Analysis and Perspective

DISCOVERY AND DISCLOSURE: HOW TO PROTECT YOUR ENVIRONMENTAL AUDIT REPORT †

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Manufacturers, lenders, and other entities face unprecedented regulatory liability under a complex array of environmental laws now expanding at every level of government. Even local ordinances—not to mention such federal statutes as the Clean Air Act as amended in 1990 or the Comprehensive Environmental Response, Compensation, and Liability Act—can easily create exposures running to tens of millions of dollars.[1] Combined with increased public awareness, aggressive enforcement, and enlarged individual responsibility of company managers or directors, these laws emphasize the need for responsible action to monitor compliance and minimize environmental liabilities.

Whether conducted by company personnel or outside consultants, environmental audits can serve public and business purposes by helping companies proactively advance regulatory compliance. Yet the principal disincentive to voluntary compliance audits has been the potential for disclosure of audit reports in enforcement contexts, especially for smaller businesses which may not be able promptly to fix what is found.

Government agencies may seek audit results during investigations preceding enforcement actions. Private groups may seek disclosure during discovery in citizen suit or toxic tort litigation. Audit reports containing damaging admissions can be a "smoking gun," giving the government evidence needed to obtain a criminal conviction. In civil actions involving company credibility as well as large damages or penalties, protecting the confidentiality of audit results can mean the difference between winning and losing. In both contexts, expanded sanctions for "knowing" failure to record or report discovered exceedances may increase these risks by "packaging evidence for prosecution," although such problems may have to be reported (and "knowing" violations may exist and be proven) independent of an audit.

This article describes practical procedures companies may use under current case law to protect themselves against disclosure of audit results by invoking, or avoiding inadvertent waiver of, attorney-client, work-product, and related privileges. It also addresses whether environmental audits, or efforts to invoke protective privileges, are "worth it," how to manage protections against disclosure while improving internal environmental management, and the interplay between disclosure, mandatory reporting, and the positive benefits or incentives audits are supposed to provide. While it necessarily focuses on environmental compliance audits, the principles discussed apply to pre-acquisition audits or "property assessments" as well.

Risks Of Voluntary Environmental Audits

When properly performed and implemented, voluntary environmental audits are an essential element in proactive programs designed to bring industrial facilities more systematically into compliance with increasingly complex laws and regulations. Such proactive approaches are not only needed to deal with increasingly aggressive civil and criminal enforcement, private citizen suits, and personal injury litigation. Given the sweeping penalties involved, they are important to company profitability and business survival, not to mention avoidance of personal liability for corporate officials or irreparable damage to public and community relations.

The greatest threat to such a proactive approach, however, is the perceived risk that audits or audit results will be used by prosecutors and private plaintiffs to impose or expand liability. Rules of law favoring broad disclosure and stringent enforcement of "remedial" environmental laws make this risk very real. Moreover, although both the U.S. Environmental Protection Agency and the U.S. Department of Justice have rhetorically extolled the value of environmental audits, neither agency has taken steps to ensure audit confidentiality. Instead, they have protected prosecutorial discretion first, leaving the fate of audit reports to individual prosecutors or circumstances.

While it constituted a major departure by expressly stating for the first time that EPA would not routinely seek disclosure of audit findings or audit reports in enforcement contexts, EPA's "Environmental Auditing Policy Statement"[2] expressly reserves EPA's right to request pertinent audit summaries or report contents on a case-by-case basis whenever: (1) audits are conducted under consent decrees or other settlement agreements requiring them, (2) a company has asserted its environmental management practices in mitigation or as a defense, or (3) state-of-mind or intent is a relevant element of inquiry, such as during a criminal investigation.[3] The last category alone undercuts EPA's policy of encouraging audits, since potential criminal liability is a major reason many environmental managers remain loath to conduct or commission audits. That effect has become particularly apparent since the 1990 amendments to the Clean Air Act made felonies of many once-minor recordkeeping or reporting omissions.[4]

DOJ's 1991 policy statement[5] offers even less of a haven. It merely states that when determining whether to prosecute for criminal violations, DOJ attorneys should "consider" if there has been "voluntary, timely and complete disclosure"

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on the part of the target. While offering a range of illustrative examples without binding criteria, the document describes its "best case" for non-prosecution as one featuring "[f]ull and prompt cooperation," entailing a "willingness to make all relevant information (including the complete results of any internal or external investigation and the names of all potential witnesses) available to government investigators and prosecutors," [6] demonstrated prompt action to correct any ongoing noncompliance, and internal disciplinary action against responsible employees.[7] This example effectively requires companies to leave themselves naked to criminal prosecution in an effort to prevent it—with no guarantee that prosecution will not follow anyway due to, *e.g.*, localized political ambitions or a situation perceived as "egregious." Finally, the DOJ policy neither mentions nor offers protection against potentially draconian civil penalties. Indeed, it seems designed to whipsaw companies into accepting such penalties in order to avoid criminal prosecutions, since the disclosure required makes such penalties virtually certain.

