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Nastygram Federalism: A Look at Federal Self-Audit Policy

David N. Cassuto

Elisabeth Haub School of Law at Pace University

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I. Introduction

Imagine that a company conducts a voluntary environmental audit. As a result of that audit the company learns it is in violation of the law. It reports the violation to the authorities and brings its operation into compliance. Should the company face a governmental enforcement action?

This is not an easy question. Absolving the company of liability would arguably reward it, not just for its honesty, but for its violation as well. It would reap the economic benefit of its noncompliance with environmental regulations and suffer no penalty when the violation is revealed. On the other hand, punishing the company carries its own potentially serious drawbacks. Vigorously prosecuting a regulated entity for admitting and correcting its error could pose a significant deterrent to any future self-policing by the regulated community.

The federal government, in the guise of the Environmental Protection Agency (EPA or Agency), has sought the middle ground on this issue. The Agency's stated policy encourages self-audits without ceding its enforcement power. EPA enumerated its policy in two successive guidance documents released in 1995 (with the second one superceding the first). In both its Interim Policy Statement¹ (issued April 3, 1995) and Final Policy Statement² (issued December 22, 1995), the Agency offered various incentives to industries to spur them to self-audit, including reducing economic penalties and not recommending criminal prosecution.³

Nineteen states have gone further, enacting laws granting various degrees of privilege to audit results

Nastygram Federalism:

A Look at Federal Environmental Self-Audit Policy

By David N. Cassuto⁶

⁶ David N. Cassuto received his J.D. from the University of California, Boalt Hall School of Law in 1998. He currently clerks for the Hon. Rosemary Barkett on the United States Court of Appeals for the 11th Circuit. His book, *DRIPPING DRY: LITERATURE, POLITICS & WATER IN THE DESERT SOUTHWEST* is forthcoming from the University of Michigan Press. The author would like to thank Arthur Haubenstock and John Dwyer for their aid and advice with this project.

1. Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875 (1995) [hereinafter Interim Policy Statement].

2. Incentives for Self-Policing, Discovery, Disclosure, Correction and Prevention of Violations, 60 Fed. Reg. 66,706 (1995) [hereinafter Final Policy Statement].

3. EPA's position presented a significant departure from its previous stance, which was "EPA will not promise to forego inspections, reduce enforcement responses, or offer other such incentives in exchange for implementation of environmental auditing or other sound environmental management practices." United States Environmental Protection Agency, Environmental Auditing Policy Statement, 51 Fed. Reg. 25,004, 25,007 (1986).

and in some cases giving immunity to the violator.⁴ States with privilege and immunity laws claim that in order to provide industry with an adequate incentive to self-police, the government must offer sufficient guarantees that they will not prosecute violators who disclose and remediate on their own initiative. Proponents of the state initiatives label the federal policy a "seek and ye shall be fined" approach to environmental management.

In states with privilege laws, regulated entities can refuse to disclose regulatory violations discovered during voluntary self-audits as long as they correct the violations within a statutorily designated time period. States with immunity regimes disallow penalties for violations that are discovered through internal self-audits and then corrected voluntarily.

EPA strongly opposed the majority of state initiatives, arguing that many privilege and immunity statutes curtail the public's right to know, interfere with the government's enforcement capability, foster litigation, and give an unfair advantage to violators over those who

comply with environmental laws.⁵ Nevertheless, neither the Interim Policy nor the Final Policy Statement enumerates EPA's likely reaction to state-created audit protections.⁶ To date, the Agency's responses have ranged from silence to threats to revoke states' authority to implement federal environmental laws (as diagrammed in State Implementation Plans, or "SIPs").⁷ Most debates have ended in compromise.

The varying state and federal policies result from different judgments about how best to enforce environmental laws. EPA maintains that companies already have adequate incentive to self-audit, that EPA policy provides further incentive, and that fear of governmental enforcement is not the primary factor deterring companies from instituting self-audit programs.⁸ The Agency further argues that additional incentives (i.e., state privilege and/or immunity statutes) undermine the delicate competitive balance among regulated entities.⁹ It reasons that entities residing in states with privilege and/or immunity statutes

4. States with some form of self-audit laws include: Arkansas, Colorado, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Mississippi, New Hampshire, New Jersey, Oregon, South Carolina, South Dakota, Texas, Utah, Virginia and Wyoming. For a capsule discussion of each state's policy, see ELIZABETH GLASS GELTMAN, *A COMPLETE GUIDE TO ENVIRONMENTAL AUDITS* 211-58 (1997).

5. See, e.g., Memorandum from Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance, EPA and Mary Nichols, Office of Air & Radiation, to Jackson Fox, Regional Counsel, Region X (Apr. 5, 1996), Re: "Effect of Audit Immunity/Privilege Laws on States' Ability to Enforce Title V Requirements" [hereinafter "Memorandum from Steven Herman"] ("EPA has consistently opposed blanket amnesties which excuse repeated noncompliance, criminal conduct, or violations that result in serious harm or risk, as well as audit privileges that shield evidence of violations from regulators and jeopardize the public's right-to-know about noncompliance."); see also David A. Dana, *The Perverse Incentives of Environmental Audit Immunity*, 81 IOWA L. REV. 969, 975-76 (1996) (arguing that immunity statutes serve more as hazard management than hazard prevention, since offering immunity for past wrongs provides no incentive not to violate in the future).

6. The Interim Policy Statement however, does suggest, without elaboration, that the EPA will heighten its scrutiny of environmental programs in states that have

passed laws protecting audit results. Interim Policy Statement, *supra* note 1, at 16,878. The Final Policy Statement, in addition to outlining EPA's firm opposition to statutory environmental audit privileges and immunities, declares the agency's willingness to work with states to address any provisions of state laws that are inconsistent with the federal policy. See Final Policy Statement, *supra* note 2, at 66,712.

7. See Lynn L. Bergeson & Lisa M. Campbell, *The Debate Over Environmental Auditing*, THE WASHINGTON LAWYER, Sept./Oct. 1997, at 43 ("Although EPA has made threats in various states, no state, to date, has been deprived of delegated authority as a result of its environmental audit privilege provisions.").

8. See *Commercial and Administrative Law Protection of Environmental Self-Evaluation Data: Hearing Before the Comm on the Judiciary*, 104th Cong. (June 29 1995) (statement of Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance, U.S. EPA) [hereinafter "Testimony of Steven Herman"] Indeed, the agency maintains that a strong enforcement mechanism provides a necessary incentive for industries to participate in voluntary compliance programs. Brian Riedel, U.S. EPA, Vice Chair (Office of Planning and Policy Analysis), Office of Enforcement and Compliance, Address to Russian delegation, San Francisco (June 20, 1997).

9. See Testimony of Steven Herman, *supra* note 8

gain a competitive advantage over those residing elsewhere. In addition, even within states with such statutes, entities willing to bend the rules will gain over those choosing to comply strictly with the law.¹⁰

Supporters of the state laws present a different scenario. They argue that encouraging companies to self-audit leads to greater environmental compliance and minimizes business uncertainties. Additionally, proponents maintain, using the results of an audit that was voluntarily conducted and disclosed to penalize the auditor deters voluntary compliance and casts a pall over the business climate.¹¹

The resulting conflict between EPA and the states has generated a flurry of "nastygrams" sent by the Agency to various states,¹² threatening to suspend or withhold a state's ability to implement federal pollution laws.¹³ In other cases, EPA has simply asked for clarification and assurance from the states that their audit laws would not interfere with their enforcement capability.¹⁴

This Article examines the evolution of EPA's audit policy, explores the reasons for states' dissatisfaction with it, and then discusses whether the federal policy should have been issued as a rule under the Administrative Procedure Act (APA).¹⁵ Part I examines the evolution of the federal audit policy and then analyzes the strengths and weaknesses of the policy in its

current form. Part II explores various types of evidentiary privilege and looks at the arguments for and against extending the privilege to audit reports. It then offers a similar analysis of the case for limited immunity, concluding that neither an expanded privilege nor immunity is necessary to encourage compliance audits, and that both provisions can seriously undermine the public's right to know and the Agency's law enforcement abilities. Part III clarifies the distinction between policies and rules under the APA in order to determine whether EPA's audit policy is actually a rule in disguise.

