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Managing Environmental Liability

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Of the many problems facing corporations today, few are as pervasive, complex and potentially damaging as liability for damage to the environment. Finding a way through a thicket of highly technical federal and state statutory, regulatory and case law, much of it relatively new, can be a daunting task indeed, particularly if the company's in-house legal resources are limited or inexperienced. What follows is an overview of issues which arise commonly in connection with environmental liability, and some suggestions for addressing them.

Does the corporation need outside counsel?

The decision by a corporation to bring in outside environmental counsel is a difficult one. With heightened stakes in the form of civil and criminal penalties, and Environmental Protection Agency ("EPA") policies which aim to "make examples" of those who ignore their environmental responsibilities to the public, the decision whether to bring in outside legal expertise to help negotiate the "mine field" and, if so, who to bring in, is worthy of thorough focus and discussion by corporate executives.

Because the nature of the representation is sensitive and often unfamiliar, a corporation, even one who has an in-house legal staff, will be ill-equipped to decide if outside counsel is needed and who to select, if they determine that counsel is required.

How outside counsel is used.

Many of the factors that come into play in deciding whether to utilize outside environmental counsel are the same as those considered in deciding whether to engage outside counsel in any other context, including:

1. When there is litigation or a clear threat of litigation;

2. When a problem arises which can potentially lead to a high dollar exposure in damages or fines;

3. Where the site involved or the court where litigation is venued is geographically distant from the home office or from the location of in-house counsel;

4. Where the problem calls for expertise which is not available in-house, such as specialized knowledge of substantive provisions of a certain state's laws, an agency's regulations or of a particular forum;

5. Where outside legal representation is needed to help assure confidentiality of sensitive information through attorney work product, attorney-client privilege or self-evaluative studies done under attorney supervision;

6. Where problems have arisen which lead to concern about civil and criminal liability for individuals or the company;

7. To lend speed, objectivity, focus and effectiveness to the process.

Factors more specific to the environmental context include situations where:

1. experience and expertise is needed to coordinate a "multi-disciplinary environmental team";

2. experience and facilities for managing complex, voluminous information and documentation is required;

3. the company is looking to develop a comprehensive environmental policy to assure that:

    a. the company is in compliance;

    b. the company's executives and employees are educated;

    c. appropriate goals are set for risk management, insurance and contract administration; and

    d. appropriate divisions of responsibility within the company are implemented;

4. assistance is needed in making decisions whether to implement an environmental audit of the company;

5. administration of the environmental audit or assessment is needed; and

6. assistance is needed in determining whether there is a duty to report, especially when there may have been a crime committed or if there is an imminent threat to public health and safety.

Many companies have no in-house counsel and no environmental counsel. Very often a company will not see the need to expend resources to develop an environmental policy, at least not until they discover that their ground water has become contaminated, or until they are named as potentially responsible parties by the EPA in a Superfund action.

The role of outside counsel is substantially more difficult when there is no in-house counsel. In-house counsel often has a sense of how to manage risk, who the key players are within the company, what types of contamination might have taken place, how the company's records are kept and what the past sins of the company may have been.

Frequently, outside environmental counsel will be called upon to coordinate the company's own efforts. Recent cases demonstrate that, to avoid liability, it will be necessary to coordinate all levels of personnel within the company: executives, environmental directors, fiscal personnel, engineers and in-house lawyers. As well, it is often outside counsel's responsibility to retain and coordinate personnel retained from outside the

company: engineers, scientists, expert witnesses, co-counsel, accountants, fiscal consultants, statisticians, publicists and insurance consultants.

Outside environmental counsel will need to have the ability to manage litigation strategy and develop a consensus among participants in the decision-making process. Outside environmental counsel will also be called upon to research., prepare and render legal opinions to the client, control dissemination of information to the media, regulatory agencies, adversaries, the public and within the company, negotiate and write settlement agreements and consent decrees and to present claims to and negotiate claims with insurance companies.

Should an environmental self audit be conducted?

Outside counsel is often asked whether a comprehensive program should be undertaken to examine problems which might exist on the property of an industrial or commercial client.