The net result is that companies cannot expect government agencies voluntarily to refrain from using audit results against them in either criminal prosecutions or civil enforcement actions. The only protections available are technical and narrowly construed evidentiary privileges that must be affirmatively asserted and not waived. Even these privileges are not certain. But given the risks at stake, companies must be aware of how such privileges operate and can best be preserved.

LEGAL PRINCIPLES GOVERNING CONFIDENTIALITY OF ENVIRONMENTAL AUDITS

The Attorney-Client Privilege

This oldest of the privileges protecting confidential communications is intended to encourage clients to communicate freely with their attorneys, both to ensure adequate representation and to foster voluntary compliance with regulatory laws.[8] Because the attorney-client privilege is an exception to rules of evidence favoring full disclosure, like other privileges or exceptions it is narrowly construed by the courts.

The elements of the attorney-client privilege have been succinctly articulated by the United States Court of Appeals for the Seventh Circuit: (1) Where legal advice of any kind is sought (2) from a professional legal adviser acting in such capacity, (3) the communications relating to that purpose, (4) made in confidence (5) by the client or the adviser, (6) are, at the client's insistence, permanently protected (7) from disclosure by the client or by the legal adviser, (8) except when the protection is waived.[9] There must be specific facts demonstrating that each of these elements have been met, and the burden of proving such facts is on the person claiming the privilege. The privilege must be affirmatively raised and not waived. Although either the client or the attorney can assert the privilege, only the client can waive it.

Underlying facts are not privileged. Only communications between privileged persons are protected. Information cannot simply be transmitted through an attorney for the purpose of shielding it. Agents of the attorney—such as a CPA, environmental health engineer, or paralegal—can assert the privilege if they are acting on the attorney's behalf and are presented to the client as an agent of the attorney. The agent must, however, be working under the direct supervision and control of the attorney for the purpose of assisting the attorney's efforts to provide legal counsel to the client.

Although these criteria can be stated clearly, they notoriously resist reduction to a single rule guiding their applicability. The Supreme Court recognized this fact when deciding *Upjohn v. United States*,[10] the lead case defining the right of corporations to claim the privilege.

Upjohn overruled a lower court's attempt to restrict the privilege solely to communications involving employees "in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney"—the so-called control group test. Noting that the communications concerned matters within the scope of the pertinent employees' corporate duties and were clearly aimed at obtaining legal advice, the court pointed out that the narrow control group test would discourage communication between lower-level employees and corporate counsel, and that such communication was particularly significant to guide the non-control group. It also observed that the narrow test would discourage communication aimed "to ensure . . . compliance with . . . [the] vast and complicated array of regulatory legislation facing" corporations.[11] But it explicitly declined to state any straightforward "set of rules" to govern the privilege in regulatory or other contexts.

As a result, courts since *Upjohn* have tended to apply a functional test to determine whether the attorney's role in preparing certain communications attaches the privilege to those communications. In doing so, they generally look for a central legal focus in the communication, rather than how much "legal output" is contained in that communication. For example, the New York Court of Appeals has held that even in the absence of legal research, communications from an attorney made to facilitate the rendering of legal advice or services will be privileged, so long as "the communication concerns legal rights and obligations and evidences other professional skills such as lawyer's judgment and recommended legal strategies." [12] Nor will the absence of a specific litigated matter or the fact the communication contains nonprivileged information defeat the privilege. The key is whether the person asserting the privilege shows that the pertinent communication "relates and integrates the facts with the law firm's assessment of the client's legal position and evidences the lawyer's motivation to convey legal advice." [13]

These principles have been affirmed in cases dealing directly with the confidentiality of environmental audits. In *United States v. Chevron U.S.A. Inc.* (757 F.Supp. 512, 32 ERC 1467), the government, pursuing civil penalties for Clean Air Act violations, sought disclosure of certain audit status reports that had been prepared by Chevron every six months to identify a refinery's efforts to investigate and correct problems identified during a previous environmental audit. Chevron argued that disclosure of the status reports would necessarily reveal the contents of the prior audit, which the company maintained was protected by attorney-client privilege. That audit had been conducted by a three-member company team that inspected the refinery and interviewed refinery personnel. The privilege applied, Chevron argued, because one team member was the senior counsel to Chevron's environmental group, and the audit was conducted to assess the refinery's compliance with environmental laws and make adjustments in procedures where appropriate.

Despite these facts, the court held that the audit—and thus the status reports—was not privileged because Chevron failed to show both that its attorney was acting in that capacity and that the audit's primary purpose was to obtain legal advice. Chevron had failed to offer proof that these criteria were met, the court stated, and so could not claim the privilege. Put differently, where the person claiming the privilege does not advance evidence indicating entitlement to

that privilege—or additional persuasive evidence where its initial showing is rebutted—the normal presumption that communications are "non-legal" and non-privileged (*e.g.*, that they were made for a business rather than a legal purpose) will control.