The Article concludes that the federal audit policy offers sufficient enticements to industry to self-audit. The overall goal of both the state and federal policies should be heightened compliance with environmental laws. Yet, state statutes bedeck the audit process with incentives to the point where companies potentially could gain more by auditing than through complying with the law. Such laws treat audits as an end in themselves. This is a dangerous trend. Business uncertainties concerning the interpretation and impact of environmental laws should be allayed through compliance rather than through audits alone. The federal audit policy, unadorned by privilege or immunity clauses, does not hallow audits, but offers only limited incentives as part of an overall policy of encouraging lawful behavior.

10. See 1995 Minn. Law 168 §§ 8, 10.

11. See, e.g., *State Official Promotes Flexibility of Pennsylvania Self-Audit Plan*, Business Publishers, Inc., Solid Waste Report, April 4, 1996, available in LEXIS, Environ Library (discussing the head of Pennsylvania's Department of Environmental Protection's support for the state's plan to refrain from penalizing companies that discover violations during compliance audits); Letter from Richard Graves, Florida Chamber of Commerce, to the editors, ST. PETERSBURG TIMES, April 6, 1996, available in LEXIS, Nexis Library, Curnews file (arguing that Florida's self-audit legislation is "known as the 'Find It, Fix It' bill because that's precisely what it encourages the finding and fixing of small environmental problems before they become big ones"); see also Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 833-37 (1994) (discussing how liability for violations found through internal auditing will reduce auditing rather than violations).

12. States receiving nastygrams include California, Colorado and Idaho. The nastygrams seemed designed to

serve notice that the EPA would frown on privilege and immunity legislation enacted by the states. See *Enviro Auditing: EPA Opposition Squelches Some State Bills*, Greenwire, June 12, 1996, available in LEXIS, Environ Library.

13. Some supporters of the state initiatives have scoffed at EPA's threat, calling it "hollow." James O'Reilly, corporate counsel for Procter & Gamble remarked that in light of federal budget realities "EPA probably would be unable to operate a complex permitting program through its regional offices." *EPA Says State Immunity Privilege Laws May Undermine Air Act Enforcement Powers*, Daily Environment Reporter, April 15, 1996, available in LEXIS, Environ Library. For information regarding EPA's strategic use of inspection resources, see U.S. EPA, *Enforcement in the 1990s*, Project 4-59 to 4-63 (1991).

14. For a discussion of state self-audit statutes and EPA's response to the various laws, see *State Immunity Privilege Laws Examined for Conflicts Affecting Delegated Programs*, Daily Environment Report, Sep. 18, 1996, available in LEXIS, Environ Library.

15. 5 U.S.C. § 553 (1994).

Perhaps even more importantly, a rule mandating an administrative enforcement procedure would create far more problems than it would solve. Agencies have enormous discretion over when to institute enforcement actions. That discretion is both court-defined and salutary.¹⁶ Agencies are far better equipped than the courts to decide when and how to expend their enforcement resources.¹⁷ A rule setting out the requirements for enforcement actions would obligate the Agency to meet those requirements when deciding whether or not to enforce. Additionally, it would create the potential for boundless litigation because defendants could litigate every facet of the rule's enforcement prerequisites.

The federal audit policy also does not appear to be a camouflaged rule which should have undergone a rulemaking in accordance with the APA.¹⁸ Neither the APA, nor the courts, have created a definitive test for differentiating policies from rules. Therefore, it is difficult to state with certainty that the audit policy should not be subject to a rulemaking. Nevertheless, the policy survives both a Force of Law and a Substantial Impacts analysis,¹⁹ the two extant judicial tests for determining whether a policy is actually a rule in disguise. Recently, EPA has also demonstrated a growing sensitivity to the nuances differentiating policies from rules. Considered in the aggregate, these factors make a strong case that the audit policy need not undergo a rulemaking procedure, nor should it.

II. Development of EPA's Environmental Audit Policy

EPA defines an environmental audit as "a systematic, documented, periodic and objective review by regulated entities of facility operations and practices related to meeting environmental requirements."²⁰ Audits constitute one facet of a larger environmental management scheme,²¹ offering periodic, or occasional inspections designed to identify existing areas of noncompliance and facilitate their correction. Audits can also help locate areas of employee noncompliance, thereby encouraging increased attentiveness among the rank and file.

In theory, self-audits reduce business fears and enhance government monitoring capabilities by enlisting the aid of the regulated entities themselves. The Agency gains because it can husband its thinly stretched enforcement resources. Regulated entities benefit because they can catch violations before they become too serious (and sometimes before they even occur), thereby sparing themselves potentially severe penalties. The public benefits because increased compliance with environmental laws brings accompanying improvements in public health and the environment. And last, companies already in compliance gain through the establishment of a level playing field in which to do business.

Though EPA issued its first authoritative policy on environmental audits in 1986,²² industries have long recognized that voluntary compliance audits often serve their best

16. See *Heckler v. Chaney*, 470 U.S. 821, 831 (1985) ["This Court has recognized on several occasions over many years that an agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion."].

17. See *id.*

18. See 5 U.S.C. § 553 (b) (1994).

19. See *Aman & Mayton*, *infra* note 93 and accompanying text.

20. Interim Policy Statement, *supra* note 1, at 16,877.

21. Industries may institute numerous other meth-

ods for ensuring environmental compliance. The draft federal sentencing guidelines for corporate environmental crimes suggest, among other tactics, continuous on-site monitoring, by specifically trained compliance personnel and by other means," as well as regular and ongoing employee training and incentives. Advisory Group on Environmental Sanctions, U.S. Sentencing Comm'n, *Environmental Guidelines for Organizations*, § 9D1.1(a)(3)(iii) (Nov. 16, 1993 Draft), reprinted in *Organizing for Corporate Compliance: Toward Standards*, C110 ALI-ABA 283, 302-03 (Mar. 1995); see also *Dana*, *supra* note 5 at 975 & n.23.

22. Environmental Auditing Policy Statement, 51 Fed. Reg. 25,004 (1986). The Agency did, however, publish an interim policy statement in November, 1985. See 50 Fed. Reg. 46,504 (1985).

interests.²³ Audits provide industry with an early warning system through which to detect existing and potential environmental violations. Managers can identify and remediate incipient problems, minimizing environmental impacts, and reducing the probability of civil or criminal enforcement actions. They can also redesign oversight and management systems to avoid future violations. In addition, audits can play an important role in avoiding citizen suits by providing information that goes beyond mere compliance data concerning nonregulatory environmental, health and safety problems.²⁴

In EPA's 1986 audit policy, the Agency sought to encourage environmental self-audits and stated that it would not routinely request copies of the audit reports.²⁵ It also indicated that facilities with self-audit systems in place would be subject to fewer inspections.²⁶ While the 1986 policy demonstrated the Agency's preference that facilities conduct self-audits, aside from its unquantified promise of "fewer inspections," however, it offered little in the way of tangible encouragement to do so. In effect, the Agency asked regulated entities that elected to self-audit to simply trust that the audit results would not be used against them.

