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November 23, 2005

VIA E-MAIL, FACSIMILE AND U.S. MAIL

California Regional Water Quality Control Board
Central Valley Region
11020 Sun Center Drive, #200
Rancho Cordova, CA 95670-6114

Attention: Antonia K. J. Vorster, Supervising Water Resources Control Engineer
(Please deliver electronic and hard copies of this letter directly to all
Members of the Regional Board immediately)

Re: Settlement of ACL Complaint No. R5-2005-0501 (Item 15 on Nov. 28-
29 Agenda); Response and Objection of Hilmar Cheese Company, Inc.
and Hilmar Whey Protein, Inc. to Comments of Office of Statewide
Initiatives and Request/Motion to Disregard Those Comments

Dear Chairman Schneider and Members of the Regional Board:

Hilmar Cheese Company, Inc. and Hilmar Whey Protein, Inc. (collectively, "Hilmar") respectfully submit their response and objection to the comments of the Office of Statewide Initiatives filed on November 21, 2005, and request that the comments be disregarded. Not only are the comments inappropriate, unauthorized and highly inaccurate, but their method of release was carefully and deliberately orchestrated to generate inaccurate and misrepresentative media coverage in an unwarranted attempt to confuse and influence the Central Valley Regional Water Quality Control Board ("Regional Board") and the public.

On November 21, 2005, the Office of Statewide Initiatives ("OSI") of the State Water Resources Control Board ("State Board") filed comments criticizing the Hilmar Settlement Agreement and contending that the Settlement Agreement should not be approved by the Regional Board. The OSI comments are based on a serious misreading of the Settlement Agreement, a faulty understanding of the facts, and a complete and utter disregard for the evidentiary showing proffered by Hilmar – a showing that has been posted on the Regional Board's web site for a number of weeks.

At the outset, however, Hilmar strongly questions the propriety of the filing by OSI and asks that it be accorded no weight on that ground alone. If a petition to review the Regional Board's decision in this matter is filed before the State Board, the State Board will be asked to address the correctness of the Regional Board's action. Similarly, if the Settlement

Agreement is approved by the Regional Board, the Agreement provides that the parties shall jointly seek confirmation of the approval by the State Board, thus asking the State Board to rule on the correctness of the Regional Board's action. In either situation, the State Board is essentially the first appellate tribunal that will review the Settlement Agreement and the correctness of the Regional Board's action. Under these circumstances, no subdivision or part of the State Board should be commenting on the matter when it is pending before the Regional Board and no such comments should be given any weight whatsoever in the deliberations of the Regional Board. Such action gives rise to fundamental and inherent conflicts of interest, and violates the federal and state constitutional rights of the parties to due process of law and a fair hearing, both at the Regional Board and the State Board level.

Similarly, the OSI comments are inappropriate because OSI has asserted that it "previously assisted, and prepared investigative reports for the Attorney General's Office and the Central Valley Regional Water Quality Control Board (Regional Water Board) in connection with the prosecution of this matter." (OSI Comments, p. 1, fn. 1.) The OSI was thus involved in the prosecution of the very matters that are the subject of the Settlement Agreement and fall clearly within the ultimate authority of the Regional Board's prosecution staff. Indeed, to the extent OSI participated in the Attorney General's criminal investigation of Hilmar, which resulted in a determination not to pursue any criminal charges, the conduct at issue was referred by the Attorney General to Regional Board prosecution staff for possible inclusion in the ACL proceeding. The Settlement Agreement, which is duly signed for prosecution staff by the Regional Board's Executive Officer, unequivocally provides that all parties, including prosecution staff, shall support the Settlement Agreement (*See* Settlement Agreement, ¶ 16.) Hence, OSI's filing of adverse comments is flatly inconsistent with the Settlement Agreement.

Moreover, the OSI comments should be disregarded because they are the comments of a staff subdivision of the State Board that were not in any way authorized by the State Board or its Executive Director. So far as Hilmar is aware, the OSI is a subdivision of State Board staff that is supposed to report directly to State Board Executive Director Celeste Cantú. However, the OSI comments indicate that Executive Director Cantú never authorized the filing of the comments, a circumstance further confirmed by the OSI comments' representation that no party involved in the comments "will advise the State Water Board concerning this matter" (OSI Comments, p. 1., fn. 1.) Indeed, as the OSI comments acknowledge, they were forwarded on a letterhead that does not even exist, but was manufactured by OSI as part of this unauthorized act. (*Ibid.*)

Beyond the procedural irregularities in the filing of the OSI comments, they are based on a fundamental misreading of the Settlement Agreement and on untrue and/or incomplete information. Hilmar asks that the OSI comments be disregarded because they are inaccurate, misleading and confuse the record.

