



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

*Performance Audit
Environmental Response and Redevelopment
Programs
Department of Environmental Quality*

Report Number:
76-146-02

Released:
April 2005

The Department of Environmental Quality (DEQ) was created by Executive Order No. 1995-18, which also transferred environmental regulatory programs to DEQ from the Department of Natural Resources. DEQ's mission is to protect and enhance Michigan's environment and public health. The environmental response and redevelopment programs determine, evaluate, and control risk to the environment and the health, safety, and welfare of Michigan's citizens by carrying out cleanup or other response activities at sites of environmental contamination.

Audit Objective:

To assess DEQ's effectiveness in identifying, assessing, and addressing environmental contamination.

Audit Conclusion:

DEQ was generally effective in identifying, assessing, and addressing environmental contamination. Our report does not include any reportable conditions related to this audit objective.

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Audit Objective:

To assess DEQ's effectiveness in identifying potentially responsible parties and recovering costs related to response activity.

Audit Conclusion:

DEQ had limited effectiveness in identifying potentially responsible parties and recovering costs related to response activity.

Reportable Condition:

DEQ needs to improve the effectiveness and appropriateness of its recovery of State funds expended for response activities at facilities (Finding 1).

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Audit Objective:

To assess DEQ's effectiveness in facilitating the redevelopment of contaminated sites.

Audit Conclusion:

DEQ was generally effective in facilitating the redevelopment of contaminated sites funded by sources other than the Clean Michigan Initiative. Our report does not include any reportable conditions related to this audit objective.

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Agency Response:

Our audit report includes 1 finding and 1 corresponding recommendation. DEQ responded that it partially agreed with the recommendation.

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April 19, 2005

Mr. Steven E. Chester, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Chester:

This is our report on the performance audit of the Environmental Response and Redevelopment Programs, Department of Environmental Quality.

This report contains our report summary; description of programs; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

Our comments, finding, and recommendation are organized by audit objective. The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Programs

The Department of Environmental Quality (DEQ) was created by Executive Order No. 1995-18, which also transferred environmental regulatory programs to DEQ from the Department of Natural Resources. DEQ's mission* is to protect and enhance Michigan's environment and public health.

The environmental response and redevelopment programs determine, evaluate, and control risk to the environment and the health, safety, and welfare of Michigan's citizens by carrying out cleanup or other response activities* at sites of environmental contamination, by promoting redevelopment of contaminated sites, and by developing and managing information about chemicals in the environment. Environmental response and redevelopment programs also provide information and assistance to Michigan's businesses and municipalities, public agencies, and the public in understanding and meeting their environmental protection responsibilities.

Effective September 15, 2002, DEQ underwent a reorganization that created, and transferred preexisting responsibilities to, new divisions. The environmental response and redevelopment programs are administered by several DEQ divisions and have a number of funding sources. For the fiscal year ended September 30, 2002, DEQ expended approximately \$20.3 million for operations and \$87.0 million for response activities and redevelopment programs.

For the period October 1, 1999 through December 31, 2002, DEQ's environmental response and redevelopment programs and their funding sources were as follows:

1. Environmental Response and Redevelopment Programs
 - a. Superfund Program: This Program was established in 1980 to provide federal funds for response activities at the most seriously contaminated sites in the nation.
 - b. State Sites Cleanup Program: This Program was established in 1996 to fund response activities at contaminated sites where the State is a liable party as an owner or operator of the site.

* See glossary at end of report for definition.

- c. Response Activities at Facilities*: These programs were established to fund response activities at Michigan sites of environmental contamination when there are no financially viable or legally liable persons, or when the liable person(s) refused to act in a timely manner, and immediate action is needed.
- d. Waterfront Improvements Program: This Program was established to reclaim and revitalize waterfront property throughout the State to maximize its economic and public value.
- e. Remediation of Contaminated Lake and River Sediments: This program was established to remediate a substantial mass of bioaccumulative toxins, such as dichlorodiphenyltrichloroethane (DDT), polychlorinated biphenyls (PCBs), and mercury.
- f. Nonpoint Source Pollution Control Grants: This program was established to provide grants to nonprofit entities or local units of government to: (1) implement physical structures as identified in approved watershed management plans and (2) conduct activities to reduce nonpoint source pollution from a specific pollutant source as identified by DEQ.
- g. Clean Water Fund Programs: These programs were established to conduct activities to protect and improve water quality.
- h. Pollution Prevention Programs: These programs were established to conduct activities to reduce or eliminate waste at its source.

