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State Water Resources Control Board

Office of Chief Counsel

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Arnold Schwarzenegger
Governor

November 28, 2005

Chairman Schneider and Members of the
California Regional Water Quality Control
Board, Central Valley Region,
c/o Antonia K.J. Vorster, Supervising
Water Resources Control Engineer
11020 Sun Center Drive, #200
Rancho Cordova, CA 95670-6114

VIA E-MAIL

RE AGENDA ITEM 15, CONSIDERATION OF PROPOSED SETTLEMENT FOR AN
ADMINISTRATIVE CIVIL LIABILITY COMPLAINT CONCERNING HILMAR CHEESE
COMPANY, INC. AND HILMAR WHEY PROTEIN, INC., MERCED COUNTY,
COMMENTS OF PROSECUTION STAFF

Dear Chairman Schneider and Members of the Regional Board:

While Hilmar Cheese Company, Inc. and Hilmar Whey Protein, Inc. (collectively Hilmar) have already submitted a written response to the comments of the State Water Resources Control Board, Office of Statewide Initiatives, Prosecution Staff write separately to provide their own comments for the Regional Water Quality Control Board's (Regional Board) consideration. In addition, our comments address the October 1, 2003 Complaint Investigation Report (Report) that the Office of Statewide Initiatives asked be provided to you today. We have asked that copies of this letter be made available to the public.

October 1, 2003 Complaint Investigation Report and Comments of Kenneth Rodrigues

As an initial matter, the fact that you are receiving the Report only the day before your consideration of the proposed settlement agreement suggests a heightened significance to the Report that is inappropriate. You should be aware that the allegations set forth in the Report, as well as those set forth in Mr. Ken Rodrigues' comments, are not new to Prosecution Staff. In fact, these allegations were considered by the Attorney General's Office in its criminal investigation of Hilmar, concluded last July, and were also fully considered by Prosecution Staff in its evaluation of this case. Accordingly, the information provided through these documents does not change our evaluation of the settlement agreement or our recommendation that you approve it. Further, we believe that the allegations contained in the Report are adequately described in the document titled Additional Information Related to Settlement, provided to you together with other settlement documents on October 26, 2005.

California Environmental Protection Agency

Context in Which Settlement Agreement was Negotiated and Reached

Second, the public comments submitted on November 21, 2005 and echoed in the press are critical of the proposed settlement agreement and urge the Regional Board not to approve it. In order for you to evaluate the settlement agreement and the significance of the comments and the investigative report relative to the agreement, it is critical that you understand what we as Prosecution Staff considered in negotiating the settlement agreement and deciding to come before you to ask for your approval. After the Executive Officer issued the complaint in January 2005, we produced 13 boxes of documents obtained from Regional Board staff's computers, in addition to the regular administrative file maintained for this facility. We carefully reviewed these documents, prepared a privilege log of almost 100 pages in length, and reviewed and electronically scanned the public file. Hilmar deposed Regional Board staff, including the Executive Officer, for several days. We also received and reviewed six or more boxes of documents provided by Hilmar. What remains in the process of preparing for an evidentiary hearing is for Prosecution Staff to depose Hilmar's employees and experts on economic benefit, retain our own experts on economic benefit and make them available for deposition. Throughout this process, Prosecution Staff carefully considered and weighed relevant evidence and testimony, both favorable and unfavorable.

Prosecution Staff had the benefit of in-depth knowledge of the record when we decided to enter settlement negotiations with Hilmar. Neither the public nor the press shares comparable familiarity with the record. We also had the benefit of the Executive Officer's years of experience and judgment through this process. After engaging in six weeks of intense negotiations, we achieved a settlement agreement that we now recommend as an appropriate resolution of this matter. As with any settlement, the agreement reflects compromises by both sides. It also, however, reflects pragmatic concerns about the expense and uncertainty of the evidentiary process. Even if the Regional Board were to prevail in an evidentiary hearing at the administrative level, such an outcome will undoubtedly lead to protracted litigation, and additional expense and allocation of resources before the Regional Board recovers any money payment. Ultimately, Prosecution Staff's intimate knowledge of the record and professional judgment that provided the context for negotiations now also form the basis of our recommendation that you approve the settlement agreement.

While the Regional Board has not held a hearing in which the parties would present evidence to more fully develop the record, Prosecution Staff believes that you have enough information *submitted by both sides* to enable you to decide whether or not you think this settlement is appropriate and in the public interest. We encourage you to debate it and decide in your policy role whether you agree.

Response to Comments of the Office of Statewide Initiatives

Finally, we address the comments submitted by the State Water Board's Office of Statewide Initiatives.

1. Administrative Process

OSI states "The proposed settlement agreement requires unconditional approval of all elements of the agreement, thereby limiting consideration of specific elements of the agreement by the Regional Water Board. This approach does not make use of the existing administrative process for resolving an ACL Complaint via a hearing and issuance of an ACL Order, which would allow for full Regional Water Board consideration and participation in the final decision. This case has been a matter of public concern, and should be resolved through the regular public process established in the California Water Code." (OSI Comments, p. 2.)

While the terms of the settlement agreement were negotiated privately, as Hilmar explains in its November 23 response, the parties are hardly trying to avoid a public process. The public was notified of the availability of the settlement materials by mail and newspaper publication and the public was given more than 3 weeks to submit public comment. The parties are now asking for the Regional Board's public consideration and approval. While we hope that the Regional Board will approve the proposed settlement, the public notice for this meeting also contemplates that the Board may, as an option, provide some direction to prosecution staff. Accordingly, the Regional Board is not being deprived of "consideration and participation in the final decision." Prosecution Staff agree with Hilmar that this settlement is authorized by the Government Code, section 11415.60. Prosecution Staff also agree with Hilmar that the Settlement Agreement itself makes clear how it may be enforced.