Chevron demonstrates the importance of establishing that the attorney is acting in that capacity and that the audit is specifically intended to help the attorney provide legal counsel. A more recent case illustrates what factors courts will examine in determining whether these elements have been proved. In *In re Grand Jury* (DC EPa, G.J. No. 91-832, 1/6/93), a company moved to quash a federal grand jury subpoena seeking 76 documents, asserting these documents were protected by attorney-client privilege and the work-product doctrine. The government sought the documents as part of its criminal investigation because it believed they might be relevant to establish criminal intent.[14]

The documents included records of an environmental consultant hired by the company to help it comply with waste disposal requirements, including a companywide waste management plan. They were labeled "attorney-client privileged" and "attorney work-product." The consultant, however, had met with company officials without the company's attorney being present. In addition, the consultant, accompanied by company personnel, had met with government regulators without the attorney. Moreover, billing documents showed no charges for time spent in consultation or meetings with the law firm. Finally, the company had disclosed some of the documents to state regulators.[15]

After reviewing the documents *in camera*, the court held they were not privileged. In doing so, it noted that merely labeling documents as privileged does not necessarily make them so. Moreover, it indicated, the company had produced no persuasive evidence that it had sought "informed legal advice" from its attorney, since any probative weight created by the document labels was rebutted by the company's course of conduct.

These cases indicate that to the extent possible (1) the attorney's role should be documented in advance by those who may later seek to invoke the privilege, and (2) conduct inconsistent with the intent to provide or secure confidential legal advice should be avoided, whether or not that conduct constitutes a waiver of confidentiality. For example, billing memoranda, whether from the attorney or the consultant, may be a valuable source of such documentation. Legal issues the lawyer will discuss should also be referenced in retainer agreements wherever possible. Those issues need not pertain to specific pending litigation, although they should be relevant to the client's rights and potential liabilities under pertinent environmental statutes. But it is not enough that audit documents identify exceedances and allow companies to take corrective action, where a non-lawyer could equally well perform that task. This is particularly true where such documents are shared with financial analysts, consulting engineers, or government regulators in circumstances which imply no confidential intent. Such circumstances may well cause courts to conclude no privilege attaches at the threshold, before any questions of deliberate or inadvertent waiver are reached.

The Work-Product Doctrine

The second major legal doctrine that may protect audit reports or their contents is the attorney work-product doctrine. The purpose of the work-product doctrine is different from that of the attorney-client privilege, which is aimed at protecting free and full communication between attorney and client. By contrast, the work-product doctrine is intended to encourage careful and thorough preparation by the attorney without fear that a litigation opponent will discover his strategy, the way he plans to organize and present evidence, or other thought processes before trial.

There are thus some important differences between the two privileges. For one thing, the work product doctrine is broader in scope: It covers much more than just oral or written communications between privileged persons and can extend to written memoranda, photographs, diagrams, drawings, and computer-generated data, including those generated by persons working for the attorney. In addition, the privilege covers thought processes and their products.[16] Finally, it is not necessarily waived by disclosure to third parties. But unlike attorney-client privilege it may be conditional, rather than absolute.

In *Hickman v. Taylor*, 329 U.S. 495 (1947), the lead case in this area, the Supreme Court established three important work-product principles: (1) Materials collected and prepared by counsel in anticipation of litigation are generally protected from disclosure; (2) the protection is qualified, meaning discovery may be required upon a sufficient showing of need by the adversary; and (3) the greatest protection is accorded materials containing the attorney's thinking, theories, analysis, mental impressions, and beliefs rather than facts or objective data.

The *Hickman* principles have been codified in Federal Rule of Civil Procedure 26(b)(3), which distinguishes "opinion" work-product from "ordinary" work-product. Rule 26(b)(3) provides absolute protection for "opinion" work-product that contains the attorney's mental impressions, reasoning, opinions, and conclusions. All other materials, called "ordinary" work-product, are discoverable upon a sufficient showing of need or hardship (*e.g.*, that the material cannot be otherwise obtained).[17] Thus, for example, the work-product doctrine would not apply where only the client's lawyer possesses a critical soil sample taken at a particular point in time, where duplicating other evidence generated for trial would be unreasonably burdensome, or where only an internal report can establish proof of "knowledge" or "intent."

The "litigation" required to be "anticipated" to invoke the work-product doctrine is not limited to judicial proceedings, but must at least be "adversarial." Thus potential administrative proceedings will invoke the doctrine, at least where the parties are entitled to cross-examine each other's witnesses and impeach their opponent's proof.

While the "litigation" need not have been actually commenced, it must be more than a remote prospect. If litigation is "fairly obvious," "probable," or "imminent," the materials will be protected. Since there is no clear line between "remote" and "probable," each case must be decided individually. However, once the privilege is determined to apply, it will continue to apply even after the litigation settles or the case concludes.[18]

Because the work-product doctrine does not cover materials prepared in the "ordinary course of business," direct and early participation of an attorney is essential to demonstrate that litigation was anticipated and led to the preparation of the materials in question. This is especially true because materials prepared for other purposes that are merely examined in anticipation of litigation are not covered.

