our draft report recommended that the Assistant Administrator for Air and Radiation take appropriate action to ensure that existing internal control procedures and the evaluation of current controls pertaining to fuel and tampering enforcement programs are documented. OMS officials responded that the Agency has not fully implemented FMFIA, but that FOSD's current controls are a major step towards assuring FMFIA objectives are being achieved. We have recommended that the Assistant Administrator require FOSD officials to clearly document their internal controls.

## OTHER MATTERS

### CRIMINAL PENALTIES WOULD BENEFIT OMS

Criminal sanctions are not provided in the Clean Air Act for flagrant violations of the tampering, fuel switching and fuel compositions. Consequently, current authority providing for civil penalties may not always result in a substantive penalty when considering the violator's damage to the environment. For example:

- An OMS investigation resulted in a $4 million proposed penalty against a distributor for numerous violations including 540 instances of distributing leaded gasoline as unleaded. An involuntary bankruptcy petition showed the distributor had no assets and no penalty could be imposed. Consequently, OMS dropped its proposed penalty and no further action against the violator was taken.

In response to our draft report, OMS officials agreed with our conclusions concerning the usefulness of criminal sanctions for flagrant violations. However, they believed that a judge who applies civil sanctions leniently will likely do the same in a criminal context.

Agency officials have acted responsibly to demonstrate their intent for criminal sanctions against violations of the environmental regulations. On July 29, 1985, EPA sent to the Office of Management and Budget a proposed bill "The Improved Environmental Enforcement Act of 1985." The bill would improve EPA's ability to enforce compliance with environmental legislation across its multi-media regulatory programs fairly and effectively. As further support for the need for criminal penalties, we suggest that OMS officials submit to the appropriate Agency officials examples of violations where criminal or injunctive actions would be appropriate for their further consideration.

## ACTION REQUIRED

In accordance with EPA Order 2750, the action official is required to provide this office with a written response to the audit report within 90 days of the audit report date.

## BACKGROUND

EPA's Office of Mobile Sources is responsible for enforcing the provisions of the Federal Clean Air Act that are designed to reduce air pollution from motor vehicles. Controlling motor vehicle emissions is important because in urban areas, emissions account for nearly (1) 90 percent of the total carbon monoxide and airborne lead, (2) over 30 percent of the hydrocarbons, and (3) nearly 40 percent of the oxides of nitrogen emitted into the atmosphere.

Motor vehicles are also a major source of lead emissions. However, this situation is improving. In March 1985, the Administrator announced a timetable to phasedown the lead content of U.S. gasoline by 90 percent. EPA's new standard, effective January 1, 1986, is expected to spare 172,000 children from adverse health effects resulting from excess blood lead levels. Overall, EPA estimates a net benefit exceeding a billion dollars a year for several years in terms of health, reduced pollution and maintenance savings.

Assuring compliance with the tampering, fuel switching and lead phasedown laws is integral to the success of the Agency's programs to control motor vehicle emissions. To encourage compliance, OMS efforts include encouraging (1) state and local compliance activities, (2) public information and education activities and (3) Federal enforcement activities. Federal enforcement activities are directed toward (1) deterring catalyst removals, fuel switching, and lead phasedown violations; and (2) re-examining and revising enforcement and penalty policies. State, local and contractor personnel have been trained as authorized EPA agents.

Since FY 1980, the Investigations and Enforcement Branch (previously the "In-Use Branch") of OMS' Field Operations and Support Division has conducted or coordinated both directed and random inspections of gasoline retailers, fleet facilities, and commercial repair facilities to deter violations. Inspections are conducted by field office or contractor inspectors. After the inspection results are received by Headquarters, officials determine if a violation has occurred and issue a Notice of Violation with a calculated proposed penalty. Settlement negotiations are initiated when the respondent receives the Notice of Violation.

In FY 1985, OMS' enforcement/investigation office conducted or coordinated over 10,000 inspections and issued 645 Notices of Violation with cumulative proposed penalties of $10.9 million. Exhibit 1 summarizes FY 1985 OMS' tampering and fuel enforcement activities. Several violations were significant. For example:

- In September 1985 EPA proposed penalties totalling $1.5 million against 10 gasoline retailers and distributors for illegal retail and wholesale gasoline activities in Houston, TX. EPA initiated the investigation based upon a complaint.

- In October 1984 EPA proposed penalties totalling $7.5 million against 10 southern Californian fuel manufacturers. These manufacturers introduced unapproved blends of methanol in unleaded fuel. EPA also initiated this investigation because of a complaint.

In these and other cases, the proposed penalties may be reduced if the parties undertake efforts to remedy each violation, prevent future violations, correct environmental damage or perform other alternative projects with sound environmental benefits. Should OMS efforts to achieve resolution prove unsuccessful, OMS can refer the case to the Department of Justice for Federal court civil prosecution with penalties sought at $10,000 per violation per day.

## FINDINGS AND RECOMMENDATIONS

### FINDING NO. 1 - PROPOSED PENALTY AMOUNTS NEED REVIEW

The penalties proposed by OMS for violations of EPA's unleaded gasoline regulations have not changed since 1975 and may need revision. Proposed penalties are in some cases only 5 to 10 percent of the amount allowed by the Clean Air Act. The effectiveness of EPA's unleaded gasoline regulations and future enforcement efforts against fuel additive violations could be improved by a formal periodic review of the proposed penalty tables to ensure penalties are large enough to encourage compliance. The effects of noncompliance with EPA's unleaded gasoline regulations are significant. For example, two to four tankfuls of leaded gasoline can permanently disable a catalytic converter which can increase emissions of harmful pollutants by as much as 800 percent.

OMS officials had also not made a timely decision regarding an increase in lead phasedown penalties. Unless these penalties are sufficient to deter violations, a refiner may violate the revised lead in gasoline standard because a penalty is cheaper than complying with the standard. Subsequent to the completion of our field work, OMS took action to raise the per gram proposed penalties in phasedown cases by 666 percent.

In addition, OMS has not finalized its draft February 1985 Civil Penalty Policy for fuel and tampering violations. Each EPA program office, in a joint effort with the Office of Enforcement and Compliance Monitoring (OECM), is to revise existing policies or write new policies to ensure conformance with the Agency's February 1984 Policy On Civil Penalties. However, OMS has not submitted its policy to OECM for review.

In reply to our draft report, the Assistant Administrator for Air and Radiation disagreed that current FOSD proposed penalties are too low, but he agreed to review the current penalty schedule. He also will re-examine OMS' draft penalty policy to determine whether it should be finalized.

#### EPA Penalties Should Deter Violations

EPA's Policy on Civil Penalties, explains when a penalty acts as a deterrent against those parties who might violate Agency regulations:

> If a penalty is to achieve deterrence, both the violator and the general public must be convinced that the penalty places the violator in a worse position than those who have complied in a timely fashion. Neither the violator nor the general public is likely to believe this if the violator is able to retain an overall advantage from noncompliance. Moreover, allowing a violator to benefit from noncompliance punishes those who have complied by placing them at a competitive disadvantage. This creates a disincentive for compliance.

The Clean Air Act authorizes penalties of $10,000 per day for each violation of the unleaded gasoline regulations and rests with the Administrator the authority to mitigate or remit such penalties. The objective of the penalty is to provide adequate deterrence to all members of the petroleum marketing

industry and, thereby, encourage compliance with the regulations. OMS determined that adequate deterrence could be achieved by assessing penalties of less than $10,000 per day for substantially all violations. Therefore, on August 29, 1975, EPA published in the Federal Register the Agency's "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act" (Guidelines). The Guidelines (See Exhibit 2) listed possible violations and appropriate penalties.

Proposed Penalty Amounts

The proposed penalties listed in the Guidelines for fuel violations are only a fraction of the amount allowed by the Clean Air Act ($10,000 per day). For example, the dispensing or offering for sale gasoline represented to be unleaded which does not conform to the lead or phospherous standards carries a $500-$1,000 penalty for a first time offender who has up to $250,000 in sales volume. This represents only 5 to 10 percent of the penalty amount allowed by the Clean Air Act. For a business with sales volume from $250,000 to $1,000,000, the penalty is only $1,000 to $2,000 for a first time offender. In addition, the proposed penalties are even further reduced and are discussed in Finding No. 2.

The penalties proposed in the Guidelines may need to be raised to give greater consideration to the damage leaded fuel does to vehicles which require unleaded fuel. Also, those who willfully violate EPA's unleaded gasoline rules should be penalized with a large dollar penalty. In addition, the business size criteria may be too small to effectively deter or dissuade large corporations from violating EPA's unleaded gasoline regulations.

OMS documents state that two to four tankfuls of leaded gasoline can permanently disable a catalytic converter. This causes emissions of hydrocarbons, carbon monoxide and nitrogen oxides to increase up to 800 percent and causes problems with the operation of the internal combustion engines designed to burn unleaded fuel. Also, a replacement catalytic converter can cost the vehicle owner in excess of $300. Further, until the destroyed catalytic converter is replaced, the environment is unnecessarily polluted.

A $500 - 1,000 penalty for a first time offender, often mitigated even lower, is not a significant deterrent. In addition, these small cases do not generally result in adverse publicity to the violator, thus, little deterrence is accomplished. A more severe monetary penalty would dissuade others from violating the regulations and ultimately reduce the EPA resources necessary to administer the regulations. The proposed penalty should be based primarily on whether the defendant willfully or purposely violated EPA's unleaded gasoline regulations, and not on whether it was a first time violation.

The Agency believes that assessing varying penalty amounts against different violators based on the size of the violator's business is a reasonable manner to achieve a significant deterrence, particularly when the violator may be a very large refiner on the one hand or a very small retailer on the other hand. We believe this rationale is sound. However, the maximum size of the business, as stated in the Guidelines, may be too small. For example, if a business sold or transferred leaded gasoline as unleaded to a distributor or a retailer, the following penalty would apply according to the size of the business for a first time offender:

| Size of Business | Amount of Penalty |
|---|---|
| $0 to less than $250,000 | $ 400 - $ 800 |
| $250,000 to less than $1,000,000 | 800 - 1,500 |
| $1,000,000 to less than $5,000,000 | 4,000 - 5,000 |
| $5,000,000 and above | 5,000 - 6,000 |

Thus, a $500 million business could be assessed the same size penalty as a business with a size of $5 million. The proposed penalty to a $500 million business is too small and results in a minimal deterrent effect.

We note that the penalty structure for stationary source violators (another program area) provides different penalties for firms with business between $5 and $20 million and over $20 million. Also, a higher penalty is considered if the violation occurred in an area with significant pollution problems.

OMS officials told us they agree that penalties for very large-sized violators are insufficient to create a deterrence. But they believe the $10,000 per day violation statutory penalty cap compels the type of approach currently used in the Guidelines. The conclusion is based upon several assumptions. For very large-sized violators, the payment of $10,000 is not a deterrent. For this type of defendant, a far greater deterrent is the adverse publicity which comes with being cited as a violator of environmental rules. They stated that there are a number of cases where large-sized defendants said they would gladly pay any penalty if OMS did not issue a press release. We found that press releases are issued by OMS for large-sized violators.

For small to medium-sized violators, OMS officials believe penalties under $10,000 do constitute a deterrence. As a result, the penalties in the Guidelines are structured to be most appropriate and proportioned for businesses which gross under $1,000,000 per year. They believe the current penalties for these smaller businesses are appropriate for the flagrancy of the violations, and create an adequate deterrence against future violations.

We recognize that adverse publicity may be a better deterrent than penalties for large-size violators and should be used. However, the adverse publicity should also be coupled with a large penalty amount. A $5,000 - $6,000 penalty for a business over $5 million or more in size, when the maximum penalty allowed by the Clean Air Act is $10,000, in our opinion, is inadequate. In July 1985, the Agency submitted a draft proposed bill, "The Improved Environmental Enforcement Act of 1985" that would generally increase the maximum civil penalties to at least $25,000 per violation. We believe this is appropriate for the regulations enforced by OMS.

We believe periodic reviews of the penalties would be also useful. EPA's unleaded gasoline regulations have been in existence for over 10 years and major accomplishments toward a cleaner environment have resulted. The regulated petroleum marketing industry has had ample time to become aware of EPA's rules and to implement internal controls to ensure compliance. Now is the time for OMS to review all penalty policies to ensure that the remaining violators incur penalties severe enough to bring about compliance.

## OMS Needed To Decide The Value Of Lead For Penalty Calculations

Agency officials had not revised the lead phasedown penalty guidelines even though the revised lead standard may have made the current penalty guidelines inadequate. In August 1985, OMS officials submitted a draft penalty revision to the appropriate Agency officials for review, however, they returned the draft for revision. Consequently, potential violators may not be adequately dissuaded from violating the new lead standard under current penalty guidelines.

OMS officials have recognized that a new valuation of lead under the lead phasedown regulations may be appropriate. A new valuation is needed because EPA has made several changes to the regulations to reduce the lead content in gasoline. These revisions allowed refiners to reduce lead ahead of schedule and "bank" those reductions made ahead of time for later use in meeting the 0.1 grams per leaded gallon (gplg) standard. Refineries can produce gasoline with more than 0.1 gplg if they produce leaded gasoline lower than the previous standard of 1.1 and .5 gplg during time periods before January 1, 1986. If a refiner does not need to use its "banked" rights, another refiner may purchase the rights. These changes in the regulations combined with other economic factors could increase the value of lead to refiners and thereby create incentives to violate the lead phasedown regulations.

