



1999

## Environmental Compliance Audits: The Arkansas Experience

Timothy T. Jones

Walter G. Wright Jr.

Mary Ellen Ternes

Follow this and additional works at: <https://lawrepository.ualr.edu/lawreview>



Part of the [Environmental Law Commons](#), and the [State and Local Government Law Commons](#)

---

### Recommended Citation

Timothy T. Jones, Walter G. Wright Jr., and Mary Ellen Ternes, *Environmental Compliance Audits: The Arkansas Experience*, 21 U. ARK. LITTLE ROCK L. REV. 191 (1999).

Available at: <https://lawrepository.ualr.edu/lawreview/vol21/iss2/2>

This Article is brought to you for free and open access by Bowen Law Repository: Scholarship & Archives. It has been accepted for inclusion in University of Arkansas at Little Rock Law Review by an authorized editor of Bowen Law Repository: Scholarship & Archives. For more information, please contact [mmserfass@ualr.edu](mailto:mmserfass@ualr.edu).

# ENVIRONMENTAL COMPLIANCE AUDITS: THE ARKANSAS EXPERIENCE

*Timothy T. Jones*<sup>\*</sup>  
*Walter G. Wright, Jr.*<sup>\*\*</sup>  
*Mary Ellen Ternes*<sup>\*\*\*</sup>

## I. INTRODUCTION

Various environmental regulatory requirements affect almost every business<sup>1</sup> operating in the United States. These requirements may range from simply submitting a form to a governmental agency identifying the type of substances generated<sup>2</sup> to mandated leak detection and prevention requirements

---

\* Assistant Regional Counsel, Environmental Protection Agency, Region VI, 1998-present, Assistant Attorney General, State of Arkansas, 1997-1998; Consultant on Law & Enforcement Programs, Commission for Environmental Cooperation ("CEC"), 1995-1997; Research Associate, Center for International Environmental Law, 1994-1995; B.A., University of Tulsa; J.D., University of Arkansas; LL.M., George Washington University.

\*\* Chairman, Environmental and Natural Resources Practice Group in the Little Rock, Arkansas, office of Mitchell, Williams, Selig, Gates & Woodyard, P.L.L.C.; Adjunct Professor, University of Arkansas at Little Rock School of Law, 1986-present; Assistant General Counsel, Petroleum Marketers Association of America, Washington, D.C., 1984-86; B.S., J.D., University of Arkansas; LL.M., George Washington University.

\*\*\* Associate, Environmental and Natural Resources Practice Group in the Little Rock, Arkansas, office of Mitchell, Williams, Selig, Gates & Woodyard, P.L.L.C.; Chemical Engineer, Superfund and Hazardous Waste Divisions (incinerator permitting), Environmental Protection Agency, Region VI, 1985-1989; B.E. Chemical Engineering, Vanderbilt University; J.D., University of Arkansas at Little Rock.

The authors would like to thank Randall Mathis, Nelson Jackson, Mike Bates, Joe Hoover, David Brown, and Bob Graham, Arkansas Department of Pollution Control & Ecology ("ADPC&E"); Steve Weaver, formerly of the ADPC&E; Bruce Jones, Michael S. Alushin, and Larry Sperling, Environmental Protection Agency ("EPA"); Thomas P. Jones, Pollution Management, Inc.; Tom Span, Lennox Industries; Linda F. Duncan, CEC; Professor Arnold Reitze; Lucy Jones, T.J. and Margaret Jones, along with Albert J. Thomas, III, and Travis Morrissey for their assistance in the preparation of this article. This article was written in Mr. Jones' private capacity and the views expressed do not reflect those of the federal Environmental Protection Agency ("EPA"). The views in this Article are solely those of the authors and do not necessarily represent those of any organization with which they are or have been associated.

1. Note that small businesses are also affected by governmental requirements. See Walter G. Wright, Jr., *In Storage Tank Funds We Trust: An Analysis of Their Role in Protecting the Environment and Small Business*, 13 U. ARK. LITTLE ROCK L.J. 417 (1991) (discussion of impact of underground storage tank regulatory program on small businesses). An example is a 1996 Congressional hearing held to examine the environmental issues confronted by a particular small business—dry cleaners. See generally *Environmental Compliance Problems Facing Dry Cleaners: Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Commerce*, 104th Cong., 1st Sess. 1 (1996).

2. An example is the federal Solid Waste Disposal Act, which prescribes various requirements for generators of substances meeting the definition of "hazardous waste." A facility generating substances meeting the definition of hazardous waste must obtain an

for petroleum underground storage tanks<sup>3</sup> or the need to obtain a complex air permit whose terms regulate many aspects of a manufacturing facility.<sup>4</sup> The federal and state environmental protection agencies utilize enforcement mechanisms to deter noncompliance with these requirements.<sup>5</sup> The enforcement mechanisms may include authority to issue compliance orders, administratively assess penalties or bring civil or criminal judicial actions.<sup>6</sup> Individuals may even be subject to such sanctions in certain circumstances.<sup>7</sup>

identification number by submitting a designated form. See 42 U.S.C. §§ 6921-6922 (Supp. 1998). Arkansas' primary environmental regulatory agency, the Arkansas Department of Pollution Control & Ecology ("ADPC&E") has assumed delegation of this federal program and the state regulations prescribing this requirement are found at ADPC&E Reg. No. 23, 262.12. The ADPC&E's name will be changed to the Arkansas Department of Environmental Quality, effective in 1999. See 1997 Ark. Acts 1219 § 2(a).

3. See Wright, *supra* note 1.

4. Both the federal and Arkansas air permitting programs are examined in some detail in Walter G. Wright, Jr. & Mary Ellen Henry, *The Arkansas Air Pollution Control Program: Past Present and Future*, 51 ARK. L. REV. 227 (1998).

5. See generally Daniel Riesel, *Environmental Enforcement: Civil and Criminal* (1997). Note that enforcement is not the exclusive method used to deter noncompliance. For example, the Arkansas Petroleum Storage Tank Trust Fund Act provides owners and operators of underground storage tanks financial reimbursement (up to certain limits) of corrective action costs and/or third party bodily injury and property damage claims related to leaks and spills from this type of equipment. See ADPC&E Reg. No. 12. The reimbursement of monies is predicated on whether the underground storage tank was in substantial compliance with the relevant federal and state environmental regulatory requirements at the time of the "occurrence" (i.e. leak or spill). See *id.* The various state petroleum storage tank trust funds, including Arkansas' are examined in Wright, *supra* note 1. Another example is the thirty percent tax credit the State of Arkansas provides for the cost of acquiring waste reduction, reuse, or recycling equipment. See ARK. CODE ANN. § 26-51-501 *et seq.* The statute requires a refund of the tax credit if within three years of the taxable year for which the credit is allowed:

"... (B) The Director of the Arkansas Department of Pollution Control and Ecology finds that the taxpayer has demonstrated a pattern of intentional failure to comply with final administrative or judicial orders which clearly indicates a disregard for environmental regulation or a pattern of prohibited conduct which could reasonably be expected to result in adverse impact." ARK. CODE ANN. § 26-51-506(f)(1)(B).

This tax credit is summarized in Walter G. Wright, Jr. & Ark Monroe, III, *Recycling in Arkansas: Selected Policy and Legal Issues*, ARK. LAW 12 (July 1992). For a 1996 survey of various state recycling tax credit programs see Walter G. Wright, Jr. & Albert J. Thomas, III, *Corporate Income Tax Credits for the Acquisition of Recycling Equipment: An Analysis of Various State Programs*, Presentation at the Air & Waste Management Association's 89th Annual Meeting (June 1996).

6. See generally Reisel, *supra* note 5. The Arkansas administrative and enforcement procedures are discussed in Wright & Henry, *supra* note 4, at 348-60 & 393-94.

7. An example would include the federal Clean Air Act, which may impose personal liability on corporate officers and directors under certain circumstances. For a brief discussion of personal liability under the federal Clean Air Act, see Wright & Henry, *supra* note 4, at 292. For a broader discussion of potential individual liability under several federal environmental statutes, see generally Andrew M. Goldberg, *Corporate Officer Liability for Federal Environmental Statute Violations*, 18 B.C. ENV'T L. AFF. L. REV. 357 (1991); Maya K. van Rossum, *Corporate Noncompliance with the Clean Water and Clean Air Acts: Theories to Hold*

Enforcement of the federal environmental statutory and regulatory requirements is not confined to governmental agencies. Almost every one of the federal environmental statutes provides private groups and individuals the opportunity to utilize the civil judicial enforcement authorities to assess penalties<sup>8</sup> given the proper circumstances.<sup>9</sup> For example there has been a significant number of federal Clean Water Act citizen suits in the past twenty-five years.<sup>10</sup> Furthermore, because of several federal Clean Air Act developments an increasing number of citizen suits involving this statute are expected.<sup>11</sup> Various citizen suit actions have been prosecuted in Arkansas.<sup>12</sup>

The sheer complexity<sup>13</sup> and volume<sup>14</sup> of environmental regulatory requirements applicable to many facilities renders continuous or one hundred percent compliance difficult.<sup>15</sup> Companies or facilities striving for compliance

---

*a Director Personally Liable*, 13 VA. ENVTL. L.J. 99 (1993); Richard S. Porter, *Environmental Law: Does the Application of the Responsible Corporate Officer Doctrine Apply to the Resource Conservation and Recovery Act*, 16 S. ILL. U. L.J. 687 (1992).

8. The penalties assessed are typically deposited in the United States Treasury. See generally Elizabeth R. Thagard, Note, *The Rule That Clean Water Act Civil Penalties Must Go to the Treasury and How to Avoid It*, 16 HARV. ENVTL. L. REV. 507 (1992). A prevailing citizen suit plaintiff may also be entitled to the costs and attorney fees incurred prosecuting the action. See Sheldon M. Novick, *LAW OF ENVIRONMENTAL PROTECTION*, 12-190.19 (1998).

9. See David Sive & Frank Friedman, *A PRACTICAL GUIDE TO ENVIRONMENTAL LAW* 302 (1997).

10. See Robert J. Martineau, Jr. & David P. Novello, *THE CLEAN AIR ACT HANDBOOK* 515 (1998). One commentator states that a dramatic increase in Clean Water Act citizen suits occurred around 1982. See Novick, *supra* note 7, at 12-190.5. Another author notes: "Environmental plaintiffs have filed hundreds of successful citizen suits during the past three decades, resulting in billions of dollars in compliance costs, civil penalties, and supplemental environmental projects--as well as the assessment of millions of dollars of attorney's fees that have funded further citizen suit enforcement actions." Richard Lazarus, *Rise and Demise of the Citizen Suit*, 15 ENVTL. F. 8 (1998).

11. A combination of increased monitoring requirements (mandated by the federal Compliance Assurance Monitoring regulations, 62 Fed. Reg. 54,900 (1997) [hereinafter CAM Regulations], expansion of the type of data or information that can constitute credible evidence of a federal Clean Air Act violation (the Credible Evidence Revisions, 62 Fed. Reg. 54,900 (1997) [hereinafter ACE Rule]) and requirement that certain facilities obtain much more detailed air permits (required by the Title V of the federal Clean Air Act, 42 U.S.C. § 7661-7661(E)(1994)) is the reason for the prediction. See Wright & Henry, *supra* note 4, at 303-18, 328-33. A general discussion of Clean Air Act citizen suits is found in Wright & Henry, *supra* note 4, at 328-33.

12. A discussion of several citizen suits that originated in Arkansas is found in Wright & Henry, *supra* note 4, at 402-04.

13. One commentator argues that the governmental environmental requirements are more complex than the tax code. See Ronnie P. Hawks, Comment, *Environmental Self-Audit Privilege and Immunity: Aid to Enforcement or Polluter Protection?*, 30 ARIZ. ST. L.J. 235 (1998).

14. An average of six hundred pages of environmental statutes and rules have been enacted and/or promulgated every year since 1972. See *id.*

15. A National Law Journal survey of corporate counsel found that two-thirds believed

(and seeking to avoid enforcement) have over the past ten years increasingly considered a liability avoidance technique known as environmental auditing.<sup>16</sup> Environmental auditing or environmental compliance auditing has been defined in various ways, but a straightforward description articulated by the federal Environmental Protection Agency ("EPA") in 1986 states:

Environmental auditing is a systematic, documented, periodic and objective review by regulated entities of facility operations and practices related to meeting environmental requirements.<sup>17</sup>

One objective of the environmental compliance audit is to identify and correct violations of applicable state and federal environmental regulatory requirements at a facility prior to discovery by a governmental agency or

---

that their companies had violated governmental environmental requirements within the preceding twelve months and only thirty percent believed full compliance is possible. See Marianne Lavelle, *Survey: General Counsel Face Environmental Toll*, NAT'L L.J. (1992), at S2 (cited in Hawks, *supra* note 16).

16. An extensive number of articles have addressed environmental auditing techniques and/or the various issues associated with these activities. See, e.g., Michael Ray Harris, *Promoting Corporate Self-Compliance: An Examination of the Debate Over Legal Protection for Environmental Audits*, 23 *ECOLOGY L. Q.* 713 (1996); Donald A. Carr & William L. Thomas, *Devising a Compliance Strategy Under the ISO 14000 International Environmental Management Standards*, 15 *PACE ENVTL. L. REV.* 86-87 (1997); James M. Weaver, et al., *State Environmental Audit Laws Advance Goals of Cleaner Environment*, 11 *NAT. RESOURCES & ENV'T* 9 (1997); Dara B. Less, *Incentives for Self-Policing: The Need for a Rule*, 2 *ENVTL. LAW.* 773 (1996); David Sorenson, *The U.S. Environmental Protection Agency's Recent Environmental Auditing Policy and Potential Conflicts with State-Created Environmental Audit Privilege Laws*, 9 *TUL. ENVTL. L.J.* 505 (1996); Lisa Koven, *The Environmental Self-Audit Evidentiary Privilege*, 45 *UCLA L. REV.* 1190 (1998); Miri Berlin, *Environmental Auditing: Entering the Eco-Information Highway*, 6 *N.Y.U. ENVTL. L.J.* 637 (1998); Brooks M. Beard, *The New Environmental Federalism: Can The EPA's Voluntary Audit Policy Survive?*, 17 *VA. ENVTL. L.J.* 27 (1997); David A. Danna, *The Perverse Incentive of Environmental Audit Immunity*, 81 *IOWA L. REV.* 976 (1996); Rena I. Steinzor, *Reinventing Environmental Regulation: The Dangerous Journey From Command to Self-Control*, 22 *HARV. ENVTL. L. REV.* 165 (1998); Kirk F. Marty, *Moving Beyond the Body Count and Toward Compliance: Legislative Options for Encouraging Environmental Self-Analysis*, 20 *VT. L. REV.* 499-500 (1995); Terrell E. Hunt & Timothy A. Wilkins, *Environmental Audits and Enforcement Policy*, 16 *HARV. ENVTL. L. REV.* 365 (1992).

17. Environmental Auditing Policy Statement, 51 *Fed. Reg.* 25,004, at 25,006 (1986) [hereinafter *Policy Statement*]. Arkansas defines an environmental audit as:

[A] voluntary, internal, and comprehensive evaluation of one (1) or more facilities or an activity at one (1) or more facilities regulated under this chapter, or federal, regional, or local counterparts or extensions thereof, or of management systems related to that facility or activity, that is designed to identify and prevent noncompliance and to improve compliance with statutory or regulatory requirements.

1995 Ark. Acts 350 (codified at ARK. CODE ANN. §§ 8-1-301-312 (Supp. 1997)) [hereinafter *Act 350*].

citizen suit plaintiff.<sup>18</sup> The audit might consider all relevant governmental environmental requirements or focus on one statute and the corresponding regulations.<sup>19</sup>

Governmental environmental enforcement agencies have recognized for some time that audits can be beneficial.<sup>20</sup> The federal Environmental

18. Environmental audits are often undertaken for a variety of other reasons. A witness at a 1997 United States Senate Hearing listed:

Assess and reduce environmental health and safety risks, both as required by regulation and on a voluntary basis that goes beyond compliance.

Anticipate upcoming regulatory requirements (which enables facilities to manage pollution control in a proactive manner).

Prioritize pollution prevention activities.

Help management understand new regulatory requirements and establish corporate policies.

Assess internal management and control systems.

Measure progress toward compliance.

Improve expeditious communication regarding environmental developments to facility personnel and, where appropriate, ensure effective communication with government agencies and the public.

Assure that capable and properly trained personnel are available at all times to perform emergency and other environmental functions.

Evaluate causes for environmental incidents and determine procedures to avoid recurrence.

Assure sufficient budgeting for environmental concerns.

Provide a means for employee training and performance evaluation.

Maximize resources through recycling, waste minimization, and other pollution prevention measures, including process changes, that may benefit the environment.

Fulfill various other obligations, such as providing appropriate disclosure to other agencies (e.g., the SEC), and evaluating the environmental aspects of corporate or real property transactions.

