507 Everything You Always Wanted to Know About EHS Auditing but Were Afraid to Ask

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Faculty Biographies

Kathleen R. Gibson

Kathleen R. Gibson is senior counsel at Deere & Company (John Deere) in Moline, Illinois. She is the EHS counsel for the company. She also provides legal advice for the logistics function. She also heads up the John Deere pro bono program.

Ms. Gibson currently serves on the board of Editors of Trends, one of the publications of the environmental section of the ABA.

She received her B.A. from the University of Illinois, Champaign-Urbana and her J.D. from Northwestern University in Chicago.

Jessine A. Monaghan

Jessine A. Monaghan is manager and counsel regulatory programs for GE Advanced Materials in Washington, DC. In that capacity she provides global issues management on a range of issues from chemical regulatory programs to emerging issues of endocrine disruption and security for chemical facilities.

Ms. Monaghan previously worked for Sotheby's, the art and antique auctioneer in London. As director and European compliance officer, she helped Sotheby's develop a compliance program and implement it across its European offices. Prior to Sotheby's, Ms. Monaghan managed environmental, health, and safety issues for GE in Europe. Her role included management of GE's environmental, health, and safety compliance program for 80 manufacturing facilities in Europe, advocacy with the European Union and national governments, and evaluation of the environmental, health, and safety aspects of mergers, acquisitions, and sales of assets. Prior to this position, she practiced law with Hunton & Williams.

Ms. Monaghan received a B.A. from Wellesley College and is a graduate of the Washington and Lee University School of Law.

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Nine EPA Audit Policy Conditions

1. Systematic Discovery of Violation

- Either through environmental audit or compliance management system
- If discovered via compliance management system, must be prepared to show:
  a) Compliance management system fulfills policy requirements and
  b) How the violation was discovered

Nine EPA Audit Policy Conditions (cont.)

2. Voluntary Discovery -- DOES NOT INCLUDE

- Emissions violations detected through a continuous emissions monitor where monitoring is required.
- NPDES violations detected through required sampling.
- Violations discovered via audit required under a Consent Order or Settlement Agreement.

Nine EPA Audit Policy Conditions (cont.)

3. Prompt Disclosure

- Must disclose violation in writing to EPA within 21 days after discovery.
  - 21 day period is triggered when any employee or agent of a facility has an objectively reasonable basis for believing that a violation has, or may have, occurred.

Nine EPA Audit Policy Conditions (cont.)

Discovery and Disclosure Must be Independent of Government or Third Party Plaintiff

- Must be Prior to:
  a) Federal/State/Local Investigation;
  b) Notice of Citizen Suit;
  c) Filing of Third Party Complaint;
  d) Whistleblower Report; and/or
  e) Imminent Discovery of Violation by Agency.

Nine EPA Audit Policy Conditions (cont.)

Corrections and Remediation

- Must certify in writing that violation has been corrected within 60 days from date of discovery, or as expeditiously as possible.

  If more than 60 days is needed, must notify EPA prior to the expiration of the 60 days.

Prevent Recurrence

Nine EPA Audit Policy Conditions (cont.)

No Repeat Violations

- Same or closely related violation cannot have occurred within the past three years.
- For multi-facility organizations, if the same or closely related violation occurred as part of a pattern of violations, no audit policy relief.

8. Certain Violations Are Excluded

- Those that result in serious actual harm to the environment.
- Those that pose imminent and substantial endangerment to human health and/or the environment.
- Violations of terms of an order, consent agreement, or plea agreement.

Nine EPA Audit Policy Conditions (cont.)

Cooperation

- Must provide EPA with appropriate information to determine applicability of audit policy.
- If there is a criminal violation, expect to provide EPA access to:
  - employees
  - information relevant to disclosed violations
  - individuals who conducted the audit/review
  - information regarding any noncompliance problems related to the disclosure

How Does EPA's Audit Policy Affect States?

- Does not apply for violations of wholly state laws and regulations (does apply for delegated programs if violation is of federal law).
- If State adopts its own audit policy, EPA will defer to State's policies.
- EPA will share information with states.

State Environmental Audit Policies

Four Examples:

California

Florida

Nebraska

New Jersey

California

CAL/EPA Recommended Guidance on Incentives for Voluntary Disclosure (Oct. 2003) ("CAL/EPA Audit Policy")

- Gravity based penalties waived - If nine conditions are satisfied (conditions are substantially the same as EPA's).
- Key Elements:
  - Violation may be discovered through audit or through entity's systematic "due diligence" in preventing, detecting, and correcting violations.
  - Disclosure must occur within 21 days of discovery of the violation.
  - No repeat violations (based on past three years).

Florida

Incentives for Self-Evaluation by the Regulated Community (April 1, 1996) ("Florida Audit Policy")

- Gravity based penalties waived - If six conditions of Florida Audit Policy are satisfied.
- Elements of Florida Audit Policy:
  - Violation may be discovered through audit or through entity's systematic "due diligence" in preventing, detecting, and correcting violations.
  - Disclosure must occur within 10 days of discovery of the violation.
  - No repeat violations (based on past three years

Nebraska

Environmental Audit Immunity Law (Neb. Rev. Stat. § 25-21, 254 *et seq.*) ("Nebraska Audit Law")

- Environmental audits are not admissible as evidence, with certain exceptions (if water contamination, significant violation, multiple violations, among others).
- If entity self-discloses a violation to Nebraska Department of Environmental Quality, civil penalties will be waived if seven conditions are satisfied.
- Does not appear to address administrative penalties.

Nebraska (cont.)

Key Elements of Nebraska Audit Law:

- Disclosure may be discovered through audit or through a "voluntary self-evaluation," which would appear to include environmental management systems.
- Disclosure must occur within 60 days of discovery of the violation.
- No express requirement excluding repeat violations.

New Jersey

Penalty Reductions for Self-Disclosure of Violations ("New Jersey Self-Disclosure Rule")

- New regulations (NJAC 7:33.1 *et seq.*) were proposed August 18, 2003, but have not been officially adopted.
- As a policy, New Jersey is allowing regulated entities to apply for penalty reductions under the proposed rules.
- Form for self-disclosure is available at http://www.nj.gov/dep/enforcement/self-disclosure.htm

New Jersey (cont.)

New Jersey Self-Disclosure Rule

- If entity satisfies nine conditions (similar to EPA Audit Policy conditions), NJDEP may waive:
  - 75% of the penalty if the violation is a Tier 2 violation (poses moderate risk to human health and environment).
  - 100% of the penalty if the violation is a Tier 1 violation (poses minimal risk to human health and environment).
- NJDEP may recover any economic benefit portion of penalty.
- Mandatory minimum penalties (WPCA) may not be waived.
- All self-disclosed violations are recorded in NJDEP's computer database - "New Jersey Environmental Management System."
- Self-Disclosure forms and related reports are public records under OPRA.

New Jersey (cont.)

Key Elements of New Jersey Self-Disclosure Rule:

- Entity must discover violation voluntarily. If the finding is required to be reported to NJDEP, still qualifies if discovered voluntarily.
- Disclosure must occur within 21 days of discovery.
- No repeat violations –
  - Tier 1 (based on past 12 months)
  - Tier 2 (based on past 36 months)

Website with links to various State self-disclosure policies and self-audit privilege/immunity laws:

www.envcap.org/audit/

What to look for with:

Ongoing Operations

Supplier/Vendor Operations

Ongoing Company Operations Audit

Purpose of Company operations audits – find and manage:

- Risk of non-compliance with law, including permits
- Risk of injury or death
- Risk to facility/ongoing operations from process safety issues
- Risk of long term liability (e.g. contaminated land)

Employ root cause analysis to prevent problems from recurring in the future

- "WHAT" was the underlying cause?
- "WHY" did the problem occur?
- "HOW" can we minimize the potential for reoccurrence?