Refineries can use lead rights through December 31, 1987. Until that date, an incentive to violate, in part, would exist because the value of lead rights to refiners would be greater than EPA's current penalty for violating the lead phasedown regulations. Thus, incurring a violation and paying the penalty would be cheaper to a refiner than to use the banked rights or to buy the rights from others. This condition creates the incentive to violate rather than to use banked lead rights, and could result in an increase in lead usage until December 31, 1987, as well as a competitive advantage to those companies who use such tactics.

A review of OMS records show that staff attorneys prepared initial draft revisions to the Agency guidelines in June 1984. OMS submitted a draft to the Agency's Office of General Counsel (OGC) in August 1985. Subsequently, OGC attorneys advised OMS officials in September 1985 that they had questions regarding the policy. However, by June 1986 OMS officials had not finalized a revision because of other priorities.

We pointed out in our draft report that the Assistant Administrator for Air and Radiation needed to make a final determination on revising the valuation of lead for lead phasedown penalty calculations. If a revision is necessary, the Assistant Administrator should give sufficient priority to issuing the revised guidelines promptly.

In reply to our draft report, OMS informed us that on July 11, 1986, a notice was published in the Federal Register (Vol. 51, at 25253-25256) which raised the per gram proposed penalties in phasedown cases from $0.0075 to $0.05. The effect of this change is a 666 percent increase in the non-compliance component of phasedown penalties.

## OMS Penalty Policy Not Final

At the time of our review, OMS had not finalized its Civil Penalty Policy for fuel and tampering violations. Consequently, Agency management officials cannot assure themselves that the OMS Civil Penalty Policy completely adheres to the Agency's Policy on Civil Penalties.

In February 1984, the Assistant Administrator for OECM issued the Agency's Policy On Civil Penalties. This policy document established a single set of goals for penalty assessment in EPA administrative and judicial enforcement actions. The document presents in general terms EPA's goals of deterrence, fair and equitable treatment of the regulated community, and swift resolution of environmental problems. The policy stated that "Each EPA program office, in a joint effort with OECM, will revise existing policies, or write new policies as needed."

OMS acted responsibly by drafting a Civil Penalty Policy for fuel and tampering violations to be consistent with the Agency-wide penalty policy. The latest version we have is dated February 7, 1985. However, the draft policy, at the time we completed our review, had not been issued in final form nor submitted to OECM for review. OMS officials said the draft policy had not been issued in final form because they believed it implements the Agency's Policy On Civil Penalties.

The OMS draft Civil Penalty Policy substantially increases the penalty amounts for fuel and tampering violations. For example, the draft policy provides for a contamination violation penalty of $1,000-$2,000 for a first time violation as compared to $500-$1,000 currently imposed.

OMS officials told us they will re-examine their draft Civil Penalty Policy and, if appropriate, finalize the document. Because the Agency's Policy on Civil Penalties is over two years old, OMS needs to take appropriate action to finalize its Civil Penalty Policy and submit it to OECM for review.

## Draft Report Recommendations

We recommended in our draft report that the Assistant Administrator for Air and Radiation take appropriate action to:

1. Work closely with the Assistant Administrator for Enforcement and Compliance Monitoring to revise the "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act" and determine whether penalty amounts for the different types of violations need to be raised. Also, consideration should be given to raising the size of business criteria for assessing the penalty amount in order to penalize large-size businesses by a larger monetary amount.

2. Determine whether the lead valuation for penalty calculations used in lead phasedown violations should be revised.

3. Issue the OMS Civil Penalty Policy in final form after review by appropriate Agency officials.

## Agency Reply To OIG Draft Report

In reply to our draft report, the Assistant Administrator disagreed that current FOSD proposed penalties are too low. He also stated that given the range of business sizes in the regulated community, OMS will never be able to create a penalty schedule that imposes both proportional penalties and has a deterrent impact. He stated that taking into account egregiousness, prior violations, and size of business, OMS cannot impose $10,000 penalties for first time violators. However, he agreed to review the current penalty schedule.

With regard to our second recommendation, OMS published a notice in the Federal Register to increase substantially the non-compliance component of lead phase-down penalties. Concerning our third recommendation, he agreed to re-examine the draft OMS penalty policy to determine whether it should be finalized pursuant to the Agency Policy On Civil Penalties, or whether OMS' present policy is sufficient.

## Auditor Comments

If a penalty is to achieve deterrence, both the violator and the general public must be convinced that the penalty places the violator in a worse position than those who have complied in a timely fashion. To do otherwise creates a disincentive for compliance and punishes those who have complied. OMS' current penalties, in some cases representing only 5 to 10 percent of the penalty amounts allowed by the Clean Air Act and often mitigated even lower, are not a significant deterrent. This also holds true for large corporations which are not penalized to the full extent of the law. The Agency is attempting to increase the maximum civil penalties to at least $25,000 per violation.

The penalties used by OMS are over 10 years old. OMS' draft Civil Penalty Policy increases the penalty amounts in some cases by 100 percent for fuel and tampering violations. We believe this is a step in the right direction. However, OMS' draft Civil Penalty Policy should also place more emphasis on whether the defendant willfully or purposely violated EPA's unleaded gasoline regulations, and not on whether it was a first time violation.

OMS also needs to coordinate its draft Civil Penalty Policy with OECM. This is in accordance with OECM's function of reviewing the efforts of each Assistant Administrator to assure that EPA develops and conducts a strong and consistent enforcement and compliance program.

The Agency Operating Guidance for FYs 1986-1987 states that EPA will continue to place high priority on attaining healthful air quality for 150 million people who live in areas not meeting National Ambient Air Quality Standards, particularly the standard for ozone. The Agency is concerned about ozone because new health data on ozone suggest that concentrations of the pollutant, typical during hot weather, are unhealthy not only for those with respiratory conditions, but also for people in good health. Higher penalties would be a step toward helping achieve the Office of Air and Radiation's number one goal of attaining healthful air across the nation.

## Recommendation

We recommend that the Assistant Administrator for Air and Radiation work closely with the Assistant Administrator for Enforcement and Compliance Monitoring to revise the "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act" to raise the penalty amounts for the different types of violations. Also, consideration should be given to (1) raising the size of business criteria for assessing the penalty amount in order to penalize large-size businesses by a larger monetary amount; (2) placing more emphasis on whether the defendant willfully or purposely violated EPA's unleaded gasoline regulations, and not on whether it was a first time violation; and (3) consider a higher penalty if the violation occurred in an area with significant pollution problems. We further recommend that simultaneously with the above action and coordinated with OECM, OMS' Civil Penalty Policy be issued in final form.

## FINDING NO. 2 - OMS' EFFORTS TO RESOLVE CASES NEED BETTER SUPPORT AND TRACKING

Case files did not always contain sufficient documentation to assure that reductions of proposed penalties were warranted. Consequently, EPA cannot be assured that all settlements were the best the Federal government could obtain. Summaries of negotiations with appropriate evidence for penalty reductions are required by Agency guidelines and would help support final settlement agreements between OMS and the violator.

OMS' draft Civil Penalty Policy states ". . . a maximum of 40 percent of the proposed penalty may be deducted if the violator promptly corrects the violation and where appropriate establishes a program designed to effectively prevent recurrence of the violations." However, case files did not always contain sufficient documentation for the Agency to assure that the reductions were warranted. In addition, settlement agreements contained clauses requiring the violator to correct the deficiencies which the violator should have corrected promptly after the Notice of Violation (NOV), i.e., before the settlement agreement. This suggests the violator did not promptly correct the violation, yet the violator was judged as qualifying for a reduction of the proposed penalty.

Our draft report recommended several steps that would increase management's assurance that reductions of proposed penalties were warranted and to improve the tracking of cases. In response to our draft report, officials improved procedures to ensure all mitigations are supported and to improve their tracking of case file development. They also obtained supporting documentation where necessary to show that violators had complied with other settlement conditions or they initiated action with the violator to comply with the terms of the other settlement conditions. We also believe the Assistant Administrator for Air and Radiation should coordinate with OECM to implement an independent periodic review of case files to ensure they contain sufficient documentation to support settlement conditions made by OMS attorneys.

### Tampering Violations

The Clean Air Act prohibits all types of repair facilities from disengaging or removing any part of a car's pollution control system. OMS can assess penalties up to $2,500 per violation against repair facilities that violate the law. Case files should be clearly documented to show the basis to support a mitigation of the proposed penalty. However, the following tampering penalties we reviewed showed mitigations which were not fully supported:

- OMS cited a transportation company for seven tampering violations and proposed a $17,500 penalty. The case file shows no prompt action by the violator to correct the violation. In addition, after EPA filed the case in court, the company representatives did not always appear. The proposed penalty, nonetheless, was reduced by 40 percent.

- OMS cited a city for tampering with many city vehicles and proposed a $327,500 penalty. The case file did not show corrective action on all violations cited in the NOV. For example, the city did not send proof of repair on all tampered vehicles. OMS mitigated the penalty to $20,000 plus other conditions valued at $176,500, which equals 60 percent of the proposed penalty.

One attorney advised us that corrections often take place and evidence will, therefore, not appear in post settlement correspondence. Our review of case files covered all available correspondence, including the above examples. Another attorney said because of their active caseload, attorneys may not always ensure that documentation supporting correcting actions is timely placed in the case file.

Lead Phasedown Violations

Over the last decade EPA has phased down the amount of lead refiners can put in gasoline. Refineries that violate the Agency's lead standard can be subject to a maximum per day penalty of $10,000. Agency guidelines explain that the specific penalty will be composed of two components, a deterrent factor and a noncompliance factor.

Similar to other types of violations we reviewed, OMS' settlement agreements substantially mitigated the initial proposed penalties involving lead phasedown violations. Case files did not show how the attorney arrived at a final mitigation using specific factors provided in the Agency's guidelines. Summarized below are the proposed and final penalties against five refiners that violated the lead phasedown regulations.

| Case Number | Proposed Penalty | Deterrent Factor | Noncompliance Factor | Final Penalty |
|---|---|---|---|---|
| 1 | $101,638 | $100,000 | $ 1,368 | $ 5,000 |
| 2 | 110,633 | 100,000 | 10,633 | 18,000 |
| 3 | 104,849 | 100,000 | 4,849 | 9,500 |
| 4 | 558,437 | 150,000 | 408,437 | 458,437 |
| 5 | 172,408 | 50,000 | 122,408 | 142,000 |

The deterrent factor is a fixed penalty for each violation and is sized so that multi-million dollar companies will be deterred from exceeding the lead standard and induced to take immediate corrective action. The noncompliance factor is a variable penalty based on an estimation of the economic benefit the company received by exceeding the lead standard in the gasoline they produced.

Agency guidelines state the deterrent factor can normally be mitigated to 60 percent of the initial proposed value based on action taken to remedy the violation. Consideration is given to immediate efforts a refiner takes to eliminate the circumstances which caused the violation. Only corrective efforts implemented during the quarter in which the violation occurred or the succeeding quarter may be considered.

In addition, mitigation of the total penalty by up to 100 percent of its value may be obtained due to financial hardship. In the first three cases cited above, the violators appeared to be granted extraordinary relief. A violator may receive extraordinary relief if it files an application that shows (1) the facts of the case, (2) why the penalty would be inequitable, (3) why the criteria for adjusting the initial penalty are insufficient, and (4) how the public interest would be protected by an extraordinary adjustment. In these three cases, we found no evidence that the violators filed a formal application for extraordinary relief.

Although the violators filed no formal application for extraordinary relief, discussions between OMS and the violator occurred. Our review of the case files, however, did not show how the attorney weighed and assessed the violator's statements to decide that the violators were entitled to extraordinary relief. Also, the case files did not show how the attorney considered the deterrent factor in arriving at a final penalty. We were advised that attorneys were primarily concerned with obtaining a penalty at least equal to the noncompliance factor. Consequently, in these cases management cannot assure that all final penalties served as an adequate deterrent to refineries inclined to violate the lead standard.

Lead Contamination Violations

We also evaluated 20 of the 29 lead contamination referrals reported in FY 1985 to EPA by its inspection contractor (Bionetics Corporation). OMS officials told us that retailers are required to stop the sale of, and immediately replace, contaminated gasoline in order to receive any penalty reductions. However, OMS case files had insufficient evidence to show that in all cases retailers stopped the sale of, and immediately replaced, the contaminated fuel. Yet, the proposed penalty was reduced. For example:

- An inspection found that on March 19, 1985, contaminated gasoline represented to be unleaded was sold or offered for sale by the Respondent. Bionetics inspectors informed the service station representative of their inspection results and referred the results to OMS on March 20, 1985. The file shows that an OMS official did not contact the service station until April 30, 1985 and the Respondent stopped sale of the gasoline on May 1, 1985. By this time a portion of the contaminated gasoline could have been sold. At the time of our review, a tentative agreement between OMS and the distributor mitigated the proposed $6,100 penalty to $1,220 in advertisements.