*Environmental Audits: Hearing Before the Senate Environment and Public Works Comm., 105<sup>th</sup> Cong. 93 (1997) [hereinafter Environmental Audits Hearing] (Statement of Paul G. Wallach, Esq., Hale & Dorr, on behalf of the National Association of Manufacturers and the Corporate Environmental Enforcement Counsel).*

19. An audit will often consider first whether there are environmental governmental requirements applicable to the facility that it has failed to recognize. For example, it may determine that one of its processes or activities causes a discharge of a "pollutant" through a "point source" into "navigable waters" therefore requiring the acquisition of a federal Clean Water Act National Pollution Discharge Elimination System ("NPDES") permit. Section 301 of the Clean Water Act imposes this permitting requirement. See 33 U.S.C. § 1311(a). The terms "pollutant," "point source" and "navigable waters" are broadly defined. See 33 U.S.C. § 1362(6)-(7),(14). Arkansas has been delegated and administers this program pursuant to ADPC&E Reg. Nos. 2 and 6. Second, assuming the required permit has already been obtained, the audit will focus on whether the facility is in compliance with this document's various effluent limitations and other requirements. Other requirements may include activities such as mandated sampling and monitoring of the effluent (*i.e.* facility wastewater). See 40 C.F.R. § 122.44(i). These sampling/monitoring results are subsequently provided to the relevant governmental agency in a document often titled Discharge Monitoring Reports ("DMRs"). See *id.*

20. EPA's original 1986 policy statement supported the use of audits. See Policy

Protection Agency ("EPA") and Department of Justice ("DOJ") have in fact developed written policies that allow the mitigation of penalties or exercise of enforcement discretion in the event such compliance promotion programs are successfully implemented.<sup>21</sup> Likewise, Arkansas<sup>22</sup> and a number of states have enacted legislation designed to encourage this activity.<sup>23</sup>

One reason for the federal and state agency interest in rewarding or encouraging such audits is the realization that the governmental agencies do not currently and are never likely to have the enforcement resources to effectively monitor the hundreds of thousands of regulated facilities.<sup>24</sup> Therefore, the idea of companies voluntarily<sup>25</sup> periodically monitoring or

---

Statement 51 Fed. Reg. at 25,004. The DOJ has stated: "Self-auditing and other forms of self-policing can play a crucial role in promoting environmentally sound business practices." Letter to Steven Herman, Esq., Assistant Administrator, Office of Enforcement and Compliance Assurance, U.S. EPA, from Lois J. Schiffer, Assistant Attorney General, Land and Natural Resources Division, U.S. DOJ (Jan. 31, 1996).

21. See Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations, 60 Fed. Reg. 66,706 (1995) [hereinafter Incentives]; U.S. Department of Justice, *Factors and Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts* (July 1, 1991) [hereinafter Factors]. The DOJ's policy provides that a vigorous voluntary compliance program can serve as a mitigating factor in the event criminal investigation is initiated against a company. See *id.* at 10-11.

22. The Arkansas environmental statutory privilege was enacted in 1995. See 1995 Ark. Acts 350. As a practical matter Act 350 and its provisions are generally more important to Arkansas facilities than the federal audit and/or enforcement policies since the ADPC&E has been delegated the authority to operate and enforce substantially all of the various programs (air, water, hazardous waste, underground storage tanks, etc.). See Wright & Henry, *supra* note 4, at 234. Nevertheless, the federal government maintains it has the authority to file an enforcement action even in delegated states. Such an action is known as "overfiling." Overfiling was examined in a 1997 United States Senate Environment and Public Works hearing. See *Enforcement of Environmental Laws: Hearing Before Committee on Environment and Public Works*, 105th Cong. (1997) [hereinafter Environmental Enforcement Hearing]. Note that a federal district court recently ruled that EPA does not have the authority under the federal Solid Waste Disposal Act to pursue a civil action against a facility that settled various violations with a delegated state. See *Harmon Industries v. Browner*, W.D. Mo., No. 97-0832-CV-W-3 (Aug. 25, 1998). The *Harmon* litigation was examined in the previously cited 1997 Congressional hearing. See *Environmental Enforcement Hearing*, at 52 (Statement of Robert G. Harmon, Chairman of the Board of Directors of Harmon Industries, Inc.).

23. A very detailed examination of many of the state audit privilege statutes enacted to date is provided in Stensvaag, *The Fine Print of State Environmental Audit Privileges*, 16 UCLA J. ENVTL. L. & POL'Y 69 (1998).

24. One author noted in regard to the rationale for record keeping for regulated facilities: "A key premise driving environmental protection is that government resources and personnel are limited so sources must keep accurate records of their emissions." Phillip Weinberg, "If It Ain't Broke . . ." *We Don't Need Another Privileges and Immunities Clause for Environmental Audits*, 22 J. CORP. L. 643 (1997).

25. By way of clarification, not all environmental audits are undertaken "voluntarily." Federal EPA actions are often resolved pursuant to consent or settlement agreements. These agreements sometimes include a commitment on the part of the alleged violator to audit all or

assessing their facilities and correcting identified noncompliance is deemed a welcome supplement to the traditional enforcement scheme.<sup>26</sup>

Environmental compliance audits are not without risk. One of the key concerns related to their use is that they are by design intended to assess a facility's compliance status with respect to relevant federal and/or state environmental regulatory programs. In other words, their objective is to identify potential violations. Further, audit results are typically discussed or documented at the end of the investigation or review. Many companies and facilities fear that whether conveyed orally or in writing, the audit results might be disclosed<sup>27</sup> or acquired by governmental agencies or other parties.<sup>28</sup>

---

a portion of one or multiple facilities in regard to compliance with a single or all relevant federal environmental regulatory programs. *See generally* Policy Statement 51 Fed. Reg. at 25,006. The document also typically requires that the facility agree to remedy the violations identified during the audit. An example is a document denominated "Consent Agreement and Consent Order the EPA Region VI Office" entered into with a Texas trucking company to address underground storage tank regulatory program violations. *See In re Merchants Fast Motor Lines, Inc., Docket #UST 6-95-101-AO-1* (March 4, 1996). This document required that the company audit several of its facilities in regard to environmental noncompliance and remedy any violations. The company was also required to undertake a pollution prevention assessment which included an analysis of the wastes generated and activities responsible for such generation along with identification of potential facility changes to reduce the volume and toxicity of such wastes. This combined work constituted what the federal EPA and some states denominate a Supplemental Environmental Project ("SEP"). SEPs are projects or actions performed by regulated parties in exchange for a reduction in penalties. The federal criteria for approval of SEPs were recently revised. *See* 63 Fed. Reg. 24,796 (1998). SEPs or in-kind payments are also sometimes utilized to settle Arkansas enforcement actions. A total of \$1,673,141 in SEPs were obtained by ADPC&E enforcement efforts in 1997-98. *See* Memorandum from David F. Kern, Legal Management Project Analyst II, ADPC&E, to Randall Mathis, Director, ADPC&E, *Updated Enforcement Chart & Graph* (Dec. 15, 1997). The 1998 federal SEP policy expresses a preference for projects involving pollution prevention techniques. *See* 63 Fed. Reg. at 24,798. For a discussion of both the federal and Arkansas SEP policies *see* Wright & Henry *supra* note 4, at 322-28 and 400-02. The ADPC&E has also included in some of its Consent Administrative Orders ("CAO") a mandate to identify (i.e. audit) and correct violations. A CAO is a settlement document that the ADPC&E typically uses to resolve an enforcement action. These ADPC&E activities are discussed in Section III(B), *infra*, of this Article.

26. Not included are activities already mandated by a facility's permit or a federal or state regulation requiring sampling, testing or monitoring. They are not "voluntarily" undertaken. For example, the federal air program requires some facilities to monitor or sample air emissions at a plant on a periodic or continuous basis and report the results to the agency. *See generally* CAM Regulations, 62 Fed. Reg. 54,900 (1992). Another example might be the discovery of the release of a "reportable quantity" of hazardous substances at a facility. Section 103(a) of the Comprehensive Response, Compensation and Liability Act would require the "persons in charge" of the facility to report this release as soon as they learn of them. *See* 42 U.S.C. § 9603(a). The EPA has promulgated regulations which defines what constitutes a reportable quantity for various hazardous substances. *See* 40 C.F.R. § 302.4. The quantity is based on how much of the relevant hazardous substance was released within a 24 hour period. *See* 40 C.F.R. § 302.6.

27. Two authors contrast financial auditing with environmental audits by stating: "In



Concerns regarding potential consequences of disclosure require companies to consider whether the benefits of an audit outweigh the risks.<sup>29</sup>

Such information or data could be damaging to a facility defending against a governmental enforcement action, federal citizen suit and/or a third party lawsuit alleging property damage, bodily injury, etc. For example, a facility investigating whether it is operating within the terms of its air permit or the corresponding regulations may generate a report with information indicating it is out of compliance. A party pursuing a federal Clean Air Act citizen suit action against the facility may be able to use this information to help prove a violation.<sup>30</sup> Similarly, a facility voluntarily investigating the type

---

addition, unlike the case of the results of financial audits, even public companies often regard environmental data obtained through an internal audit as non-public information." George Van Cleve & Keith W. Holman, *Promise and Reality in the Enforcement of the Amended Clean Air Act II: Federal Enforceability and Environmental Auditing*, 27 ENVTL. L. REP. 10151, 10158 (1997).

28. A related risk is that by definition company or facility management are provided knowledge of the existence of violations of federal environmental programs. The federal and some state environmental statutes provide that criminal penalties may be imposed in certain circumstances in the case of knowing violations. See Andrew J. Turner, *Mens Rea in Environmental Crime Prosecutions: Ignorantia Juris and the White Collar Criminal*, 23 COL. J. OF ENVTL. L. 217 (1998). Once such violations are identified facility management may have been provided "knowledge" of the violations. Consequently, the failure to address such noncompliance risks the imposition of criminal penalties. Company or facility management should therefore be prepared *prior* to undertaking the audit to remedy any violation that is discovered. One early commentator opined it may be unwise for a company to undertake an environmental audit if it does not intend to act on the results. See Phillip Reed, *Environmental Audits and Confidentiality: Can What You Know Hurt You As Much As What You Don't Know?*, 13 ENVTL. L. REP. 10303 (1983).

29. One author states:

All of this hoopla about the confidentiality of audit documents has made many companies nervous about the auditing process. At some, the auditing function has been frozen in place, cut back, or tied more closely to the general counsel's office. Worried managers and counsel have scaled back the scope or nature of audits out of a concern that the potential enforcement risk generated by the audit may be greater than the enforcement risk that the audits are attempting to prevent.

David J. Hayes, 13 ENVTL. F. 18, 20 (1996). However, EPA policies purport to restrict the circumstances in which such information can be acquired and the extent of its use at the state and federal levels is a subject of debate. See generally Susan J. Spicer, *Turning Environmental Litigation on its EAR: The Effects of Recent State Initiatives Encouraging Environmental Audits*, 8 VILL. ENVTL. L.J. 50 (1997).

30. A court addressed this scenario in *Unitek Environmental Services v. Hawaiian Cement*, 27 Env'tl. L. Rep. 20,483 (D. Haw. 1993). Documents analyzing the plants' compliance status were deemed credible evidence that could be considered. The use of such data, studies, or audits voluntarily generated or otherwise to prove noncompliance has become much more of a concern in the federal Clean Air Act area because of the 1997 promulgation of the "Any Credible Evidence" Rule. See ACE Rule, 62 Fed. Reg. 54,900 (1997). The ACE Rule states EPA's belief that various types of data such as engineering calculations, indirect estimates of emissions, and direct measurement of emissions by a variety of methods can be used to determine compliance. Two commentators note:

and extent of subsurface (i.e. residing in the soil and/or groundwater) contaminants on its property incurs the risk that an adjacent landowner could use such data in a third party common law action for damages in the event of alleged migration across boundary lines.

While some of the information generated by an environmental audit may trigger state or federal reporting requirements,<sup>31</sup> more often it probably does not. For example, if petroleum (i.e. regulated substances)<sup>32</sup> is discovered adjacent to an underground storage tank, regulations implementing Subtitle I of the federal Solid Waste Disposal Act require that this fact be reported to the relevant government agency within twenty-four hours.<sup>33</sup> In contrast, a facility that determines during an audit that drums of hazardous waste are mislabeled

---

Under the rule, EPA may now use 'any credible evidence' to prove violations under the Clean Air Act. Prior to this rule, EPA was limited to the use of performance tests, such as stack tests, to prove that a company violated the Act. The practical effect of the Credible Evidence Rule is that EPA may now use a broader array of information to prove noncompliance with the Clean Air Act. By expanding the types of evidence that EPA can use to prove violations under the Clean Air Act, EPA has potentially raised the stakes for companies considering undertaking compliance audits. Indeed, compliance audits are exactly the type of evidence at which the Credible Evidence Rule appears to be aimed. The Credible Evidence Rule potentially increases the incentives for EPA to seek out audit results which document noncompliance with the Clean Air Act. As a practical matter, there has been no indication that EPA has sought out such audit results. However, at a minimum, the Credible Evidence Rule creates yet one more uncertainty for entities considering undertaking a compliance audit.

Douglas P. McLeod & Kirk F. Merty, *Can You Afford to Perform an Environmental Audit?*, Presentation at the Air & Waste Management Association's 91st Annual Meeting (June 1998). In fact, environmental organizations expressed concern that their gains in information disclosure provided by various environmental programs would be undermined by state legislation protecting audit information. See Beard, *supra* note 16. The actual motive is deemed to be prevention of audits being used in citizen suits and common law actions. See Harris, *supra* note 16. Some groups also believe "bad" actors will escape responsibility for their actions while those who complied in the first place are not rewarded. See *id.* For a discussion of Clean Air Act citizen suits, see Wright & Henry, *supra* note 4, at 328-33. The ACE Rule is discussed in the same article at pages 313-18.

31. See Arnold W. Reitze & Lee D. Hoffman, *Self-Reporting and Self-Monitoring Requirements Under Environmental Laws*, 1 ENVTL. LAW. 681 (1995); James R. Arnold, *Disclosure of Environmental Liabilities to Government Agencies and Third Parties*, CA47 ALL-ABA 381 (1995); and Arnold W. Reitze & Steve Schell, *Reporting Requirements for Nonroutine Hazardous Pollutant Releases Under Federal Environmental Laws*, 5 ENVTL. LAW. 1 (1998). These articles provide a comprehensive discussion of the myriad of federal environmental statutory and regulatory reporting requirements.

32. The federal and Arkansas underground storage tank regulations are applicable to underground storage tanks that contain "regulated substances." See 40 C.F.R. § 280.12. The term regulated substances includes "petroleum." See *id.*

33. See 42 U.S.C. § 6991(a); 40 C.F.R. § 280.50. Arkansas incorporates by reference the federal underground storage tank regulations in ADPC&E Reg. No. 12. A variety of underground storage tank issues are discussed in Wright & Henry, *supra* note 1.

in violation of the Subtitle C regulations of the federal Solid Waste Disposal Act arguably does not have an obligation to report this to the governmental agency.<sup>34</sup> Of course, even if a discovered condition or deficiency is not subject to a reporting requirement, facilities sometimes deem it in their best interest to provide such information to the government in an attempt to resolve the matter and/or obtain penalty mitigation as provided by the previously cited federal EPA voluntary reporting policy.<sup>35</sup> Nevertheless, some companies have in the past and continue to be reluctant to voluntarily generate environmental audit information which might be obtained by governmental agencies or other parties.<sup>36</sup>

---

34. ADPC&E Reg. No. 23, 262.31 requires that generators of hazardous waste place labels containing certain information on the containers holding these substances. In some situations the requirement to report is unclear. Consider for example an audit that finds that greater quantities of hazardous waste were generated at a facility than originally believed. This discrepancy does not necessarily need to be reported to a governmental agency. Nevertheless, ADPC&E Reg. No. 23 requires that an annual report be provided to the agency listing the amounts of each type of hazardous waste generated during the previous calendar year. See ADPC&E Reg. No. 23, 40 C.F.R. 262.24. There is perhaps an implied obligation upon discovery of this inaccuracy to submit a corrected annual report. A discussion of ADPC&E Reg. No. 23 and the corresponding federal regulations is found in Allan Gates, *Does Arkansas (Or Anyone Else) Have a Valid Mixture or Derived-From Rule?*, 15 U. ARK. LITTLE ROCK L.J. 697 (1993); Steve Weaver, *The "Mixture" and "Derived-From" Rules Are Alive and Well in Arkansas*, 15 U. ARK. LITTLE ROCK L.J. 713 (1993); Mary Ellen Henry, Note, *Retroactive Vacature of the Mixture and Derived-From Rules Under RCRA*, United v. Goodner Bros. Aircraft, Inc., 15 U. ARK. LITTLE ROCK L.J. 727 (1993). An overview of recent hazardous waste regulatory and judicial developments is provided by Mary Ellen Henry & Walter G. Wright, Jr., *Hazardous Waste: 1998 Regulatory and Judicial Developments*, Presentation at the Air & Waste Management Association's 91st Annual Meeting (June 1998).

35. See Incentives, 60 Fed. Reg. 66,706 (1995). Some companies recognize that whether what is discovered is an environmental condition (i.e. soil contamination) or regulatory violation a risk exists that a subsequent government inspection will reveal the issue. Therefore, regardless of whether the condition or deficiency must be reported, companies sometimes decide that a federal or state governmental agency may be more inclined to refrain from instituting enforcement if a report is voluntarily and promptly submitted. The theoretical additional benefit to the company is that an internal contingent liability is resolved. However, there is always a risk that regardless of the voluntary disclosure the government agency will undertake enforcement and/or mandate that the environmental condition be addressed. The cited EPA policy is an attempt to address this concern at the federal level.

36. For an early article discussing the potential risks related to environmental compliance audits see James W. Moorman & Laurence S. Kirsch, *Environmental Compliance Assessments: Why Do Them, How To Do Them and How Not To Do Them*, 26 WAKE FOREST L. REV. 97 (1991). Despite the perceived risks, EPA cites a Price Waterhouse survey for the proposition that environmental auditing is practiced by 75% of the corporations surveyed. See *The Federal-State Relationship: A Look Into EPA Regulatory Efforts: Hearing Before the Subcommittee on Oversight and Investigations of the House Committee on Commerce*, 105th Cong. 56 (1996) [hereinafter Federal-State Hearings] (written statement of Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance, U.S. EPA).

