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BILL ANALYSIS

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Senate Bill 728 (as enrolled) **PUBLIC ACT 132 of 1996**
Sponsor: Senator Loren Bennett
Senate Committee: Natural Resources and Environmental Affairs
House Committee: Conservation, Environment and Great Lakes

Date Completed: 3-18-96

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 added Part 148 to the Natural Resources and Environmental Protection Act to provide for environmental audits; specify that they are privileged and protected from disclosure; specify the conditions under which they may or must be disclosed; provide that law enforcement authorities may request environmental audit reports, or seize reports pursuant to a search warrant, and provide for hearings on objections to disclosure; provide for immunity for certain violations of the Act if a person voluntarily discloses a violation to the appropriate State or local agency; create a rebuttable presumption that a disclosure is voluntary; specify a penalty for use of Part 148 to commit fraud; and require the Department of Environmental Quality to maintain a data base of voluntary disclosures and to report to the Legislature on the effectiveness of Part 148.

The bill defines "environmental audit" as 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 previously corrected specific instance of noncompliance, that is designed to identify historical or current noncompliance and prevent noncompliance or improve compliance with one or more of those 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" means a document or a set of documents, each labeled at the time it is created "environmental audit report: privileged document" and created as a result of an environmental audit. The report must include supporting information, which may 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 are created or prepared for the primary purpose and in the course of or as a result of an environmental audit. An environmental audit report also may include an implementation plan that addresses correcting past noncompliance, improving current compliance, improving an environmental management system, and preventing future noncompliance, as appropriate.

Privilege

Under the bill, the owner or operator of a facility, or an employee or agent of the owner or operator, at any time may conduct an environmental audit, and may create an environmental audit report. Generally, an environmental audit report created under the bill is privileged and protected from disclosure. The privilege, however, does not extend to any of the following regardless of whether they are 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.
-- Pretreatment monitoring results that a publicly owned treatment works or control authority requires any industrial user to report to a publicly owned treatment works or control authority, including results establishing a violation of the industrial user's discharge permit or applicable local ordinance.
-- Information legally obtained from a source independent of the environmental audit or from a person who did not obtain the information from the environmental audit.
-- Machinery and equipment maintenance records.

Except as otherwise provided in the bill, a person who conducts an environmental audit and a person to whom the environmental audit results are disclosed may not be compelled to testify regarding any information obtained solely through the environmental audit report that is a privileged portion of the report. Further, the privileged portions of a report are not subject to discovery and not admissible as evidence in any civil, criminal, or administrative proceeding.

The privilege provided for in the bill may be expressly waived by the person for whom the environmental audit report was prepared. The waiver applies only to the portion or portions of the environmental audit report that are 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, does not waive the privilege. Further, the privilege is not waived if the disclosure is made under the terms of a confidentiality agreement between the person for whom the environmental audit report was prepared and either a) government officials, or b) 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, or a disclosure made between a subsidiary and a parent corporation or between members of a partnership, joint venture, or other similarly related entities.

Request for Disclosure/Assertion of Privilege

A request by State or local law enforcement authorities for disclosure of an environmental audit report must 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 may seize an environmental audit report for which privilege is asserted, pursuant to a lawful search warrant. Upon seizure, the law enforcement authorities immediately must place the report under seal, and file it with the court that authorized the search warrant. The law enforcement authorities or the court also must provide notice of the filing to any person who is eligible to assert the privilege. Unless and until the court orders disclosure, or the privilege has been waived, the law enforcement authorities may not inspect, review, or disclose the contents of the report.

Within 30 business days after receipt of a request for disclosure or subpoena or after notice of a filing has been provided, the person asserting the privilege may object in writing to the disclosure of the report on the basis that it is privileged. Upon receipt of such an objection, the State or local law enforcement authorities may 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 are privileged or subject to disclosure. The motion must be brought in camera and under

seal. The circuit court has 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 waives the privilege as to that person.

Upon the filing of a petition for an in camera hearing, the person asserting the privilege must 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 is claimed. A person asserting the privilege in response to a request for disclosure or subpoena also must provide a copy of the environmental audit report to the court.

Upon the filing of a petition for an in camera hearing, the court must 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 are privileged or subject to disclosure. The counsel for the State or local law enforcement agency seeking disclosure and the counsel for the person asserting the privilege must participate in the in camera hearing but may not disclose the contents of the environmental audit report for which privilege is claimed unless the court so orders.