2. Funding Sources for Environmental Response and Redevelopment Programs

- a. Clean Michigan Initiative (CMI) Bond: In November 1998, Michigan citizens approved a \$675 million CMI Bond to be used for implementing brownfield* environmental and redevelopment response; protecting and enhancing Michigan's lakes, rivers, and streams; reclaiming and revitalizing local waterfronts; making critical State park improvements; enhancing local parks and recreational opportunities; preventing pollution; and protecting the public from lead hazards. Six categories of the CMI Bond are administered by DEQ: response activities at facilities; waterfront improvements; remediation of

* See glossary at end of report for definition.

contaminated lake and river sediments; nonpoint source pollution control grants; clean water fund programs; and pollution prevention programs.

- b. Cleanup and Redevelopment Fund: This Fund was created by Act 380, P.A. 1996, to provide a permanent, ongoing funding mechanism for the environmental response and redevelopment programs. The Fund consists of 80% of the State's share of annual unclaimed bottle deposit revenues and the transfer of Environmental Protection Bond Fund revenues appropriated in prior fiscal years to DEQ for solid waste alternative projects, pursuant to Section 324.19507 of the *Michigan Compiled Laws*. Additionally, in July 1996, the State committed up to \$30 million a year in general funds for DEQ's Environmental Cleanup and Redevelopment Programs.
- c. Environmental Protection Bond Fund: In November 1988, Michigan voters approved Proposal C, Environmental Protection Bond Issue. This proposal authorized the use of up to \$660 million of general obligation bonds for environmental protection throughout Michigan. Sections 324.19501 - 324.19513 of the *Michigan Compiled Laws* provide for the specific use of these funds.
- d. Environmental Protection Fund: This Fund was established by Act 133, P.A. 1996, to be credited with the net proceeds allocable to the nonconventional fuel credit contained in Section 29 of the Internal Revenue Code.
- e. General Fund: This Fund is the State's operating fund. It accounts for the financial resources and transactions not accounted for in other funds.
- f. Revitalization Revolving Loan Fund: This Fund was established by Act 380, P.A. 1996, to accept funds from any source for the purpose of making loans to certain local units of government to provide for eligible activities at certain properties in order to promote economic redevelopment.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of the Environmental Response and Redevelopment Programs, Department of Environmental Quality (DEQ), had the following objectives:

1. To assess DEQ's effectiveness* in identifying, assessing, and addressing environmental contamination.
2. To assess DEQ's effectiveness in identifying potentially responsible parties and recovering costs related to response activity.
3. To assess DEQ's effectiveness in facilitating the redevelopment of contaminated sites.

Audit Scope

Our audit scope was to examine the program and other records of the environmental response and redevelopment programs. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, performed from May 2002 through April 2003, included an examination of records and activities primarily for the period October 1, 1999 through December 31, 2002.

To accomplish our objectives, we conducted a preliminary review of environmental response and redevelopment program operations. This included interviewing program staff and reviewing applicable statutes, rules, policies and procedures, reports, and other reference materials.

* See glossary at end of report for definition.

We reviewed DEQ's processes for prioritizing and selecting contaminated sites for necessary remedial action. We assessed the efficiency* of cleanup projects overseen by contracted project managers.

We selected a sample of response activity projects at 4 of the 8 DEQ district offices for which DEQ had expended funds. We reviewed documentation for these projects to determine compliance with applicable requirements and to assess project outcomes. We interviewed program staff from the 4 district offices to obtain their input on the management of response activity projects and on DEQ's remediation and redevelopment responsibilities.

We assessed the effectiveness of DEQ's procedures for identifying potentially responsible parties and assessing their ability to reimburse the State for response activities. Also, we reviewed selected project documentation to determine the effectiveness of DEQ's efforts in recovering all appropriate costs for response activities and damages to natural resources.

