

October 4, 2011

Dr. Len Peters, Cabinet Secretary  
Kentucky Energy and Environment Cabinet  
500 Mero Street  
5th Floor, Capital Plaza Tower  
Frankfort, KY 40601

Re: Intervenors' Comments on Agreed Order submitted in *Energy & Env't Cabinet v. Nally & Hamilton Enterprises, Inc.*, File No. DOW-42445-039

Dear Dr. Peters,

Pursuant to Hearing Officer Blanton's order dated September 15, 2011, Intervenors Appalachian Voices, Kentuckians For The Commonwealth, Waterkeeper Alliance, Kentucky Riverkeeper, and Ms. Pat Banks in her capacity as the Kentucky Riverkeeper hereby submit the following objections to the proposed Agreed Order entered by defendant Nally & Hamilton Enterprises, Inc. (Nally) and plaintiff Energy and Environment Cabinet. Intervenors object to the Agreed Order, and it should not be entered. The Secretary does not have enough information before him to inform a decision that this Agreed Order was based on a reasonable investigation of the violations or that it will remedy past violations and deter violations in the future. Intervenors request that this case be returned to the Office of Administrative Hearings for further elaboration by the Cabinet on its investigation, and the factors that led it to sign this Agreed Order, and/or further discovery on these issues by Intervenors.

For at least the past five years, Nally has been submitting false and incomplete reports to the Cabinet regarding the pollution discharged from its mining operations into Kentucky waterways. The Cabinet never detected these violations. Intervenors brought these violations to light for the first time in March 2011. Subsequently, the Cabinet filed a complaint against Nally in the Office of Administrative Hearings alleging these and other violations. The Cabinet never prosecuted the case, however, and seems always to have planned on settling it. Without even attempting to involve Intervenors in the negotiations (although Intervenors were full parties to the case by July 2011), the Cabinet and Nally negotiated and ultimately signed an Agreed Order purporting to resolve not only the violations in the Complaint but also tens of thousands of additional, unspecified violations.

The Agreed Order was negotiated in secret, and to date the Cabinet has provided no responses to Intervenors' discovery requests in this case. The Secretary therefore lacks the most basic information necessary to inform an evaluation of the Agreed Order, such as what factors the Cabinet considered in reaching the agreement with Nally. *See* K.R.S. § 13B.150(2)(d) (court may reverse a final order of the agency if it is arbitrary or capricious); *Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (agency's failure to examine the relevant data is a factor in determining whether decision is "arbitrary," and agency must "articulate a satisfactory explanation for its action"). The Secretary also does not have the most important underlying facts relevant to the Agreed Order, because there has been little to no investigation or discovery regarding those facts. For instance, as discussed below, the Cabinet seems not to have investigated the possibility that Nally's violations were the result of intentional fraud, and there is no evidence that the Cabinet calculated what civil penalty amount is necessary to deter future violations. These facts are crucial to evaluating whether the Agreed Order is reasonable and fair, or instead arbitrary and ineffective.

Although this missing information makes it impossible to evaluate fully the adequacy of the Agreed Order, the Order is also deficient on its face. First, the Agreed Order does not list or even describe what violations are being resolved, referring to some of them only as the same "types" of violations listed in the Complaint. It isn't clear the Cabinet even knows what violations this settlement would resolve. The Agreed Order also leaves most remedial measures completely undefined, requiring only that Nally submit *proposed* remedial measures 30 days *after* the Agreed Order is entered. This makes it impossible to determine whether those remedial measures will fix Nally's violations. Finally, the so-called "stipulated penalties" in the Agreed Order are ineffectual because they are discretionary, and thus may never even be assessed by the Cabinet.

Nally's violations were egregious, affected all of its mining operations, and have been going on for at least five years undetected by the Cabinet. Kentucky citizens deserve to know the truth about the cause of these violations, and how a coal company could get away with filing patently false discharge reports year after year. At least, before the Agreed Order is entered the Cabinet should provide evidence that it investigated the relevant facts and circumstances before deciding to settle this case behind closed doors.

## BACKGROUND

Nally owns and operates coal mining facilities in eastern Kentucky that discharge polluted water into tributaries of the Kentucky and Cumberland Rivers. Under the federal Clean Water Act, citizens may sue dischargers who violate the Act or permits issued under the Act. 33 U.S.C. § 1365(a), (f). Before suing, citizens must first send the discharger a “notice letter” outlining the violations. *Id.* § 1365(b). On March 9, 2011, Intervenors sent Nally a notice letter stating their intent to sue for multiple violations of the terms of Kentucky’s Coal General Permit. Intervenors had discovered, by analyzing data received from the Cabinet through Open Records Act requests, that Nally had repeatedly filed false and incomplete discharge monitoring reports (DMRs) regarding the pollutants discharged from Nally’s mining operations. For instance, Nally submitted many reports containing data that exactly repeated data already submitted in a prior month. Intervenors sent copies of this letter to DOW.

