

8/22/96

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

BEFORE THE ADMINISTRATOR

IN THE MATTER OF)	
)	
COMMERCIAL CARTAGE COMPANY,)	DOCKET NO. CAA-93-H-002
)	
)	
RESPONDENT)	

ORDER ON DISCOVERY

Complainant has moved for discovery in this proceeding under Section 205(c) of the Clean Air Act (42 U.S.C. § 7524(c)) for the purpose of evaluating Commercial Cartage's (CCC's) ability to pay the proposed penalty of \$81,000 (Discovery Request, dated July 22, 1996). The motion recites, inter alia, that CCC has not complied with the order, dated April 2, 1996, which directed CCC to supply on or before April 26, 1996, a copy of its most recent financial statements, e.g., balance sheets, profit and loss or income and expense statements, and a copy of its Federal and state tax returns for the past three years.^{1/} CCC's stated reason for failing to furnish listed financial data is that its records are in storage and cannot be readily accessed and that it has obtained

^{1/} In response to the order requiring CCC to furnish a copy of its certificate of corporate dissolution, if any, CCC has provided a copy of the revocation of its operating authority, effective November 29, 1994, issued by the Interstate Commerce Commission (Prehearing Exchange, dated April 25, 1996). Complainant alleges, however, that there are several companies operating under the name of Commercial Cartage Co. in various states, including St. Louis, Missouri, and that a firm's authority to operate is normally reinstated provided it purchases adequate insurance (Discovery Request at 2).

extensions, and not yet filed, its tax returns for the years 1994 and 1995 (Prehearing Exchange). Complainant moves that CCC be directed to comply with the April 2, 1996, order and to provide other data, a substantial part of which is relevant only on the assumption that there has been "self-dealing" between CCC and its corporate principals.^{2/} CCC has not responded to the motion.

In accordance with Rule 22.19(f)(1) (40 CFR Part 22), the ALJ may order discovery in addition to prehearing exchanges upon findings: (i) that such discovery will not in any way unreasonably delay the proceeding; (ii) that the information to be obtained is not otherwise obtainable; (iii) that the information has significant probative value. The complaint in this proceeding was filed on June 2, 1993, and the hearing is currently scheduled to commence on September 24, 1996. Delays in bringing this matter to a hearing are attributable to several factors other than discovery. Complainant apparently intends to use the information it seeks to, inter alia, determine the necessity and reasonableness of specific expenditures, the accuracy and validity of accounts and amounts, to determine whether unnecessary or luxury items are being charged to the company and whether the company has transferred assets to officers or shareholders at less than fair market value. Assuming that Complainant had immediate and unfettered access to CCC's books and records, these determinations almost certainly could not be

^{2/} Complainant's request for financial data and income tax returns of CCC's principals was denied, because there was no evidence that the corporation was merely an alter ego of such individuals (Order, dated April 2, 1996).

made with any semblance of validity in the time remaining before the hearing. In sum, granting discovery of the magnitude contemplated for the purposes intended would require a continuance. Although a continuance of the hearing would not ipso facto constitute unreasonable delay, the length of time this proceeding has been pending dictates against granting a continuance absent the most compelling circumstances. These considerations indicate that a finding the requested discovery will not unreasonably delay the proceeding may be made only with hesitation and that, absent stronger justification than has been shown here, the scope of discovery should be curtailed.^{3/} While there does not appear to be any question but that the information sought is obtainable only from CCC, only a part of the requested discovery has been shown to have "significant probative value". Rulings upon Complainant's requests follow:

Nos. 1 and 2. Number 1 asks for a copy of CCC's Federal and state tax returns for the past three years, or if the returns have not yet been filed, a copy of the preliminary drafts, and a copy of the three most recently filed Federal and state tax returns. Number 2 asks for a copy of CCC's most current financial statements.

^{3/} Guidelines for the Assessment of Civil Penalties Under Section 16 of the Toxic Substances Control Act; PCB Penalty Policy (45 Fed. Reg. 59770, September 10, 1980) recognize the unreasonable burden that extensive financial analysis in determining ability to pay may place on the Agency as well as on the firm (Id. 59775). Instead, the Agency concluded that four percent of a firm's gross sales or revenues would be a reasonable guide as to a firm's ability to pay.

Ruling: These documents are obviously relevant and probative on the "ability to pay" issue. Although the request for tax returns has been expanded, CCC was essentially directed to provide these documents by the April 2 order. These requests will be granted.

Nos. 3, 4, 5, and 6. Number 3 asks for CCC's year-end trial balances for the past five years, Number 4 asks for CCC's chart of accounts for the past five years, Number 5 asks for CCC's general ledger for the period January 1, 1991, to the present, and Number 6 asks for CCC's depreciation schedule since the date of incorporation. Complainant explains that a year-end trial balance is listing of all the accounts maintained by a company with the year-end balance in each of the identified accounts, a chart of accounts is a listing by account number of each account included in a company's financial records, an account is the record used to record increases and decreases in a single asset, expense, liability, or equity amount and that the entire group of accounts is called the general ledger. A depreciation schedule is a detailed schedule of a corporation's assets which have a useful life of one year or more.

According to Complainant, the trial balance must first be reviewed to identify those accounts which are relevant to Respondent's ability to pay the proposed penalty and knowledge of the components making up each account (amount) listed on the tax return is necessary so that the relevant assets, expenses and liabilities may be evaluated to determine the necessity and

appropriateness of each. Complainant says that the chart of accounts is necessary because company-generated documents may identify accounts by number only and that without a description of the accounts, proper analysis of the accounts and substantiating documents cannot be performed. Complainant asserts that general ledgers for the past five years will, in conjunction with other requested documentation, be used to make numerous determinations including the necessity of specific expenditures, the accuracy of the accounts being analyzed, and the validity of amounts identified. According to Complainant, the depreciation schedule will show if any assets have been recently purchased and the associated cost, will show if there are unnecessary or luxury items being paid for by the corporation, will show whether assets have been transferred to an unrelated party or whether a distribution has been made to a shareholder or other related party, and will show the amount the company paid for an asset.