While both the federal EPA and DOJ have policies in place to encourage performance of environmental audits, neither guarantee that their respective agencies will not attempt to obtain these documents and use them in an enforcement action.<sup>37</sup> Regardless, citizen plaintiffs would not be bound by an EPA or DOJ decision not to seek to obtain or use the environmental audit. Substantial attention has therefore been devoted in the past to the potential use of the attorney/client, work product and/or self-evaluation privileges to maintain the confidentiality of audit documents.<sup>38</sup> The perceived inadequacies or practical problems related to the use of these three common law doctrines triggered an effort beginning several years ago to enact statutory privileges at the federal and state level to better ensure the maintenance of the confidentiality of environmental audits. Both EPA and DOJ have opposed the creation of such a statutory privilege<sup>39</sup> and to date Congress has failed to enact one at the federal level.<sup>40</sup>

---

37. See generally Policy Statement, 51 Fed. Reg. 25,004 (1986); Incentives, 60 Fed. Reg. 66,706 (1995). The DOJ stated in part in a 1996 letter to EPA the following in regards to this issue:

The Department generally will not seek an environmental audit from a regulated entity prior to receipt of other information suggesting that the entity has committed violations of environmental law. However, once an investigation is begun on the basis of independent information of violations, the Department seeks all relevant information, including audit reports.

Letter to Steven Herman from Lois J. Schiffer, *supra* note 20.

38. See generally Moorman & Kirsch, *supra* note 36.

39. See Environmental Audits Hearing, *supra* note 18, at 49-55 (statement of Steven A. Herman, Assistant Administrator, Office of Environmental Compliance Assurance, U.S. EPA). The national environmental groups also generally oppose environmental audit statutory privileges at the federal and state level. See Environmental Audits Hearing, *supra* note 18, at 106 (statement of Mark Woodall, Chair Legislative Committee, Sierra Club, Georgia Chapter). A list of environmental and public interest groups opposing such state legislation was provided in EPA's written statement at this hearing. See Environmental Audits Hearing, *supra* note 18, at 58-59 (statement of Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance, U.S. EPA). See also David Roland, *The Case Against an Environmental Audit Privilege*, NATIONAL ENVTL. ENFORCEMENT J. 3 (Sept. 1994). One commentator expressed concern that state variances in enforcement (as opposed to uniform federal standards) could result in local governments using these differences to attract industry. See Kirsten H. Engel, *State Environmental Standard-setting: Is There a "Race" and Is It "To the Bottom?"*, 48 HASTINGS L.J. (1997).

40. In the legislative history of the 1990 amendments to the Clean Air Act Congress attempted to encourage environmental audits by stating:

Nothing in subsection 113(c) is intended to discourage owners or operators of sources subject to this Act from conducting self-evaluations or self-audits and acting to correct any problems identified. On the contrary, the environmental benefits from such review and prompt corrective action are substantial and section 113 should be read to encourage self-evaluation and self-audits.

Owners and operators of sources are in the best position to identify deficiencies and correct them, and should be encouraged to adopt procedures where internal compliance audits are performed and management is informed. Such

The experience at the state level has been different. A number of states, including Arkansas, have developed statutory privileges for environmental compliance audits.<sup>41</sup> While the regulated community has been supportive of such state efforts,<sup>42</sup> these privileges have been a source of tension with the EPA.<sup>43</sup> The EPA has communicated its desire to various states, including

internal audits will improve the owners' and operators' ability to identify and correct problems before, rather than after, government inspections and other enforcement actions are needed.

The criminal penalties available under subsection 113(c) should not be applied in a situation where a person, acting in good faith, promptly reports the results of an audit and promptly acts to correct any deviation. Knowledge gained by an individual solely in conducting an audit or while attempting to correct any deficiencies identified in the audit or the audit report itself should not ordinarily form the basis of the intent which results in criminal penalties.

*Joint Explanatory Statement of the Committee of Conference for the Clean Air Act 1990 Amendments*, 136 Cong. 13,101 (daily ed. Oct. 27, 1990). Clean Air Act Amendments of 1990, Pub. L. No. 101-549, 104 Stat. 2399 (codified as amended at 42 U.S.C. §§ 7401-7679 (1994)).

41. Two commentators report that as of 1998 twenty states have enacted such legislation. See McLeod & Merty, *supra* note 30. Various versions of such legislation are found in Alaska, Arkansas, Colorado, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Montana, Nevada, New Hampshire, Ohio, Oregon, South Carolina, South Dakota, Texas, Utah, Virginia and Wyoming. See McLeod & Merty, *supra* note 30.

42. See Federal-State Hearings, *supra* note 36, at 22-26 (written statement of Samuel Z. Chamberlain, II, Director of Environmental Affairs, Sterling Chemicals, Inc.).

43. Colorado's Attorney General testified in a 1998 Congressional hearing in regard to that state's audit legislation:

As you know, EPA is trying to eviscerate these laws in all states that have them. EPA has used two tactics recently to discourage use of these laws and to force the repeal or amendment of these laws.

First, EPA is thwarting state initiatives in the audit area by discouraging companies from using audit laws. EPA has successfully done this by taking actions, or threatening action, which appears to retaliate against companies that use the provisions of the audit law. These actions include overfilings and burdensome requests for information.

For example, in Colorado, several entities that have used the immunity provisions of the state law—including one public entity, the Denver Water Board—received letters from EPA requesting information about violations voluntarily disclosed to the state. Further, EPA has threatened to overfile in those cases. I understand that EPA has, in fact, overfiled against companies utilizing self-audit laws in other states.

This campaign of intimidation obviously discourages use of state self-audit laws. Any company that comes forward under a state law knows that it is giving EPA a blueprint for a federal enforcement action. EPA has thus practically nullified state audit laws, even in states that have not yet buckled to EPA's pressure by actually amending or repealing the laws. In Colorado, we believe EPA's intimidating tactics explain why only twenty-five entities, out of thousands of business facilities in Colorado, have used the law.

*Id.* at 52 (written statement of Hon. Gale A. Norton, Colorado Attorney General). EPA's objection to these privileges was stated in part as follows:

Regarding state audit laws, we recognize that states may find different ways to

Arkansas, that changes be made to these privilege statutes.<sup>44</sup> EPA has indicated

---

encourage companies to voluntarily discover, disclose, and correct environmental violations. But, at the same time, we are concerned that some of the approaches being taken actually can allow polluters to keep secret from the public critical information about potential threats to health and the environment, and can obstruct the ability of the states and the public to hold the regulated community accountable by maintaining and utilizing an adequate enforcement program.

Let me be clear that we have two distinct issues regarding State audit laws—one of policy and one of law. On the policy level, we oppose all State audit privilege and immunity laws in any form. Both EPA and DOJ have repeatedly testified before Congress and State legislatures that audit privileges make it more difficult to enforce the nation's environmental laws by making it easier to shield evidence of wrongdoing. A privilege law invites defendants to claim many types of evidence relevant to a violation as privileged, including sampling data and information concerning the cause of and possible environmental contamination resulting from a violation. A privilege could, consequently, breed litigation and waste government resources as both parties struggle to determine what materials fell within the protected scope of the audit. Furthermore, a 1995 study by Price Waterhouse of 369 businesses entitled *The Voluntary Environmental Audit Survey of U.S. Business* indicated that a privilege is not needed to encourage voluntary compliance.

Ultimately, an audit privilege invites secrecy and breeds distrust with the community thereby undermining the kind of openness that builds trust between regulators, the regulated community, and the public necessary for the regulated community to be able to effectively police itself. We also oppose blanket immunities as a matter of policy, because, among other things, they can eliminate the important deterrent effect of penalties and result in disparate treatment of companies in States with different immunity laws.

The second issue we have with these audit laws is legal. Under Federal law, EPA has to ensure that the States retain certain minimum enforcement authorities required by Federal law for program approval, delegation, and authorization. More specifically, EPA must assure that a State audit immunity law does not deprive a State of its authority to obtain injunctive relief and civil and criminal penalties for any violation of program requirements. In determining whether these requirements are met, EPA is particularly concerned with whether a State has the authority to: (1) obtain immediate and complete injunctive relief; (2) recover civil penalties for significant economic benefit, repeat violations and violations of judicial or administrative orders, serious harm, and activities that may present an imminent and substantial endangerment; and (3) obtain criminal fines and sanctions for willful and knowing violations of Federal law.

Environmental Enforcement Hearing, *supra* note 22, at 160 (statement of Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance, U.S. EPA). See also Weinberg, *supra* note 24, for an argument that state privilege is an unnecessary incentive for the regulated community to undertake audits. EPA also spelled out its reasons for opposing such state legislation in its promulgation of its more recent audit policy. See Incentives, 60 Fed. Reg. at 66,710. See also Koven, *supra* note 16.

44. See Letter from Jerry Clifford, Acting Regional Administrator, EPA, to Randall Mathis, Director, ADPC&E (September 15, 1997) (addressing Arkansas operation of Resource Conservation and Recovery Act). Disagreements between the states and EPA are not limited to statutory audit privileges. For example, EPA and Arkansas have recently clashed over the appropriate enforcement procedures in regards to air program violations. See Memorandum from Bennie S. Salem, Divisional Inspector General, Office of Inspector General, EPA, to Jerry

that such changes must be made to avoid jeopardizing the state's ability to maintain and/or obtain delegation of a particular program.<sup>45</sup> In turn, some members of Congress have been critical of EPA's disagreements with the states on these issues.<sup>46</sup> Several Congressional hearings have focused on these tensions and the continuing interest in enacting a federal privilege statute.<sup>47</sup>

A related issue involves a number of companies' efforts to implement environmental management systems. As the country moves toward the year 2000, various companies, including many in Arkansas, will feel increasing pressure to adopt international standards including environmental management and auditing systems if they wish to compete in the global marketplace.<sup>48</sup> Through the use of environmental management systems, companies like Apple Computer, Colgate-Palmolive, Anheuser-Busch, and the Coca-Cola Company are reexamining their production processes and discovering more efficient ways to reduce costs and improve their products and services.<sup>49</sup> A related

---

Clifford, Acting Regional Administrator, EPA Region VI, Region VI's Oversight of Arkansas Enforcement Data (Audit Report Number EIFAF7-06-0014-7100295) (Sept. 26, 1997) (Inspector General's view of adequacy of ADPC&E efforts to identify and institute enforcement actions against significant CAA violators); Letter to Bennie S. Salem, Divisional Inspector General, Office of Inspector General, EPA, from Steve Weaver, Policy Advisor to the Director, ADPC&E, Arkansas Response to Draft Report Issued by the U.S.E.P.A. Office of Inspector General (Sept. 12, 1997) (ADPC&E criticism of previously cited Inspector General Report). A discussion of this issue is found in Wright & Henry, *supra* note 4, at 394-98.

45. See Wright & Henry, *supra* note 4, at 394-98. The Colorado Attorney General noted: EPA's second tactic has been to threaten to revoke the delegated environmental programs from any state that has a self-audit law not to EPA's liking. Revoking the delegated programs basically means EPA would take over enforcement of the Clean Air Act, Clean Water Act and the Resource Conservation and Recovery Act, and thus not let the states administer programs under these statutes. EPA's threat of revocation has worked in many states. States including Michigan, Texas and Idaho have simply backed down in the face of EPA pressure.

Federal-State Hearings, *supra* note 36, at 52 (written statement of Hon. Gale A. Norton, Colorado Attorney General).

46. Congress has held three recent hearings that have focused in part on environmental audits and the federal/state disagreements regarding statutory privileges. See Environmental Enforcement Hearing, *supra* note 23; Federal-State Hearings, *supra* note 36; Environmental Audits Hearing, *supra* note 18. The senatorial critics of EPA's policy on this issue include Senator Tim Hutchinson of Arkansas. See Environmental Audits Hearing, *supra* note 18, at 20 (statement of Honorable Tim Hutchinson).

47. See Environmental Enforcement Hearing, *supra* note 22; Federal-State Hearings, *supra* note 36; Environmental Audits Hearing, *supra* note 18. Despite the existence of an audit privilege statute in a given state the enactment of a federal provision is deemed important by some because of the EPA and DOJ position that it does not curtail their federal authority to obtain such documents. In other words, would the Arkansas privilege statute shield audits requested by EPA or DOJ using their federal statutory enforcement authorities?

48. See generally Harris, *supra* note 16.

49. See generally Carr & Thomas, *supra* note 16.

endeavor that potentially provides both cost savings through reduction of waste disposal costs and reduction of liability risk is a pollution prevention audit.

Part I of this Article has introduced the concept of environmental compliance auditing and the rationale for this activity.<sup>50</sup> Part II briefly addresses the common law techniques sometimes used to attempt to maintain their confidentiality. Because of the common law privileges' legal and practical inadequacies, the Arkansas effort to provide limited statutory protection for these documents is discussed in Part III. The changes to the Arkansas statute that may result because of EPA's objections will be considered. To put the Arkansas statute in context, Part IV provides a brief historical review of EPA's audit policies. The relationship between compliance auditing and pollution prevention will be explored in Part V. A discussion of one Arkansas manufacturing facility's pollution prevention efforts will also be examined. Finally, the limited incentives available to promote pollution prevention will be discussed in Section VI.

## II. COMMON LAW PRIVILEGES

Three common law privileges are potentially available to maintain the confidentiality of an audit depending on the jurisdiction and the circumstances involved in its development.

### A. Attorney Client Privilege

Arkansas Rule of Evidence 502(b) states "a client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client (1) between himself . . . and his lawyer . . ." The Arkansas Supreme Court has stated that the purpose of the privilege is

---

50. This article will not address the important role environmental audits or "assessments" often play in commercial transactions involving improved or unimproved properties. Those transactions might include the sale/purchase, leasing or financing of such properties. Of course, there is some overlap between the two types of audits since the transactional assessment would typically consider compliance status in the case of improved properties (i.e. active facilities). However, a transactional assessment would be more likely to focus on the potential existence of contamination at the property or facility (in the soil, groundwater, etc.) than a compliance audit. The assessment will play a role in determining both the value of the facility and the prospective lessee's or purchaser's ability to undertake a particular use in the future. A seller or lessor might, however, use an assessment to set a "baseline" of the environmental conditions existing at the time of the transfer of the facility. Transactional environmental assessments are addressed in Walter G. Wright, Jr., *The Seasons They Are a Changin': An Update on Management of Environmental Issues Related to Commercial Transactions*, ARK. LAW. 8 (Autumn 1993).



“designed to secure subjective freedom of mind for the client in seeking legal advice.”<sup>51</sup>

No Arkansas cases have examined the applicability of the attorney-client privilege to an environmental audit. Other jurisdictions addressing this question apply the formalities of the privilege rather strictly. In *In re Grand Jury Matter*,<sup>52</sup> a Pennsylvania District Court was faced with the question of whether a party could lawfully assert the attorney-client privilege and ignore a subpoena requesting waste handling records. The defendant in the matter claimed that the subpoena should be quashed because their attorney had hired a consultant to aid in compliance assurance. The court rejected this contention, instead finding that the communications must concern legal advice and could not be merely in the realm of consulting services.<sup>53</sup> Instrumental in the decision was a finding that the consultant was working more directly for the company than the attorney.<sup>54</sup>

More recently, a New York District Court further restricted the applicability of the attorney-client privilege in the environmental context. In *United States Postal Service v. Phelps Dodge Refining Corp.*,<sup>55</sup> the court refused to allow a company to invoke the attorney client privilege in respect to documents created by an engineering firm hired to do environmental studies.

Several courts have found the attorney-client privilege to exist for documents created by an environmental consultant. In *Arizona ex rel. Corbin v. Ybarra*,<sup>56</sup> a corporate attorney retained a consultant to investigate possible violations of the state Hazardous Waste Management Act. The court found that under these circumstances, the consultant was part of the attorney's investigative staff and the report prepared following the investigation was for internal use and subject to the attorney-client privilege. Also, in *Olen Properties Corp. v. Sheldahl, Inc.*<sup>57</sup> a court determined an environmental audit

---

51. See *Arkansas Nat'l Bank v. Cleburne County Bank*, 258 Ark. 329, 331, 525 S.W.2d 82 (1975). One court stated that the privilege can be invoked: (1) Where legal advice of any kind is sought, (2) from a professional legal advisor in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence, (5) by the client, (6) are at his instance permanently protected, (7) from disclosure by himself or the legal advisor, (8) except the protection be waived. See *United States v. Lawless*, 709 F.2d 485, 487 (7th Cir. 1983) (citing 8 JOHN HENRY WIGMORE, EVIDENCE § 2292).

52. 147 F.R.D. 82 (E.D. Pa. 1992).

53. See *id.* at 85.

54. In 1989 a federal district court rejected the application of the attorney-client privilege because the company failed to demonstrate its in-house counsel was acting in a legal capacity. See *United States v. Chevron*, No. CIV-88-6681, 1989 U.S. Dist. LEXIS 12267, at \*17 (E.D. Pa. Oct. 16, 1989).

55. 852 F. Supp. 156 (E.D.N.Y. 1994).

56. 777 P.2d 686 (Ariz. 1989).

57. No. CV 91-646-WDK, 1994 WL 212135, at \*20 (C.D. Cal. Sept. 16, 1993).

was prepared so as to obtain legal advice and therefore protected by the attorney client privilege.<sup>58</sup>

## B. Self-Critical Analysis Privilege

A few jurisdictions have found that confidentiality is provided by a "self-critical analysis" privilege. In *Reichhold Chemicals, Inc. v. Textron, Inc.*,<sup>59</sup> a Florida District court found that a self-critical analysis privilege existed for environmental audits unless the party opposing the privilege could show extraordinary circumstances or need. A federal district court in Georgia applying that state's common law found that documents or files prepared by a company to evaluate its compliance with environmental laws were encompassed by a self-critical analysis privilege.<sup>60</sup> The court in *United States v. Dexter*<sup>61</sup> found that this privilege would obstruct enforcement and disallowed its use.