Though EPA stated that it would not routinely demand copies of audit reports, it reserved the right to request them whenever necessary.²⁷ Furthermore, despite its stated preference for self-audits, EPA declined to alter its enforcement response based on whether a facility self-audited.²⁸ In short, though the 1986 policy defined a clear Agency preference and hinted at Agency cooperation, it failed to make self-auditing sufficiently attractive to regulated entities.²⁹ Because it did not create explicit Agency guidelines, the policy did not provide companies with any degree of certainty while

leaving them exposed to substantial enforcement actions

A. The Interim Policy

In 1995, EPA announced a new, Interim Policy designed to provide incentives for entities to self-audit.³⁰ Companies that self-audited and met certain conditions would enjoy reduced civil penalties and a commitment from the Agency not to refer the case to the Department of Justice for criminal prosecution.³¹ Conditions for lessened Agency response included:

- 1 Voluntary self-policing—regulated entity must discover the violation through a voluntary audit or self-evaluation rather than through statutory obligation
- 2 Voluntary disclosure—entity must disclose the violation to the appropriate state and federal agencies as soon as it is discovered
- 3 Prompt correction—violation must be corrected within sixty days or, if more time is needed, as expeditiously as possible
- 4 Remediation of imminent and substantial endangerment—entity must promptly remediate any condition which may cause imminent and substantial harm to humans or the environment
- 5 Remediation of harm and prevention of repeat violations
- 6 No lack of appropriate preventive measures—violation cannot indicate that entity failed to take appropriate steps to avoid repeat or recurring violations

23. See Terrell Hunt & Timothy Wilkins, *Environmental Audits and Enforcement Policy*, 16 *HARV ENVTL. L. REV.* 365, 371 (1992).

24. See *id.*

25. See *Environmental Auditing Policy Statement*, 51 *Fed. Reg.* at 25,007.

26. See *id.*

27. See *id.*

28. See *id.*

29. See David Sorenson, Comment, *The U.S. Environmental Protection Agency's Recent Environmental Auditing Policy and Potential Conflict with State-Created Environmental Audit Privilege Laws*, 9 *THE ENVTL. L.J.* 483, 486 (1996); see also, Hunt & Wilkins, *supra* note 23, at 366; G. Van Velsor Wolf, Jr., *Self-Audit Privilege and Disclosure*, SB18 ALI-ABA 537-543 (1996).

30. See *Interim Policy Statement*, *supra* note 1, at 16,875.

31. See *id.* at 16,877-78.

7 Cooperation—entity must cooperate as required by EPA and provide such information as is necessary to determine applicability of the policy.³²

The reduced civil penalties included EPA's commitment to seek recovery of only the economic benefit gained through noncompliance³³ rather than "gravity-based" penalties³⁴ from entities which met all the requirements set forth in the policy.³⁵ The Agency further agreed to lessen gravity-based penalties by 75 percent in cases where most but not all of the conditions are met.³⁶

The Interim Policy expressed EPA's strong opposition to state statutes granting various forms of immunity to entities performing self-audits and/or privileging the results of those audits.³⁷ In the Agency's view, such privileges and immunities, "could be used to shield criminal misconduct, drive up litigation costs and create an atmosphere of distrust between regulators, industry, and local communities."³⁸ In addition, EPA maintained that, since the principal rationale for self-audit statutes lay in limiting the exposure of entities that conduct self-audits and act on their findings, and since the Interim Policy addressed these concerns, state self-audit statutes that exceeded EPA's policy

served only to hinder enforcement efforts.³⁹ Consequently, the Agency stated its intention to "scrutinize enforcement more closely" in states with self-audit statutes and to increase federal enforcement where the Agency believed the statutes interfered with a state's ability to meet federal requirements for enforcement and protecting the citizenry.⁴⁰

B. The Final Policy

EPA invited response to the Interim Policy from the public, industry, public interest groups and state officials.⁴¹ In December, 1995, the Agency released its final policy statement.⁴² Among industry's chief concerns with the Interim Policy had been the parameters of "voluntary" reports and "voluntary" audits.⁴³ It was not clear, for example, whether violations discovered as part of an entity's due diligence qualified for penalty mitigation. The Final Policy Statement attempted to address industry complaints by clarifying the definition of voluntary disclosure and stating that certain monitoring efforts, which were arguably not "voluntary," including an entity's due diligence, would not per se disqualify an entity from penalty mitigation.⁴⁴ The Final Policy Statement also clarified the requirements for waiver or diminution of gravity-based penal-

32. *Id.* at 16,877

33. See Interim Policy Statement, *supra* note 1, at 16,877. The agency's purpose in recovering economic benefits was to "preserve a level playing field in which violators do not gain a competitive advantage through non-compliance." *Id.*

34. Gravity-based penalties are those that exceed the amount necessary to recover any economic benefit the violator might have reaped as a result of the violation. See Sorenson, *supra* note 29 at n.25.

35. The potential savings to the regulated entity arising from its escaping gravity-based penalties can be substantial. For example, GTE Corporation recently disclosed and resolved 600 violations at 314 facilities in 21 states. The settlement between GTE and EPA requires the company to pay a \$52,264 penalty intended to offset the economic gain acquired through noncompliance. Because GTE disclosed and remediated according to the audit policy, however, EPA waived another \$2.8 million in gravity-based penalties. See "GTE Corrects 600 Violations Through EPA's Self-Disclosure Policy," AUDIT POLICY UPDATE, UNITED STATES ENVIRONMENTAL PROTECTION AGENCY, VOLUME 3 No. 1, Mar. 1998 (on file with author).

36. See Interim Policy Statement, *supra* note 1, at 16,877

37. See *id.* at 16,878.

38. *Id.*

39. See *id.* The Interim Policy Statement argued that granting additional privileges and immunity to self-auditors would undermine efforts to open up environmental decisionmaking to public scrutiny, shield bad actors and conceal crucial information and increase litigation as opposing sides battled over what was and was not privileged or immune.

40. See *id.*; see also, Enforcement: Lower Penalties Seen by Enforcement Chief Under Upcoming EPA Policy on Company Audits, 25 ENV'T REP (BNA) 2379 (Mar 31, 1995).

41. See Interim Policy Statement, *supra* note 1, at 16,875.

42. See Final Policy Statement, *supra* note 2, at 66,706.

43. See Wolf, *supra* note 29 at 543.

44. See Final Policy Statement, *supra* note 2, at 66,708.

ties, refining the language of the Interim Policy and in the process expanding the list of prerequisites from seven to nine:

1. Violation must have been discovered pursuant to an environmental audit or other systematic procedure.
2. Regulated entity must have discovered the violation voluntarily—not through a legally mandated monitoring program.
3. The entity must disclose violations within ten days of its discovery.
4. Disclosure must precede any Agency action or citizen suit.
5. Entity must correct the violation within sixty days or notify the Agency in writing as to why it will take longer.
6. Entity must agree in writing to institute measures to prevent recurrence.
7. Same or similar violation cannot have occurred at the facility within the last three years, nor can it be part of a pattern of violations by parent organization over previous five years.
8. Violation must not have resulted in serious harm or imminent and substantial endangerment to human health or the environment, nor can it have violated the terms of any judicial order or consent agreement.
9. Entity must cooperate with EPA by providing information and access to employees.⁴⁵

If an entity does not discover the violation through an audit or similar procedure, but satisfies the remaining criteria, EPA will reduce gravity-based penalties by 75 percent.⁴⁶

45. *Id.* at 66,712.

