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Muddying the Waters: Wrongful Profits as a Measure of Economic Benefit to Violators of the Clean Water Act in the Wake of United States v. Union Township

Matthew B. McGuire

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Muddying the Waters: "Wrongful Profits" as a Measure of Economic Benefit to Violators of the Clean Water Act in the Wake of *United States v. Union Township*

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I. Introduction

Developing civil sanctions against violators of the Clean Water Act[1] (the "Act") has proved to be the most difficult aspect of implementing this piece of legislation.[2] One of the most important issues that has been settled is that the courts hearing cases involving violations of the Act have wide latitude in determining the penalties to be imposed on defendants who violate the Act.[3] This latitude is governed by a broad set of standards set forth in the Act at section 1319(d).[4] This provision states that courts should consider the following factors in determining the penalty for a violation: (1) the seriousness of the violation; (2) the economic benefit obtained by the violator; (3) any history of violations by the

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1. 33 U.S.C.A. § 1251 *et seq.* (West 1998). Subsection (a) states in pertinent part:

> "The objective of this chapter is to restore and maintain the chemical, physical, and biological integrity of the Nation's waters. In order to achieve this objective it is hereby declared that, consistent with the provisions of this chapter-
>
> (1) it is the national goal that the discharge of pollutants into the navigable waters be eliminated by 1985;
> (2) it is the national goal that wherever attainable, an interim goal of water quality which provides for the protection and propagation of fish, shellfish, and wildlife and provides for recreation in and on the water be achieved by July 1, 1983;
> (3) it is the national policy that the discharge of toxic pollutants in toxic amounts be prohibited;
> (4) it is the national policy that Federal financial assistance be provided to construct publicly owned waste treatment works;
> (5) it is the national policy that areawide waste treatment management planning processes be developed and implemented to assure adequate control of sources of pollutants in each State;
> (6) it is the national policy that a major research and demonstration effort be made to develop technology necessary to eliminate the discharge of pollutants into the navigable waters, waters of the contiguous zone and the oceans; and
> (7) it is the national policy that programs for the control of nonpoint sources of pollution be developed and implemented in an expeditious manner so as to enable the goals of this chapter to be met through the control of both point and nonpoint sources of pollution."

2. United States v. Municipal Authority of Union Township, 150 F.3d 259, 264 (3rd Cir. 1998).
3. *See id.* at 265 (citing Sierra Club v. Cedar Point Oil Co., 73 F.3d 546, 576 (5th Cir. 1996)).
4. 33 U.S.C.A. § 1319(d) (West 1998).

party; (4) the violator's good-faith efforts to comply with the Act's standards; (5) the economic impact of the penalty upon the violator; and (6) "such other matters as justice may require."[5] Based on this guidance, courts have tried to achieve remedial and punitive objectives in assessing civil penalties.[6] The purpose of these objectives is to cause violators to be unable to factor these penalties into their cost of doing business.[7] The most nebulous factor listed in the statute, and the one courts have struggled with most, is the economic benefit factor.[8]

The objective of this comment is to discuss the framework for how the federal courts have determined economic penalties under the Act. Specifically, this comment discusses the role of the economic benefit factor, how it is evaluated, and the impact of the "wrongful profits" analysis on determining economic benefit in light of traditional methods. This factor will be analyzed in light of the Third Circuit's recent decision in *U.S. v. Union Township* where the Court became the first federal appellate court to accept a "wrongful profits" approach to determining economic benefit in civil penalty cases under the Act.[9] Before the economic benefit

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5. *See id.*

6. *Union Township* , 150 F.3d at 263. The court sought to evaluate the "cost of doing business" analysis by referring to the EPA's own guidelines for determining economic benefit.

> "An organization's decision to comply with environmental regulations usually implies a commitment of financial resources; both initially, in the form of a capital investment or one time expenditure, and over time, in the form of annual, continuing expenses. These expenditures might result in better protection of public health or environmental quality; however, they are unlikely to yield any direct economic benefit (i.e., net gain) to the organization. If these financial resources were not used for compliance, they presumably would be invested in projects with an expected direct economic benefit to the organization. This concept of alternative investment; that is, the amount the violator would normally expect to make by not investing in pollution control, is the basis for calculating the economic benefit of noncompliance. As part of the Civil Penalty Policy, EPA uses the Agency's penalty authority to remove or neutralize the economic incentive to violate environmental regulations. In the absence of enforcement and appropriate penalties, it is usually in the organizations best economic interest to delay the commitment of funds for compliance with environmental regulations and to avoid certain other associated costs, such as operating and maintenance expenses."

Quoting: EPA BEN User's Manual I-6 (July 1990), quoted in Friends of the Earth, Inc. v. Laidlaw Envtl. Servs., 890 F. Supp. 470 (D.S.C. 1995).

7. *See id.*

8. *See id.*

9. *Union Township*, 150 F.3d 259. "It is not surprising that no published case has used this method of ascertaining a violator's economic benefit because it is the rare violator who actually loses money by delaying compliance with the law." *See*

factor can be discussed, it is necessary to understand the background of how the judiciary has developed its power of unilaterally determining civil penalties under the Clean Water Act.

