SUBJECT: Environmental Health and Safety Audit Privilege Act

COMMITTEE: Environmental Regulation — committee substitute recommended

VOTE: 8 ayes — Chisum, Jackson, Dukes, Howard, Kuempel, Saunders, Talton, Yost

0 nays

1 absent — Stiles

WITNESSES: For — Jim Awalt, Monarch Paint Company; Dan V. Bartosh, American Electronics Association - Texas Environmental Policy Workgroup; Thomas F. Cooke, Texas Independent Producers and Royalty Owners Association; Gary Gibbs, Association of Electric Companies of Texas; Donald Legg, Texas Association of Business and Chamber of Commerce; Bud McMillan, General Motors Corp; Ross Wilson, Texas Cattle Feeders Association; Charles Hays, Texas Natural Gas Pipeline Association; Jon Fisher, Texas Chemical Council; Karen Coffee, Texas Automobile Dealers Association; Benjamin Sebree, Texas Mid-Continent Oil and Gas Association; Charlie Sorrells, Eastman Chemical/Texas Eastman.

Against — Kate Kelley, Travis County Commissioners Court/Travis County Attorney's Office; Cathy Sisk, Harris County Attorney/District Attorney; Ken Kramer, Sierra Club; Leslie Fields, Texas State Conference of the National Association for the Advancement of Colored People.

On — Reggie James, Consumer's Union; John A. Riley, Texas Natural Resource Conservation Commission.

DIGEST: CSHB 2473 proposes the Environmental Health and Safety Audit Privilege Act to restrict access to reports produced from voluntary environmental or health and safety audits of regulated facilities. Such reports would be privileged and not admissible in a civil, criminal or administrative proceeding. The privilege would apply to audits conducted on or after the bill became effective, which would be immediately if approved by two-thirds of the membership of each house.

The bill would also provide limited immunity from administrative, civil or criminal penalties for a person who voluntarily disclosed a violation of an environmental or health and safety law to an appropriate regulatory agency. The disclosure would have to arise from a voluntary environmental or health and safety audit.

Certain voluntary environmental, health or safety audit reports done by facilities regulated by environmental or health or safety laws would not be admissible in a civil action, a criminal or an administrative proceeding. A party who claimed a privileged audit would have the burden of establishing the applicability of the privilege. Owners or operators who had created audit reports could waive their audit privilege.

Testimony and documents could not be compelled from persons who conducted any portion of the audit, but did not personally observe actual violations taking place, a custodian of the audit results or a person to whom the audit results were disclosed for the purposes of correcting the violation or other business dealings.

An employee of a state agency could not use a privileged audit report during an agency inspection of a regulated facility or operation.

An audit report could include each document and communication produced from the audit, a tracking system to ensure compliance and supporting information like employee interviews and field notes collected in the course of the audit. Each document in an audit report would be labeled: COMPLIANCE REPORT: PRIVILEGED AUDIT".

Materials not subject to privilege. Materials not subject to the audit privilege provided for in CSHB 2473 would include documents or other information required by a regulatory agency to be collected, maintained or reported under a federal or state environmental or health and safety law; information obtained from sampling or observation by a regulatory agency; or information obtained from a source not involved in the preparation of the audit report.

Required disclosure of an audit. Disclosure of a portion of an audit in a civil, criminal or administrative proceeding could be required by a court or administrative hearings official after an *in camera* (in chambers) review if the court determined that the privilege was claimed for a fraudulent purpose, a portion of the audit was not subject to privilege or the audit showed a discovery of noncompliance with the law and appropriate compliance efforts were not promptly initiated.

A party seeking disclosure would have to prove that one of these conditions existed. A decision by an administrative hearing official that one of these conditions existed would be directly appealable without additional disclosure.

In camera review. An audit could be obtained under a search warrant, criminal subpoena or discovery if there was reasonable cause to believe a criminal offense had been committed. On receipt of such an audit the state's attorney would seal the report. The owner/operator for whom the report was prepared could file a petition requesting an *in camera* review to determine whether or not the report was privileged. If a petition were not filed within 30 days, the audit privilege would be waived.

The court would be required to schedule the review within 45 days from when the petition was filed and authorize the state's attorney to unseal the report and review it to prepare for the *in camera* review. Information used in preparation for the review would be confidential, could not be used in any investigation or legal proceeding, and would not be subject to disclosure under the Texas Open Records Act.