46. *See id.* at 66,711. The language concerning reducing gravity-based penalties represented a substantial improvement in clarity from the Interim Policy Statement. Whereas the Final Policy stated that the penalties would be reduced 75 percent if the entity satisfied conditions 2-9, the Interim Policy had said that penalties may be reduced "up to" 75 percent where "most" conditions were met. *Id.* at 66,707.

47. *See id.*

The Final Policy Statement also declares that EPA will not recommend cases for criminal prosecution if violators meet the nine requirements listed above, and their management does not show a conscious involvement with, or willful blindness to, the violations.⁴⁷ And, as with the Interim Policy, the Agency declared that it would not routinely request or use audit reports to initiate investigations, though it reserved the right to request the reports if it gains independent knowledge of a violation.⁴⁸ If, for example, EPA learned through a tip from a company employee or through some other form of monitoring that a company that had recently completed an audit was out of compliance, the Agency could request the audit results as part of its enforcement effort.

Though the Final Policy Statement eliminates much of the uncertainty and confusion arising from the Interim Policy, critics complain that several crucial issues remain unresolved and that the Final Policy Statement fails to provide any significant relief to regulated industries.⁴⁹ First, the line between gravity-based penalties (the punitive portion of the fine) and recovery of any economic benefit reaped from the violation (the "level playing field" component) is far from clear. Second, though EPA declares that it may decline to seek any recovery where the economic gain is "insignificant," it does not specify what "insignificant amount" means.⁵⁰

Third, perhaps the most significant flaw in the Final Policy Statement, according to one commentator, lies in its failure to elaborate how entities that self-audit would be protected from third-party suits. If an entity self-audits and discloses the information, it could then face exposure to toxic tort suits or, in a more likely

48. *See id.*

49. *See, e.g.* Wolf, *supra* note 29, at 545; Clinton J. Elliott, *Kentucky's Environmental Self-Audit Privilege: State Protection or Increased Federal Scrutiny?* 23 N. Ky. L. Rev. 1, 12 (1995); Ronald E. Cardwell, *Self-Audit Act: An Incentive for Voluntary Compliance?* 8-Oct S.C. Law 38, 41-42 (1996).

50. *See* Wolf, *supra* note 29, at 545. An agency source who wishes to remain anonymous notes, however, that "six figures is a good rule of thumb."

scenario, to potentially devastating citizen enforcement suits filed by public interest groups.⁵¹ Suits in tort require a showing of harm and accompanying proof of causation. But probative showings of harm and causation are often difficult, especially because not all violations result in harm and even when they do, it is often difficult to link conclusively the violation to the harm. Citizen enforcement suits, by contrast, require no such showing of harm; the only harm they need to prove is the existence of the violation itself.⁵² Consequently, the specter of such suits, which often call for civil penalties and attorney's fees, as well as requiring a costly defense, can be sobering to a company considering a voluntary compliance audit.

First, the Final Policy Statement declines to specify EPA's methodology for determining economic benefit for a given violation. Generally, however, the Agency utilizes the BEN model for determining economic benefit.⁵³ While EPA does not specify whether it intends to apply BEN to all laws and violations,⁵⁴ this seems a minor problem and one that is easily remedied either through querying the Audit Policy Quick Response Team (QRT)⁵⁵ or during the Agency's follow-up studies.⁵⁶

The second criticism is of the Agency's failure to specify the precise amount of economic benefit that would spur the Agency to attempt recovery and is even less valid. Entities audit to

correct existing and potential violations, head off enforcement measures, and minimize the risk of accident, injury, costly litigation and bad public relations. If an entity decides not to self-audit out of concern that EPA will seek to recover economic benefits, two likely conclusions can be extrapolated: (1) the entity has committed a violation that has brought it a sizable illicit return (otherwise the specter of losing those benefits would not offer cause for concern); and (2) since minor compliance violations are rarely the source of large ill-gotten gains, the violation or violations were likely of a serious nature.

Given the probable seriousness of the transgressions, the gravity-based penalties arising from an Agency enforcement action could greatly outweigh any economic benefit gained through the violation. This is particularly true because the risk that the Agency will take an enforcement action for minor violations is minimal, whereas it is much more likely to invest the time and resources to penalize significant violations. Therefore, even without the added shield of privilege or immunity statutes, companies with major violations (or the potential thereof) have the most to gain from the audit policy and its concomitant protections.⁵⁷

Delineating precisely what constitutes a "significant" economic gain would remove the Agency's discretion to differentiate between larger and smaller entities that have committed vio-

51. See *id.* at 546; Elliott, *supra* note 49 at 14-15 (audit documents subject to public review "may provide a wealth of information for environmental organizations and public interest groups acting as private attorneys general").

52. The violation must be present or demonstrably imminent, however, past violations do not suffice for standing in citizen suits. See *Steel Company v. Citizens for a Better Environment*, 523 U.S. 83 (1998), 1998 WL 8804 (U.S. III) at *13-14 (1998).

53. BEN is a computer modeling method that estimates the economic benefit gained by a company through its failure to comply with environmental regulations. Among the criteria used in making the determination are the cost of obtaining the necessary permits; time spent out of compliance; the required capital investment; and the interest on capital gained during noncompliance. For further information on the BEN model, see EPA Office of Compliance Assurance (OECA) website at (visited May 14, 1999) <http://es.epa.gov/oeca/models/ben.html>.

54. See Wolf, *supra* note 29 at 545 (arguing that with

some statutes, such as FIFRA, it is unclear whether BEN applies).

55. The QRT is comprised of members of each major media enforcement program, as well as the Department of Justice and representatives of each EPA region. It is chaired by the Office of Regulatory Enforcement within the EPA Office of Regulatory Enforcement (OECA). The QRT's stated mission is to "expeditiously, fairly, and consistently resolve nationally significant issues involving application of the audit policy in specific cases." Audit Policy Update (EPA Office of Enforcement and Compliance Assurance), Jan. 1997 at 3.

56. EPA has committed itself to conducting a follow-up study within three years of the issuance of the Final Policy Statement to determine the policy's effectiveness. See Final Policy Statement, *supra* note 2, at 66,706.

57. This is provided, of course, that the agency correctly assesses the economic benefit gained through the violation. If the EPA incorrectly assesses the benefit, the cost to the violator could be much higher or lower

lations, as well as among the violations themselves. A \$10,000 violation might mean nothing to a large oil company, but it would likely matter a great deal to a small dry cleaner. The Agency currently has discretion to consider the ratio of the cost of compliance to the environmental benefit/risk. Insisting that the Agency decree exactly what constitutes a significant amount would eliminate its flexibility in individual cases, while offering a benefit of questionable worth.

Furthermore, if EPA revealed the dollar amount at which they would initiate enforcement, that would create a pernicious reverse incentive. Entities could break the law with relative impunity as long as their transgressions did not bring them the specified amount of economic gain. That freedom to infract points to poor strategy by the enforcing Agency. Just as the police do not publish the number of miles over the posted speed limit at which they start ticketing, so too would a parallel tactic prove counterproductive for EPA. It bears noting that though the police do not state their policy for speeders, people know that they will almost never get ticketed for small amounts over the speed limit. Similarly, in the environmental arena, small violations are de facto tolerated, but the uncertainty over when enforcement begins helps to maintain acceptable compliance levels.

