

INITIAL STATEMENT OF REASONS
DIVISION 4-PROPOSITION 65 PRIVATE ENFORCEMENT

REVISION OF CHAPTERS 1 AND 3
TITLE 11, CALIFORNIA CODE OF REGULATIONS

I. GENERAL PURPOSE OF PROPOSED REGULATIONS

This rulemaking is intended to: (1) ensure that the State’s Office of Environmental Health Hazard Assessment (“OEHHA”) receives the civil penalty funds specified in Proposition 65, so that it has adequate resources for Proposition 65 implementation activities; (2) limit the ability of private plaintiffs to divert the statutorily mandated penalty to themselves or to third parties, in the form of Additional Settlement Payments; (3) increase the transparency of settlements in private party Proposition 65 cases, to ensure that any monies allocated to Additional Settlement Payments are spent on matters with a sufficient nexus to the litigation and to the State of California; and (4) reduce the financial incentives for private plaintiffs to bring and settle Proposition 65 cases that do not confer substantial public benefit, while in no way discouraging cases and settlements that do confer such benefit. The Attorney General believes that these regulatory changes will help restore public confidence that Proposition 65 is used for its proper health-protective purposes and not abused for private gain.

The specific anticipated benefits of the rulemaking are that the State would have the funding necessary for Proposition 65 scientific support activities, such as listing additional chemicals and identifying “safe harbor” exposure levels for listed chemicals; that the use of Proposition 65 Additional Settlement Payments would be limited to situations with a close nexus to the violation alleged; that the terms of private settlements would be more transparent both to the public, and to the courts that must evaluate the reasonableness of settlements; and that there would be less incentive for private party litigation that confers little public benefit.

The proposed regulations are authorized under existing Health and Safety Code section 25249.7(f); they do not implement any new legislation.

II. PROBLEM THE REGULATIONS ARE INTENDED TO ADDRESS

The proposed regulations stem from the Attorney General’s concerns regarding private party litigation under Proposition 65, which arise from many years of monitoring such litigation from the notice through judgment/settlement stage. These concerns overlap with but do not directly mirror broader public concerns, insofar as the Attorney General readily acknowledges that many public health benefits accrue from private party Proposition 65 litigation that are not readily apparent to the public. For example, private party litigation has led many businesses to reformulate their products to avoid use of listed chemicals, or change their practices to avoid creating exposures to listed chemicals.

Notwithstanding the benefits from certain private party litigation under Proposition 65, the Attorney General has significant ongoing concerns with respect to private enforcement actions under the statute. These include: the private bar’s diversion of large amounts of what should be

statutory penalty payments to Additional Settlement Payments, with a corresponding reduction in payment to OEHHA for Proposition 65 support activities; private party settlements that include Additional Settlement Payments with an insufficient nexus to the violation alleged, and an insufficient connection to California; private party settlements that include only a vague and general description of how any Additional Settlement Payments will be spent, and provide for little or no court or public oversight of expenditures; and excessive attorney's fee awards in relation to public health benefit conferred.

The overarching goal of the present regulations is to increase the likelihood that private enforcement of Proposition 65 will be used to further the voters' intent in enacting the law: reducing the discharge of, and warning the public regarding exposures to, toxic chemicals.

III. ECONOMIC IMPACT ASSESSMENT

There are two potential economic impacts of the proposed regulation on businesses in California. The first impact will be to nonprofit corporations and consumer and environmental groups that receive funding through "Additional Settlement Payments" ("ASPs") in Proposition 65 settlements. These groups include some of the private enforcers of Proposition 65 that use ASPs to fund their work, and third parties that receive ASPs. Average annual ASPs recovered in private Proposition 65 settlements over the last three years, however, were \$2.8 million. (See Annual Summaries of Private Settlements, at <http://oag.ca.gov/prop65>.) While the proposed regulations may result in a portion of future settlement funds being allocated as civil penalties instead of as ASPs, it is anticipated that private enforcers will continue to recover ASPs. Therefore, any economic impact on groups that receive ASPs necessarily will be less than the amounts recovered over recent years.

The second potential economic impact of the proposed regulation arises from the increased specificity the regulation prescribes for defining, documenting, and reporting the use of ASPs. These requirements must be met by the nonprofit and consumer and environmental groups that collect funding through ASPs. While there may be costs associated with complying with the requirements, the current regulation requires entities that receive ASPs to be able to demonstrate how funds will be spent and to assure that the funds are being spent for the proper, designated purpose. The proposed regulation should not, therefore, create any significant increase in the costs of documenting how ASPs are used.