On May 6, 2011, in response to Intervenors’ notice letter, the Cabinet initiated this proceeding by filing the Administrative Complaint against Nally. The Complaint details many of the same permit violations described by Intervenors in their notice letter, including the repeated, false data. The Cabinet only discovered these violations after receiving Intervenors’ notice letter. *See* Agreed Order ¶¶ 5-7 (on or about March 9, the Cabinet was served with Intervenors’ notice letter; on or about March 17, and between March 14 and April 26, the Cabinet reviewed DMRs submitted by Nally). The Cabinet began negotiating a settlement with Nally in April—before it even filed the Complaint. Agreed Order ¶ 13. Intervenors were never included in those negotiations.

Intervenors moved to intervene in the administrative proceeding, and were granted full party status on July 7. *See* July 7, 2011 Order, attached here as Exhibit 1. Shortly thereafter, Intervenors propounded discovery requests on Nally and the Cabinet in order to determine facts relevant to the Cabinet’s allegations, Nally’s alleged defenses, what caused Nally’s violations of the law, and the appropriate civil penalties and remedies. Nally partially responded to these discovery requests. The Cabinet, however, provided no discovery responses. Although the Cabinet’s responses were due by August 23, 2011, the Cabinet simply emailed Intervenors on that day saying that it was refusing to respond to Intervenors’ requests because settlement negotiations with Nally were “currently ongoing.” *See* Exhibit 2. The Cabinet took this unilateral action despite the fact that there is no provision in any of the administrative regulations

allowing a party to violate discovery obligations simply because settlement negotiations are “ongoing.”

On August 23, Intervenors sent a new notice letter to Nally, copying DOW, which outlined additional permit violations committed by Nally over the past five years.

On August 30, the Cabinet and Nally filed a joint motion requesting a continuance of all litigation activity on the basis that they would soon submit an Agreed Order to resolve the violations alleged in the Complaint. They did not file the Agreed Order until September 6. The Agreed Order purports to resolve “the claims asserted in the Administrative Complaint” as well as “the same types of claims that were revealed upon the Cabinet’s review of DMRs submitted for all of Nally’s other operations,” including “the claims asserted in the two Notice of Intent to Sue letters from Intervenors.” Agreed Order ¶ 19.

On September 15, Hearing Officer Blanton granted Nally and the Cabinet’s motion for a continuance of litigation activity. He also granted Intervenors the opportunity to file these objections, on the consent of all parties, in order to allow consideration of the objections by the Secretary. *See* September 15, 2011 Order at 4-5, attached here as Exhibit 3.

### **THE AGREED ORDER SHOULD NOT BE ENTERED**

#### **The Agreed Order Was Negotiated Behind Closed Doors**

The Cabinet and Nally conducted their settlement negotiations behind closed doors. Intervenors were not alerted to the negotiations until August 23, and then only to be told that the negotiations were nearly final, so the Cabinet would not be producing discovery responses. Exhibit 2. Intervenors were never invited to participate in the negotiations, even though Hearing Officer Blanton expressly encouraged such participation, *see* Exhibit 1 at 7-8 (strongly encouraging that a full settlement be reached between all parties, “including the Intervening Plaintiffs”), and even though Intervenors expressly asked to be included, *see* Exhibit 4.

Intervenors’ expertise and interest in this case would have aided in the negotiation of an effective and reasonable settlement. It was the investigation by Intervenors that led to the discovery of these violations in the first place. Intervenors’ only interest in this case is protecting the public health and natural resources of Kentucky citizens from water pollution.

The Cabinet’s decision to conduct its negotiations in secret is emblematic of why the Agreed Order is irretrievably flawed. The Cabinet has tried to settle this case without public

scrutiny, without providing Intervenors or the public any information about the case, the violations, or its own investigation (if any) into the underlying cause of the violations, and without giving substantive explanations or support for why the terms of the Agreed Order are reasonable and will effectively deter future violations. This secrecy is especially inappropriate under the circumstances of this case, where the Cabinet itself became part of the problem by failing to detect Nally's violations for at least the past five years. Public scrutiny and the participation of Intervenors are especially needed here.

**The Secretary Cannot Make an Informed Evaluation of the Agreed Order  
on the Current Record**

The Cabinet and Nally have refused to provide, through discovery or otherwise, the information necessary to make an informed evaluation of the Agreed Order. The Secretary therefore should not enter the Agreed Order until further discovery can be had with regard to the cause of Nally's violations and why this settlement will fix past violations and deter future violations. At least, the Secretary should not enter the Agreed Order before receiving a factually-supported explanation from the Cabinet on those issues. To enter the Agreed Order without such information would be arbitrary, because there would be no basis for finding the Agreed Order a reasonable solution to Nally's violations.

