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BILL ANALYSIS

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Senate Bill 728 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Loren Bennett
Committee: Natural Resources and Environmental Affairs

Date Completed: 1-23-96

RATIONALE

Apparently, private industry is increasingly aware of the importance of complying with environmental regulations, and many if not most people support the concept of self-initiated audits to determine a company's compliance status. Reportedly, however, businesses commonly fear that information compiled through an audit will be used by regulatory agencies to identify areas of violation for enforcement action. This concern also is shared by municipalities; the Michigan Municipal League reports "a profound reluctance by municipal officials to perform environmental audits for fear that revelations of compliance deficiencies will trigger enforcement actions by state agencies or costly lawsuits by disgruntled local residents". To alleviate these fears and promote voluntary compliance with environmental laws, it has been suggested that businesses and municipalities would be encouraged to perform self-evaluations if they were assured protection against the disclosure and use of audit findings.

CONTENT

The bill would add Part 148 to the Natural Resources and Environmental Protection Act to provide for environmental audits; specify that they would be privileged and protected from disclosure; specify the conditions under which they could be disclosed; provide that law enforcement authorities could request environmental audit reports, or seize reports pursuant to a search warrant, and provide for hearings on objections to disclosure; provide for immunity for a violation of the Act if a person voluntarily disclosed the violation to the appropriate State or local agency; create a rebuttable presumption that a disclosure was voluntary; specify penalties for violations of the bill; and require a report to the Legislature on the effectiveness of Part 148.

"Environmental audit" would mean a voluntary and internal evaluation conducted on or after the bill's effective date of one or more facilities or an activity at one or more facilities regulated under State, Federal, regional, or local laws or ordinances, or of environmental management systems or processes related to the facilities or activity or of a specific instance of noncompliance, that was designed to identify historical or current noncompliance and prevent noncompliance or improve compliance with one or more of the laws, or to identify an environmental hazard, contamination, or other adverse environmental condition, or to improve an environmental management system or process. "Environmental audit report" would mean a document or a set of documents, each labeled "environmental audit report: privileged document" and created as a result of an environmental audit. The report would have to include supporting information, which could include field notes, records of observations, findings, opinions, suggestions, conclusions, drafts, memoranda, follow-up reports, drawings, photographs, computer-generated or electronically recorded information, maps, charts, graphs, and surveys, if the supporting information or documents were collected or developed for the primary purpose and in the course of or as a result of an environmental audit. An environmental audit report also could include an implementation plan that addressed correcting past noncompliance, improving current compliance, improving an environmental management system, and preventing future noncompliance, as appropriate.

Privilege

The owner or operator of a facility, or an employee or agent of the owner or operator, at any time could conduct an environmental audit, and could create an environmental audit report. Generally, an environmental audit report created under the bill would be privileged and protected from disclosure.

The privilege, however, would not extend to any of the following regardless of whether they were included within an environmental audit report:

-- Documents, communication, data, reports, or other information required to be made available or reported to a regulatory agency or any other person by statute, rule, ordinance, permit, order, consent agreement, or as otherwise provided by law.
-- Information obtained by observation, sampling, or monitoring by any regulatory agency.
-- Information legally obtained from a source independent of the environmental audit.
-- Machinery and equipment maintenance records.

Except as otherwise provided in the bill, a person who conducted an environmental audit and a person to whom the environmental audit results were disclosed could not be compelled to testify regarding any matter that was the subject of the environmental audit and that was a privileged portion of the environmental audit report. Further, the privileged portions of a report would not be subject to discovery and would not be admissible as evidence in any civil, criminal, or administrative proceeding.

The privilege provided for in the bill could be expressly waived by the person for whom the environmental audit report was prepared. The waiver would apply only to the portion or portions of the environmental audit report that were specifically waived.

