

Environmental Audits

BACKGROUND

In carrying out the Clinton's administration's move to "reinvent environmental regulations," the U.S. Environmental Protection Agency (EPA) adopted an audit policy in 1995 intended to greatly reduce—and in many cases waive completely—fines and penalties imposed on companies for violating environmental laws, if the company voluntarily disclosed and promptly corrected the problem. The policy was adopted under the authority granted the EPA to exercise discretion in enforcing environmental regulations; the agency takes into consideration such circumstances as how quickly the company disclosed its violation(s) to regulators, how quickly the violation was corrected, its severity, company compliance history, and the violation's environmental consequences. Several states followed suit, including Michigan, which enacted the Environmental Audit Privilege and Immunity Law (P.A. 132 of 1996). Public Act 132 permitted firms that conduct internal environmental audits to (1) to hold the results as *privileged* information—that is, protect the results from public scrutiny—and (2) enjoy, under certain circumstances, automatic *immunity* from prosecution for violations.

GLOSSARY

Audit

In the environmental context, an internal review of a facility's operations to ascertain the extent of compliance with environmental laws and regulations; also called a self-audit or internal audit.

Delegated authority

In an environmental context, the federal delegation of responsibility to a state for the administration of federal air, water, hazardous waste, and other environmental laws; an example of devolution.

Privilege

The right to keep certain information confidential.

Following the audit law's adoption, the Michigan Environmental Council (MEC), a statewide organization representing many environmental groups, petitioned the EPA to revoke the authority that had been delegated to Michigan to administer federal air, water, hazardous waste, and other environmental laws. The MEC claimed that the new audit law violated the terms of the EPA's delegation agreement with Michigan by (1) permitting Michigan companies to keep information confidential that under federal law must be available to the public and (2) automatically granting companies, under certain circumstances, immunity from prosecution for violations. The MEC took the position that the delegation agreement required the state to (1) enforce violations of its environmental laws and (2) publicly disclose information about such violations.

The MEC's and similar petitions from environmental organizations nationwide, prompted the EPA to examine environmental audit laws in 19 states, to many of which had been delegated authority to administer federal environmental programs. The EPA evaluated state audit laws for consistency with EPA audit policy and with federal statutes that establish the minimum requirements imposed on states that have been given delegated authority. Following the examination, the EPA notified Michigan that the state's new audit law was inconsistent with its delegated authority to enforce federal environmental laws. Specifically, the EPA cited the broad exemption from

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prosecution that the law gave companies that violate environmental regulations (some such violations constitute a criminal act) and the failure to require proper public disclosure of violations; the EPA advised that it would revoke Michigan's delegated authority unless the law was amended.

Negotiations ensued, and the Michigan Department of Environmental Quality (MDEQ) and the EPA agreed on the sections of the audit law that would have to be changed to ensure that the state would enjoy continued delegated authority. The appropriate legislation—P.A.s 133 and 134 of 1997—was enacted in November 1997.

DISCUSSION

The 1995 EPA audit policy directs its enforcement and compliance staff, in imposing penalties for certain civil and administrative violations, to consider whether the information regarding the violation has been voluntarily provided by the violator. Penalties may be reduced or eliminated if the violation came to the agency's attention voluntarily and prompt corrective action was taken. Nevertheless, some regulated entities are reluctant to conduct internal audits because they fear the consequences.

The new EPA audit policy gives enforcement discretion not only to its own people but also to state environmental agencies that are administering, under delegated authority, federal environmental law. Michigan took the federal policy a step further, codifying into state law (P.A. 132 of 1996) (1) privilege (confidentiality)—that is, permission for regulated entities to keep to themselves certain information collected in their internal environmental audit and (2) immunity, in certain circumstances, from fines and penalties, if the entity promptly disclosed and corrected violations.

Public Act 132 (1) defined *environmental audit* broadly, including any report resulting from an internal investigation to determine past or present compliance, prevent noncompliance, or improve compliance; (2) excused entities from reporting to the state that they were conducting such an audit; and (3) in general,

provided immunity to prosecution for civil, criminal, and administrative penalties for violations discovered during an internal audit, if violations were disclosed to the state, corrective action taken, and the violations had not resulted from gross negligence. In the first year following the audit law's enactment, MDEQ records show that 15 Michigan facilities disclosed environmental violations discovered during an internal audit; each initiated corrective action and sought immunity under P.A. 132's provisions.

Support for Audit Privilege and Immunity

The MDEQ, Michigan Chamber of Commerce, Michigan Chemical Council, and other business organizations in Michigan supported P.A. 132, believing that incentives were needed to encourage regulated entities to voluntarily conduct self-audits, report on problems, and take corrective action. The law's supporters argued that without it, many environmental problems would go undetected and/or uncorrected. They maintain that the objective of improved environmental compliance and the goal of a cleaner, safer environment are better served by encouraging those who are regulated to voluntarily, without fear of prosecution, monitor their activities and promptly correct any problems discovered.