- An inspection found that on March 11, 1985, contaminated gasoline represented to be unleaded was sold or offered for sale by the Respondent. Although inspectors told the service station representative of their inspection results, the file does not indicate that the service station stopped the sale of the contaminated gasoline. An OMS official called the Respondent on April 22, 1985. However, the case file does not show that the Respondent took prompt action to replace the contaminated gasoline. OMS officials mitigated the initial $7,200 penalty to $1,440 cash and a $2,880 donation to a university.

- An inspection found that on March 5, 1985, contaminated gasoline represented to be unleaded was sold or offered for sale by the Respondent. Bionetics inspectors informed the service station representative of their inspection results and referred the case to OMS on March 20, 1985. On April 22, 1985, an OMS employee called the Respondent regarding the contamination. The respondent said he issued a memo to his drivers to prevent further contamination. However, the case file does not show that the Respondent immediately replaced the gasoline. OMS mitigated the penalty from $7,000 to $1,400 cash and $1,400 in newspaper ads.

The report used by the inspection contractor for referrals to OMS of lead contamination cases does not contain a section dealing with immediate corrective action. In addition, the contractor is to call an OMS employee immediately when a contamination is found. However, the employee receiving the call uses a form that does not ask the inspector whether the retail outlet stopped the sale of contaminated gasoline promptly. Such a section is needed to not only provide evidence to support a reduction in the proposed penalty, but also as an incentive to the violator to stop the sale of the contaminated fuel.

## Summarizing Negotiations Better Would Also Help Support Settlements

EPA's "Guidelines for the Assessment of Civil Penalties Under Section 211(d) of the Clean Air Act" describe a summary of the settlement conference in the form of a memorandum. The memorandum is to describe in detail the evidence and the conclusions upon which EPA relied in either granting or rejecting the request for adjustment.

Case files did not contain a memorandum that summarized a final settlement conference or that summarized all the negotiations. OMS officials told us they believe a summary memorandum is not needed because attorneys are supposed to document all relevant discussions. However, as stated in this report, our review of case files showed that negotiations were not well documented.

A summary of all negotiations would be useful in supporting the final settlement agreement. Otherwise, discrepancies may exist between the final settlement agreement and prior correspondence describing corrective action that the respondent would take as part of the settlement.

The summary should state the nature of the evidence presented in support of the penalty reduction. Copies of all relevant documents should be attached to the summary. In addition, the next responsible supervisory level should sign off indicating review and agreement with the settlement decision. This would serve as a excellent OMS' administrative internal control over establishment and mitigation of the proposed penalty.

## OMS Needs A Better Tracking System For Open Cases

At January 28, 1986, OMS had approximately 750 active cases with cumulative proposed penalties of $32 million. Our review of OMS tracking reports showed 197 of these cases with cumulative proposed penalties of $16.1 million have remained open for more than 6 months. As processing time increases, (1) the deterrent value of the penalty decreases, (2) compromises of the penalties are more probable and (3) the total cost of U.S. Treasury short-term borrowing is increased because collection of fines is untimely. Although the increased cost to the U.S. Treasury borrowing is incidental to the delays in processing violations and settling cases, timely processing of violations is critical to an effective enforcement program.

In a November 1985 memorandum to EPA senior officials, the Administrator outlined a six-point environmental management plan for the Agency. One of the points was to "ensure a strong enforcement presence." He also pointed out that the Agency should follow through on enforcement actions with timely tracking and increased emphasis on bringing cases to a successful conclusion.

Also, in January 1985, a memorandum by the FOSD Director advised his staff that the Agency's Office of Enforcement and Compliance Monitoring reemphasized the need to refer nonstale cases to the DOJ. The FOSD Director considers timely referral to the Department of Justice (DOJ) as essential to the integrity of the Agency's enforcement strategy for fuel and tampering violations. He required that a decision to proceed with a referral should normally be made three months after OMS issues an NOV. In those cases where a referral decision cannot be made, the attorney is required to prepare written justification to support the decision.

Through the first 9 months of FY 1985, OMS issued 229 NOVs in its Eastern Field Offices, excluding NOVs subsequently dropped. As of January 28, 1986, OMS' status report of open cases showed no settlement or referral to DOJ for 89 of the 229 NOVs with cumulative proposed penalties of $1.9 million. In addition, the January 28, 1986 status report also shows no settlement or referral to DOJ on an additional 67 NOVs issued during FYs 1983 and 1984 with cumulative proposed penalties of $972,000.

Similarly, the October 17, 1985 status report of Western Field Office cases showed 36 FY 1984 and 1985 cases over 6 months old as unresolved with cumulative proposed penalties of at least $13.2 million. The status report showed no information regarding success in negotiations or referrals to DOJ.

Our review of 10 cases show some discussions occurring between responsible OMS attorneys and the violators. However, in three cases, negotiations were either not documented or else negotiations between OMS and the violator were infrequent. In five other cases the respondents were not cooperating with OMS attorneys to resolve violations. These delays were not reported on the OMS tracking report which would help alert management early to problem cases. For example:

- In December 1983, OMS issued a $21,000 proposed penalty against a company for allowing the introduction in March 1983 of leaded fuel into vehicles requiring unleaded fuel. During 1984, the company did not cooperate with OMS and, in January 1985, the OMS attorney told the violator that the case would be referred to the DOJ. OMS, however, did not refer the case to DOJ and further discussions in 1985 did not result in a settlement agreement. The attorney told us she does not know what to do with the case because the violation occurred in May 1983 and DOJ will probably not accept the case because the violation is too old.

- In August 1984, OMS issued a $35,000 proposed penalty against a company for five instances of introducing leaded fuel into vehicles requiring unleaded fuel. In October 1984, the violator's attorney stated a willingness to begin discussions. However, sporadic discussion in 1985 did not result in a settlement agreement and the case was unresolved as of January 28, 1986.

- In December 1984, OMS issued a $56,650 penalty against a city for introducing leaded gasoline into seven vehicles requiring unleaded gasoline. The NOV also cited one nozzle, one label and one sign violation. In February 1985 the city contacted OMS regarding remedial action. The case file showed an OMS attorney did not contact the city's representative until November 1985 regarding a settlement and cited a backlog of cases

as the reason for his delay in contacting the city. As of January 1986, OMS and city officials were negotiating a settlement consisting of a cash penalty and a public information program.

Supervisory officials said attorneys do not always enter relevant information into the tracking system.

Recent case files still show that attorneys are not always providing written justification of why they have not referred cases to the DOJ. During our audit, the Chief, Investigations and Enforcement Branch, advised all attorneys that he would meet with each attorney to expedite older unresolved cases. We believe his action is appropriate and should be performed quarterly. Also, in cases where an NOV has been outstanding for three months, attorneys should comply with the FOSD Director's January 1985 memorandum. Further, personnel should be reminded of the importance of entering sufficient and accurate information into the tracking system.

Draft Report Recommendations

We recommended in our draft report that the Assistant Administrator for Air and Radiation take appropriate action to:

1. Establish procedures that will ensure the proposed penalty is only reduced in those cases where violators fully meet the reduction criteria. When Agency contract inspectors call OMS about a contamination, OMS records should show whether the retail outlet stopped sale of the gasoline when told of the contamination by the inspector. Also, develop an independent review process to ensure that decisions to mitigate and adjust proposed penalties are fully documented in case files.

2. Require attorneys to prepare a formal summary of negotiations to support the final settlement agreement. The summary should be reviewed and approved by supervisory personnel.

3. Establish a penalty tracking system with timeframe goals to ensure expeditious processing of all civil penalties, and monitor staff progress in meeting timeframe goals. Files should be documented with explanations when cases exceed established timeframe goals. Also, personnel should be reminded that entering sufficient and accurate information into the tracking system is important, and that performance standards require this activity.

Agency Reply To OIG Draft Report

In reply to our draft report the Assistant Administrator responded to our recommendations as follows:

> OMS attorneys make efforts in all cases to assure that appropriate remedial measures are undertaken and documented in some manner within the case file. Because of the variety of cases and situations OMS encounters, the appropriate documentation may range from very elaborate programs to simple statements regarding corrective action. FOSD is

presently implementing procedures that will require a memorandum accompanying all settlement agreements describing both the violator's remedial efforts and the supporting documentation in the case file.

With respect to several lead phasedown settlements, the Assistant Administrator stated that this situation has been corrected and, in any event, the settlements achieved in these cases were justified.

Regarding an independent review, the Assistant Administrator stated that an Action Memorandum accompanying all settlement agreements is reviewed by supervisory personnel, thus providing the independent review recommended in our report. The Assistant Administrator, in response to Finding No, 5, further added that he did not see a need for an independent review of case files but did not object to such a review if it could be handled in a relatively nonintrusive manner.

With respect to a formal summary of negotiations, the Assistant Administrator stated that an "Action Memorandum," when done properly, is a sufficient summary of all the major factors that should be brought to management's attention. FOSD officials will re-educate staff attorneys on the need to complete their action memoranda properly and give them closer scrutiny in the review process.

The Assistant Administrator believed the present monitoring system provides the necessary indicia to adequately monitor case analysis. OMS will investigate the utility of tracking problem cases separately with written explanations to management in order to improve their process.

Auditor Comments

FOSD is implementing procedures requiring a memorandum for all cases describing both the violator's remedial efforts and the supporting documentation in the case file. This action is proper. We believe for lead contamination cases the memorandum should show whether the retail outlet stopped sale of the gasoline when told of the contamination by the inspector. Further, the Assistant Administrator stated that corrective action has been taken on lead phasedown settlements.

Regarding an independent review of case files, we believe such a review would benefit both the Assistant Administrator and Agency management. These reviews would work to assure the integrity of OMS' enforcement procedures and correct inadequate performance. These types of reviews are the responsibility of the Office of Enforcement and Compliance Monitoring.

The Assistant Administrator is seeking to improve the process for monitoring case file development. In response to our draft report, FOSD employees' review of case files showed that FOSD's tracking reports were not always accurate (see page 27 Footnote 1). Appropriate action should be taken to ensure management has an accurate report to help them monitor case file development. We agree with the response that attorneys should be reminded of the need to maintain the data tracking system and that they should be evaluated accordingly under their performance standards.

OMS actions planned and taken to correct the weaknesses reported in this finding are proper. The Assistant Administrator should ensure that OMS implements these corrective procedures. In addition, there is a need for the Assistant Administrator to implement an independent periodic review of OMS' enforcement procedures.

Recommendation

We recommend that the Assistant Administrator for Air and Radiation take appropriate action to (1) ensure that OMS complete its actions to correct the cited weaknesses and (2) coordinate with OECM to implement an independent periodic review of a representative sample of case files to ensure that case files contain sufficient documentation to support settlement conditions made by OMS attorneys.

## FINDING NO. 3 - SETTLEMENTS WOULD BENEFIT FROM ADDITIONAL GUIDANCE ON ALTERNATIVES TO CASH PENALTY PAYMENTS

OMS policy allows a violator to undertake an OMS approved project as an alternative to a cash penalty. However, the impact of some alternatives is speculative because the environmental benefits are unclear. OMS attorneys do not have specific criteria on acceptable projects and they do not have adequate criteria for determining how much credit should be given to alternative payments. Consequently, the Agency's goal of acceptable environmentally beneficial projects may not be achieved in all cases and the deterrent value of the final settlement may not be accomplished.

Our draft report recommended that OMS develop criteria and examples for attorneys to follow when assigning credit to alternative payments and that case files show how the attorney calculated the credit for alternative payments. In response to our draft report, officials provided us a 1980 FOSD memorandum that allowed attorneys to mitigate proposed penalties at a rate of two dollars for each dollar spent by the violator on an alternative project. Officials believed that to quantify the credit or environmental benefit for alternative projects would be unending, arbitrary and unnecessary.

We believe there is a need for OMS to reasonably determine the value of alternative projects. The 1980 memorandum stated that a primary reason for the two for one credit is that it will generally take more than a one dollar reduction of the penalty for each dollar spent by the respondent in order to encourage the respondent to undertake these activities. We believe this basis is inadequate for mitigating millions in proposed penalties, and additional criteria are needed.

With respect to developing criteria for alternative projects, OECM reviewed the Agency's Civil Penalty Policy and likewise found a need for additional clarification regarding alternative payments.

### Alternative Payments Are Part Of EPA's Policy

In August 1975, EPA issued "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act" (Guidelines). The Guidelines established a system for assessment and mitigation of penalties for violations of the Agency's unleaded gasoline regulations. With respect to mitigation, the Guidelines explained that mitigation of a penalty may occur when:

- The violator takes prompt action to prevent a violation and prevent its recurrence;
- The penalty may cause the violator severe economic hardship;
- Special circumstances exist and equity could not be served within the above limitations.

Agency official subsequently recognized that in some cases environmentally beneficial projects could be an effective alternative to a cash penalty. The Agency's Policy On Civil Penalties (Policy) issued in February 1984 explained:

> The Agency has accepted various environmentally beneficial expenditures in settlement of a fine and chosen not to pursue more severe penalties. In general, the regulated community has been very receptive to this practice. In many cases, violators have found "alternative payments" to be more attractive than a traditional penalty. Many useful projects have been accomplished with such funds. But, in some instances, EPA has accepted for credit certain expenditures whose actual environmental benefit has been somewhat speculative.