Information not authorized for disclosure that was offered in any civil, criminal or administrative proceeding would be suppressed by a court on the motion of a party. A party disclosing audit information would have the burden of proving that the evidence did not arise from unauthorized disclosure, review or use.

An order could be submitted that would stipulate that specific information in an audit report would or would not be subject to privilege, and a court could compel disclosure of only those parts of an audit report relevant to issues in dispute.

Disclosing privileged information obtained from an *in camera* review, would be a Class B misdemeanor, maximum penalty of 180 days in jail and a $2,000 fine. A court could find in contempt of court a person who disclosed information and could order appropriate relief.

Audit privilege stands despite certain disclosures. Audit privilege would not be waived through disclosure of that report if:

• the disclosure was made only to an employee, legal representative, partner, officer, director or independent contractor of the owner or operator for the purpose of correcting an issue raised in the audit;

• the disclosure was made under the terms of a confidentiality agreement between a partner, transferee, lender, governmental official, state or federal agency and the owner/operator. Anyone violating a confidentiality agreement would be liable for damages caused by the disclosure and for other penalties stipulated in the agreement;

• the disclosure was made under a claim of confidentiality to a governmental official or agency by either the person for whom the audit is prepared or the owner/operator. This information would not be subject to the Texas Open Records Act, and disclosure by a public employee or public entity in violation of a claim of confidentiality would be a Class B misdemeanor, maximum penalty of 180 days in jail and a $2,000 fine.

Immunity for voluntary disclosure. A person who voluntarily disclosed a violation of an environmental or health and safety law would, under certain circumstances, be immune from an administrative, civil or criminal penalty. A disclosure would not be considered voluntary if it were a report to a regulatory agency required solely by a specific condition of an enforcement order or decree. A disclosure would be voluntary only if:

• the person who made the disclosure initiated an appropriate effort to achieve compliance, pursued that effort with due diligence, corrected the noncompliance within a reasonable time and cooperated with the appropriate agency in connection with an investigation of the issues identified in the disclosure;

• the disclosure was made promptly after knowledge of the information to be disclosed was obtained;

• the disclosure was made in writing to an agency with regulatory authority over the violation disclosed;

• the violation was not independently detected by an agency before the disclosure was made and

• the information disclosed was discovered through a voluntary environmental, health and safety audit.

In an action against a person claiming immunity, that person would have to establish a prima facie case that the disclosure was voluntary. The enforcement authority would then have the burden of rebutting the presumption either by a preponderance of the evidence or (in a criminal case) by proof beyond a reasonable doubt.

No immunity in certain cases. A person making a voluntary disclosure of a violation would not be immune from penalties if:

• the disclosed violation was committed intentionally or knowingly by the person disclosing it or by another whose conduct that person was responsible for, or by a member of a company's management and the company's policies or lack of prevention systems contributed materially to the occurrence of the violation;

• the disclosed violation was committed recklessly by a person, or by another whose conduct that person was responsible for, or the company's policies or lack of prevention systems contributed materially to the occurrence of the violation, which resulted in substantial off-site harm to persons, property or the environment.

Acting "intentionally" and "recklessly" would be defined by Penal Code, sec. 6.03, Definitions of Culpable States, but "knowingly or with knowledge" would, for the purposes of CSHB 2473, mean acting knowingly with respect to the nature or result of a person's conduct, when

one is aware of the person's physical acts or aware that their conduct will cause the result.

Penalties would be mitigated by how voluntary the disclosure was, the efforts of the discloser to conduct audits, remediation, the discloser's cooperation with investigating government officials, relative lack of harm or economic benefit or other relevant considerations.

SUPPORTERS SAY:

CSHB 2473 would encourage compliance with environmental and occupational health and safety laws. The bill would protect good corporate citizens who are trying, through voluntary environmental audits, to comply with a complex web of overlapping federal, state and local environmental or health and safety laws. The bill would encourage corporations to seek agency guidance for the most efficient solutions to environmental or health and safety problems without fear of self-incrimination.

The state should do everything in its power to help and encourage businesses who are going beyond their legal duty to comply with the law. At least 10 other states have already passed audit privilege laws, and many more may soon do so.

The bill would not affect the ability of regulatory agencies to conduct inspections or carry out normal enforcement activities. State enforcement relies in large part on two activities this bill would encourage: self-policing and voluntary compliance.