Proponents contend that P.A. 132 contained safeguards adequate to prevent abuse. They point out that the privilege it conferred extended neither to information that the law *requires* be reported nor to information collected by a regulatory agency or an independent source. Supporters believe that the immunity it conferred was appropriate, because disclosing a violation did not excuse the violator from paying either the cost of corrective action or compensation for damages; moreover, they point out, the law did not provide immunity for gross negligence or repeated violations.

Opposition to Audit Privilege and Immunity

The Michigan Environmental Council, many non-MEC environmental organizations, and the EPA opposed P.A. 132 as originally passed. The MEC ar-

gued that the law eroded two decades of environmental regulation intended to correct abuses that had left Michigan with a legacy of hazardous waste and environmental problems. Environmental organizations were particularly concerned that the law did not require those conducting audits and asserting privilege to notify the state unless they voluntarily chose to divulge a violation. They asserted that the public's right to know was seriously impaired by the privilege provisions, which permitted companies to shield information about environmental problems that could affect the public health and environment.

The EPA said that P.A. 132 (1) failed to encourage the regulated community to disclose audit information about violations and (2) permitted violators to avoid taking corrective action. The agency also expressed concern that the Michigan law extended immunity too far. The EPA's position was that immunity should not be extended when violations (1) pose imminent or substantial danger or actual harm to the environment or the public health or (2) have been committed by a business that achieved a significant economic benefit over its competitors as a result of not complying with regulations.

The Compromise

If it had been necessary for the EPA to carry out its threat to rescind Michigan's authority to administer federal environmental statutes dealing with air, water, and wetlands, there would have been significant implications for Michigan's business community.

- Companies would be back to dealing with the federal agency—which has little direct experience in Michigan—on many environmental permit and compliance issues; most firms prefer to deal with the state.
- Business and municipalities would have to contend with a dual regulatory system; both state and federal permits would be required for many activities affecting the environment.
- The state's leeway to explore innovative and cost-effective approaches to pollution control would be severely limited.

- The state's attractiveness to new business and industry would diminish.

Thus, despite its opposition to changing the new law, the Michigan business community supported a compromise with the EPA, so that Michigan could retain its delegated authority. The compromise's terms eventually were supported by the MEC and other environment organizations.

The agreed-on amendments to the audit law are encompassed in two bills enacted in November 1997, which have four major provisions.

- To assert the privilege of withholding environmental self-audit information from public scrutiny and to obtain immunity from prosecution for environmental violations, a business must notify the MDEQ prior to initiating an internal environmental audit and describe the audit's scope.
- The environmental audit must be completed within six months unless extended by the MDEQ.
- Privilege does not apply (1) to criminal investigations, (2) where fraud is involved, or (3) where corrective action is not taken within a reasonable time.
- There is no immunity where (1) there has been serious harm or imminent and substantial danger to human health or the environment, (2) an administrative or judicial order has been violated, (3) a regulatory violation has resulted in significant economic benefit for the company, or (4) there has been failure to obtain or meet the requirements of a wetlands permit.

In addition, the business community won a major concession—a letter from the EPA assistant administrator stating that the agency will not specifically target a company for enforcement action solely on the basis that the company has formally notified the MDEQ that it is conducting an internal audit.

The Future

The skirmish over environmental audits has ended for now. The delicate compromise fashioned between the

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state and the business community, on the one hand, and the EPA and state environmental organizations, on the other, easily can come apart. If a major environmental problem develops that is attributable to the application of the audit law, or a significant environmental enforcement action is taken that is based on information that surfaced through an internal audit, there will be a move to change the Michigan law again.

The audit conflict is a indicator of the serious debate that is occurring as environmental policy undergoes a fundamental shift toward more self-regulation and less government “command and control.” The U.S. business community, to enable it to compete better in the world economy, is pressing both state and federal agencies to give it the flexibility it needs to develop innovative and cost-effective ways to comply with environmental regulation. Environmentalists are concerned that the changes in protection statutes are occurring too fast—without sufficient consideration of the long-term consequences—just to satisfy the demand for faster economic growth. Complicating the debate is the fact that the federal government appears to be saying the same thing as the states—there is a need to reinvent environmental regulations—but many states are moving faster to change environmental laws than the federal government appears willing to support.

See also Air Quality; Devolution; Water Quality.

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[See Michigan Forward (Oct. 1997) “Michigan’s Environmental Audit Privilege and Immunity Law: MDEQ, EPA Resolve Differences.” Also available on the Internet www.michamber.com/publication/michigan_forward/9710mfj/contents.html]

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[See *Notes on the Budget and Economy* (Sept.-Oct. 1997), “Environmental Audits: Privilege and Immunity” www.state.mi.us/sfa/notestc.html]

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[Also see *Federal Register* (Dec. 22, 1996) “Final Audit Policy” <http://es.epa.gov/search97cgi/s97r>]