Regarding how much credit EPA should give to alternative payments, the Policy explains that EPA must not lower the amount it decides to accept in penalties by more than the after-tax amount the violator spends on the project. The Policy states:

> This limitation does not apply to public awareness activities such as those employed for fuel switching and tampering violations under the Clean Air Act. The purpose of the limitation is to preserve the deterrent value of the settlement. But these valuations are often the result of public misconceptions about the economic value of these violations. Consequently, the public awareness activities can be effective in preventing others from violating the law. Thus the high general deterrent value of public awareness activities in these circumstances obviates the need for the one-to-one requirement on penalty credits.

When considering alternative payments, officials must keep in mind the Agency's goals of deterrence, fair and equitable treatment of the regulated community and swift resolution of environmental problems. The Agency must be careful in approving alternative payments because, as the Policy points out, the Agency has accepted for credit certain expenditures whose actual environmental benefit has been somewhat speculative. The Agency's Policy, however, does not provide specific criteria and examples of acceptable environmentally beneficial projects or the credit that should be given.

OMS Makes Extensive Use Of Alternative Payments

Our review shows that OMS has made innovative and extensive use of alternative payments. For example:

- A settlement agreement with one refiner in part required the refiner to establish, conduct and maintain a program for unleaded gasoline quality assurance among its branded marketers and retailers. In addition, the refiner agreed to sample unleaded gasoline at its retail outlets in the United States for contamination.

- A settlement agreement with a county required in part that county officials design a notice on the air pollution effects and federal laws regarding automobile tampering and fuel switching and mail the notice to 160,000 owners of motor vehicles registered in the county.

OMS has drafted a Civil Penalty Policy to implement the Agency's Policy. OMS' draft Civil Penalty Policy explains that the use of alternative payments is an integral and important part of its fuel and tampering enforcement program.

Officials believe a substantial amount of the misfueling and tampering occurring nationwide is caused by misperceptions held by the public and the regulated community. Public information programs are by far the most common type of project accepted by OMS as an alternative payment.

Although OMS' draft policy deems alternative payments as important, the draft policy does not give attorneys specific criteria or examples to follow when evaluating alternative payments and how much credit should be assigned for each dollar the violator spends. In determining whether or not, or to what degree, to permit alternative payments, the draft policy only states: ". . . the negotiating team must consider all the equities of the case, especially the degree of the respondents culpability in the violation."

With respect to how much credit can be given to alternative payments, OMS' draft policy allows $2 of credit for each $1 spent by the respondent but states the final cash penalty cannot be less than 20 percent of the proposed penalty. However, the draft policy does not explain what type of alternative payments may mitigate the cash penalty to 20 percent and what type of projects should be extended $2 of credit for each $1 spent by the respondent. Instead the draft policy provides general guidance for attorneys to follow:

> The negotiating team has the discretion to determine how much credit shall be given for alternative payments made in implementing a public information program. An overall review of the respondent's culpability and the equities of the case will form the basis of such a determination. The maximum credit that generally should be extended is $2 worth of credit given for $1 spent by a respondent on a public information program.

In our review of FY 1985 cases settled by the Eastern Field Offices, attorneys did not perform an analysis of alternative payments and settlement conditions for the purposes of assigning a credit. Instead, the case files imply that attorneys assign a maximum $2 for every $1 actually expended by violators on alternative payments. A maximum credit for alternative payments plus the cash penalty often results in a settlement value equal to or less than 60 percent of the proposed penalty. As discussed in Finding No. 2, OMS generally deducts 40 percent from the proposed penalty for prompt action to correct the violation by the violator.

Generally, only by doubling the value of other settlement conditions can OMS achieve 60 percent or above of the proposed penalty. For example, the FY 1985 settlements by the Eastern Field Offices, summarized below, show that when other settlement conditions are doubled in value, the final calculated value equals 60 percent in 45 percent of the cases In an additional 29 percent of the cases, when other settlement conditions are doubled in value, the final calculated value does not meet the minimum amount the Agency should obtain (60 percent). Moreover, few violators (4 percent) pay a cash penalty exceeding 60 percent of the proposed penalty. Thus, OMS management has less assurance that all projects' actual credit value is valid.

## SUMMARY - EASTERN OFFICES

## FY 85 NOVs SETTLED AS OF JANUARY 27, 1986

| | |
|---|---|
| Total Notices of Violation | 143 |
| 1. When The Cash Penalty Alone Is Considered: | |
| -- Settlements In Which The Cash Penalty Exceeds 60% | 6 ( 4 percent) |
| -- Settlements In Which The Cash Penalty Equals 60% | 21 (15 percent) |
| -- Settlements In Which The Cash Penalty Is Less Than 60% | 116 (81 percent) |
| 2. When The Face Value Of Other Settlement Conditions Are Doubled In Value:[1] | |
| -- Settlements In Which The Cash Penalty Plus Double The Face Value Of Other Settlement Conditions Exceeds 60% | 37 (26 percent) |
| -- Settlements In Which The Cash Penalty Plus Double The Face Value Of Other Settlement Conditions Equals 60% | 64 (45 percent) |
| -- Settlements In Which The Cash Penalty Plus Double The Face Value Of Other Settlement Conditions Is Less Than 60% (Includes 23 cases slightly below 60%) | 42 (29 percent) |

With respect to the table and how much credit should be assigned to alternative payments, OMS officials said that attorneys are not provided more specific guidance because attorneys need flexibility when negotiating other settlement conditions.

We agree that attorneys need flexibility, however, specific criteria and examples would help ensure that the actual environmental benefit from the alternative payment is not speculative and has been assigned an accurate valuation. An accurate valuation of the alternative payment plus the cash penalty will help assure EPA that the final settlement is the best the Agency can obtain.

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1. Our draft report showed statistics based on an OMS tracking report dated January 27, 1986. Subsequently, FOSD employees reviewed the individual case files for these 143 cases and found additional conditions that were not shown on their tracking report. We have adjusted the table to reflect the results of FOSD's review.

Without specific criteria and examples, OMS attorneys have not calculated what credits they assign to alternative payments. Without this calculation, attorneys have difficulty in assuring they have reached the best possible settlement with a just penalty that accomplishes the deterrent value of the settlement. Attorneys may be inclined to give maximum credit to alternative payments even though different types of alternative payments have different degrees of environmental impact. The types of alternative payments negotiated by OMS, for example, have included:

- Purchase of a $20,000 van for a rehabilitation center which would have the slogan "Breathe Clean Air . . . Use Unleaded Gas" on the van.
- A $30,000 donation to a University for the specific purpose of funding a cooperative program of student internships and legal research under the sponsorship of the State Department of Health.
- A $7,500 donation to the National Association of State Directors of Law Enforcement Training to sponsor an environmental training and enforcement certification seminar.
- A $25,000 donation to two colleges for purposes of sponsoring environmental internships, scholarships and research on topics of environmental law.

We believe that alternative payments can be appropriate such as the two examples cited on page 25 of this report. However, the environmental benefits from other alternatives like the four examples above are not as effective in deterring violations of the fuels regulations and the impact of these alternative projects may be questionable. Motor vehicle tampering and fuel switching surveys over the last several years continue to show high rates of tampering and misfueling.

OMS' draft Civil Penalty Policy needs additional criteria for, and examples of, acceptable environmentally beneficial projects, along with guidance for determining the credit of the project. Otherwise OMS cannot provide assurance that (1) the settlement is just, and provides a deterrence against future violations, and (2) all alternative payments have had a significant impact.

In December 1985, FOSD's Chief, Investigations and Enforcement Branch, advised the FOSD Director that he had established a task force to evaluate all factors relating to FOSD's settlement practice with respondents who refused to settle cases. His action is appropriate. We believe the Task Force should include developing more specific guidance on quantifying the value of alternative payments including specific examples.

Draft Report Recommendations

We recommended in our draft report that the Assistant Administrator for Air and Radiation develop criteria and examples in OMS' draft Civil Penalty Policy for attorneys to follow when assigning credit to alternative payments. Case files should show how the attorney calculated credit for alternative payments.

Agency Reply To OIG Draft Report

In reply to our draft report, the Assistant Administrator stated that FOSD case attorneys have all been provided with a copy of a December 1980 FOSD memorandum which states that "As a rule of thumb the attorney may assume that mitigation at a rate of two dollars for each dollar spent is reasonable . . . ." The response stated that to attempt to reasonably quantify the precise credit or environmental benefit assigned to diverse alternative projects would be an unending and arbitrary task and one which is unnecessary.

Auditor Comments

We believe there is a need by all enforcement officials to reasonably quantify the credit to be given and the environmental benefit obtained from alternative projects. EPA's Policy On Civil Penalties stated that in some instances EPA accepted for credit certain expenditures whose actual environmental benefit was speculative. Our audit showed OMS has negotiated both exceptional public information programs and other alternative projects whose environmental benefits appear speculative. These and other projects may not be deserving of a 2 for 1 credit.

OMS' December 22, 1980 memorandum, cited in the Assistant Administrator's response, states that OMS prefers public information and education efforts (mass mailings, radio, television and magazine ads, bumperstickers, and posters). We agree that educating the public about the hazards of misfueling is worthwhile. However, the memo encourages flexibility and reminds the attorney that the 2 for 1 credit encourages respondents to undertake the activity rather than representing the value of the program. The memo states:

> There is no hard and fast rule regarding the amount of mitigation which is appropriate in these cases. However, the attorney should keep two things in mind. First, it will generally take more than $1 reduction of the penalty for each dollar spent by the respondent in order to encourage the respondent to undertake these activities. As a rule of thumb the attorney may assume that mitigation at a rate of two dollars for each dollar spent is reasonable, but this is not an inflexible guideline which must be applied.

OMS has issued proposed penalties of over $46 million over the last three years and has made innovative and extensive use of alternative payments. We do not believe the 1980 memorandum is an adequate basis for mitigating millions in proposed penalties. Officials need to provide clearer criteria for mitigating these proposed penalties when public information projects are undertaken by the violators. The 2 for 1 credit may not always be justified, especially if it is solely to encourage the violator to undertake the activity.

In October 1985, OECM's Legal Enforcement Policy Division (LEPD) reviewed recommendations of the Agency's Task Force on Alternative Enforcement Remedies. The Task Force believed the Agency's Policy On Civil Penalties needed additional clarification regarding alternative payments. LEPD proposed to revise the Agency's Policy discussion of alternative payments to provide clear criteria for, and examples of, acceptable environmentally beneficial projects, along with guidance on quantifying the value of alternative payments. Although LEPD's work is not complete, we believe OMS should coordinate with LEPD and

act promptly to provide clearer criteria and guidance on quantifying the value of alternative payments. Otherwise, mitigations may be inappropriate.

Recommendations

We recommend the Assistant Administrator for Air and Radiation coordinate with LEPD and develop criteria and examples in OMS' draft Civil Penalty Policy for attorneys to follow when assigning credit to alternative payments. Case files should show how the attorney calculated the credit for alternative payments.

## FINDING NO. 4 - CONTROLS OVER PENALTIES HAVE IMPROVED BUT FURTHER IMPROVEMENTS CAN BE MADE

OMS controls over cash penalties owed to the Federal government and controls over other settlement conditions were inadequate. Consequently, we found instances where Agency employees lost penalty payments and instances where violators did not comply with other settlement conditions. OMS also needs formal procedures to ensure that collection of the entire civil penalty occurs when violators (1) do not comply with all settlement agreement conditions or (2) do not comply in a timely manner.

OMS and Financial Management Division (FMD) officials have initiated some steps and our draft report recommended additional actions to improve collection procedures and controls over cash penalties. Further, FMD plans to forward information on penalty payments to the Internal Revenue Service.

### Actions That Will Improve Penalty Collections

By law (31 U.S.C. 66a), agency heads are required to provide effective controls and accountability over all funds for which they are responsible. When controls are not established over penalties owed to the Government, an increased risk exists that penalty payments may not be handled properly. Accordingly, EPA's Financial Management Manual requires each program official to designate one individual within the program to handle the collections of all cash, checks, or money orders. FMD employees have overall responsibility for recording and transmitting all receipts to a Federal Reserve Bank for deposit.

Neither OMS nor Agency financial management officials had statistics to show cumulative cash penalties paid by fiscal year. However, in FY 1985 OMS settled 285 cases with cumulative penalties of $1.4 million that violators agreed to pay. In addition, at September 30, 1985, OMS had 775 active cases with cumulative proposed penalties of $32.4 million. Thus, millions in cash penalties can be expected from OMS' eventual settlement of these cases.

When OMS attorneys reach an agreement with the violator, the settlement agreement usually requires the violator to send a check to FMD with written confirmation to the responsible OMS attorney. However, OMS did not notify FMD of penalties due the Government. Consequently, FMD did not establish accounts receivables over the penalties.

