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Why Exxon's $20 million Clean Air Act penalty assessment loss is really a victory

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ExxonMobil Corp.[1] was hit with the largest civil penalty assessment ever seen in a Clean Air Act citizen suit when the U.S. District Court for the Southern District of Texas on April 26 assessed a nearly $20 million civil penalty against the company. Yet that penalty represents a victory for Exxon, partially through good advocacy, but mainly through the hard and consistent work of Exxon's environmental compliance staff, which prioritized compliance long before the case was even filed.

While the size of the penalty will cause Exxon's shareholders consternation, the important take-away is that the significant environmental compliance work Exxon does on a day-to-day basis matters, and resulted in a significantly lower penalty assessment than it otherwise would have faced for non-compliance with its CAA permits. The case presents important lessons for regulators and regulated parties alike. The judgment also provides encouragement to citizens groups to take on bigger and more sophisticated operations with some prospect for success.

The litigation began in December 2010 when, after filing a requisite 60-day notice letter, Environment Texas Citizen Lobby Inc. teamed up with the Sierra Club to file a seven count CAA citizen suit against Exxon.[2] The case was filed in the Southern District of Texas, sitting in Houston, within whose jurisdiction Exxon operates a refinery and two petrochemical plants in nearby Baytown, Texas. The groups sought civil penalties for Exxon's alleged past infractions and injunctive relief to compel the company to take further action and better manage its facility operations, and appoint a third-party to oversee those efforts.

Claims under the CAA are subject to a 5-year statute of limitations under 28 U.S.C.A. § 2462,[3] so the groups' suit focused on Exxon's operations reaching back to Oct. 14, 2005 (i.e., five years before the groups filed the 60-day pre-suit notice letter).

In particular, the groups focused on Exxon's alleged non-compliance with five separate CAA Title V operating permits issued by the Texas Commission on Environmental Quality. Like most citizen suit cases, the plaintiff groups relied on Exxon's own publicly filed data, reports and regulatory filings to establish the company's past and on-going alleged violations.

The Title V permits authorized Exxon to emit pollutants in specified amounts from all three facilities. The emissions were substantial, and the permits inventoried and accounted for hundreds of individual emission sources. Exxon's efforts to control and reduce those emissions were similarly substantial, and the company did so through its equipment type, process designs, raw material composition and end-of-stack controls. Monitoring and reporting on individual sources within each facility was a substantial component of each Title V permit, and it was a function to which Exxon employees and contractors devoted considerable time, effort and expense.

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Anyone familiar with Title V permits for large complex operations like Exxon's Baytown facilities will appreciate that each permit can be as thick as a metropolitan telephone directory — a distillation, if you will, of thousands of pages of technical discussions, hundreds of analytical results, dozens upon dozens of process flow and schematic diagrams, drawings and maps, and a collection of permits to construct and modify individual sources.

Exxon's application probably filled five or more four-drawer file cabinets. Digitized, the permit files for each facility likely would have been gigabyte size; the applications terabyte size. The Title V permits included provisions incorporating by reference the entire application, including all amendments and modifications submitted during the multi-year review process. The permits also contained every "applicable" federal and Texas statute and regulation implicated by the operations described in the application.

Saying that Exxon's management of its Title V compliance was a complex undertaking would be a gross understatement. In the words of the District Court, "[t]aking all permit conditions together, the [Baytown] Complex is regulated by 120,000 permit conditions related to air quality, each of which is tracked ... for compliance

purposes." Title V compliance tracking is monumental, and often made more challenging by the hazardous nature of refinery operations, and the overlay of complex safety procedures and requirements designed to prevent catastrophic events.

The District Court recognized this reality when it found:

> Both the TCEQ and the [Environmental Protection Agency] recognize it is not possible to operate any facility — especially one as complex as the [Baytown] Complex — in a manner that eliminates all emissions events and deviations. Despite good practices, at any industrial facility there will always be mechanical failure and human imperfection leading to noncompliance with Title V permit conditions.

That is the truth. The record developed at trial included testimony from current and former TCEQ employees responsible for overseeing Exxon's operations and painted a picture of significant compliance undertakings by Exxon personnel and contractors. It also illustrated open exchanges between the regulator and Exxon over means and methods to manage emission sources at a complex and dangerous operation like Baytown. At the time suit was filed, Exxon was thoroughly engaged with TCEQ staff on permit compliance issues. That said, not all of Exxon's non-compliance issues were "fixed."

When the CAA was amended in 1990 to add Title V permitting for so-called "major" emission sources, it expressly created a "permit shield." The permit shield provides that a facility operator can be shielded from enforcement actions, including citizen suits, alleging non-compliance with statutory or regulatory provisions that were not expressly included in the permit when issued.[4] While permittees hope to have and rely on the "shield," it can be difficult to fathom its scope, even in permits which include it, given the number of regulations incorporated by reference.