**No evidence the Cabinet investigated intentional misreporting:**

There is no evidence that the Cabinet investigated whether Nally's tens of thousands of reporting violations were committed intentionally. In fact, it seems the Cabinet simply took Nally's word for it with regard to what happened. The Agreed Order, as well as a memorandum of law submitted by Nally, suggest that the Cabinet's "investigation" of the cause of the violations consisted of the Cabinet accepting Nally's self-serving explanation in the form of an affidavit written by one of its lab's employees, Ms. Rebecca Monhollon. *See* Agreed Order ¶ 13 ("Nally provided the Cabinet with information as to the causes of" its violations); Reply Memorandum in Support of Motion for Continuance at 6, attached here as Exhibit 5 ("The point is the Cabinet has already conducted its investigation. Nally provided appropriate explanations to the Cabinet in response to the Cabinet's inquiries as to how certain transcription errors were made by its laboratory as were set forth in the Affidavit of Rebecca Monhollon ...").<sup>1</sup>

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<sup>1</sup> The Cabinet did conduct a Performance Audit Inspection of Nally's lab, but that was in November 2010, before the Cabinet learned of the vast majority of Nally's reporting violations, such as the repetitions of data from month to month.

According to Ms. Monhollon, the problems with Nally's DMRs were the result of "unintentional transcription error[s]." Monhollon Affidavit ¶ 14, attached here as Exhibit 6. Specifically, the lab would use an older month's DMR as an electronic template for creating a later month's DMR for the same outfall; if the lab employee changed the date but forgot to update the template with new effluent data from the bench sheets, the old data set—already submitted for a prior month—would accidentally be submitted again under a new date. Exhibit 6 (Monhollon Aff.) ¶ 15.

Ms. Monhollon's affidavit, however, cannot explain all of the irregularities in Nally's DMRs and bench sheets. Many of those irregularities are strongly suggestive of intentional misreporting.

For instance, some of the violations detailed in Intervenors' August 23 notice letter cannot be explained by Ms. Monhollon's affidavit. According to the affidavit, a "previous quarterly report" for a given outfall is sometimes used as a template for a later quarterly report, and the lab simply forgets to "delete the previous month's data, and replace it with new data." Exhibit 6 (Monhollon Aff.) ¶ 15. That does not explain, however, how effluent data from one outfall would end up on the DMR for an entirely different outfall—which happened repeatedly. *See* August 23 Notice Letter, attached here as Exhibit 7. The DMR for one outfall should not be used as a template for a different outfall, because nearly all of the information on the DMR would need to be changed—the mine name, the receiving water name, the permit numbers, the latitude and longitude of the outfall, and so forth, as well as the effluent data. But as shown in the attached examples, Nally submitted DMRs for two different outfalls in which all of that information about the outfall was changed, and only the effluent data (and Nally's name and address) remained the same. Exhibit 8. This strongly suggests intentional misreporting. If someone used one outfall's DMR as a template for another outfall, it is not credible that he or she would "accidentally" forget to change the effluent data while at the same time "remembering" to change nearly every single other piece of information on that DMR.

Nally's bench sheets also provide evidence of intentional misreporting. Bench sheets are the documents supposedly created in the lab that contain a hand-written account of the lab's water sampling and testing results. The information on the bench sheet is then supposed to be transcribed onto the electronic DMRs, which are submitted to the Cabinet. Exhibit 6 (Monhollon Aff.) ¶ 8. Nally claims that "[e]ach of the bench sheets demonstrates that proper sampling and

analysis was conducted,” Exhibit 6 (Monhollon Aff.) ¶ 16, even if the bench sheet information was never properly transcribed onto the DMRs.

At least some of Nally’s bench sheets contain patently false numbers, however, and may have been intentionally fabricated. For example, Nally has produced hand-written bench sheets from May 2008 for permit number 897-0441, outfall 16, that contain effluent data that match exactly the data in an electronic DMR submitted to the Cabinet for the month of February 2008. *See* Exhibit 9. (The February DMR would have been submitted in April 2008, after the end of the first quarter.) This means someone at Nally’s lab wrote the May bench sheets by hand, dated them May 2008, but filled the bench sheets with data entirely unrelated to May discharges—data that had already been submitted to the Cabinet in April, a month before the May discharges even occurred.