Another problem with specifying the precise amount of the economic gain that the Agency would deem significant lies in the fact that doing so would come perilously close to a rule rather than a policy.⁵⁸ Setting a specific level of gain and specifying a precise Agency response does far more than merely suggest the policy that the

Agency might apply in an adjudication. It creates a rule of conduct and sets a mandatory Agency response. Consequently, defining the precise nature of a violation and mandating a particular Agency response would probably require a rule-making, rather than just the issuance of a guidance document.⁵⁹ Since it makes little sense from an enforcement standpoint to attach a specific dollar figure to "significant amount," it seems wholly ill-advised to force the Agency to instigate a rulemaking on this issue.

The third complaint, that without privileging audit results, entities performing self-audits open themselves up to potentially damaging tort and citizen enforcement suits, demands a more rigorous inquiry. The predicate of this criticism seems skewed. The violation, not the self-audit, creates grounds for civil suit. A self-audit merely brings the violation to light in a manner designed to mitigate Agency enforcement.

We must assume that the entity believes that the violation will eventually come to light even without an audit. If not, the entire argument over whether to protect self-audits becomes moot because there is no incentive to perform one.⁶⁰ If the regulated entity can violate environmental laws with impunity, then it need not fear Agency enforcement or citizen enforcement suits and self-audits become pointless. Rather than audit and potentially lose the economic benefits arising from its violations, the entity would more likely continue to violate and thereby also continue reaping the windfall profits stemming from its misconduct.⁶¹ One can also imagine a cycle of steadily worsening behavior whereby an entity violates to enormous financial gain, commis-

58. See, e.g., *Community Nutrition Inst. v. Young*, 818 F.2d 943 (D.C. Cir. 1987) (disallowing FDA policy defining maximum aflatoxin levels in food because the policy was couched in mandatory terms and therefore had the effect of a rule).

59. See *id.* at 945-48; *U.S. Telephone Ass'n v. Fed. Communications Comm'n*, 28 F.3d 1232, 1234 (D.C. Cir. 1994) (finding that FCC penalty schedule setting base forfeiture amounts for violations "does not fit the paradigm of a policy statement").

60. See Dana, *supra* note 5, at 978 ("Corporations cannot be assumed to choose the mix of management options that maximize environmental compliance and well-being unless it is in their financial interest to do so."); see also Lawrence E. Mitchell, *Cooperation and Constraint*

in the Modern Corporation: An Inquiry into the Causes of Corporate Immorality, 73 TEXAS L. REV. 477, 479-92 (1995).

61. But see *Violations Disclosed Under Immunity Law Would Have Eluded Texas, Observers Agree*, Daily Environment Report, April 24, 1996 (discussing how companies conducting audits under shield of the state's new self-audit law are turning up violations that would have gone undetected by state regulators). It bears noting, however, that state agencies do not have the resources or personnel of the federal EPA. Violations that may have escaped state inspectors may eventually have been caught at the federal level. Or, the violations might eventually have led to an illegal and/or harmful release that would have incurred not just the wrath of the Agency, but a rash of citizen suits as well.

sions an audit to gain immunity for its past actions, and then begins the cycle again, this time violating different laws.

Regulated entities uncertain about whether they are complying with environmental laws must choose between two difficult alternatives: (1) gamble that EPA will not discover the violation independently and impose the full brunt of the available economic and possibly criminal penalties; or (2) conduct a self-audit, disclose any violations, and reach a settlement with the Agency. This course of action would reduce economic penalties⁶² and likely remove the threat of criminal prosecution as well.⁶³

Once the violation stands revealed, the violator may find itself the target of private civil suits. Yet, to structure the audit policy so as to shield violators from civil suits by granting immunity to and/or privileging the results of audits,⁶⁴ seems counter to EPA's mandate to protect the public and the environment.⁶⁵ For an entity to complain that the federal enforcement policy fails to shield it from the complaints of injured parties (in tort suits) seems akin to a criminal grousing because his plea bargain does not protect him from civil suits.

The fear that reporting audit results will expose entities to civil suit also seems overstated. Since tort suits require significant harm, anyone who had experienced such harm would undoubtedly seek to learn its cause and would have a great deal of information at her disposal.⁶⁶ Furthermore, prompt reporting and correction of a violation would go far towards mitigating civil liability by eliminating the

point source of any contamination before it causes harm or, at a minimum, before it causes further harm.

Also, a recent Supreme Court decision has effectively eliminated standing for citizen enforcement suits in cases where the government has taken an enforcement action.⁶⁷ The Court held that neither vindication of the rule of law without cognizable injury, nor past illegal conduct, nor the unsubstantiated threat of future injury, satisfy the redressability requirement for Article III standing.⁶⁸

Citizen enforcement suits routinely seek to penalize wrongdoers by seeking statutory damages. A successful citizen suit therefore swells the coffers of the federal treasury more than it benefits the citizen litigant(s). The Court's clarification of the redressability standard eliminates standing in these instances.⁶⁹

Further, the illegal conduct presumably ceases once an Agency enforcement action occurs. If so, there is no present or looming future injury and therefore no standing.⁷⁰ Requiring that an entity disgorge the economic benefit gained through noncompliance (as mandated by the audit policy) constitutes an Agency enforcement action. Consequently, if an entity self-audits, discloses the results, remedies the discovered violations, and then pays the penalty mandated by the Agency, it gains a shield from citizen suits. The Court's clarification of the redressability standard eliminates standing in these instances.⁷¹

An interesting situation may arise when the economic benefit from a violation is insuf-

62. See Sorenson, *supra* note 29 at 489.

63. See Audit Policy Update (EPA Office of Enforcement and Compliance Assurance), January 1997, at 3 (noting that the decision not to charge at least three companies with environmental crimes arising from their voluntary disclosure of violations, "stemmed from the considerations expressly set forth in the Audit Policy.").

64. See Final Policy Statement, *supra* note 2, at 66,710 (outlining EPA's opposition to state laws that privilege the results of environmental audits).

65. See, e.g., *id.* (purpose of the policy is to "enhance protection of human health and the environment by encouraging regulated entities to voluntarily discover, disclose, correct and prevent violations of federal environmental requirements").

66. See, e.g., the Toxic Release Inventory, available online at, (last modified Mar. 31, 1998) <www.epa.gov/enviro/html/tris/tris_query_java.html>, as well as the information that would normally become available through civil discovery.

67. See, *Steel Co. v. Citizens for a Better Environment*, 523 U.S. 83 (1998), 1998 WL 8804 (U.S. III) at *13-14 (1998) ("It is an immense and unacceptable stretch to call the presumption [of future injury] into service as a substitute for the allegation of present or threatened injury upon which initial standing must be based.")

68. See *id.*

69. See *id.*

70. See *id.*

71. See *id.*

ficiently large to merit an enforcement action. Following an audit, a company might wish to enter into a settlement agreement with EPA, despite the Agency's apparent lack of interest, in order to defuse the risk of a citizen suit. The Agency enforcement action would actually work to the polluter's benefit by quashing the deterrent power of a potential citizen enforcement suit.

Even assuming that the government should lessen the potential liability of entities that disclose and correct violations through self-audits, the incentives offered in the Final Policy Statement do just that. In addition to the protection from citizen enforcement suits gained via Agency enforcement actions, the Agency's mitigated response to violations discovered through voluntary audits⁷² encourages industries to periodically scrutinize their behavior. That scrutiny enables prompt discovery and remediation of current violations as well as the avoidance of potential future problems. Entities can self-correct before their actions injure the public, thereby heading off possible tort suits as well as creating a climate of good will among the citizenry.⁷³

Lastly, concern about confidentiality does not appear to play much of a role in industry decisions concerning self-audits.⁷⁴ The absence of protection from third party suits has not deterred industry from self-auditing. A 1995 Price Waterhouse survey found that, among the few large or mid-sized companies that have elected not to self-audit, concern about confidentiality was not a significant factor in their decision.⁷⁵ Their reasons were primarily economic.