Disclosure of an environmental audit report, and information generated by it, by the person for whom the report was prepared, or by the person's employee or agent, to an employee or legal representative of the person or to an agent of the person retained to address an issue or issues raised by the environmental audit would not waive the privilege. Further, the privilege would not be waived if the disclosure were made under the terms of a confidentiality agreement between the person for whom the environmental audit report was prepared and either of the following:

-- A partner or potential partner, or a transferee or potential transferee of, or a lender or potential lender for, or a trustee of, the business or facility audited.
-- Governmental officials.

Request for Disclosure/Assertion of Privilege

A request by State or local law enforcement authorities for disclosure of an environmental audit report would have to be made by a written request delivered by certified mail or a demand by lawful subpoena.

To the extent authorized by the Code of Criminal Procedure, State or local law enforcement authorities could seize an environmental audit report for which privilege was asserted, pursuant to a lawful search warrant. Upon seizure, the law enforcement authorities immediately would have to place the report under seal, and file it with the court that authorized the search warrant. The law enforcement authorities or the court also would have to provide notice of the filing to any person who was eligible to assert the privilege. Unless and until the court ordered disclosure, or the privilege had been waived, the law enforcement authorities could not inspect, review, or disclose the contents of the report.

Within 60 days after receipt of a request for disclosure or subpoena or after notice of a filing had been provided, the person asserting the privilege could object in writing to the disclosure of the report on the basis that it was privileged. Upon receipt of such an objection, the State or local law enforcement authorities could file with the circuit court, and serve upon the person, a petition requesting an in camera hearing (in private, or in the judge's chambers) on whether the report or portions of it were privileged or subject to disclosure. The motion would have to be brought in camera and under seal. The circuit court would have jurisdiction over a petition requesting a hearing after receipt of a request for disclosure or subpoena. Failure of the person asserting the privilege to object to disclosure would waive the privilege as to that person.

Upon the filing of a petition for an in camera hearing, the person asserting the privilege would have to demonstrate in the in camera hearing the year the report was prepared, the identity of the entity conducting the audit, the name of the audited facility or facilities, and a brief description of the portion or portions of the report for which privilege was claimed. A person asserting the privilege in response to a request for disclosure or subpoena also would have to provide a copy of the environmental audit report to the court.

Upon the filing of a petition for an in camera hearing, the court would have to issue an order under seal scheduling, within 45 days after the filing of the petition, an in camera hearing to determine whether the report or portions of it were privileged or subject to disclosure.

The court, after in camera review, could require disclosure of material for which privilege was asserted, if the court determined that the privilege was asserted for a fraudulent purpose; the material was not subject to the privilege; or, even if subject to the privilege, the material showed evidence of noncompliance with State, Federal, regional, or local environmental laws, permits, consent agreements, regulations, ordinances, or orders, and the owner or operator failed to take corrective action or eliminate any violation of law identified during the audit within a reasonable time.

If the court determined that the material was not privileged, but the party asserting the privilege filed an appeal of this finding, the material, motions, and pleadings would have to be kept under seal during the pendency of the appeal.

A person asserting the privilege would have the burden of proving a prima facie case as to the privilege (a case established by sufficient evidence, which can be overcome by contradictory evidence). A person seeking disclosure of an environmental audit report would have the burden of proving by a preponderance of the evidence that privilege did not exist under Part 148. The parties disputing the existence of the privilege at any time could stipulate to entry of an order directing that specific information contained in a report would or would not be subject to the privilege. Upon making a disclosure determination, the court could compel the disclosure only of those portions of a report relevant to issues in dispute in the proceeding.

