ENVIRONMENTAL AUDITS: AN OFTEN OVERLOOKED TOOL FOR CITIES

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I. INTRODUCTION

The Texas Environmental, Health, and Safety Audit Privilege Act (the "Act")[1] provides a unique opportunity for regulated entities to achieve compliance with environmental and occupational health and safety laws while also gaining protection from potential penalties. The Act, which was originally enacted in 1995 and published in 1997, and was revised in both 2009 and 2013, allows entities and individuals to conduct voluntary audits of a facility's compliance with environmental health laws and regulations in exchange for privilege of audit reports and immunity from penalties for violations discovered during the audit with certain exceptions. The Act's stated purpose is "to encourage voluntary compliance with environmental and occupational health and safety laws."[2] In other words, the Act aims to incentivize owners and operators of facilities to take affirmative corrective acts. Significantly, the Act's protections have allowed for owners to conduct more extensive investigations of their business operations without concerns about any resulting costly penalties.

II. PRIVILEGE FOR AUDIT REPORTS

The privilege granted under the Act provides a limited evidentiary privilege for audit reports developed according to the Act.[3] Pursuant to the Act, an audit report is a report developed from an "environmental or health and safety audit," which is defined as:

> a systematic voluntary evaluation, review, or assessment of compliance with environmental or health and safety laws or with any permit issued under an environmental or health and safety law conducted by an owner or operator, an employee of an owner or operator, a person, including an employee or independent contractor of the person, that is considering the acquisition of a regulated facility or operation, or an independent contractor of:
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> (A) a regulated facility or operation; or
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> (B) an activity at a regulated facility or operation.[4]

An audit report may include: (1) a description of the scope of the audit; (2) memoranda and documents; (3) implementation plans or tracking systems; and (4) attached supporting information such as interviews, field notes, legal analyses, lab data, and photos.[5] Each document in a report

[1] Tex. Rev. Civ. Stat. Ann. art. 4447cc (West 2013).
[2] *Id.* § 2.
[3] *Id.* § 5.
[4] *Id.* §§ 3(a)(4); 4(a).
[5] *Id.* § 4(b)-(c).

should be labeled as privileged, though failure to do so does not result in automatic waiver under the Act.[6]

Pursuant to the privilege provided by the Act, an audit report is generally not admissible as evidence or subject to discovery in a civil or administrative proceeding.[7] Accordingly, a person called or subpoenaed as a witness cannot be compelled to testify about or produce an audit report if (1) the person did not personally observe the physical events; (2) the audit results were relayed to the person in their capacity as an employee, contractor, representative, officer, director, or potential purchaser of the facility; or (3) the person is a custodian of the audit report.[8] Also, a person who actually observed the events of a violation may testify about those events but is not required to testify about those events in relation to the audit report.[9] The burden to demonstrate the privilege's applicability is on the party asserting the privilege.[10]

There are several waivers and exceptions under the Act. For example, the Act does not grant privilege to documents, reports, or data that are required to be disclosed under state or federal law or to information obtained outside of the audit process – such as information obtained from compliance with reporting requirements under a water quality discharge permit.[11] Additionally, the Act's privilege does not apply to the extent the owner or operator of the facility expressly waives the privilege, or if a court or administrative hearings official determines that the privilege was asserted for a fraudulent purpose.[12] Similarly, the privilege does not apply if a court or administrative hearings official determines that the audit report demonstrates noncompliance but that efforts to achieve compliance were not promptly initiated or pursued with reasonable diligence.[13]

It should also be noted that the privilege does not apply to criminal proceedings.[14] Privileged information may not be disclosed to the EPA or other federal agencies – if information is shared, privilege granted under the Act will be waived.[15] Thus, it is important for entities and individuals who seek to take advantage of the Act's privileges to ensure that audit report documents are properly identified and labeled, facility personnel are advised of their obligations under the Act, and owners and operators do not voluntarily disclose audit information not otherwise required for reporting under federal or state law.

