UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

BEFORE THE ADMINISTRATOR

IN THE MATTER OF	)	
	)	
1836 REALTY CORPORATION,	)	DOCKET NO. CWA-2-I-98-1017
	)	
	)	
RESPONDENT	)	

ORDER GRANTING COMPLAINANT'S MOTION FOR ISSUANCE OF A DISCOVERY ORDER

On August 27, 1998, the Complainant (United States Environmental Protection Agency ("EPA")) filed a Motion for Issuance of a Discovery Order seeking financial information pertaining to the Respondent's (1836 Realty Corporation) ability to pay the proposed penalty. On September 15, 1998, the Respondent submitted an Objection to Region's Motion for Issuance of a Discovery Order and a Motion for Extension of Time to Respond to Complainant's Motion. On September 29, 1998, the Complainant filed Complainant's Request to File Reply to Respondent's Objection to the Region's Motion for Issuance of a Discovery Order. Then, on October 9, 1998, the Respondent submitted a Request to File a Reply to Region's Reply to Respondent's Objection to the Region's Motion for Issuance of a Discovery Order. The Complainant's Motion for Issuance of a Discovery Order is **Granted**. [(1)]

Sections 22.19(a)-(e) of the Consolidated Rules of Practice Governing the Administrative Assessment of Civil Penalties and the Revocation or Suspension of Permits ("Rules of Practice"), 40 C.F.R. § 22.19(a)-(e), provide for the prehearing exchange of witness lists, documents, and information between the parties. Essentially, this exchange consists of discovery for the parties. "Further discovery" is permitted under Section 22.19(f) of the Rules of Practice only after motion therefor is filed and the Administrative Law Judge determines that the requested further discovery meets the specific criteria set forth in that subsection. In pertinent part, subsection (f)(1) regarding further discovery provides that:

i. That such discovery will not in any way unreasonably delay the proceeding;

ii. That the information to be obtained is not otherwise obtainable;

and

iii. That such information has significant probative value.

Pursuant to Section 22.19(f)(1) of the Rules of Practice, the EPA moves for the issuance of a discovery order to obtain financial information to evaluate the Respondent's ability to pay the proposed penalty. Specifically, the EPA requests that the Respondent be directed to fully and accurately complete Interrogatories and Requests for Production of Documents which have been prepared by the EPA and are attached to the motion as Attachments A, B, and C.

In support of its motion, the EPA argues that this discovery request satisfies the stated requirements for discovery under the governing regulation at Section 22.19 (f) (1) of the Rules of Practice. In this regard, the EPA asserts that the issuance of a discovery order will expedite rather than delay the proceedings by ensuring that all the information necessary for the Presiding Officer to consider in determining the appropriateness of the proposed penalty is submitted in a timely fashion. The EPA maintains that the information sought is not otherwise obtainable. According to the EPA, there is no available financial information concerning the Respondent and any related companies having the same corporate officers and/or shareholders and the Respondent has refused to provide the requested information on an informal basis. (Exhibits 1, 2a-c). The EPA submits that the requested information will be probative of the Respondent's ability to pay the proposed penalty according to the standards by which the EPA evaluates such a claim.

Further, the EPA argues that the discovery motion should be granted because the EPA policy of examining the financial status of interrelated business entities is valid as a matter of policy when a respondent, such as the Respondent in the instant matter, asserts an inability to pay the proposed penalty. In this regard, the EPA contends that the Environmental Appeals Board's (EAB) holding in New Waterbury, Ltd., TSCA Appeal No. 93-2, 5 EAD 529, 542 (EAB, Oct. 20, 1994), concerning the EPA's access to a respondent's financial records is applicable by analogy to the instant matter and supports the issuance of a discovery order. The EPA notes that in New Waterbury, a case involving violations of the Toxic Substances Control Act ("TSCA") and the application of the penalty policy under TSCA, the EAB held that "in any case when ability to pay is put in issue, the Region must be given access to the respondent's financial records before the start of such hearing." The EPA submits that the EAB's decision in New Waterbury establishes that under the TSCA Penalty Policy,

an evaluation of whether a penalty should be reduced based on the respondent's alleged inability to pay requires an examination of "whether the respondent is part of a complex arrangement of interrelated small companies" and that the "Region examine those corporate relationships to establish the respondent's cash flow and likely future course, including the respondent's ability to obtain resources or borrow funds from those related corporate entities." Id. at 547.

The EPA argues that TSCA's Penalty Policy's recommendation to examine related business entities (those with the same corporate officers or shareholders) should apply to proposed penalties under all the EPA's regulatory statutes when a respondent's ability to pay is placed at issue. For example, the EPA notes that the ABEL computer model, which the EPA employs as one means of analyzing a respondent's ability to pay a penalty, contains the same guidance to investigate other firms related by common ownership or officers. The EPA contends that the principles in New Waterbury have been specifically applied to Clean Water Act cases. See In the Matter of Catalina Yachts, Inc., No. EPCRA-09-94-0015, 1996 EPCRA LEXIS 16, at 4.