II. Background

A. *Constitutional Considerations in Civil Suits Under the Clean Water Act*

Numerous constitutional considerations involved in the judicial imposition of civil penalties under the Clean Water Act exist.[10] Perhaps the most important issue to litigants under the Act is who will decide their fate: a judge or a jury. The United States Supreme Court addressed this very issue in *Tull v. United States*.[11]

In *Tull*, the Supreme Court first considered whether the Seventh Amendment of the U.S. Constitution[12] required a jury trial in civil actions under the Clean Water Act that were brought by the federal government.[13] In *Tull*, the federal government brought a civil action under the Clean Water Act against a developer in Virginia.[14] To solidify land for housing developments, the developer dumped fill into a wetland area, despite the fact that he did not have a permit to do so as required under the Act.[15] The Federal Court of the Eastern District of Virginia held a bench trial and assessed a monetary penalty of $333,000. On appeal, the Fourth Circuit affirmed this decision, holding that the developer

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id. at 265-66.

10. For a comprehensive review of various constitutional considerations in Clean Water Act jurisprudence, *See*: Richard C. Stanley & Thomas M. Flanagan, *5th Circuit Symposium: Constitutional Law*, 42 Loy. L. Rev. 491 (1996); Charles Jared Knight, *State Law-Punitive Damages Schemes and the Seventh Amendment Right to Jury Trial in the Federal Courts*, 14 Rev. Litig. 657 (1995); Peter McKenna, *Constitutional Law-Sovereign Immunity-States May Not Impose Civil Penalties on the United States Government for Violations of State Statutes Promulgaled Under the Authority of the Clean Water Act and the Resource Conservation and Recovery Act-U.S. Department of Energy v. Ohio*, 23 SETON HALL L. REV. 762 (1993).

11. Tull v. United States, 481 U.S. 412 (1987).

12. U.S. CONST. amend. VII.

13. *See Tull*, 481 U.S. at 413.

14. *See id.* at 414.

15. *See id.* at 414. *See* 33 U.S.C. §§ 1311, 1344 (2000). Section 1344(a) states in pertinent part "[t]he Secretary may issue permits, after notice and opportunity for public hearings for the discharge of dredged material into the navigable waters at specified disposal sites." 33 U.S.C. § 1344(a) (2000). The term (navigable water)" means the waters of the United States and the territorial seas." 33 U.S.C. § 1362(7) (2000). Section 1311 sets forth the limitations for effluent discharge.

was not entitled to a jury trial as a matter of right under the Seventh Amendment.[16]

The Supreme Court began its analysis by reviewing the causes of action that traditionally triggered the Seventh Amendment right to trial by jury, namely, those which arose in the English Courts of Law.[17] The Court noted that there was no clear decision on this point because the Act proscribed injunctive relief under Section 1319(b), and monetary damages under Section 1319(d).[18] The Court held that because "1319(d)'s concerns are by no means limited to restoration of the status quo," a factor more dispositive of injunctive relief, defendants in a civil action under the Clean Water Act are entitled to a jury trial in order to determine liability.[19]

While determining that defendants were entitled to a jury on questions of liability, the Court ruled that defendants were not guaranteed a jury to determine the specific amount of any penalty which was to be assessed.[20] The Court found that "[t]he assessment of civil penalties thus cannot be said to involve the substance of a common law right to a trial by jury nor a fundamental element of a jury trial."[21] Because there is no need for a jury trial to decide the amounts of penalties under the Act, Congress was free to set the penalties or delegate this duty to the judiciary.[22] The Court went on to state that the highly discretionary nature of the penalty calculations were traditionally performed by judges, and the authority to

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16. *Tull,* 481 U.S. at 416.

17. *See id.* at 417-18.

> "The Seventh Amendment to the United States Constitution does not "create" a right to jury trial; rather, it preserves that right in the federal courts as it existed at common law in 1791, the date of the amendment's ratification by the original states. Although the purpose and language of the jury trial guarantee appear to be straightforward, over the years it has proven to be one of the most difficult constitutional provisions to apply. This is due largely to the ambiguities surrounding the jury trial in English and American practice in 1791. For example, historically there was no right to a jury in suits that sought only equitable relief, such as an injunction or specific performance. However, at the time of the Seventh Amendment's ratification, the law/equity dichotomy was by no means well defined. The respective jurisdiction of both courts was blurred and shifting, so that application of the historical test created by the Seventh Amendment necessarily has been confusing and imprecise."

See e.g. JACK H. FRIEDENTHAL ET AL., CIVIL PROCEDURE § 11.3 (2nd Ed. 1993). For a detailed discussion of modern treatment of Seventh Amendment cases, *see id.* at § 11.5. (An Analysis of Beacon Theaters, Inc. v. Westover and its progeny).

18. *See Tull,* 481 U.S. at 422-25.

19. *See id.* at 424.

20. *See id.* at 426.

21. *Id., supra* note 16.

22. FRIEDENTHAL, *supra* note 17, at 426.

determine the amount of penalties was therefore vested in the courts.[23]

B. Traditional Methods for Determining Economic Benefit to Violators of the Act

According to United States Environmental Protection Agency ("EPA")[24] policy statements, "[t]he objective of the economic benefit calculation is to place violators in the same financial position as they would have been if they had complied on time."[25] In practice, the penalty provisions are designed so that: (1) the violator will not gain a competitive advantage over others in the same business who are in compliance with the Act, and (2) the violator will not be able to factor these costs into the normal operating budget of their respective business's.[26] It is important to note that the EPA policies on this subject also state that if the economic benefit to a violator is negative, the government should recognize this factor as $0 in determining penalty calculations.[27] While the EPA has suggested that penalty assessments begin at the

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23. *See id.* at 427.

24. EPA Interim Clean Water Act Settlement Policy, p.2 (March 1, 1995). "Section 309 of the Clean Water Act (CWA), (33 U.S.C. § 1319) authorizes the Administrator of the U.S. Environmental Protection Agency... to bring civil judicial and administrative actions against those who violate certain enumerated requirements of the CWA. In such actions, the Administrator may seek civil penalties."