The answer to this question largely depends on the nature of the operations of the corporation. If it is determined that the corporation's operations may have caused contamination or the properties are susceptible to having environmental contamination, there is little question that an audit should be undertaken.

If the audit program reveals contamination, it is important to determine precisely what the contamination is and when the contamination took place. In the event that there was a prior owner or adjacent land owner who may have been responsible, it is best to proceed immediately so that those who may be responsible will not be able to avoid paying because of passage of time and dissipation of assets.

When is the confidentiality of environmental findings protected?

There are three doctrines under which confidentiality of environmental reports is sought to be protected:

1. attorney-client privilege;
2. attorney work product; and
3. self-evaluative privilege.

In addition, the EPA has issued guidelines outlining when it will seek the results of environmental audits. Although confidentiality is available for some environmental reports conducted under the auspices of counsel, this protection is clearly far from absolute; and, the analysis of whether findings will be held confidential is to be decided on the facts, case by case. For example, a routine management analysis is not protected by attorney-client privilege; but, a review sought as part of the providing of legal advice may be protected.

1. Attorney-client privilege. Attorney-client privilege applies to communications from, as well as to, the attorney. The information provided to the attorney and the advice rendered may be protected. The 1981 United States Supreme Court case, Upjohn v. United States, 449 U.S. 383 (1981), sets out the elements required to provide the report confidentiality protection: (1) the communications must be in order to obtain legal advice; (2) the communications must be with an attorney; (3) both the attorney and client must act in a manner consistent with the intent to maintain confidentiality of the communications; and (4) neither the attorney nor the client may have waived the privilege.

2. Work product privilege. A prime example of what meets the test of attorney work product is the attorney's opinion as to whether the facilities of the client violate environmental laws. The confidentiality of the attorney's opinion can be asserted by either the attorney or the client-corporation.

Rule 26(b)(3) of the Federal Rules of Civil Procedure codifies the elements of attorney work product by providing qualified protection for documents, notes and other tangible things prepared for or by an attorney "in anticipation of litigation" as well as for "mental impressions, conclusions, opinions, or legal theories of an attorney."

The courts have held that the work of consultants hired by the attorney on the client's behalf is protected although it may be afforded somewhat less protection than that of the attorney.

3. Self evaluative privilege. Self-evaluative privilege is discussed in *Berdice v. Doctors Hospital, Inc.*, 50 F.R.D. 249 (D.D.C. 1970), *aff'd mem.*, 479 F. 2d 920 (D.C. Cir. 1973). Under this doctrine, which is still evolving, the courts have indicated a willingness, consistent with public policy, to protect a company's candid self-evaluation of compliance with state or federal laws.

The doctrine protects only the self-evaluative elements of reports, not the factual material itself; and, exceptional necessity can overcome the right to confidentiality of even the self-evaluative information.

There are three elements to be considered in deciding whether self-evaluative confidentiality will be afforded:

1. Whether the information to be shielded from discovery results from a critical self-analysis by the party seeking the protection;

2. Whether the public has a strong interest in preserving the free flow of the type of information sought; and

3. Whether information is of the type whose flow would be curtailed if discovery were allowed.

4. EPA policy concerning confidentiality. The EPA has issued a policy statement that encourages environmental reviews by assuring, at least to some extent, that the EPA will not demand the environmental report. The EPA Environmental Auditing Policy Statement, 51 Fed. Reg. 25,004, 25,006 (1986), does not provide a full answer, as it leaves the EPA with the power to demand the documentation. The Guidelines provide: "EPA's authority to request an audit report...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 material to a criminal investigation."

The Policy statement goes on to say that "EPA expects such requests to be limited, most likely focused on particular information needs rather then on the entire report or other data otherwise available to the Agency".

The Policy Statement sets out specific examples of instances when requests for the audit reports may be necessary, such as when "audits are conducted under consent decrees or other settlement agreements; a company has placed its management practices at issue by raising them as a defense, or state of mind are a relevant element of inquiry, such as during a criminal investigation."