Even jurisdictions that recognize the privilege significantly restrict its applicability. Further, a federal district court in Arkansas has stated that the Eighth Circuit Court of Appeals does not recognize the self-critical analysis privilege.<sup>62</sup> The Court noted that the audit contained the only information

---

58. Certain procedures may enhance the possibility of the applicability of a privilege. Two authors suggest the following if an outside environmental consultant is retained to conduct an audit:

The consultant should report directly to counsel for purposes of protecting the information gathered as privileged, and to control the type of record being assembled. All draft and final reports should be submitted to outside counsel for review and distribution. Distribution of such reports should be limited within the company on a need-to-know basis, and confidential materials should be labeled and segregated from nonprivileged materials.

Mary Ellen Kris & Gail L. Vannelli, *Today's Criminal Environmental Enforcement Program: Why You May be Vulnerable and Why You Should Guard Against Prosecution Through an Environmental Audit*, 16 COL. J. OF ENVTL. L. at 248 (1991).

59. 157 F.R.D. 522 (N.D. Fla. 1994). See also *CPC Int'l, Inc. v. Hartford Accident & Indem. Co.*, 620 A.2d 462 (N.J. 1992), which found a privilege. The self-critical analysis privilege is also recognized in a variety of other consulting contexts. See generally *Tharp v. Sivyer Steel Corp.*, 149 F.R.D. 177 (S.D. Iowa 1993); *Banks v. Lockheed-Georgia Co.*, 53 F.R.D. 283 (N.D. Ga. 1971); *Bredice v. Doctors Hospital, Inc.*, 50 F.R.D. 249 (D.D.C. 1970).

60. See *Joiner v. Hercules, Inc.*, 169 F.R.D. 695, 698-99 (S.D. Ga. 1996).

61. 132 F.R.D. 8, 9-10 (D. Conn. 1990).

62. See *Carr v. El Dorado Chemical Co.*, No. 96-1081, 1997 U.S. Dist. LEXIS 5752 (W.D. Ark. April 14, 1997). The Court addressed a motion to compel production of an environmental audit. In the opinion the Court summarized the restrictions to this privilege as:

[1] [T]he privilege typically extends only to subjective impressions and opinions contained in a written report, not objective facts (citing *Webb v. Westinghouse Electric Corp.*, 81 F.R.D. 431, 434 (E.D. Pa. 1978)).

[2] [T]he privilege makes sense only when the protected information 'must be of a type whose flow would be curtailed if discovery was allowed' (quoting *Dowling v.*

about the facility's releases and patterns/practices.<sup>63</sup> It believed that access to the data was necessary to assess a continuing risk from those releases to plaintiffs and the public.<sup>64</sup>

### C. Work-Product Privilege

The attorney work product exception provides slightly different protection than the attorney-client privilege. The Arkansas Supreme Court has stated that "[w]ork product is not the same as a privilege that protects the sanctity of confidential communications; the attorney-client privilege and the work-product rule the principles upon which they are based, while susceptible to confusion, are separate and distinct."<sup>65</sup> The federal rule governing attorney work product states:

[A] party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative . . . only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means.<sup>66</sup>

---

American Hawaii Cruises, Inc., 971 F.2d 423, 425-26 (9th Cir. 1992)).

[3] [T]he privilege arguably may not apply when the materials are relevant to the investigation of a federal regulatory agency (citing *Federal Trade Commission v. TRW, Inc.*, 620 F.2d 207, 210-11 (D.C. Cir. 1980)).

[4] '[N]o material should be privileged unless it was prepared with the expectation that it would be kept confidential, and has in fact been kept confidential' (quoting *Dowling*, 971 F.2d at 426).

*Id.* See also *LEAN Inc. v. Evans Industries, Inc.*, 43 Env't Rep. Cas. (BNA) 1170 (E.D. La. 1996). The Court disallowed self-evaluation privilege in part because it was not convinced that environmental audits were always performed with the understanding that they would remain confidential.

63. See *id.* at 25.

64. See *id.* This decision is one of several discussed in a 1998 United States House of Representatives hearing. See *Federal-State Hearing supra* note 36 at 154-55. (U.S. EPA response to Commerce Committee questions).

65. *Parker v. Southern Farm Bureau Ins. Co.*, 326 Ark. 1073, 935 S.W.2d 556 (1996).

66. FED. R. CIV. P. 26(b)(3).

Issues frequently arise as to what is "in anticipation of litigation."<sup>67</sup> The work product rule might not provide protection for audits that are prepared for compliance assurance and not in contemplation of imminent litigation.

Questions regarding the applicability of these privileges to environmental audits and the previously described risks related to their disclosure have been one reason for the interest in enacting the Arkansas and other states' statutory privileges. There is also a practical reason for seeking a confidentiality mechanism other than the common law privileges.<sup>68</sup> To stay within the common law privileges the audit process has to be supervised by an attorney.<sup>69</sup> This might be an expensive and/or awkward arrangement.<sup>70</sup>

### III. ARKANSAS ENVIRONMENTAL AUDITING DEVELOPMENTS

#### A. The Arkansas Environmental Audit Privilege Statute

##### 1. *Legislative History*

In 1995, the Arkansas General Assembly addressed the regulated industries' concerns regarding the adverse consequences that full, unfettered admission of self-compliance audits would have on self-monitoring.<sup>71</sup> In Act

---

67. See *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596, 604 (8th Cir. 1977). In an unrelated context, the EPA itself asserted both the attorney client and work product privileges in a successful attempt to prevent disclosure under the federal Freedom of Information Act ("FOIA"), 5 U.S.C. § 552, *et seq.*, of various documents it generated related to four Michigan Superfund sites. See *Chemcentral/Grand Rapids Corporation v. United States Environmental Protection Agency*, No. 91-C-4380, 1992 WL 281322, at \*5 (N.D. Ill. Oct. 6, 1992). The Comprehensive Response Compensation and Liability Act or "Superfund" is found at 42 U.S.C. § 9601 *et seq.* In *Chemcentral* the court found that various EPA documents fit within either the attorney client or work product privileges and therefore met the deliberative process exemption of the FOIA. This exemption protects communications between federal agencies and outside consultants or other persons whose opinions or recommendations are part of the agency's own deliberative process. See *Dow Jones & Co., Inc. v. Dept. of Justice*, 917 F.2d 571, 574-75 (D.C. Cir. 1990). In addressing the work product privilege the *Chemcentral* court found that the documents at issue did not simply involve collecting background information regarding the four Michigan Superfund sites. The court also cited the fact that the EPA office labeled the documents "Enforcement Confidential" or "Attorney Client Privileged."

68. For a discussion of the practical considerations involved in maintaining the confidentiality of audits under common-law privileges see David R. Erickson & Sarah D. Matthews, *Environmental Compliance Audits: Analysis of Current Law, Federal Policy Considerations to Best Protect Their Confidentiality*, 63 UMKC L. REV. 491, 521-24 (1995).

69. See Hawks, *supra* note 13, at 242.

70. See Hawks, *supra* note 13, at 242.

71. Governor Jim Guy Tucker signed Act 350 on February 17, 1995. See ENVIRONMENTAL NEWS (Ark. Envtl. Federation) 1 (March/April 1995). See also D. Keith Fortner, *Environmental Law Survey*, 18 U. ARK. LITTLE ROCK L.J. 327, 335 (1996). Both industrial and some state environmentalists endorsed the legislation. See Seth Blomeley, *State*

350 of 1995, the legislature found “that the protection of the environment is enhanced by the public’s voluntary compliance with environmental laws and that the public will benefit from incentives to identify and remedy environmental compliance issues.”

## 2. *Summary of the Arkansas Environmental Audit Privilege Statute*

Act 350<sup>72</sup> provides a means of encouraging self-auditing by creating a limited protection against disclosure of potentially adverse information contained in the evaluation. The statute allows a facility<sup>73</sup> to conduct a

*Risks \$3 Million Loss as Law Stands*, ARK. DEMOCRAT GAZETTE, Aug. 31, 1998, at 7A. The environmental groups originally supporting the legislation included Arkansans for Environmental Reform and the Arkansas Sierra Club.

72. ARK. CODE ANN. § 8-1-301 *et seq.* (Michie 1997).

73. ARK. CODE ANN. § 8-1-303(a) describes the scope of the privilege:

In order to encourage owners and operators of facilities and persons conducting other activities regulated under this chapter, or its federal counterparts or extensions, both to conduct voluntary internal environmental audits of their compliance programs and management systems and to access and improve compliance with statutory and regulatory requirements, an environmental audit privilege is created to protect the confidentiality of communications relating to voluntary internal environmental audits.

*Id.* One commentator has expressed confusion as to who can invoke the Arkansas privilege. See Stensvagg, *supra* note 23, at 93-94. Stensvagg states:

The Arkansas legislature has enacted somewhat confusing language concerning the actors who may invoke the environmental audit privilege. On the one hand, the portion of the statute expressly creating the privilege states that it is designed to encourage “owners and operators of facilities and persons conducting activities regulated under this chapter, or its federal counterparts or extensions” to engage in auditing. The portion of the statute defining “environmental audit,” on the other hand, provides that a privileged audit must involve an evaluation of a facility (or an activity at a facility) “regulated under this chapter, or federal, regional, or local counterparts or extensions thereof.” Arguably, the broader language used in defining “environmental audit” should prevail. If so, this means that the qualifying audits may be performed at facilities and for activities regulated under regional or local counterparts (or extensions) of the pertinent federal and state laws.

Who are the actors cross-referenced in this manner? They include, first, persons conducting activities regulated under “this chapter” of the Arkansas Code. It is at least questionable, however, that the legislature meant the cross-reference to be this narrow. Chapter 1 (“General Provisions”) of the Arkansas Code Title 8 (“Environmental Law”)—the chapter in which the environmental audit privilege is codified—consists of three subchapters: (1) provisions setting up a system of permit issuance fees and authorizing inspections; (2) provisions setting forth additional powers of the Arkansas Department of Pollution Control and Ecology and the Arkansas Pollution Control and Ecology Commission; and (3) the environmental audit privilege. If the audit privilege extended literally to only those facilities and persons whose activities were regulated under those subchapters, it might protect very few actors and, more importantly, might serve as a trap to unsuspecting companies.

voluntary “environmental audit”<sup>74</sup> report which is privileged, provided the statutory provisions are followed. The “environmental audit report” is the set of documents developed as a result of the audit and it must be marked “ENVIRONMENTAL AUDIT REPORT: PRIVILEGED DOCUMENT.”<sup>75</sup>

The term environmental audit report is broadly defined to include:

1. Field notes, records of observations, findings, opinions, suggestions, conclusions, drafts, memoranda, drawings, photographs, computer-generated or electronically recorded information, maps, charts, graphs, and surveys collected or developed for the primary purpose of preparing an environmental audit;<sup>76</sup>
2. An audit report prepared by the auditor that includes: (a.) the scope of the audit; (b.) the information gained in the audit; (c.) conclusions and recommendations; (d.) exhibits and appendices;<sup>77</sup>
3. Memoranda and documents analyzing a portion of or all of the audit report and discussing implementation issues; and<sup>78</sup>
4. An implementation plan that addresses correcting past compliance, improving current compliance, and preventing future noncompliance.<sup>79</sup>

What the legislature most likely meant to say was “facilities and persons conducting . . . activities under this *title*”—meaning Title 8 of the Arkansas Code. Other chapters in Title 8 cover such things as environmental testing, water and air pollution, water pollution control facilities, solid waste, and hazardous wastes. Given the logic of the environmental audit privilege, it may well be that the legislature intended to refer to persons regulated under these statutory programs, or under any ‘federal, regional, or local counterparts or extensions’ of these statutes.

*Id.*

74. “Environmental Audit” is defined in ARK. CODE ANN. § 8-1-302(3)(A) (Supp. 1997) as:

[A] voluntary internal, and comprehensive evaluation of one (1) or more facilities or an activity at one (1) or more facilities regulated under this chapter, or federal, regional, or local counterparts or extensions thereof, or of management systems related to that facility or activity, that is designed to identify and prevent noncompliance and to improve compliance with statutory or regulatory requirements.

*Id.*

75. ARK. CODE ANN. § 8-1-302(4) (Supp. 1997).

76. ARK. CODE ANN. § 8-1-302(4)(A) (Supp. 1997). The potentially protected material clearly encompasses a number of documents in addition to the actual audit report itself. It is therefore important for facilities to recognize that as information (i.e. sampling data, etc.) or documents (i.e. employee interviews, etc.) are initially generated the required statutory procedures to provide them confidentiality should be followed to ensure protection for these materials. *See id.*

77. *See* ARK. CODE ANN. § 8-1-302(4)(B) (Michie 1997).

78. *See* ARK. CODE ANN. § 8-1-302(4)(C) (Michie 1997).

79. *See* ARK. CODE ANN. § 8-1-302(4)(D) (Michie 1997).

The audit privilege is intended to make the report inadmissible in criminal, civil, or administrative actions, including enforcement actions.<sup>80</sup> However, the extent of the privilege is limited and can be waived under a variety of circumstances.<sup>81</sup> The privilege similarly does not apply to “[d]ocuments, communications, data, reports, or other information that must be collected, developed, maintained, reported, or otherwise made available to a regulatory agency[.]”<sup>82</sup> In a legal action, parties may stipulate as to the admissibility or

80. See ARK. CODE ANN. § 8-1-303(b) (Michie 1997). One author in an article critical of state audit privilege statutes references the Arkansas provision and states:

Finally, privilege statutes will impose barriers not just to government enforcement of environmental laws, but to citizen suits and tort litigation as well. For example, the Arkansas statute typically provides that ‘an environmental audit report shall be privileged and shall not be admissible as evidence in any civil, criminal or administrative legal action.’

Weinberg, *supra* note 24, at 653-54.

81. See ARK. CODE ANN. § 8-1-304 (Michie 1997) provides the following situations in which waiver of the privilege may be found:

(a) The privilege described in § 8-1-303 does not apply to the extent that:

(1) It is waived expressly by the owner or operator of the facility that prepared or caused to be prepared the environmental audit report;

(2) The owner or operator of a facility or person conducting an activity seeks to introduce an environmental audit report as evidence;

(3) The owner or operator of a facility authorizes the disclosure of the environmental audit report to any party, except where:

(A) Disclosure is made under the terms of a confidentiality agreement between the owner or operator of a facility and:

(i) A potential purchaser of the facility; or

(ii) A customer, lending institution, or insurance company with an existing or proposed relationship with the facility; or

(B) Disclosure is made under the terms of a confidentiality agreement between government officials and the owner or operator of a facility; or

(C) Disclosure is made to an independent contractor retained by the owner or operator of the facility for the purpose of identifying noncompliance with statutory or regulatory requirements and assisting the owner or operator in achieving compliance with reasonable diligence.

(b) The waiver of the privilege described in § 8-1-303 may be for part or all of the environmental audit report and said waiver of privilege extends only to that part of the environmental audit report expressly waived by the owner or operator of a facility.

ARK. CODE ANN. § 8-1-304 (Michie 1997). The expansion of Act 350 to potential purchasers and lenders is presumably intended to ensure that an audit or assessment performed in a transactional context (proposed sale or loan) would be protected even as it is inevitably provided to the other parties in the commercial transaction.

82. ARK. CODE ANN. § 8-1-305 (Michie 1997). For example, a facility required by its NPDES water discharge permit to periodically sample its effluent (i.e. wastewater) and submit discharge monitoring reports to the ADPC&E could not retain these results as privileged under this program. ADPC&E Reg. No. 6 addresses the NPDES permit requirements and associated sampling/reporting provisions. These sampling and reporting requirements are found in part in 40 C.F.R. § 122.44(i).

nonadmissibility of information contained in the report.<sup>83</sup> Disclosure of the audit report may also be appropriate in a civil action when it is shown that the privilege was fraudulently asserted, the material was not subject to the privilege, or the report shows a violation of state or federal law or regulation of almost any kind; and the person asserting the privilege did not "promptly initiate and pursue appropriate efforts to achieve compliance with reasonable diligence."<sup>84</sup> The privilege will be disregarded in criminal matters on the same grounds.<sup>85</sup> In either civil or criminal actions, noncompliance will not be found for failure to obtain a permit, provided the person filed an application for a permit not more than ninety days after becoming aware of the noncompliance.<sup>86</sup>

The audit privilege statute provides a means by which a prosecuting authority may obtain a copy of the audit report.<sup>87</sup> The prosecuting authority must have information that was obtained from a source independent of the audit report that indicates a probable cause to believe that a violation has occurred.<sup>88</sup> The seizure of the report may be accomplished by warrant, subpoena, or through discovery.<sup>89</sup> Within thirty (30) days after the seizure, the person who caused the report to be created may file with the prosecuting tribunal a petition requesting a hearing on the admissibility of parts of the report or the report as a whole.<sup>90</sup> Once the tribunal has received the petition, it must set an *in camera* hearing within forty-five (45) days to determine the admissibility of the part of the report or the document as a whole.<sup>91</sup> The burden of proof of establishing the validity of the privilege is borne by the party asserting the privilege.<sup>92</sup>

The Arkansas audit privilege was addressed by a court for the first time in *Carr v. El Dorado Chemical Co.*<sup>93</sup> In *Carr*, the plaintiffs filed a motion to compel production of two documents relating to problems with the defendant's wastewater treatment system.<sup>94</sup> The defendant inadvertently produced a

---

83. See ARK. CODE ANN. § 8-1-305 (Michie 1997).

84. See ARK. CODE ANN. § 8-1-307 (Michie 1997). The requirement to remedy noncompliance is arguably another non-enforcement mechanism that motivates companies or facilities to expeditiously eliminate violations.