25. *See id.*

> "The purpose of this policy is to further four important environmental goals. First, penalties should be large enough to deter noncompliance. Second, penalties should help ensure a level playing field by ensuring that violators do not obtain an economic advantage over their competitors. These two goals generally require that penalties recover the economic benefit of noncompliance, plus an appropriate gravity component. Third, CWA penalties should be generally consistent across the country. This is desirable as it not only prevents the creation of "pollution havens" in different parts of the nation, but also provides fair and equitable treatment to the regulated community wherever they may operate. Fourth, settlement penalties should be based on a logical calculation methodology to promote swift resolution of enforcement actions and the underlying violations."

See id. at 3.

26. *See id.* at 4. "The settlement policy is based on this formula: Penalty = Economic Benefit + Gravity +/- Gravity Adjustment Factors - Litigation Considerations - Ability to Pay - Supplemental Environmental Projects."

27. *See id.* at 5. While the EPA indicates that the settlement policy is not a tool for actual litigation, some courts have found it helpful as a guide during the penalty phase of civil actions under the Clean Water Act.

statutory maximum, many of the federal courts have disagreed with this methodology.[28]

There has developed two competing schools of thought regarding penalty calculation in civil cases under the Act. First, the "top-down method", endorsed by Fifth and Eleventh Circuits, begins the penalty calculation at the statutory maximum.[29] Once this "ceiling" is in place, the court usually reduces the penalty, if necessary, by applying the six factors listed in section 1319(d) of the Act.[30] The other method, which is used in the Third Circuit, is referred to as the "bottom-up" method.[31] A court applying this method starts with the economic benefit factor as its baseline.[32] It begins by determining what, if any, economic benefit was gained by the violator during the violation.[33] Once this numerical value is determined, the court will then adjust the calculation upward by evaluating the other five statutory provisions listed in 1319(d).[34] Therefore, the economic benefit factor plays a far greater role in those circuits where the "bottom-up" method is implemented based on its use as the baseline for further penalty calculations.[35]

In many instances it may prove difficult to determine with precision, the economic benefit a particular violator has enjoyed throughout the course of its violations.[36] Nevertheless, the EPA has

28. United States v. Gulf Park Water Company, Inc., 14 F. Supp.2d 854, 858 (S.D. Miss. 1998). District Judge Bramlette offers a concise summary of the Federal Circuit split in authority on penalty calculation methodology to be further discussed in Section II-B of this comment.

29. *See* United States v. Marine Shale Processors, 81 F.3d 1329 (5th Cir. 1996); Atlantic States Legal Foundation v. Tyson Foods, 897 F.2d 1128 (11th Cir. 1990); Hawaii's Thousand Friends v. City and County of Honolulu, 821 F. Supp. 1368 (D. Haw. 1993); Atlantic States Legal Foundation, Inc. v. Universal Tool & Stamping Co., 786 F. Supp. 743 (N.D. Ind. 1992); Weber v. Trinity Meadows Raceway, Inc., 1996 WL 477049 (N.D. Tex. 1996).

30. *Gulf Park Water,* 14 F. Supp.2d at 859.

31. *Union Township,* 150 F.3d at 265 (acknowledging the Court's freedom to choose between the two methods based on statutory silence to specific penalty calculation methods). *See also,* Friends of the Earth v. Laidlaw Environmental Service *(TOC),* Inc., 956 F. Supp. 588 (D.S.C. 1997); Student Public Interest Group of New Jersey, Inc. v. Monsanto Co., 1988 WL 156691 (D.N.J. 1988); Chesapeake Bay Foundation, Inc. v. Gwaltney of Smithfield, 611 F. Supp. 1542 (E.D. Va. 1985).

32. *See id.*

33. *See id.*

34. *See id.*

35. *Id.* Once a figure was set for the economic benefit factor, the court would consider good faith, history of violations, ability to pay, etc.

36. *Union Township,* 150 F.3d at 265. For example, it may be difficult to determine when the violator was not complying. Also the use of inflation and weighted average cost of capital makes it somewhat more challenging to find a precise number.

generally proposed that the best way to measure economic benefit, in most cases, is to determine the amount the violator should have previously spent to rectify the problems that ultimately led to its violation.[37] "As a general rule, the best evidence of what the violator should have done to prevent the violations, is what it eventually does (or will do) to achieve compliance.[38]

Some commentators have called this calculation method the "least-cost alternative."[39] This method is based on the premise that a reasonable, rational business owner will expend only enough capital resources to bring his business into minimum compliance with the mandates of the Act.[40] "In most cases the least-cost alternative will involve the installation of pollution abatement equipment rather than production curtailments."[41]

III. Wrongful Profits as Adopted By the 3rd Circuit: *U.S. v. Union Township*

A. *Initial Litigation in Federal District Court*

The dispute in *United States v. Union Township*, arose from a judicial imposition of civil penalties under section 1319(d) of the Act.[42] Dean Dairy, a defendant in the action, was charged with close to 1800 violations of the Act during a five-year period.[43] The company had consistently over produced non-toxic pollutants and sent them into the Union Township Publicly Owned Treatment Works ("POTW").[44] Due to the POTW's overproduction, the Kishacoquillas Creek, into which the POTW discharges, became unable

37. *See supra* note 24.