The latter limitation on the work-product doctrine is of obvious importance in cases involving periodic voluntary environmental compliance audits. Reports generated by such audits should be clearly marked on every page as "privileged and confidential" and "material prepared in anticipation of litigation." Moreover, they should be generated at the express

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written request of counsel and should be kept by the attorney. Where possible, the attorney should document any pending or threatened litigation and expressly state that the audit was prepared in anticipation of that action.[19]

Another important characteristic of the work-product doctrine is that it extends to materials prepared by the lawyer's representatives acting on the lawyer's behalf, at the lawyer's direction, for the purpose of assisting the attorney's efforts in preparing for litigation. Thus, to maximize the protective shield of the work-product doctrine, environmental audits should be performed by outside consultants hired by the attorney and acting under the attorney's supervision. As with the attorney-client privilege, audit reports should be made only to the attorney, who should control the release of audit results to the client.

Like attorney-client privilege, the work-product doctrine can be waived inadvertently if otherwise protected materials are disclosed to an opponent. Disclosure to a third party, however, will not result in waiver unless "such disclosure substantially increases the possibility that an opposing party could obtain the information disclosed." [20] *Myrna West v. Marion Laboratories* was an employment discrimination action in which the plaintiff sought discovery of documents the defendant-employer had released to the Office of Federal Contract Compliance Programs in connection with its investigation of the plaintiff's complaint of discrimination. Because OFCCP was prohibited by regulation from releasing the documents to the plaintiff, the court found the defendant's release of the documents to OFCCP had not increased the plaintiff's chances of obtaining such documents. Therefore, the court held, the work-product doctrine had not been waived.

Companies should carefully assess whether to release audit reports to prosecutors. Notwithstanding the Justice Department policy, which seeks complete voluntary disclosure of audit results to prosecutors, if the government is not prohibited by law from releasing information to potential adverse parties, or is arguably required to do so under the Freedom of Information Act, giving audit reports to the government may result in waiver of work-product protection. Companies may then be required to disclose such reports to private plaintiffs in any subsequent citizen or toxic tort suit. Similar considerations apply to disclosure of audit reports to such private third parties as lenders financing a potential corporate acquisition.[21]

The 'Self-Evaluative' Privilege

Also known as the "self-critical analysis" privilege, this more recent, judicially created privilege recognizes that disclosure of documents reflecting candid self-examination will deter or suppress socially useful investigations intended either to improve health and safety or to ensure better compliance with the law.[22]

The self-evaluative privilege was first recognized in *Bredice v. Doctors Hospital Inc.*, 50 F.R.D. 249 (DC DC, 1970), *aff'd*, 479 F.2d 920 (CA DC, 1973). *Bredice* held that the minutes of hospital peer review staff meetings were privileged from discovery in a private malpractice action against the hospital because of the compelling public interest in maintaining the confidentiality of such staff meetings to ensure free communication among, and improved delivery of health care by, the hospital's staff. The privilege has since been judicially recognized in several other contexts, including cases involving certain investigatory reports and equal employment opportunity forms submitted to the government.[23]

Given the policy considerations underlying this privilege, it would appear ideally suited to protecting environmental audits. Unfortunately, except where it has been codified by statute, the privilege "at most remains largely undefined and has not generally been recognized." [24] This may be in part because a general self-evaluative privilege would create the most sweeping exception to principles favoring disclosure, and in part because that exception could limit what is perceived to be full enforcement of broadly remedial environmental public health and safety laws. Even in the employment context, some courts have strictly limited the privilege to subjective, evaluative materials prepared for mandatory governmental reports and have ordered disclosure of non-evaluative facts, statistics, or other data.[25] Many courts have been reluctant to apply it at all.[26]

Because of its limitations, the self-evaluative privilege appears to offer little protection in the context of environmental auditing. The privilege essentially balances competing policy interests regarding disclosure, and courts have refused to apply it in cases where the documents in question are sought by a government agency.[27] For example, in *U.S. v. Dexter Corp.*, 132 F.R.D. 8, 31 ERC 2027 (DC Conn, 1990), the court held there was no self-evaluative privilege in an action brought by the United States, at EPA's request, to enforce the Clean Water Act. The court reasoned that because the statute expressly prohibits the discharge of oil or hazardous substances into or upon navigable waters of the United States [28] and empowers EPA to commence a civil action to enforce the statute,[29] Congress articulated an overriding public policy favoring unimpeded enforcement of the Clean Water Act. That public policy, the court held, outweighed any policy favoring the self-evaluative privilege.[30]

Unless current efforts to create a legislative or regulatory "safe harbor" for environmental audits succeed,[31] cases like *Dexter* may have sounded the death knell for the self-evaluative privilege in this context. Every major environmental statute contains language similar to the Clean Water Act provisions cited in *Dexter*. Moreover, *Dexter's* analysis would appear equally applicable to congressionally authorized citizen suits commenced under such statutes. Any court after the *Dexter* case would likely reason that, by expressly granting citizens the right to enforce a statute, Congress created a superior public policy favoring private enforcement. In addition, because of the close link between public and private remedies in the environmental area, it is unclear whether the self-evaluative privilege still has any force in such common-law litigation as toxic-tort, trespass, or nuisance suits.

