Legal Considerations in Environmental Audit Decisions

Without some safeguards, your own audit information can become the source of self-incrimination or a way of helping your adversaries build a case against you.

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An environmental audit program is implemented to identify and correct, as early as possible, any existing or potential environmental compliance problems or environmental liability risks present in an operation. Audit and remedial action programs are motivated by fear of potential major civil and criminal liability. The audit must be carefully planned so that the results can be kept confidential and undiscovered by the government or other parties.

Without some safeguards, your own audit information can become the source of self-incrimination or a way of helping your adversaries build a case against you. Damaging information in an audit report could also prove useful to groups seeking to block a merger or acquisition or to dissident shareholders. Therefore, it is important to plan out your environmental audit procedure in such a way that its external release is controlled without interfering with your ability to generate the information for internal purposes.

Any noncompliance or environmental risks that are discovered must be corrected. If your company does not correct an environmental problem uncovered by an audit, without a valid legal basis for not doing so, the company and individuals may be subject to criminal liability for a knowing violation or from intentional or reckless conduct.

Legal benefits of auditing

Aside from the question of what happens to the information that is generated, there are some related legal aspects of auditing that are quite important. One aspect is the potential liability that one can avoid by having maximum environmental knowledge. In this day and age of multimillion dollar cleanup costs and expensive personal injury and property damage liability, internal environmental knowledge can save a lot of money. It is quickly becoming the norm for industrial and other real estate buyers, sellers and lenders to make serious inquiry into the environmental status of the business and of the property prior to committing to any deal. From your perspective as the potential seller, how much you know about your operation, and what you do with that information can make or break your long-run business success.

In its simplest form, knowing that risks are too high might motivate you to quickly sell and distance yourself from the operation. However, such knowledge can also lead to quite the opposite result. By openly disclosing to buyers the presence of a particular environmental problem on a site, you may assist the buyer in managing that problem in a way that neither the buyer nor the seller will be

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subject to governmental intervention or other costs or liabilities. Your buyer, acting in a sense as your agent, can protect your mutual interests best by having as much knowledge about the site as possible. In some situations, you may feel that retaining control of potential problems is the most prudent thing to do. Your knowledge of particular environmental problems then may influence you to hold onto a piece of property and manage it yourself to avoid environmental liabilities.

Good internal information can also help avoid potential liability in the areas of safety and health. Although common multimillion dollar liabilities are a relatively recent phenomenon in environmental law, such liabilities have existed for many years in the areas of occupational exposure to chronic diseases and liability for dangerous products. The internal auditing mechanism in the environmental area can and in many cases should be expanded to include occupational safety and health and product safety.

Significant public relations benefits can result from an established environmental audit program. Similarly, environmental audit programs are effective tools to sensitize plant personnel to environmental issues and related corporate concerns. For those compannies with widely diversified businesses, foreign facilities, and decentralized corporate management, audit programs not only identify compliance status and environmental risks, but they can also familiarize upper management with the various operations of the company and the environmental hazards involved with them.

Preserve confidential information

Our main concern in dealing with environmental audits is preserving the confidentiality of the information generated. In the early 1980s, extended discussion was held with EPA regarding the protection that should be given to companies who voluntarily perform environmental audits. In 1981, it looked as if EPA was going to adopt a policy whereby it would not inspect a company's facilities once the company had allowed it to review and approve its environmental auditing program. That policy never came to pass, however, and in its place, EPA finally released its Environmental Auditing Policy Statement.

The EPA Policy Statement in the *Federal Register* (July 9, 1986) specifies: "It is EPA policy to encourage the use of environmental auditing by regulated entities to help achieve and maintain compliance with environmental laws and regulations, as well as to help identify and correct unregulated environmental hazards." The EPA acknowledged industry's concern that audit reports could be demanded and used in compliance witch hunts. EPA refused, however, to give up its authority to request audit reports, citing its broad statutory authority to request any relevant information on the environmental compliance status of regulated entities.

However, it did rule out routine EPA requests for audit reports. Instead, EPA will limit requests to reports that are needed to accomplish a statutory mission, are materials to a criminal investigation, or contain information that cannot be obtained from monitoring, reporting, or other data already in EPA files. EPA will also continue its practice to demand environmental audit reports:

1. In consent decrees
2. Where a company has placed its management practices at issue by raising them as affirmative defenses
3. Where an individual's state of mind or intent is a necessary element (as in a criminal investigation)

Contrary to what was discussed in the early 80s, EPA refused to forego inspections or provide other incentives to

Table I. Essential elements of an effective auditing program.