38. *EPA Interim Settlement Policy,* P.5 (March 1, 1995). *See Union Township* 150 F.3d at 264. "The theory is that economic benefit represents the opportunity a polluter had to earn a return on funds that should have been spent to purchase, operate, and maintain appropriate pollution control devices." *Id.*

39. Robert H. Fuhrman, Kenneth T. Wise and M. Alexis Maniatis, *Consideration of Wrongful Profits in Environmental Civil Penalty Cases*, DAILY ENVIRONMENTAL REPORT (BNA) (September 16, 1998).

40. *See id.*

41. *See id.*

42. United States v. Municipality of Union Township, 929 F.S. at 800, 802. "Section 1319(d) provides that the violator of a permit issued persuant to the Act shall be subject to a civil penalty not to exceed $25,000 per day for each violation." *Id.*

43. *See id.* Dean Dairy was also found liable for 79 instances of interference with Union Township's POTW.

44. *See id.* at 803-04. *See* 40 CFR § 403.3 (o), (p), (q), and (r) which define Publicly Owned Treatment Works.

to sustain a major fish population.[45] Chief Judge Rambo of the Middle District of Pennsylvania assessed a penalty of $4,031,000.[46]

Judge Rambo made this penalty determination after considering the factors listed in section 1319(d) of the Act. The court pointed out that it was rejecting the top-down method of penalty calculation, instead adopting the bottom-up approach.[47] In using the bottom-up approach, it was necessary for the court to determine the economic benefit that Dean Dairy had realized in order to establish a starting point for penalty assessment.[48]

Despite the fact that both parties had stipulated that Dean Dairy did not realize any economic benefit from their delay in improving their facilities to conform to EPA standards, the court assigned an economic benefit value of $2,015,500.[49] The court stated that despite this stipulation "[Dean Dairy subsidiary] Fairmont did, however, realize an economic benefit during the period of violations by producing at a volume above that which would have allowed it to operate within its IU permit."[50] This figure was based on average income of $417,000 per year between July of 1989 to April of 1994 which would have been forfeited by the company had it stopped producing for one particular customer.[51] Had Fairmont stopped production for this customer, it would have been able to reduce its daily discharge to allowable levels.[52] In reaching this economic determination, the Court did not evaluate what the least-cost alternative would have been had Dean Dairy chosen to comply with its responsibilities under the Act.[53]

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45. *See id.* Environmental degradation of the creek had been found as early as 1984. The Court found that the POTW was responsible for the deteriorating water quality. "Because of this environmental damage to the Creek, the Pennsylvania Fish and Boat Commission ceased stocking the creek in the vicinity of the POTW's discharge point. The cessation of 890 the fish stocking program in 1993 removed 3,200 trout from 3.8 mile of the Creek." *Id.*

46. *See id.* at 809.

47. *See Union Township,* 929 F. Supp. at 806.

48. *See id.* at 806. The Court specifically rejected the Government's contention that it begin its penalty calculation at the "top" with the statutory maximum penalty. In this case the maximum penalty allowed under section 1319(d) would have been $45,825,000.

49. *See id.*

50. *See id.* at 805.

51. *See id.* at 804-07.

52. *See Union Township,* 929 F. Supp. at 804-07.

53. *See id.* The Court did make note of the fact that Fairmont did in fact install a pretreatment facility at a cost of $865,000. Construction began in early 1994 and became operational in April 1995. Consistent with its wrongful profits approach, the Court did not identify what the cost of the system would have been in 1989, its annual operating costs, or the interest value on the capital expenditure delay.

B. *Third Circuit Court of Appeals Review*

In July of 1998, the Third Circuit Court of Appeals affirmed the district court's ruling. More importantly, it became the first Federal Court to accept a "wrongful profits" approach to determine the economic benefit enjoyed by a violator of the Act.[54] While Dean Dairy challenged the District Court ruling on one other ground, the thrust of its argument was that the "wrongful profits" analysis was not a proper method of determining economic benefit under the Act.[55]

At the outset, the Court acknowledged that "[c]ourts use economic benefit analysis to level the economic playing field and prevent violators from gaining an unfair competitive advantage."[56] It was also noted that the EPA uses the economic benefit factor to take away any existing incentive to violate the Act.[57] The Court took care to identify the prevailing line of reasoning which states that the economic benefit factor need not be proven with precision.[58] In many cases the economic benefit may not be subject to precise determination. In light of this difficulty, economic benefit need only be reasonably approximated.[59] Based on this reasonable approximation analysis, the Court reasoned that the $417,000 per year estimation accurately reflected the economic benefit of non-compliance to Fairmont.[60] They upheld this despite the fact that Fairmont had not actually "netted" $417,000 and in

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54. *See Union Township, supra* note 9.

55. *See id.* at 260. Dean Dairy also appealed on the ground that the District Court erred as a matter of law when it ruled that the economic condition of the parent company when determining the ability of a subsidiary to pay a proffered fine. "If the subsidiary does not retain its revenues, as the evidence showed in this case, then its parent's financial resources are highly relevant." *See id.* at 268. Further, the parent company's financial statements were only one of a number of factors in determining whether or not the fine would threaten company solvency. *See id.*

56. *Id.* at 263 (quoting United States v. Smithfield Foods, Inc. 972 F. Supp. 338, 348 (E.D. Va. 1997)).

57. *See supra* note 24.

58. *Union Township* 150 F.3d at 264. *See* Public Interest Research Group of New Jersey v. Powell Duffryn Terminals, Inc., 913 F.2d 64. "[R]easonable approximation of economic benefit is sufficient to meet plaintiff's burden for this factor . . . . The determination of economic benefit or other factors will not require an elaborate or burdensome evidentiary showing. Reasonable approximations of economic benefit will suffice." *See id.* at 80.