Importantly, however, Oregon recently enacted the first statute in the nation that codifies a self-evaluative privilege for environmental audits. The statute is explicitly intended to encourage compliance auditing and resulting rectification of non-compliance. It therefore reverses the normal presumptions and generally excludes audit reports from admission in civil, criminal, or administrative proceedings unless one of several exceptions applies. The most significant exception is that audit reports become admissible where they show the company had discovered evidence of non-compliance and failed to pursue compliance with reasonable diligence.[32]

ARE AUDITS—OR ATTEMPTS TO INVOKE AUDIT PRIVILEGES—WORTH IT?

Some Practical Steps To Preserve Privileges

Whether or not privileges may be successfully invoked to prevent their discovery, audit reports that are not part of a comprehensive program designed to correct identified problems effectively will create more risks than they resolve. Unless concerns identified by an audit are timely and effec-

tively corrected, the audit probably will generate damaging information about non-compliance that could aid government enforcement efforts. This is particularly true because privileges do not protect facts, as opposed to communications or thought processes.

As a result, because audits tend to document "knowledge" of facts constituting violations on the part of company officials, they can form a *per se* basis for criminal prosecutions. The *In re Grand Jury* case shows that EPA is willing to seek such documents for this purpose. Moreover, under the DOJ policy statement, government attorneys, in deciding whether to prosecute criminally, will consider (1) whether a company's audit program includes sufficient measures to identify and prevent non-compliance, and (2) whether a company has taken prompt and complete actions to correct identified problems.[33] These criteria are designed to prevent incentives for "sham" audits and ensure that audit results are promptly followed up. However, subject to potential arguments that (a) companies need not disclose anything about their audit programs to prosecutors and (b) companies with even inadequate audit programs should not be treated worse than those with none at all, they virtually guarantee at least civil prosecution where significant non-compliance is involved.

Conversely, a program that promptly fixes identified concerns provides better protection than privileges alone. Such programs need not rely heavily on privileges. To ensure that an audit program achieves these ends, it is essential that companies set aside in advance adequate resources to cover the reasonably anticipated costs of correcting non-compliance or contamination problems identified by an audit, put in place a process for promptly identifying and beginning to deploy corrective resources after problems are identified, and/or limit the scope of the audit itself. The audit program should also include feedback and accountability measures to ensure (1) that responsible company officials follow through to resolve problems iden.ified by the audit and (2) that the causes of repeated problems are isolated and progressively reduced.

Nevertheless, privileges can provide both "breathing room" for audits to operate openly and effectively without the kinds of defensive procedures which have driven up health care costs, and a "zone of freedom" that encourages more companies to become proactive in reasonable ways. Indeed, these elements of a sound environmental management program are not inconsistent with preserving privileges against disclosure. As the *Chevron* case indicates, such preservation may be more a matter of form and proper documentation than major substantive change.

There are some practical steps that can be taken to accomplish this end:

- Audits should be performed at the written request of the company's attorney. The attorney, in requesting the audit, should make clear that the audit is intended to assist his efforts to legally advise the company.
- Whenever an audit is conducted in anticipation of any pending or threatened litigation or enforcement action, the attorney should document what that action is, why it is anticipated, that the audit is being conducted specifically to assist the attorney in preparing for such dispute, and how the audit results relate to any claims which might be asserted in that action.
- The audit should be performed by an outside consultant hired by the attorney, not hired by the company. The contract between the attorney and consultant should specify that the audit is being performed at the attorney's request to assist in legally advising the client, that the consultant is acting at the direction and under the supervision of the attorney, that the consultant will submit its report solely to the attorney, and that the report will be the property of the attorney, not the company. The contract should also specify that the attorney will have an opportunity to personally review and revise the report before it is finalized. Once finalized, drafts should be destroyed.
- The attorney should actively participate in all significant meetings between the consultant and the company. The attorney should request such meetings in writing, making clear the audit is intended to assist in advising the client about potential or actual violations of law. The attorney should also be present at any meetings with government regulators that deal with matters that are the subject of the audit.
- Each page of all audit documents should be labeled "attorney-client privileged," "attorney work-product" and, where applicable, "prepared in anticipation of litigation." To avoid waiver, the attorney or company should keep the documents in a secure place and tightly control their distribution on a strict "need to know" basis.
- Audit reports should not be given to senior management officials unless they have direct responsibility for carrying out or overseeing the company's efforts to correct problems identified by the audit.
- Because none of the privileges protects purely factual information, audit reports should either be written as a neutral description or with factual data segregated so that they can be disclosed without revealing evaluative or analytical information. Alternatively, attorneys can attempt to maximize protection under the work-product doctrine by loading the audit report with legal strategies and analysis. Unfortunately, the latter course may result in a holding that the entire report be disclosed because facts are inseparable from analysis and that the burden is on the attorney to take reasonable steps to protect his or her own thought processes. Moreover, the issue may be moot to the extent that facts constituting violations must be independently reported or can be elicited through direct testimony. Because the underlying issue is what constitutes "facts," the better route is usually to characterize audit findings as "areas of concern" rather than violations or exceedances—an approach that better avoids admissions or "smoking guns."