OMS employees also did not have an effective system to monitor penalty payments. Contrary to EPA's Financial Management Manual, OMS did not designate one individual to handle penalty collections. Instead, all OMS attorneys were supposed to periodically review their case files to ensure they received a copy of the violator's check from FMD. However, because of their limited time and active caseload, one supervisory attorney said that attorneys did not always review their closed files for evidence of payment. Because OMS and FMD did not have effective monitoring procedures over penalties owned the Government, we reviewed all cases for FYs 1983, 1984 and 1985 with a final cash penalty of $5,000, or greater. We found instances where we could not find proof of payment in either OMS or FMD files. Also penalty payments were not handled properly by Agency employees. For example:

- A county sent a $20,000 penalty check to OMS in May 1984. OMS forwarded the check to EPA's Collection Office using the appropriate transmittal form. Collection Office officials stated they had no record of the check and OMS did not have a return copy of the transmittal form showing receipt of the check by the Collection Office. In addition, there is no evidence that the check cleared the county's bank. After we brought the matter to the attention of OMS officials, they contacted the county and county officials submitted another check for $20,000 on November 29, 1985.

- An oil company sent a check for $24,000 to EPA's Collection Office in November 1984. However, the Collection Office has no record of receiving or depositing the check. Again, after we brought this matter to the attention of OMS officials, they contacted the company and company officials submitted another check for $24,000 on November 20, 1985.

In both cases, OMS' management information report showed the cases as settled and a date that the violator supposedly accomplished all terms in the settlement agreement.

Our review also showed that OMS procedures did not clearly indicate OMS would request FMD to demand payment and impose the full penalty if the violator did not pay. An OMS official stated that imposition of the full proposed (nonmitigated) penalty is appropriate after the debtor has received a dunning letter from EPA, and still has not paid the penalty. Therefore, when cases are referred for collection to EPA's Collection Office, i.e., when the debt is 90 days past due, the nonmitigated penalty should be sought. The official intends to revise the collection procedures to include this procedure and to have FMD process penalty collections in this manner.

In September 1985 FMD and OMS officials met to discuss penalty collection procedures. FMD officials suggested:

- OMS insert new language into OMS settlement agreements involving the Debt Collection Act;

- OMS send a copy of the settlement agreement to FMD, marked "Billing Copy", so that FMD can open an account over the debt;

- FMD would send dunning letters after a debt is 30 days past due and if unpaid after 90 days the debt would go to EPA's Collection Officer;

- For failure to pay the mitigated penalty, EPA could impose the proposed penalty plus interest.

We recommended OMS include these suggestions in its procedures and a January 1986 OMS memorandum to all employees implemented the suggestions. FMD officials advised us that a computerized accounts receivable system should be operating by September 1986. OMS officials should periodically reconcile their records to FMD's accounts receivable reports to ensure the accuracy of accounts receivable.

OMS officials have initiated action to improve collection procedures. OMS and FMD should also ensure an adequate system exists to alert OMS officials when payments are not made or not made timely. Where necessary, OMS officials can then impose the proposed penalty depending on the circumstances in that case.

### Case Files And OMS Tracking Report Do Not Always Show Violators Compliance With Other Settlement Conditions

OMS' current monitoring procedures and tracking system do not ensure that all violators have complied with other settlement conditions. As with cash penalties, attorneys said they follow up on other settlement conditions as time permits. We also found that OMS' tracking report of cases does not always provide complete information regarding the status of violators' efforts to comply with other settlement terms. Consequently, a risk exists that OMS may not always promptly detect those violators who neglect or decide not to comply with other terms in the settlement agreement.

For the period covered by our review (FYs 1983 - 1985), OMS negotiated other settlement conditions if the conditions had value to the Agency's community health and environmental goals. For example, OMS believes a substantial amount of misfueling and tampering nationwide is caused by misperceptions held by the public and the regulated community. Therefore, negotiations can result in the violator undertaking a public information program or other environmentally beneficial expenditures instead of paying a more severe cash penalty. OMS' monitoring of violators' compliance with other settlement conditions is important because OMS allows $2 credit for every $1 the violator spends in a public information type program.

We reviewed cases for evidence that violators complied with other settlement conditions. We provided OMS officials a list of cases where we found insufficient evidence that the violator complied with other settlement conditions. For example:

| Case No. | Other Conditions With No Evidence Of Performance | Value Of Other Conditions |
|---|---|---|
| 1 | Magazine article | $ 15,300 |
| 2 | Advertisements | $ 9,930 |
| 3 | Newspaper ads | $ 4,000 |
| 4 | Distribute 50 million coffee cups with message imprinted on each cup | $ 43,000 |
| 5 | Numerous conditions | $200,000 |
| 6 | Repair all damaged vehicles | Cannot be determined |

Our review of 76 cases showed 31 cases with at least one settlement condition that we could not verify. OMS officials acted to determine whether the violator complied with all settlement conditions in these 31 cases. In most cases, OMS officials said additional documentation has been obtained from violators to support compliance but did not describe the type of documentation acceptable. In four instances where the violator did not comply, OMS has contacted the violator and requested that he comply with the other settlement conditions.

As with cash penalties, control over "other" settlement conditions is difficult because no one individual is responsible for monitoring violators' progress in complying with these conditions. Supporting documentation received by OMS to show compliance is routed to the responsible attorney for filing. Attorneys, because of their active caseload, will review settled cases as time permits to ensure violators submit adequate documentation. However, an attorney may concentrate on his active caseload and not have time to ensure adequate supporting documentation is received on all settled cases.

In order for OMS to monitor violators' compliance with all settlement conditions, specific due dates should be established for all conditions in the agreement. However, in 18 of 76 cases we reviewed the settlement agreement did not give specific due dates for all settlement conditions. For example, Case No. 2 did not have specific dates established for the three required magazine articles. Consequently, violators may be less inclined to comply with other settlement conditions in a timely manner, and OMS attorneys may forget to check on the violators' compliance as time passes and as they become involved with other cases.

Currently, OMS' tracking report is not an effective tool for monitoring violator's compliance with other settlement conditions because the report format does not include sufficient data to allow adequate monitoring. The purpose of an enforcement tracking system is to assist the program office in monitoring attorneys' progress in settling a violation and monitoring the violators' progress in complying with the terms in the settlement agreement. In accordance with EPA's policy of strict enforcement, OMS' settlement agreements state that failure to timely pay or failure to comply with any of the terms of the agreement will result in the violator owing the entire proposed civil penalty. An inadequate tracking system increases the risk that a violator's failure to comply with all terms of the agreement will not be detected or detected timely by OMS.

The tracking report currently allows the attorney to show that other settlement conditions exist and a date that all terms have been accomplished. Because OMS settles hundreds of cases a year and makes extensive use of alternative payments, a tracking system should list the specific settlement conditions, the specific due date for each condition, and the violator's progress in complying with these conditions.

Even if the tracking report allowed for additional data to monitor compliance, OMS officials said that getting all attorneys to enter sufficient or accurate data is difficult. Some attorneys do not view the entering of data into the tracking system as especially important. For example, the tracking report showed an August 23, 1985 terms accomplished date for Case No. 2 even though our review showed the violator may have published only one of three required articles.

We discussed these issues with OMS officials and they are reviewing their current tracking system to ensure inclusion of more information on violators' status in completing other settlement conditions. They also said they would remind supervisory attorneys to ensure all conditions have specific due dates. These actions are appropriate. All personnel should be reminded that entering sufficient and accurate information into the tracking system is important.

Penalty Information Should Be Forwarded To U.S Internal Revenue Service

The Agency does not forward information to the Internal Revenue Service (IRS) on penalties paid or violators' alternative payments. Consequently, violators could be deducting these expenditures for tax purposes. In FYs 1983 through 1985, OMS proposed cumulative penalties of $38 million and in several cases companies paid large cash penalties. Two companies recently paid $600,000 and $458,000 for lead phasedown violations.

In addition, penalty adjustments often include alternative payments such as donations, newspaper ads, and other public information type expenditures. For example:

- One violator's settlement agreement required the violator to contribute $24,300 to the American Cancer Society, and an additional $24,300 for newspaper advertising, advertising on company vehicles, and a letter to members of a state petroleum marketers association. The violator's representative asked the OMS attorney for "A neutral position by the EPA concerning the tax deductible status of the above-mentioned charitable contribution and ad campaign expenditures."

- As part of a settlement agreement, a company agreed to pay a $65,000 cash penalty. In addition, the company agreed to perform certain public awareness programs with an estimated cost of $300,000.

These deductions, according to Chicago IRS officials, are not tax deductible yet the company could easily deduct these expenditures. Even in the event of an audit, the IRS auditor would not necessarily be aware that these payments were made in lieu of a cash penalty. IRS officials also said they would welcome information from EPA on cash penalties or alternative payments.

* * * * *

OMS has acted to improve controls over cash collections but needs to ensure that violators always submit sufficient documentation to show timely compliance with other settlement conditions. Other settlement conditions, when practicable, should include specific due dates for compliance and should require submission of documentation to show that the violator complied with the other settlement conditions. Also, OMS' management information system should be improved to provide more information to attorneys which will assist them in monitoring the status of violators' efforts to comply with other settlement conditions. Finally, EPA needs to establish a system to forward to the IRS information on cash penalty payments and violators' alternative payments.

## Draft Report Recommendations

We recommended in our draft report that the Assistant Administrator for Air and Radiation:

1. Include in all settlement agreements that have other conditions, specific due dates for compliance with those conditions and amend OMS' management information system to include data showing the status of the violators' efforts to comply with all settlement conditions.

2. Periodically reconcile OMS penalty records to FMD's accounts receivable reports.

3. Emphasize to all attorneys that a case should not be considered closed, with a terms accomplished date entered in the management information system, until the violator submits documentation showing compliance with all conditions. Attorneys should be advised of the specific type of documentation acceptable to show compliance. Also, personnel should be reminded that entering sufficient and accurate information into the tracking system is important.

4. Initiate action with FMD to forward information on cash penalty payments and violators' alternative payments to the Internal Revenue Service.

## Agency Reply To OIG Draft Report

In reply to our draft report, the Assistant Administrator responded to recommendations 1 through 4:

1. FOSD attorneys will be reminded to draft settlements with specific due dates, and managers will continue to monitor in this area. In addition, officials are evaluating various systems to improve their tracking of violators' efforts to comply with all settlement conditions including (a) the addition of a new completion date field in OMS case tracking computer system, (b) use of a new cover memorandum form for settlement agreements on which public information terms and their due dates are specified, (c) use of a new Accomplishment of Settlement Terms memorandum to be submitted by attorneys when all settlement terms have been accomplished (which also specifies the evidence that the terms were accomplished), and (d) a review with each attorney to ensure that each has an appropriate system to keep track of due dates in general.

2. FOSD and FMD officials will meet to develop a procedure to reconcile accounts receivable.

3. FOSD will have attorneys prepare an Accomplishment of Settlement Terms memorandum to management when they receive documentation from the violator showing all settlement terms have been accomplished.

4. FOSD officials determined that FMD has a procedure in place to notify the IRS of penalty payments, which they will implement for FOSD cases.

### Auditor Comments

We believe the actions taken and planned, if properly implemented, will correct the cited deficiencies.

### Recommendations

We recommend that the Assistant Administrator ensure that OMS complete its actions to correct the cited weaknesses.

## FINDING NO. 5 - OMS SHOULD ENSURE CLEAR PROCEDURES FOR PURSUING VIOLATIONS AGAINST SMALL REFINERIES

OMS did not pursue several violators of the lead phasedown regulations. As a result, cumulative proposed penalties of $1,765,000 were not negotiated for collection. Our draft report recommended that the Assistant Administrator for Air and Radiation (1) establish clear procedures for attorneys to follow in lead phasedown violations and (2) initiate an independent periodic review of a representative sample of enforcement procedures to ensure all Agency requirements are met.

OMS officials agreed with our recommendations concerning the necessity for establishing clear procedures for attorneys to follow in lead phasedown violations and stated they would not object to an independent review of cases. Accordingly, we recommend that the Assistant Administrator take appropriate action to implement our draft report's recommendations.

### Procedures For Pursuing Small Violations Were Unclear

In FY 1984, EPA's former Assistant Administrator for Air and Radiation announced ". . . a national enforcement strategy to crack down on violators of the tampering and fuel regulations." Recently, the Agency's current Assistant Administrator also said that "EPA has a policy of strict enforcement of lead phasedown violations." Lead phasedown refers to EPA's decision to reduce the lead content of U.S. gasoline.

OMS has cited gasoline refiners and importers for over 100 violations of the lead phasedown regulations, with cumulative proposed civil penalties of over $16 million. Recently, OMS proposed civil penalties of $2.6 million against a refiner that prepared false reports of lead usage. The refiner used 300 million more grams of lead than allowed for the volume of leaded gasoline produced from October 1, 1983 through December 31, 1984.

Although OMS has pursued significant violations, procedures were unclear for pursuing penalties against small refiners that had apparent violations of the lead phasedown regulations. Prior to July 1, 1983, EPA regulations provided for less stringent standards for small refineries. Refineries that were "large" were subject to a more stringent lead standard. Although some penalties could not be pursued because of the small refiners financial hardship, case file memoranda we reviewed also showed:

- OMS officials were uncertain on how to classify refineries as large or small when the refinery was a subsidiary of a large company.
- Officials did not have a clear policy for liability of parties during periods where the ownership of the refinery was split between two parties.
- Officials considered the violation of the standard too small to pursue a penalty. The economic benefit derived by the company was insignificant in their opinion.