We reviewed site revitalization grants and DEQ's use of covenants not to sue and their impact on the redevelopment of contaminated sites. Also, we reviewed the application and selection process for the funding of redevelopment and brownfield site response activities.

Agency Responses and Prior Audit Follow-Up

Our audit report includes 1 finding and 1 corresponding recommendation. DEQ responded that it partially agreed with the recommendation.

The agency preliminary response that follows the recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require DEQ to develop a formal response to our audit finding and recommendation within 60 days after release of the audit report.

Prior to the departmental reorganization in September 2002, the environmental response and redevelopment programs were administered by the former Environmental Response Division, Department of Environmental Quality. Prior to the Executive Order

* See glossary at end of report for definition.

that created the Department of Environmental Quality, the environmental response and redevelopment programs were administered by the Environmental Response Division, Department of Natural Resources. We released our most recent performance audit of Environmental Response Division, Department of Natural Resources (#7514693), in March 1996. DEQ has complied with all 12 of the audit findings in that report.

COMMENTS, FINDING, RECOMMENDATION,
AND AGENCY PRELIMINARY RESPONSE

IDENTIFYING, ASSESSING, AND ADDRESSING ENVIRONMENTAL CONTAMINATION

COMMENT

Audit Objective: To assess the Department of Environmental Quality's (DEQ's) effectiveness in identifying, assessing, and addressing environmental contamination.

Conclusion: DEQ was generally effective in identifying, assessing, and addressing environmental contamination. Our report does not include any reportable conditions* related to this audit objective.

IDENTIFYING POTENTIALLY RESPONSIBLE PARTIES AND RECOVERING COSTS RELATED TO RESPONSE ACTIVITY

COMMENT

Audit Objective: To assess DEQ's effectiveness in identifying potentially responsible parties and recovering costs related to response activity.

Conclusion: DEQ had limited effectiveness in identifying potentially responsible parties and recovering costs related to response activity. Our assessment disclosed a reportable condition related to response activity cost recovery (Finding 1).

FINDING

1. Response Activity Cost Recovery

DEQ needs to improve the effectiveness and appropriateness of its recovery of State funds expended for response activities at facilities. Implementing an objective and standardized enforcement program could expedite settlement and improve the effectiveness of the recovery of State funds expended for response activities.

Sections 324.20126a and 324.20137 of the *Michigan Compiled Laws* provide for the recovery of all costs of response activity lawfully incurred by the State, including civil fines and natural resource damages. In accordance with Delegation Letter ERD-201-05, dated October 13, 1997, DEQ has delegated the responsibility

* See glossary at end of report for definition.

for the recovery of response activity costs to its deputy director or division chief (currently, the Remediation and Redevelopment Division [RRD]). RRD's Compliance and Enforcement Section (CES) is responsible for response activity cost recovery. Also, CES tracks compliance with the financial aspects of settlements reached with the State for facilities it regulates. RRD staff or the designated project manager under the agreement is responsible for ensuring that liable parties comply with response activities required under settlement agreements. However, Section 324.20134(1) of the *Michigan Compiled Laws* authorizes DEQ and the Department of Attorney General to enter into a consent order with a person who is liable under Section 324.20126. For the period October 1, 1999 through December 31, 2002, DEQ negotiated 56 settlements and collected approximately \$22.1 million for response activity costs, civil fines, and natural resource damages. For the period October 1, 1999 through December 31, 2002, DEQ spent approximately \$9.5 million at 95 facilities. From the inception of response activities through December 31, 2002, DEQ spent approximately \$140.5 million at 769 facilities.

Our review of the negotiation process for 5 response activity cost recovery cases disclosed:

- a. DEQ's Executive Division* did not allow CES to pursue negotiated settlements with liable parties through its established process. As a result, DEQ did not achieve cost recovery settlements in a timely and equitable manner.