The Attorney General's Office assesses the economic impact of the proposed regulation in the areas required to be assessed under Government Code Section 11346, subdivision (b)(1), as follows:

(A) *The creation or elimination of jobs within the state.* There may be less work for lawyers, legal assistants, investigators, and employees of nonprofits that enforce Proposition 65 or whose work is funded from ASPs. However, the proposal will not eliminate ASPs as a source of funding, and private enforcers will continue to receive 25 percent of any civil penalty and recover attorney's fees and costs where justified. Accordingly, the Attorney General concludes that the regulation is not likely to eliminate any jobs.

(B) *The creation of new businesses or the elimination of existing businesses within the state.* No impact.

(C) *The expansion of businesses currently doing business within the state.* No impact.

(D) *The benefits of the regulation to the health and welfare of California residents, worker safety, and the state's environment.* By clarifying that the mere fact of reformulation may not establish the existence of a significant public benefit in a Proposition 65 settlement, the regulation will help to ensure that agreements with reformulation requirements result in an actual reduction or elimination of exposures to listed chemicals. By clarifying that ASPs must have a "clear and substantial nexus" to the violation alleged, and that the funded activity must be designed to have a "direct and primary effect within the State of California," the regulation will help ensure that ASPs are used for the benefit of California residents, workers, and the environment. By potentially increasing the allocation of private settlement payments to OEHHA as civil penalties, the proposed regulation will support OEHHA's overall mission of protecting and enhancing public health and the environment by scientific evaluation of the risks posed by hazardous substances.

IV. EVIDENCE SUPPORTING DETERMINATION OF NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS.

The proposed regulations directly affect private persons and law firms who bring civil actions in the public interest under Proposition 65. They also indirectly affect businesses that receive Proposition 65 notices from private parties, and the law firms that defend them. Both by altering the allocation of monetary recoveries in Proposition 65 settlements, and modifying a presumption regarding award of attorney's fees to plaintiffs' counsel, the proposed regulations may reduce the profitability of plaintiffs' legal actions that have little public benefit. The proposed regulations may correspondingly reduce litigation costs for certain defendant businesses.

By increasing the funding available to OEHHA from private party settlements, and thereby enhancing its ability to issue Proposition 65 regulations and establish Proposition 65 safe harbor levels, in the long term the proposed regulation may result in cost savings for both plaintiffs and defendant businesses by reducing the overall cost of Proposition 65 litigation.

Because these various economic effects may to some extent cancel each other out, it is not possible to predict the potential cost impact on any representative person or business in California. However, any such impact is not anticipated to be significant. As such, the Attorney General does not foresee significant statewide adverse economic effects on either plaintiffs' or defense law firms, or businesses that receive Proposition 65 notices.

V. REASONABLE ALTERNATIVES TO THE REGULATIONS AND THE AGENCY'S REASONS FOR REJECTING THEM.

The Attorney General has identified no reasonable alternatives to the proposed regulatory changes that would either be more effective in carrying out the purpose for which the action is proposed, that would be as effective and less burdensome, or that would lessen any adverse impact on small businesses. In reaching this conclusion, the Attorney General's Office has

considered burdens on private parties, cost effectiveness, and effectiveness in implementing the statutory policies of Proposition 65.

VI. TECHNICAL, THEORETICAL, AND EMPIRICAL STUDIES, REPORTS, OR SIMILAR DOCUMENTS.

In proposing these regulatory changes, the Attorney General has relied on the annual summaries and reports of private settlements posted on the Attorney General’s Proposition 65 website at www.oag.ca.gov/prop65, on private enforcement reporting and the underlying documents posted at the same location under the “Search 60-Day Notice” tab, and on the Office of the Attorney General’s experience reviewing Proposition 65 private enforcement actions, including but not limited to, motions to approve settlements and/or consent judgments filed by private enforcers.