59. *See id.*

60. *Union Township*, 150 F.3d at 265. This number was arrived at by the evaluation of the testimony of Dean Dairy's controller.

reality had gained no measurable level of advantage over competitors in their industry.[61]

The Court seemed eager to show that there are various means in which to determine economic benefit. It stated:

> "There are methods other than the delayed or avoided capital expenditure for ascertaining economic benefit, a fact that appellant and the amici decline to acknowledge. It is significant that neither the statute nor the case law support the contention that the cost avoidance method is the only permissible method of determining the amount a polluter has gained from violating the law."[62]

Despite this statement, the decision did not make any reference to alternatives other than the wrongful profits method which it acknowledged was being used for the first time in Clean Water Act litigation.[63] Further, the Court made no attempt to set forth any particular holding as to when a wrongful profits analysis would be proper.

During its period of noncompliance, Fairmont had been required to pay additional fees to Union Township based on the level of waste that was being sent through the POTW.[64] These fees that were assessed due to the excess production caused the business to operate at a loss for some time.[65] This was a non-factor to the Court as it stated, "The fact that the violator has also penalized itself by failing to implement cost-effective methods that would have put it into compliance with its permit and thereby save it money certainly is no basis to mitigate its penalty."[66] By reducing the output of its plant, i.e. reducing the number of customers it serviced, Fairmont could have avoided overloading the Municipal Township POTW and avoided the effects of the Penalties under the Act.[67] Due to the fact that it did not, the Court held that the $417,000 average income per year between 1989 and 1994 represented a reasonable approximation of economic benefit under section 1319(d) and hence allowed the Court to level the economic playing field between Fairmont and its competitors.[68]

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61. *See id.* at 266.
62. *See id.*
63. *See supra* note 9.
64. *Union Township,* 150 F.3d at 266.
65. *See Union Township,* 929 F. Supp. at 804-05.
66. *See Union Township,* 150 F.3d at 266.
67. *See id.*
68. *See id.* at 267.

IV. Analysis

It should be noted at the outset that the purpose of this comment is not to justify or otherwise endorse the actions of Fairmont and its business practices. Quite the contrary, Fairmont deserved the penalty it received based on its history of violations and relative indifference to those continuing violations. The end result of *United States v. Union Township* is correct, yet the means utilized to achieve that end are flawed and should not be followed by other courts faced with similar factual situations.

The "wrongful profits" analysis adopted by the Third Circuit is flawed for a number of reasons. First, this approach is an arbitrary standard that is difficult to apply and achieves no more, if not less, than traditional methods of determining economic benefit under the Act. Second, in order for penalties to be consistent throughout the country, a well-established method of economic accountability for violators should be established. The wrongful profits analysis undermines this attempt at consistency. Third, this analysis will not help to level the economic playing field between those who comply and those who do not. Finally, and perhaps most importantly, this type of analysis usually will not lead to a reasonable approximation of economic benefit to a particular violator such as Fairmont.

A. The Arbitrary Nature of the Wrongful Profits Analysis

It is without contention that the federal courts have a wide range of discretion in determining civil penalties under the Act.[69] By virtue of section 1319(d), judges may impose a penalty up to $25,000 per day per violation.[70] The question thus becomes how much discretion do individual judges have in determining the meanings of the words contained in section 1319(d)? The wrongful

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69. *See Tyson Foods,* 897 F.2d at 1139-1142; *see also Gulf Park Water,* 14 F. Supp.2d at 858.

70. 33 U.S.C.A. 1319(d) (West 1998). States in pertinent part:

> "Any person who violates section 1311, 1312, 1216, 1317, 1318, 1328, or 1345 of this title, or any permit condition or limitation implementing any of such sections in a permit issued under section 1342 of this title by the Administrator, or by a State, or in a permit issued under section 1344 of this title by a State, or any requirement imposed in a pretreatment program approved under section 1342(a)(3) or 1342(b)(8) of this title, and any person who violates any order issued by the Administrator under subsection (a) of this section, shall be subject to a civil penalty not to exceed $25,000 per day for each violation.... For purposes of this subsection, a single operational upset which leads to simultaneous violations of more than one pollutant parameter shall be treated as a single violation."

profits analysis, as adopted by the Third Circuit, crystallizes this issue. The analysis adopted by the third circuit is arbitrary in the sense that it does not shed any light on how and when a wrongful profits approach should be made.[71]

In is well accepted that the least-cost alternative method of economic benefit calculation is the most consistent calculation method available.[72] While there are some variations on this particularity, in can be summed up quite simply: what are the minimum costs that a reasonable business person would expend to become compliant with the Act?[73] Add on to this figure a standard interest rate over the time period, factor in inflation and then adjust this figure by the weighted average cost of capital.[74] What this formula represents is a standard (while not necessarily simplistic) method of determining economic benefit.[75] A third circuit wrongful profits analysis is the antithesis of the least-cost alternative. The economic benefit factor is the one factor that can be quantified to some degree of certainty.[76] While this figure, using the least-cost method, will rarely, if ever, be precise, it provides a standard calculation that is far more precise than the arbitrary wrongful profits method.[77]

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71. *See Union Township,* 150 F.3d at 262, 266. The court merely acknowledges that there are means other than the least cost alternative to evaluate economic benefit. Despite acknowledging that Dean Dairy had a cost of $865,000 to build the plant, the court decided this was not a factor to be used in determining economic benefit. Further, there is absolutely no indication at any point in the opinion regarding how or when the wrongful profits analysis should be applied.