Ongoing Company Operations Audit

Health & Safety

–LOTO
–Ergonomics
–Machine guarding
–Slip, trip, fall hazards
–Contractors
–Fall protection
–Confined spaces
–Cranes and lifts

- Traffic
- Signs
- Wiring
- PPE use
- Housekeeping
- Storage racks
- Fire extinguishers
- Evacuation drills
- Evacuation routes
- Fire fighting equipment
- Alarms
- Egress points
- Industrial Hygiene
- Fork Trucks
- Driver Safety
- Medical Services

Ongoing Company Operations Audit

Environmental

Waste

- Drums
- Accumulation times
- Storage areas
- Grounding
- Segregation
- Spill response
- Inventory

Air

- Emission inventories
- Permits/Exemption letters
- Fugitive dust
- MR&R records
- Facility expansions

Water

- Permits
- Piping
- Storm water
- Management of Change

Ongoing Company Operations Audit

Chemical Management

- Labeling of containers, piping
- Storage areas
- Approved chemical inventory
- MSDS
- Compressed gas cylinders
- Bulk storage
- Import/Export
- Haz Com
- Shipping
- Grounding

Ongoing Company Operations Audit
Use of Root Cause Analysis

"WHAT" is the issue?

- An improperly labeled container . . . Is it really distilled water?

"WHY" did the problem occur?

- Lack of training on proper containers
- Lack of available containers
- Lack of inspection program

"HOW" can we minimize the potential for reoccurrence?

- Review Hazcom training and stress secondary containers
- Include on Inspection Checklist

Purpose of Supplier/Vendor Audits:

•To ensure that only suppliers that are environmentally responsible are considered as providers of processes or services to your company

•Corrective action program, with toll-gates to ensure compliance for suppliers with correctable issues

Risk from suppliers/vendors include:

- Legal Liability from Supplier Environmental Liability
- Reputation
- Financial
- Work Stoppage/Loss of Supply

Legal Liabilities Background

United States

- State Solid Waste and Hazardous Substance Statutes
- SUPERFUND (aka 1980 Comprehensive Environmental Response, Compensation and Liability Act (CERCLA))
  - "Cradle to Grave" liability for waste disposal
  - Potentially Responsible Parties (PRPs) pay the bill for cleanup of sites
  - "Polluter Pays"

SUPERFUND Interpretation Changes

Not just waste vendors…"farmout" suppliers also

- United States of America and State of Iowa v. Aceto Agricultural Chemicals Corp. (Eighth Circuit 1989)
  - Company held liable for cleanup at a supplier's facility
  - Court drew distinctions based on the nature of the relationship between the supplier and the customer

Voluntary Cleanup Cost Recovery Changes

- Cooper Industries v. Aviall Services Inc. (U.S. Supreme Court, No. 02-1192, 12/13/04)
  - Parties who initiate private cleanups cannot sue to recover costs without a prior enforcement action
  - Predicted to dampen voluntary actions if PRPs cannot enter into negotiations with other PRPs without an administrative settlement

Industry Standard Changes

- ISO14001:2004
  - November 2004 revision incorporates supplier environmental aspects into environmental management system
  - 18-month phase-in period

A Typical U.S. Supplier Category Program

- Focus on new suppliers
  (Already have liability/exposure with old suppliers)
- All suppliers are placed into one of four categories from an environmental risk standpoint

Supplier Categories

Category I: Purchased goods, products, and services not unique to the company

Category II (Outsourcing): Purchased goods or products with specifications or materials unique to the Company.

Category III (Farm out): Purchased goods or processes at supplier's site, and on Company materials. *Also includes services on Company property, or the Company's leased property or subleased buildings.*

Category II vs. Category III

With Category II, the supplier owns the materials and performs the named operations on it until it is shipped to us. With Category III, the named operations are performed on the material the company owns.

Supplier Categories

Category IV: Waste disposal services, or any service associated with waste disposal

Focus of Evaluation Program

Highest Risk

- Category III – Farmed out operations
- Category IV – Waste Disposal Services

Supply Management's Role in Category III Program

- For proposed **new** Category III suppliers:
  - Categorize suppliers
  - Must conduct screening evaluations **<u>BEFORE</u>** we do any business with them
  - Make decision about whether to use supplier
- For **existing** Category III suppliers:
  - Always be on the lookout for indicators of problems when you visit a supplier

Look Up…

Paint on the Roof (air emissions)

Look Down…

Evidence of Chemical Spills (stained, pitted concrete)

Pits / Sumps

Look All Around…

Poor Housekeeping

Are they handling wastes properly?

Excessive Numbers of Drums

If a spill occurs, where will it go?

Indicators of Problems

Do they have proper containment for wastewater?

A supplier's housekeeping and environmental management performance is correlated to their overall reliability as a supplier.

Supplier Profile Control Change

As of December 2004, New U.S. SAP Supplier Profiles require an environmental risk classification

If Cat III or IV are checked, e-mail automatically generated to Corporate Environmental Control

From: John Deere Supplier Network
Sent: Wednesday, June 08, 2005 9:34 AM
To: Howard Joanne M
Subject: Supplier 0000324493 created

Supplier 0000324493 created

Supplier Name:Hobbs Implement Co Inc
Environmental Risk Categories: 3
Created By: Rhonda Miller (309)765-3137
Unit: Worldwide Logistics

Corporate Env Control check if already inspected / approved

Notification to site thru profile creator, site env contact, SM contact, etc. that an evaluation has to be done due to their risk

New Category III Supplier Evaluation Instructions

1. Site visit
2. Look for indicators of problems
3. Complete Evaluation Form
   - Low/Medium/High Risk
   - Evaluation Categories
     - Site History / Environmental Performance
     - Management Organization of Supplier
     - Air Pollution Control
     - Water Pollution Control
     - Solid and Hazardous Waste Management
     - Spill Control and Emergency Planning

"Look up, look down, look all around"

Category III Supplier Decision Process

- If no high risk boxes are checked, supplier's environmental risk is in the acceptable range
- If one or more high risk boxes are checked, review information with Environmental, and choose from one or more of five alternatives

Alternatives for Dealing with High Risk Category III Suppliers

- Drop supplier or eliminate from consideration
- Monitor performance for high risk issues
- Perform additional evaluation (e.g., more detailed environmental inspection)
- Provide assistance to supplier to alleviate high risk concern (an important option in 3rd world countries)
- Agree to live with the risk

How do I provide assistance to a Supplier to Address a concern?

- **Give supplier clear explanation of "must do's"; don't make them guess what's wrong**
  - Provide a written list of "items of concern"
  - Be simple and factual in your descriptions
  - **Do Not** speculate on local law compliance or include judgmental statements

- **Tell them they might want to hire an EHS expert (this may be particularly true in 3rd world countries)**

- **Refer them to government environmental agencies/institutes for help (this may be particularly true in 3rd world countries)**

But, DO NOT Attempt to Tell Them How to Fix the Issues!

How do I provide assistance to a Supplier to Address a concern?

Why can't I just help or tell the supplier how to fix their problems?

- **Suppliers are separate legal entities that the Company does not control**
- **Giving advice may expose the Company to liability for the supplier's non-compliance**
  - The Company will rarely completely understand the Suppliers operations, so the risk of giving incomplete or incorrect advice is high
- **The supplier needs to "own" the fix:**
  - The supplier needs to understand why the issue is a problem
  - And, internalize the local requirements and the solution
  - Otherwise the fix may only be temporary, and the risk are back for the Company

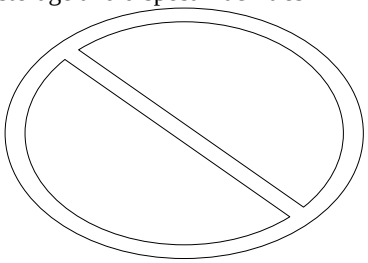
Category IV - Waste Vendor Audits

Applicable to what?

- Off-site waste management facilities (performing waste recycling, treatment, storage and disposal activities)

Why are they required?