In November 1982, an OMS attorney recognized the need for a policy on small refiners with one violation. However, OMS did not issue a formal policy with

guidance on how to proceed with these types of cases and our review of case files showed that procedures for processing violations against small refineries were not entirely clear. For example, the last document in one case file, dated March 16, 1983, advised the OMS attorney to hold open the case file pending a decision on small violations. OMS did not issue a policy and the attorney performed no additional work on the case.

Subsequently, in November and December 1985, officials prepared memoranda to not pursue 12 similar civil penalties with cumulative proposed penalties of $1,765,000 against refineries that may have violated the lead phasedown regulations. For example:

-- A refiner's quarterly gasoline production reports showed consistent small excessive lead amounts in gasoline that the refiner produced over several months. An EPA attorney drafted a Notice of Violation (NOV) and calculated a proposed penalty against the refiner for $750,000. OMS did not issue a NOV even though the attorney targeted this case as a high priority. Other OMS officials opposed a violation because the amounts of excess lead in the refiner's production reports were extremely small.

-- A refiner reported three violations of the small refinery standards in 1981 and 1982. In December 1985, the attorney stated the case ". . . was one of those that got stalled out because of uncertainty on the classification of the refineries."

In other cases, the memoranda specifically cited lack of policies for liability of parties during periods where the ownership of the refinery was split between two parties. OMS did not have a policy for liability of individuals who purchased a refiner which had violated the lead phasedown regulations. In the case of one refinery, an attorney noted that OMS pursued violations which were not tied up in policy questions.

OMS officials stated the issue of small violations is one that plagues every enforcement program and that their policy is perhaps not completely efficient. However, officials emphasized that significant violations are pursued and that the above type of small violations will not reoccur.

Our review shows that OMS has taken action on significant violations. Violations differ in significance, but not sending an NOV or sending a NOV containing no deterrent penalty would not distinguish a violator from a complying refiner. By taking no action, OMS could have invited more violations because refiners had little fear of penalty. OMS should develop procedures for attorneys to follow in lead phasedown violations. Our review showed that no review of OMS cases occurs by Agency officials independent of the OMS enforcement program. This type of review is made by headquarters of regional programs to assure that the programs are operating effectively and efficiently. A similar independent review of OMS cases would benefit OMS management by providing assurance that policy or procedural questions such as the type described in this finding are promptly resolved.

Draft Report Recommendation

We recommended in our draft report that the Assistant Administrator for Air and Radiation take appropriate action to:

1. Establish clear procedures for attorneys to follow in lead phasedown violations.

2. Initiate an independent periodic review of a representative sample of case files to ensure all requirements are met.

Agency Comments

The Assistant Administrator agreed with our recommendation concerning the necessity for establishing clear procedures for attorneys to follow in lead phasedown violations. The Assistant Administrator did not see a need for an independent review of cases. He stated that current procedures contain enough safeguards to assure compliance with our procedures. He added, however, that if a periodic review could be handled in a relatively non-intrusive manner, he would not object to it being conducted.

Auditor Comments

The Assistant Administrator needs to develop clear procedures for attorneys to follow in lead phasedown violations. Regarding our second recommendation, an independent review of FOSD cases would benefit both OMS and Agency management. A review would include evaluations of OMS' accomplishment reporting and enforcement case development work to ensure integrity of the system and correct inadequate performance. These types of reviews are the responsibility of OECM. The review would also help assure OECM that FOSD's enforcement program is consistent with the Agency's enforcement policy and that issues, like those described in this audit, are resolved promptly.

Recommendations

We recommend that the Assistant Administrator for Air and Radiation take appropriate action to:

1. Establish clear procedures for attorneys to follow in lead phasedown violations.

2. Coordinate with OECM for a periodic review of OMS case files to ensure that the Agency's enforcement policy and requirements are met.

## FINDING NO. 6 - FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT NOT FULLY IMPLEMENTED

Field Operations and Support Division officials did not fully participate in the Federal Managers' Financial Integrity Act (FMFIA) process. Consequently, officials did not document specific internal control procedures and techniques to show that their programs and activities are carried out in accordance with Agency directives. Unless officials document specific internal control procedures and techniques, there is a risk that FOSD's activities, if performed improperly, will not be detected. For example, Finding No. 4 of our report describes instances where Agency employees lost penalty payments. Agency officials have acted to strengthen this year's FMFIA process. We believe their actions provide FOSD officials the opportunity to fully participate in the FMFIA process and to adequately document and evaluate their internal control procedures and techniques.

Our draft report recommended that the Assistant Administrator for Air and Radiation take appropriate action to ensure that existing internal control procedures and the evaluation of current controls pertaining to fuel and tampering enforcement programs are documented. OMS officials responded that the Agency has not fully implemented FMFIA, but that FOSD's current controls are a major step towards assuming FMFIA objectives are being achieved. We have recommended that the Assistant Administrator require FOSD officials to clearly document their internal controls.

Responding to continuing disclosures of fraud, waste, and abuse across a wide spectrum of Federal government operations, which were largely attributable to serious weaknesses in agencies' internal controls, the Congress in 1982 enacted FMFIA. It strengthens the existing requirements of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal controls in order to provide effective controls over, and accountability for, all funds, property, and other assets for which an Agency is responsible. FMFIA is intended to help reduce fraud, waste, and abuse in Federal government activities and operations.

### Agency And OMS Actions To Implement FMFIA

In order to implement the FMFIA, the Agency issued EPA Order 1000.24 on "Establishing, Evaluating, and Reporting on Internal Control Systems" in February 1984. In accordance with this Order, the Agency developed a specific process for implementing the FMFIA. The process required Assistant Administrators, Associate Administrators, Staff Office Directors, and the Inspector General to report on the status of internal controls over their programs or functions (assessable units).

In October 1985, the Director of OMS submitted his most recent annual report on internal controls to the Acting Assistant Administrator for Air and Radiation in order to comply with the Agency's process. The Director described OMS' actions to implement FMFIA and listed the following weaknesses as identified and corrected during FY 1985.

1. Procedures were improved to improve timely review of Confidential Statements of Employment and Financial Interest.

2. Additional resources were requested to perform audits of state and local inspection/maintenance programs.

In addition, the OMS Director initiated a series of internal control reviews which would extend into FY 1986. We believe these internal control reviews will help strengthen OMS' operations.

OMS' actions to implement FMFIA, however, did not include specific documentation of internal control procedures and techniques to show that all of FOSD's enforcement programs and activities are carried out in accordance with Agency directives. We reviewed OMS' internal control documentation to determine, for example, specific internal control procedures that FOSD management uses to ensure that penalty collections are made timely, other settlement conditions are complied with, and that fuel and tampering cases are settled or dropped in accordance with Agency directives. Specific internal control techniques for these types of activities were not described in OMS' internal control documentation. FOSD's specific internal control techniques were not described because FOSD's officials were not required to fully participate in the FMFIA process. Instead, OMS' Program Management Office was primarily responsible for developing OMS' internal control documentation.

Exhibit 3 shows excerpts from OMS' documentation pertaining to the event cycle, objectives and techniques for the Mobile Sources Enforcement assessable unit. The Exhibit shows that the assessable unit's event cycle is a restatement of the assessable unit which conflicts with OMB Guidelines for Internal Controls. These guidelines state:

> Event cycles are the processes used to initiate and perform related activities, create the necessary documentation, and gather and report related data. In other words, an event cycle is a series of steps taken to get something done.

Because the enforcement event cycle was broadly stated, control objectives and techniques were also not stated specifically. OMB guidelines define internal control objectives and techniques as follows:

Control Objectives - are desired goals or conditions for a specific event cycle that reflect the application of the overall objectives of internal control to that specific cycle.

Control Techniques - are the processes or documents that enable the control objectives to be achieved.

Exhibit 3 shows that OMS mobile source enforcement objectives and techniques are described in broad terms. For example, the internal control documentation states the following as an internal control technique to assure that vehicle emission control systems are not removed or rendered inoperative:

> Carry out investigations and enforcement actions against violators of Federal anti-tampering/fuel switching regulations.

This statement of an FOSD activity should be supported by specific documented internal control checks to ensure that the activity is carried out in accordance with Agency directives. For example:

- A checklist could ensure proper processing of tips/complaints about fuel switching or tampering by periodically requiring a review for (1) timely resolution; (2) timely feedback from local agencies when FOSD makes a referral; (3) timely feedback by FOSD to the regional, local agency official or other outside party providing tips or complaints; and (4) efficient and effective management of resources in resolving complaints.

- Periodic reviews of FOSD's management information system should include steps to adequately control and monitor errors by:

  1. Preventing erroneous data from entering the system that describes the status of OMS cases.

  2. Monitoring the status of those error corrections.

One OMS official stated the Agency has no one qualified to provide them detailed guidance on the specific actions any one manager must take to comply with FMFIA. The only training device the Agency has available, according to the official, is a video tape about the FMFIA. Although FOSD managers viewed the film, they believed the film did not meet their needs.

The Internal Control Staff (ICS) of EPA's Resource Management Division has established a new process for evaluating the Agency's internal controls in FY 1986. As a result, Agency programs will resegment their functions and operations in assessable units at the division level. Thus, officials in each division will be required to complete an assessment of internal controls over these functions and operations.

We believe the new assessment process will permit FOSD officials to fully participate in the FMFIA process. Officials will need to document existing internal control procedures and evaluate these controls in order to determine where improvements can be made. Officials should begin these steps for the new assessment process.

Draft Report Recommendation

We recommended in our draft report that the Assistant Administrator for Air and Radiation take appropriate action to ensure that existing internal control procedures and the evaluation of current controls pertaining to fuel and tampering enforcement programs are documented.

Agency Reply To OIG Draft Report

The Assistant Administrator stated that EPA has not, as an Agency, fully implemented all aspects of FMFIA. He also stated that as Agency rules and guidelines in this area become more firmly established, he will take appropriate action to further establish proper controls for all areas within the Office of Air and Radiation. In the meantime, he believed that the controls established within FOSD for tracking and documenting the enforcement process are a major step towards assuming that FMFIA objectives are being achieved.

## Auditor Comments

We recognize that management judgment is involved in reaching a conclusion that OMS' established internal control system provides reasonable assurance that FMFIA requirements are being achieved. However, our discussions with FOSD officials, and a review of FOSD's records show that they did not fully participate in the FMFIA process. Thus, specific internal control checks were not sufficiently documented. In August 1986, OMB revised Circular A-123 that prescribes policies and procedures that agencies should follow in their internal control systems. The Circular included a statement that all management levels shall be involved in ensuring the adequacy of controls. FOSD officials can begin this process by documenting its existing internal controls. This will give management an adequate basis to conclude that the FMFIA objectives are being achieved.

## Recommendation

We recommend that the Assistant Administrator for Air and Radiation take appropriate action to ensure that existing internal control procedures and the evaluation of current controls pertaining to fuel and tampering enforcement programs are documented. This action can be coordinated with the Internal Control staff of EPA's Resource Management Division and the employee who developed the OMS pilot internal control review process.

## OTHER MATTERS

### CRIMINAL PENALTIES WOULD BENEFIT OMS

Criminal sanctions are not provided in the Clean Air Act for flagrant violations of the tampering, fuel switching and fuel compositions. Consequently current authority providing for civil penalties may not always result in a substantive penalty when considering the violator's damage to the environment. OMS is attempting to get statutory authority for criminal sanctions.

OMS issued several hundred NOVs in FYs 1983 through 1985 with cumulative proposed civil penalties of $38 million. Our review of OMS' enforcement program showed flagrant fuel and tampering violations where violators paid minimal or no penalty. Criminal sanctions may have been more appropriate. OMS' current authority of imposing civil penalties has not always resulted in penalties appropriate when considering the damage to the environment. For example:

- An OMS investigation resulted in a $4 million proposed penalty against a distributor for numerous violations including 540 instances of distributing leaded gasoline as unleaded. An involuntary bankruptcy petition showed the distributor had no assets and no penalty could be imposed. Consequently, OMS dropped its proposed penalty and no further action against the violator was taken.

- In FY 1984, OMS issued a $120,000 proposed penalty against a muffler shop for 48 tampering violations. OMS had evidence the shop removed at least 1,400 catalytic coverters, had enlarged an excess of 700 gasoline filler inlet restrictors and was currently installing single and dual exhaust pipes in place of catalytic converters. A U.S. District Court imposed a final cash penalty of $7,500 and enjoined the shop from performing such actions in the future.

Agency officials have recognized that as environmental programs mature, the enforcement authorities available to take enforcement action are not always appropriate. OMS officials also stated that Section 211 of the Clean Air Act does not provide them injunctive authority (requiring a party to refrain from taking some specified action). On July 29, 1985, EPA sent to the Office of Management and Budget a proposed bill "The Improved Environmental Enforcement Act of 1985." The bill would improve EPA's ability to enforce compliance with environmental legislation across its multi-media regulatory programs fairly and effectively.

The purposes of developing and submitting to the Congress this multi-media enforcement bill were two-fold: (1) to organize EPA's legislative recommendations for easy reference and cross-media comparison by congressional committees during individual reauthorizations, and (2) to focus attention on the need for change in EPA's enforcement authorities.