VII. SECTION-BY-SECTION ANALYSIS

1. Chapter 1: Reporting Requirements

a. Section 3000: Authority

Language has been added to Section 3000 to make clear that settlements occurring after the provision of a 60-day notice but prior to filing of a complaint must be reported to the Attorney General. This clarification makes the regulations consistent with Health and Safety Code section 25249.7(f)(1), which provides that “any private person settling any violation of this chapter in a notice . . . shall, after the action *or violation* is subject . . . to a settlement . . . submit to the Attorney General a reporting form that includes the results of that settlement . . .” (emphasis added).

b. Section 3001: Definitions

Consistent with the changes to section 3000, section 3001(e) has been amended to include within the definition of a “Settlement” any pre-filing agreements resulting from a 60-day notice. A new subdivision (f) has been added to provide a definition of the “Additional Settlement Payments” that are the primary subject of this rulemaking. Because these payments may be denominated in various ways in private-party settlements (*e.g.*, as “payments in lieu of penalties,” “additional payments,” or otherwise), the Attorney General has by regulation defined them in the negative, as payments that are not civil penalties, cost reimbursements, or attorney’s fees.

c. Section 3003: Settlements

Consistent with the changes to section 3000, and to subdivision (e) of section 3001, section 3003 has been amended to ensure, through new subdivision (c), that private parties serve upon the Attorney General any post-notice, *pre-filing*, settlement, and a Report of Settlement, for settlements completed prior to the filing of a complaint. This provision makes the regulations consistent with Health and Safety Code section 25249.7(f)(1), which provides that “any private person settling any violation of this chapter in a notice . . . shall, after the action *or violation* is subject . . . to a settlement . . . submit to the Attorney General a reporting form that includes the results of that settlement . . .” (emphasis added). Settlements subject to this subdivision must be

reported within five days, which is the same amount of time in section 3003(a) for settlements of private Proposition 65 actions that occur after the filing of a complaint. The Attorney General's on-line reporting system already accommodates reporting of pre-filing settlements. Additionally, subdivision (b) has been amended to be gender-neutral, by substituting the phrase "she or he" for "he" in describing the Attorney General.

2. Chapter 3: Settlement Guidelines

a. Section 3201: Attorney's Fees

Based upon review of hundreds of private party settlements over an extended period, the Attorney General's Office has grown concerned about the frequency and magnitude of attorney's fees recoveries in cases that involve quantitatively insignificant exposure to a listed chemical, and/or untenable exposure scenarios. In such cases, while a noticed party may agree to reformulate a product simply to avoid the cost of proving that exposure is below the level requiring a consumer warning, it is debatable that a meaningful public benefit accrues from the reformulation. Subdivision (b)(2) of section 3201 has accordingly been revised to make rebuttable the presumption that reformulation constitutes a sufficient showing of public benefit for attorney's fees purposes. This makes section 3201(b)(2) more closely parallel subdivision (b)(1), which provides that where a settlement results in provision of a warning, whether the warning constitutes a significant public benefit is fact-dependent. Subdivision (b)(1) has been clarified by the addition of the modifier "significant" before the phrase "public benefit," so that the phrase better tracks the language of the applicable attorney's fee statute, which requires "a *significant* public benefit, whether pecuniary or nonpecuniary...." (Code Civ. Proc., § 1021.5, subd. (a) (emphasis added).) In section 3201(d), a typographical error has been corrected ("attorney" has been changed to "attorneys"). Section 3201(e) has been amended to clarify that, in addition to claims for attorney's fees, claims for investigation costs should be justified with contemporaneously kept records of actual time spent or costs incurred. This clarifies the intent of the current regulation.

b. Section 3203: Reasonable Civil Penalty

Section 3203 has been amended to prompt greater private party justification, and judicial scrutiny, of settlements through which all or a portion of a civil penalty is waived in response to certain conduct by the defendant, or an Additional Settlement Payment is made in lieu of a portion of the penalty. This is because Proposition 65 (in Health & Saf. Code, § 25249.12(c)(1)) expressly contemplates that the state shall receive 75% of any penalty in a Proposition 65 action; any agreement to forgo all or a portion of this penalty runs the risk of defeating the voters' intention that penalty funds be used "to implement and administer" Proposition 65. (*Ibid.*)

Subdivision (a) of section 3203 has been amended to indicate that the appropriateness of a zero- or minimal-penalty settlement is fact-dependent. It has also been updated to reflect that the Department of Toxic Substances Control is no longer the state agency recipient of Proposition 65 penalties. The proper agency recipient, the Office of Environmental Health Hazard Assessment (OEHHA), is identified in amended subdivision (b), which contains additional language previously in subdivision (a).

The content of section 3203(b), which pertained to what are now defined as Additional Settlement Payments, has been moved to section 3204, with the amendments described below.