- To ensure that the waste management facilities comply with all applicable regulations
- To evaluate the potential liability posed by the waste recycling, treatment, storage and disposal facilities



Outside the U.S.: Emerging Laws

EU Environmental Liability Directive

- "Polluter Pays" Principle published into EU Law 20 April 2004
- Member States must transpose into national law by 30 April 2007
- Does not apply to damage prior to 30 April 2007
- Insurance encouraged

China Soil and Groundwater Contamination Circular

- Issued by SEPA June 1, 2004
- First mandatory measure on historical liability / cleanup
- SEPA officials are reviewing U.S. and other countries' soil and groundwater legislation/regulations with goal to develop more detailed rules addressing this area within the next 12-24 months

International Considerations

- Legal structures may differ, but big reputational risk exists nonetheless (e.g. Bophal, Nike "sweatshops")
- Enforcement is increasing
- Penalties still (comparatively) low – but starting to be perceived as a way to fund enforcement programs
- Many countries have no civil enforcement process – EHS cases usually pursued as *criminal* matters
- A good outsider resource for audit protocols and checklists is Enhesa; they also provide other services such as country profiles and regulatory updates http://www.enhesa.com/enhesa/en/default.asp

Managing a Corrective Action Process

Remember to qualify for EPA's Audit Policy requires correction within 60 days (in some states <60 days); being able to document it helps your case

Process:

- Assign corrective actions to specific individuals
- Track closure with a "Weekly Audit Findings Status Report"
  - Electronic systems can be used to generate e-mail reminders to the individuals assigned to close the audit finding
  - Electronic systems allow easy update of closure
- Make sure the action taken complies with the letter of the law
- Consider verifying closure (particularly for remote locations or suppliers) with:
  - Documents (copy of permit, monitoring report, training record, government inspection report, etc.)
  - Photos
  - Interview in person or on the phone
  - Onsite inspection

Using EHS Auditing as a Competitive Tool

- Use the Environmental Management System to achieve cost savings on labor, energy, and material resources
- Lower the risk of costly administrative, civil, or even criminal liability
- Consider the Federal Sentencing Guidelines and Sarbanes-Oxley Act of 2002 in evaluating the design and implementation of a new or existing program

An audit is only useful if it is coupled with a comprehensive program to analyze and address the results of the audit

Get the Best Out of Your Business, Engineering, and Legal Resources

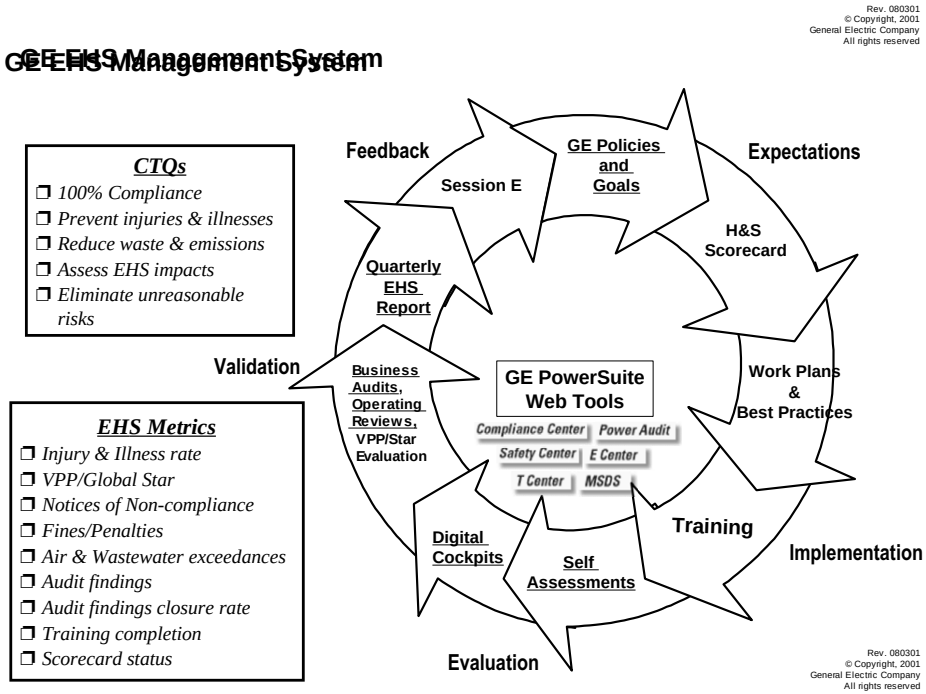
- Push critical information to top managers
- Reflect changes in law in the compliance program.
- Closer environmental management results in longer periods of trouble-free operations
- Enhance coordination among business managers, engineers, lawyers, and consultants
- Strengthen the program to fix the process as well as the problem

Get the Best Out of Your Business, Engineering, and Legal Resources (cont.)

- Business managers and lawyers work in tandem to find the optimal legal or technical solution
- EH&S team should be the company's top performers
- Use outsiders with care

List of Attachments

1. GE EHS Management System
2. List of John Deere "Safety and Environmental Consultants" computer links
3. John Deere, "Supplier Environmental Evaluation Process"
4. Sample John Deere Environmental Audit Scorecard
5. Sample Hunton & Williams Environmental Assessment Program Records Review Checklist with Attachment 1 (Scope Categories) and Attachment 2 (Document Checklist)
6. "*Cooper v. Aviall*: Supreme Court Limits Potentially Responsible Parties' Right to Bring Contribution Lawsuits Under CERCLA Section 113," co-author, Kathy Robb, Environment Reporter, Vol. 36, No. 3, pp. 145-49 (Jan. 21, 2005)
7. "On the Cutting Edge: An Insider's Perspective -- Questions Regarding CERCLA Section 107 Loom after *Cooper*," BNA Environmental Due Diligence Guide, No. 2, p. 11 (Feb. 17, 2005)



On the Cutting Edge: An Insider's Perspective

Question Regarding CERCLA Section 107 Looms After *Cooper*, Attorney Says

The ambiguity resulting from the U.S. Supreme Court's decision in *Cooper Industries Inc. v. Aviall Services Inc.* (125 S. Ct. 577, 59 ERC 1545 (2004)) regarding whether potentially responsible parties have an implied right to contribution under Section 107 of the superfund law is the most problematic aspect of the decision, a New York City attorney told BNA Feb. 11.

Because ''the lower courts have been left to diverge on this issue. . . it could be considerable time before the issue works its way back to the U.S. Supreme Court or through Congress for a legislative fix,'' Kathy Robb told BNA. Robb is a partner with Hunton & Williams in the firm's New York office.

In *Cooper*, the U.S. Supreme Court ruled that to bring a contribution action under Section 113 of the Comprehensive Environmental Response, Compensation, and Liability Act, a party first must have been subject to an enforcement action under Section 106 or 107 of the act. As such, parties incurring cleanup costs voluntarily no longer are able to recover contribution costs under Section 113.

In its decision, the court refused to consider whether Aviall had an implied right to contribution under Section 107 of CERCLA.

As a result of the landmark decision, which overturned rulings of eight federal circuit courts, well accepted assumptions about how cleanups are conducted and costs are recovered have been turned upside down.

If it winds up that cost recovery is available to PRPs under Section 107, Robb said, PRPs may find it beneficial. Because Section 107 ''offers a longer statute of limitations period than Section 113, places the burden of proof on defendants rather than the plaintiffs, and imposes joint and several liability rather than simply several [liability],'' it ''could ultimately be a positive for PRPs seeking contribution,'' she said.

However, Robb cautions that it ''remains to be seen whether 107 will be available.'' Since CERCLA was amended in 1986 when Section 113 was added, courts consistently have held that PRPs have no right to recover under 107. ''But that was in the context of 113 being available,'' she said. In light of *Cooper*, ''it will be interesting to see how the government and courts come out on [recovery under] 107,'' Robb added.

Robb told BNA the decision has directly affected how she is advising clients. ''Any client currently remediating a site without an enforcement order should consider whether it makes sense to suspend

remediation efforts and approach EPA or the state to negotiate a judicially or administratively approved settlement.''

In addition, Robb said, ''clients defending a pending contribution lawsuit should consider whether *Cooper* offers the opportunity to argue that the action should be dismissed.''

On the flip side, ''plaintiffs in a pending contribution action might want to amend their complaint to include a Section 107 implied right of contribution claim if they did not include it initially,'' Robb continued.