In addition, the EPA maintains that the federal courts have followed a type of analysis in reviewing inability to pay claims similar to that employed by the EAB in New Waterbury. See United States of America v. The Municipal Authority of Union Township; Dean Diary Products Company No. 97-7115, 1998 U.S. App. LEXIS 16440, at 28-29 (3rd Cir. 1998). In Dean Diary, the court found it proper to look at the assets and finances of the violator's corporate parent in evaluating the potential impact of the penalty on the violator. In doing so, the EPA argues that the court explicitly rejected the defendant's claim that it was legal error for the district court to consider the financial condition of the defendant-subsidiary's corporate parent.

The EPA emphasizes that, like New Waterbury and Dean Diary, the approach advocated in the instant motion does not seek to hold other business entities liable. Rather, the related entities are looked to as a reasonable and legitimate source of funds affecting the potential economic impact on the Respondent.

In the instant matter, the EPA claims to have information that there are other related entities, including Robert S. Potter, the President and sole shareholder of Respondent 1836 Realty Corporation, who can reasonably be looked to as a source from which 1836 Realty Corporation may draw funds to pay the proposed penalty. The EPA claims to have identified several small closely held

corporations of which Robert S. Potter is President, including: Respondent 1836 Realty Corporation; 1850 Realty Corporation; Pro Oil, Inc.; Potter Oil, Inc.; Skees Realty, Ltd.; Rosemere Realty, Inc.; and Lyttle Realty, Ltd. (Exhibits 4a-g, respectively). According to the EPA, all these companies have the same mailing address and apparently share office space in the same building which is located at 1850 Warwick Avenue (Exhibits 4a-g). Moreover, the EPA claims that Robert S. Potter, in his individual capacity, was the original owner of the property currently owned by Respondent 1836 Realty Corporation, as well as the adjacent property.

The EPA contends that the file also reveals a flow of assets among some of the companies in the network of related entities of which Robert S. Potter is the controlling corporate officer. One such instance cited by the EPA allegedly involved a February 27, 1998, transaction in which 1850 Realty Corporation signed a quitclaim deed conveying part of its property, which is adjacent to 1836 Realty Corporation's gas station, to Respondent 1836 Realty Corporation for $250,000 in monetary consideration (Exhibit 3a). In turn, the EPA reports that 1836 Realty Corporation granted and conveyed to 1850 Realty Corporation a purchase money mortgage on the same property for the $250,000 purchase price (Exhibit 3b). The EPA contends that the net effect of these transactions is that 1850 Realty Corporation holds a mortgage on the property conveyed and is now able to claim a $250,000 debt from 1836 Realty Corporation and that 1836 Realty Corporation now has an additional annual expense of mortgage interest payable to 1850 Realty Corporation, thereby decreasing 1836 Realty's annual net income available to pay penalties.

According to the EPA, at the time of the transaction Robert S. Potter was the President, Vice President, Secretary, Treasurer, and Director for both 1836 and 1850 Realty Corporations and his signature appears on both the quitclaim deed and mortgage deed transactions dated February 27, 1998 (Exhibits 3a, b, 4a, b). The EPA argues that the complex arrangement of interrelated companies controlled by Robert S. Potter extends beyond 1836 and 1850 Realty Corporations. According to the EPA, 1836 Realty Corporation is also connected with Pro Oil, Inc., Potter Oil, Inc., and possibly several other corporations.

Hence, the EPA argues that in order to evaluate fully the extent of Robert S. Potter's control over Respondent 1836 Realty Corporation and to examine his financial health, the EPA requests information concerning Mr. Potter, including his tax returns. In addition, the EPA requests that the Respondent complete the attached Interrogatories and Requests in order to verify whether there is a complex arrangement of interrelated small companies all controlled by Robert S.

Potter. The EPA maintains that the information requested in the Interrogatories and Requests will enable the EPA to determine if there are any other companies within the "Potter" corporate web and the extent to which the assets of those companies affect the Respondent's ability to pay the proposed penalty.

The Respondent opposes the Motion for Issuance of a Discovery Order. The Respondent states that it continuously has objected to the EPA's request for financial information pertaining to other corporations on the ground that such information is not relevant. The Respondent alleges that the EPA has been abusing its power under Section 308 of the Clean Water Act, 33 U.S.C. § 1318, in an attempt to procure financial information that the EPA is not entitled to receive. The Respondent maintains that the EPA has been provided with all the financial information relative to Respondent 1836 Realty Corporation.

The Respondent argues that the EPA's motion for the issuance of a discovery order is based on faulty reasoning and incongruous case law. Specifically, the Respondent contends that the case of New Waterbury, cited by the EPA as authority in support of its motion for discovery, is easily distinguishable from the instant case on its facts. The Respondent notes that the New Waterbury case concerned a limited partnership, New Waterbury, that was managed by a corporation, Winston Management. The Respondent further notes that the EAB found that it was proper to look into Winston Management's financial records because Winston Management was solely responsible for the viability of New Waterbury.