In the present case, the permit shield defense was not available because the groups' allegations focused on Exxon's compliance with the permit itself. Exxon therefore could not fend off the citizen suit based on the fact that it had permits

As is almost always the case in citizen suit actions, what turned out to be most significant were Exxon's own "admissions" regarding its non-compliance with some of its 120,000 Title V permit requirements. The 1990 CAA amendments imposed annual compliance certification requirements on Title V permittees requiring them to certify that they conducted their facility operations in compliance with all Title V permit requirements. The amendments also required permittees to specifically call out exceptions, called "deviations."[5] Permittees make the annual certification subject to penalties for falsities, so it is quite a serious document, and is treated as such by sophisticated permittees like Exxon.

Exxon complied with this certification requirement — perhaps overcomplied — and self-reported numerous "deviations," "recordable events" and "reportable events" where its facilities were not in strict compliance with the Title V permit. Exxon also gave TCEQ periodic reports on its efforts to correct those incidents. In 2012, shortly after the Sierra Club and Environment Texas filed suit, Exxon entered a consent order with the TCEQ to establish schedules to abate its violations, implement corrective measures and pay civil penalties.

According to Exxon, many of these measures were in-progress at the time the groups filed suit. At trial, Exxon also presented evidence that it was proactively managing compliance concerns at the Baytown Complex.

Although certain elements of the Baytown Complex operations would have been maintained as confidential for national security reasons, the compliance certifications TCEQ required of Exxon and the company's periodic compliance reports would have been a matter of public record. Given the complexity of the complaint, it is clear the Sierra Club and Environment Texas spent a lot of time sifting through Exxon's public filings to create their suit.

> While Exxon could not run from the violations, its conduct and responsible actions to address environmental compliance resulted in a substantially reduced penalty.

Like several other federal environmental statutes, the CAA contains a citizen suit provision, found at 42 U.S.C. A. § 7604, which authorizes "citizen attorneys general" to file private suits to enjoin statute violations when the EPA has failed to do so. This right of action extends to violations of implementing regulations and any permits issued thereunder. A District Court hearing such a suit has the power to assess penalties and enter injunctive relief to abate violations as prescribed in the CAA, just as if the case had been filed by the EPA.

To prove their case that Exxon had and continued to violate its Title V permits, the Sierra Club and Environment Texas used spreadsheets summarizing each "reportable" event, "recordable" event, and "deviation" revealed in Exxon's records between October 2005 and the end of 2013.[6] Exxon stipulated to the accuracy of the list prior to trial since it was based on reports and records the company submitted to TCEQ or maintained under the Title V permits. That said, Exxon argued that it had substantially complied with the permit, was operating under state oversight under the consent order, had paid penalties for some of the violations, and was working diligently and in good faith to resolve all non-compliance issues at the Baytown Complex.

The groups asked the District Court to assess each event and deviation as a separate violation, and urged the court to assess the maximum allowable daily penalty, $37,500, for each day the event or deviation continued. The evidence established that Exxon had violated various permit conditions over 10,000 days during the 8 year time frame at issue, amounting to approximately 3 violations per day.

According to the District Court, the groups originally sought a penalty in excess of $1 billion, but reduced their demand to $642 million following the 13-day bench trial.[7]

Exxon was critical of the groups' approach on numerous grounds, pointing out that some reportable events were nothing more that electrical shorts caused by rodents or birds, or in one case, a smoldering ash tray extinguished with a glass of water. But Exxon had trained its employees to record or report every incident or deviation and its employees did so, scrupulously, even for minor incidents like the ash tray.

An "open book" approach like this is what regulators dream about, and it establishes a permittee's strong basis for credibility. Yet, it becomes an exercise in frustration when a citizen attorney general is permitted to step in to call a permittee out for its candid and fulsome disclosures. It moves into the realm of a nightmare when the citizen attorney general asks a court to "max out" the statutory penalty for each recorded incident.

At the end of the day, Exxon faced the difficult, indeed, the nearly insurmountable task of having to cross-examine its own records and develop evidence to re-explain incidents or develop evidence to contextualize them. It did just this, and in 2015, on the strength of Exxon's evidence, the District Court entered judgment for Exxon and declined to assess civil penalties or grant injunctive relief.

The groups appealed the decision to the 5th U.S. Circuit Court of Appeals, which in April 2016 issued an opinion vacating and remanding the District Court's decision, with instructions to revisit the imposition of civil penalties under certain counts in the complaint.[8] The circuit court found that the Sierra Club and Environment Texas presented competent evidence of violations, and said those incidents warranted a more thorough review under the statutory penalty guidelines.