72. Final Policy Statement, *supra* note 2, at 66,706 (summarizing incentives to self-audit).

73. Compare Gail S. Port, *Does EPA Policy Really Provide Protection?* NEW YORK LAW JOURNAL, June 12, 1995 (public interest groups that are unsatisfied with agency response or the efforts to remedy the violation may still elect to sue, even after a company has voluntarily disclosed and attempted to correct a violation). Suits can only be filed, however, if the company's efforts to correct the problem have failed.

74. See Testimony of Steven Herman, *supra* note 8, ("[S]urveys on audit practices and our discussions with

III. Privileges and Immunities

As mentioned above, despite EPA's efforts to fashion the Final Policy Statement to meet state concerns, many states remain unsatisfied with the federal audit policy. Eighteen states have passed laws granting various levels of evidentiary privilege to audit reports as well as in some cases, allowing immunity for the violator. State audit statutes fall generally into two categories: (1) statutes offering a qualified privilege and no immunity (most state statutes fall into this category), and (2) statutes offering both a qualified privilege and immunity.⁷⁶ This section looks at the legal and policy reasoning behind an evidentiary privilege and immunity.

A. Privilege

Legislatures, both at the state and federal level, can create new privileges through statute. For the most part, however, Congress and the state legislatures have been chary of shielding information from the judicial and administrative process that the courts have not already shielded through common law evidentiary privilege. According to Wigmore, four conditions must be met in order to justify a judicial privilege:

- 1 The communications must originate in a *confidence* that they they will not be disclosed
2. This element of *confidentiality* must be *essential* to the full and satisfactory maintenance of the relation between the parties.
3. The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.

stakeholders convinced us that any 'chilling effect' that our enforcement policies had on self-auditing has been more than offset by existing incentives to have a comprehensive auditing program")

75 See *Voluntary Environmental Audit Survey of U.S. Business*, Price Waterhouse LLP (March 1995) at 47 [hereinafter "Price Waterhouse Survey"]; see also Final Policy Statement, *supra* note 2, at 66,710 (citing survey as evidence in opposition to state laws granting privilege or immunity)

76 See Sorenson, *supra* note 29, at 491

4. The *injury* that would inure to the relation by the disclosure of the communication must be *greater than the benefit* thereby gained for the correct disposal of the litigation.⁷⁷

In deciding whether to extend a privilege, courts must balance the competing policy considerations of complete disclosure of relevant facts and the public interest in maintaining the confidentiality of certain communications. In general, courts have shown a marked reluctance to create new privileges.⁷⁸ There currently exist three evidentiary precedents for privileging the results of audits: attorney-client privilege, self-critical analysis, and the work product doctrine. As several commentators have shown, none of these extant doctrines comfortably encompass a proposed audit privilege.⁷⁹

B. Immunity

Several state self-audit laws provide both civil and criminal immunity to companies that disclose violations in accordance with state guidelines.⁸⁰ Without immunity, even if the evaluative information of an audit were privileged, government investigators could use discovery to gain access to the factual information contained in the audit. Consider the Arkansas privilege statute, if a state pollution control Agency has independent information giving it probable cause to believe an environmental offense has been committed, it can obtain a copy of an audit report. (1) under a search warrant, (2) under a subpoena; or (3) through dis-

covery.⁸¹ If the Agency uncovers evidence of a violation it can seek penalties.

By contrast, immunity statutes provide auditing entities with complete protection from penalty. For example, Wyoming's statute states, "If an owner or operator of a facility regulated under this act voluntarily reports to the department a violation disclosed by the audit the department shall not seek civil penalties or injunctive relief for the violation reported."⁸² The law goes on to list four caveats, excluding from immunity violations where:

- i) the facility is under investigation for any violation of this act at the time the violation is reported;
- (ii) the owner or operator does not take action to eliminate the violation within the time frame specified in an order affirmed by the council or otherwise made final pursuant to W.S. 35-11-701(c)(ii);
- (iii) the violation is the result of gross negligence or recklessness; or
- (iv) the department has assumed primacy over a federally delegated environmental law and a waiver of penalty authority would result in a state program less stringent than the federal program or the waiver would violate any federal rule or regulation required to maintain state primacy.⁸³

Other state laws vary in language and scope,⁸⁴ but all offer some form of immunity from civil

77. Wigmore, Evidence, § 2285 (McNaughten rev. 1961) (emphasis in original).

78. See *University of Pennsylvania v. EEOC*, 493 U.S. 182, 189 (1990) (acknowledging that, while the Federal Rules of Evidence "provide the courts with flexibility to develop rules of privilege on a case-by-case basis, we are disinclined to exercise this authority expansively").

79. See *Hunt & Wilkins*, *supra* note 23, at 377-402; *Sorenson*, *supra* note 29, at 490-500.

80. Those states are: Idaho, 1995 Idaho Sess. Laws 359; Kansas, 1995 Kan. Sess. Laws 204; Minnesota, 1995 Minn. Laws 168; Texas, 1995 Tex. Gen. Laws 219; Virginia, Va. Code Ann. § 10.1-1198 (1995); and Wyoming, Wyo. Stat. §§ 35-11-1105, 1106 (Mitchie 1998). It bears noting, however, that Idaho's law sunsets in 1998 and the governor has recently agreed not to seek its renewal. Telephone

Interview with Brian Riedel, U.S. EPA, Vice Chair (Office of Planning and Policy Analysis), Office of Enforcement and Compliance & Editor, EPA Audit Policy Update (April 5 1997) [hereinafter Riedel Interview]. In addition, EPA is currently negotiating with Texas to remove the criminal immunity provision from its audit law *Id.*

81. See ARK. CODE ANN. § 8-1-309(a) (Mitchie 1997) (proceeding to obtain environmental audit report)

82. WYO. STAT. ANN. § 35-11-1106 (a) (Mitchie 1997).

83. *Id.*

84. Minnesota's law, for example, institutes a pilot program for voluntary compliance. Participation is limited to regulated entities that have not been the subject of an enforcement action resulting in a penalty for at least one year previous to their enrollment. See 1995 Minn. Law 168 §§ 8, 10.

and/or criminal prosecution to companies that disclose violations in compliance with the statutory guidelines.

Granting statutory immunity to entities that voluntarily disclose violations raises many similar policy issues to audit privilege. Immunity allows polluters to benefit from their misdeeds without fear of prosecution,⁸⁵ while creating the potential for uneven enforcement.⁸⁶ In a state with a privilege and immunity regime an entity could disclose and remedy only one of the several violations it discovered during an audit. It would gain immunity from any penalty for that violation while keeping the rest of the audit information privileged. In this way the entity would look like a good corporate citizen while continuing to reap the benefits of its remaining violations. By contrast, an entity in a state without a privilege and/or immunity statute would have to disclose the full results of any audits and face any penalties arising from all the violations discovered during the audit process.

Further, by making it more attractive to *correct* noncompliance, audit immunity diminishes corporate incentive to *prevent* noncompliance in the first place.⁸⁷ Since corporations earn a return on all current assets, they would clearly prefer to defer low-return expenditures like pollution technology for as long as possible. Without immunity, a company considering delaying its investment in pollution control technology must weigh: (1) the risk of substantial economic and gravity-based penalties if it gets caught, and (2) the costs of disgorging its economic gains and installing new technology at potentially higher prices (if it audits and discloses the violation with the intent of remedying the problem).