The Respondent states that 1836 Realty Corporation is not a subsidiary corporation and is not involved in a parent-subsidiary relationship. The Respondent asserts that the EPA is aware that 1836 Realty Corporation is an independent corporation. The Respondent accordingly argues that the case of New Waterbury is readily distinguishable from the instant case and, therefore, does not provide authority for obtaining the extensive financial information that is the subject of the motion for discovery.

The Respondent also argues that the holding in the Third Circuit case of Dean Diary, cited by the EPA in support of its motion for discovery, is incongruous to the facts in this case. The Respondent notes that in Dean Diary, the court found that in evaluating the potential impact of a penalty on an alleged violator, it was proper to examine the assets and finances of the alleged violator's corporate parent. Again, the Respondent points out that 1836 Realty Corporation is not involved in a parent-subsidiary relationship. The Respondent also argues that a decision of the Third Circuit is not controlling law.

The Respondent contends that the EPA has not demonstrated that 1836 Realty Corporation is intermingled with other Rhode Island corporations. Specifically, the Respondent asserts that the EPA has not shown one transaction that proves that 1836 Realty Corporation is financially controlled by any of the corporations mentioned in the EPA's memorandum. The Respondent, therefore, argues that the information sought by the EPA on motion for discovery is irrelevant.

Finally, the Respondent contends that it has provided the EPA with the financial information necessary to determine the economic impact of the penalty on the alleged violator. The Respondent avers that the EPA has identified its main reason for seeking the requested financial information; that is, to harass and gather information for future litigation against the president of the Respondent, Robert S. Potter. The Respondent asserts that the EPA is on a fishing expedition and does not need the requested information to meet its burden to prove the appropriateness of the proposed penalty.

The EPA counters that the Respondent's allegation that the EPA has used Section 308 of the Clean Water Act to obtain financial information is factually incorrect, and that its statement that the EPA is "abusing" its statutory authority is designed to leave an inaccurate and misleading impression. With regard to the Respondent's assertion that New Waterbury is limited only to situations involving corporations in a parent/subsidiary relationship, the EPA submits that the question at issue is not whether the Respondent is an independent corporation but rather is whether the Respondent, in light of its relationship with other closely related entities, can afford to pay the proposed penalty. Further, the EPA points out that in New Waterbury there was no parent-subsidiary relationship between New Waterbury and Winston Management.

The EPA asserts that based on the alleged facts set forth in its motion for discovery, the instant case suggests a clear pattern of intimacy between the corporations and control by their common officer and sole shareholder, Robert S. Potter. The EPA clarifies that its intention in seeking the requested financial information is not to "harass" Robert S. Potter, as the Respondent alleges. Rather, the EPA maintains that having demonstrated some evidence of financial interrelatedness, it has requested discovery to examine the financial interrelationships of the "Potter" corporations to determine if the Respondent can afford to pay the proposed penalty.

In further response to the EPA's motion for discovery, the Respondent reiterates its arguments that the requested financial information of the "other

related entities" is not probative, and therefore, not relative. The Respondent maintains that the EPA continues to misinterpret the Respondent's assertions concerning the New Waterbury case. Specifically, the Respondent contends that 1836 Realty Corporation does not have a relationship remotely similar to the relationship in New Waterbury. In this regard, the Respondent maintains that the Respondent in the instant matter does not have any intermingling relationships similar to those between New Waterbury, Winston Management, Vanta, and Trevor C. Roberts. In addition, the Respondent argues that the fact that a corporation has only one director/shareholder is insufficient grounds to disregard the corporate entity. United States v. Daugherty, 599 F.Supp. 671 (E.D. Tenn., N.D. 1984).

The EPA's arguments in support of its discovery motion seeking financial information pertaining to the Respondent and alleged related companies are persuasive. Specifically, I note that the EPA has submitted information strongly suggesting some financial interrelatedness between 1836 Realty Corporation and some of the specified companies that have Mr. Potter as officer and or sole shareholder. Pursuant to the EAB's holding in New Waterbury, which by analogy may be applied to the instant case, I find that the EPA's motion for discovery is warranted in order for the EPA to examine the degree of financial interrelatedness between the Respondent and any of its related business enterprises and the degree of control exercised by one corporation or individual over the other to determine the economic impact of the proposed penalty on the Respondent. The EAB's holding in New Waterbury is not limited to parent-subsidiary relationships. Even though the Third Circuit's holding in Dean Diary is not controlling in the instant matter which arises within the jurisdiction of the First Circuit, this case presents additional authority, albeit indirect authority, for the EPA's position. The Respondent has offered no authority to support a contrary position. Further, there is no information in the file to support the Respondent's averment that the EPA is seeking the requested financial information simply to harass Robert S. Potter or to gather information for future litigation against Mr. Potter.

Accordingly, the EPA's Motion for Issuance of a Discovery Order is **Granted**.

Original signed by Judge Gunning

_____

Barbara A. Gunning
Administrative Law Judge

Dated: 11-06-98

Washington, DC