By taking some or all of these steps, companies can help ensure that audit documents remain privileged and avoid inadvertent waiver. They can then make informed judgments regarding if, how and when they should consciously waive these privileges.

It is important to note that waiver may not even be an issue where, as is often the case, violations or exceedances must independently be reported.[34] In that case, either there are no privileges, or mandatory reporting overrides any privileges, at least with respect to the circumstances required to be reported. The existence of an audit or audit report is irrelevant to the basic reporting obligation, since in any event the company would be charged with imputed knowledge of matters required to be reported, to the extent any employee was aware of those matters.

But where reportable violations are discovered or documented through an audit, the company may still choose to disclose pertinent portions of the audit report, either for good-faith mitigation, to improve regulatory relations, to establish that disclosure was "voluntary" because the violations would not practicably have been identified or reported "but for" a voluntary audit,[35] or for other reasons. For similar reasons, the company may choose to disclose portions of its audit report where non-reportable exceedances are at stake. In all these cases, careful attention to the scope and elements of any applicable privilege is necessary to ensure (1) that the

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amount of material disclosed matches the benefits sought to be obtained, (2) that the entire audit report will not inadvertently be disclosed, and (3) that the company will not be left vulnerable to suits by third parties based on that report's contents.

Such a situation, with wide-ranging implications, arose this past summer when the Coors Brewing Co. discovered, through a voluntary audit, that VOC emissions from fermentation processes at its Colorado plant substantially exceeded those predicted by standard EPA emission factors and incorporated in emission inventory and permit assumptions (24 ER 570). As required, Coors reported the emissions. Coors' disclosures have not only led EPA to develop new emission factors and presumptive control requirements for breweries, but have resulted in a million-dollar proposed fine by the Colorado Department of Health for Coors' alleged emission inventory misstatements and permit violations. It remains unclear whether, because Coors discovered the new data through use of a voluntary audit, the fine—the largest ever issued by that state agency— will be reduced.[36]

Conclusions

Companies may take a variety of steps to protect audit reports or results from discovery by government investigators or third parties. However, blanket protection may not be possible, and the steps needed to approach it may impede the aim of internalizing proactive environmental management within the company. Moreover, because even the best-laid efforts at protection may be overruled by an individual judge ordering disclosure in specific circumstances, audit reports should always be drafted with the possibility of disclosure in mind.

Privileges against disclosure can, however, be maximized through careful procedures and information management programs designed to achieve that goal. But whether that game is worth the candle w'll turn on such factors as the company's tolerance for legalistic procedures, whether its environmental or plant manager can work through (rather than against) lawyers, the degree to which the steps outlined above may themselves be internalized (*e.g.*, by having in-house lawyers manage internal audit teams), and how the company weighs the legal protections offered by privileges, against the pragmatic protections (and difficulties) of a policy that takes prompt steps to fix what is found.

Footnotes:

† This article was adapted from a paper presented to the 86th annual meeting of the Air and Waste Management Association in Denver in June 1993. It is the second in a three-part series of Analysis and Perspective articles addressing auditor liability, the liabilities of those hiring environmental auditors or conducting internal environmental audits, and innovative methods of reducing those liabilities by financing corrective actions which more promptly and inexpensively fix the areas of concern that audits find. For the first article, see Hymes and Levin, "Liability Without End? Consultants, Contracts, and the Limits of Environmental Responsibility," 24 ER 863 (BNA) (Sept. 10, 1993). The third article, by Harvey and Levin, "What You Can Do If You Don't Have Cash: Financing Alternatives for Environmental Compliance," will be published in an upcoming issue of *Environment Reporter—Current Developments*.

[1] *See, e.g.*, New York City Local Law 76 (1985), *codified as* Administrative Code of the City of New York §§ 24-146.1, 27-198.1 *et seq.* (1992) (requiring commercial landlords to remove all asbestos from offices being renovated for new tenants). *See also, e.g.*, CERCLA Sections 107(a)(1)(C) and (c)(1)(D), 42 USC 9607(a)(1)(C) and (c)(1)(D) (strict retroactive liability for response costs plus up to $50,000,000 in natural resource damages for "an[y] owner or operator or any other responsible person for each release of a hazardous substance or incident involving release of a hazardous substance"); Clean Air Act Sections 113(c)(5) and (6) and 113(h), 42 USC 7413 (c)(5) and (6) 42 USC 7413(h) (felony penalties of up to 30 years and $2,000,000 per day of violation for "knowing release" of listed hazardous air pollutants or extremely hazardous substances by any "person," including individual "senior management personnel" or "responsible corporate officer[s]").