85. See ARK. CODE ANN. § 8-1-308 (Michie 1997).

86. See ARK. CODE ANN. §§ 8-1-307(b)(1), 308(b)(1) (Michie 1997).

87. See ARK. CODE ANN. § 8-1-309 (Michie 1997).

88. See *id.* § 8-1-309(a)(1).

89. See *id.* § 8-1-309(a)(2).

90. See *id.* § 8-1-309(b).

91. See *id.* § 8-1-309(c).

92. See *id.*

93. See *Carr v. El Dorado Chem. Co.*, No. 96-1081, 1997 U.S. Dist. LEXIS 5752 (W.D. Ark., April 14, 1997).

94. See *id.* at \*2.



portion of the first document that was requested.<sup>95</sup> The plaintiffs then requested that the court review, *in camera*, both documents that had originally been requested to determine if they were privileged in whole or in part.<sup>96</sup> The request subsequently became moot when it was determined that what was thought to be only a part of the document was actually the whole document.<sup>97</sup>

The defendant refused to disclose the second document asserting that “an environmental audit conducted by Monsanto relating to the defendant, El Dorado Chemical Company facility, is privileged communication and protected from disclosure by virtue of the Arkansas statutory environmental audit privilege . . . and the common law critical self-analysis privilege.”<sup>98</sup> The statute was enacted in 1995 while the document in question was contained in a March 29, 1993 memorandum.<sup>99</sup> The issue before the court was whether the intent of the Arkansas General Assembly, in creating this limited privilege, was for it to retroactively apply to documents created prior to the enactment of the statute. The court examined the statute’s stated purpose and found no evidence of a legislative intent to apply the privilege retroactively. The court also found it persuasive that the audit “could not have been performed in reliance upon the fact that it would not be subject to discovery.”<sup>100</sup>

### 3. *Potential Changes*

The Arkansas privilege statute has become a source of disagreement between the EPA and ADPC&E.<sup>101</sup> The EPA has asked the ADPC&E to revise Act 350 in three ways “to assure that the ADPC&E retains the requisite authorities for RCRA<sup>102</sup> program authorization”:

1. [M]ake the privilege created by the Audit Law inapplicable to criminal violations and proceedings;

---

95. *See id.*

96. *See id.*

97. *See id.*

98. *See id.* at \*3. The court disposed of the “self-critical analysis privilege” by pointing to the fact that the Eighth Circuit does not recognize such a privilege. *See id.* The absence of such a privilege further illustrates the need for the Arkansas Environmental Audit Privilege.

99. *See Carr*, 1997 U.S. Dist. LEXIS 5752, at \*6.

100. *Id.* at \*7.

101. Note that the national environmental groups have threatened legal action against EPA if it delegates federal authority to states with expansive privilege legislation. *See Beard, supra* note 16. Those groups would argue that such audit privileges hinder enforcement. *See Beard, supra* note 16.

102. “RCRA” refers to the Resource Conservation and Recovery Act (otherwise known as the federal Solid Waste Disposal Act,) 42 U.S.C. § 6901 *et seq.* which regulates the generation, transportation, treatment, storage and disposal of hazardous wastes. The Arkansas regulations implementing this statute are found in ADPC&E Reg. No. 23.

2. [C]larify that the public's right of access to compliance information is not weakened by the Audit Law<sup>103</sup>;
3. [C]larify that the Audit Law will not circumvent RCRA's requirements concerning permitting and interim status.<sup>104</sup>

In response to this request, a draft ADPC&E bill was produced for consideration by the state legislature when the Arkansas General Assembly convenes in 1999.<sup>105</sup> This proposed Act would repeal the sections of the statute allowing the application of the privilege in criminal matters.<sup>106</sup> The act would also repeal other subsections referring to the privilege in a criminal matter.<sup>107</sup> A representative of ADPC&E has stated that EPA's request will have little effect upon industry within the state due to the fact that the agency's policy is to cooperate with industry to assure compliance before assessing fines.<sup>108</sup>

## B. ADPC&E Audit Practices

The federal government refuses to guarantee that it will not attempt to acquire and use an audit in certain circumstances.<sup>109</sup> In contrast, the Arkansas General Assembly has obviously by statute decreed that audits will not be

---

103. Hawks, *supra* note 13, at 259.

104. See Letter from Jerry Clifford, Acting Regional Administrator, EPA, to Randall Mathis, Director, ADPC&E (Sep. 15, 1997). See also Blomeley, *supra* note 71. State statutory audit privilege issues have not arisen solely in the RCRA delegation process. For example, EPA Region VI's approval of the Texas Title V program has involved revisions of that state's audit legislation. See E.G. Fiesinger, *Title V Operating Permits in Texas: The Saga Continues*, Presentation at the Air & Waste Management Association's 91st Annual Meeting (June 1998) (examining the Texas CAA Title V program and the role its audit legislation has played in the delegation process).

105. See Act To Repeal The Applicability Of Environmental Audit Privilege To Criminal Actions, 1999 Regular Session (proposed) (on file with authors). EPA is extending the time period ADPC&E has to make these revisions until the General Assembly meets in January, 1999. See Telephone Interview with Mike Bates, Chief, Hazardous Waste Division, ADPC&E (Oct. 2, 1998). See also Blomeley, *supra* note 71, at 7A.

106. See Act To Repeal The Applicability Of Environmental Audit Privilege To Criminal Actions, 1999 Regular Session (proposed) (on file with authors).

107. See *id.* Based on an ongoing discussion between EPA and ADPC&E it is believed that these amendments would address the concerns identified in the previously cited September 15, 1997 letter from EPA to ADPC&E. See Telephone Interview with Mike Bates, *supra* note 105. Note, however, the amendments do not address EPA's requirement to clarify the public's right of access to information and the effect on RCRA permitting and interim status.

108. See Blomeley, *supra* note 71, at 7A (quoting Al Eckert, Chief of the ADPC&E Legal Division).

109. See Incentives, 60 Fed. Reg. at 66,708 (EPA states that it will not routinely request audits).

available to the ADPC&E or other parties unless one of the exceptions is applicable.<sup>110</sup>

The ADPC&E has utilized audits as an additional tool to facilitate compliance. It frequently incorporates audit requirements in its settlement documents (i.e. Consent Administrative Orders ["CAOs"]) used to resolve enforcement actions.<sup>111</sup> Such provisions are most often incorporated into the CAOs settling Arkansas Hazardous Waste Management Act<sup>112</sup> or Arkansas Water & Air Pollution Control Act<sup>113</sup> enforcement actions if the ADPC&E believes that the facility would benefit from an audit.<sup>114</sup> For example, if the facility was not inspected regularly, or was newly regulated, it may not be fully aware of the applicable regulatory requirements. At such a facility ADPC&E believes a compliance audit may serve to provide a "report card" of its compliance status with regard to the applicable regulations.<sup>115</sup> Facilities that are inspected periodically, particularly those that have been regulated for many years, are assumed to be aware of their compliance status, and not as likely to benefit from such an audit.<sup>116</sup> In such cases, the ADPC&E would be less likely

---

110. Arkansas' experience to date has not demonstrated an increase in voluntary disclosure of violations by the regulated community. See Interview with Randall Mathis, Director, ADPC&E (June 22, 1998). However, this may not be surprising since unlike either EPA's voluntary disclosure policy or a few other state programs, Arkansas does not provide for immunity from enforcement. See Incentives, 60 Fed. Reg. 66,706 (1995). Colorado's voluntary disclosure/immunity program is described in Federal-State Hearings, *supra* note 36, at 52 (testimony of Hon. Gale A. Norton, Colorado Attorney General). Also, the lack of voluntary disclosures to the agencies does not mean facilities are not increasingly auditing and correcting violations in view of the confidentiality protection provided by Act 350.

111. See Telephone Interview with Nelson Jackson, Attorney, Legal Division, ADPC&E (Sept. 29, 1998); Telephone Interview with David Brown, Hazardous Waste Division, ADPC&E (Sept. 29, 1998). The audit mandates placed in ADPC&E CAOs are not always focused on a search for non-compliance. For example, see *In re El Dorado Chem. Co.*, LIS 95-070 (May 4, 1995) in which that facility agreed to undertake subsurface monitoring and under certain circumstances a waste minimization assessment. Also, either EPA or ADPC&E might negotiate a SEP in a consent order in which the alleged violator agrees to implement pollution controls or mandates that exceed the actual regulatory requirements. The DOJ and a Fort Smith, Arkansas manufacturing facility entered into a 1996 consent decree that required in part that air emission controls be installed that exceeded existing governmental standards. See *United States v. GNB Industrial Battery Company, Inc.*, Consent Decree, 96-2129 (W.D. Ark. 1996).

112. See ARK. CODE ANN. § 8-7-201. This program is implemented through Reg. No. 23 by the ADPC&E Hazardous Waste Division.

113. See ARK. CODE ANN. § 8-3-101 *et seq.* This program is implemented through Reg. Nos. 18, 19 & 26 by the ADPC&E Air Division. See *generally* Wright & Henry, *supra* note 4.

114. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

115. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

116. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

to negotiate an audit requirement in the CAO. However, the ADPC&E believes that even facilities that have been regulated for some time would benefit from a compliance audit requirement if a significant regulatory requirement was consistently ignored or there was a failure in matters such as record keeping.<sup>117</sup>

If an audit requirement is included in a CAO, a time frame for its completion is specified.<sup>118</sup> Also, the ADPC&E requires the simultaneous submission of a report describing the measures taken by the facility to correct the instances of identified noncompliance.<sup>119</sup> The results of these mandated audits will not be used as a basis for additional enforcement.<sup>120</sup> Depending upon the circumstance, the ADPC&E may address discovered instances of noncompliance by incorporating additional remedial requirements into a modification of the original CAO. In the alternative, the ADPC&E may simply require that the instances of noncompliance be corrected.<sup>121</sup> The decision to initiate an action is within ADPC&E's enforcement discretion. Further, the ADPC&E might use an audit in a future enforcement action if the report prepared by the facility was subsequently proven to be erroneous or fraudulent.<sup>122</sup>

Some audits simply result from a governmental inspection as opposed to a specific request or mandate. For example, a facility may feel pressured after a standard inspection to further investigate the identified deficiencies.<sup>123</sup> Facilities that find it necessary to determine their compliance status through an audit are often uncomfortable with their degree of understanding of the applicable governmental requirements.<sup>124</sup> This may be particularly important

---

117. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111. For example, sometimes an ADPC&E Air Division inspection discovers air emission sources at a facility that should have been included in an air permit. See Interview with Nelson Jackson, *supra* note 111. The ADPC&E may therefore deem it appropriate to have the facility determine through an audit whether there are other sources of emissions that should be included in an air permit.

118. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

119. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

120. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

121. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

122. See Interview with Nelson Jackson, *supra* note 111; Interview with David Brown, *supra* note 111.

123. See Telephone Interview with Thomas P. Jones, Vice-President, Pollution Management, Inc. (Oct. 1, 1998).

124. See *id.*

if the facility is subject to a new environmental regulatory program.<sup>125</sup> Similar considerations are applicable if an existing regulatory program is modified.<sup>126</sup>

---

125. For example, a number of facilities are in the process of acquiring much more detailed and complex air permits as required by the CAA Title V program. See 42 U.S.C. §§ 7661-7661(f). The regulations implementing the Title V program in Arkansas are found in Reg. No. 26. The complexity of the new permits has motivated some facilities to assess whether the emission limits and other Title V conditions are achievable through "dry runs" or other exercises prior to their actual imposition. For a description of the Title V program, see Wright & Henry, *supra* note 4, at 303-08 and 386-91.

126. Federal and state regulations are revised periodically for a variety of reasons. Recent examples in Arkansas are the proposed revisions to two key regulations (ADPC&E Reg. Nos. 18 & 19) that in part implement the CAA in Arkansas. The Arkansas air quality program underwent fundamental changes beginning in August, 1998. The regulatory scheme set up by the ADPC&E Reg. No. 18 (the "Arkansas Air Code") and ADPC&E Reg. No. 19 (State Implementation Plan ["SIP"] Regulations) were products of two years of negotiations with industry. Several provisions of these two regulations were rejected by EPA on August 25, 1998. See Letter from Robert E. Hanneschlager, P.E., Acting Director, Multimedia Planning and Permitting Division, U.S. EPA, Region VI, to Randall Mathis, Director, Arkansas Department of Pollution Control & Ecology (Aug. 25, 1998) (on file with the ADPC&E).

ADPC&E Reg. Nos. 18 and 19 were extensively revised on July 1, 1997. The relevant revision to Reg. No. 19 was submitted to EPA as a proposed CAA SIP revision shortly thereafter. The 1997 Reg. No. 19 applied only to "major sources" of federally regulated air pollutants ("FRAP"), i.e., sources emitting over 100 tons per year ("tpy") of any one FRAP, 25 tpy of any combination of hazardous air pollutants ("HAPs"), or 10 tpy of any one HAP. Reg. No. 18 addressed all sources emitting less than these amounts of FRAPs or HAPs, or emitting any other amount of a state regulated pollutant, and allowed some sources to operate pursuant to an "Air Pollution Prevention Plan" ("APPP") rather than an air permit. Reg. No. 19 also provided for self-implementing minor modification provisions. However it did not contain opacity limitations. With its August 1998 letter, the EPA rejected the 1997 proposed SIP revisions, stating that they violated Section 110(a)(2)(C) of the CAA, as well as regulations codified pursuant thereto (40 C.F.R. §§ 51.160-163) that require minor new source review pursuant to a state's SIP. The EPA also rejected Arkansas' minor modification procedures along with the deletion of opacity requirements. The EPA noted that minor modifications required action by the ADPC&E and that opacity must be included in the SIP as a surrogate for meeting the National Ambient Air Quality Standards ("NAAQS") for particulates.

In response to the EPA's August 15, 1998 letter and SIP denial, the ADPC&E issued proposed revisions to Reg. Nos. 18 and 19, in September, 1998. The proposed revisions eliminated the major versus minor source distinction between Reg. Nos. 18 and 19. Assuming these proposed regulations are eventually adopted, Reg. No. 19 would apply to sources emitting much lower emission rates, for example, 40 tpy of carbon monoxide, 25 tpy of either nitrogen oxide, sulfur oxide, volatile organic compounds, or 15 tpy of particulate matter. The revisions also propose to remove the self-implementing minor modification procedure from Reg. No. 19 and reinstate the opacity requirement. Reg. No. 18 would no longer provides for APPPs, but allows sources emitting less than the Reg. No. 19 thresholds to potentially escape permitting altogether. See Wright & Henry, *supra* note 4, at 368-83 (providing a detailed discussion of Reg. Nos. 18 and 19 prior to the proposed revisions). This is a classic example of program changes that will force many companies to reassess the requirements applicable to their facilities and obligations related thereto. For example, some facility operations may no longer be exempt from the requirement to obtain an air permit.

These proposed revisions to Reg. No 19 were approved by the EPA with comments by letter dated November 20, 1998. See Letter from Jole C. Luehrs, Chief Air Permits Section,

Finally, employee downsizing may occasionally motivate a company to undertake an audit.<sup>127</sup> The environmental manager position may have been eliminated, forcing a non-environmental professional such as a shipping manager or human relations specialist to assume responsibility for environmental compliance.<sup>128</sup> In cases where there is a lack of depth in knowledge of the applicable regulations, the facility will sometimes hire an outside consultant to conduct an audit.<sup>129</sup>

#### IV. FEDERAL AUDIT POLICY

##### A. EPA/DOJ

To put the Arkansas statutory audit privilege in context it is helpful to understand the history of federal environmental auditing policies. The EPA issued its first policy addressing environmental audits on November 8, 1985.<sup>130</sup> This first policy initiative was released as an interim guidance. It listed the elements of effective environmental auditing<sup>131</sup> with an intent of enhancing its effectiveness. The comments received on the interim guidance dealt primarily

---

U.S. EPA, Region VI, to Keith Michaels, Chief, Air Division, Arkansas Department of Pollution Control and Ecology (Nov. 20, 1998). Specifically, the EPA stated that the Arkansas Audit Privilege Statute must not apply to construction which occurs prior to issuance of a permit required to Regulation 19 because Regulation 19 requires pre-construction permits. *See id.* at 2-3. Additionally, the EPA stated that the Arkansas Environmental Variances Act, 1995 Ark. Acts 943, must not be interpreted to allow a temporary variance of interim authority to construct a source subject to Regulation 19, again because Regulation 19 requires pre-construction permits. *See id.*, at 3. A full discussion of the Arkansas Environmental Variances Act is contained in Wright & Henry, *supra*, note 4, at 345-47.

127. *See* Telephone Interview with Thomas P. Jones, *supra* note 123.

128. *See* Telephone Interview with Thomas P. Jones, *supra* note 123. Corporate downsizing is a common reason for a facility's noncompliance. Even if an employee had original responsibility for these issues he or she may have taken on additional areas of responsibility. Environmental regulations are complicated and voluminous. It may be difficult to effectively ensure environmental compliance on a part-time basis depending on the scope of requirements applicable to a given facility. *See id.*

129. *See* Telephone Interview with Thomas P. Jones, *supra* note 123.

130. *See* Environmental Audit Policy Statement, 50 Fed. Reg. 46,504 (1985). For additional historical perspective, see "Current Practices in Environmental Auditing," EPA Report No. EPA-230-09-83-006, February 1984; "Annotated Bibliography on Environmental Auditing," Fifth Edition, September 1985; Policy Statement, 51 Fed. Reg. at 25,007.