Robb also urged PRPs considering a cleanup under a state voluntary cleanup program to consider carefully whether they have potential claims against others to preserve before beginning the cleanup.

''The decision is certain to delay participation in VCPs while parties sort our their options, and it will increase transaction costs not only for the parties [cleaning up] but for EPA and the states.''

''From a public policy perspective, voluntary cleanups may now be delayed or deferred, and litigation encouraged—both negative outcomes,'' Robb concluded.

An in-depth article analyzing the Cooper decision co-authored by Robb is published at EDDG Section 231:1565. Robb can be contacted at krobb@hunton.com.

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Analysis & Perspective

Superfund

Supreme Court Limits Potentially Responsible Parties' Right To Bring Contribution Claims Under CERCLA Section 113

By Kathy Robb and Marian Waldmann

SUPERFUND

NO CONTRIBUTION AS A SOLUTION?

This analysis examines the U.S. Supreme Court's decision last month in *Cooper Industries Inc. v. Aviall Services Inc.*, in which it ruled that potentially responsible parties who voluntarily clean up a site cannot sue potentially responsible parties for contribution under Section 113 of the Comprehensive Environmental Response, Compensation, and Liability Act. In the article, the authors analyze the court's decision and discuss the effect it will have on contaminated site cleanups and the recovery of cleanup costs. While lower courts grapple with the issues raised by the Supreme Court's decision, the authors suggest the regulated community can hope Congress will amend the superfund law to clarify a potentially responsible party's right to seek contribution or cost recovery under the statute.

This article was written by Kathy Robb and Marian Waldmann. Robb is a partner with Hunton & Williams in New York City, specializing in energy, environmental, and administrative law. Waldmann is an associate at the law firm.

The opinions expressed here do not represent those of BNA, which welcomes other points of view.

Introduction

On Dec. 13, 2004, the U.S. Supreme Court held in *Cooper Industries Inc. v. Aviall Services Inc.*[1] that a private party that has not been sued under Sections 106 or 107(a) of the Comprehensive Environmental Response, Compensation, and Liability Act[2] (CERCLA) may not bring a claim for contribution under Section 113(f)(1) against other potentially responsible parties to recover contaminated property cleanup costs incurred voluntarily.

The Supreme Court reversed long-standing contribution practice in many circuits and cast doubt on when a PRP can sue to recover response costs that exceed its equitable share. The decision has broad implications for PRPs planning to seek contribution for costs incurred cleaning up contaminated property voluntarily without litigation or a judicially or administratively approved settlement in place.

As originally enacted in 1980, CERCLA Sections 106, 107, and 113 address liability and enforcement. Section 106 allows the U.S. Environmental Protection Agency to issue and to enforce administrative orders to compel PRPs to take actions necessary to protect public health, welfare, or the environment. Section 107 establishes strict, joint, and several liability under CERCLA and permits cost recovery for necessary response costs. Section 113 covers civil proceedings.

Until the enactment of the Superfund Amendments and Reauthorization Act in 1986, these sections all were interpreted to include an implied right to contribution under the cost recovery theory advanced in Section 107. In addition to making other changes, Congress attempted in the SARA amendments to clarify questions on contribution by adding Section 113(f), which expressly allows a right to contribution.

History of the Aviall Case

In 1981, Aviall purchased from Cooper Industries four aircraft engine manufacturing facilities in Texas. Aviall subsequently discovered petroleum and hazardous substances contamination at the site from both Aviall's and Cooper Industries' operations. Aviall notified the Texas Natural Resources Conservation Commission of the condition, and the commission directed Aviall to remediate the site or face an enforcement action.

Aviall undertook remediation of the site without being sued or entering into an administratively or judicially approved settlement and subsequently sold the properties. Aviall then sued Cooper Industries in federal court seeking to recover a portion of the nearly $5 million in cleanup costs Aviall had incurred.

Aviall alleged that, as a PRP as defined under Section 107(a), it was entitled to contribution from Cooper Industries under Section 113(f)(1) for response costs Aviall incurred at the site.

Decisions in the Lower Courts

Aviall brought the initial suit against Cooper Industries in 1997 in the U.S. District Court for the Northern District of Texas. Aviall asserted a claim for cost recovery under several theories, including CERCLA Sections 107 and 113. The original complaint was amended to combine the Section 107 and Section 113 claims into one CERCLA claim. Following motions for summary judgment submitted by both parties, the district court found for Cooper Industries, stating that Aviall's Section 113 claim was barred because it was not brought during or after a Section 106 or Section 107 action.[3]

The Fifth Circuit initially affirmed this decision,[4] but upon a rehearing *en banc*, a divided Fifth Circuit reversed the district court. The *en banc* court found that "may" in Section 113 was permissive and was not limited by the subsequent language requiring an enforcement action. In support of its decision, the Fifth Circuit relied in part on the legislative history of the SARA amendments and on the purpose of CERCLA to "promote prompt and effective cleanup."[5] Cooper Industries then petitioned the U.S. Supreme Court to review the decision.

Prior to granting certiorari, the Supreme Court invited the United States Solicitor General to file briefs "expressing the views of the United States" in an order dated April 21, 2003.[6] In a brief filed Dec. 12, 2003, the United States urged the court to grant the petition for a writ of certiorari, stating that "the court of appeals' divided *en banc* decision, which holds that a contribution action is available [to Aviall], is mistaken."[7] The United States argued the federal courts face "a substantial burden" in resolving federal suits for contribution brought "whenever they please" by responsible parties, who then may be ordered to "pay 'contribution' to another responsible party when the joint liability they potentially owe to the federal or state government under CERCLA has not been discharged."[8]

The Supreme Court granted certiorari Jan. 9, 2004.[9] Amicus briefs were filed in support of Aviall by 23 states and one commonwealth,[10] nine professional associations,[11] and 14 corporate parties.[12] The United States filed the sole amicus brief in support of Cooper Industries.

The Clear Meaning of 'May.'

The Supreme Court disagreed with the *en banc* decision of the Fifth Circuit, holding that "the clear meaning of CERCLA's text" allows a PRP to seek contribution under Section 113(f)(1) only "during or following" a civil enforcement action under Section 106 or a cost recovery action under Section 107(a) or, alternatively, under Section 113(f)(3)(B) "after an administratively or judicially approved settlement that resolves liability to the United States or a State."[13]

The Supreme Court concluded that because Aviall never was subject to such an action or settlement, Aviall could not bring an action under Section 113. In addition, the Supreme Court expressly declined to address whether Aviall could recover cleanup costs under Section 107(a) as a PRP, either directly or through an implied right to contribution.

In reaching its decision, the Supreme Court focused on the enabling clause of CERCLA Section 113, which states that a PRP "may seek contribution from any other person who is liable or potentially liable under section [107(a)] ... during or following any civil action under section [106] ... or ... [107]."[14] Aviall argued "may" was permissive and did not limit contribution to situations where a party either was sued by EPA or a state or had settled its liability. The Supreme Court, relying on "the natural meaning" of the word "may," rejected this argument, stating "the natural meaning of 'may' in the context of the enabling clause is that it authorizes certain contribution actions--ones that satisfy the subsequent specified condition--and no others."[15] The court stated that the permissive interpretation urged by Aviall would "render ... entirely superfluous" the explicit "during or following" condition of Section 113(f)(1), as well as Section 113(f)(3)(B), which permits contribution actions after settlement.[16]

Aviall Abrogates Appellate Decisions

Prior to the *Aviall* decision, most appellate courts, including the U.S. Courts of Appeals for the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and Tenth Circuits, interpreted CERCLA Section 113(f)(1) broadly to allow a plaintiff PRP to sue other PRPs to recover response costs at any time after such costs were incurred, even in the absence of a civil action against the plaintiff.[17] This approach encouraged PRP cooperation without costly litigation. As a result of the *Aviall* decision, however, PRPs now will be required to have a pending or adjudged Section 106 enforcement action or a Section 107(a) cost recovery action against them prior to bringing a contribution claim under Section 113(f)(1), or to have settled liability with the United States or a state prior to bringing a contribution claim under Section 113(f)(3)(B).

