*EDMUND G. BROWN JR.*
*Attorney General*

*State of California*
*DEPARTMENT OF JUSTICE*

1515 CLAY STREET, 20TH FLOOR
P.O. BOX 70550
OAKLAND, CA. 94612-0550

Public: (510) 622-2100
Telephone: (510) 622-2183
Facsimile: (510) 622-2270
E-Mail: Harrison.Pollak@doj.ca.gov

December 22, 2010

Proposition 65 Private Plaintiffs and Counsel
(See attached list of addressees)

Dear Counsel:

We are writing to you in your capacity as a representative of a party that has brought and settled private Proposition cases or as counsel for such an entity. We intend to share the letter with other members of the private bar as well.

As you know, the Attorney General has the statutory authority to review private party settlements under Proposition 65 and to participate in court proceedings for approval of those settlements. Based on that authority, we have, from time to time, raised with the parties and the courts issues that are of particular concern. Some of those issues are addressed in the Attorney General Guidelines promulgated in California Code of Regulations, Title 11, sections 3200-04. We intend to continue our review and oversight in the future.

We write now about one of our concerns with private Proposition 65 settlements. In many private-party cases the parties allocate all or nearly all of the penalty payment as a "payment in lieu of penalties" – often to the group bringing the case – instead of treating it as a civil penalty. This represents a departure from the statutory allocation of penalty payments between the Office of Environmental Health Hazards Assessment ("OEHHA"), which receives 75 percent of the civil penalty, and the private plaintiff, which receives 25 percent. (Health & Saf. Code, § 25249.12, subd. (c).) While the practice of offsetting penalties with payments in lieu of a penalty has been ongoing for some time, there are no guidelines to assist a court when it determines whether the allocation is reasonable, as it must to approve a private Proposition 65 settlement. (Health & Saf. Code, § 25249.7, subd. (f)(4)(C).) We are not prepared to offer guidelines at this time, but rather, we request feedback as we consider the issue.[1]

[1] Our decision to solicit feedback on this particular issue does not mean that it is the Attorney General's only area of concern with private settlements, or, necessarily, that it is the Attorney General's area of greatest concern. It is an area that merits further consideration and discussion.

The Statutory Penalty Framework

We begin, as we must, with the statute itself. Proposition 65 provides that anyone who violates Proposition 65 "*shall be liable* for a civil penalty not to exceed two thousand five hundred dollars ($2500) per day for each violation." (Health & Saf. Code § 25249.7(b)(1) (emphasis added).) The statute further specifies the factors that should be considered in assessing the penalty amount. (*Id.* at § 25249.7(b)(2).) Of the penalty amount, 75 percent is paid to the Office of Environmental Health Hazard Assessment ("OEHHA") and 25 percent to the party bringing the action. (*Id.* at §§ 25249.12(c), (d).)

The statute therefore provides for several outcomes: First, unless the statutory penalty factors justify a penalty of zero, a penalty should be part of any settlement. Second, a significant portion of the penalty will be paid to OEHHA to fund its Proposition 65 activities. In fact, based on decisions made by the Legislature, all of OEHHA's Proposition 65 activities are now funded from the penalty payments. Finally, the private enforcer receives a significant portion of the penalty to be used as it chooses.

Payments in lieu of penalties

In the past, our office has treated payments in lieu of penalty as an appropriate offset to civil penalties in Proposition 65 cases. We have included such payments in many of our own settlements, and we have not objected to parties using them in private settlements where they are appropriate under the circumstances and will be put to specific and legitimate uses by accountable recipients.

The Attorney General's guidelines for private settlements, which provide the Attorney General's view as to the legality and appropriateness of various types of settlement provisions, provide that payments in lieu of a penalty may be a proper offset to the civil penalty if there is a nexus between the litigation and the funded activities and if the recipient entity is accountable. The relevant section of the guidelines states as follows:

> (b) Where a settlement provides additional payments to an entity in lieu of a civil penalty (including, for example, funds for environmental activities, public education programs, and funds to the plaintiff for additional enforcement of Proposition 65 or other laws), such payments may be a proper "offset" to the penalty amount or cy pres remedy, but are only proper if the following requirements are met:
>
> > (1) The funded activities have a nexus to the basis for the litigation, i.e., the funds should address the same public harm as that allegedly caused by the defendant(s) in the particular case.

> (2) The recipient should be an entity that is accountable, i.e., is able to demonstrate how the funds will be spent and can assure that the funds are being spent for the proper, designated purpose.
>
> (3) If the entity receiving the funds will in turn make grants of funds to other entities for specified purposes, the method of selection of the ultimate recipient of settlement funds must be set forth in the settlement agreement or in a separate public document referenced in the agreement. The selection procedure may vary depending on the facts of the particular case, but must give significant weight to a prospective grantee's ability to perform the funded task and its reliability and accountability.