Immunity for Voluntary Disclosure

A person would be immune from any administrative or civil sanctions and fines and from criminal penalties and fines for negligent acts or omissions related to a violation of the Act, or the rules promulgated under it, if the person made a voluntary disclosure to the appropriate State or local agency. The person making the voluntary disclosure under these provisions would have to provide information to support the claim that the disclosure was voluntary at the time it was made to the State or local agency. A disclosure of information would be voluntary if it were made promptly after knowledge of the information disclosed was obtained by the person and it arose out of an environmental audit, and the person making the disclosure initiated an appropriate and good-faith effort to achieve compliance, pursued compliance with due diligence, and promptly corrected the noncompliance or condition after discovery of the violation. If evidence showed that the noncompliance was the failure to obtain a permit, appropriate and good-faith efforts to correct the noncompliance could be demonstrated by the submittal of a complete permit application within a reasonable time.

There would be a rebuttable presumption that a disclosure made under the bill was voluntary. The presumption of voluntary disclosure could be rebutted by presentation of an adequate showing to the administrative hearing officer or appropriate trier of fact that the disclosure did not satisfy the requirements for a voluntary disclosure. The State or local agency would have to bear the burden of rebutting the presumption of voluntariness. Agency action determining that disclosure was not voluntary would have to be considered final agency action subject to judicial review.

Unless a final determination showed that a voluntary disclosure had not occurred, a notice of violation or cease and desist order could not include any administrative or civil sanction or fine or any criminal penalty or fine for negligent acts or omissions by the person making the voluntary disclosure.

The elimination of administrative or civil sanctions or fines or criminal penalties or fines would not apply if a person had been found by a court or administrative law judge to have committed serious violations that constituted a pattern of continuous or repeated violations of environmental laws, rules, regulations, permit conditions, settlement agreements, or orders on consent and that were due to separate and distinct events giving rise to the violations, within the three-year period prior to the date of the disclosure. A pattern of continuous or repeated violations also could be demonstrated by multiple settlement agreements related to substantially the same alleged violations concerning serious instances of noncompliance with environmental laws that occurred within the three-year period immediately prior to the date of the voluntary disclosure. In determining whether a person had a pattern of continuous or repeated violations, the court or administrative law judge would have to base the decision on the compliance history of the specific facility at issue.

In those cases in which the conditions of a voluntary disclosure were not met but a good-faith effort was made voluntarily to disclose and resolve a violation detected in a voluntary environmental audit, the State and local environmental and law

enforcement authorities would have to consider the nature and extent of any good-faith effort in deciding the appropriate enforcement response and would have to mitigate any penalties based on a showing that one or more of the conditions for voluntary disclosure had been met.

The immunity provided by these provisions would not abrogate a person's responsibilities as provided by applicable law to correct the violation, conduct necessary remediation, or pay damages.

Penalties

Except as provided below, a person who knowingly divulged or disseminated all or part of the privileged information contained in an environmental audit report in violation of the bill, or knowingly divulged or disseminated all or part of the information contained in a report that was provided to the person in violation of the bill, would be guilty of a misdemeanor punishable by a maximum fine of $25,000. In addition, the court could sanction the person through contempt proceedings and could order other relief, including dismissal or suppression of evidence, as it determined appropriate.

A person who in good faith made a disclosure to a law enforcement agency for the purpose of establishing that privilege was asserted for a fraudulent purpose would not be subject to the preceding provisions. In order for the law enforcement agency to obtain disclosure of the environmental audit report upon which the privilege was asserted, the agency would have to proceed as provided in the bill.

A person who used Part 148 to commit fraud would be guilty of a misdemeanor punishable by a fine of up to $25,000.

The bill specifies that these provisions would not be intended to limit any rights an aggrieved party could have.

Other Privilege

The bill specifies that Part 148 would not limit, waive, or abrogate the scope or nature of any statutory or common law privilege, including the work product doctrine and the attorney-client privilege.

Report to Legislature

Within five years after the bill's effective date, the Department of Environmental Quality would have to prepare and submit to the standing committees of the Legislature with jurisdiction over issues pertaining to natural resources and the environment a report evaluating the effectiveness of Part 148 and specifically detailing whether this part had been effective in encouraging the use of environmental audits and in identifying and correcting environmental problems and conditions.