The OSI comments criticize the Settlement Agreement on the merits in four respects. Hilmar will address each in turn.

1. Administrative Process

In this section, the OSI comments voice two concerns. First, they state that “[t]his case has been a matter of public concern, and should be resolved through the regular public process established in the California Water Code.” (OSI Comments, p. 2.) This case, however, is being resolved through a very public, statutorily authorized process. Government Code section 11415.60 provides: “(a) An agency may formulate and issue a decision by settlement, pursuant to an agreement of the parties, without conducting an adjudicative proceeding. Subject to subdivision (c) [which provides that “[a] settlement is subject to any necessary agency approval.”], “the settlement may be on any terms the parties determine are appropriate.” An adjudicative proceeding, therefore, is not required. The fact that an adjudicative proceeding may be held is no reason to hold one at great cost in time and resources to the parties and the State and to reject a settlement that otherwise is appropriate, proper and in the public interest, as this settlement is. Moreover, Hilmar and prosecution staff proposed a public comment schedule that would have provided more than ample time for public scrutiny and comment, and the Regional Board Chair established a comment schedule that allowed even more time for public scrutiny and comment.

Second, the OSI comments state that “[t]he agreement should clarify how the provisions of the Settlement Agreement may be enforced should HCC not comply with them.” (OSI Comments, p. 2.) The Settlement Agreement, however, already makes clear how it is to be enforced should Hilmar not comply. For example, in the event Hilmar fails to make the payments provided for in Paragraph 3, the Agreement provides that a clerk’s judgment may be issued pursuant to Water Code section 13328 for the unpaid amounts, and that the Regional Board may recover its attorneys’ fees and costs incurred in seeking to collect the amounts due, along with interest at the rate of 10% on the unpaid amounts. Moreover, Hilmar does not get the benefit of the release and covenant not to sue in Paragraph 5 if it fails to pay the amounts specified in Paragraph 3, or for any period of time it fails to comply (except as provided) with the Interim Operating Limits set forth in Paragraph 5(c) or for any period in which a report required by Paragraph 5(d) is late. Paragraph 4, respecting the Supplemental Environmental Project, also contains enforcement provisions to ensure Hilmar’s compliance. Hilmar thus has every incentive to fully comply with the Settlement Agreement, and every intention of doing so.

2. Interim Limits

In this section, the OSI comments state that there is no “discussion or justification” presented for the Interim Operating Limits in Paragraph 5(c) of the Settlement Agreement, and that these limits are proposed “without reference to any supporting legal authority allowing their use.” (OSI Comments, p. 3.) The Interim Operating Limits, however, reflect Hilmar’s existing discharge, and do not permit an increase in either the quantity of the

discharge or the level of EC in that discharge. Accordingly, as provided in the Adjudicatory Team's proposed Order, "This action to adopt an Order Approving Settlement Agreement which resolves the ACL Complaint is exempt from the provisions of the California Environmental Quality Act, . . . because there is no expansion of an existing discharge."

Moreover, as asserted in Recital B.2. of the Settlement Agreement, and as supported by Hilmar's prepared direct testimony and expert reports (which OSI appears not to have consulted), (1) Hilmar's wastewater is not toxic; (2) impacts to groundwater as a result of Hilmar's wastewater discharge are limited, do not pose a threat to public health, and are susceptible to cleanup and abatement; and (3) there is no proven, reliable technology to treat all of Hilmar's wastewater to Hilmar's existing permit requirement (900 μ mhos/cm EC) that is economically or environmentally sustainable. (*See* Expert Report and Prepared Direct Testimony of Kennedy/Jenks Consultants Regarding: Nature, Extent, Gravity, Toxicity and Susceptibility to Cleanup; Prepared Direct Testimony of Tedd Struckmeyer and Warrant Climo.) Additionally, Hilmar already is subject to a Cleanup and Abatement Order, Order No. R5-2004-0722, which affords a further measure of public protection with regard to the authorized discharge during the Interim Operating Period.

The Interim Operating Limits, accordingly, are both authorized and justifiable. They continue to require Hilmar to treat its wastewater in a manner which no other California food processor is required to do or is doing.