72. *See supra* note 30. "As EPA administrative judges have recognized, the economic benefit calculation should reflect the least costly means of compliance." *See* In the Matter of Puerto Rico Urban Renewal & Housing Corporation, Respondent, 1993 WL 313357 (E.P.A. 1993). "[The BEN] model utilizes current economic and inflation values to calculate savings from noncompliance based on the inputs such as the cost of population control equipment, the date respondent should have been in compliance and the date of actual compliance.." *Id.* at 6.

73. *Union Township,* 150 F.3d at 265; United States v. Smithfield Foods, 972 F. Supp. 338, 349 (E.D. Va. 1997).

74. *Smithfield Foods,* 972 F. Supp. at 349, Fn. 18. "The WACC [weighted average cost of capital] is the average return a company expects to make for its investors, in order to maintain its current level of investors and its current level of business operations."

75. *See* Robert H. Fuhrman, *A Discussion of Technical Problems With EPA's BEN Model*, 1 ENVTL. LAW 561. A highly technical criticism based on faulty inflationary variables based in the BEN program.

76. While it will always be difficult to show precisely, it is the one factor in section 1319(d) to which a specific dollar amount can be attributed to.

77. This precision is based upon the fact that 99% of the violators will have had the opportunity to come into compliance in the past and a dollar amount can be attributed to the amount that would have brought them into compliance at any given point of time. This is not available with the wrongful profits analysis because

There may in fact be times when a wrongful profits analysis is needed a very rare case.[78] If the 3rd Circuit sought to enunciate this type of analysis, *Union Township* was exactly the wrong case in which to do it. As the Court acknowledged, Dean Dairy finally did build its pre-treatment facility at a cost of $865,000.[79] With this figure the Court could have very easily gone back to the first day Dean Dairy violated the Act and performed the aforementioned calculation. It is possible that this figure could have been greater than the benefit, as deduced by the Court. Either way, that figure could have been adjusted upwards to the amount desired based on the other factors listed in section 1319(d).[80]

By insisting on instituting this new methodology, the Third Circuit has given no guidance to the courts beneath it.[81] Furthermore, the arbitrary nature of its implementation could cause confusion to these lower courts because there seems no other reason other than the will of the court for its implementation.[82] Random and arbitrary determinations such as these types of analysis does not lend themselves to judicial economy or effective dispute resolution at the district court level.

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in every situation there is likely to multiple form of compliance available with no particular method better than another.

78. *Gulf Park Water,* 14 F. Supp. 2d at 862.

> "In Gwaltney, 611 F. Supp. at 1588, the district court recognized at least three distinct type of economic benefit:
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> > First, by delaying the expenditure of funds on compliance, a violator obtains the use of the money for other purposes in the meantime. Second, a violator may also avoid some costs altogether-for example, the costs of maintaining and operating the pollution control system until it is implemented. *Third, a violator may, in addition, obtain a competitive advantage as a result of its violation-for example, it may be able to offer its goods at a lower price, thereby possibly increasing its sales and profits.*" (Emphasis added).

The third example would be the only way in which a wrongful profits analysis could accurately be used. This would be due to excess of profits that would be gained over competitors. This factual situation was not present in *Union Township*.

79. *Union Township,* 929 F. Supp. at 805.

80. Dean Dairy had a significant history of violations; lack of good faith and economic impact on the parent company would have been relatively small.

81. *See supra* note 70.

82. *See id.*

B. *The Third Circuit Wrongful Profits Analysis Is Not a Standard Which Can Be Consistently Applied*

One EPA goal in determining civil penalties under the act is uniformity.[83] While this is a lofty goal, unlikely to be achieved, a framework for consistency should be developed and carried out by the courts throughout the federal system. The wrongful profits approach inherently does not lend itself to consistency because it actually represents differing methods of compliance rather than economic benefit.[84] As one group of commentators has noted:

> "In its Dean Dairy decision, the appellate court asserted that the approach adopted by the lower court did not conflict with basic economic principles. However, basing a benefit calculation on production cutbacks when a less costly means of compliance was available makes no economic sense.
>
> Assume that a company could have achieved compliance at a facility in one of three ways: (1) by shutting down a factory, which would have resulted in a loss of $1 million in revenue; (2) by shutting down certain operations, which would have resulted in a $100,000 loss; or (3) by installing a filter, at a cost of $1,000. Are each of these amounts alternative measures of economic benefit? No. These amounts are the costs of alternative means of compliance, not alternative approaches to measuring economic benefit."[85]

The example above brings a murky problem properly into focus. Section 1319(d), for which the courts rely on to assess civil penalties, does not seek to empower the courts or other enforcement entities to define compliance methods prior to the judgement of guilt in a civil action under the act.[86] What it does ask is, how much economic leverage has this violator gained over competitors who have complied?

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83. EPA Interim Settlement Policy, P.3 (March 1, 1995). *See supra* note 24.

84. Robert H. Fuhrman, Kenneth T. Wise and M. Alexis Maniatis, *Consideration of 'Wrongful Profits' in Environmental Civil Penalty Cases*, DAILY ENVIRONMENTAL REPORT (BNA September 16, 1998). P.3.

85. *See id.* at 3-4.

86. Marcia R. Gelpe and Janis L. Barnes, *Penalties In Settlements of Citizens Suit Enforcement Actions Under the Clean Water Act*, 16 WM. MITCHELL L. REV. 1025-1028. The point of civil penalties is to punish violators for not complying with the Act. Section 1319(d) does not contain any references to retroactive compliance methods which is ultimately what the Third Circuit analysis achieves.