On remand, the District Court weighed a variety of factors and ultimately found that there were 97 reportable events, 3,734 recordable events and 901 deviations during 10,000 different days, warranting the assessment of a civil penalty.

During the remand proceedings, Exxon pointed out that many of its alleged violations dealt with recordkeeping and did not result in any environmental harm, or pose a threat to public health or safety. Exxon argued that its other violations involving "excessive" emissions were episodic in nature, and did not signify ongoing problems or cause its facilities to exceed their annual emission caps under the Title V permits.

Exxon also pointed out that many of the alleged violations were addressed in its state consent order and were resolved through its payment of over $1 million in state civil penalties, and an agreement to undertake some $20 million in environmental improvement projects not otherwise required by law. According to Exxon, its resolution of those violations were consistent with enforcement provisions in Texas' air quality plan — the Texas State Implementation Plan — and should have mitigated an assessment of federal civil penalties under the CAA.

Exxon urged the District Court to consider that the TCEQ had "conscientiously enforced the CAA" at the Baytown Complex throughout the compliance period being examined. The Sierra Club and Environment Texas argued on the other hand that the TCEQ had effectively mollycoddled Exxon, a large state employer and tax revenue generator.

Judge David Hittner followed the circuit court's instructions and entered judgment in favor of the environmental groups, finding that Exxon had violated the CAA by failing to comply with its Title V permits in numerous ways and on numerous occasions between October 2005 and 2013. The District Court assessed a record civil penalty for a citizen suit, in the amount of $19,951,278. Judge Hittner also stated his intention to award the groups' attorney fees and costs, "subject to the timely submission of proper documentation." Those legal costs, which were incurred over 7 years, are likely to add at least another $1 million to the final judgment.

In deference to Exxon's ongoing work with the TCEQ, the judge once again declined to grant injunctive relief, or to appoint a third party to oversee Exxon's continuing efforts to manage its Title V compliance.[9]

In support of the significant but still lesser penalty, the District Court found, among other things, no "credible evidence that any of the specific Events and Deviations were of a duration and concentration to—even potentially—adversely affect human health or the environment." The District Court also noted that Exxon had spent escalating amounts on its environmental compliance efforts every year since 2005. In 2005, it spent over $460 million and by 2013, over $680 million. Thus, Exxon's non-compliance was not due to a lack of effort or expense, but occurred despite its significant effort and expense.

The court also noted that Exxon's efforts resulted in declining facility emissions each year, and said it was a mitigating factor indicating that Exxon was working to achieve environmental benefits through better emission controls and reduced overall emissions. The court additionally found that the Baytown facility's overall emissions remained well below Exxon's state-imposed emission caps even in years when emissions violations occurred. The court also found that Exxon's close work with

the TCEQ on compliance initiatives, which preceded the environmental groups' lawsuit, was a significant factor.

In the end, Exxon will pay a nearly $20 million civil penalty to the federal Clean Air Fund, and reimburse the groups' attorney fees and costs.[10] The penalty is significant, certainly in the world of citizen suit awards, but it is a relatively modest assessment compared to what could have been imposed if Exxon had not been so proactive in its environmental compliance programs, or demonstrated its commitment to better managing its Title V permit requirements, through its close cooperation with the TCEQ and its significant financial commitments to the environmental compliance function.

While environmental groups will certainly crow for having driven a significant federal enforcement action, Exxon, like many publicly-traded companies with sophisticated environmental reporting programs is an easy target precisely because it is so transparent in recording events and deviations. It is at least a little ironic that the companies which hold themselves to the highest standards are most often the targets of these types of actions, while less scrupulous or sophisticated entities often fly under the radar screens of citizens groups and regulators alike.

But Exxon "won" this case by presenting credible evidence that it is aggressively working to maintain compliance with its permits, improve its overall compliance efforts and lower overall emissions from the facilities. While Exxon could not run from the violations, its conduct and responsible actions to address environmental compliance problems carried the day and resulted in a substantially reduced penalty exposure. While Exxon will certainly not be happy to pay the penalty, particularly given its preexisting financial commitment to compliance efforts, it is a very favorable outcome. But the litigation and its final outcome present several important take-aways for regulators and the companies they regulate:

1. Fundamentally, environmental com-pliance is important.

2. Self-reporting non-compliance can and will draw the attention of regulators and other potential antagonists. That said, self-reporting and "facing up" to noncompliance with regulators can help a permittee establish and maintain the credibility of its environmental compliance programs and help avoid harsher penalty outcomes.

3. Having and maintaining a capable and adequately-funded in-house environmental compliance staff and function is critical — the existence and performance of Exxon's staff contributed to a substantial reduction of its potential civil penalty exposure. Companies that seek to mitigate penalty awards have a stronger argument if non-compliance incidents occur despite their best efforts, rather than in the absence of them.