85. See Testimony of Steven Herman, *supra* note 8. Testifying against a proposed immunity provision at the federal level, Herman noted that "the penalty immunity provision in the bill gives violators an economic advantage over their law-abiding competitors. [T]o maintain a level playing field, the federal and state governments must be able to recoup the economic benefit of violations—even inadvertent ones that are discovered voluntarily." *Id.*

86. See Interim Policy Statement, *supra* note 1, at 16,878.

Companies residing in states with immunity statutes no longer need worry about relinquishing the economic benefits gained through noncompliance. They must only assess the odds of getting caught before conducting an audit against the substantial windfall they stand to reap through noncompliance coupled with the immunity they stand to gain through their eventual audit. Assuming the existence of an immunity statute and given the dwindling government resources devoted to environmental enforcement, engaging in a cycle of violation and compliance audits rather than investing in prevention appears to make good economic sense.⁸⁸ Given this counterproductive effect on pollution control, the advisability of immunity statutes bears serious reevaluation.⁸⁹

IV. Is EPA Policy on Self-Audits A Rule in Disguise?

One of the major complaints leveled by industry at EPA's audit policy was that it is actually a disguised rule that should have undergone an APA rulemaking procedure.⁹⁰ According to critics, the audit policy delineates the Agency's enforcement response to environmental violations with such certainty that it should be subject to a rulemaking as required by the APA.⁹¹

This section examines the differences between policies and rules under the APA, and as interpreted by the courts. It then analyzes the audit policy to determine whether it should have been issued as a rule. The analysis concludes by finding the audit policy a valid statement of policy, not in need of an APA rulemaking.

87. See Dana, *supra* note 5, at 979-91.

88. See *id.* for a full discussion of the economics of prevention, inaction, or auditing under an immunity framework.

89. See *id.*

90. See Riedel Interview, *supra* note 79 (discussing the feedback collected by the agency during the comment period between publication of the Interim and Final Policy Statements), see also Final Policy Statement, *supra* note 2, at 66,710.

91. See 5 U.S.C. § 553 (b) (1994).

A. Rules vs. Policy Under the Administrative Procedure Act

Rules are Agency-made laws.⁹² Agencies cannot pass rules unless authorized by statute. But, so long as a rule does not exceed the Agency's statutory authority (including the APA), it is enforceable as law. Further, unlike the legislative branch of the government, agencies are not constrained by the separation of powers doctrine. Within the limits of their mandate, the APA, and due process, agencies make, enforce, and adjudicate laws.⁹³ Because agencies wield such power, the APA requires that Agency-made rules undergo a review process, including publishing the proposed rule in the Federal Register,⁹⁴ inviting public comment,⁹⁵ composing a mandatory Agency response to those comments,⁹⁶ and allowing the opportunity for judicial review.⁹⁷ Policies, on the other hand, do not formally bind agencies or regulated entities and therefore require no formal review process. Consequently, in matters where the Agency wishes to allow both itself and its constituents latitude, policies can prove more efficient and expedient than rules.

Policies suggest the position the Agency will likely take in an adjudication. Rather than promulgating specific rules of conduct, policies explain the likely reaction of the Agency to certain behavior. They are meant to guide both the Agency and its constituents in determining how the Agency will likely respond to certain behavior. Rules serve a similar function; they do not lock the Agency into an enforcement strategy since any such actions are taken at the discretion of the Agency. However, a rule would establish a binding set of criteria that must be met before initiating enforcement. The decision

whether to enforce, if the criteria are met, belongs to the Agency.⁹⁸ But the criteria, once promulgated in a rule, eliminate much of the flexibility that would be available under a policy.

Because they do not legally bind the Agency or its regulated entities, policies are not subject to judicial review. The flexibility offered by a policy may sometimes outweigh the increased force of law that inheres in a rule. The rulemaking process may seem overly burdensome, and the constraints of a formal rule may inhibit the Agency's responsiveness. In addition, the Agency may not feel entirely secure with its policy, and may wish to avoid the scrutiny that accompanies a formal rulemaking.⁹⁹

Since agencies control activities and disperse items of great value (e.g., licenses, food stamps, health care), a statement of the Agency's position on a given issue can have a profound impact upon regulated entities. Those who cannot afford to displease the entity that controls their livelihood will likely change their behavior to meet Agency guidelines. Consequently, in practice, the line between a rule, which mandates certain behavior, and a policy, which "suggests" behavior while relying on the threat of Agency action for emphasis, can become quite blurred.¹⁰⁰

Indeed, a key reason that agencies often prefer policies is that the confusion over how to distinguish a policy from a rule has led to considerable judicial deference for Agency actions. Policies currently receive the deferential "arbitrary and capricious" standard of review that courts once reserved for legislative rules.¹⁰¹ This allows agencies to make binding pronouncements without subjecting those pro-

92. See *Immigration and Naturalization Serv. v. Chadha*, 462 U.S. 919 (1983) (acknowledging that agency-made rules are laws enforceable in the same manner as those made by Congress).

93. See Alfred C. Aman, Jr. & William T. Mayton, *Administrative Law*, § 4.1 (1993).

94. See 5 U.S.C. § 553(b) (1994).

95. See 5 U.S.C. § 553(c) (1994).

96. See *id.*

97. See 5 U.S.C. § 553 (1994); see also *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 541-50

(1978) (establishing procedural requirements for rulemaking; agencies may, at their discretion, impose additional requirements, but the courts may not do so).

98. See *Heckler v. Chaney*, 470 U.S. 821, 831 (1985).

99. See Aman & Mayton, *supra* note 93, at § 4.0.

100. See *id.* at § 4.2.2; see also Robert A. Anthony, "Interpretive" Rules, "Legislative" Rules and "Spurious" Rules. *Lifting the Smog*, 8 ADMIN. L.J. AM. U. 1, 9, especially n. 29 (1994) (analyzing and classifying the binding effects of various agency documents).

101. See APA, 5 U.S.C. § 706(2) (1994) ("The reviewing court shall hold unlawful and set aside agency

nouncements to the scrutiny of a rulemaking.¹⁰² Free from the pressure that the public and industry can bring to bear, an Agency can effectively operate by fiat rather than with the oversight mandated by the APA.¹⁰³

In a number of cases, the courts have found that policy statements by agencies amounted to rules in disguise.¹⁰⁴ At other times they have upheld the Agency's policy guidelines as appropriate. In *Iowa Power & Light Co. v. Burlington Northern, Inc.*,¹⁰⁵ for example, the Eighth Circuit held that the Interstate Commerce Commission's (ICC) practice of determining the reasonableness of the contracts between railroads and shippers on a case-by-case basis amounted to a policy rather than a rule. The railroads had claimed that the policy bound the Agency to a specific code of behavior and should therefore have been set down for a rulemaking. The court disagreed, finding that the policy did not establish a binding legal norm for all contractual arrangements. Instead, it left the Agency free to "exercise considerable discretion" when evalu-

ating individual cases.¹⁰⁶ Rather than setting down the substance of Agency determinations, the policy instead referred to the form by which those determinations would be made. The court found that form without substance did not amount to a rule, and therefore did not warrant the railroad's participation in its formulation.¹⁰⁷

The D.C. Circuit used similar reasoning in *National Latino Media Coalition v. Federal Communications Commission*.¹⁰⁸ The FCC released a written announcement stating that it intended to conduct a lottery to determine which of the many equally qualified applicants would receive an FCC license.¹⁰⁹ The court concluded that the announcement was a policy rather than a rule, stating: "These statements merely present an interpretation of the Agency's governing statute. They do not bind the Commission ever to conduct a tie-breaker lottery."¹¹⁰

action, findings and conclusions found to be arbitrary, capricious, an abuse of discretion"). *Id.* Courts have also applied this standard to policy statements; *see, e.g.*, *Bechtel v. FCC*, 10 F.3d 875, 877 (D.C. Cir. 1993); *Capital Network Sys. v. FCC*, 3 F.3d 1526, 1530 (D.C. Cir. 1993); *American Trucking Ass'n v. United States*, 755 F.2d 1292, 1299 (7th Cir. 1985).