3. Scope of Violations Covered

In this section, the OSI comments state that the Settlement Agreement "would preclude action by the Regional Water Board even if new evidence is discovered with respect to the criminal investigation, and would prohibit the Regional Water Board from assessing liability for virtually all future violations until such time as the Board adopts new waste discharge requirements. We are concerned with the precedent of granting immunity from civil liability for all such past and future violations." (OSI Comments, p. 4.)

Again, the comments reflect a fundamental misreading and misunderstanding of the Settlement Agreement. The Agreement does not provide a release from any criminal liability, as the Regional Board cannot provide such a release. The release as to civil liability for past violations also is limited to violations of which Regional Board Staff had "actual knowledge" of the alleged facts as of the date of the Settlement Agreement. Hilmar also is potentially subject to civil liability for future violations of its existing Waste Discharge Requirements ("Permit") if it fails to comply with the Interim Operating Limits. Moreover, nothing in the Settlement Agreement restricts the Board's ability to take enforcement action, including seeking civil liability, to ensure compliance with the Cleanup and Abatement Order or other administrative orders that may be issued by the Board (for example, to address any conditions of nuisance, pollution, odors or vectors that may be created by Hilmar's discharge). Accordingly, the Settlement Agreement by no means grants immunity from criminal or civil

liability for all past and future violations. In actual fact, it very clearly preserves much such liability.

4. **Economic Benefit**

In this section, the OSI comments complain that “the amount in the proposed settlement is substantially less than the economic benefit conservatively estimated by Regional Water Board staff.” However, the economic benefit estimated by Regional Board staff is no more than a flawed allegation which Hilmar has vigorously disputed with competent expert evidence. As asserted in Recital B.2. of the Settlement Agreement, “Hilmar has not derived any economic benefit from non-compliance with the EC limit in the Permit.” This assertion is supported by the Expert Report and Prepared Direct Testimony of Mark Berkman, PhD, and David Sunding, PhD, which the OSI comments do not refer to and the OSI apparently did not even consider. Drs. Berkman and Sunding concluded that the \$4 million penalty originally proposed in the ACL Complaint “cannot be justified on economic grounds” because: (1) “The RWB Staff did not apply SWCRB policy guidance in a rigorous and coherent manner”; (2) “Hilmar did not gain any economic benefit from noncompliance”; and (3) “The RWB Staff’s proposed penalty is not in the public interest.” (*See* Berkman/Sunding Expert Report, at p. 3, and generally.)

Accordingly, the settlement does not allow Hilmar to reap any economic benefit from noncompliance. Rather, as asserted in Recital B.2. of the Settlement Agreement, and supported by Hilmar’s prepared direct testimony, Hilmar has spent more than \$85 million over the past eight years in its attempts to comply with its Permit, which Hilmar contends imposed an unprecedented EC discharge limit that never should have been imposed on Hilmar in the first instance and which has proven to be unachievable for all of Hilmar’s wastewater. (*See* Prepared Direct Testimony of John Jeter.) In addition, Hilmar’s costs of attempting to comply with that limit are approximately three times greater than the costs of other cheese plants in California, placing Hilmar at a severe competitive disadvantage in the marketplace. (*See* CDFA Studies cited in the Berkman/Sunding Expert Report, at p. 15, and included in Appendix B to the report.) A careful review of the facts leads inescapably to the conclusion that not only did Hilmar not receive an economic benefit, but that its good-faith efforts to work with the Board to attain compliance have caused it to operate at a significant competitive disadvantage to the rest of the industry in California.

In sum, the OSI comments are both inappropriate and in error, and Hilmar respectfully asks that its request to disregard those comments be granted.

The Settlement Agreement should be approved as proposed.

Respectfully submitted,



Mark Fogelman
Craig S. Bloomgarden

Counsel for Hilmar Cheese Company, Inc., and
Hilmar Whey Protein, Inc.

cc: Robert Schneider, Regional Board Chair	Sopac Mulholland, Regional Board Member
Karl E. Longley, Regional Board Vice-Chair	John Russell, Regional Board Staff
Paul Betancourt, Regional Board Member	Steven Blum, Regional Board Counsel
Alison Brizard, Regional Board Member	Ted Cobb, Regional Board Counsel
Christopher Cabaldon, Regional Board Member	M. Catherine George, Senior Staff Counsel
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