Ruling: Complainant's motion is based on the notion that an Agency auditor will review over five years of CCC's expenditures (its depreciation schedule since the date of CCC's incorporation) and determine the necessity and reasonableness of such expenditures and whether the depreciation schedule fairly reflects the value of items shown or transferred to officers or shareholders. The idea being that property having a greater value than shown on the depreciation schedule, unreasonable or unnecessary expenditures and property transferred at less than fair market value are assets, the latter constituting potential accounts receivable to CCC from

officers, directors, shareholders, or related parties, from which the proposed penalty may be paid. It is immediately apparent that whether the auditor's review will reveal assets such as those listed or similar assets is theoretical and speculative. It follows that the information requested has not been shown to have "significant probative value." Moreover, determinations that an expenditure is unnecessary or unreasonable or that property has been transferred at less than fair market raise collateral issues that are likely to be disputed. For example, even if some or all the mentioned determinations were made and are fully supportable, a purported account receivable from an officer or shareholder having little income and few assets would be of little value. It should also be noted that the Agency's "Guidance on Determining a Violator's Ability to Pay a Civil Penalty" (GM 56, December 16, 1986) emphasizes that "(t)ax returns are the most complete and in the most consistent form for analysis" and does not include a company's basic records, such as a general ledger, as among documents which may be requested.^{4/} Request Nos. 3 through 6 will be denied.

^{4/} The Guidance provides: Financial information to request from for-profit entities may include the most recent three to five years of: 1. Tax Returns; 2. Balance Sheets; 3. Income statements; 4. Statements of changes in financial position; 5. Statements of operations; 6. Retained earnings statements; 7. Loan applications, financing agreements, security agreements; 8. Annual reports; or 9. Business services, such as Compustat, Dun and Bradstreet, or Value Line (Id.3).

In view of the foregoing, disposition of Complainant's discovery requests for other specific documents does not require discussion. Request No. 7 asks CCC to provide a copy of all completed 1099, 1098, and W-2 forms issued to officers and shareholders of Respondent and the corporate group for the years 1991 through 1995 inclusive; No. 8 asks for a copy of lease agreements for all property rented by Respondent since 1991; No. 9 asks for a copy of sales agreements, bills of sale, deeds, etc. of any assets sold by Respondent within the past 5 years; No. 10 asks for a copy of all sales agreements, bills of sale, deeds, etc. of property purchased by Respondent within the past 5 years; No. 11 asks for a copy of all bank statements for all bank accounts maintained by Respondent for the past years; No. 12 asks for a copy of loan applications and loan documents for all outstanding loans to Respondent; No. 13 asks that for any loans from a shareholder to Respondent a copy of the canceled check [from the shareholder] and the loan documents be provided^{5/}; and No. 14 asks for a copy of any management representation letters to an independent auditor within the past five years regarding any litigation in which CCC may be involved which may have a material impact on the company's financial statements [condition], and to any going concern.

Ruling: CCC will be directed to comply with Request No. 12. The balance of these requests will be denied.

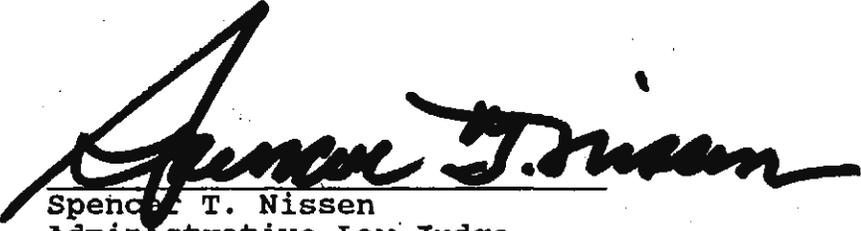
^{5/} A canceled check written by a shareholder, or anyone else for that matter, to CCC would not normally be in CCC's possession.

Although not labeled as such, Complainant has also submitted interrogatories, the stated purpose of which assertedly is to determine the extent of CCC's resources and assets, to evaluate CCC's financial viability based upon its outstanding debts and ability to raise funds from various sources, and to evaluate CCC's corporate structure to determine whether it is linked to related businesses with substantial assets. Although conceivably relevant, this information has not been shown to have "significant probative value". Moreover, the information, if obtained, raises collateral issues which may well require a continuance of the hearing date. The request that CCC be directed to answer these interrogatories will be denied.

ORDER

Complainant's motion for discovery is granted in part and denied in part as indicated above. CCC is directed to comply with the order, dated April 2, 1996, and furnish the documents as to which discovery has been granted on or before September 13, 1996.

Dated this 32nd day of August 1996.


Spencer T. Nissen
Administrative Law Judge

CERTIFICATE OF SERVICE

I do hereby certify that the foregoing **Order On Discovery** was filed in re Commercial Cartage Company, Inc; Docket No. CAA-93-H-002 and that exact copies of the same were mailed to the following:

(Interoffice)

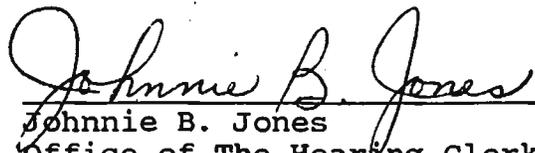
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Dated: August 22, 1996