131. In both the interim guidance and final policy, EPA drew heavily from "Compendium of Audit Standards" (1983, Walter Willborn, American Society for Quality Control) and "Standards from the Professional Practice of Internal Auditing" (1981, The Institute of Internal Auditors, Inc.). *See* Buck J. Wynne & C. Gregory Rogers, Corporate Environmental Compliance Management: Federal Government Benchmarks, presented at the ABA SONREEL October 1, 1993 First Annual Meeting in Asheville, North Carolina.

with possible EPA requests for audit reports and concern that the agency would use these documents for environmental compliance 'witch hunts.'<sup>132</sup>

The EPA's final policy, released on July 9, 1986, did not differ significantly from the interim guidance. The EPA's cited objectives in releasing this final policy included helping to initiate auditing activities by providing a model for acceptable programs, identifying the criteria considered important, assisting regulatory agencies in their negotiation of CAO provisions addressing environmental auditing, and to guide states and localities considering auditing initiatives.<sup>133</sup> The EPA identified the following important elements of an auditing system: (1) top management support; (2) independent auditing function; (3) adequate staffing and training; (4) explicit objectives, scope, resources, and frequency; (5) a process sufficient to collect the necessary information to achieve objective; (6) specific procedures for developing reports of audit findings, corrective actions, and schedules for compliance; (7) quality assurance procedures.<sup>134</sup>

With regard to requests for audit reports, the EPA incorporated into its final policy some additional clarification in response to comments requesting delineation of specific circumstances where the agency may request audit reports.<sup>135</sup> However, the EPA maintained that audit reports, or at least the relevant portion(s), would be requested if they were necessary for an investigation, i.e., if the information could not be attained through monitoring, or other data sources.<sup>136</sup> The EPA declined to incorporate any positive incentives, stating that "the 'incentives' most frequently mentioned in this context are fraught with legal and political obstacles."<sup>137</sup>

The DOJ issued its first policy addressing environmental audits five years later on July 1, 1991.<sup>138</sup> This 1991 policy was similar to the EPA's 1986 policy with regard to when DOJ would ask for copies of audit reports.<sup>139</sup> Both the DOJ and the EPA's policies encouraged voluntary auditing and provided some

---

132. See Policy Statement, 51 Fed. Reg. at 25,007.

133. See Wynne & Rogers, *supra* note 131, at 10.

134. See Wynne & Rogers, *supra* note 131, at 11-14.

135. See Policy Statement, 51 Fed. Reg. at 25,007.

136. See *id.* at 25,007.

137. See *id.* at 25,007.

138. See U.S. Department of Justice, *Factors and Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts* (July 1, 1991).

139. Audit reports would not be requested unless they were necessary for an investigation. See Policy Statement, 51 Fed. Reg. at 25,007 ("EPA's authority to request an audit report, or relevant portions thereof, will be exercised on a case-by-case basis where the Agency determines it is needed to accomplish a statutory mission, or where the government deems it to be material to a criminal investigation."). See also Letter to Steven Herman from Lois J. Schiffer, *supra* note 20.

recognition of facilities' auditing efforts in enforcement activities. However, both policies also maintained that audit reports may be used in civil enforcement actions or criminal prosecutions. Thus, audit reports would not be requested unless they were necessary for an investigation.

These federal policies arguably did not facilitate voluntary compliance audits. Therefore, the EPA explored different approaches. In 1994, the EPA published a notice in the Federal Register seeking facilities to participate in "Pilot Project Proposals" in which the agency would reassess facilities' environmental audit procedures.<sup>140</sup> Then, on June 20, 1994, the EPA noticed two-day public meetings scheduled for July 1994, Washington, D.C., and January, 1995, in San Francisco, to discuss its "environmental auditing policy and related environmental compliance self-evaluation and disclosure issues."<sup>141</sup> The EPA invited stakeholders from industry, trade groups, state environmental commissioners, and attorneys general, district attorneys, public interest organizations and professional environmental auditors.<sup>142</sup> During the hearings, several groups opposing confidentiality for voluntary environmental compliance audit reports argued it amounted to "corporate concealment rights."<sup>143</sup>

Following the July hearings, the EPA published a restatement of policies related to environmental audits on July 28, 1994.<sup>144</sup> In its restatement, the agency announced its intent to "encourage the private sector to collect data and survey auditing practices in order to gauge the effect of enforcement policies on self-evaluation and disclosure."<sup>145</sup> The EPA subsequently published another interim policy on April 3, 1995.<sup>146</sup> With this interim policy, the EPA provided federal civil penalty mitigation if several conditions and limitations were met. Public response focused on the fact that the EPA limited application of the penalty mitigation to violations that were "voluntarily" reported.<sup>147</sup> It was argued that many conditions and deficiencies were already subject to

---

140. Grants and Cooperative Agreements; availability, etc. See Environmental Leadership Program: Request for Pilot Project Proposals, 59 Fed. Reg. 32,062, 32,063 (1994) (public notice).

141. See Meeting: Environmental Audit Policy, 59 Fed. Reg. 31,914 (1994) (public notice).

142. See Incentives, 60 Fed. Reg. at 66,706.

143. See David Rubenstein, *Organizations Fight for Confidentiality of Self-Audits*, CORP. LEGAL TIMES, March 1995, at 20.

144. See Restatement of Policies Related to Environmental Auditing, 59 Fed. Reg. 38,455, 38,456 (1994).

145. *Id.*

146. See Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875 (1995).

147. See *id.* at 16,877.



mandatory reporting,<sup>148</sup> and were often discovered by means other than audits, such as normal monitoring and record keeping.<sup>149</sup>

The EPA published its final policy statement regarding voluntary environmental compliance auditing on December 22, 1995.<sup>150</sup> In this long-awaited final guidance, the EPA maintained its position with regard to voluntary reporting pursuant to a qualifying environmental audit.<sup>151</sup> However, for qualifying violations, the EPA provided the following incentives for reporting the instances of non-compliance: (1) no gravity-based penalties or reduction of gravity-based penalties by 75%; (2) no criminal recommendations; (3) no routine request for audit reports.<sup>152</sup>

Qualification was predicated on meeting nine qualifying conditions. These nine are: (1) systematic discovery; (2) voluntary discovery; (3) prompt disclosure; (4) discovery and disclosure independent of government or third-party plaintiff; (5) correction and remediation; (6) prevent recurrence; (7) no repeat violations; (8) other violations excluded; (9) cooperation.

The first and second condition, systematic and voluntary discovery, require that the discovery of the instance of non-compliance must be pursuant to a qualifying environmental audit, i.e., an objective, documented, systematic procedure or practice reflecting regulated entity's due diligence in preventing, detecting, and correcting violations.<sup>153</sup> The key, of course, is whether the audit and subsequent reporting is actually voluntary. To ensure that the audit and discovery of the violation is voluntary, the EPA requires that the violation must be identified and disclosed apart from any mandated sampling or monitoring.

The third condition, prompt reporting, requires reporting of the violation in writing within ten days of discovery. The fourth condition, independent discovery and disclosure, requires disclosure prior to: commencement of a federal, state or local inspection/investigation; notice of a citizen suit; filing of a complaint by third party; reporting of the violation to the EPA by a "whistle blower" employee; or imminent discovery of the violation by a regulatory agency. With this fourth condition, the EPA ensures that the facility is

---

148. See Reitze & Hoffman, *supra* note 31; Reitze & Schell, *supra* note 31, for a discussion of the various federal reporting requirements.

149. See James T. Banks, *EPA's New Enforcement Policy: At Last, a Reliable Roadmap to Civil Penalty Mitigation for Self-Disclosed Violations*, 26 *Envtl. L. Rep. (ENVTL. L. INST.)* 10227, 10230 (1996).

150. See *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations*, 60 *Fed. Reg.* 66,706 (1995).

151. The EPA remains opposed to audit privileges because one of the rationales behind the policy statement was the movement of states toward incentive programs. See Dara B. Less, *Incentives for Self-Policing: The Need For a Rule*, 2 *ENVTL. LAW* 773 (1996).

152. See *id.* at 761-62.

153. See *id.* at 762.

rewarded for taking the initiative, and not for attempting to simply escape impending liability.

The EPA requires in the fifth condition correction and remediation of the discovered violation within sixty days. The facility must certify in writing that the violations have been corrected, and take appropriate measures to remedy environmental or human harm. Condition six requires that the regulated entity must agree in writing to take steps to prevent recurrence of the violation.

Under condition seven, repeated violations do not qualify for the policy's positive incentives. Thus, the violation in question must not have occurred within the past three years at the same facility. Moreover, the violation must not be part of a pattern of federal, state or local violation by a parent organization which occurred within the past five years. The eighth condition provides that serious violations do not qualify. Violations must not result in serious actual harm, or have presented an imminent and substantial endangerment to human health or environment. Qualifying violations must also not violate specific terms of any judicial or administrative order or consent agreement. Finally, to qualify for the positive incentives under the policy, the ninth condition requires that the facility cooperate with the EPA by providing all requested documents and access to employees to assist with investigation, assistance with noncompliance problems related to disclosure, in addition to assistance with any environmental consequences related to violations.

In 1997, the EPA issued an Audit Policy Interpretive Guidance ("Guidance").<sup>154</sup> This guidance answered several questions that arose in the EPA Regional offices during the implementation of this policy. The EPA addressed questions such as whether a violator would be deemed to have voluntarily discovered its violations if done during an audit required as part of a binding settlement.<sup>155</sup> Also questioned was whether in order to comply with the prompt disclosure requirement, an entity planning to perform an audit of numerous similar facilities must send a separate notification to the EPA within 10 days of discovering each violation, or can the violator consolidate its disclosures and submit them after the normal deadline.<sup>156</sup> The Guidance did

---

154. See Memorandum from Steven A. Herman, Assistant Administrator, U.S. EPA, to Regional Administrators (Jan. 15, 1997).

155. EPA's response: Where a violator—without any legal obligation to do so—already has committed to conducting a compliance audit prior to any formal or informal enforcement response, an obligation to conduct such an audit with the same material scope and purpose can be incorporated into a binding settlement with EPA without automatically disqualifying violations discovered under the audit from obtaining penalty mitigation under the Audit Policy. See *id.* Companies acquiring facilities should note that in "arm's length" transactions, the current and former owners may be treated by the EPA as separate entities in certain circumstances. For guidance, see Memorandum from A. Herman to Regional Administrators, *supra* note 154.

156. EPA's response: A violator may consolidate its submission of certain information to

not in any way expand the applicability of the EPA's Final Audit Policy to violations not previously covered.

## B. Congressional Activity

Legislation has been introduced that would prevent the EPA or DOJ from using audit information in an enforcement action. A Senate bill introduced in 1997 is Section 866 titled "Environmental Protection Partnership Act 1997." It has not to date been enacted.<sup>157</sup>

## V. INCENTIVES FOR POLLUTION PREVENTION AS RELATED TO COMPLIANCE AUDITING

Companies that viewed environmental regulation as simply an issue of risk analysis are currently considering its role in advancing innovation and its impact on competitiveness.<sup>158</sup> This effort is being assisted by forty-nine of the fifty states.<sup>159</sup> They have developed and implemented approximately 150 technical assistance programs designed to promote environmental compliance and pollution prevention.<sup>160</sup> Pollution prevention refers to a movement over the past ten years toward the reduction of air emissions, waste discharges or waste generation as opposed to "end-of-pipe control strategies."<sup>161</sup> Pollution prevention arguably results in the use of less natural resources and elimination of waste streams, resulting in financial savings.<sup>162</sup> In contrast, compliance auditing simply provides information to corporate decision makers about legal and economic risk.<sup>163</sup>

---

EPA, but the disclosure of potential violations still must be made to EPA within 10 days of discovering a violation. *See id.*

157. A 1997 Senate hearing discussed section 866 and other audit issues. *See Environmental Audits Hearing, supra* note 18.

158. *See Carr & Thomas, supra* note 16. *See also* Tony Lent & Richard P. Wells, *Corporate Environmental Management: Study Shows Shift from Compliance to Strategy*, 1 TOTAL QUALITY ENVTL. MGMT. 379 (1992).

159. *See* Carol Foley & Michael Elliot, *Systems Design and the Promotion of Pollution Prevention: Building More Effective Technical Assistance Programs*, 29 GA. L. REV. 450 (Winter 1995).

160. *See id.*

161. *See* Frances H. Irwin, *An Integrated Framework for Preventing Pollution and Protecting the Environment*, 22 ENVTL. L. 35 (1992).

162. *See generally* Bradley C. Bobertz, *The Tools of Prevention: Opportunities for Promoting Pollution Prevention Under Federal Environmental Legislation*, 12 VA. ENVTL. L.J. 1 (1992).

163. *See* Steinzor, *supra* note 16; Michael E. Porter & Claas van der Linde, *Green and Competitive*, 73 HARV. BUS. REV. 120 (1995); Noah Walley & Bradley Whitehead, *It's Not Easy Being Green*, 72 HARV. BUS. REV. 46 (1994).

Both pollution prevention and compliance auditing are important tools for companies to prevent exposure to environmental liabilities. While potentially expensive, each has the potential for achieving significant fixed capital and operating costs reductions.<sup>164</sup> The prevention of environmental damage is arguably preferable to the resulting required remedies.<sup>165</sup> Similarly, preventing the creation of environmental hazards is the most effective method of reducing environmental expenditures.<sup>166</sup>

One author argues that audit immunity and/or privileges tend to decrease the cost to businesses of addressing ongoing violations through internal auditing; hence, reducing the incentive companies have to initially prevent noncompliance.<sup>167</sup>

Wherever prevention actually would succeed in eliminating or drastically reducing risk beyond levels achievable through auditing, and audit immunity results in a shift from prevention to auditing, audit immunity must be understood as compliance-reducing rather than compliance enhancing.<sup>168</sup>

However, where pollution prevention would result in the same net regulatory compliance as auditing, movement from compliance auditing to pollution prevention would not result in any compliance benefits for the regulated industry.<sup>169</sup> Yet, pollution prevention activities may provide public relations benefits, worker safety and reduced costs to a company willing to expend the capital to explore pollution prevention.

Managing compliance through auditing can be resource intensive. It may limit the resources available for pollution prevention initiatives involving process engineers, research staff, or equipment operators.<sup>170</sup> Another institutional impediment may be the prior expenditures of significant resources on pollution control technology.<sup>171</sup> Therefore, traditional compliance assurance activities may limit or eliminate resources needed to examine potential pollution prevention activities.

---

164. See U.S. General Accounting Office, *Environmental Auditing*, (Pub. No. GAO/RCED-95-37) (1995).

165. See Danna, *supra* note 16, at 976.

166. Tom Span, *Manager of Environmental and Safety of a Lennox Industries, Inc. Stuttgart, Arkansas plant*, notes: "If you eliminate a waste stream, such as a discharging polluted water, you do not need a permit and there is no need for a compliance audit of this part of the operation." Telephone Interview with Tom Span, July 22, 1998.

167. See Danna, *supra* note 16, at 978.

168. See Danna, *supra* note 16, at 987.

169. See Danna, *supra* note 16, at 987.

170. See Michele Ochsner, *Pollution Prevention: An Overview of Regulatory Incentives and Barriers*, 6 N.Y.U. ENVTL. L.J. 593 (1998).

171. See *id.*

Industry, the states, federal government and environmental groups often have divergent views about statutory environmental audit privileges.<sup>172</sup> Still, pollution prevention programs may be an opportunity for these divergent stakeholders to reach a consensus on an issue. One author notes that amid the current policy debate: “[T]he role of environmental law in providing crucial incentives for pollution prevention tends to receive too little attention.”<sup>173</sup>

#### A. Pollution Prevention Auditing

Pollution prevention is frequently referred to as “source reduction” or “toxic use reduction,” and can be defined as “the use of materials, processes or practices that reduce or eliminate the creation of pollutants or wastes at the source.”<sup>174</sup> Such activities offer potential enhancement of worker health and safety procedures, hazardous materials accident prevention, less toxic substances in commerce, and the environmentally responsible disposition of the final product.<sup>175</sup> However, establishing and implementing pollution prevention programs may require significant experimentation to develop a process modification or new product that conforms to industry or consumer specifications.<sup>176</sup> Also, the benefits are unpredictable.<sup>177</sup> Moreover, if the economic incentives of pollution prevention do not achieve the savings required to implement such measures companies may question the economic wisdom of such an expenditure.<sup>178</sup> Two authors note: “An audit system can be designed to assess improvements (or deficiencies) in such areas as: (i) the ‘environmental friendliness’ of production processes; (ii) the effectiveness of management; (iii) employee training; (iv) progress toward corporate goals; and (v) the adequacy of internal policies and standards.”<sup>179</sup> Businesses often conduct audits in part to obtain environmental insurance and investment capital.<sup>180</sup> Currently, pollution prevention auditing is not always a part of a facility’s environmental assessment process. However, in the future as the efficiency of a process

---

172. See Beard, *supra* note 16, at 3.

173. See Ochsner, *supra* note 170, at 586.

174. Office of Research and Development, U.S. Env’tl. Protection Agency, Facility Pollution Prevention Guide 1 (EPA/600/R-92/088, 1992). The EPA prepared a detailed examination of pollution prevention activities in a recent publication titled *Environmental Protection Agency, Pollution Prevention 1997—A Progress Report* (June 1997).

175. See Ochsner, *supra* note 170, at 601.

176. See Ochsner, *supra* note 170, at 591.

177. See Ochsner, *supra* note 170, at 591. The benefits might include raw material savings, process efficiency and the market for “green” products. See Ochsner, *supra* note 170, at 591.

178. A legal mandate may be required. See Ochsner, *supra* note 170, at 591.

179. See Carr & Thomas, *supra* note 16, at 136-37.

180. See Carr & Thomas, *supra* note 16, at 136-37.

becomes more important from a competitive perspective, the pollution prevention audit may grow in importance.