Proposed MCL 324.14801-324.14810

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Although most firms want to comply with environmental laws and regulations, and generally are willing to undertake and pay for the cost of finding and fixing noncompliance items, they greatly fear the civil penalties that can run into the hundreds of thousands of dollars for past instances of noncompliance--even if those items have been corrected. This fear can have a serious "chilling effect" on a business's decision to conduct an environmental audit of its facilities. Many companies also may hesitate to look for environmental problems because current law could enable regulators, citizen groups, or other third parties to obtain a company's private, voluntarily generated documents. Current protections against disclosure are inadequate, since the most a business can do is hire lawyers and hope to have its documents protected under the attorney-client privilege or attorney work product doctrine. In addition, municipalities are afraid that discoveries of noncompliance could lead to costly and nonproductive citizen suits. The result is that environmental audits are avoided, important opportunities to improve companies' environmental self-reporting and compliance efforts are missed, and cooperation between industry and government is discouraged.

These concerns were cited by a number of respondents in a Price Waterhouse national survey dated March 1995, whose results were based on the responses of 369 companies. According to the survey, among the companies that currently audit, two-thirds would be encouraged to perform even more audits if regulators adopted an enforcement policy that eliminated penalties for self-identified, reported, and corrected items. The report further states,

"Although many companies appear to be auditing for reasons other than a fear of governmental enforcement actions, there is still a perceived reluctance among industry to expand their audit programs, in the face of possible enforcement action... [M]ore than 45% of the respondents stated that information could be used against them in citizen's suits, toxic tort litigation, civil enforcement actions or as a roadmap of knowledge in a criminal enforcement action." Of those respondents that do not have environmental auditing programs, 20% indicated that they were concerned that audit information could be used against the company. Although methods such as the attorney-client privilege are sometimes successful in preventing the disclosure of audit information, "...they have not consistently held up when challenged in court. The self-evaluation privilege is also not considered a strong defense unless backed up by a state privilege law."

The bill would address these concerns by providing that information obtained through a voluntary environmental audit would be privileged and not subject to disclosure, and a person would be immune from civil and criminal sanctions for voluntarily disclosing violations of the Act that were found in an audit. Information would not be privileged, however, if it were required by law to be reported, if it were obtained by a regulatory agency through observation, sampling, or monitoring, or if were legally obtained from a source independent of the audit. The bill also would establish procedures under which a law enforcement agency could seek disclosure of an audit report, and a court would have to determine whether the report was privileged. Even if privileged, a court could order disclosure if there were evidence of noncompliance with an environmental law, and the owner or operator failed to correct the problem within a reasonable time. In addition, for immunity to apply, a disclosure would have to be made promptly and the person making it would have to initiate an appropriate and good-faith effort to comply, pursue compliance with due diligence, and promptly correct the problem. Furthermore, immunity would not be available if a person committed a pattern of continuous or repeated violations of environmental laws within a three-year period.

The bill would give both private businesses and municipal governments a significant incentive to examine their operations, identify problem areas, and correct environmental deficiencies. Ultimately, by leading to a greater level of voluntary compliance with environmental laws and regulations, the bill would result in increased protection for the health and safety of the public and the quality of the environment. Reportedly, more than 30 states either have adopted or are considering the adoption of audit protection legislation.

Supporting Argument

The bill would encourage businesses to undertake the environmental audits necessary to compete in international markets. In order to do so, Michigan firms may have to provide evidence that they adhere to environmental management practices and standards. Specifically, according to testimony on behalf of the Greater Detroit and Grand Rapids Area Chambers of Commerce, an international set of voluntary environmental management standards--referred to as the "ISO 14000" series--includes specifications and guidelines for environmental auditing, and provides for the certification of firms that meet the standards. It is expected that the standards will be formally adopted by the end of this year, following international balloting. Many Michigan companies that trade internationally and their suppliers and vendors will have to decide whether to comply with ISO 14000. Since noncompliance might be a significant barrier to trading in the world market, businesses should not be discouraged from self-auditing due to fears about the regulatory consequences of disclosure. By removing the disincentives now associated with environmental audits, the bill would help Michigan business position itself to compete in world markets and thereby would help the State's economy grow.