New subdivision (c) of section 3203 provides that any reduction in civil penalties that is tied to certain conduct of the defendant, such as product reformulation, must be verifiable as to both the connection to the underlying litigation and the benefit to California. New subdivision (d) of section 3203 further strengthens these nexus requirements by requiring plaintiffs to demonstrate to the court's satisfaction that the public interest is served by the proposed reduction in (*i.e.*, offset to) the civil penalty required by statute. These provisions will ensure additional transparency in settlements where a private prosecutor has agreed to waive civil penalties in exchange for certain conduct by the defendant. It will help courts, the Attorney General, and the public, evaluate whether the agreement is consistent with the health-protective purposes of Proposition 65, and ensure that a defendant's compliance with the agreement is verifiable.

c. Section 3204: Additional Settlement Payments

New section 3204 addresses a variety of Attorney General concerns with respect to private litigants' use of Additional Settlement Payments. This section considerably expands the requirements for such payments that were previously contained in former section 3203(b).

Section 3204(a) facilitates judicial, Attorney General, and public scrutiny of Additional Settlement Payments by flatly prohibiting their use in out-of-court settlements. Health and Safety Code section 25249.7(f)(4) requires private enforcers to submit most Proposition 65 settlements for court approval. This gives courts an opportunity to review any ASPs, and to ensure they will be, and are, in fact, used for purposes consistent with Proposition 65. When private parties settle an alleged violation out of court, however, there is no judicial review or oversight. Subdivision (a) puts private parties on notice of the Attorney General's view that alleged Proposition 65 violations should not be resolved by private parties in exchange for payments other than statutory civil penalties or attorney's fees and costs without judicial review and continuing oversight.

Section 3204(b) aims to curtail the over-reach, vagueness, and limited accountability that has characterized many ASP provisions in even those private-party settlements filed in court. This subsection identifies the criteria that private parties must satisfy to prevent the Attorney General from objecting to an Additional Settlement Payment in a proposed settlement.

Section 3204(b)(1) addresses the problematic level of diversion of funds from OEHHA to private plaintiffs through ASPs, which compromises OEHHA's ability to perform the Proposition 65 work with which it is uniquely entrusted, such as listing chemicals and establishing safe harbor levels. The Attorney General's Annual Summaries of Private Settlements (<http://oag.ca.gov/prop65>) indicate that certain private enforcers consistently recover higher ASPs than civil penalties. As ASPs increase in proportion to the civil penalty in a settlement, there is increased risk that the settlement is not consistent with the statutory framework of levying civil penalties for violations, of which 75 percent is directed to OEHHA. This section accordingly caps the amount of a permissible ASP, by providing that it may not exceed the amount of guaranteed ("noncontingent") civil penalty paid to OEHHA.

Subdivision (b)(2) likewise aims to insure that ASPs advance the purpose of Proposition 65, by requiring that their contemplated uses have a “clear and substantial nexus” to the underlying violation. This in turn requires that they be used to address the same environmental harm, and do so through funded activity that will directly and primarily benefit California. This subdivision addresses the Attorney General’s concerns that even where ASPs are used for public interest environmental purposes, they are frequently used for purposes largely unrelated to the Proposition 65 case at issue. Regardless of the independent merits of the projects funded through ASPs, the Attorney General does not believe that unrelated projects should be funded at the expense of OEHHA funding for Proposition 65 purposes.

Paragraphs (3), (4), and (5) of subdivision (b) all aim to increase transparency in the use of ASPs, by requiring that recipient entities be accountable for the use of funds; describe with specificity the uses to which funds will be put; and maintain documentation of fund expenditures. Paragraph (6) identifies information that private parties will be expected to provide to facilitate Attorney General and court review of proposed ASPs, as follows: information regarding the entity receiving the payments (section 3204(b)(6)(A)); the entity’s potential economic interest in the payments (section 3204(b)(6)(B)); the means by which the plaintiff will track expenditures (section 3204(b)(6)(C)); and the selection process for any grantees who will receive a portion of the payments (section 3204(b)(6)(D)). Evaluation of this information will permit the Attorney General and the court to assess the likelihood of performance of contemplated activities, and will increase the public transparency of the use of Proposition 65 settlement monies.

d. Section 3205: Other Provisions

The “Other Provisions” section was previously section 3204. It has been renumbered to reflect the addition of a new regulation section immediately prior. No changes have been made to its text, except to add an erroneously omitted word (“are”) in subdivision (a)(1).