2. Interim Limits

OSI points out that the proposed settlement agreement would allow for an increase in the flow limit and electrical conductivity limit beyond that allowed by Hilmar's current waste discharge requirements (97-206) and that these relaxed effluent limitations are proposed without reference to supporting legal authority. OSI asserts that the interim limits "appear to amount to a de-facto amendment of the WDRs. (OSI Comments, pp. 2-3.)

The proposed settlement agreement recognizes the discharge situation, including flow limit and electrical conductivity limits, as it exists today at the Hilmar facility with its current operations. This does not violate the California Environmental Quality Act nor does it violate the State Water Board's anti-degradation policy. The settlement agreement does not amend the waste discharge requirements but instead recognizes the status quo for an interim period that will allow the Regional Board to free up the resources to pursue new regulatory requirements to address the Hilmar facility operations on a going-forward basis. The settlement agreement identifies a date certain by which Hilmar must submit a revised report of waste discharge. The revised report of waste discharge will be the starting point for a public process to develop new regulatory requirements at the facility. The process of adopting new waste discharge requirements will

require CEQA compliance, compliance with the anti-degradation policy and all other applicable regulatory requirements.

3. Scope of Violations Covered

OSI states: "The proposed settlement agreement would cover virtually all past violations, including alleged violations associated with the Attorney General's criminal investigations. It would preclude action by the Regional Water Board even if new evidence is discovered with respect to the criminal investigation, and would prohibit the Regional Water Board from assessing liability for virtually all future violations until such time as the Board adopts new waste discharge requirements. We are deeply concerned with the precedent of granting immunity from civil liability for all such past and future violations." (OSI Comments, p. 4.)

Prosecution Staff concurs with Hilmar's November 23 response on this point but would add the following points. The Attorney General's Office concluded its criminal investigation in July 2005 and provided copies of investigative materials to the Regional Board for consideration in pursuing administrative enforcement. Prosecution Staff evaluated these materials, as it did those alleged by the October 2003 investigative Report, and determined it was appropriate to include them within the scope of the matters covered by the proposed settlement agreement. These allegations are described in the Additional Information Related to Settlement. As Hilmar correctly points out, the settlement agreement does not purport to release Hilmar from criminal liability. It should be clear that the settlement agreement does not purport to and cannot legally prevent any law enforcement agency from deciding to pursue criminal charges against Hilmar with regard to any allegation resolved by this settlement agreement.

While the Regional Board would be giving up its ability to impose additional civil liability for matters covered under the agreement, the settlement agreement was crafted to ensure that the Board retains all of its other regulatory tools, including injunctive relief to address odors, pollution or nuisance. This includes the ability to issue and enforce cleanup orders, including the December 2004 Cleanup and Abatement Order, or other enforcement orders, including cease and desist orders, at the site. Nothing about the agreement will preclude the Regional Board from requiring that Hilmar cleanup and abate the effects of any waste discharged at its site at any time.

4. Economic Benefit

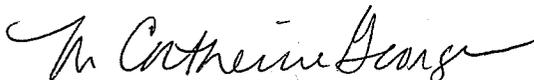
OSI states: "While recovery of the economic benefit is not mandatory in this case, the amount in the proposed settlement agreement is substantially less than the economic benefit conservatively estimated by Regional Water Board staff, estimated to be between \$3.54 million and \$22.2 million. A cursory analysis by State Water Board staff indicates that the actual economic benefit that Hilmar enjoyed as a result of the violations covered by the ACL Complaint could be as high as \$40 million. Since the Regional Board has not revised the estimated economic benefit based

on the expanded scope of the proposed agreement, it cannot fully consider the economic benefit as required. Approval of the proposed settlement agreement would not recover even the original estimated economic benefit. Unless the economic benefit the discharger has reaped from noncompliance is recovered, the incentive remains to incur future violations as a 'cost of doing business.'" (OSI Comments, p. 4.)

The Regional Board is not required to assess the economic benefit in this case. However, what is clear from OSI's comments and Hilmar's response is that we do not know what is the actual economic benefit to Hilmar from the alleged violations. There is a range of estimates of as high as \$40 million to as low as \$0, as Hilmar asserts. Moreover, the ACL Complaint issued by the Executive Officer proposed that liability be assessed at \$4 million. By asking you to approve this settlement agreement, Prosecution Staff is not asking you to determine what the actual economic benefit is or whether \$3 million adequately recovers the economic benefit. This is not an evidentiary hearing and were we to proceed to such a hearing, Prosecution Staff would first retain experts to help it evaluate the actual economic benefit to Hilmar. Instead we are asking you to determine based on all of the information before you whether the proposed settlement agreement is appropriate and in the public interest.

Thank you for your consideration of Prosecution Staff's comments.

Sincerely,



M. Catherine George
Senior Staff Counsel

cc: See next page

cc: **Via Hand Delivery**

Robert Schneider, Regional Board Chair
Karl Longley, Regional Board Vice-Chair
Paul Betancourt, Regional Board Member
Alson Brizard, Regional Board Member
Christopher Cabaldon, Regional Board Member
Dan Odenweller, Regional Board Member
Kate Hart, Regional Board Member
Linda Adams, Regional Board Member
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