Intervenors provided the February 2008 DMR with their brief to the Hearing Officer opposing the motion for a continuance. Nally’s response was nothing short of remarkable. Along with its reply memorandum of law in support of the continuance, Nally produced an entirely different DMR for February 2008 than the one that was on file with the Cabinet (and which was obtained by Intervenors through Open Records Act requests). *See* Exhibit 5 (Reply Memorandum of Law), at Exhibit 4 thereto. On Nally’s new version of its February 2008 DMR, outfall 16 reported having no flow (“Flow, 0”). *Id.* Nally did not explain how the DMR in its files came to be different from the DMR on file with the Cabinet, which had supposedly been submitted by Nally.

This glaring discrepancy requires further investigation. Nally and the Cabinet, however, advocate for entry of the Agreed Order with no further explanation and no discovery into this or any other issue in the case, preferring instead to sweep problems like this under the rug. *See* Exhibit 5 (Reply Memorandum of Law) at 6 (concluding its discussion of the unexplained, discrepant DMRs by saying: “The point is the Cabinet has already conducted its investigation”). This reluctance is understandable, given that one or both of them is clearly at fault. But the Secretary should not allow these parties to close the book on egregious problems without any investigation or assurances that such problems will be fixed.

Nally’s bench sheets reveal other serious problems as well. For starters, a number of Nally’s bench sheets match each other. *See, e.g.,* Exhibit 10 (5/6/09 bench sheet matching 5/21/09 bench sheet; 4/10/09 bench sheet partially matching 7/10/09 bench sheet). Matching,

hand-written bench sheets obviously cannot be explained by Ms. Monhollon's defense of accidentally forgetting to update data in electronic DMR templates. Instead, someone wrote down the same effluent data twice, onto two bench sheets, and gave those bench sheets two different sampling dates. Whatever he or she was using as the basis for those numbers, it could not have been actual test results matching those sampling dates. In at least one instance, *see* Exhibit 10, the matching bench sheets are dated months apart: some parameters on the 4/10/2009 bench sheet match those on the 7/10/2009 bench sheet. It is difficult to conceive of an innocent explanation for such matching numbers.

There are other irregularities on the bench sheets as well. For instance, for permit 807-0307, Nally produced bench sheets dated July 11 and July 14 that are identical other than the dates; it appears someone turned the "11" on one bench sheet into a "14" on the other. Exhibit 11. For permit 866-0311, there is a bench sheet that is meant to contain data for 7/29/09 (it matches the 7/29/09 DMR), but it is labeled "7-29-10." Exhibit 11. This misdating is consistent with someone writing the bench sheet years after the fact (perhaps copying down information from the DMR itself), and forgetting to back-date to the correct year. For permit 861-0479, there is a bench sheet dated "4-31-10," even though that date doesn't exist (April only has 30 days). Exhibit 11. It appears this bench sheet used to say "5/1/10," but that date was crossed out and "4-31-10" entered. Perhaps the lab failed to take an April sample and as a result, backdated a May 1 sample with a non-existent April date.

In addition to the bench sheets, there are also emails between Nally employees and lab personnel that suggest Nally submitted reports it knew could be false. For instance, there is an email between a Nally employee and its lab where the Nally employee writes that he will "go ahead and turn these in but ponds 2 and 9 probably flow when it rains." Exhibit 12. This email suggests that Nally turned in a DMR that said "no flow" for certain ponds despite the fact that Nally knew the ponds "probably flow" when it rains, and thus would be discharging pollution that month. Another example is an email from a lab employee to Nally saying, "I had this one as a flow and I took it off because I thought you said it was not flowing." Exhibit 12. This suggests that the lab does not actually have any idea which ponds are flowing (and thus discharging pollution) or not. Even though in this instance it seems the lab had some reason to think the pond was flowing ("I had this one as a flow"), the email suggests that it changed some report to reflect that it was not flowing, simply because Nally said so. These emails require



further investigation into Nally and the lab's practices, to see whether Nally and the lab were knowingly failing to monitor discharges.

There are also discrepancies between Cabinet-issued inspections of non-compliance and DMRs submitted by Nally. These discrepancies provide evidence that Nally either knowingly failed to monitor its discharges or knowingly failed to report actual discharges. For instance, an inspection of non-compliance issued by the Cabinet's Department for Natural Resources states that on March 27, 2009, one of Nally's outfalls was discharging water that did not meet effluent limitations criteria. Exhibit 13. That inspection report attached a photograph, taken on March 27, of the sub-standard discharge flowing from the outfall. *See id.* Yet Nally submitted a DMR which said—for that very same outfall, and on that very same day (March 27, 2009)—that there was nothing at all flowing out of the outfall that day. Exhibit 13. Because there is documented proof from the State that this outfall was not only discharging, but was discharging water at illegal pollution levels, the fact that Nally still submitted a “no flow” report for that same day suggests that there was intentional falsification of its DMRs.

