

# ARIZONA STATE SENATE

## RESEARCH STAFF



TO: MEMBERS OF THE SENATE BORDER  
SECURITY, FEDERALISM & STATES'  
SOVEREIGNTY COMMITTEE

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DATE: March 13, 2012

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SUBJECT: Strike everything amendment to H.B. 2199,  
relating to privilege; environmental audits

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### Purpose

Establishes a privilege for environmental audits that are conducted by a regulated organization or its independent contractor for the purpose of determining compliance with environmental laws.

### Background

During the 1990s, a national debate took place over the use of environmental audit programs as a method to encourage organizations to voluntarily disclose violations of environmental laws and regulations in return for immunity from liability for those violations. According to the U.S. Environmental Protection Agency (EPA), an environmental audit is a systematic, documented, periodic and objective review by regulated entities of facility operations and practices related to meeting environmental requirements.

A number of states have adopted such programs during the mid-1990s and currently states vary on the types of audit privilege and immunity laws they have in place. An audit privilege generally refers the ability of a regulated business to keep a portion or portions of an environmental self-evaluation confidential, but does not apply to information that is required to be disclosed or provided. Immunity generally refers to, but is not limited to, protection from violations of a state or federal environmental law or regulation or an administrative order. Attempts to enact similar laws in Arizona have made it through various stages of the legislative process, but ultimately were not enacted.

In 1995, the EPA developed an Environmental Audit Policy, which was updated in 2000. The EPA's *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations* is designed to encourage greater compliance with federal laws and regulations relating to the environment (60 CFR 70, 19816-19627). Under this program, regulated entities voluntarily monitor compliance with regulations and report violations that they find on their own. Some of the benefits of self-policing include penalties that are no longer based on gravity of the violation so long as the entity has complied with EPA rules during its self-audit. To avoid penalties, the entity must meet nine conditions prescribed in the EPA's rule. In general, EPA opposes state laws that provide for environmental *immunity* under specified conditions, which include criminal conduct, repeat or pattern violations and violations of existing court or administrative orders (*Source: EPA*).

There is no anticipated fiscal impact to the state General Fund associated with this legislation.

Provisions

1. Establishes an administrative and civil evidentiary privilege for environmental audits that are conducted by an organization or its independent contractor to determine compliance with environmental laws. Defines an *environmental law* as any federal, state or local law or regulation, as well as a permit issued by governmental entities that aims to protect the environment.
2. Clarifies that the strike everything amendment's provisions relating to the environmental audit privilege cannot be construed as providing civil or criminal immunity to anyone.

*Environmental Audit Privilege*

3. Stipulates that any audit report or portion of a report is considered privileged and cannot be admitted as evidence or be subject to discovery in civil or administrative proceeding *unless* any of the following apply:
  - a) the privilege is expressly waived by the regulated entity (i.e. owner or operator);
  - b) disclosure that is required by a court or administrative hearing official; or
  - c) to the extent that any portion of the audit report contains nonprivileged materials.
4. Prescribes the possible contents of an audit report (e.g. documents, communication, exhibits and appendices). The following are *nonprivileged* materials:
  - a) documents or other specified communication or information that a regulatory agency requires to be maintained or reported by law;
  - b) information obtained by a regulatory agency through observation, monitoring or sampling; and
  - c) information obtained through an independent source that is not involved in the audit report.
5. Prohibits a person from being compelled to testify or produce a document related to an audit in a civil or administrative proceeding if the testimony or document would disclose privileged information *and* if the person is any of the following:
  - a) someone who conducted any portion of the audit, but did not personally observe physical events;
  - b) someone to whom the audit results are disclosed; and
  - c) a custodian of the audit results.
6. Allows a person who has participated in the audit and who *has* physically observed events of a violation to testify to those events, but they cannot be compelled to disclose privileged information.
7. Prohibits a state agency employee from using an audit report during an inspection.
8. Specifies that the burden of proving the privilege exists rests with the entity that is asserting the privilege.

Disclosure

9. Provides that the disclosure of an audit report or any related information does not waive the privilege so long as the disclosure is made for any of the following reasons:
  - a) to address or correct a matter raised by the audit and that is made to specified parties that have relationship to the owner or operator;
  - b) under a claim of confidentiality between the person for whom the audit was prepared or the regulated entity *and* to other specified third parties (e.g. lender, potential partner, insurance company); or
  - c) under a claim of confidentiality to a governmental official or regulatory agency by the person for whom the audit was prepared or the owner or operator.
10. Subjects a third party that violates a confidentiality agreement to damages and other penalties pursuant to the agreement.
11. Specifies that information disclosed to a governmental official or agency is confidential and not subject to further disclosure.
12. Prescribes a class 1 misdemeanor for any Arizona entity, employee or official who violates disclosure requirements. An audit report that is not labeled as privilege is an affirmative defense, but the lack of labeling cannot be used as a defense if the entity, employee or official knew or had reason to know the audit report was privileged.
13. Specifies that the disclosure provisions do not circumvent state or federal protections for anyone who discloses information to law enforcement authorities.

Courts and Administrative Hearings

14. Allows a court or administrative hearing official to require disclosure of a portion of the audit report in a proceeding so long as the action is deemed to be consistent with the rules of procedure through an *in camera review*. The disclosure decision also must be tied to any of the following purposes:
  - a) the privilege has been asserted for a fraudulent reason;
  - b) the portion of the audit report is not privileged; or
  - c) there is evidence of noncompliance with an environmental law and measures to comply with the law were not promptly initiated and pursued with reasonable diligence.
15. Stipulates that the party seeking disclosure for the above three reasons has the burden of proof.
16. Specifies that a disclosure decision in an administrative hearing is appealable. The party asked to disclose does not have to disclose materials unless the decision is appealed to a court and that court orders the party to do so. The party also has the right to an interlocutory appeal of that court's decision in an appropriate appellate court.
17. Prescribes a \$10,000 fine, as well as any other sanctions under Arizona's Rules of Administrative Procedure, to anyone who claims privilege to avoid disclosure of requested materials and did so knowing that the materials were *nonprivileged*.

Review by a Regulatory Agency or Governmental Authority

18. Specifies that the audit privilege is not waived in the following situations:
  - a) for any purposes that are *unrelated* to a criminal charge in a criminal proceeding; or
  - b) review by a regulatory agency under a specific environmental law, with the exception of nonprivileged materials.
19. Requires the entity claiming privilege to be notified by the governmental authority *if* an environmental law requires the information to be made available to the public.
20. If information is disclosed under review by a regulatory agency or governmental authority, requires a court or administrative hearing official to suppress evidence that is derived from the review, disclosure or use of privileged materials at a proceeding. The party that receives information that leads to such evidence must prove that it did not arise or derive from review of privileged materials.

*Miscellaneous*

21. Specifies that each document in an audit report should be labeled to indicate it is privileged (e.g. "Compliance Report: Privileged Document"). A lack of labeling does not waive the privilege or presume that the privilege does not apply.
22. Requires an audit to be completed within six months of initiation, unless an extension is warranted.
23. Defines actual harm, audit report, environmental law, organization, person, and regulated facility or operation.
24. Becomes effective on the general effective date.