Response: According to the Price Waterhouse survey, "For those companies with both domestic (U.S.) and international operations, 88% performed environmental auditing." It appears that these firms already are highly motivated to conduct self-audits, without the privilege and immunity proposed by the bill.

Opposing Argument

It is widely recognized that voluntary audits are an important component of ensuring compliance with environmental laws and regulations, and many people agree that certain incentives should be extended to those who conduct self-audits. The privilege and immunity proposed by this bill, however, would be excessive. In crafting incentives for companies to audit their own environmental compliance, Michigan should pattern itself after the United States Environmental Protection Agency (EPA)--both because Federal and State coordination is essential to maintaining consistency in enforcement, and because the EPA

policy contains a reasonable incentive program that accords neither immunity nor a privilege. The EPA's policy, promulgated in December 1995, provides several incentives to conduct environmental audits and to disclose and correct violations: (1) The EPA will completely eliminate gravity-based, or punitive, penalties for companies or other regulated entities that voluntarily identify, disclose, and correct violations in accordance with the policy's conditions. The EPA also will reduce penalties by up to 75% for entities that meet most, but not all, of the conditions. (2) The EPA will not recommend that criminal charges be brought against a company that uncovers violations through an environmental audit or due diligence, promptly discloses and expeditiously corrects the violations, and meets all other conditions of the policy. (3) The EPA will not request voluntary environmental audit reports to trigger or initiate enforcement investigations. The EPA believes that this policy strikes a balance between the encouragement of environmentally responsible behavior and the loss of some regulatory discretion.

In a letter to the Michigan Environmental Council, the EPA also identified specific concerns with Senate Bill 728. The EPA opposes the creation of a privilege that could shield from the government and the public virtually all factual information about an aspect of environmental noncompliance; believes that the bill would encourage litigation over the scope of the privilege; and believes that the in camera process would complicate investigations and criminal prosecutions because the government would have to establish by a preponderance of the evidence that one of the bill's exceptions applied. The EPA also points out that, unlike common law privileges, the audit privilege contained in the bill would protect factual data as well as legal conclusions; the definitions of "audit" and "audit report" are so broad that they could cover and protect almost any internal written documents vaguely related to facility operations or violations discovered by a company on its own; the bill would allow industry to dictate its own pace in correcting violations; and the audit privilege would not give companies any incentive to disclose the information collected during an audit.

Further, according to the EPA letter, the bill would encourage companies to conduct audits for the purpose of creating a defense against future enforcement actions, rather than for the purpose of expeditiously correcting violations and disseminating information disclosed during an audit, including information having significant environmental and human health impacts. The bill also would protect violations involving significant economic benefits from noncompliance, which would permit certain companies to enjoy an unfair economic advantage over their complying competitors.

Finally, another major concern of the EPA involves the impact of the bill's immunity provisions on criminal prosecution and civil and administrative enforcement. The language of the bill "appears to shield from enforcement violations that involve criminal negligence or recklessness including acts or omissions that present an imminent and substantial endangerment or involve actual harm. Even recklessness with a total disregard for human life would be shielded from criminal prosecution."

Opposing Argument

Many people believe that industry concerns over the use of environmental audit results are unfounded. In the Price Waterhouse survey, 75% of the respondents already have an environmental auditing program, and these firms "...indicated most frequently that they were motivated to audit by a desire to identify and correct problems and to improve the company's overall environmental program... Limited company resources was the reason most frequently cited by respondents as a detractor from their company's willingness to expand their audit program...". The 25% without auditing programs "...appear most frequently to base their reasons for not auditing on the lack of any perceived need for an audit program as opposed to the influence of outside fears or pressures."