Still unclear is whether a PRP may bring a cost recovery claim against other PRPs under CERCLA Section 107 to compel reimbursement for cleanup costs fairly attributable to those PRPs. The lower courts are split as to whether a PRP, as opposed to a nonliable party, may bring a claim under Section 107.

Before the enactment of SARA, which added the Section 113 right to contribution, most courts found CERCLA included an implied right to contribution. Since SARA was enacted, the appellate courts consistently have held that a PRP is limited solely to contribution claims under Section 113 and cannot bring a Section 107 claim.[18] The appellate courts have found that cost recovery actions made under Section 107 only can be brought by plaintiffs that are not PRPs.

The focus in the circuit cases typically has been on the "any other" language in Section 107(a)(4)(B). Section 107(a) lists all the parties liable for "any necessary costs of response incurred by *any other* person" (emphasis added).[19] The courts have interpreted "any other" to refer to innocent parties not listed in Section 107(a)(1)-(4) as liable for contamination. Because, by definition, a PRP is not an "innocent party," Section 107 suits are not an option. Courts have reasoned that PRPs should not be seeking cost recovery, but instead should seek contribution, which is the remedy explicitly available under Section 113.[20]

Some circuits, however, have acknowledged there may be cases where PRPs would be allowed to bring a Section 107 action. For example, the U.S. Court of Appeals for the Seventh Circuit has made an exception for presumptive PRPs who can establish an affirmative defense, such as the innocent landowner defense, under CERCLA.[21] The U.S. Court of Appeals for the First Circuit also has noted that "a PRP who spontaneously initiates a cleanup without governmental prodding might be able to pursue an implied right of action for contribution under [Section 107(c)]."[22]

Still Open for Interpretation

The Supreme Court declined to rule on the issue of whether a PRP could sue for cost recovery under Section 107 in the *Aviall* decision. The majority reasoned they were not briefed on this particular issue and the only precedent was in the form of dictum in the Supreme Court's opinion in *Key Tronic Corp. v. United States*.[23] Interestingly, Justice Ruth Bader Ginsburg's dissent in *Aviall*, in which Justice John Paul Stevens joined, relies on the Supreme Court's decision in *Key Tronic*, where the Court unanimously stated that Section 107 "unquestionably provides a cause of action for [potentially responsible persons (PRPs)] to seek recovery of cleanup costs."[24] Justice Ginsburg did not disagree with the Court's holding in *Aviall* regarding the limitations on contribution actions under Section 113(f); her view was that the Court also should have ruled on the Section 107 claim.

The Supreme Court also did not expressly address in *Aviall* the issue of implied right to contribution under Section 107. Instead, the court cites two earlier Supreme Court cases where the court rejected the argument that an implied right to contribution exists under the interpretation of the Sherman, Clayton, Equal Pay and Civil Rights Acts.[25]

In both cases, the Supreme Court held that there was no common law or implied right to contribution under these federal statutes, finding that the issue of whether there was a right to contribution should be decided by Congress. Neither case involved CERCLA. These cases could be distinguished from *Aviall*, however, on the grounds that as a matter of public policy, parties who wrongfully violate non-retroactive federal laws should not be allowed to obtain contribution, while voluntary cleanups under CERCLA should be strongly encouraged.[26]

While the cases cited by the majority in *Aviall* seem to indicate the Supreme Court may not interpret Section 107 to include an implied right to contribution, an analysis of the dissents in *Key Tronic* and *Aviall* suggests at least four of the justices believe Section 107 provides a PRP with a cause of action.

In their *Aviall* dissent, Justices Ginsburg and Stevens relied on the court's unanimous conclusion in *Key Tronic* that Section 107 provided a PRP with a cause of action. Additionally, Justices Antonin Scalia and Clarence Thomas argued in their *Key Tronic* dissent that PRPs have an express right to cost recovery under Section 107.[27] These dissents, considered together, suggest a reasonable possibility that the Supreme Court might grant a right to cost recovery under Section 107 to PRPs seeking reimbursement under circumstances similar to Aviall.

It also is possible, however, that the right to recover costs may be limited to the sorts of costs specifically authorized in the *Key Tronic* decision, namely, costs incurred to identify other PRPs and oversee response measures--the kinds of costs not owed to the United States or a state and not incurred to discharge a common liability shared by jointly liable parties to the United States or a state. The majority in *Aviall* points out that in *Key Tronic*, the court "did not even classify [Section 107] precisely as a right to cost recovery or a right of contribution," and states that the *Aviall* dissent reflects this ambiguity.[28]

The issue of whether Aviall may recover costs under Section 107(a)(4)(B) even though it is a PRP, or whether Aviall has an implied right of contribution under Section 107, were not briefed by Aviall because it had combined its original Section 107(a) and 113(f)(1) claims into a single joint CERCLA claim under Section 113 (f)(1) when it amended its complaint. Aviall asserted it had done so to conform its pleadings to Fifth Circuit precedent that governed at the time it filed the pleadings.

The U.S. Supreme Court remanded the case for consideration of the Section 107 issues.

Aviall also may raise questions about the constitutionality of the Section 106 order regime, depending on how the Supreme Court's decision is interpreted by the lower courts. Applying *Aviall*, parties that are issued Section 106 orders may not have a right of contribution against other PRPs that do not receive orders. Under EPA's interpretation of its order authority, parties subject to a Section 106 order cannot challenge the order until after they have performed the cleanup. Even if their subsequent challenge is successful, parties to the Section 106 order then may not be able to obtain contribution following *Aviall* because the Section 106 parties' claims would not have arisen during or after a Section 106 or 107 action or following a settlement with the United States or a state.[29]

Where Do We Go From Here?

The *Aviall* decision discourages PRPs from voluntarily remediating or complying with a government order to remediate contaminated sites because they might not be able to seek contribution from other PRPs for the costs incurred.

The Government Accountability Office estimates there are as many as 450,000 contaminated sites in the

United States.[30] Currently, private parties play a major role in cleaning up sites, often without any significant government involvement and certainly without administrative or judicial proceedings.

The *Aviall* decision is certain to discourage parties dealing with contaminated property from addressing the contamination without first seeking an administrative settlement to protect potential contribution claims. Administrative settlements will add significant time and cost to any cleanup. Challenges to administrative settlements by parties potentially affected by the settlement at a particular site also will add cost and delay.

The decision also may result in pushing down the burden of completing these settlements to the states, with parties seeking settlements from the state to expressly preserve the right to seek contribution from nonparties. Parties also may increase reliance on state and common law claims to obtain contribution.

EPA is vested with increased bargaining power under *Aviall* because the agency decides which PRPs to name in an order and whether to grant settlement. Not only does this potentially affect all contaminated sites, it raises particular questions at the many sites where the United States is itself a PRP. Under *Aviall*, a PRP cannot sue the federal government for contribution unless the government first brings an enforcement action against the PRP or enters into an approved settlement with the PRP. This seemingly presents a conflict of interest for the U.S. government and it is unclear how EPA will address this issue at sites where the federal government is a PRP.

The decision also runs counter to a decade of federal and state initiatives specifically designed to encourage the voluntary remediation of sites in urban areas, often called brownfields. The limits on contribution in *Aviall* may discourage the purchase of contaminated property. As buyers consider the added expense, time, and uncertainty that may be associated with pursuing contribution, they may reconsider taking on a property that they formerly might have purchased and cleaned up voluntarily with the intent of pursuing contribution without having to be sued themselves or entering into an approved settlement first.

In light of *Aviall*, a PRP currently remediating a site other than pursuant to a judicially approved consent decree, such as under an administrative order on consent, a unilateral administrative order, or various state cleanup programs, and intending to seek contribution from other PRPs should carefully reevaluate its contribution claim to determine whether it is consistent with the *Aviall* interpretation of contribution rights under Section 113(f)(1) or 113(f)(3)(B). If it is not, the PRP may want to adjust its litigation strategy and also seek a settlement consistent with the *Aviall* decision before incurring cleanup costs. Alternatively, the PRP may want to attempt pursuing a Section 107 claim, pleading both a direct right of cost recovery under Section 107(a)(4)(B) and an implied right to contribution under Section 107.