By attempting to classify economic benefit as methods of compliance, the Third Circuit has developed a methodology that will be impossible to replicate. Essentially this method will allow the courts to look back at the time when the violations took place and proscribe a particular method of compliance that should have occurred at a certain point in time.[87] This determination will take place without even a cursory consideration of what the least cost alternative would have been.[88] This method will never be able to be consistently applied because there are simply too many ways in which a court could proscribe precedent compliance methods.[89] As difficult as consistency is to achieve, the *Union Township* methodology will make this goal an impossibility by giving unfettered control to the judges.[90] Due to the fact that in many cases there will be multiple compliance scenarios, it is almost out of the realm of possibility that a lower court will be reversed unless the fine so hindered the financial status of the company to render it insolvent.[91]

C. The Third Circuit Wrongful Profits Approach to Determining Economic Benefit Is Not a Proper Approach to Leveling the Economic Playing Field

Perhaps the most important goal in assessing civil penalties under the act is to ensure that violators of the act do not gain an economic advantage of competitors who are in compliance with the act. By leveling the economic playing field between those in compliance with the act and those who are not, the goals of the Act can be carried out with greater efficacy.[92] In theory this is true because a company who is in violation of the act because it has not

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87. *See supra* note 84. Based on this example, the wrongful profits analysis could arrive at separate conclusions neither of which would be an accurate measure of economic benefit. The first would be to shut the plant down at a loss to the company of $1,000,000. This is not a measure of economic benefit but rather a proscribed method of compliance not contemplated by section 1319(d). The second result would be the $100,000 loss marked by a closing of certain plant operations. The only alternative the wrongful profit analysis would not contemplate, and the one that it should, is the final method that calls for the company to come into compliance by installing a $1,000 filter. This final number accurately quantifies the economic savings this company would have gained over its competitors.

88. *See id.*

89. *See id.* This particular example would lead to three completely different results. An economic benefit of $1,000,000, $100,000, or $1,000.

90. *See id.* at 4.

91. *See id.* at 1.

92. *Smithfield Foods,* 972 F. Supp. at 347.

taken the requisite steps to become compliant will have the economic advantage they gained taken away from them by virtue of the powers vested in section 1319(d).[93] The loss of this economic benefit serves as a significant deterrent to noncompliance.[94] In practice however, many violators do not comply because they do not think they will be caught or could quickly bring themselves into compliance when identified by the requisite enforcement entity.[95] It is at this time when these violators must have their economic benefit of non-compliance taken back.

The Third Circuit approach will not help to achieve this goal because in many instances it will over-emphasize the economic benefit at the expense of the other factors in section 1319(d). In essence this approach distorts the true level of economic benefit enjoyed by a company who does not comply with the Act.[96] This distortion will not allow courts that attempt to use this method an adequate determination on how much the violator actually gained. The *Union Township* decision will not level the economic playing field but rather will slant it unnecessarily against those who have not complied. Certainly, courts may adjust the penalties to suit the situation or even impose the statutory maximum.[97] What courts should not do is base their economic benefit analysis on unsound legal and economic theories.

In determining civil penalties under the Act, courts would be wise to avoid the Third Circuit approach. The wrongful profits analysis may serve to over-inflate the actual enjoyed benefit of noncompliance. If additional penalties, above and beyond the benefits of noncompliance, are desired, courts should look to the additional factors enumerated in section 1319(d).

D. The Wrongful Profits Analysis Does Not Reasonably Approximate the Economic Benefit Enjoyed By Violators

It is widely recognized that the economic benefit calculation is rarely precise.[98] The case in *United States v. Gulf Park Water* is an interesting comparison to the case in *Union Township*.[99] The Gulf

93. *See id.*

94. Friends of the Earth v. Laidlaw Envt'l Services, 890 F. Supp. 470, 482 (D.S.C. 1995).

95. Lois J. Schiffer, Ann C. Juliano, *REFORM OF ENVIRONMENTAL REGULATIONS: THREE POINTS*, 12 NAT. RESOURCES & ENV'T 175 178-179 (1998).

96. *See infra* note 103.

97. *See supra* note 69.

98. *See Gulf Park Water Co.*, 14 F. Supp.2d at 863.

99. *See id.* at 857.

Park Water Company was found guilty of dumping wastewater without a National Pollutant Elimination System Permit ("NPDES").[100] Gulf Park Water Company was compelled by the court to connect its plant to the regional wastewater treatment facility.[101] Over a five-year period, the Gulf Park Water Company committed over 1,800 violations of the Act.[102]

When the court set out to determine the penalty, it emphasized that it was selecting the "top down" method of penalty calculation.[103] In discussing its view of the economic benefit factor the court stated "[a] defendant should not be placed in a better position, due to its failure to comply with the law, than it would have been if it had made the necessary expenditures under the law."[104] The court explained that the expert called by the government assessed an economic benefit of $1.2 million dollars.[105] This figure was reduced by the court to $600,000.[106] The court reasoned:

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100. *See id.*

101. *See id.* The Company had been dumping wastewater illegally since 1985.

102. *See id.* at 858. "Inasmuch as the statute does not require either method, this Court exercises its discretion and elects to use the "top-down" method when calculating the appropriate penalty for the defendants' violations." *See id.*

103. *See Gulf Park Water Co.,* 14 F. Supp.2d at 862. The court was advocating the idea that in order for the penalty assessed to have an impact on the violator, the penalty ultimately assigned must more than just the economic benefit enjoyed. If the only penalty factor was the economic benefit, companies could factor this cost into their cost of doing business. The penalty must have the requisite deterrent effect.