Intervenors have seen nothing to suggest that the Cabinet investigated or even noticed any of these problems. But without understanding the true cause of Nally's violations it is impossible to know what will fix them, and therefore it is impossible to know whether the Agreed Order will be effective. For instance, if Nally's violations were intentional and the bench sheets were falsified, no amount of “double-checking” the DMRs will fix these violations going forward. Higher penalties would also be needed to deter and punish intentional violations.

No evidence the Cabinet investigated discharge violations:

The Cabinet also seems not to have considered or investigated the possibility that Nally's reporting violations masked serious discharge violations. As described above, the bench sheets are not a reliable indicator of the amount of pollution Nally has been discharging over the years. Even if the bench sheets were not intentionally falsified, there is plenty of evidence that Nally's sampling and testing were woefully inadequate. For instance, in November 2010 the Cabinet conducted a Performance Audit Inspection of Nally's lab. Among other deficiencies, the Cabinet found the following:

- There was no documentation that the pH or conductivity meters used by the field samplers were calibrated. (PAI Summary of Findings, at 5, attached here as Exhibit 14)

- The chain-of-custody and bench sheet forms used by the lab “do not meet the required standards.” (Exhibit 14 (PAI Summary of Findings) at 6)
- The bench sheet template “was deficient in several areas.” (Exhibit 14 (PAI Summary of Findings) at 7)
- The lab’s method of sample and data handling “is not acceptable” and “[i]nadequate quality assurance during the sample handling and analysis process can bring the validity of the resulting data into question.” (Exhibit 14 (PAI Summary of Findings) at 7)

Most significantly, DOW gave Nally’s lab “blind” water samples that contained predetermined quantities of different pollutants, and asked the lab to test for those pollutants. The lab’s test results were “unacceptable” for three out of the seven parameters. Exhibit 14 (PAI Summary of Findings) at 13. For example, the sample contained 28.6 mg/L of Total Suspended Solids (TSS). The “acceptable” range of results would have been 21.2 to 36 mg/L. The result obtained by Nally’s lab was 7 mg/L. Exhibit 14 at 13. If this water sample had been a discharge from Nally’s mines, the lab would have underreported the pollutant TSS by 75%.

Despite these glaring indications that Nally’s lab has been producing a highly inaccurate picture of Nally’s discharges, the Cabinet seems to have made no further effort to determine whether Nally’s reporting violations masked serious discharge violations. Although it is impossible to go back in time and sample past discharges, the Cabinet could have tested current discharges, which would at least give an approximation of past discharges. The Cabinet did not do so, as far as Intervenors are aware.

In July, Intervenors attempted to perform such tests themselves. They filed a discovery request with Nally to do split sample tests at some of Nally’s mines. *See* Request for Entry, attached here as Exhibit 15. Intervenors requested that a sample of water be collected from certain of Nally’s outfalls so that the sample could then be “split” with half tested by Intervenors and half tested by the lab. If a comparison of the results showed that the lab was seriously underreporting Nally’s pollution, and that the discharges were above legal limits, this would be probative evidence that the lab’s reporting violations in the past masked discharge violations.<sup>2</sup>

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<sup>2</sup> Nally resisted this discovery and Intervenors moved to compel. Although the Hearing Officer denied the motion to compel because he had already granted the Cabinet and Nally’s motion for a continuance of litigation activity, he did so without prejudice, noting that this ruling was “certainly not on the substantive merits of the motion.” Exhibit 3 (September 15 Order) at 6.

Obtaining this information is necessary to evaluate the reasonableness and effectiveness of the Agreed Order. If the reporting violations masked discharge violations, that would make it even more likely that the reporting violations were intentional. It would make the violations more serious and dangerous, and warrant higher civil penalties. It would also warrant different remedial measures directly addressed to sampling and testing procedures.

There is no indication the Cabinet calculated the amount needed to deter violations:

Deterrence should be the primary goal in assessing a civil penalty. But there is no evidence that the Cabinet calculated what civil penalty amount would be needed to deter future violations. To make such a calculation, the Cabinet would need to know at least (1) how much money Nally saved by violating its permits, and (2) how much of an impact the \$507,000 fine will have on Nally's finances. If complying with the law would have cost Nally more money than violating its permits and paying this fine, the fine will be worthless as a deterrent. If the fine makes a negligible impact on Nally's bottom line, it is also unlikely to be a good deterrent of future violations.