The court, after in camera review, must require disclosure of material for which privilege is asserted, if the court determines either that the privilege is asserted for a fraudulent purpose; or that, even if subject to the privilege, the material shows 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, but not exceeding three years after discovery of the noncompliance or violation unless a longer period of time is set forth in a schedule of compliance in an order issued by the Department of Environmental Quality (DEQ), after notice in the DEQ's calendar, and following the Department's determination that acceptable progress is being made. In addition, after in camera review, the court may require disclosure of material for which privilege is asserted if the court determines that the material is not subject to the privilege.

If the court determines that the material is not privileged, but the party asserting the privilege files an application for leave to appeal this finding, the material, motions, and pleadings must be disclosed unless the court specifically determines that all or a portion of the information must be kept under seal during the pendency of the appeal.

A person asserting the privilege has 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 has the burden of proving by a preponderance of the evidence that privilege does not exist under Part 148. The parties disputing the existence of the privilege at any time may stipulate to entry of an order directing that specific information contained in a report is or is not subject to the privilege. Upon making a disclosure determination, the court may compel the disclosure only of those portions of a report relevant to issues in dispute in the proceeding.

Immunity for Voluntary Disclosure

The bill provides that a person is immune from any administrative or civil penalties and fines under the Act and from criminal penalties and fines for negligent acts or omissions under the Act related to a violation of Article 2 and Chapters 1 and 3 of Article 3, or the rules promulgated under those articles, if the person makes a voluntary disclosure to the appropriate State or local agency. (Article 2 pertains to pollution control. Chapter 1 of Article 3 governs habitat protection and inland waters, and Chapter 3 concerns management of nonrenewable resources.) The immunity provided for in these provisions does not apply to any criminal penalties and fines for gross negligence. The person making the voluntary disclosure under these provisions must provide information to support the claim that the disclosure is voluntary at the time it is made to the State or local agency. A disclosure of information is voluntary if it is made promptly after knowledge of the information disclosed is obtained by the person, the disclosure arises out of an environmental audit, the audit occurs before the person is made aware that he or she is under investigation by a regulatory agency for potential violations of the Act, and the person making the disclosure initiates an appropriate and good-faith effort to achieve compliance, pursues compliance with due diligence, and promptly corrects the noncompliance or condition after discovery of the violation. If evidence shows that the noncompliance is the failure to obtain a permit, appropriate and good-faith efforts to correct the noncompliance may be demonstrated by the

submittal of a complete permit application within a reasonable time.

The bill provides that there is a rebuttable presumption that a disclosure made under the bill is voluntary. The presumption of voluntary disclosure may 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 must bear the burden of rebutting the presumption of voluntariness. Agency action determining that disclosure was not voluntary must be considered final agency action subject to judicial review.

Unless a final determination shows that a voluntary disclosure has not occurred, a notice of violation or cease and desist order may not include any administrative or civil penalty 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 penalties or fines or criminal penalties or fines does not apply if a person has been found by a court or administrative law judge to have knowingly committed a criminal act or committed serious violations that constitute a pattern of continuous or repeated violations of environmental laws, rules, regulations, permit conditions, settlement agreements, or orders on consent or judicial orders 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 may 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 has a pattern of continuous or repeated violations, the court or administrative law judge must base the decision on the compliance history of the specific facility at issue.

In those cases in which the conditions of a voluntary disclosure are 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 must consider the nature and extent of any good-faith effort in deciding the appropriate enforcement response and must mitigate any civil penalties based on a showing that one or more of the conditions for voluntary disclosure have been met.

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

Except for the immunity provided by these provisions, Part 148 does not limit or affect the authority of any other provisions of the Act or any other provision of law.

Fraud

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

Other Privilege

The bill specifies that Part 148 does 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.

Date Base/Report to Legislature

The bill requires the DEQ to establish and maintain a data base of the voluntary disclosures made under Part 148. The data base must include the number of voluntary disclosures made on an annual basis and summarize in general categories the types of violations and the time needed to achieve compliance. The Department annually must publish a report containing the information in this data base.

Within five years after the bill's effective date, the DEQ must 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 has been effective in encouraging the use of environmental audits and in identifying and correcting environmental problems and conditions.