Although businesses and municipalities articulate a fear of overzealous and unfair use of audit results, and some companies might have received a request for documents, there has been no actual showing of any cases in which this State has prosecuted a company that undertook an audit, discovered a violation, and reported it to the State. At the Federal level, the EPA reports that only about 1% of the more than 4,000 enforcement actions commenced by the EPA during 1993 and 1994 were initiated on the basis of voluntarily disclosed information; in all of these cases, the violators received either mitigated penalties or a lower level of enforcement response.

Response: The Price Waterhouse survey also states that 25 companies (9%) reported that their compliance audit findings were involuntarily discovered or disclosed. When disclosed voluntarily, 31 companies reported that their

findings were used for enforcement purposes against them.

Opposing Argument
According to *Black's Law Dictionary*, a "privilege" is a "particular and peculiar benefit or advantage enjoyed by a person, company, or class, beyond the common advantages of other citizens". This concept does not belong in discussions of environmental auditing. Designating audit reports as privileged information would elevate them to a very limited class that includes attorney-client, doctor-patient, and husband-wife communications. The proposed privilege would mock citizens' right to know about business and governmental activities that affect public health and safety, and would create huge opportunities for cloaking environmental misdeeds and omissions. Moreover, creating a privilege for audit results would be unnecessary in view of the bill's immunity provisions.

Opposing Argument
The bill's use of vague terms would do little to ensure environmental compliance. A court could order the disclosure of material that showed evidence of noncompliance if the owner or operator failed to take corrective action or eliminate a violation "within a reasonable time". For purposes of immunity, a disclosure would be voluntary if it were made "promptly", if the person initiated an "appropriate and good-faith effort" to achieve compliance, pursued compliance with "due diligence", and "promptly" corrected the noncompliance. Failure to obtain a permit could be corrected if a person submitted a permit application "within a reasonable time".

Furthermore, the proposed time frames for asserting the privilege and petitioning for protection are extremely long and inconsistent with deadlines prescribed by the Michigan Court Rules (which generally allow 28 days for a response to requests for the production of documents). Under the bill, a party receiving a request would have 60 days to file a petition contesting the request. Altogether, it could take up to 105 days before a court even scheduled an in camera hearing on a petition, and then the information could be kept under seal for another year or two if a party appealed the court's decision. Given these time frames, the need for the information could well be negated by the delay.

Opposing Argument
The bill would place the burden of persuasion on the party seeking disclosure of an environmental audit report. This would be a very difficult burden to meet if that person did not have access to the report or the information contained in it. Nothing in the bill suggests that the report would be reviewable by the person requesting the information as part of the in camera hearing process in order to meet the burden. Similarly, it would be difficult to rebut the presumption that a disclosure was voluntary, for purposes of immunity, given the absence of information available to the party attempting to rebut the presumption.

Opposing Argument
The bill could jeopardize the State's ability to administer regulatory programs delegated to it by the EPA. Currently, the Department of Environmental Quality administers a variety of programs on behalf of the Federal government under the condition that State regulations are consistent with and no more lenient than applicable Federal regulations. According to the EPA, the bill would put an unreasonable constraint on State enforcement. If the State could not prove its case against a violator because the necessary information was privileged, the EPA might have to step in and undertake an enforcement action. The EPA would still have the right and responsibility to perform its statutory duty to protect public health and the environment from violations of Federal law, wherever necessary.

Opposing Argument
The bill would establish procedures under which State or local *law enforcement authorities* could request disclosure of an environmental audit report. It is unclear whether other regulatory authorities requesting an audit report would be subject to these provisions, or whether they would be precluded from seeking disclosure altogether.

Legislative Analyst: S. Margules

FISCAL IMPACT

The bill would have no direct fiscal impact on the Department of Environmental Quality.

Fiscal Analyst: G. Cutler

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