One measure of Nally's cost-savings from violating its permits is available: the difference between what Nally paid its lab before 2011 and what it is paying its lab now. Based on the lab's invoices, *see* Exhibit 16 attached here, it seems that the Cabinet's Performance Audit Inspection in November 2010 precipitated a large jump in the amount the lab charged Nally for water analysis. This was presumably because after the PAI, the lab increased its efforts to comply with permit requirements and regulations, and more compliance costs more money. In 2006, Nally paid around \$3,300 per month for water analysis. Exhibit 16. In 2010, before the PAI, Nally was paying around \$4,000. *Id.* But in December of 2010 and 2011, the monthly payments jumped to \$6,500. *Id.* Nally's non-compliance therefore appears to have saved the company at least \$2,500 per month since 2001 (when it began using the lab), which totals \$300,000. This amount does not take into account a number of other cost savings, including the rate of return for Nally on saving that money over ten years and any penalties Nally avoided paying over the years as a result of the lab potentially covering up permit limit exceedences. The true savings to Nally from violating its permit were therefore likely much higher than \$300,000.

The Cabinet has also provided no explanation for why the settlement amount should be such a tiny fraction of the maximum allowable penalty. Under Kentucky law the maximum penalty for each of Nally's violations is \$25,000 "for each day during which such violation

continues.” K.R.S. § 224.99-010. The Cabinet states that its Complaint alleged 4,630 violations. Agreed Order ¶ 11. If each of these violations was counted as only one day each,<sup>3</sup> and even if the Agreed Order were only resolving the violations listed in the Complaint, that would mean a maximum penalty amount of \$115,750,000. The civil penalty assessed (\$507,000) amounts to 0.4% of that maximum.

But the Agreed Order actually attempts to resolve many more violations than the 4,630 listed in the Complaint. In fact, Nally and the Cabinet claim that the Agreed Order covers all similar “types” of violations, in all of Nally’s mines, apparently going back at least five years. *See* Agreed Order ¶ 19; K.R.S. § 413.120 (five year statute of limitations). Nally has stipulated that “it fully expected the same types of . . . issues that were alleged in the Administrative Complaint occurred at its other surface coal mining operations.” Agreed Order ¶ 14.

The Complaint addressed violations at 16 of Nally’s mines over the course of three years (2008, 2009, and 2010). The Agreed Order, by contrast, covers 66 mines and at least five years. If 16 mines over three years resulted in 4,630 violations, as the Cabinet alleged in its Complaint, that would equate to roughly 96 violations per mine, per year. Using this estimate, 66 mines and 5 years would result in 31,680 violations—which is the approximate number of violations apparently addressed by the Agreed Order. The maximum penalty for these 31,680 violations, assuming only one day of violation each, would be \$792,000,000. The civil penalty actually assessed (\$507,000) is a minuscule percentage of that maximum: 0.06%.

To further illustrate the inadequacy of the fines and remedial measures in the Agreed Order, we have created a chart comparing it to other recent Clean Water Act settlements entered between the United States EPA and other coal companies. *See* Table attached here as Exhibit 17. The fines in these EPA settlements range from \$4 million to \$20 million, and the number of violations resolved range from 400 to 4,500. (Further information on these settlements and links to the consent decrees can be found at <http://cfpub.epa.gov/compliance/cases/index.cfm>.) The Agreed Order doesn’t come close to achieving what is achieved by any of these consent decrees, despite the fact that each of those coal companies committed fewer violations than Nally.

Intervenors are not advocating for the maximum penalty amount always to be assessed in every case. But the Cabinet has made a dramatic downward departure from the maximum

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<sup>3</sup> The Cabinet refused to respond to Intervenors’ request regarding how many days the Cabinet asserts Nally has violated the law.

penalty amount, while providing no explanation as to why this departure is reasonable and appropriate and why this fine will provide an effective deterrent against future violations. The Agreed Order should not be entered, and the matter should either be returned to the Cabinet with instructions to provide an explanation for why the settlement is adequate, appropriate, and in the public interest, or returned to the Hearing Officer for a continuation of discovery. It would be arbitrary for the Secretary to endorse this settlement while lacking the most basic information necessary to determine whether it: (a) is based on a reasonable and thorough investigation, (b) adequately remedies past violations, and (c) will meaningfully deter future violations.

**Certain Provisions Of The Agreed Order Are Unreasonable On Their Face**

It is not clear that the Cabinet knows how many violations are being resolved:

Paragraph 19 is the only part of the Agreed Order that purports to describe which of Nally's violations are being resolved. That paragraph makes clear that the settlement is meant to function as a shield to protect Nally from future enforcement, not just a sword to enforce the laws Nally has broken. Nally admitted that "it fully expected" that "the same types of DMR monitoring, testing, recordkeeping, and reporting issues" alleged in the Complaint would have occurred at all of its 66 mining operations. Agreed Order ¶ 14. As a result, the Cabinet and Nally have now reached a settlement not only of the claims in the Complaint, but also "the same types of claims that were revealed upon the Cabinet's review of DMRs submitted for all of Nally's other operations covered by permits listed in Appendix A." Agreed Order ¶ 19. (Appendix A lists all 66 of Nally's mining facilities, *see* Agreed Order ¶ 11.)