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 have greatly feared 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 have hesitated to look for environmental problems because the law could enable regulators, citizen groups, or other third parties to obtain a company's private, voluntarily generated documents. Available protections against disclosure have been inadequate, since the most a business could do is hire lawyers and hope to have its documents protected under the attorney-client privilege or attorney work product doctrine. In addition, municipalities have been afraid that discoveries of noncompliance could lead to costly and nonproductive citizen suits. The result is that environmental audits have been avoided, important opportunities to improve companies' environmental self-reporting and compliance efforts have been missed, and cooperation between industry and government has been 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 assertion of 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 addresses these concerns by providing that information obtained through a voluntary environmental audit is privileged and not subject to disclosure, and a person is immune from civil and criminal sanctions for voluntarily disclosing specific violations of the Act that are found in an audit. Information is not privileged, however, if it is required by law to be reported, if it is obtained by a regulatory agency through observation, sampling, or monitoring, if it is legally obtained from a source independent of the audit or from someone who did not obtain the information from the audit, or if it comprises premonitoring results required to be reported to a publicly owned treatment works or control authority. The bill also establishes procedures under which a law enforcement agency may seek disclosure of an audit report, and a court must determine whether the report is privileged. A court must order disclosure if the privilege is asserted for a fraudulent purpose or, even if privileged, the material shows 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 must be made promptly and the person making it must initiate an appropriate and good-faith effort to comply, pursue compliance with due diligence, and promptly correct the problem. Furthermore, immunity is not available if a person commits a pattern of continuous or repeated violations of environmental laws within a three-year period.

The bill gives 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 will result in increased protection for the health and safety of the public and the quality of the environment. The bill also may result in reduced enforcement costs for the State and local units of government, and help add a nonregulatory dimension to Michigan's environmental protection programs. Reportedly, more than 30 states either have adopted or are considering the adoption of audit protection legislation.

Supporting Argument

The bill will 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 associated with environmental audits, the bill will help Michigan business position itself to compete in world markets and thereby will help improve the State's economy.

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 provided 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 provided by this bill, however, are 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 can shield from the government and the public virtually all factual information about an aspect of environmental noncompliance; believes that the bill will encourage litigation over the scope of the privilege; and believes that the in camera process will complicate investigations and criminal prosecutions because the government must establish by a preponderance of the evidence that one of the bill's exceptions apply. The EPA also points out that, unlike common law privileges, the audit privilege contained in the bill protects factual data as well as legal conclusions; the definitions of "audit" and "audit report" are so broad that they may cover and protect almost any internal written documents vaguely related to facility operations or violations discovered by a company on its own; the bill allows industry to dictate its own pace in correcting violations; and the audit privilege does not give companies any incentive to disclose the information collected during an audit.

Further, according to the EPA letter, the bill will 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 protects violations involving significant economic benefits from noncompliance, which will 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."

Response: A person is not immune from civil or criminal liability if a court or administrative law judge finds that the person knowingly committed a criminal act or committed serious violations that constitute a pattern of continuous or repeated violations. A person also remains criminally liable for gross negligence. Furthermore, immunity does not apply unless an environmental audit occurs before a person is made aware that he or she is under investigation. These provisions should relieve some of the concerns raised by the EPA.

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 elevates them to a very limited class that includes attorney-client, doctor-patient, and husband-wife communications. The bill's privilege mocks citizens' right to know about business and governmental activities that affect public health and safety, and creates huge opportunities for cloaking environmental misdeeds and omissions. Moreover, creating a privilege for audit results is unnecessary in view of the bill's immunity provisions.

Opposing Argument

The bill's use of vague terms will do little to ensure environmental compliance. For purposes of immunity, a disclosure is voluntary if it is made "promptly", if the person initiates an "appropriate and good-faith effort" to achieve compliance, pursues compliance with "due diligence", and "promptly" corrects the noncompliance. Failure to obtain a permit may be corrected if a person submits a permit application "within a reasonable time".

Furthermore, the 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 has 30 business days to file a petition contesting the request, and a court has another 45 days to schedule an in camera hearing on the petition. Then, the court may seal the information for another year or two if a party appeals the decision. Given these time frames, the need for the information might well be negated by the delay.

Opposing Argument

The bill places the burden of persuasion on the party seeking disclosure of an environmental audit report. This will be a very difficult burden to meet

if that person does not have access to the report or the information contained in it. Similarly, it will be difficult to rebut the presumption that a disclosure is voluntary, for purposes of immunity, given the absence of information available to the party attempting to rebut the presumption.

Response: Under the bill, counsel for the State or local law enforcement agency seeking disclosure (as well as counsel for the person asserting the privilege) are to participate in the in camera hearing.

Opposing Argument

The bill might jeopardize the State's ability to administer regulatory programs delegated to it by the EPA. 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 puts an unreasonable constraint on State enforcement. If the State cannot prove its case against a violator because the necessary information is privileged, the EPA might have to step in and undertake an enforcement action. The EPA still has 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 establishes procedures under which State or local *law enforcement authorities* may request disclosure of an environmental audit report. It is unclear whether other regulatory authorities requesting an audit report are subject to these provisions, or whether they are precluded from seeking disclosure altogether.

Legislative Analyst: S. Margules

FISCAL IMPACT

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

Fiscal Analyst: G. Cutler

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