(Cal. Code Regs., tit. 11, § 3203, subd. (b).)

Allocation Between Civil Penalties and Payments in Lieu of Penalties

As stated above, historically our office has not objected to offsetting part of the penalty in Proposition 65 settlements with payments in lieu of a penalty, even though, in one sense, the practice deprives OEHHA of its full share of the civil penalty as contemplated in the statute. Our view has been that using part of a penalty for projects that have a nexus to the basis of the litigation may advance the purposes of the statute and therefore would not violate public policy. (See *Rich Vision Centers, Inc. v. Board of Medical Examiners* (1983) 144 Cal.App.3d 110, 115-16 [Courts have the authority to order relief as part of a consent judgment that goes beyond what is in a statute, provided the settlement does not violate public policy].) However, if payments in lieu of a penalty are to be included in a settlement, there must be some balance between the statutory policy of providing the bulk of the penalty payment to OEHHA and applying payments to other purposes.

One approach we offer, simply as an example, would be to say that payments in lieu of a penalty – used for purposes other than reducing or eliminating the actual exposures that underlie the litigation[2] – should not exceed the share of civil penalties deposited with OEHHA. Thus if the total payment (not including attorneys' fees) were $700,000, no more than $300,000 (i.e., 43 percent) would be available to offset the penalty. The remaining $400,000 civil penalty would be allocated between OEHHA, which receives $300,000, and the plaintiff, which receives

[2] The concern we address here is not with settlements that give credit to a defendant for taking measures beyond what is required by law to reduce the exposures that gave rise to the violations. Moreover, we do not have the same concerns with payments made to fund technology or equipment that will prevent or reduce ongoing exposures that led to the litigation, since they provide direct relief from the violations.

$100,000. OEHHA's 75-percent share of the civil penalty would be equal to the payment in lieu of penalty.

Arguably, this approach would reduce the risk of payments in lieu of penalties undercutting the Proposition 65 penalty provisions. We do not contend, however, that the allocation would have to be the same in every case. A plaintiff is always justified to collect the entire amount as a civil penalty, while circumstances unique to a case might justify increasing the payment in lieu of penalties compared to other cases.

Apart from the question of the amount of money allocated to payments in lieu of penalties, our concern is heightened where the settlement requires the payment in lieu of penalty be paid to the plaintiff instead of directing the payment to an independent third party. In such cases, there appears to be an inherent conflict of interest. Under the statute, 25 cents of every dollar of civil penalty goes to the plaintiff, compared to 100 cents of every dollar that goes to the plaintiff when it receives the payment in lieu of penalties. This creates an incentive for the plaintiff to channel more of the settlement payment away from civil penalties and toward the payment in lieu of penalty.

While we are troubled by the increasing use of payments in lieu of penalties, we have not at this time reached a conclusion on how to resolve our concerns. We would be interested in hearing your views, and the views of others, on what the appropriate role is for payments in lieu of penalties in Proposition 65 settlements, and whether there should be guidelines for determining an appropriate balance between civil penalties and payments in lieu of penalties.

Description of How Penalties in Lieu of Payments Will Be Used

As you know, when we review a settlement with a payment in lieu of penalties, we look for a nexus between the funded activities and the basis for the litigation. (Cal. Code Regs., tit. 11, § 3203, subd. (b)(1).) But settlements often do not describe the intended use of such payments with specificity. Instead, some settlements make a blanket statement along the lines of, "The payment in lieu of penalties is to be used by [name of group] for the purpose of educating and protecting people from exposures to toxic chemicals." Describing the use of funds with such a lack of specificity makes it extremely difficult to determine whether there is a sufficient nexus to the litigation. It also makes it difficult to confirm afterward that the funds were used as intended.

To demonstrate compliance with the nexus requirement, settlements that include a payment in lieu of penalties should describe how the funds will be used in more detail, either in the settlement itself or in documents that accompany the approval motion. What specific activities or projects will the payments fund? For how long? This kind of additional information will help us to review settlements, and it will assist courts when they review and make findings about the settlement.

It is especially important for groups that receive payments in lieu of penalties from their own cases to explain at the outset how they will use the funds and then to account for the expenditures. Groups that receive grants from their own cases should be prepared to provide an accounting to the court or to our office that connects payments in lieu of penalties in each case to how the payments were used.

Use of Payment in Lieu of Penalties for Attorneys' Fees

Based on our existing guidelines, we do not think payments in lieu of penalties in private cases can be used to recoup attorneys' fees, whether incurred in the past or in the future. The statutory basis for an attorneys' fees award is Code of Civil Procedure 1021.5, which allows the plaintiff to recover attorneys' fees for enforcing a significant public right. The separate and distinct statutory basis for a payment in lieu of penalty is Health and Safety Code section 25249.7, subdivision (b), which imposes civil penalties for violations of Proposition 65. When a court reviews a private Proposition 65 settlement, it must make express findings that both kinds of payments are reasonable before it approves the settlement. (Health & Saf. Code, § 25249.7, subd. (f)(4)(B)-(C).) Once the court has found that the penalty and payments in lieu of the penalty are reasonable and that the attorneys' fees are reasonable, there should be no reshuffling of the amounts.