In 2 of the 5 cases, DEQ's Executive Division removed CES from the response activity cost recovery negotiation process and negotiated directly with the liable parties. In addition, the Executive Division did not inform the Department of Attorney General on a timely basis of settlement offers made during the negotiations with one liable party. Specifically, we noted:

- (1) In the first case, DEQ performed response activity at a cost of approximately \$6 million. The DEQ Executive Division has had ongoing negotiations since 1998 with the liable parties for a permanent remedy to prevent further spread of the residual contamination. Timely settlement in this case was necessary due to the detection of high levels of

* See glossary at end of report for definition.

contaminants in the groundwater* at the site, which was located in the wellhead protection area for a city's municipal well field.

- (2) In the second case, DEQ performed remedial response activities at a cost of approximately \$2.5 million. Although DEQ had been negotiating since 1996 with the liable party as to its responsibility to fund a remedy, there was no settlement. During the protracted negotiations, groundwater contamination and impacts to lake bottomland and reef habitat continued at the site, which is located on the shore of one of the Great Lakes.

CES administrators stated that the Executive Division's takeover of the settlement negotiation process generally resulted in prolonging the time necessary to reach a settlement. Prolonging the resolution of response activity cost recovery settlements may increase the likelihood of further contamination at a site and decrease the likelihood of cost recovery from the liable party.

- b. The Department's Executive Division prohibited the Department of Attorney General from using all available statutory authority in its pursuit of recovering response activity costs or of securing adequate and timely response activity to avoid incurring State response activity costs.

RRD requested that the Executive Division authorize the use of the federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) in order to pursue the recovery of over \$2.5 million in response activity costs incurred by the State at a facility where the liable party filed for bankruptcy. The Executive Division's denial of this request complicated RRD's ability to pursue the State response activity costs as well as its ability to require response activity at this facility.

- c. DEQ's Executive Division impeded CES's ability to pursue response activity cost recovery through court actions.

Allowing CES to pursue cost recovery through court actions, when it determines that negotiations will not be successful, should result in a more effective recovery of costs.

* See glossary at end of report for definition.

Executive Order No. 1995-18 and Delegation Letter ERD-201, revised October 13, 1997, require that the Executive Division make all requests for the Department of Attorney General assistance in settlement negotiations.

In one of the response activity cost recovery settlement cases reviewed, documentation prepared by CES staff in 1998 and 2000 recommended court action for the recovery of \$6.8 million of response activity costs after settlement negotiations that began in 1988 had ceased. CES staff informed us that the Executive Division denied RRD's request that the Department of Attorney General pursue the cost recovery through court action and directed RRD to continue negotiations. As of April 30, 2003, RRD was still negotiating a cost recovery settlement.

Allowing RRD to refer cases to the Department of Attorney General to pursue cost recovery through court actions could result in a more effective recovery of costs.

- d. The Executive Division and the RRD Executive Section did not document their decisions to reduce response activity costs and penalties owed by liable parties.

In one case, the Executive Division offered to settle \$6.8 million in outstanding response activity costs and interest for \$5 million without documenting the rationale for the offer.

In a second case, the Executive Division reduced outstanding response activity costs and civil penalties of \$400,000 to \$50,000 in a consent decree without documenting the rationale for the reduction.

In a third case, the Executive Division reduced from \$6.45 million to \$3.35 million a liable party's obligation to operate a long-term remediation plan after the liable party informed DEQ that it refused to pay more than \$4 million toward the cost of the planned remediation. The Executive Division did not document the basis for the reduction, including whether the liable party had the financial ability to pay for the total cost of the remediation plan.

In a fourth case, the RRD Executive Section reduced penalties assessed by CES against a liable party from \$415,000 to \$20,000 without documenting the basis for the reduction.

Maintaining documentation to support reductions to settlements and penalties would provide assurance that the reductions were in the best interest of the State.

RECOMMENDATION

We recommend that DEQ improve the effectiveness and appropriateness of its recovery of State funds expended for response activities at facilities.