Although the Policy Statement provides some comfort as to EPA's philosophy, it certainly does not provide full protection from disclosure.

Protecting confidentiality.

In order to maximize the confidentiality of environmental reports, the following practical steps should be taken:

- The attorney should gather as much information as possible. For example, the attorney should make handwritten notes and memos of conversations rather than having a consultant or an employee make the recordation;
- Establish that there is more than a mere *possibility* of litigation;
- Do not assume that a turnover of records to the government means that there has been waiver of privilege. This is not always the case;
- Marking the documents "CONFIDENTIAL" is helpful to confirm the intent to maintain confidentiality;
- Even though it is not a complete protection, the attorney should hire any environmental consultants; it does afford some help in maintaining confidentiality;
- Set out a clear scope of audit. The clear definition of what will be done if something is found is extremely important;
- Assemble an experienced and competent audit team with objectivity;
- Reduce recommendations and factual data to writing in such a manner as to separate subjective or evaluative information from factual information;
- Limit the number of copies of audit working papers and reports to an absolute minimum;
- Route all correspondence through counsel, with a request that counsel review and advise prior to distribution;
- Have audits initiated at the express request of counsel;
- Maintain a log of all copies and establish a retention and destruction policy;
- Train all auditors and others involved on how to avoid unnecessary waiver;
- Be especially careful of automated data management systems, fax machines, computer modems and other ways in which confidential documents may be maintained in a retrievable fashion without your thinking that they are. Remember that the regulators are aware of how this information is stored and will ask for it when they make a discovery demand in litigation or issue a subpoena in the course of an investigation.

The lawyer's obligation to report violation.

A question related to the confidentiality issue is what obligation does the attorney have to inform regulatory authorities if the lawyer finds out that a client's property is contaminated?

First, each of the following environmental statutes contains obligations to report spills and discharges under certain circumstances and provides a schedule of penalties for violations; The Clean Water Act, The Resource Conservation and Recovery Act ("RCRA"), The Emergency Planning and Community Right-to-Know Laws ("EPCRA"), The Superfund Laws ("CERCLA"), The Hazardous Materials Transportation Act ("HTMA") and the Toxic Substances Control Act ("TSCA"). Provisions dealing with PCB spills and leaking underground storage tanks also contain reporting requirements.

Second, the discovery of a client's criminal conduct during an internal investigation may trigger a mandatory disclosure requirement. In these instances, as the failure to report can give rise to separate and additional liability on the part of the corporation and its officers, counsel must so advise them. Where the criminal conduct is ongoing and the client has ignored counsel's recommendation to report the criminal conduct to the regulatory authorities.

Third, in less clear area, counsel is faced with a dilemma. This is especially true where the strategy is to "stonewall" and to offer no cooperation to the government while asserting the privilege against self-incrimination. There is clearly tension between Canon 7 of the Model Code of Professional Responsibility, which calls for "zealous representation of the client within bounds of law," and Disciplinary Rule 7102(a)(7) which states that "a lawyer shall not...counsel or assist his client in conduct the lawyer knows to be illegal or fraudulent."

Fourth, destruction of records is illegal; and there are specific provisions under Superfund Law prohibiting knowingly destroying, concealing, erasing, mutilating, falsifying or otherwise rendering unavailable records or otherwise rendering unavailable records required by EPA regulations to be kept for any hazardous substance storage facility. RCRA prohibits knowingly destroying, altering a manifest or other document "required to be maintained...for purposes of compliance with regulations."

Fifth, obstruction of justice statutes have been applied to those who have destroyed documents which have been or may be sought in connection with civil or criminal proceedings; see 18 U.S.C. **Section** 1503 and 18 U.S.C. **Section** 1505. Many states also have statutes which cover this area.

PART II Criminal liability.

On July 1, 1991, the U.S. Department of Justice published guidelines for its criminal prosecution of an environmental crime, entitled "Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts By the Violator."