Moreover, the Attorney General's settlement guidelines state that "[c]ivil penalties . . . should not be 'traded' for payments of attorney's fees." (Cal. Code Regs., § 3203, subd. (a).) While this proscription refers primarily to situations where, during settlement negotiations, the private plaintiff offers to reduce the penalty in exchange for receiving higher attorneys' fees, using the in-lieu-of-penalty payment to pay for attorneys' fees to be incurred in the future raises similar concerns. It effectively shifts the burden of reimbursing the plaintiff's attorneys' fees onto the public because the public loses the benefit of the penalty payment (or in-lieu-of-penalty payment) just as it would if penalties were traded for fees during negotiations.

Therefore, we are inclined to view attorneys' fees as beyond the scope of acceptable uses for payments in lieu of penalties in private settlements, which have other options for recovering attorneys' fees.

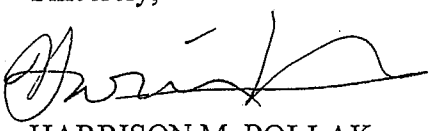
Conclusion

This letter addresses some of our concerns associated with offsetting penalty payments in private Proposition 65 cases with payments in lieu of penalties. It does not cover every issue that might arise with the practice, nor does it represent the Attorney General's final views on the issue. Moreover, the letter does not address other concerns our office may have with private settlements, such as the growing imbalance between penalties and attorneys' fees, and the size of attorneys' fee awards for settlements where the defendant promptly corrects the violation and there is little or no litigation. While guidelines exist to determine the reasonableness of a civil penalty and of attorneys' fees, there are no similar guidelines to evaluate the allocation and use

of payments in lieu of penalties in a private Proposition 65 settlement. Accordingly, we are sharing our concern and initial views on this particular issue at this time.

We will continue to review these issues carefully and we welcome your input. Please provide us with your responses no later than February 1, 2011. I will be out of the office for an extended leave beginning December 27. In my absence, please contact Deputy Attorneys General Sue Fiering or Tim Sullivan to discuss this letter or to provide feedback. You may reach them at the address on the letterhead or by electronic mail (Susan.Fiering@doj.ca.gov; Timothy.Sullivan@doj.ca.gov), or by calling 510-622-2100.

Sincerely,



HARRISON M. POLLAK
Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General

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List of Addressees 12/22/10

Roger Carrick
Carrick Law Group, P.C.
350 Grand Avenue, Sutie 2930
Los Angeles, CA 90071

Clifford Chanler
Chanler Law Group
72 Huckleberry Hill Road
New Canaan, CT

Karen Evans
Law Office of Karen A. Evans
4218 Biona Place
San Diego, CA 92116

Larry Fahn
As You Sow
311 California Street, Suite 510
San Francisco, CA 94104

Ellison Folk
Shute, Mihaly & Weinberger LLP
396 Hayes Street
San Francisco, CA 94102

Richard Franco
Center for Environmental Health
2201 Broadway, Suite 302
Oakland, CA 94612

Michael Freund
Law Offices of Michael Freund
1915 Addison Street
Berkeley, CA 94704

Brian Gaffney
Lippe Gaffney Wagner LLP
329 Bryant Street, Suite 3D
San Francisco, CA 94107

Anothey Graham
Graham & Martin LLP
3030 S Harbor Blvd., Suite 250
Santa Ana, CA 92704

Gideon Kracov
Law Office of Gideon Kracov
801 South Grand Avenue, 11th Floor
Los Angeles, CA 90017-4645

Dottie LeMieux
Green Legal Solutions
8 Willow Street
San Rafael, CA 94901

Andrew Packard
Law Offices of Andrew Packard
100 Petaluma Blvd. N, Suite 301
Petaluma, CA 94952

Eric Somers
Lexington Law Group LLP
1627 Irving Street
San Francisco, CA 94122

William Verick
Klamath Environmental Law Center
424 First Street
Eureka, CA 95501-0404

James Wheaton
Environmental Law Foundation
424 First Street
Eureka, CA 95501-0404

Reuben Yeroushalmi
Yeroushalmi & Associates
9100 Wilshire Blvd., Suite 610E
Beverly Hills, CA 90212

Matthew E. Jackson, Esq.
101 N. Victory Blvd., Suite L-127
Burbank, CA 91502

Raphael Metzger
Metzger Law Group
401 E. Ocean Blvd., Suite 800
Long Beach, CA 90802-4966

Stephen Ure
Law Offices of Stephen Ure, PC
1518 Sixth Avenue
San Diego, CA 92101