AGENCY PRELIMINARY RESPONSE

DEQ partially agreed with the recommendation. DEQ informed us that it has already taken steps to improve the effectiveness and appropriateness of its recovery of State funds expended for response activities at facilities. DEQ indicated that the Executive Division has established an Office of Civil Enforcement Coordination to improve the predictability, reliability, and effectiveness of DEQ enforcement actions across divisions. In addition, DEQ indicated that this Office, along with the appropriate deputy director, also facilitates timely discussions with DEQ and the Department of Attorney General to resolve matters and ensure that proper follow-up occurs if there is a breakdown in productive settlement negotiations. DEQ informed us that the associated standardization of enforcement actions and the development of more consistent DEQ policies and procedures result in better documentation of DEQ actions, justification for settlements reached, and timely enforcement actions. DEQ also informed us that all requests for referrals to the Department of Attorney General have been supported by the current Executive Division.

In addition, DEQ informed us that Michigan's cleanup program is based on a causation standard as opposed to the strict liability standard of the federal cleanup program (CERCLA). However, DEQ also informed us that in spite of this liability standard, it negotiated 56 settlements and collected approximately \$22.1 million for response activity costs, civil fines, and natural resource damages. DEQ indicated that a causation-based standard creates many challenges in establishing that a person has liability and, as such, it may not always be appropriate for the Department of Attorney General to bring a cause of action under CERCLA. DEQ

also indicated that the Department of Attorney General, thus, carefully assesses each case that would be filed under CERCLA.

DEQ informed us that the current Executive Division, consistent with the DEQ strategic plan, encourages the use of all enforcement tools to obtain the best outcome for the program. This includes, but is not limited to, the use of CERCLA when its use is consistent with program objectives. DEQ also informed us that the current Executive Division has referred cases to the Department of Attorney General for enforcement under CERCLA where it is consistent with overall program objectives.

FACILITATING THE REDEVELOPMENT OF CONTAMINATED SITES

COMMENT

Background: DEQ's environmental response and redevelopment programs are funded by multiple sources consisting of the following: Clean Michigan Initiative (CMI) Bond, Cleanup and Redevelopment Fund, Environmental Protection Bond Fund, Environmental Protection Fund, General Fund, and Revitalization Revolving Loan Fund. For purposes of this audit objective, our conclusion is based on projects funded by sources other than CMI. Our conclusions pertaining to CMI-funded sites are contained in our concurrent audit of the Clean Michigan Initiative, Natural Resources Protection Programs, Department of Environmental Quality and Department of Community Health (#7621703).

Audit Objective: To assess DEQ's effectiveness in facilitating the redevelopment of contaminated sites.

Conclusion: **DEQ was generally effective in facilitating the redevelopment of contaminated sites funded by sources other than CMI.** Our report does not include any reportable conditions related to this audit objective.

GLOSSARY

Glossary of Acronyms and Terms

brownfield	An abandoned, idle, or underused industrial or commercial property, often in an urban area, where expansion or redevelopment is hindered or complicated by real or perceived environmental conditions.
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act of 1980.
CES	Compliance and Enforcement Section.
CMI	Clean Michigan Initiative.
DEQ	Department of Environmental Quality.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical with the minimum amount of resources.
Executive Division	Consists of the DEQ director, deputy directors, executive assistant to the director, legislative liaison, director of southeast offices, and regulatory reform officer.
facility	Any area, place, or property where a hazardous substance in excess of the concentrations that satisfy the requirements of Sections 324.20120a(1)(a) or 324.20120a(17) of the <i>Michigan Compiled Laws</i> or the cleanup criteria for unrestricted residential use under part 213 of NREPA has been released, deposited, disposed of, or otherwise comes to be located. A facility does not include any area, place, or property at which response activities have been completed that satisfy the cleanup criteria for the residential category

provided for in Sections 324.20120a(1)(a) and 324.20120a(17) or at which corrective action has been completed under part 213 of NREPA that satisfies the cleanup criteria for unrestricted residential use.

groundwater	Water below the land surface in the zone of saturation.
mission	The agency's main purpose or the reason that the agency was established.
NREPA	Natural Resources Environmental Protection Act (Act 451, P.A. 1994).
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
RRD	Remediation and Redevelopment Division.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
response activity	The evaluation, interim response activity, remedial action, or other actions necessary to protect the public health, safety, or welfare; the environment; or the State's natural resources.

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