[2] EPA first published its policy on Nov. 8, 1985, as interim guidance (50 FR 46504). EPA then issued a final policy statement July 9, 1986 (51 FR 25004).

[3] 51 FR at 25007.

[4] *See, e.g.*, CAA Sections 113(c)(1)-(4), 42 USC 7413(c)(1)-(4).

[5] U.S. Department of Justice, *Factors in Decisions on Criminal Prosecutions For Environmental Violations In the Context of Significant Voluntary Compliance or Disclosure Efforts By the Violator* (July 1, 1991)—hereafter referred to as *Factors*.

[6] *Id.*, at pp. 3-4.

[7] *Id.*, at p. 5.

[8] *See, e.g.*, E. Epstein & M. Martin, *The Attorney-Client Privilege and the Work-Product Doctrine*, 2-3 (ABA 1989).

[9] *International Surplus Lines Ins. Co. v. Willis Corroon Corp.*, 1992 U.S. Dist. LEXIS 17332 (DC NIll, 11/10/92) (quoting *United States v. White*, 950 F.2d 426, 430 (CA 7, 1991).

[10] 449 U.S. 383 (1981).

[11] 449 U.S. at 392.

[12] *Rossi v. Blue Cross*, 73 N.Y.2d 588, 594 (1989).

[13] *Spectrum Systems Intern'l v. Chemical Bank*, 78 N.Y.2d 371, 380 (1991).

[14] Telephone conference with Cheryl L. Jamieson, Esq., EPA Region III (Feb. 5, 1993).

[15] *Id.*

[16] Epstein & Martin, *supra* n. 8, at 110.

[17] *See, e.g., Reedy v. Lull Engineering Co.*, 137 F.R.D. 405 (DC MFla, 1991) (defendant equipment manufacturer was entitled to discover photographs and videotape of equipment and accident scene taken by plaintiff's attorney because, due to plaintiff's delay in filing suit, documents were the only substantial equivalent of accident scene available); *Diamond v. Straton*, 95 F.R.D. 503 (DC SNY, 1982) (work-product privilege did not apply because plaintiffs suing on travel insurance policy for intentional infliction of emotional distress had a substantial need to examine documents bearing directly on plaintiff's claim that defendant acted intentionally or recklessly).

[18] *See Duplan Corp. v. Moulinage et Retorderie de Chavanoz*, 509 F.2d 730 (CA 4, 1974), *cert. denied*, 420 U.S. 997 (1975) (privilege does not expire once litigation for which work product was prepared concludes); *Bruce v. Christian*, 113 F.R.D. 554 (DC SNY, 1986) (Rule 26(b)(3) protects materials prepared for any litigation or trial as long as they were prepared by or for a party to subsequent litigation); *United States v. Capitol Service Inc.*, 89 F.R.D. 578 (DC EWis, 1981) (work-product privilege extends to documents prepared in anticipation of any litigation, not just documents prepared for specific litigation). *But see Revlon Inc. v. Carson Products Co.*, 37 F.R. Serv.2d 325 (DC SNY, 1983) (documents prepared by party's attorney not in contemplation of instant litigation, but in connection with terminated litigation, and which had nothing to do with instant litigation, were not entitled to work-product protection).

[19] Arguably, materials released in response to statutory or regulatory reporting or recordkeeping obligations should be protected because they were prepared in anticipation of litigation. The basic rationale is that such activities are inherently designed to identify potential substantive violations, and that failures to keep correct records or make correct reports are themselves prosecutable violations. However, due to the cloudy distinction between "remote" or "probable" litigation, it is not clear that the privilege will apply in such cases.

[20] *Myrna West v. Marion Laboratories*, 1991 U.S. Dist. LEXIS 18457, pp. 9-10 (DC WMo, 12/12/91) (quoting *GAF Corp. v. Eastman Kodak Co.*, 85 F.R.D. 46, 52 (DC SNY, 1979)).

[21] One method of dealing with such transactional issues is to disclose only a separate, sanitized summary of audit results. Where fuller disclosure to a lender is contemplated, the lender should contractually agree to respect confidentiality before audit reports or results are made available. Although such a confidentiality agreement may not avoid waiver of the privilege, it could create a

deterrent cause of action against the lender if it disclosed either such materials or the fact they had been disclosed to it. Thus, the net effect may be the same as non-disclosure.

[22] *Hardy v. New York News Inc.*, 114 F.R.D. 633, 640 (DC SNY, 1987). *See generally*, Note, "The Privilege of Self-Critical Analysis," 96 *Harv. L. Rev.* 1083 (1983).

[23] *See Hardy, supra*, 114 F.R.D. at 640 (collecting cases).