The *Aviall* decision undoubtedly will require Congress or the courts to further define PRP contribution rights.

The issues will move through the lower courts with all deliberate speed and eventually will come before the Supreme Court for final review. In the meantime, the regulated community can hope Congress will amend CERCLA once again to further clarify a PRP's right to seek contribution or cost recovery under the statute.

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[1] 543 U.S. __ , 59 ERC 1545 (2004). The decision reversed the *en banc* decision of the U.S. Court of Appeals for the Fifth Circuit, *Aviall Services Inc. v. Cooper Industries Inc.*, 312 F.3d 677, 55 ERC 1417 (5th Cir. 2002).

[2] 42 USC 9601 et seq.

[3] *Aviall Services Inc. v. Cooper Industries Inc.*, 2000 WL 31730 (N.D. Tex. 2000).

[4] *Aviall Services Inc. v. Cooper Industries Inc.*, 263 F.3d 134, 52 ERC 2057 (5th Cir. 2001).

[5] *Aviall Services Inc. v. Cooper Industries Inc.*, 312 F.3d 677, 696, 55 ERC 1417 (5th Cir. 2002).

[6] 538 U.S. __, 123 S. Ct. 1823 (2003).

[7] *Brief Amicus Curiae of the United States*, 2003 WL 22977858 at *1, *Aviall Services Inc.* (No. 02-1192). Aviall, and several amici, mentioned in their briefs that the position the government took in *Aviall* on contribution suits under Section 113 was contrary to its prior position in other cases addressing contribution. *See, e.g. Brief of Respondent* at 13, *Aviall Services Inc.* (No. 02-1192); *Brief of Amici Curiae Atlantic Richfield Co. et al*., 2004 WL 791894 at *22, *Aviall Services Inc.* (No. 02-1192).

[8] *Id.* at *18.

[9] *Cooper Industries Inc. v. Aviall Services Inc.*, *cert. granted*, 540 U.S. __, 124 S. Ct. 981 (2004).

[10] The states of Arizona, California, Colorado, Connecticut, Delaware, Illinois, Louisiana, Massachusetts, Michigan, Missouri, Montana, Nevada, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Washington, Wisconsin, Wyoming, and the Commonwealth of Puerto Rico filed a brief in support of Aviall.

[11] The American Chemistry Council, American Gas Association, American Petroleum Institute, Corporate Environmental Enforcement Council, Edison Electric Institute, Environmental Technology Council, Superfund Settlements Project, Texas Oil and Gas Association, and Utility Solid Waste Activities Group filed briefs in support of Aviall.

[12] Atlantic Richfield Co., Bluewater Network, ConocoPhillips Co., Crane Co., E.I. Dupont De Nemours and Co. Inc., Federal Mogul Corp., Ford Motor Co., General Dynamics Corp., General Motors Corp., Geomatrix Consultants Inc., LFR Inc., Lockheed Martin Corp., Montrose Chemical Corp. of California, and Source Group Inc.

[13] *Cooper Industries Inc. v. Aviall Services Inc.*, 543 U.S. ___, No. 02-1192, slip op. at 8 (2004).

[14] 42 USC 9613(f)(1).

[15] *Aviall Services Inc.*, slip op. at 7.

[16] *Id.*

[17] *Bedford Affiliates v. Sills*, 156 F.3d 416, 47 ERC 1449 (2d Cir. 1998) (contribution action commenced following negotiations with state agency and consent order); *Crofton Ventures Ltd.Partnership v. G & H Partnership*, 258 F.3d 292, 294, 52 ERC 2005 (4th Cir. 2001) (petitioner commenced voluntary cleanup under state supervision and then brought contribution action); *Amoco Oil Co. v. Borden Inc.*, 889 F.2d 664, 30 ERC 1745 (5th Cir. 1989) (action for contribution brought after Amoco was informed by state agency of contamination); *Kalamazoo River Study Group v. Rockwell Int'l Corp.*, 274 F.3d 1043, 1046, 53 ERC 1705 (6th Cir. 2001) (companies entered consent order with state agency prior to suing for contribution); *PMC Inc. v. Sherwin-Williams Co.*, 151 F.3d 610, 613, 47 ERC 1185 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 871, 48 ERC 1096 (contribution suit brought after state agency "required" petitioner to clean up site); *Control Data Corp. v. S.C.S.C. Corp.*, 53 F.3d 930, 932-33, 935, 40 ERC 1884 (8th Cir. 1995) (Control Data sued for contribution following a voluntary consent decree); *Cadillac Fairview/California Inc. v. Dow Chem. Co.*, 299 F.3d 1019, 1024, 54 ERC 2057 (9th Cir. 2002) (contribution suit with no indication of prior civil action); *Morrison Ents. v. McShares Inc.*, 302 F.3d 1127 (10th Cir. 2002) (contribution action brought following a state-ordered investigation of site contamination).

[18] *Bedford Affiliates v. Sills*, 156 F.3d 416, 423-424, 47 ERC 1449 (2d Cir. 1998); *Centerior Serv. Co. v. Acme Scrap Iron & Metal Corp.*, 153 F.3d 344, 349-356, 47 ERC 1285 (6th Cir. 1998); *Pneumo Abex Corp. v. High Point, T. & D. R. Co.*, 142 F.3d 769, 776, 46 ERC 1481 (4th Cir. 1998), *cert. denied*, 119 S.Ct. 407, 47 ERC 2024; *Pinal Creek Group v. Newmont Mining Corp.*, 118 F.3d 1298, 1301-1306, 45 ERC 1588 (9th Cir. 1997); *New Castle County v. Halliburton NUS Corp.*, 111 F.3d 1116, 1120-1124, 44 ERC 1513 (3rd Cir. 1997); *Redwing Carriers, Inc. v. Saraland Apartments*, 94 F.3d 1489, 1496 and n. 7, 43 ERC 1196 (11th Cir. 1996); *United States v. Colorado and E.R. Co.*, 50 F.3d 1530, 1534-1536 (10th Cir. 1995); *United Technologies Corp. v. Browning-Ferris Industries*, 33 F.3d 96, 98-103, 39 ERC 1097 (1st Cir. 1994).

[19] 42 USC 9607(a)(4)(B).

[20] Sections 107 and 113 differ in four other fundamental ways. First, Section 107 offers a six-year statute of limitations and Section 113 offers three years. Some courts have reasoned that this difference supports the

view that PRPs cannot bring Section 107 claims because Congress would have intended the six-year statute to apply to innocent parties only. Second, liability under Section 107 may be joint and several, while most circuits have held that liability under Section 113 is several only. Third, the burden of proof is switched from the defendant in Section 107 claims to the plaintiff in Section 113 claims. Finally, Section 107 does not specifically allow equitable allocation; Section 113 does.

[21] *NutraSweet Co. v. X-L Engineering Co.*, 227 F.3d 776, 783-84, 51 ERC 1161 (7th Cir. 2000); *AM Int'l Inc. v. Datacard Corp.*, 106 F.3d 1342, 44 ERC 1001 (7th Cir. 1997); *Akzo Coatings Inc. v. Aigner Corp.*, 30 F.3d 761, 39 ERC 1013 (7th Cir. 1994).

[22] *United Technologies*, 33 F.3d 96, n.8, 39 ERC 1097 (1st Cir. 1994).

[23] 511 U.S. 809, 38 ERC 1633 (1994) (holding certain attorneys' fees were recoverable under Section 107 as necessary costs of response).

[24] *Aviall Services, Inc.*, slip op., dissent at 1 (Ginsburg, J. dissenting).

[25] *Texas Industries Inc. v. Radcliff Materials Inc.*, 451 U.S. 630, 638-641 (1981) (finding the court would not recognize an implied right to contribution under the Sherman Act or the Clayton Act); *Northwest Airlines Inc. v. Transport Workers*, 551 U.S. 77, 90-99 (1981) (stating the court would not recognize an implied right to contribution under the Equal Pay Act of 1963 or Title VII of the Civil Rights Act of 1964).