Many industries — utilities, high tech companies and refineries, for instance — have taken the initiative to create voluntary environmental audit divisions or designated auditors to improve compliance by recommending actions to their facilities and tracking compliance with these recommendations. Their efforts to conduct these audits have been hampered, however, by the possibility that a governmental agency or other entity will obtain copies of the audit findings and use that information against them in court or release it to the media. This penalizes them for noncompliance in the very area they were trying voluntarily to rectify through the audit. Noncompliance can result in fines of up to $25,000 a day per violation, additional legal costs and negative publicity.

In Pennsylvania a waste management company whose audit had uncovered that persons contracted to run a landfill were taking in more waste than the permit allowed was fined $4 million by the state Department of Environmental Resources. In another example, the Colorado Department of Health in 1993 proposed a $1-million fine against Coors Brewing Company for excessive volatile organic compound (VOC) emissions that the company had discovered and reported. The VOC emission problem was previously unknown to the brewing company or the regulatory agency. Such stories have a chilling effect on companies that operate in Texas. It is ironic that well-intentioned companies who perform voluntary environmental audits are punished while under current law, polluters who are acting in bad faith would not be caught because they would never initiate an audit to ensure compliance knowing that someone could use it for discovery.

Audits, which often include monitoring and reporting systems, are one of the best way to assess corporate compliance with regulations, but fear of the potential liability created by the audits has had a chilling effect. Through discovery, these audits can provide a road map for regulators, prosecutors and third-party plaintiffs. The audit privilege, however, does not hamper pursuit of a legitimate complaint. The underlying facts of a violation can still be uncovered through discovery. Audits frequently include proprietary business information that a company does not want disclosed.

Most businesses make good-faith efforts to comply with regulations, but laws and administrative rules are continually revised, and there is always the possibility of inadvertent oversight. It undermines the whole purpose of an audit if, when companies identify a problem voluntarily, they are sued or fined. The result is that the language of voluntary audit reports is often so watered down as to be incomprehensible — not only to the agency or entity that might bring an enforcement action against the company, but also to the company's management. Consequently, no one can figure out the appropriate corrective action to ensure compliance.

Fear of audit information disclosure has led to audit reports being presented only orally or to the hiring of attorneys so the information can be protected by attorney-client privilege. Companies are unlikely to conduct comprehensive voluntary audits if the findings can be used in discovery.

Time and money spent "sanitizing" audits would be better spent finding and correcting problems that pose a threat to the environment, health or safety. CSHB 2473 would encourage facility management and audit staff to freely discuss compliance issues that may have surfaced due to a voluntary audit.

Some corporate legal advisers have become understandably wary of even producing audits, since this might leave the company vulnerable to substantial penalties, adverse public reaction and potential self-incrimination if audit results are disclosed. This is counterproductive both for the company, the public and the regulatory agencies.

Many small businesses do not have the money to arrange to have an audit protected by attorney-client privilege. Dry cleaners and paint shops may be too frightened to hire a consultant to find out what they really need to do, in case it might expose them to enforcement action. CSHB 2437 would give small businesses the confidence to share audit information with an agency and find out what they could do to avoid environmental damage or hazards.

The bill would also provide a limited immunity for voluntary disclosure of problems, which would provide an incentive for companies to disclose problems and seek advice from regulatory agencies and begin to rectify the violation with agency input. This would encourage disclosure of problems that would never have been found by the regulatory agencies on their own, because of limited agency resources.

Helping businesses comply with the law would help protect the environment and public health and safety far more effectively than penalizing those who are making a genuine effort to comply with the law. Voluntarily disclosing information could allow a company limited immunity from penalties, but the company would still have to comply with environmental laws and work quickly to solve any problem. Usually, when a company makes a voluntary disclosure or investigation of an environmental problem, it is a problem a regulatory agency would never have found on its own. Companies are accountable for, and must correct, any violations they find, even if they are not penalized.

The bill contains numerous safeguards to prevent companies from misusing either their audit privilege or the immunity gained from voluntary disclosure. Administrative, civil or criminal penalties could be imposed for a voluntarily disclosed violation if that offense was committed knowingly, intentionally or if a reckless violation resulted in off-site harm. The great majority of prosecuted crimes fall into these categories, so prosecutors would not be foreclosed from current enforcement activities. Additionally, only violations discovered through an audit (not merely observed in daily observations) would be protected.

Judges already have enormous discretionary power and giving them the right to resolve questions of privilege *in camera* prior to a charging decision, would not be a significant change in current practice.