4. "Cutting a deal" with state environmental agencies, while important in and of itself, may not be enough to prevent "overfiling" by aggressive neighbors or groups seeking to act as citizen attorneys general. Also, some settlements — like court-approved settlements — may be better than others in foreclosing EPA overfilling or federal citizen suits.

5. State agencies need to appreciate and respect the significant risks and exposures their regulated companies face before they impose myriad recordkeeping and reporting requirements on permittees, since a permittee's failure to maintain a perfect record is a permit violation and potentially, a federal violation.

6. Federal civil penalties are orders of magnitude higher than state penalties, so there are legitimate reasons to work closely with state regulators to timely resolve non-compliance penalties at the state level before they are escalated by the EPA or citizen attorneys general. As seen in this case, Exxon's TCEQ settlements ultimately proved ineffective in foreclosing federal penalties, but the settlements were a substantial mitigating factor in the calculation of the federal penalty.

7. Self-reporting non-compliance in public filings under federal and state strict liability statutes like the CAA make "gotcha" cases relatively easy to file, so developing the "equities" supporting mitigation (or for citizens groups, enhancement) of the penalty calculation is important. Exxon appears to have done a stellar job introducing mitigating factors.

8. In-house environmental compliance managers must exercise some judgment in deciding what is and is not reportable and, where appropriate, adding contextual information for later use in mitigation arguments. Increasingly, these types of records are online forms that only allow for a "yes" or "no" response, with no option for explanation. This is a problem, and some consideration should be given to modifying in-house and online regulatory reporting forms (such as semi-annual compliance certifications and reports) to permit explanations. Where that option is not available, it is important for management to contemporaneously record in the company's own records explanatory notes.

9. Some records can be created after the fact, as long as it is noted that they were prepared at a later date. For example, some permits and regulations require the permittee to maintain an inspection log for certain pieces of equipment or an operational area. It is not

unusual for an inspection to take place without an accompanying log entry. Environmental health and safety managers should periodically check these logs to identify gaps in entries and attempt to ascertain whether the inspection was performed. If it was, an appropriate entry should be made, or an inspection report created. That said, any later-prepared inspection report or log entry must be noted as such so it is not inadvertently represented to regulatory authorities as a contemporaneous record. The detailed spreadsheets developed by the plaintiffs in the Exxon litigation capitalized on records, sometimes incomplete records, within Exxon's own files — this issue frequently is the focus of EPA Resource Conservation and Recovery Act inspections of regulated aboveground storage tanks or hazardous waste storage areas. So, accurate and complete records are important.

10. When a plaintiff, whether the EPA or a citizen attorney general, has inflated and unreasonable expectations in terms of litigation outcomes, it is impossible to avoid the burden and expense of a trial, and defense counsel must proceed on the expectation that it will try the case. While legal defenses to the claim that the facility is in violation are important (many of these cases rely on statutory strict liability provisions), mitigation issues are even more important, as seen in the Exxon case. In my experience, citizen groups file their notices and initiate their claims with laudable objectives like obtaining environmental compliance, but often with unreasonable expectation and demands, which include "voluntary donations" to like-minded organizations or layers of additional operational oversight. But more sophisticated organizations also generally are willing to work with targeted companies on plans that make sense and can even, in the long run, generate more good will for the company within the affected community.

NOTES

[1] *Environment Texas Citizen Lobby Inc. et al. v ExxonMobil Corp. et al.*, No. H-10-4969, 2017 WL 2331679, (S.D. Tex. Apr. 26, 2017). Named in the suit were ExxonMobil Corporation, ExxonMobil Chemical Co. and ExxonMobil Refining & Supply Co.

[2] Upon receipt of the 60-day notice letter, the EPA could have stepped in to file its own enforcement action, but it chose not to.

[3] *See U.S. v. Midwest Generation LLC*, 720 F.3d 644 (7th Cir. 2013).

[4] The shield does not automatically issue with every Title V permit the permit must expressly include one. EPA's implementing regulation found at 40 C.F.R. § 70.61(f)(12) provides that a Title V permit that does not expressly state that a permit shield exists shall be presumed not to provide such a shield.

[5] 42 U.S.C.A. § 7607.

[6] The bench trial commenced in early 2014, so plaintiffs' evidence extended up to the start of trial.

[7] At least one media report asserted that the groups had offered to settle the case before trial for a civil penalty of just over $40 million.

[8] *Env't Tex. Citizen Lobby Inc. v. ExxonMobil Corp.*, 824 F.3d 507 (5th Cir. 2016).

[9] In its remand decision, the District Court judge noted that the groups had not challenged his earlier decision to deny the requested injunctive relief in their 5th Circuit appeal.

[10] At the penning of this article, no appeals had been filed from the remand judgment.

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