[26] The majority in *Aviall*, however, notes in discussing implied rights of contribution that Congress "explicitly recognized a particular set . . . of the contribution rights previously implied by courts from provisions of CERCLA and the common law" in enacting Section 113(f)(1). *Aviall Services Inc.*, slip op. at 12.

[27] *Key Tronic*, 511 U.S. at 821-824, 38 ERC 1633 (Scalia, J. dissenting) (Justices Scalia and Thomas found that enforcement actions, as part of the necessary costs of response, included all attorneys' fees).

[28] *Aviall Services Inc.*, slip op. at 11.

[29] This constitutional question may be avoided by the lower courts if they choose to return to a pre-SARA construction of Section 107 allowing any other person to seek cost recovery.

[30] US General Accounting Office, *Community Development: Local Growth Issues: Federal Opportunities and Challenges* (RCED-00-178) 118 (Sept. 2000).

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STATE ENVIRONMENTAL AUDIT PRIVILEGE

ATTACHMENT 1

SAMPLE
ENVIRONMENTAL ASSESSMENT PROGRAM
SCOPE

1. Wastewater discharges (direct, indirect or subsurface)
2. Construction storm water discharges
3. Drinking water (including water quality and backflow prevention)
4. Air emissions
5. Regulated refrigerant management
6. RCRA wastes (hazardous, universal and non-hazardous)
7. Community right-to-know
8. Insecticides, fungicides and rodenticides
9. PCB items and wastes
10. Asbestos (excluding workplace safety issues)
11. Superfund (including chemical release reporting)
12. Oil storage (including SPCC planning and UST/AST requirements)
13. Wetlands and waterways
14. Lead-based paint
15. Monitoring wells and underground injection control
16. OSHA hazardous waste operations and emergency response
17. Chemical and product management

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SAMPLE
ENVIRONMENTAL ASSESSMENT PROGRAM
RECORDS REVIEW

The Environmental Assessment Program (EAP) is designed to evaluate compliance with applicable environmental laws. The EAP encompasses 17 compliance categories, which are listed on Attachment 1. For each category, the assessment team will review environmental performance based on a standard checklist, which is included as Attachment 2. In order to fairly and comprehensively review a facility's environmental performance, the assessment team needs to have ready access to all relevant environmental documents and to facility personnel with responsibility for and knowledge about the facility's environmental functions. The following list reflects environmental documents that should be made available to the assessment team:

1. Correspondence with regulatory agencies, including the Department of Environmental Quality, the Department of Health and the Environmental Protection Agency;
2. Notices of violation or other enforcement-related records;
3. Regulatory agency inspection reports;
4. Environmental permits, including permits for wastewater discharges, construction storm water discharges and air emissions;
5. Environmental plans, including plans relating to oil discharge prevention, storm water pollution prevention, wastewater slug control, hazardous waste contingencies and emergency response;
6. Air emission and wastewater discharge monitoring results;
7. Inspection logs for emissions sources (like generators and boilers) storage areas (like drummed oil and chemical storage rooms, aboveground storage tanks and hazardous waste storage areas), operations that may affect environmental compliance (like oil unloading/loading, housekeeping and laboratories) and site features / impacts;
8. Waste generator identification numbers and waste disposal manifests, including PCB wastes, asbestos wastes, hazardous wastes, medical wastes and oily wastes;
9. Agreements with contractors that perform environmental activities, including pesticide contractors, waste disposal contractors and special project contractors (like asbestos or lead based paint removal);
10. Employee training records and certifications;
11. Backflow prevention inspection records;

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12. CFC/HCFC refrigerant records for any comfort cooling units that have a refrigerant charge of more than 50 pounds (per circuit);
13. Asbestos and lead-based paint surveys;
14. Material safety data sheets;
15. Community right to know reports, including chemical lists and Tier 2 reports;
16. Underground storage tank records, including registrations, financial assurance, monitoring reports and closure reports;
17. Wetlands-related records, including any delineation maps, permits and mitigation plans;
18. Existing environmental reports, including Phase I and Phase II environmental site assessments; and
19. Site plans and/or building layout drawings.

In addition to making these documents generally available to the assessment team, the facility should designate one or more knowledgeable employees to be on hand to discuss these documents (or the absence thereof) and respond to questions about them.

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ATTACHMENT 2

SAMPLE
ENVIRONMENTAL ASSESSMENT PROGRAM
CHECKLIST

1. **Permits / plans** (timeliness, completeness and accuracy of all required permit applications; availability and status of all required permits and plans; other potential permitting- or plan-related gaps)

2. **Implementation** (general status of implementation and awareness of all permits, plans and other regulatory requirements)

3. **Reporting** (timeliness, completeness and accuracy of required reporting, including to County officials and the public)

4. **Recordkeeping** (availability and effectiveness of the facility's management of required records)

5. **Training** (status and effectiveness of facility's management of required training programs)

6. **Inspections** (timeliness and completeness of required inspections; timeliness and completeness of facility response to issues disclosed by inspections)

7. **Environmental compliance and enforcement history** (record of NOVs, compliance orders, administrative settlements and other adverse environmental performance claims by government agencies or third parties)

8. **Potential environmental liabilities** (observed or reported practices that may expose or exacerbate the facility's exposure to liability)

9. **Other environmental issues** (past practices, specific site conditions, neighboring conditions, facility operations, personnel or management practices that may effect compliance or environmental performance)

Everything You Always Wanted to Know About EHS (Environmental, Health, and Safety) Auditing But Were Afraid to Ask

Association of Corporate Counsel
Tuesday, October 18, 2005 11:00 a.m.

Moderator:

Jessine A. Monaghan, Manager & Counsel Regulatory Programs, GE Advanced Materials

Panelists:

Kathleen R. Gibson, Senior Counsel, Deere & Company

Kathy Robb, Partner, Hunton & Williams

Mary E. Storella, Senior Counsel, Schering-Plough Corporation

Covering today:

- Why self-evaluate?
- Elements of an EHS audit
- Potential Governmental Policies, Laws, Privileges, and Immunities
    - Federal
    - States
- What to look for with
    - Ongoing operations
    - Suppliers
- International Considerations
- Managing a Corrective Action Process
- Using EHS Auditing as a Competitive Tool

Not covering:

- Transactional due diligence audits – reason for audit is different, most of the same principles apply
    - Audit findings can be used for assessing risk, liabilities and costs and as a punch-list for post-closing corrective action

Why Self-evaluate?

- Manage risks and correct EHS problems before they result in injury, incident or government enforcement
- Assess compliance with law
- Achieve compliance through advice and recommendations from the audit
- Benefit from EPA and State audit policies to reduce the possibility of gravity-based penalties
- Enhance Operations awareness of EHS compliance status – day-to-day compliance is in their hands

Principles of an Effective Program

- Communication to all employees of the company's standard operating procedures to comply with environmental laws
- Incentives for managers and employees to comply with environmental laws
- Policies, standards and procedures that document and identify for employees and agents how to comply with environmental, health and safety law

Principles of an Effective Program (cont.)

- Appointment of a person or persons responsible for leading the corporate program on compliance with environmental, health and safety law
- Systems to verify that standards are achieved and procedures are carried out (i.e., routine auditing or monitoring) and to give employees a mechanism to report violations without fear of reprisal
- Procedures to promptly remedy acts of noncompliance

Key Questions in Planning an EHS Audit

- What Are the Program Objectives?
  - Compliance with law
  - Avoiding liabilities
  - Creating a system of accountability of management
  - Tracking compliance costs
- Who Are the Auditors?
  - Corporate control with full-time corporate auditors
  - Corporate control with part-time corporate auditors selected from divisions
  - A small corporate oversight group with delegation of the audit function to the operating divisions
  - A small corporate oversight group with the use of external, independent auditors

Planning an EHS Audit (cont.)