1. Explicit top management support for environmental auditing and a commitment to follow up on audit findings
2. An environmental auditing group independent of audited activities
3. Adequate team staffing and auditor training
4. Explicit audit program objectives, scope, resources, and frequency
5. Process that collects, analyzes, interprets and documents information sufficient to achieve the audit's objectives
6. Specific procedures to promptly prepare candid, clear and appropriate written reports on the audit findings
7. Corrective actions and schedules for implementation
8. Quality assurance procedures to assure the accuracy and thoroughness of environmental audits

> **The audit must be carefully planned so that the results are kept confidential and undiscovered by the government or other parties.**

companies that voluntarily implement an environmental audit program. EPA did point out that effective environmental audit programs should reduce the number of government inspections at a facility, since EPA addresses environmental problems on a priority basis, and consequently inspects facilities with poor environmental track records and practices more often then others. Table 1 shows the essential factors of an effective auditing program. In addition, EPA expressed a willingness to consider the existence of an environmental audit program when formulating penalties or other enforcement options on a case-by-case basis. The presence of a genuine effort to avoid and promptly correct violations, as with a *bona fide* environmental audit program, should work to remove at least the punitive factor in determining penalties.

EPA expects to use environmental auditing provisions in consent decrees and other settlement negotiations in situations where ongoing auditing could reduce the likelihood of recurring problems at the same facility or where the agency suspects that similar problems may exist at other facilities owned by the same company. EPA also encouraged industry to voluntarily notify appropriate state or federal officials any time internal audits turn up significant environmental or public health risks even if those risks do not rise to the level requiring immediate notice to the government.

Protected under the Freedom of Information Act

Confidentiality cannot be preserved 100% of the time. First of all, in some cases federal and state reporting requirements mandate the immediate notification of the government when you learn of certain environmental problems. The simple fact an environmental audit lead to your learning of a problem that must be disclosed under one of these reporting requirements does not negate the obligation to report. Second, EPA has broad authority to compel the production of information on environmental compliance at regulated facilities. Lastly, even in the absence of an express notice requirement, if EPA, the SEC, or a private plaintiff is attempting to obtain copies of your audit reports in the context of an enforcement case or a lawsuit, only limited forms of protection are available.

In the early 80s, some commentators and authors of articles on environmental auditing hypothesized that a special form of protection for environmental audit reports might develop as a matter of public policy. This form of protection was dubbed a self-evaluation privilege. However, development of such privilege has been extremely limited. The two established legal doctrines that can be used to protect environmental information from disclosure are the attorney-client privilege and attorney work product.

One point of clarification is critical. Trade secrets and various other confidential information in possession of government agencies are protected under the Freedom of Information Act and similar state laws. Although the Freedom of Information Act created a principle that most governmental records must be made available to the public, if there are in the records pertaining to your company confidential and trade secret information, some limited protection is available. These laws may govern public access to copies of your environmental audit reports already in an agency's files. But the Freedom of Information Act does not address initial disclosure of information, such as environmental audits, to the government itself. It is critical to protect against disclosures of environmental audit information to the government.

Parties to litigation generally have the right to obtain any relevant information in the hands of other parties. Such liberal discovery applies to administrative subpoenas as well as court cases. This discovery rule is broad enough to reach any information that reasonably may lead to the discovery of admissible evidence even if the initial information itself would not be admissible in court. Environmental audits probably fit within that definition in the context of government enforcement cases, government investigations, or private environmentally-based law-suits.

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Attorney-client privilege

The attorney-client privilege is an exception to the general rule of liberal discovery. It was developed for the most part by the courts to encourage open communications between a client (in this case the company) and his attorney (either inside or outside counsel). The elements that support a claim of attorney-client privilege are shown in the box. What does this mean in the context of environmental audits? It is critical to establish the purpose of the environmental audit program in the beginning by identifying several key points through corporate minutes, a resolution by the board of directors, or at least by a directive from upper management.

- The program should be designed solely for internal deliberation and review, not to fulfill a reporting requirement to a government agency or to any third party such as a prospective purchaser or a joint venture partner. Otherwise, the confidentiality portion of the rule will be lost as well as the claim for attorney-client privilege.
- The management directive should expressly delegate responsibility for the audit program to in-house (or outside) legal counsel, making clear that the audit program is designed for the corporation to seek legal advice from its attorney.
- The directive should specifically grant to counsel the authority to collect the necessary information from all levels of the company and should authorize the use of nonlegal assistants (such as engineers or consultants) from both inside and outside the company. It should also instruct all company employees to cooperate fully with the attorney or his/her assistants as a part of the audit and explain the purpose of the audit program and its need for confidentiality.
- The directive should direct the attorney to protect the confidentiality of the information generated, and to limit the distribution of the generated audit report to those company personnel with a need to know such information.