This vaguely-worded paragraph does not say that the Cabinet actually discovered any particular number of additional violations at Nally's other mines, and it certainly does not purport to list or describe those violations. These other violations are said to "include"—but are not limited to—the claims in Intervenor's notice letters and violations listed in Notices of Violation attached to the Agreed Order. Agreed Order ¶ 19. It seems, therefore, that the Cabinet may not even know what violations it is resolving in this Agreed Order. Nonetheless, the Agreed Order attempts to absolve Nally of any further penalties for such violations, as long as they are the same "type" as those in the Complaint. This Agreed Order inappropriately attempts to shield Nally from further prosecution for violations that the Cabinet may not have investigated or discovered and that are, in any event, undisclosed to the public.

Remedial measures left to future development:

There are effectively no remedial measures proposed in the Agreed Order. The Cabinet and Nally instead describe steps that Nally should take, after the Secretary signs the Agreed Order, to *develop* remedial measures. *See* Agreed Order ¶¶ 22-23. Specifically, Nally will be required to review its current procedures and then prepare a corrective action plan (CAP) that will be submitted to the Cabinet within thirty days of entry of the Agreed Order. Agreed Order ¶ 22. The CAP must contain and address a number of issues, including “procedures” Nally will implement to achieve compliance, “practices” to confirm that DMRs will contain complete and accurate information, and “processes” to confirm that information provided on future DMRs is consistent with agency policy. *See* Agreed Order ¶ 22(a)-(f).

None of these “practices,” “processes” or “procedures” is actually spelled out or detailed in any way. Development of those crucial elements is left entirely up to Nally. Although the Cabinet need not approve Nally’s proposed CAP, if the Cabinet fails to respond to it within 30 days the CAP becomes effective by default. Agreed Order ¶ 23. Nally has, in effect, been told to develop its own remedial measures, which is absurd—like a prosecutor entering a plea bargain that allows the defendant to decide his own prison term. Nally has been violating its permits for at least five years; there is no basis to think it can now be trusted to fix its own problems. Likewise, the Cabinet has failed to detect those violations for at least five years, and there is no reason to assume it will provide appropriate oversight of Nally’s hand-crafted solutions.

The table reproduced in Exhibit 17 compares this lack of remedial measures in the Agreed Order to the specific remedial measures required of other coal companies in recent Clean Water Act settlements. The settlements entered by EPA include up to \$200 million worth of remedial measures, and specifically enumerate and require many actions to fix compliance problems. These include:

- constructing a wastewater treatment plant that includes pretreatment, reverse osmosis, evaporation and/or crystallization technologies, and relocating discharges from two mines to another river where the discharges will comply with permit limits;
- implementing a compliance management system, requiring an audit to evaluate the adequacy of that system, requiring an initial treatment system audit as well as an internal audit of all mines on a regular basis, requiring outlet inspections at least twice a month to identify problems, requiring annual third-party audits at each facility, implementing an

electronic data tracking and notification system, and implementing a violations response plan that includes daily monitoring and treatment;

- implementing an environmental management system including a database to track information, requiring internal and third-party compliance audits, requiring response actions for future violations, requiring annual training for all individuals with environmental responsibilities, and implementing five stream restoration projects; and
- implementing an electronic tracking system, requiring internal and third-party audits, requiring employee training, testing downstream from ten different outlets per year, implementing 20 stream remediation projects, and setting aside 200 acres of riverfront land for conservation.

The so-called remedial measures proposed in the Agreed Order contain nothing close to these items. The Secretary should not accept the Agreed Order because it essentially contains no mandatory remedial measures, and there is no indication that leaving Nally to develop its own remedial measures will prove at all effective in remedying past violations or preventing future violations from occurring.

Stipulated penalties are discretionary, too low, and end too soon:

Although the Agreed Order purports to lay out stipulated penalties for future violations by Nally, the stipulated penalties are toothless because the Cabinet, in its discretion, may not even assess them. Moreover, the amounts of the stipulated penalties are too small, and they remain in effect for too short a time. *See* Agreed Order ¶ 32.

First, the stipulated penalties all state that the Cabinet “may” assess the penalty in the event Nally commits another violation—not that it “shall” assess the penalty. Agreed Order ¶ 32(a)-(d); *see also* Agreed Order ¶ 33 (“The Cabinet may, in its discretion, waive stipulated penalties that would otherwise be due.”). This means no stipulated penalty may ever actually be assessed. Knowledge of that fact, combined with the Cabinet’s history of lax enforcement, is sure to dampen any deterrence effect that legitimate stipulated penalties would otherwise have had on Nally.

