New York Law Journal

October 13, 1994 Thursday

**SECTION:** Pg. 2, (col. 3) Vol. 212

**LENGTH:** 1317 words

**HEADLINE:** ENVIRONMENTAL AUDITS;
RULING EXEMPTS INTERNAL STUDY FROM DISCOVERY;
Corporate Update

**BYLINE:** Peter Blackman

RULING EXEMPTS INTERNAL STUDY FROM DISCOVERY

**N**EW YORK ATTORNEYS handling a Florida groundwater contamination suit last month convinced a district court there to extend a self-critical analysis privilege to environmental litigation for what practitioners believe is the first time in the country. The privilege exempts from discovery self-appraisals by a company that seeks in good faith to assess its past compliance with the law.

The Florida ruling comes at a time when the creation of some privilege for internal environmental audits has become hotly debated nationwide. Four states since July 1993 have carved out a statutory privilege similar to the one given a judicial nod in Florida. An attempt to do so in the New York State Senate was stalled in the Rules Committee this summer.

While the Florida decision in **Reichold Chemicals Inc. v. Textron Inc.,** Case No. 92-30393-RV (N. Dist. Ct.-Fla.) is not binding, practitioners are cheered by the ruling.

The qualified privilege accepted in **Reichold** was first applied to the medical malpractice area in 1970. It has since been invoked successfully in other areas of the law, such as employment, securities, product liability and academic peer reviews.

**Safe From Self-Incrimination**

The public policy behind the privilege is to encourage businesses to undertake internal audits and shield them from the risk of creating a self-incriminating record.

The privilege is qualified because it can be overcome by a showing of extraordinary circumstances or special need. Another important limitation is that it applies only to subjective impressions and opinions that come out of self-evaluative investigations. Factual data and documents underlying such conclusions are discoverable.

William A. Ruskin, who recently joined Schulte, Roth & Zabel as a partner, led the team that won the privilege on behalf of Reichold Chemicals Inc., the owner of a chemical plant in Pensacola, Fla. Reichold had sued a group of 15 other chemical companies that had had an interest in the facility at one time or another since 1906. The plaintiff is seeking damages caused by waste disposed during the other

companies' watch. The defendants hoped to mitigate their damages by discovering the results of Reichold's own audit that might have indicated some fault by Reichold.

At the time he argued the case, Mr. Ruskin was a partner at the now defunct Lord Day & Lord, Barrett Smith.

**Battle Lines Drawn**

The battle lines over the privilege were drawn some time ago. In favor are environmental lawyers in private practice, in-house corporate legal departments and the industry in general. Opposing the privilege are prosecutors and lawyers at environmental action groups and public interest organizations.

Meanwhile, the Environmental Protection Agency has taken no stand and a debate within the agency has raged during the past few months. The split within the EPA comes from the conflict between its official policy of fostering internal audits by industry and its prosecutorial role in bringing administrative actions against polluters.

Until its stance is clear, the EPA has been active in trying to thwart state efforts to copy Oregon, which passed a statute allowing an environmental audit privilege. Only Colorado, Indiana and Kentucky have followed suit, despite attempts elsewhere, including the aborted proposal here by State Senator Owen Johnson (R-Babylon), chairman of the Senate Environmental Conservation Committee.

The Oregon statute, enacted in July 1993, requires that for a company to enjoy the privilege, it undertake remedial action against any violations uncovered in its investigation. This constraint, among several others, makes the statutory privilege for the most part narrower than the Florida ruling, said John T. Kolaga, a partner at Whiteman, Osterman & Hanna in Buffalo.

On the other hand, one way the statutory privilege may prove broader is that it applies to suits brought by the government and its administrative agencies. The Florida suit involved an action between private litigants and the court thus did not address whether the privilege would extend to government prosecutions. Nonetheless, the privilege in all its other contexts has never been applied to documents sought by government agencies. See **In re Grand Jury Proceedings,** DC Md (Judge Frank A. Kaufman), No. K-94-2153.

**Companies Are Wary**

In response to the misgivings of industry that the results of self-examinations could be used against it by the government, the Justice Department and other environmental watchdogs have issued policy statements promising to hold off from seeking such data, barring extraordinary circumstances such as imminent dangers to surrounding populations. But since governmental reassurances are not legally binding they have failed to placate companies, and the disincentives to undertaking internal investigations remain, said Michael B. Gerrard, a partner at Berle, Kass & Case.

Proponents of the privilege claim it would encourage more voluntary auditing. The primary government interest should be to correct substantive conditions and not point fingers, said Mr. Gerrard, who added that the possibility of companies abusing the privilege is outweighed by its benefits.

Mr. Ruskin, the attorney in **Reichold,** stressed that the privilege granted in the Florida case applies only to past violations, not studies of possible future environmental risks. But Mr. Gerrard explained the difficulty of separating out backward- and forward-looking studies. The privilege is retrospective because the problem was there a while, but it's prospective when it's still there, he said.

Companies fear that without a privilege, information gathered in an audit may come back to haunt them, thus they tend to conclude that it is better to bury their head in the sand, according to Lawrence P. **Schnapf**, an associate at Schulte Roth who also came from Lord Day.

Regarding the pledge of many prosecutors not to bring criminal charges based on voluntary internal audits, Mr. **Schnapf** said the potential of criminal penalties, even if improbable, is enough to have a chilling effect on such self-analysis programs.

**New Level of Secrecy**

James A. Sevinsky, chief of the Environmental Protection Bureau of the New York State Attorney General's Office, summarized objections to a new environmental privilege voiced by many prosecutors and the National Association of Attorney Generals. If the privilege were used against government probes, he said, it would compromise the government's interest in enforcing environmental laws and regulations. Exempting audit findings from government discovery, according to Mr. Sevinsky, also would create a loophole whereby a company blithely polluting for several years can get home free merely by doing an audit. Such a loophole is unfair to the similarly situated companies which have gone through the expense and trouble of complying all along, he said.

Mr. Sevinsky contended that prosecutorial discretion has proved sufficient in protecting companies which do conduct audits. There are almost no examples where a company was clubbed over the head, indicted or slapped with a serious enforcement action solely because of an environmental audit the company conducted, he said. In the one or two instances in which prosecutorial abuse may have occurred, the incriminating evidence was arguably obtainable without discovery of audit results, Mr. Sevinsky said.

Mr. Sevinsky added that a new privilege would create a whole new class of secret information, which runs counter to the general trend in environmental law toward more openness.

Most companies have come around to performing audits even without the privilege, said Mr. Sevinsky. He noted that the duty of care reasonability standard has risen over the years that a company might in some situations risk criminal liability if it does not scrutinize its past