- Potential Legal Issues
  - Written vs. oral reports?
  - Retained documentation?
  - Corporate counsel involvement?
  - Protection from discovery?
  - Report format and watchwords?
- What is the Program Scope and Coverage?
  - Frequency of audits
  - All regulations?
  - All plants, random samples, or directed sample
  - Facility level self assessments
  - Vendor/Supplier audits?

Planning an EHS Audit (cont.)

- Waste contractor audits?
- Scheduled or unannounced visits?
- Reporting protocols?

- What Will the Process Include?
  - Pre-visit questionnaire
  - Pre-visit, on-site, post-visit procedures
  - Document review with procedures for representative sampling
  - Interviews
  - Physical inspection - observations
  - Use of auditing tools ensure a thorough audit and consistency; they include protocols, compliance checklists (on site use of portable computers where tools are digital)

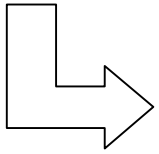
Planning an EHS Audit (cont.)

- How to Select and Train Auditors?
  - Skills required
  - Attorney's role
  - Training procedures
  - Full-time vs. part-time auditor
- Supporting Tools
  - Pre-visit questionnaire
  - Compliance checklist
  - Regulatory updates
  - Audit reports
  - Guidance/procedures manual
  - Follow-up reports
  - Computer support
  - Training

Process Map for an Audit

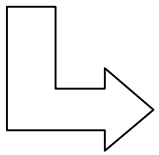
Pre-Audit Activities

- Audit Team Leader Discusses Logistics w/ Site & Audit Team
- Team members Trained on Auditing Techniques



On-Site Activities

- Audit Kickoff Meeting
- Initial Site Walk
- Complete Audit Components:
  - Interviews
  - Document Review
  - Observations
- Daily Closeout Meetings
- Final Audit Closeout -- Report & Findings



Post-Audit Activities

- Follow-up with Site on findings
- Follow-up with governments agencies if needed
- Corrective action as appropriate

Protecting Audit Information:

Audits and Privileges

Protecting Audit Information

Think before you create; properly dispose of obsolete information

- Audit records can be obtained and used:
  - By the government in an investigation
  - Through discovery in civil litigation
  - By the public, through employees talking
  - Freedom of Information Act (FOIA) requests (U.S.)
- Use judgment when writing findings or taking photos
  - Recognize sensitive areas - use common sense
  - Use words carefully - avoid exaggeration, inappropriate humor
  - Disseminate the audit and result to those who need it, in sections if appropriate

Protecting Audit Information (cont)

- Check legal holds and retention requirements first. See Zubulake v. UBS Warburg (five opinions from the Southern District of New York)
- Properly Dispose of Obsolete Information in Accordance with Records Management Policies:
  - Action Plans
  - Supporting notes
  - Field notes
  - Drafts
  - Photos
  - Any document that is not a current action report

Protecting Audit Information

Privileges

Oral and written communications are discoverable by adversaries

Unless They Are "Privileged"

- **Attorney-Client Privilege**
- **Work Product Privilege**
- **Self-Evaluation Privilege**
- **Environmental Audit Privilege**

Legal Privileges All Involve A Balance Between Competing Social Policies. None Are Absolute.

Protecting Audit Information

Attorney-Client Privilege: Key Elements

Confidential

- Subjective: Client must intend to keep secret.
- Objective: Must, in fact, safeguard
  - "Need-to-know" circulation within company.
  - Markings: **"Privileged and Confidential"**
- Cannot communicate in presence of third parties
  - Exception: Joint defense/common interest.

"Lawyer"

- In-house or outside counsel and agents under their control.
- "Kovel" consultants/experts if retained for purpose of assisting lawyer in providing legal advice.

Communications

- Not facts or pre-existing documents.
- Not "ministerial" (e.g., transmittals).
- Usually not amount of fees, terms of engagement.
- Some courts: Not attorney to client, attorney to attorney, or attorney's internal notes/memos unless they reveal client communications (but may be work product).

Legal advice

- Not "primarily" business advice. Harmony Gold U.S.A., Inc., v. FASA Corp. 169 F.R.D. 113 (N.D. Ill 1996); City of Springfield v. Rexnord Corp., 196 F.R.D. 7 (D. Mass, 2000.); Picard Chemical, Inc. Profit Sharing Plan v. Perrigo Co., (W.D. Mich. 1996.)
- Not merely because lawyer is present (BOD meetings).
- Some courts: Could it have been done by non-lawyers?

"DO'S and DON'Ts" To Protect A-C Privilege

Do Take Reasonable Precautions to Protect Confidentiality and Avoid Waiver; recognize that in-house counsel have not enjoyed the same presumption of a predominant legal purpose as have outside counsel

- **Avoid unnecessary use of privilege**

- **Make express that participation of EHS counsel is to provide legal advice, and try to segregate legal advice from other business advice by use of separate communications**

- **Clearly <u>mark</u> privileged communications, *including e-mails*:**
  "ATTORNEY-CLIENT COMMUNICATION; PRIVILEGED & CONFIDENTIAL" *<u>OR</u>* "PRIVILEGED & CONFIDENTIAL; PREPARED AT REQUEST OF COUNSEL" (in Header or Footer of <u>every</u> page)

- **Segregate privileged communications into a separate file or folder**

- **Restrict distribution:**
  Do <u>not</u> send or forward privileged communications to anyone outside the Company; only share them with those inside the Company with a "need to know"

Do Not "Abuse" Claims of Privilege:

-- Be careful not to "over-mark" documents
-- Every communication cc'd to an attorney is not per se "privileged"

Protecting Audit Information

Attorney-Client Privilege: practical example for audits

- **A non-lawyer employee discovers that a hazardous material UST at a facility is leaking into a nearby river. Before taking a picture of the leak or creating any documents the employee notifies the company's EHS attorney.**

- **Attorney sends out the following message to a small control group:**

  This is to advise that company legal counsel are conducting a confidential and attorney client privileged investigation into EHS and related matters in connection with an incident at a facility involving a leaking UST. Each of you, because of your knowledge or expertise, will work under the supervision of counsel's office in this matter. Information gathered during this investigation, documents that come into your possession or that you create, and all communications to which you are a party should be considered confidential information and gathered solely for the purpose of giving legal advice to the company. As such, they may be subject to Attorney-client privilege. Please maintain any such information in a separate, secure file labeled "**Attorney-Client Privileged and Confidential**" and do not disclose it to anyone not part of the investigative team unless directed to do so by the Company legal counsel, even after the investigation ends.

States with Privilege and Immunity Laws

Privilege only (5):

- Arkansas
- Indiana
- Illinois
- Mississippi
- Oregon

Immunity only (1):

- Rhode Island

Privilege & Immunity (19):

- Alaska
- Arizona
- Colorado
- Idaho
- Iowa
- Kansas
- Kentucky
- Michigan
- Montana
- Nebraska
- Nevada
- New Hampshire
- Ohio
- South Carolina
- South Dakota
- Texas
- Utah
- Virginia
- Wyoming

General Requirements (but specifics vary by state):

–Audit Must Be Voluntary

–Report Must Be Labeled "Environmental Audit - Privileged Document" or Equivalent

–Violations Must Be Promptly Corrected

–Results Must Be Kept Confidential

Federal and State Environmental Audit Policies

Environmental Audit Policies

Federal

- USEPA's Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations ("EPA Audit Policy")

Nineteen States with Audit Policies/Laws

- California
- Connecticut
- Delaware
- Florida
- Indiana
- Maine
- Maryland
- Massachusetts
- Minnesota
- Nebraska
- New Jersey
- New Mexico
- New York
- North Carolina
- Oregon
- Pennsylvania
- Tennessee
- Vermont
- Washington

EPA Audit Policy

What Are the Incentives?

- If you meet all nine conditions –
  - Gravity-based penalties are eliminated.
- If you meet all conditions, except that the violation was not detected through systematic discovery –
  - Gravity-based penalties will be reduced by 75%.
- No recommendation for criminal prosecution (systematic discovery is not a condition).
- No routine requests for audit reports.