The guidelines spell out some examples of responsible corporate environmental behavior which may lead to application of prosecutorial discretion to afford the offender leniency. The factors to be considered in the favorable exercise of prosecutorial discretion are:

1. voluntary disclosure
2. cooperation
3. preventive measures and compliance programs
4. pervasiveness of non-compliance
5. internal disciplinary actions in response to environmental violations; and
6. subsequent compliance efforts.

Criminal liability of individual directors and officers.

There is now a substantial risk of individual criminal indictment in connection with violation of environmental laws. Each of the major environmental statutes includes both civil and criminal sanctions for violations against both the corporation and the individual corporate officer or director.

Of the 641 indictments for federal environmental crimes between 1983 and 1990, 442 were of individuals and, of 501 convictions or pleas, 344 involved individual defendants.

The EPA policy called "Enforcement First" has been well publicized and, in a time of shrinking resources, the EPA has focused its efforts on getting convictions of individuals to deter future infractions.

The articulated EPA perception has been that the imposition of large fines on corporations has not helped deter environmental crime. Environmental authorities believe that, when faced with fines only, the corporations will merely pay them as a part of their operating budgets rather than spend to change their ways. On the other hand, having officers serve jail time sends quite a different message.

Cases have held that merely holding a responsible position in a corporation without personal knowledge or participation was a basis for criminal liability. *United States v. Park,* 421 U.S. 658 (1975), is significant because it imposed a duty on responsible officials not only to address violations which occurred but also to implement a policy that assured violations would not occur.

In the more recent case of *United States v. Northeastern Pharmaceutical Chemical Co., Inc., ("NEPACCO")*, 810 F. 2d 726 (8th Cir. 1986), *cert. denied,* 484 U.S. 848 (1987), a plant supervisor was held liable because he actually knew about, had actual responsibility and was directly responsible for the transportation and disposal of the NEPACCO plant's hazardous substances.

Although it was not necessary to the decision, the 8th Circuit's opinion suggested that "it is the authority to control the handling and disposal of hazardous substances that is critical under the statutory scheme."

Even those who are not officers may be held personally liable; for example, in *United States v. Carr,* 880 F.2d 1550 (2d Cir. 1989), the court concluded that constructive knowledge establishes culpability if a person of "relatively low rank" is in a position "to detect, prevent, and abate a release of hazardous substances."

Parent company liability for subsidiary violators.

In traditional cases, such as *Joslyn Corp. v. T.L. Jones & Co., Inc.*, 696 F. Supp. 222, 227 (W.D. La 1988), *aff'd*, 893 F. 2d 80 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1017 (1991), and *In Re Acushnet River & New Bedford Harbor Proceedings re Alleged PCB Pollution*, 675 F. Supp. 22, 33 (D. Mass 1987), traditional piercing the corporate veil analysis was followed, still making it difficult to hold the parent liable.

However, in some more liberal cases, under CERCLA, the court found that the parent company's control was "pervasive" and "all encompassing" and placed no special significance on the corporate structure. In cases such as *United States. V. Kayser-Roth* 910 F. 2d 24 (1st Cir. 1990) and *United States v. Nicolet, Inc.* 857 F.2d 202 (3rd Cir. 1988) the parent companies were held directly liable without resort to a piercing the corporate veil analysis.

In *Colorado v. Idardo Mining Co.*, 707 F. Supp. 1227 (D.C. 1989), *rev'd on other grounds*, 32 E.R.C. 1001 (10th Cir. 1989), the parent company was held liable as an owner/operator, and the court stated that the parent: (a) has the power to make timely discoveries; (b) has the power to direct the activities of the persons who control the mechanisms which caused the pollution; and (c) has the capacity to prevent and abate the damage.

Environmental liability of successors.

The EPA Guidance published in 1984 takes a broad view of CERCLA hazardous waste clean-up liability with regard to corporate successor and shareholder liability. See "Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites Under CERCLA," from Courtney M. Price, Assistant Administrator for Enforcement and Compliance Monitoring, June 13, 1984.