Second, the stipulated penalty amounts are extremely small. For instance, for each “effluent limitation exceedance related to the Agreed Order,” a stipulated penalty of \$1,000 per violation “may be assessed.” Agreed Order ¶ 32(c). By contrast, EPA’s recent settlement with Arch Coal (attached here as Exhibit 18) *began* with fines of \$1,000, but contained graduated

penalties such that the fines will increase from \$1,000 up to \$10,000 for violations that are not fixed within a certain amount of time (for monthly average violations, the fines go up to \$20,000). Exhibit 18 ¶ 95. By contrast, the Agreed Order's stipulated penalties remain \$1,000 no matter how many times Nally violates its effluent limits.

Third, the stipulated penalties may only be valid for one year after the Agreed Order is entered, if Nally is deemed to have complied with the order during that time. *See* Agreed Order ¶ 45 (stating that the Agreed Order "shall terminate" upon Nally's completion of all requirements and compliance for a period of one year after entry). By contrast, EPA's recent settlement with Arch Coal will not terminate until at least four years after the defendant's "continuous satisfactory compliance" with the terms of the decree. Exhibit 18 ¶ 136.

Installment payments make the fine too lenient:

The Cabinet, finally, has provided no explanation for its decision to allow Nally to pay its civil penalty in four installments, with the last payment not due for a full year and a half after the Agreed Order is entered. Agreed Order ¶ 30. There is no provision for the Cabinet to collect, on behalf of Kentucky citizens, any interest on the unpaid balance while Nally takes a year and a half to pay the full fine. This is essentially a reduction in Nally's fine by an amount equal to the interest Nally can earn on that money over a year and half. Before signing any Agreed Order with this provision the Secretary should at least require the Cabinet to provide some explanation for its decision to allow Nally to pay its fine in installments, without paying interest.

**CONCLUSION**

The Secretary should not enter the Agreed Order. This case should either be remanded to the Cabinet to compel an explanation as to why the Agreed Order is based on a reasonable and thorough investigation, why it adequately remedies past violations, and how it will meaningfully deter future violations, or else it should be remanded to the Hearing Officer for the continuance of fact discovery on those issues.

Kentucky citizens deserve to know the truth about what led to Nally's tens of thousands of violations, and why this Agreed Order will fix those violations and protect the safety of their streams and rivers. They deserve to know whether the Cabinet represented their interests in coming to this agreement.



Respectfully submitted,



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## EXHIBIT LIST

- EXHIBIT 1: July 7, 2011 Order in *Energy & Env't Cabinet v. Nally & Hamilton Enterprises, Inc.*, File No. DOW-42445-039
- EXHIBIT 2: Email from Cabinet regarding discovery (Aug. 23, 2011)
- EXHIBIT 3: September 15, 2011 Order in *Energy & Env't Cabinet v. Nally & Hamilton Enterprises, Inc.*, File No. DOW-42445-039
- EXHIBIT 4: Letter from Intervenors regarding settlement negotiations (July 13, 2011)
- EXHIBIT 5: Nally's Reply Memorandum of Law on Continuance Motion (Sept. 13, 2011) (*excerpt*) and Exhibit 4 to Memorandum
- EXHIBIT 6: Affidavit of Rebecca Monhollon (April 29, 2011)
- EXHIBIT 7: Intervenors' August 23, 2011 Notice Letter
- EXHIBIT 8: Sample Nally DMRs (807-0347 and 807-0355, February 2011)
- EXHIBIT 9: Nally 1st Quarter 2008 DMR for 897-0441 (*excerpt*) and May 2008 bench sheet (897-0441)
- EXHIBIT 10: Sample Nally bench sheets (848-0233 and 866-0304)
- EXHIBIT 11: Sample Nally bench sheets (807-0307, 866-0311, 861-0479) and Nally 3rd Quarter 2009 DMR for 866-0311 (*excerpt*)
- EXHIBIT 12: Sample Emails between Nally and Technical Water Laboratories
- EXHIBIT 13: Inspection of non-compliance (March 2009) (*excerpt*) and Nally 1st Quarter 2009 DMR for 848-0184 (*excerpt*)
- EXHIBIT 14: Performance Audit Inspection Summary of Findings (November 2010)
- EXHIBIT 15: Intervenors' Request to Nally to Permit Entry (July 15, 2011)
- EXHIBIT 16: Technical Water Laboratories Invoices to Nally (2006, 2010, and 2011)
- EXHIBIT 17: Table of consent decrees
- EXHIBIT 18: Consent Decree between EPA and Arch Coal (March 2011) (*excerpt*)

## CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of this comment letter and accompanying exhibits were sent by first class mail and email on this date, the 4th day of October, 2011, to the following:


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