The provisions of the proposed bill fall into three primary categories: judicial penalties, criminal enforcement, and administrative enforcement. The basic principle of the criminal enforcement recommendations is that all environmental statutes should include felony provisions within the range of available

criminal penalties. Absent such statutory authority, it is difficult to obtain criminal prosecutions for even serious environmental violations, and harder still to obtain sentences commensurate with the health risks involved.

The Clean Air Act expired on September 30, 1981. As of June 13, 1986, no hearings have been scheduled by either the House of Representatives or the Senate. Further, Senate and House activity is uncertain at this time.

In response to our draft report, OMS officials agreed with our conclusions concerning the usefulness of criminal sanctions for flagrant violations. However, they believed that the judge who applies civil sanctions leniently will likely do the same in a criminal context.

Agency officials have acted responsibily to demonstrate their intent to obtain criminal sanctions against violations of the environmental regulations. Our review of OMS enforcement programs showed instances where criminal penalties would be appropriate. As further support for the need for criminal penalties, we suggest that OMS officials submit to the appropriate Agency officials examples of violations where criminal or injunctive actions would be appropriate.

EXHIBIT 1
(See page 7)

## Activities Summary
## Tampering & Fuel Switching Enforcement

| | 09/01 thru 09/30/85 Proposed Penalties & Amounts | Cumulative Proposed Penalties |
|---|---|---|
| I. Active Cases | | |
| A. Post-NOV | | |
| 1. Tampering | 66 ($ 2,374,000) | N/A |
| 2. Fuels | 579 ($30,001,550) | N/A |
| B. Pre-NOV | | |
| 1. Tampering | 13 ($ N/A ) | N/A |
| 2. Fuels | 117 ($ N/A ) | N/A |
| C. Total: | 775 ($32,375,550) | |
| II. NOV's Issued | | |
| A. Tampering (Catalyst removals) | 4 ($ 259,300) | 23 ($ 621,800) |
| B. Fuels | | |
| 1. Introductions | 2 ($ 116,900) | 43 ($ 1,883,050) |
| 2. Small Nozzles | 11 ($ 4,000) | 170 ($ 225,550) |
| 3. Excess Lead | 46 ($ 266,800) | 399 ($ 3,186,280) |
| 4. Alcohol | 0 ($ 0 ) | 10 ($ 4,940,000) |
| III. Cases Settled | | |
| A. Tampering | 1 ($ 1,450) | 5 ($ 29,750) |
| B. Fuels | 27 ($ 114,640) | 280 ($ 539,523) |
| C. Cases Dropped | 3 ($ 608,400) | 104 ($ 1,128,000) |
| IV. Cases Referred to DOJ | | |
| A. Tampering | 0 ($ 0 ) | 4 ($ 142,500) |
| B. Fuels | 0 ($ 0 ) | 29 ($12,726,200) |
| V. Cases Filed in Fed. Dist. Ct. | | |
| A. Tampering | 0 ($ 0 ) | 1 ($ 47,500) |
| B. Fuels | 0 ($ 0 ) | 23 ($12,408,200) |

## GUIDELINES FOR PENALTY ASSESSED

### Possible Violations

| Schedule No. | Section Reference | Description |
|---|---|---|
| 1 | 80.22(a), 80.23(a)(1) liability | Introduction of leaded gasoline from a leaded pump into a vehicle requiring unleaded gasoline. |
| 1 | 80.6 | Refusal of retailer or wholesale purchaser-consumer or distributor to permit entry, inspection, sampling or testing. |
| 2 | 80.22(a), 80.23 (a),(b),(c), and (d) liability | Dispensing or offering for sale gasoline represented to be unleaded which does not conform to the leade or phosphorus standards (contamination). |
| 2 | 80.22(f)(1) | Failure to equip leaded gasoline pumps with proper nozzles. |
| 3 | 80.21(a) | Sale or transfer of leaded gasoline represented to be unleaded to a distributor or retailer or wholesale purchaser-consumer. |
| 3 | 80.21(b) | Causing unleaded gasoline to exceed the lead or phosphorus standards upon delivery (carrier). |
| 4 | 80.22(b) | Failure to offer for sale a grade of unleaded gasoline. |
| 4 | 80.7 | Failure to provide information upon request of the regional administrator or his authorized delegate. |
| 5 | 80.22(f)(2) | Failure to equip unleaded gasoline pumps with proper nozzles. |
| 6 | 80.22(e) | Failure to properly label gasoline pumps |
| 7 | 80.22(d) | Failure to post the required sign at a retail outlet or wholesale purchaser-consumer facility. |

Civil penalty assessment table 1/

| Schedule No. | Number of previous violations | Size of business 2/ I | II | III | IV |
|---|---|---|---|---|---|
| 1 | 2 or more | 7,000 | 10,000 | 10,000 | 10,000 |
| | 2 | 4,000 | 6,000 | 8,000 | 9,000 |
| | 1 | 2,000 | 4,000 | 7,000 | 8,000 |
| | 0 | 1,000 | 2,000 | 6,000 | 7,000 |
| 2 | 3 or more | 6,000-7,000 | 8,000-10,000 | 9,000-10,000 | 9,000-10,000 |
| | 2 | 3,000-4,000 | 5,000- 6,000 | 7,000- 8,000 | 8,000- 9,000 |
| | 1 | 1,000-2,000 | 3,000- 4,000 | 6,000- 7,000 | 7,000- 8,000 |
| | 0 | 500-1,000 | 1,000- 2,000 | 5,000- 6,000 | 6,000- 7,000 |
| 3 | 2 or more | 5,000-6,000 | 7,000- 8,000 | 9,000-10,000 | 9,000-10,000 |
| | 2 | 2,000-3,000 | 4,000- 5,000 | 6,000- 7,000 | 7,000- 8,000 |
| | 1 | 800-1,500 | 2,000- 3,000 | 5,000- 6,000 | 6,000- 7,000 |
| | 0 | 400- 800 | 800- 1,500 | 4,000- 5,000 | 5,000- 6,000 |
| 4 | 2 or more | 5,000 | 7,000 | 9,000 | 9,000 |
| | 2 | 2,000 | 3,000 | 6,000 | 7,000 |
| | 1 | 1,000 | 2,000 | 4,000 | 5,000 |
| | 0 | 500 | 1,000 | 2,000 | 3,000 |
| 5 | 3 or more | 1,500 | 2,000 | 2,500 | 3,000 |
| | 2 | 1,150 | 1,500 | 2,000 | 2,500 |
| | 1 | 800 | 1,100 | 1,500 | 2,000 |
| | 0 | 500 | 800 | 1,000 | 1,500 |
| 6 | 3 or more | 1,400 | 1,600 | 1,800 | 2,000 |
| | 2 | 1,050 | 1,250 | 1,450 | 1,650 |
| | 1 | 700 | 900 | 1,100 | 1,300 |
| | 0 | 450 | 600 | 800 | 950 |
| 7 | 2 or more | 700 | 800 | 900 | 1,000 |
| | 2 | 600 | 700 | 800 | 900 |
| | 1 | 500 | 600 | 700 | 800 |
| | 0 | 400 | 500 | 600 | 700 |

1/ The dollar amount in each cell should be multiplied by the number of days over which the violation continued.

2/ I=$0 to less than $250,000; II=$250,000 to less than $1,000,000; III=$1,000,000 to less than $5,000,000, IV=$5,000,000 and above.

EPA ORGANIZATION: Office of Mobile Sources

ASSESSABLE UNIT: MOBLIE SOURCE ENFORCEMENT DOLLARS: $6,030,600 FTE's: 94.4

PREPARED BY: Kevin Hull Date: 3/20/84

| EVENT CYCLE | OBJECTIVES | TECHNIQUES |
|---|---|---|
| A. Mobile Source Enforcement | 1. Assure that new and in-use vehicles are capable of meeting emissions standards throughout their useful lives. | a. Operate recall program to mandate repair of non-complying in-use vehicles. |
| | | b. Carry out Selective Enforcement Audits (SEA's) of assembly line vehicles, and monitor manufacturer auditing. |
| | | c. Carry out program to assure that non-standard imported vehicles meet applicable requirements. |
| | | d. Grant waivers to emissions standards as appropriate. |
| | 2. Assure that vehicle emission control systems are not removed or rendered inoperative. | a. Carry out investigations and enforcement actions against violators of Federal anti-tampering/fuel switching regulations. |
| | | b. Support implementation of State and local anti-tampering/fuel switching programs. |

EPA ORGANIZATION: Office of Mobile Sources

ASSESSABLE UNIT: MOBILE SOURCE ENFORCEMENT DOLLARS: $6,030,600 FTE's: 94.4

PREPARED BY: Kevin Hull Date: 3/20/84

| EVENT CYCLE | OBJECTIVES | TECHNIQUES |
|---|---|---|
| | 3. Assure that harmful additives are not present in motor vehicle fuels. | a. Enforce lead phasedown program limiting the presence of lead in gasoline.<br>b. Grant waivers for fuel additives as appropriate.<br>c. Carry out investigations and enforcement actions against violators of Federal regulations governing fuels and fuel additives. |

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

AUG 22 1986

OFFICE OF
AIR AND RADIATION

MEMORANDUM

SUBJECT: Comments on the Inspector General's Audit of the Office of Mobile Sources

FROM: J. Craig Potter
Assistant Administrator for Air and Radiation

TO: Ernest E. Bradley III
Assistant Inspector General for Audits

Thank you for the opportunity to comment on your draft audit report on the Office of Mobile Sources' Establishment, Mitigation and Collection of Penalties.

I would like to make some general comments about the enforcement program in the Office of Mobile Sources (OMS) before addressing your six specific findings. The Field Operations and Support Division (FOSD) has been enforcing the anti-tampering provisions of the Clean Air Act and the Fuels Regulations, including lead phasedown and Fuel Additive Regulations, since it was created in 1979. Since fiscal 1983, it has issued 2160 Notices of Violation, proposed penalties of over $46 million, and has referred over 60 cases to the Department of Justice. During this period approximately 1,200 cases have been settled, and approximately $4 million in penalties have been collected. Former Administrator Ruckelshaus singled out OMS enforcement for its innovative approach to settlement, which involves seeking, in addition to a civil penalty, appropriate remedies designed to not only correct the violative conditions but also to correct public misperceptions which often lead to tampering and fuel switching, and to generally increase public awareness of the need to preserve motor vehicle emission systems. Most FOSD settlements involve such innovative activities.

FOSD has accomplished significant enforcement activities in the face of resource reductions. The average caseload for an FOSD attorney since FY83 is over 60 cases. Remarkably, case processing time has been reduced over this period, both in terms

of the time needed to issue notices of violation, and the time needed to settle cases. FOSD has developed innovative procedures to shorten the processing of its more routine cases, and is continuing to explore avenues to expedite the enforcement process.

In sum, I believe that OMS' enforcement program is an excellent one.

Response to Finding No. 1--Proposed Penalty Amounts Need Review

Your finding number 1 made a number of observations and recommendations concerning the size of the proposed penalties in FOSD cases.

The size of proposed penalties in FOSD fuels cases (under section 211(c) of the Clean Air Act and 40 C.F.R. Part 80) is limited by the statutory penalty of $10,000 per day per violation (Section 211(d)). FOSD policy is to calculate a proposed penalty in each case by adjusting the statutory $10,000 penalty to take into account the egregiousness of the particular violation, prior violations by the defendant, and the size of the defendant's business. These adjustments are formalized in the published "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act (Guidelines)."

You made observations and recommendations in three general areas: 1) the size of the penalties proposed by FOSD should be reviewed and possibly increased; 2) proposed penalties for lead phasedown cases should be raised; and 3) the FOSD penalty policy document should be reviewed and issued.

Your first recommendation is that FOSD should review our proposed penalty schedule in non-lead phasedown cases and determine whether penalty amounts are too low. We agree to review this schedule, although we strongly disagree with your conclusion that penalties currently proposed by FOSD are too low. As we discussed in detail in our April 18, 1986 response to your position paper #5 (copy attached), our penalty schedule properly takes into account business size, nature of the violation (both as to type and degree) and violation history. Our penalty schedule does account for inflation, since many companies that had low gross revenues in 1975 would be in higher business size categories and thus subject to higher penalties in 1986. A $500-$1,000 penalty for a category I violator would thus have the same deterrent

impact in 1986 as in 1975. Similarly, given the range of business sizes in the regulated community, we will never be able to create a penalty schedule that imposes both proportional penalties and has a deterrent impact. If we are to have a policy which results in penalties that are proportioned to take into account egregiousness, prior violations and size of business, we simply cannot impose $10,000 penalties for first time violators, even those which are very large.

With regard to the second point regarding phasedown penalties, this has been accomplished. On July 11, 1986, a notice was published in the Federal Register (Vol. 51, at 25253-25256) which raised the per-gram proposed penalties in phasedown cases from $0.0075 to $0.05 (copy attached). The effect of this change is a 666% increase in the non-compliance component of phasedown case penalties.

Concerning your third recommendation, we will agree to re-examine the Penalty Policy we drafted two years ago, to determine whether it should be finalized pursuant to the Agency Policy on Civil Penalties, or whether our present policy is sufficient.