OPPONENTS SAY:

CSHB 2473 would allow polluters to escape being held accountable when they violate environmental or health and safety laws, by allowing them to keep audit findings secret. This bill would provide for an unprecedented privilege against discovery. Polluters should be held liable for the damages and hazards caused by violations of environmental or safety laws, no matter how the problem is discovered.

The contamination of the state's resources threatens the health of current and future generations. The secrecy that would be established by CSHB 2473 would apply to victims of environmental negligence as well as government enforcement actions. Individuals harmed by a violation of an environmental law might sue for damages only to find that a privileged audit report contained the only direct evidence of a violation. Audit privileges would in effect void portions of the state's health and safety and environmental statutes, and there is no proof that voluntary compliance with environmental laws would increase.

The U.S. Environmental Protection Agency (EPA) has said that state environmental audit privileges weaken state enforcement programs. The EPA has announced that it will scrutinize enforcement more closely in states with an audit privilege and/or penalty immunity law and may find it necessary to increase federal enforcement.

An audit privilege is not necessary to encourage companies to do environmental audits. There are many incentives for companies to conduct voluntary environmental audits since an effective audit program reduces a company's risk of fines by identifying problems before the government or a private citizen initiates action. In fact, large industry is increasingly using audits. Few small businesses have enough money to prepare environmental audits, so audit privileges would end up benefitting only major industries, which would use the privilege to act with impunity.

Voluntary audits are hardly ever used against companies in civil and criminal prosecution, so there is no justification for establishing a broad evidentiary privilege for audit reports. Neither of the only two well-known cases in which prosecutors used information contained in voluntary audits was in Texas. Privileges limit access to relevant and often persuasive evidence and are not favored in the law when narrower policy options could address the problem.

It would be unwise to establish a broad evidentiary privilege for information developed through environmental audits and to give immunity from prosecution to those who voluntarily disclose their violations to a government agency. This would generate public suspicion and concern that something dangerous is being hidden. Audit privileges may end up increasing litigation rather than cooperation and compliance.

Audit privilege and immunity from voluntary disclosure could both be subject to abuse by companies. A corporation could quickly perform an audit after it had discovered a violation of an environmental, health or safety law in order to shield that information from agencies and the public, or quickly disclose a problem to avoid penalties. An audit may contain the only direct evidence of a problem, and audit privilege may stop all attempts to substantiate an enforcement case or an individual's suit for damages. Repeat violators should be fined, not repeatedly excused just because they reported and corrected the violation each time.

This bill would undermine the discretion of local prosecutors to respond appropriately to violations of the law on a case-by-case basis. Immunity should not be granted by legislative fiat; this bill would create a immunized class of defendants. The bill would also add to litigation costs and

decrease prosecutors' abilities to take enforcement actions if they were forced to routinely go to court to demonstrate the inapplicability of the privilege in order to subpoena certain documents or witnesses.

Judges lack the time or inclination to comb the pages of environmental audits, which can be thousands of highly technical pages long, to decide what portions can be disclosed. Grand juries, not judges, should determine whether an audit report should be disclosed. When judges resolve questions of privilege *in camera* prior to a decision on charges, this shifts the responsibilities traditionally allocated to prosecutors to the judiciary, raising questions about the separation of powers.

If the state was trying to prosecute a case in which the judge ruled *in camera* that the information was privileged, it would be very difficult for the state to prove that evidence obtained subsequent to the *in camera* proceeding was derived independently from review of the privileged audit report.

Environmental consultants would be put in a moral and legal dilemma if they uncovered a serious threat to public health while conducting an audit and the company refused to correct the problem.

OTHER OPPONENTS SAY:

The public would be much better served if instead of providing sweeping immunity for voluntary disclosure, the bill would provide reduced civil penalties for those who reveal violations voluntarily.

The bill should provide that immunity from penalties would expire within two years after completion of the audit, to ensure that companies correct their problems expeditiously.

Audit privileges should only apply to government officials and agencies, who can take enforcement action against companies. There is no reason for them to apply to concerned citizens, injured plaintiffs, the media or representatives.

NOTES:

HB 2473 as filed would have established a privilege for compliance management systems (on-going voluntary compliance assurance programs established by regulated facilities); would not have provided that voluntary

disclosure to an agency be in writing; would not have allowed an administrative hearings official to conduct an in camera review, and did not include language that immunity would not apply if a knowing violation or reckless violation that resulted in substantial off-site harm had been involved.

The companion bill, SB 1591 by Brown, which is similar to the filed version of HB 2473, was left pending in the Senate Natural Resources Committee on April 12.