Keep the audit report confidential

The format of the environmental audit report should clearly specify that it is a legal document prepared by legal counsel and intended to be preserved as confidential. For example, the front of the report should be stamped prominently with words like "privileged and confidential legal communication." A draft audit report prepared by the audit team should be reviewed by counsel who should then personally prepare the final report. Separate files to store environmental audit reports should be established, and they should be secure and labeled "privileged and confidential material." Access to the files should be limited to those with a need to know. Corporate personnel who supply information for the audit should not keep notes, summaries or memoranda of the information provided during the audit.

Even when the elements necessary for attorney-client privilege are present, you must take care not to waive that privilege. It is waived if the holder of the privilege, in this case the corporation, voluntarily divulges the information

Items Supporting a Claim of Attorney-Client Privilege

- Communications between present or past employees and an attorney or his agent at the direction of corporate superiors in order for the company to secure legal advice.
- Communications must be part of a factual investigation with the goal of obtaining legal advice about the particular subject.
- Communications, which do not come from upper-level management, must be on a subject not available from upper-level management; The communications must be needed to form a basis for the legal advice sought by the company.
- Communications must concern matters within the scope of the communicating employee's corporate duties.
- Communicating employees themselves should have been informed that the communications are required for the purpose of obtaining legal advice.
- Employees should have been informed of the confidentiality of the communications.
- Company must subsequently treat the communications as confidential and not disclose them any more broadly than appropriate under the circumstances.

more broadly than is reasonable under the circumstances. You must not distribute parts of the environmental audit report claimed as privileged to outsiders or even to company people without a real need to know.

The extent of reasonable distribution of the audit report depends both on the material in question and on the context. With regard to the raw data you obtained during the audit, comparatively wide distribution may be necessary to the effective operation of your business. You might make such information available to the environmental compliance personnel at the facility, the facility manager, the corporate environmental affairs department, and any other technical or operational groups in the company with a *bona fide* use for the information. On the other hand, you should give narrower distribution to the conclusions drawn by the environmental audit team under the direction of legal counsel. It is reasonable to send the compliance and risk conclusions to the facility manager, the general counsel's office, the director of environmental affairs, and upper management, but broader dissemination should be restricted. Certain specialized legal conclusions might warrant even narrower distribution than that. For example, if problems were uncovered with the communications channels as a part of the environmental audit process or if particular compliance concerns and recommendations for correction were made, such information might well be limited to upper management.

By following these steps you will increase your company's chances of protecting the information from your environmental audit under the attorney-client privilege.

Work product doctrine

The work product doctrine is the second way to protect some of the information generated in your environmental audit. The work product rule protects materials prepared by or for legal counsel in anticipation of litigation. It applies to documents and other reports, not just communications, but it does not apply to the facts contained in the documents if such facts are discoverable some other way.

This element of "in anticipation of litigation" generally presents the most difficult stumbling block to protecting environmental audit reports as work product. The remote possibility of litigation that is always present in business is not sufficient. On the other hand, a suit does not need to be already filed in the courts either. Determinations are made on a case-by-case basis, and the question is whether there is a reasonable basis to anticipate litigation. Generally, in an ongoing operation without a particular existing environmental compliance concern, this element would not be satisfied.

To maximize the chances of satisfying this element, however, the corporate directive creating the environmental audit program should also identify the distinct possibility of governmental enforcement and private litigation in the environmental compliance area as a concern of the corporation and as one of the reasons why the corporation is implementing an environmental audit program.

There are other limits to the work product doctrine as well. In many cases, even work product prepared in anticipation of litigation is not absolutely protected. Rather, those seeking the documents can obtain them upon a showing that they are otherwise unable to obtain the information without undue hardship. A distinction is drawn between documents representing work product in general and those containing specific opinions, mental impressions and thought processes of the attorney. Courts have held that such opinions of counsel deserve more protection, and often give documents containing them absolute protection.

Therefore, to maximize the chance of protecting environmental audit reports, it is prudent to have legal counsel actually record collection of the raw data. The way this might occur, for example, is to have the attorney actually conduct the employee interviews. If written questionnaires are utilized as an early step in the data collection process, they might be sent to the attorney for review who would then draft a memorandum of his/her conclusions based upon them. Although involving counsel to this extent may add to the cost of the audit program, it helps assure that your company does not do the investigative work for your adversaries.

The chemical industry has made considerable progress in effectively using audit programs to increase environmental compliance. The process can be made as risk-free as it possibly can be by taking a few additional steps to protect the information generated. ■