In *Smith Land & Improvements Corp. v. Celotex Corp.*, 851 F. 2d 86 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989), the Third Circuit held that it was the intent of Congress to broadly interpret successor liability: "Congressional intent supports the conclusion that, when choosing between the taxpayers or a successor corporation, the successor should bear the cost. Benefits from use of the pollutant as well as savings resulting from the failure to use nonhazardous disposal methods inured to the original corporation, its successors, and their respective stockholders and accrued only indirectly, if at all, to the general public. We believe it in line with the thrust of the legislation to permit – if not require – successor liability under traditional concepts." *Id.* at pp. 91-92.

Ten rules for managing environmental liability.

For outside counsel, it is imperative that the intricacies of the client's business be learned in order to head off environmental liability. If outside counsel is unable to learnt the client's operations, the products that the client produces and the properties that the client holds, counsel will be handicapped in providing effective

advice. The client should be aware that failure to fully apprise counsel exposes not only their company and employees to liability but the lawyers as well.

If the following principles are followed, they will provide counsel with basic information requisite to effective representation and the client with a basic program for environmental risk management:

1. For properties which the company already owns, develop a full understanding of what operations, products, or facilities the company is involved in and of the regulations and laws which apply. Know the issues; do not be overwhelmed with what is not known. It is not essential to know each and every regulation by rote. Master the specific provisions which relate most to the company and the industry. What chemicals are involved? What protective equipment or installations are required or available? What new methods of production are coming available which will eliminate or reduce environmental problems in the first place?

2. For properties which the company is considering purchasing, conduct pre-purchase inspections, and, if a decision is made to purchase, keep written reports in the file to have them available to assert a due diligence defense against a later suit for hazardous waste clean-up cost.

3. For purchases of assets of another company, or the purchase of another company, make sure that a full inventory of assets and real property is undertaken and that environmental problems are addressed before the sale goes ahead.

4. In all instances, if an environmental problem arises, do not be anxious to go ahead with the deal; it may be best to clean up before the purchase is consummated. In some cases, it may be best not to purchase at all. If the risk cannot be quantified, do not buy the property.

5. Encourage a written policy on environmental compliance. Encourage its wide dissemination within the company. Set up procedures to assure that the policy is being followed company wide as a part of overall corporate decision making.

6. Some companies include the environmental awareness and efficacy of its employees in annual salary reviews.

7. Emphasize employee education, and set out clear work place rules for all employees.

8. Conduct periodic audits of the company's operations for possible contamination. To the fullest extent possible, establish confidentiality of written reports which evaluate your performance through setting up a program to protect information as privileged.

9. However, do not count on confidentiality. If a serious problem develops, the confidentiality may be breached. Therefore, it is important that the transgressions not only be studied but that a policy for correction be implemented as soon as the problems are discovered.

10. With regard to maintaining confidentiality, follow the common sense steps set forth in the section on confidentiality in Part I of this article.

11. Develop a records retention and destruction policy; commit it to writing and follow it. In developing the policy, understand and fully comply with regulatory requirements for compliance and remember that records may be kept by individual employees or by computers rather than simply in a central file.

12. Know what the regulators have on the company. On an ongoing basis, use the Freedom of Information Act in order to gain access to the regulators' files. In this way, an awareness can be

developed of any surprises which may exist. Make sure that all of the bases are covered: EPA regional offices, all state agencies, local and regional agencies.

13. Develop a policy regarding provision for independent legal counsel to employees who may be named in environmental enforcement actions and designate a coordinator to deal with criminal investigations.

14. Develop a plan to address search and seizure, including designation of counsel to deal with prosecutors; implementation of a policy regarding the photocopying of records by regulators, prosecutors and members of the press; and setting of guidelines for investigatory interviews of employees.

15. Develop an enlightened public relations approach and explain the compliance program to employees. Develop a program of incorporating employee suggestions into company policy. Remember that the biggest source of leads to regulators is the disgruntled employee. Develop a program to deal with employee concerns in a constructive manner.

Conclusion

The best way to deal with environmental liability is through foresight and planning. The suggestions set forth above should aid corporate governors and their counsel in recognizing potential issues in this area and formulating an approach for dealing with them.