Three activities are necessary for an effective pollution prevention initiative:

(1) changes in raw material inputs to industrial systems, especially reducing the use of toxic chemicals and of scarce and nonrenewable natural resources; (2) waste reduction by making industrial systems more efficient in converting raw materials into products and wastes into valuable byproducts; and (3) changes in the design, composition, and packaging of products to create "green", or environmentally preferable, products that minimize harm to public health and the environment over their entire lifecycles.<sup>181</sup>

Michael Porter, a professor at Harvard Business School, believes successful financial performance is compatible with environmental goals.<sup>182</sup> Porter bases his view on the opportunities provided by reduction of resource use and expenditures necessitated by remediation.<sup>183</sup> The financial resources saved by such activities are available for pollution control and assist the long-term competitiveness of U.S. companies.<sup>184</sup> Examples of these initiatives include: 3M's "pollution prevention pays" program and Dow Chemical's waste reduction project.<sup>185</sup>

Benchmarking,<sup>186</sup> where a company compare itself with a "best-in class" example, is another important concept in developing and implementing pollution prevention because it shortens the learning curve and provides concrete examples of what is realistically possible utilizing certain methods. Examples of pollution prevention activities include projects designed to "reduce scrapping, recycle solvent, recover and sell waste products and improve housekeeping and maintenance functions."<sup>187</sup>

---

181. Joel S. Hirschhorn, *Pollution Prevention Comes of Age*, 29 GA. L. REV. 326 (Winter 1995).

182. See Steinzor, *supra* note 16, at 165.

183. See Michael E. Porter, *America's Green Strategy*, SCI. AM., Apr. 1991, at 168 ("The conflict between environmental protection and economic competitiveness is a false dichotomy.") *Id.*

184. See Steinzor, *supra* note 16, at 165.

185. See Steinzor, *supra* note 16, at 165.

186. For a further discussion of benchmarking, see Kenneth M. Karch, *Benchmarking at Environmental Management at Weyehauser*, 3 TOTAL QUALITY MGMT. (1996) at 297-308.

187. See Ochsner, *supra* note 16, at 606.

## B. An Arkansas Example—Lennox Industries

Lennox Industries, Inc. has manufactured heating and air conditioning equipment since 1895.<sup>188</sup> Its 500,000 square feet Stuttgart, Arkansas plant began operation in 1975 and employs 951.<sup>189</sup> Pollution prevention has been of interest to this facility for the past ten years.<sup>190</sup> Tom Span, Manager of Environment and Safety Department for the facility stated that "pollution prevention not only makes good environmental sense, it also makes good economic sense."<sup>191</sup> The company has for example expended \$600,000 to create LenLube, a product that has allowed Lennox to decrease air emissions from sixty-one tons a year in 1989 to approximately three tons in 1996.<sup>192</sup> Lennox states that LenLube contains "no volatile organic air emissions, is not toxic and is not hazardous."<sup>193</sup> However, Lennox had to revise a decades-old process to create it.<sup>194</sup> Other Lennox pollution prevention programs include: replacement of toluene-based adhesive in lieu of a water-based product; phase out of lead-based sealant;<sup>195</sup> and the elimination of chromium, cadmium and lead in the metal finishing and painting operation.<sup>196</sup>

---

188. See Lennox Industries Inc. Earns Pollution Prevention Award, Arkansas Environment ("AEF") Federation Press Release, (Oct. 14, 1996) (On file with AEF) [hereinafter Lennox].

189. See *id.*

190. See *id.*

191. See Interview with Tom Span, *supra* note 163.

192. See Lennox, *supra* note 188, at 1.

193. See Lennox, *supra* note 188, at 1.

194. See Lennox, *supra* note 188, at 1.

195. See Lennox, *supra* note 188, at 1.

196. See Lennox, *supra* note 188. This results in a 100% reduction of hazardous waste generated. See Lennox, *supra* note 188. Additional examples of pollution prevention implementation are found in Kurt A. Strasser, *Preventing Pollution*, 8 FORDHAM ENVTL. L.J. 1 (1996).

## VI. ARKANSAS POLLUTION PREVENTION INCENTIVES

Economic incentives<sup>197</sup> can be either positive or negative.<sup>198</sup> They are analogous to the proverbial "carrot and stick." Positive incentives, such as free compliance advice and technical assistance, may save—or provide additional money, or produce other kinds of tangible benefits for a facility.<sup>199</sup> When facilities produce financial savings on manufacturing or compliance expenditures, or receive a tax benefit or government subsidy, an incentive to implement these policies is achieved.<sup>200</sup> In contrast, negative incentives might be viewed as penalties or costs associated with a given activity. Enforcement of environmental laws is a negative incentive. It makes non-compliance more expensive for a business which therefore works to avoid the threat. One author states: "In the purest form, negative incentives include avoiding liability for cleanup costs or private damages, escaping punitive enforcement actions, and keeping a company's image from becoming tarnished in the public eye."<sup>201</sup>

Both positive and negative incentives are important because they affect the value of a business.<sup>202</sup> Consequently, businesses seek to reduce, or at least

---

197. For a discussion of incentives see Marshall J. Breger et al., *Providing Economic Incentives in Environmental Regulation*, 8 YALE J. ON REG. 463 (1991); Robert W. Hahn & Robert N. Stavins, *Incentive Based Environmental Regulation: A New Era from an Old Idea?* 18 ECOLOGY L.Q. 1 (1991); Timothy A. Wilkins, *Agency Discretion and Advances in Regulatory Theory: Flexible Agency Approaches Toward the Regulated Community as a Model for the Congress-Agency Relationship*, 63 GEO. WASH. L. REV. 479 (1995); Robert N. Stavins, *Project 88 Harnessing Market Forces to Protect Our Environment*, (Washington D.C., 1988) (on file with the Harvard Kennedy School of Government); Michael J. Casey, *Economic and Tax Incentives for a Cleaner Environment: A Survey of Marketable Pollution Permits and Pollution Taxes*, 1 DICK. J. ENVTL. L. & POL'Y 40 (1991); and David M. Driesen, *Is Emissions Trading an Economic Incentive Program?: Replacing the Command and Control/Economic Incentive Dichotomy*, 55 WASH & LEE L. REV. 289, 306 (1998) ("The term economic incentive is attractive because it promises redemption from the plodding nature of governmental decisions.").

198. See Steinzor, *supra* note 16, at 154. Another important concept is that of incremental cost which can be defined as the economic difference between the cost of a baseline activity and the cost of implementing an environmentally preferred alternative. See Timothy T. Jones, *Implementation of the Montreal Protocol: Barriers, Constraints and Opportunities*, 3 ENVTL. LAW 813, 849 (1997). See also J.B. Ruhl, *Complexity Theory as a Paradigm for the Dynamical Law—and Society System: A Wake Up Call for Legal Reductionism and the Modern Administrative State*, 45 DUKE L. J. 849, 914 (1996); Royal C. Gardner, *Exporting American Values: Tenth Amendment Principles and International Environmental Assistance*, 22 HARV. ENVTL. L. REV. 1, 39 (1998); Jeffery L. Dunoff, *From Green To Global: Toward the Transformation of International Environmental Law*, 19 HARV. ENVTL. L. REV. 241, 290 (1995).

199. See Steinzor, *supra* note 16, at 154.

200. See Steinzor, *supra* note 16, at 154.

201. Steinzor, *supra* note 16, at 155.

202. See Arnold, *supra* note 31, at 384.



understand, the potential risks and costs of their regulated activities, including the possibility of criminal and civil liability that could result from voluntary disclosure.<sup>203</sup> Large and small companies face similar risks. Nevertheless, the benefits of auditing for larger companies arguably outweigh the perceived risk. Because of the greater financial and technical resources<sup>204</sup> larger companies are better able to absorb the costs of environmental management systems, fines and implementation of corrective actions, than many smaller companies.<sup>205</sup>

#### A. Incentives for Pollution Prevention/Compliance Auditing

Several developments encourage regulated entities to embrace pollution prevention. They include increasing expense of managing pollution and a realization that it costs less to prevent it in the first place.<sup>206</sup> The administrative expense of ensuring compliance with the various environmental regulations provides an incentive for companies to review possible pollution prevention opportunities.<sup>207</sup> The avoidance of enforcement actions is more likely if companies are diligent in addressing the issues.<sup>208</sup> One author notes:

Corporate directors and officers exercise due diligence concerning law compliance when they make good faith efforts to pursue law compliance in conjunction with the corporate activities initiated and maintained under their leadership. This will be the case if directors and officers institute effective law compliance measures which are sufficient to support a good faith belief by the directors and officers that corporate activities are being conducted lawfully.<sup>209</sup>

---

203. See Beard, *supra* note 16, at 20.

204. See Kirk F. Marty, *Moving Beyond the Body Count and Toward Compliance: Legislative Options for Encouraging Environmental Self-Analysis*, 20 VT. L. REV. 495, 500 (1995).

205. See *id.*

206. See Stephen M. Johnson, *From Reaction To Proaction: The 1990 Pollution Prevention Act*, 17 COLUM. J. ENVTL. L. 153, 159 (1992).

207. See *id.*

208. Recently an official with the Office of the New York Attorney General stated that environmental auditing is a part of the reasonable standard of care expected of regulated entities, and is a "essential business practice." Companies conducting environmental audits may receive deference in New York, as opposed to those not conducting audits (who may receive stiffer penalties). See *Companies that Fail to Audit May Face State Criminal Charges, Prosecutors Say*, 173 DAILY ENV'T REP. (BNA) at D-3 (Sept. 9, 1994); see also Ronnie P. Hawks, *Environmental Self-Audit Privilege and Immunity: Aid to Enforcement or Polluter Protection?*, 30 ARIZ. ST. L.J. 235, 238 (Spring 1998).

209. Richard S. Gruner, *Director and Officer Liability for Defective Compliance Systems: Caremark and Beyond*, 995 PLI/Corp 60-62 (June, 1997).

Among the risks managers consider are governmental enforcement activities or citizen suits in the event of non-compliance.<sup>210</sup> There is also the common law obligation to avoid accidental releases.<sup>211</sup> These legal and financial risks of non-compliance often provide an appropriate incentive for businesses to operate safely and within the law.<sup>212</sup> Another factor motivating pollution prevention is public opinion.<sup>213</sup> Finally, businesses are also implementing pollution prevention because it has the potential to increase the efficiency of industrial processes.<sup>214</sup> This is becoming an important consideration in some instances as raw material and operating costs increase.<sup>215</sup>

Effective enforcement of environmental laws, which is a negative incentive, makes illegal activity problematic and expensive "by reducing the illicit benefits of unpunished (or successful) misconduct, without affecting the probability that it is detected by enforcement officials."<sup>216</sup> Perhaps one of the most effective components of criminal enforcement is that the results of enforcement activities, including potential prison sentences and loss of government contracts, are not easily quantifiable and may have ramifications that affect more than simple net-profit or loss.<sup>217</sup> Effective enforcement of environmental laws therefore creates an incentive for facilities to examine pollution prevention and conduct compliance auditing.

### 1. *Governmental Pollution Prevention Mandates*

Pollution prevention is increasingly mandated either through required permits or as a SEP to settle enforcement actions. For example, the proposed EPA Region 6 NPDES General Concentrated Animal Feeding Operation ("CAFO") Permit requires a pollution prevention plan.<sup>218</sup> This permit will not

---

210. See Spicer, *supra* note 28, at 51-52.

211. See Spicer, *supra* note 28, at 51-52.

212. See Spicer, *supra* note 28, at 51-52. See also Samuel P. Hays, *The Future of Environmental Regulation*, 15 J. L. & COM. 565-66 (1996).

213. See Stephen M. Johnson, *From Reaction To Proaction: The 1990 Pollution Prevention Act*, 17 COLUM. J. ENVTL. L. 153, 160 (1992).

214. See *id.*

215. See *id.*

216. See Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 693 (1997).

217. See Lois J. Schiffer & Allison B. Rumsey, *Criminal Enforcement in a Cooperative Environment*, SB43 ALI-ABA 279, 299 (May 8, 1997).

218. See NPDES General Permits for Discharges From Concentrated Animal Feeding Operations, 63 Fed. Reg. 34,874, 34,882 (June 26, 1998). See also United States Department of Agriculture and EPA, *Draft Unified National Strategy for Animal Feeding Operations* 18 (Sept. 11, 1998).

be effective in Arkansas since it operates the Clean Water Act NPDES program.<sup>219</sup> Nevertheless, it may influence ADPC&E's CAFO efforts.

A current example of a pollution prevention mandate required in Arkansas is a Resource Conservation and Recovery Act ("RCRA")<sup>220</sup> program. RCRA was amended by the Hazardous and Solid Waste Amendments of 1984 ("HSWA")<sup>221</sup> to require "generators of hazardous waste that ship their waste off-site certify: (1) that they have a hazardous waste minimization program in place to reduce the volume and toxicity of their waste "to the degree determined by the generator to be economically practicable" and (2) that the proposed method of treatment, storage, or disposal of their waste is the practicable method of treatment, storage, or disposal "currently available to the generator which minimizes the present and future threat to human health and the environment."<sup>222</sup> Similarly, HSWA also requires certification by generators who treat, store, or dispose of waste within their own facilities.<sup>223</sup> These facilities are required to undertake such certification before they can receive a permit.<sup>224</sup> The waste minimization mandate only applies to generators and does not specify the content of the waste minimization plan.<sup>225</sup>

Another example of pollution prevention requirements are the ADPC&E permits (Industrial and Construction) required for owners or operators of facilities discharging storm water associated with industrial activity or from construction sites.<sup>226</sup> To obtain permit coverage, an owner/operator must develop a pollution prevention plan for the facility.<sup>227</sup> The plans for the

219. See ADPC&E Reg. No. 6.

220. See 42 U.S.C. § 6901-92(k) (1994).

221. See Pub. L. No. 98-616, 98 Stat. 3221 (1984) (codified within sections of 42 U.S.C.) See generally U.S. ENVIRONMENTAL PROTECTION AGENCY, THE NATION'S HAZARDOUS WASTE MANAGEMENT PROGRAM AT A CROSSROADS: THE RCRA IMPLEMENTATION STUDY (1990).

222. 42 U.S.C. § 6922(b) (1988). The certification is required as part of the "manifest" that hazardous waste generators must prepare when they transport waste to a treatment, storage or disposal facility. See *id.* See also 40 C.F.R. § 262.20(a) (1990). Generators of hazardous waste who produce between 100 and 1000 kilograms of the substances within a calendar month are defined as "small quantity generators" and different rules apply. See 42 U.S.C. § 6921(d) (Supp. 1997). Of these facilities, EPA mandates generators to certify a "good faith effort" toward waste minimization and that they selected the "best waste minimization method that is available to [the generator] and that [the generator] can afford." 40 C.F.R. § 262 app. (1990). See Stephen M. Johnson, *From Reaction To Proaction: The 1990 Pollution Prevention Act*, 17 COLUM. J. ENVTL. L. 167 (1992).

223. 42 U.S.C. § 6922(b) (1988).

224. See 42 U.S.C. § 6925(h) (1988); see also 40 C.F.R. § 264.73(b)(9) (1990).

225. See *id.* The EPA guidance on what a waste minimization program should entail is found at 54 Fed. Reg. 25,056 (1989).

226. See ARK. CODE ANN. § 8-4-101 *et seq.* (Michie 1997). See also 33 U.S.C. § 1251 *et seq.*

227. See ADPC&E Storm water Construction permit III(D) and Industrial permit III(C). It must be prepared in accordance with good engineering practices.

industrial activity permit must be developed within sixty days after a Notice of Intent to be covered is given to ADPC&E.<sup>228</sup> The permit for construction activities requires the development of a pollution prevention plan.<sup>229</sup>

Also important is the federal Pollution Prevention Act of 1990.<sup>230</sup> It provided that pollution prevention projects could be a component of a penalty assessed for violating regulations.<sup>231</sup> The EPA decision to allow pollution prevention projects to constitute SEPs, reduces penalties for violations based on such expenditures.<sup>232</sup> Mr. Hirschhorn references an example:

In one enforcement case, the agency fined an electroplater \$100,000 for various violation of environmental regulations. The agency demanded a payment of \$50,000 and offered to forgive the remainder of the penalty if the electroplater performed and submitted for review a detailed waste minimization plan. The process changes reduced its waste by over sixty percent and saved the company enough money to offset both the fine and investments.<sup>233</sup>

## 2. *Positive Incentive Programs (financial and technical assistance)*

During the 1990s, over twenty-six states created pollution prevention, waste reduction, or toxics use abatement programs.<sup>234</sup> These programs differ in requirements and their aggressiveness, yet share similar definitions, techniques, facility planning concepts, and a technical assistance component.<sup>235</sup>

Currently, there are several examples of incentive programs that encourage and reward pollution prevention activities by regulated entities. However, the majority of these programs are limited to small businesses. Small businesses provide both important economic development and employment, yet also possess a large potential for pollution and environmental

---

228. See ADPC&E Storm water Industrial permit III(C)(1)(a)(1).

229. See ADPC&E Storm water Construction permit II(D)(1)(a).

230. See Hirschhorn, *supra* note 181, at 331-32.

231. See Hirschhorn, *supra* note 181, at 331-32.

232. See Hirschhorn, *supra* note 181, at 331-32. See also *Forced Volunteerism: The New Regulatory Push to Prevent Pollution*, Chem. Reg. Rep. (BNA), January 22, 1993 available in Westlaw 16 Chem 1996, BNA/ENV database.