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[6] Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 4(d) (West 2013) ("each document in an audit report should be labeled 'COMPLIANCE REPORT: PRIVILEGED DOCUMENT' . . .").
[7] *Id.* § 5(b).
[8] *Id.* § 5(c).
[9] *Id.* § 5(d).
[10] *Id.* § 5(f).
[11] *Id.* § 8(a).
[12] *Id.* §§ 6(a); 7(a)(1).
[13] *Id.* § 7(a)(3).
[14] *See id.* §§ 5(b); 6(e); 9(a).
[15] *See id.* § 6 (a)-(b).

III. IMMUNITY FOR VIOLATIONS

In addition to the privilege afforded by the Act, an entity may enjoy immunity for disclosures of violations discovered during a voluntary audit conducted pursuant to the Act.[16] For immunity to apply, the disclosure must have been voluntary.[17] This immunity does not affect TCEQ's authority to seek injunctive relief, make technical recommendations, or generally enforce compliance.

To receive immunity under the Act, an entity must first submit a Notice of Audit ("NOA").[18] An NOA is a letter submitted to the TCEQ expressing intent to initiate an environmental audit.[19] The NOA must specify the facility or portion of the facility to be audited, the anticipated time the audit will begin, and the planned audit's general scope.[20] If during the audit any violations are discovered, a Disclosure of Violation ("DOV") must be sent to TCEQ in writing by certified mail promptly after the violation is discovered.[21] Immunity is contingent on the fact that the violation was noted and made as a result of the audit – the violation must not have been detected independent of the audit or an investigation of the violation must not have been initiated before the disclosure was made to TCEQ.[22]

Then, within a reasonable amount of time following the DOV, the person must take appropriate action to correct the violation including cooperating with the appropriate agencies in the investigation of any issues discovered through the audit.[23] Additionally, to gain immunity, the violations must lack injury or imminent and substantial risk of injury, and disclosure of the violation must not be required by an enforcement order or decree.[24] In the context of a pre-acquisition audit, a DOV must be made within 45 days after the acquisition closing date to retain immunity.[25] It should be noted that neither the NOA nor the DOV are confidential and are available to the public.

The Act explicitly limits the duration of the audit to a reasonable time not to exceed six months, or in the case of a pre-acquisition audit, six months from the closing date, unless an extension is approved.[26] A person may submit a letter requesting an extension of the time period allowed for the audit investigation prior to the end of the time period with sufficient information

[16] Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 10(a) (West 2013).
[17] *Id.*
[18] *Id.* § 10(g).
[19] *Id.*
[20] *Id.*
[21] *Id.* § 10(b)
[22] *Id.* § 10(b)(3)-(4).
[23] *Id.* § 10(b)(5)-(6).
[24] *Id.* § 10(b)(7); (c).
[25] *Id.* § 10(b)(1)(B).
[26] *Id.* § 4(e).

for the TCEQ to determine whether reasonable grounds exist to grant an extension.[27] Failure to provide sufficient information could jeopardize the approval of the extension and consequently immunity under the Act.

Immunity does not apply if the person who made the disclosure (1) intentionally or knowingly committed the violation or (2) was reckless or responsible for the violation and the violation resulted in substantial injury.[28] Additionally, immunity does not apply if the violation "resulted in a substantial economic benefit which gives the violator a clear advantage over its business competitors."[29] Likewise, immunity does not apply if the person claiming immunity has repeatedly committed significant violations and failed to attempt to bring the facility into compliance.[30] A person claiming immunity for a voluntary disclosure has the burden of proof to establish that immunity applies.[31]

IV. CONCLUSION

The Act is used extensively by for-profit companies seeking to limit their liabilities. The Act has historically not been availed by political subdivisions, primarily because there is limited understanding of the benefits of the Act. This tool, when used properly, can assist public entities in ensuring ongoing compliance and better regulatory understanding of their permit obligations.

[27] *See id.* §4(e).
[28] Tex. Rev. Civ. Stat. Ann. art. 4447cc, § 10(d) (West 2013).
[29] *Id.* § 10(d)(5).
[30] *Id.* § 10(h).
[31] *Id.* §10(f).