Response to Finding Number 2--OMS Efforts to Resolve Cases Need Better Support and Tracking

Your Finding No. 2 addresses several separate and distinct aspects of OMS' process of resolving cases, each of which are discussed below:

1. As you correctly state, it is OMS policy to provide 40% mitigation for respondent's efforts to correct the violations and take steps to prevent future violations. OMS attorneys make efforts in all cases to assure that appropriate remedial measures are undertaken and documented in some manner within the case file. Because of the variety of cases and situations OMS encounters, the appropriate documentation may range from very elaborate programs to contact customers and inspect or repair vehicles, purchase invoices for new fuels equipment or emission control devices, instructions to employees, affidavits regarding corrective measures to simple statements in the file regarding remedial efforts. In some cases, violations have been corrected at the

time of inspection and enforcement action is based exclusively on prior records or statements and no further documentation of corrective action is even appropriate. 1/

You also commented on several lead phasedown settlements, where the case files did not clearly document how we arrived at the final penalty. This situation has been corrected and, in any event, the settlements achieved in these cases were justified. The 1979 penalty guidelines were designed with major refiners and large violations in mind, where $50,000 Deterrence Factors 2/ (DF's) would be appropriate. We

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1/ You cite the following tampering case files for lack of specific documentation:

- Cited for seven tampering violations with a proposed penalty of $17,500. This case was resolved in federal district court, where different factors are involved in reaching settlement than in a routine NOV settlement. The final settlement, strongly supported by the Department of Justice, considered such factors as the probability of success, the likely recovery in court, and the cost of going to trial. The collected penalty represents an excellent resolution of this litigation.

_____ - Cited for 131 tampering violations with a proposed penalty of $327,500. A significant number of the tampered vehicles cited were properly configured at the time of inspection. Those violations were based entirely on employee statements and old work invoices and thus no further documentation of repair was appropriate. Respondent provided documents to evidence the purchase of new emission control devices and statements from responsible city officials regarding the repair of all other vehicles. In addition, a team of OMS and regional personnel inspected a significant sample of the cited vehicles still in service and relevant maintenance invoices and identified no further nonconformities. In addition, the city instituted increased vehicle maintenance and emissions inspections, well beyond the manufacturer's recommendations, in order to prevent recurrence of the prior problems.

2/ Lead Phasedown penalties have two components. The deterrence factor is designed to deter violations regardless of economic benefit, while the noncompliance factor is essentially a measure of the economic benefit to the violator from the violation(s). The sum of the DF and NCF is the proposed penalty.

concluded that where Non-Compliance Factors (NCF's) were small imposition of a large DF would be unfair. However, some DF was necessary and it should be comparable to the NCF. For larger NCF's we decided it was in the government's best interest to obtain the NCF plus a moderate DF as opposed to prolonged negotiations and possible litigation to obtain a larger DF, which would have still been small compared to the NCF. We believe that these settlements are sufficient, all factors considered.

You also recommended that OMS establish procedures for independent review to assure that the criteria for reduction of proposed penalties are met, including the stopping of sale in contamination cases. 3/ We are presently implementing procedures that will require that the Action Memorandum accompanying all settlement agreements describe both the violator's remedial efforts and the supporting documentation in the case file. This memorandum is reviewed by all supervisory personnel involved in the final approval of settlement agreements, thus providing the independent review as recommended in your report.

2. You discuss the need to summarize settlement negotiations and/or conference(s) between the attorney and respondents and recommend that a formal summary be prepared in all cases for supervisory review. We believe the Action Memorandum that accompanies all final agreements with the addition described previously, should serve this purpose. When it is done properly it is a sufficient summary of all the major factors that need be brought to management's attention, particularly considering the large number of cases handled by this office. We will reeducate staff attorneys on the need to complete their action memorandums properly and give them closer scrutiny in the review process. Negotiations are documented by each attorney in their own particular manner as they occur, and management sees no need to dictate any particular format. Further, problematic cases involving extended or complex negotiations are usually brought to management's attention as they are being resolved.

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3/ You cite three cases where there was insufficient evidence in the file to justify mitigation. In , the respondent was the distributor, and was not notified until after the contaminated fuel was sold. Since he had no opportunity to mitigate, we thought it unfair to deny the 40% reduction. In , the failure to mitigate was taken into consideration--hence the 40% innovative settlement expenditure in addition to the 20% cash penalty. In the 40% mitigation should not have been granted.

3. You discuss extensively OMS' need for a "Better Tracking System for Open Cases" and recommend that OMS establish a better system and document delays with written explanations. OMS presently has an operational computerized case tracking system which presently serves a number of worthwhile functions for staff attorneys, management and outside requests for OMS data. This system presently provides management the necessary indicia to adequately monitor case status and, in fact, Field Office Section Chiefs and the Branch Chief use this system for periodic attorney case reviews. These formal reviews and more frequent informal meetings as needed provide management and attorneys an opportunity to discuss the reasons for unusual delays or problematic cases and determine the appropriate course of action. We will investigate the utility of tracking problem cases separately with "written explanations to management" in order to improve our process.

Deleted (See Footnote A/)

Response to Finding Number 3--Settlements Would Benefit From Additional Guidance on Alternatives to Cash Penalty Payments.

You recommend that OMS attorneys be provided criteria and examples for alternative payments and that cases show the calculated credit for alternative payments. FOSD case attorneys have all been provided with a copy of a December 22, 1980 In-Use Branch memo entitled "Conduct of Settlement Negotiations." This memo builds on EPA's 1975 "Guidelines for the Assessment of Civil Penalties under Section 211(d) of the Clean Air Act" and contains substantial discussion on

A/ The data in the report, which this response pertains, has been deleted.

general settlement policy, preparation for and conduct of settlement negotiations, mitigation factors and the assessment of special circumstances. This memo, in its discussion of alternative settlement projects, very clearly states "As a rule of thumb the attorney may assume that mitigation at a rate of two dollars for each dollar spent is reasonable, ...." This has been and continues to be OMS general policy and guidance for the settlement of cases in this manner.

OMS case attorneys have pioneered the use of this alternative settlement concept within EPA resulting in numerous innovative, creative and worthwhile programs and activities towards meeting the goals of this program. Your audit has examined only a small percentage of the creative efforts that have resulted. These efforts have resulted from a wealth of expertise and understanding of the causes, effects, mechanisms and deterrence of tampering and fuel switching accumulated over the last six years by lawyers, investigators and management. These settlements have established mutually beneficial relationships with many trade associations, public interest organizations, educational institutions, environmental groups, state and local agencies and a myriad of other organizations that have productively enhanced EPA's ability to meet the goals of this program in a comprehensive manner. Many of these activities take advantage of a particular respondent's available expertise, resources or contacts and are often balanced by the attorney against the culpability of the alleged violator and the strength of the case. Their value simply cannot be meaningfully assessed by an out-of-pocket cost or any other universal indicia but instead must be evaluated by an informed staff in the full context from which they were proposed. To attempt to reasonably quantify the precise credit or environmental benefit assigned to the myriad of diverse alternative projects developed by OMS would likely be an unending and arbitrary task and one which we believe unnecessary. Supervisory personnel interact closely with case attorneys in the design and accreditation of new projects and share examples of previous successful efforts. We believe that case attorneys must retain the flexibility to design these alternative projects within the context of the general guidance that already exists and subject to supervisory review prior to final agency commitment precisely as they have done for the last six years.

In addition, your report lists 43 [5]/ cases for which you claim that cash plus double the value of other settlement conditions is less than 60% ("guidelines"). These were reviewed by OMS staff. In fact, the overwhelming percentage of cases you reviewed were at or above guidelines. Of the 43 cases reviewed, 24 were found to be within guidelines. Five (5) of

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[5]/ Excluding those listed as slightly below 60%, and one not identified by case number.

these 24 cases were found to be above guideline settlements and several very substantially above guidelines. These range roughly from 65% to 114% of the proposed penalty (using $2 credit for $1 spent). Seven other cases involved very substantial public information campaigns and very clearly meet the criteria for "special circumstances" in the settlement guidelines. For example, FOSD # 1995 involved a proposed penalty of $593,650. The settlement consisted of a substantial cash penalty of $65,000, very costly remedial action, 6 weeks of AAA automotive emission testing for the general public with AAA's diagnostic mobile van in three major cities, newspaper advertisements, posters, 18,000 billing inserts mailed to customers throughout the state containing a clean air public information message and bumper stickers. At least two of the cases were municipal cases, where we often obtain particularly beneficial settlement activities taking advantage of municipalities' unique position to educate their citizens regarding tampering and fuel switching. All municipal cases involved direct mailings to citizens and one case--FOSD # 2006--involved a direct mailing to all citizens. Of the remaining 12 settlements, six were only $100 to $200 below the 60% level. The remaining six settlements all involved very small cases where a penalty was collected along with some public education activity. These were settled to avoid the cost of litigation--a very good reason for settlement.

Response to Finding No. 4 -- Controls over Penalties Have Improved, But Further Improvements Can be Made

Your finding number four involves FOSD procedures for assuring that negotiated settlement terms--both money penalties and public information activities--are carried out by defendants in a timely manner. You make recommendations and observations in the following areas: 1) ensuring that due dates are specified for public information terms in settlement agreements, and that management oversees completion of these terms; 2) ensuring that defendants supply adequate proof of accomplishing settlement terms, and that this is accurately coded into the computer; 3) that FOSD reconcile penalty accounts receivable with the Financial Management Division (FMD); and 4) that FMD forward information on settlement terms to the IRS.

With regard to your first point regarding specified due dates in settlement agreements and management oversight of their completion, we agree that these are important areas. It has always been FOSD policy to make the terms of settlement agreement as specific as possible. Because all settlement agreements are reviewed before being executed on behalf of

the Agency, such specificity can be and is monitored in every settled case. FOSD attorneys will be reminded to craft settlements with specific due dates, and managers will continue to monitor in this area.

Regarding management oversight of the completion of public information settlement terms, we are evaluating various systems, including the addition of a new completion date field in our case tracking computer system, use of a new cover memorandum form for settlement agreements on which public information terms and their due dates are specified, use of a new Accomplishment of Settlement Terms memorandum to be submitted by attorneys when all settlement terms have been accomplished (which also specifies the evidence that the terms were accomplished), and a review with each attorney to ensure that each has an appropriate system to keep track of due dates in general.

The second area about which you commented involves our receipt of proper documentation that settlement terms were accomplished. We agree that this is an important area, and believe we have done a fairly good job in the past.[6/] The Accomplishment of Settlement Terms memorandum, discussed above, will allow consistent oversight in this area. In addition, during periodic case reviews, proper coding of computer items will continue to be monitored.

Your last two points involve reconciling accounts receivable with FMD, and forwarding settlement terms to the IRS. We have been in contact with FMD, and learned that FMD has a procedure in place to notify IRS of penalty payments, which they will implement for FOSD cases. In addition, both we and FMD would like to have a procedure to reconcile accounts receivable, and have scheduled a meeting to develop such a procedure.

Response to Finding Number 5--OMS Should Ensure Clear Procedures for Pursuing Violations Against Small Refiners.

Your draft Finding No. 5 discusses OMS procedures for pursuing lead phasedown violations against small refiners and for pursuing relatively insignificant violations.

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6/ Of the six cases you cite as examples of deficiencies in this area, four either had good documentation in the file, or the documentation had been received but not yet put into the file because the IG auditor had possession of the file.

This matter is moot since the same standard now applies to large and small refineries. We agree with your recommendation concerning the necessity for establishing clear procedures for attorneys to follow in lead phasedown violations. We believe that our procedures are clear for lead usage violations, while we are in the process of finalizing our procedures for lead banking violations.

Concerning your recommendation that an independent periodic review by non-OMS Agency officials of a representative sample of case files be initiated, we simply do not see any need for instituting such a procedure. We believe that our present system contains enough safeguards to assure compliance with our procedures. However, if a periodic review could be handled in a relatively non-intrusive matter, we would not object to its being conducted.

Response to Finding Number 6--Federal Managers' Financial Integrity Act Not Fully Implemented

You expressed your concern that the Office of Mobile Sources is not fully implementing the provisions of the Federal Managers' Financial Integrity Act. We feel that OMS is actually one of the Agency's leaders in implementing FMFIA.

EPA has not, as an Agency, fully implemented all aspects of FMFIA. EPA is in the process of developing internal control processes as part of FMFIA implementation. OMS, however, started a pilot internal control review process focusing on administrative support functions in the Ann Arbor Motor Vehicles Emissions Laboratory. The developer of the OMS pilot process has been asked to train internal control coordinators for other programs. Thus, OMS is actually in a leadership role at EPA in this area.

As Agency rules and guidelines in this area become more firmly established, we will take appropriate action to further establish proper controls for all areas within the Office of Air and Radiation. In the meantime, the controls established within FOSD for tracking and documenting the enforcement process are a major step towards assuming that FMFIA objectives are being achieved.

Other Matters

We generally agree with your conclusions concerning the usefulness of criminal sanctions for flagrant and/or particularly egregious violations. We have previously submitted such recommendations to Congress. We note, however, that the judge who applies civil sanctions leniently will likely do the same in a criminal context.

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