233. Hirschhorn, *supra* note 181, at 332.

234. See Kenneth Geiser, *The Unfinished Business of Pollution Prevention*, 29 GA. L. REV. 476 (1995). The federal government also began to realize the importance of pollution prevention. A 1993 Executive Order compelled federal facilities to implement a fifty percent toxic emissions reduction by 1999 while also setting a voluntary source reduction target. See Exec. Order No. 12,856, 58 Fed. Reg. 41,981, 41,983 (1993). The EPA also developed and implemented the voluntary 33/50 program which involved a pledge by companies to reduce their use of seventeen chemicals within a five year time frame. See 56 Fed. Reg. 7849-64 (1991).

235. See Geiser, *supra* note 234, at 476.

damage.<sup>236</sup> Two programs with a broader focus are the Arkansas recycling tax credit program<sup>237</sup> and the Arkansas Science and Technology Authority ("ASTA") grants.

The Arkansas program provides for a tax credit, as well as the "recapture of the credit in certain instances, as an incentive for taxpayers to engage in waste reduction, reuse and/or recycling activities." ADPC&E determines whether a project is eligible for the tax credit. The program provides a financial incentive for companies to employ new technology that uses recyclables arguably enhancing pollution prevention.

The ASTA grant program was developed to assist Arkansas companies with enhancing products or processes through transfer of technology, such as pollution prevention activities, to improve competitiveness. The ASTA will pay up to \$3,750 for technology transfers to qualified applicant. Funding of \$375,000 was appropriated each 1996-97 biennium year for the Technology Development and Technology Transfer programs.<sup>238</sup> The limited amount of funding available restricts the size and complexity of potential projects and recipients.

Small businesses in Arkansas<sup>239</sup> often lack the necessary "technical and financial resources to comply with the law, let alone engage in proactive environmental management strategies like environmental auditing."<sup>240</sup> They share the same enforcement risks but are more vulnerable because of their size.<sup>241</sup> A disincentive for small businesses to audit is that this activity and related legal and technical advice about disclosure can be very expensive.<sup>242</sup> For this reason, both the EPA and state agencies have created special programs for small businesses. Under the CAA states are required to adopt small

---

236. See Harris, *supra* note 16, at 719.

237. See ARK. CODE ANN. § 26-51-501 *et seq.* The ADPC&E implements this program through Reg. No. 16. See generally Wright & Monroe, *supra* note 5. Many states, including Arkansas, also structure their regulations to the extent possible to encourage (or at least remove disincentives) for the reuse of commercial and industrial wastes. For a discussion of various relevant state provisions, including one in Arkansas, see Walter G. Wright, Jr., *State Regulation of the Beneficial Reuse of Manufacturing Residues*, Presentation at the Air & Waste Management Association's 88th Annual Meeting (June 1995).

238. See ASTA 96 Media Kit, Arkansas Science and Technology Authority (on file with the ASTA). See also Technology Transfer Assistance Grant Program Rules (4-13-94) (on file with the ASTA) For more information contact Mr. James T. Benham, Vice President, Finance, ASTA, (501) 324-9006.

239. The definition of "small business" includes "a person, corporation, partnership, or other entity who employs 100 or fewer individuals." 60 Fed. Reg. 32,676 (1995).

240. Harris, *supra* note 16, at 719.

241. See Beard, *supra* note 16, at 21.

242. See Miri Berlin, *Environmental Auditing: Entering the Eco-Information Highway*, 6 N.Y.U. ENVTL. L.J. 623 (1998).

business compliance assistance programs.<sup>243</sup> The EPA allows states to develop programs that offer small businesses the opportunity to remedy violations uncovered while participating in a compliance program. Compliance assistance has been expanded to other federal environmental programs.<sup>244</sup>

Pursuant to the Mentor-Protégé Partnership, the ADPC&E will provide technical advice to small business using industry volunteers skilled in environmental management issues. The volunteers are comprised of environmental professionals from participating firms.<sup>245</sup> These experts provide advice on pollution prevention and regulatory compliance issues.<sup>246</sup> There are two different programs established under the "Clean Team." Program One is an industry to industry assistance program that uses volunteers to provide free technical assistance to participating businesses. To qualify, a small business must have fewer than 100 full time employees.<sup>247</sup> Program Two is titled Industry to Industry with Regulatory Assistance. ADPC&E, working with private sector volunteers, will arrange an on-site multi-media environmental audit.<sup>248</sup> The program requires participants to achieve compliance within a reasonable time period.<sup>249</sup>

The EPA also encourages compliance through voluntary programs. These include programs<sup>250</sup> similar to the ones EPA helped the states set up and fund.<sup>251</sup> These programs promote pollution prevention and compliance

---

243. See Lois J. Schiffer & Ann C. Juliano, *Reform of Environmental Regulations: Three Points*, 12 WTR NAT. RESOURCES & ENV'T 177 (1998).

244. See *id.*

245. The companies include: Albermarle Corp., American Transportation Corp., Amercable, Amoco Foam Products Co., Ark. Eastman Div., Arkansas Environmental Academy, Atlantic Research Corp., Baxter Healthcare Corp., CH2M Hill, City of Fayetteville, City of Morrilton, ConAgra Poultry Corp., Cooper Tire and Rubber Co., Crain Industries, Inc., Daisy Mfg. Co., Inc., Darling Store Fixtures, Dassault Falcon Jet Corp., Entergy, Exxsorbet Technical Services, Inc., F M Corp., Florida Drum Delta Corp., Georgia-Pacific Corp., Goodner Aircraft Painting, Inc., Green Bay Packaging, Incop., Halstead Metal Products, International Paper, Lennox Industries, Loral Vought Systems, Magnetics Ark., Nucor Steel, OK Industries, Osceola Products Co., Pace Industries, Planters Co., Potlatch Corp., Quanex/Macsteel Div., Raytheon Aircraft Corp., Remington Arms Co., Reynolds Metal Co., Rineco, Riverside Furniture Corp., S-B Power Tool Co., Sonat Exploration, Southwire Ark., Stephens Production, Structural Metals, Inc., The Trane Co., Timex Corp., U.S. Vanadium Corp., UALR-Biology Dept., Viskase Corp., Weyerhaeuser Co.

246. See *The Clean Team, Industry Helping Industry*, ADPC&E (pamphlet on file with ADPC&E).

247. See *id.*

248. See *id.*

249. See *id.*

250. See EPA Small Business Compliance Assistance Centers, EPA #305-F97-7003 (Spring 1998) (pamphlet on file with EPA Region 6). It provides phone numbers and web-site addresses for EPA compliance assistance based on industrial sectors such as agriculture, chemical, metal finishing, etc.

251. See U.S. EPA Region 6 Guidance for Submitting Proposals for Pollution Prevention

auditing. They include EPA's 33/50 Program which involved a voluntary pledge by relevant industries to reduce emissions of seventeen chemicals by thirty-three percent by 1992 and fifty percent by the end of 1995.<sup>252</sup>

Besides incentives for pollution prevention, EPA also recognizes the importance of providing incentives for small businesses. The EPA Small Business Policy provides guidance to state and local governments on the development of these incentives.<sup>253</sup> The Small Business Policy's<sup>254</sup> goal was to expand the Clean Air Act's Small Business Assistance Program ("SBAP")<sup>255</sup> to other media.<sup>256</sup>

The Small Business Policy allows a state, under some circumstances, to refrain from initiating an enforcement action for ninety days and to keep confidential the name and location of small businesses meeting the Policy's requirements.<sup>257</sup>

The EPA's Interim Policy on Compliance Incentives for Small Businesses was designed to "promote environmental compliance among small businesses by providing incentives for participation in compliance assistance programs, and encouraging the prompt correction of violations."<sup>258</sup> When it is clear that a small company acted with good-faith in attempting to comply with environmental regulations, no evidence of criminal activities is present, and "that there is no significant health, safety, or environmental threat, the EPA will either mitigate or refrain from initiating civil penalties."<sup>259</sup> Further, when a small business voluntarily discloses and addresses environmental non-compliance through participation in a compliance assistance program, the EPA will forgo the penalty.<sup>260</sup> However, despite the need to encourage small businesses to comply and ensure they have the necessary resources to make informed decisions, if small businesses and large businesses have different

---

Incentives for States FY 1998, Grant/Cooperative Agreement Funds (program 1-2) (On file with EPA Region 6). It provides funding for Region 6 states for pollution prevention programs.

252. See Hirschhorn, *supra* note 181, at 332-33.

253. See Beard, *supra* note 16, at 22.

254. See also Regulatory Flexibility Act of 1980, Pub. L. No. 96-354, 94 Stat. 1164 (as amended by Small Business Regulatory Enforcement Fairness Act of 1996, at 5 U.S.C. § 611(a)(3)(A)) (1994). See generally Barry A. Pineles, *The Small Business Regulatory Enforcement Fairness Act: New Options in Regulatory Relief*, 5 COMM'LAW CONSP'CTUS 29 (1997).

255. See the Clean Air Act's Small Business Assistance Program (SBAP) (Interim Policy on Compliance for Small Businesses, 60 Fed. Reg. 32,677 (1995)).

256. See Beard, *supra* note 16, at 23.

257. Beard, *supra* note 16, at 23.

258. Interim Policy on Compliance Incentives for Small Businesses, 60 Fed. Reg. 32,675 (1995). See also Beard, *supra* note 16, at 22.

259. Beard, *supra* note 16, at 23.

260. See Beard, *supra* note 16, at 23.

rules, "the effectiveness of each program will suffer due to inconsistent application, financial inequities, and general uncertainty."<sup>261</sup>

## B. Potential Future Arkansas Incentives

Pollution prevention is generally considered an activity worth encouraging. Unfortunately, pollution prevention is not always cost-effective, requiring incentives and subsidies<sup>262</sup> such as tax breaks<sup>263</sup> to encourage its use. Otherwise, pollution prevention may not provide enough "return on investment."<sup>264</sup> An important consideration is "whether the benefits of a given incentive will accrue over the short or long-term, especially from a corporate perspective. Investments in superior performance often deliver economic benefits over the long run. Yet proposals to commit corporate resources to such investments typically compete with other potential uses of the funds that deliver a larger return over the short run."<sup>265</sup> Perhaps the greatest problem in addressing these trade-offs is also the largest deterrent to the development and implementation of pollution prevention.<sup>266</sup> Regardless of the government and industry incentives, pollution prevention issues often do not reach the corporate decision makers, and thus, they are easily marginalized in larger discussions of business operations.<sup>267</sup>

Pollution prevention activities may still be the most cost-effective method to achieve regulatory compliance since, in some instances, they provide a lower net cost to the company compared to end-of-pipe technologies; yet the activities "may or may not be profitable in an absolute sense."<sup>268</sup> The financial resources expended for pollution prevention will be judged by the funds saved on field inspections, accident prevention and training, and expenditures on cleanup costs and site remediation.<sup>269</sup> These pollution prevention initiatives are

---

261. See Beard, *supra* note 16, at 23.

262. For a discussion of environmental subsidies, see Robert F. Blomquist, *Models and Metaphors for Encouraging Responsible Private Management of Transboundary Toxic Substances Risk: Toward a Theory of International Incentive-Based Environmental Experimentation*, 18 U. PA. J. INT'L ECON. L. 507, 548 (1997).

263. For a discussion of the subject see Kirk W. Junker, *Tax Exemption for Pollution Control Devices in Pennsylvania*, 34 DUQ. L. REV. 503 (1996); Miriam Joels Silver, Note, *Federal Tax Incentives for Historic Preservation: A Strategy for Conservation and Investment*, 10 HOFSTRA L. REV. 887 (1982). See also David C. Holtz, Monica Heitzmann, "Primary Purpose" *Pollution Control Tax Incentives: Is the Public Getting What It's Paying For?* 31 LAND & WATER L. REV. 401 (1996).

264. See Ochsner, *supra* note 16, at 608-09.

265. See Steinzor, *supra* note 16, at 155-56.

266. See Steinzor, *supra* note 16, at 155-56.

267. See Geiser, *supra* note 234, at 491.

268. See Ochsner, *supra* note 16, at 720.

269. See Harris, *supra* note 16, at 720.



designed to avoid problems and expenditures.<sup>270</sup> Yet, pollution prevention does not always provide short-term returns on investment.<sup>271</sup> "Although the savings achievable through simple changes in procedures (e.g., changes in housekeeping and inventory) may be obvious, the nature of the investment needed to implement more complex source reduction projects (such as those involving manufacturing technology or product formulas) may be far less clear."<sup>272</sup> However,

corporate shareholders—the residual claimants to the profits of corporations—are increasingly recognizing that corporate compliance problems which produce large fines or liabilities can significantly damage shareholder interests.<sup>273</sup>

Still, regardless of the potential for enforcement actions, some businesses do not perform compliance audits.<sup>274</sup> The reasons for such reluctance varies. The causes may include: ambivalence concerning environmental laws; the lack of the financial resources necessary for implement auditing; or, the belief that the risks of auditing overshadow the potential benefits.<sup>275</sup> Compounding the difficulties in implementing pollution prevention, companies also face the dilemma of component decision making, where "the choice of an alternative can impose costs which are directly borne by other divisions or departments in the firm, and of which (the decision maker) has imperfect knowledge."<sup>276</sup>

The development of new assistance programs for pollution prevention and auditing might increase compliance with environmental laws in Arkansas. Programs should be based on sectoral delineation such as metal finishing, wood finishing, chemical production, etc.<sup>277</sup> They should target both industry

270. See Harris, *supra* note 16, at 720.

271. See Harris, *supra* note 16, at 720.

272. See Harris, *supra* note 16, at 720.

273. Richard S. Gruner, *General Counsel In An Area Of Compliance Programs and Corporate Self-Policing*, 46 EMORY L.J. 1134 (1997). For corporate environmental information disclosure and Securities and Exchange Commission rules, see generally Michael Gollub, *Reducing Uncertainty in Environmental Disclosure: Why the Securities and Exchange Commission Should Return to the Basics*, 4 ENVTL. LAW. 311 (Feb. 1998). See also John W. Bagby et al., *How Green Was My Balance Sheet?: Corporate Liability and Environmental Disclosure*, 14 VA. ENVTL. L.J. 225 (1995).

274. See Kirk F. Marty, *Moving Beyond the Body Count and Toward Compliance: Legislative Options for Encouraging Environmental Self-Analysis*, 20 VT. L. REV. 499-500 (1995).

275. See *id.*

276. Carol Foley & Michael Elliot, *Systems Design and the Promotion of Pollution Prevention: Building More Effective Technical Assistance Programs*, 29 GA. L. REV. 449, 465 (1995). See also Jacques Cremer, *Corporate Culture and Shared Knowledge*, 2 INDUS. & CORP. CHANGE 351, 360 (1993).

277. Benchmarking may be an appropriate method of comparing companies capacity, base

sectors and pollutants with the most significant potential impact on the environment. Both the federal and state governments might consider limited grants or loan assistance programs targeted toward funding of compliance auditing or pollution prevention.<sup>278</sup> Financial assistance might allow companies to hire consultants or train an employee for compliance responsibilities.<sup>279</sup> Another promising idea is the use of recognition and awards programs, such as the AEF Pollution Prevention Awards, to encourage pollution prevention and compliance activities.<sup>280</sup>

State or federal agencies could additionally advocate incentives for compliance auditing by methods that do not involve a privilege or impact third parties.<sup>281</sup> Legislation developed in New Jersey, which provides "a 'grace period' for minor violations that are promptly reported and corrected" is instructive.<sup>282</sup> Any violation exceeding twelve months in duration is exempted.

## VII. CONCLUSION

Both the federal and state environmental regulatory programs pose a challenge to Arkansas businesses. The challenge stems, to a certain extent, from both their complexity and penchant for change. This of course poses a special burden for smaller businesses. Nevertheless, the need for compliance is critical in view of the twin threat of both governmental and citizen suit enforcement. Many companies have been using environmental compliance auditing as a tool to facilitate compliance for many years and the regulated community, for a variety of reasons, appears to view self-examination and self-correction as an important compliance tool.<sup>283</sup> However, some companies fear

---

on sectoral determination. The assistance programs could facilitate benchmarking studies in an industry sector and use the information and the political strength of the "buy in" associated with such an approach to evaluate the sector's organizational and technological needs." See Foley & Elliot, *supra* note 276, at 471.

278. See Harris, *supra* note 16, at 23. To enhance compliance and pollution prevention assistance programs, the program should: "(1) improve companies' organizational capability to address problems systemically; and (2) help them systemically to reduce the environmental impact of their manufacturing practices." These programs could also benefit from an assessment mythology or diagnostic test to determine the companies technological and organizational capacity. See Carol Foley, Michael Elliot, *Systems Design and the Promotion of Pollution Prevention: Building More Effective Technical Assistance Programs*, 29 GA. L. REV. 449, 471 (Winter 1995).

279. See Harris, *supra* note 16, at 23.

280. See Ochsner, *supra* note 16, at 615.

281. See Spicer, *supra* note 28, at 53.

282. N.J. STAT. ANN. §§ 13:1D-125 to 131 (West Supp. 1996). See Spicer, *supra* note 16, at 53. However, this amnesty legislation may be subject to the same concerns and potential problems concerning authorization of federal programs to states.

283. See Carr & Thomas, *supra* note 16, at 97.

that the results of an audit may be used against them. This is a special concern in the case of federal statutory citizen suits since such plaintiffs are clearly not bound by the enforcement discretion both the EPA and the DOJ have articulated in their audit policies.

Various states, including Arkansas, have responded to this issue through the enactment of audit privilege statutes. Arkansas' 1995 legislation was fairly typical of those statutes that simply provide privilege as opposed to immunity. Nevertheless, it is clear that unless Congress intervenes with federal legislation, that in Arkansas and a number of other states, the privilege laws will be modified to accommodate EPA concerns. An additional tool that warrants further consideration over the next decade is pollution prevention. Careful consideration of the net benefits of this tool to some companies should be considered. Also, further attention should be focused on the ability of the government to encourage such activities through the expansion and/or development of various incentives.