104. *See id.* at 863. The court described the government's economic expert's testimony and findings:

> "James Fagan, the plaintiff's expert in calculating economic benefit, opined that the defendants enjoyed and economic benefit of roughly $1.2 million, based on the fact that the defendants delayed and/or avoided spending money to come into compliance and had the benefit of that money until they eventually spent it to come into compliance.
>
> Specifically, Mr. Fagan considered the delayed cost of constructing the connection between the Gulf Water facility and the Regional wastewater facility. He assumed that Gulf Park should have incurred this cost ($407,000) in July of 1985 when it was ordered to connect to the Ocean Springs system. He also considered the avoided annual operation and maintenance costs of $12,000 per year. By calculating a 10% rate of return on delayed expenditures and then adding avoided costs, he calculated a total economic benefit to the defendants of 41,193,000."

Id.

105. *See id.*

106. *See id.* at 864.

> "The parameters are broad and the contingencies are many, but the Court finds that $600,000 is a reasonable approximation of the economic benefit, having subtracted from Mr. Fagan's formula the $200,000 figure and having applied offsetting factors and *expenses which the defendants incurred as a result of not having made the connection.* Obviously, the defendants have benefited economically by their violations. As a result the second statutory [economic benefit] factor is not mitigating. *However, the amount of benefit will be taken into account in the overall assessment of the penalty.*"[107] (emphasis added).

After analyzing the remaining 1319(d) factors the court ultimately assessed a penalty in the amount of $1,500,000.[108]

The reasoning of the court in *Gulf Park Water* is important to this discussion because it represent a reasonable calculation of economic benefit. This is the perfect example of what the *Union Township* court should have done but failed to do. The court eschewed inflated figures for the economic benefit factor and assessed an amount that was equal to the amount gained due to its noncompliance.[109] This is a reasonable approximation of what the cost avoided by the defendant was. Further, the court acknowledged that any additional penalties to be levied would be considered by evaluating the other factors.[110]

If the *Gulf Park Water* court had applied the Third Circuit wrongful profits analysis, it would have had to take all of the revenues gained by the company during its five year period of noncompliance and assessed it as economic benefit. This is because the only way for Gulf Park Water to come into compliance would have been to completely shut down its operation.[111] Instead, it made a reasonable calculation based on what it would have cost

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107. *See id.* at 864.

108. *Gulf Park Water Co.*, 14 F. Supp.2d at 863.

109. *See id.*

110. *Gulf Park Water* at 861-863. This differs from that of *Union Township* because prior to 1989, Dean Dairy had been in compliance with the Act. After 1989, the plant began to discharge more than it was allowed and fell into violation of the Act. Therefore, the Third Circuit could simply attempt to justify its decision on the basis of reduction in waste production despite the fact that it had a figure available for the least-cost alternative method. The Court in *Gulf Park Water* was unable, or unwilling, to adopt the wrongful profits analysis because the only method of compliance other than building the line to the regional authority, was to cease operations at the plant in 1985. This is just another example of the how the wrongful profits analysis dictates methods of compliance rather than measuring economic benefit.

111. *Id.* at 863-864.

them to comply when the violation period began.[112] While the court cited to Judge Rambo's District Court decision in *UnionTownship*, it implicitly rejected the foundation of that case's analysis of economic benefit.[113] This rejection came in the form of applying a least cost alternative to the facts before it. The wrongful profits approach purports to measure economic benefit in the same reasonable manner, yet it simply lacks the rationality inherent in the *Gulf Park Water* reasoning.

V. Conclusion

The Third Circuit decision in United States v. United Township is the first opinion in any federal court to utilize a wrongful profits approach to determining economic benefit under the Clean Water Act. While the economic benefit factor is but one of six factors used to determine penalties under the Act, it is the starting point in the courts that elect the "bottom-up" method of penalty calculation. Even in those circuits that use the "top-down" method, it still retains an important position among the factors listed in section 1319(d).

The wrongful profits approach, as adopted by the Third Circuit is poor judicial policy which should not be replicated by other federal courts. In essence, the wrongful profits analysis chooses methods of compliance rather than measure the actual saved costs of noncompliance. In the future, courts should remain steadfast in their application of the least-cost alternative as a measure of economic benefit under the act. The wrongful profits analysis is an arbitrary method incapable of being consistently applied. Furthermore, this analysis will not, in most cases, properly level the economic playing field vis-à-vis other companies similarly situated. Again, this is because the wrongful profits analysis is truly a choice of compliance method disguised with economic overtones. Just because both choices have financial implication does not mean that they are both accurate. The least-cost alternative method is by far the more accurate method to use when trying to level the economic playing field. Finally, the wrongful profits analysis can never truly be a reasonable approximation of economic benefit because it does not accurately reflect the violator's gain. In addition, as a measure of compliance, rather than economic benefit, the wrongful profits analysis will not offer an estimation of asset savings but rather as the cost for a particular method of proscribed compliance.

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112. *See id.*

113. *See Gulf Park Water Co.*, 14 F. Supp.2d at 863-864.

It is important for the other federal courts who hear cases similar to *Union Township* to seek out the least cost alternative, as the court in *Gulf Park Water* did, and apply that figure rather than a compliance amount which does not accurately reflect basic economic principles such as the reasonable business operator. The Third Circuit's wrongful profits approach in *Union Township* is a decision that hopefully will not be followed by the other federal circuits.

Matthew B. McGuire, Esq.