[24] *Federal Trade Commission v. TRW Inc.*, 628 F.2d 207, 210 (CA DC, 1980); *see Meyers v. Uniroyal Chem. Co.*, 1992 U.S. Dist. LEXIS 6472, p. *3 (DC EPa, 5/5/92); *U.S. v. Dexter Corp.*, 132 F.R.D. 8, 9 (31 ERC 2027 (1990)). *See also*, J.H. Young and S.J. Pannell, "Courts Still Skeptical of Self-Criticism Privilege," *Legal Times* p. 14 (Jan. 6, 1986).

[25] *Hardy, supra*, 114 F.R.D. at 641. *See Steinele v. Boeing Co.*, 1992 U.S. Dist. LEXIS 2708, p. *28 (DC Kan, 2/3/92).

[26] *Federal Trade Commission v. TRW, supra*, 628 F.2d at 210. This reluctance has continued despite tacit efforts by EPA, in its "Environmental Auditing Policy Statement," to encourage courts to broaden the privilege. *See, e.g.*, 51 FR at 25004 col. 1, 25006 cols. 2-3, 25007 col. 2.

[27] *Federal Trade Commission v. TRW, supra*; *U.S. v. Dexter Corp., supra*, 132 F.R.D. at 9.

[28] *See* 33 USC 1321(b)(1).

[29] *See id.* at Section 1321(b)(6)(B).

[30] 132 F.R.D. at pp. 9-10 (collecting cases).

[31] In the Clean Air Act Amendments of 1990, Congress ultimately rejected a legislative "safe harbor" based on self-evaluative audits and their benefits. It noted that "[n]othing in [the act's expanded criminal penalties] is intended to discourage ... sources from conducting self-evaluations or self-audits" and that "knowledge gained by an individual solely in conducting an audit ... should not ordinarily form the basis of the intent which results in criminal penalties." But it left the issue to prosecutorial discretion. *See* HRep 101-952, 101st Cong., 2d Sess. 348 (Oct. 26, 1990). *But cf., e.g.*, "Attorney Widely Circulating Bill to Shield Company Audits From Lawsuits," *Inside EPA*, p. 16 (March 16, 1982); M. Levin & K. Smith, "Is Ignorance Bliss?" 40 *J. Air & Waste Mgt. Ass'n.* 608 (May 1990).

[32] Oregon Senate Bill 912, Section 30 (July 1993). *See* T. Lindley and J. Hodson, "Environmental Audit Privilege: Oregon's Experiment," 24 ER 1221 (BNA) (Oct. 29, 1993), for a discussion and text of the statute.

[33] U.S. Dep't of Justice, *Factors*, p. 5 (July 1, 1991).

[34] Nearly every major federal and state environmental law contains extensive reporting requirements. *See e.g.*, Comprehensive, Environmental Response, Compensation and Liability Act, 42 USC 9603(a) (requiring immediate notice to National Response Center and appropriate state and local authorities of a "release" of a "hazardous substance" in excess of reportable quantities); Resource Conservation and Recovery Act, 40 CFR 264.76 and 265.76 (requiring, in the case of an emergency, notice to EPA's regional administrator of the receipt and handling by any treatment, storage and disposal facility of any unmanifested waste); Clean Water Act, 33 USC 1321(b)(5) (requiring immediate notice to National Response Center of any spill of oil or hazardous substance from vessel or facility) and 40 CFR 122.41(1)(4) (requiring notice within 24 hours of certain non-compliance with water pollution permits); Emergency Planning and Community Right-to-Know Act, 42 USC 11004 and 40 CFR 355.40 (requiring immediate notice to Local Emergency Planning Committee and the State Emergency Response Commission of any release outside facility of reportable quantity of EPCRA "extremely hazardous substance" or CERCLA "hazardous substance"). Such provisions have progressively been expanded by requirements that companies both conduct enhanced emissions monitoring and periodically certify compliance or exceedances. *See, e.g.*, Clean Air Act, as amended, Sections 114(a)(3), 503b(c), 504c(c), (*codified* at 42 USC 7414(a)(3), 7661b(c), 7661c(c)); 58 FR 54648 (Oct. 22, 1993) (proposed enhanced compliance monitoring rule).

[35] Under the DOJ policy, a company will apparently get no credit for disclosing information unless the disclosure is "voluntary." Thus, companies cannot expect prosecutorial leniency where there is already a reporting obligation. U.S. Dep't of Justice, *Factors*, *supra*, p. 3. However, the DOJ policy leaves open what consequences ensue where a voluntary audit develops express knowledge of a reportable violation.

EPA's policy statement contains similar language, but is similarly ambiguous. It merely states that it is not intended to "alter regulated entities' existing or future obligations to monitor, record or report information required under environmental statutes, regulations or permits ..." and points out that "certain audit findings may by law have to be reported to government agencies" (51 FR at 25007). Like the DOJ policy, it does not reach, and therefore leaves room to argue, that violations which must be reported, but are only discovered or documented due to voluntary audits, should be treated as "voluntarily disclosed" for these purposes.

[36] *See, e.g.*, "$1.05 Million Fine Against Coors May Deter Corporate Environmental Audits, Firm Says," 24 ER 570 (BNA) (July 30, 1993).