102. *See* Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 ADMIN. L. REV. 59 (1995) (arguing that courts accord greater deference to policy statements and interpretative rules than to legislative rules and that policy statements often bind judges to the same extent as do rules). Professor Pierce analyzes *Stinson v. United States*, 508 U.S. 36 (1993) and *Williams v. United States*, 503 U.S. 193 (1992), both of which involved interpretive rules rather than policy statements. Though Professor Pierce's analysis seems to conflate interpretive rules and policy statements, he is correct in observing that the Court seems to merge the two as well. He uses the aforementioned decisions to demonstrate how the Court has mandated significant judicial deference to both policies and interpretive rules. In *Stinson*, for example, which reviewed Sentencing Commission legislative documents rather than policy statements, the Court declared that "[t]he principle that the Guidelines Manual is binding on federal courts applies as well to policy statements." *Stinson*, 508 U.S. at 42.

103. *See* Robert A. Anthony & David A. Codevilla, *Pro-Ossification: A Harder Look at Agency Policy Statements*, 31 WAKE FOREST L. REV. 667, 669 (1996).

104. *See, e.g.*, *Columbia Broadcasting Sys. v. United*

States, 316 U.S. 407 (1942). In this famous "CBS case" the Supreme Court held that the FCC's announced disfavor of certain contractual relationships between local and network radio stations amounted to a policy rather than a rule. *United States Tel. Ass'n v. Federal Communications Comm'n*, 28 F.3d 1232 (D.C. Cir. 1994) (penalty schedule promulgated by FCC amounted to a "rule in masquerade" and was therefore subject to a formal rulemaking). *Chamber of Commerce v. OSHA*, 636 F.2d 464 (D.C. Cir. 1980) (OSHA's announcement that employers' failure to pay employees for accompanying agency inspector on "workaround" inspections would be prosecuted as discrimination amounted to a rule and must therefore undergo a formal rulemaking).

105. *See* *Iowa Power & Light Co. v. Burlington Northern, Inc.*, 647 F.2d 796 (8th Cir. 1981), *cert. denied*, 455 U.S. 907 (1982).

106. *See id.* at 811.

107. *See id.* For a good discussion of this case as well as the policy/rule dichotomy, *see* William T. Mayton, *The Concept of a Rule and the 'Substantial Impact' Test in Rulemaking*, 33 ENVTL. L.J. 889, 919 (1984).

108. *National Latino Media Coalition v. Federal Communications Comm'n*, 816 F.2d 785 (D.C. Cir. 1987).

109. *See id.* at 787.

110. *Id.* at 789. For further discussion of this and related cases, *see* Paul N. Rechenberg, Note, *Losing The Battle On Obscenity, But Can We Win The War? The National Endowment For The Arts Fight Against Funding Obscene Artistic Works*, 57 MONT. REV. 299, 311 (1992).

B. Tests for Determining Whether a Policy is Actually a Rule

Two tests have emerged for determining whether an Agency dictate amounts to a policy or a rule: the "Force of Law" test and the "Substantial Impact" test.¹¹¹ The Force of Law test looks at the legal impact of the Agency action. Under this test, the policy statement has the force of law if both the Agency and its regulated entities behave as if the Agency requires adherence to its stated position. If so, the policy is actually a disguised rule and subject to a rulemaking.¹¹² The Substantial Impact test is less formalist. It looks to whether the Agency action causes "palpable effects" to regulated entities and the general public. If so, then the action must undergo the scrutiny and public comment that accompanies a rulemaking procedure.¹¹³ Under either test, the audit policy does not qualify as a rule.

1 Force of Law Test

The Force of Law test has two prerequisites. First, Congress must formally grant a rulemaking power to an Agency.¹¹⁴ Rulemaking power accompanies any delegation of substantive power by Congress to an Agency, although the parameters of the rulemaking power may vary from statute to statute.¹¹⁵ For example, Congress may delegate authority to EPA to enforce the Clean Air Act but reserve for itself the right to determine emissions standards for carbon monoxide for new cars. Whereas, in the Clean Water Act, Congress may give EPA full authority to set effluent quality standards in every area.

Second, the proposed rule must derive its authority from the statute that the Agency is implementing. To show an illegal act by a regulated entity, the Agency need only show a violation of the rule, rather than a violation of the statute. In other words, statutes lay out broad

parameters and goals, instructing agencies to adopt rules which then fill in the gaps, specifying which behavior does and does not conform with the law. Reasoning syllogistically, if a rule specifies how to obey a law, and an entity violates the rule, then the entity must have violated the law as well.

The leading case for the Force of Law approach is *Pacific Gas & Electric Co. v. Federal Power Commission*.¹¹⁶ In upholding the Power Commission's use of a policy statement rather than a rule to announce its methodology for curtailing natural gas usage during times of shortage, the D.C. Circuit found that the Commission had merely announced the policy it would use in subsequent adjudications, rather than creating a blanket rule. The opinion laid out the difference between a policy and a rule as follows:

In administrative proceedings involving a substantive rule, the issues are whether the adjudicated facts conform to the rule and whether the rule should be waived or applied in that particular instance.

A general statement of policy on the other hand, does not establish a "binding norm." [T]he Agency cannot apply or rely on a general statement of policy as law. [W]hen the Agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued.¹¹⁷

Though the Power Commission's policy effectively forced many natural gas users to begin an immediate search for alternative energy sources, the court nonetheless found that, since the decision had been issued as a

111. See *Aman & Mayton*, *supra* note 93, at § 4.3.

112. See, e.g., *Pacific Gas & Elec. Co. v. Federal Power Comm'n*, 506 F.2d 33 (D.C. Cir. 1974).

113. See *National Helium Corp. v. Federal Energy Admin.*, 569 F.2d 1137 (Temp. Emer. Ct. App. 1977).

114. See, e.g., *American Postal Workers Union v.*

United States Postal Serv. 707 F.2d 548, 558 (D.C. Cir. 1983), *cert. denied*, 465 U.S. 1100 (1984).

115. See *Morton v. Ruiz*, 415 U.S. 199, 231 (1974).

116. See *Pacific Gas & Elec. Co. v. Federal Power Comm'n*, 506 F.2d 33 (D.C. Cir. 1974).

117. *Id.* at 38-39.

policy statement, it lacked the "force of law"¹¹⁸ and therefore could not possibly have been enforced as such. The tautology embedded in this reasoning (a policy cannot have the force of a rule because policies lack the force of rules) has not been lost on the courts, including the D.C. Circuit in later decisions.¹¹⁹ While no binding precedent exists dictating the proper test for determining whether a policy is in fact a rule in disguise, recent years have witnessed a drift away from the Force of Law test and toward the Substantial Effects test.¹²⁰

2. Applying the Force of Law Test to the Audit Policy

Though courts have applied the Force of Law test less frequently in recent years, the test has not been categorically discarded. Furthermore, there remains no consensus as to the best method for distinguishing rules from policies. It will therefore prove instructive for both legal and analytical reasons to apply the test to the federal audit policy.

A rule dictates behavior, either of the regulated entity or the regulating Agency. By contrast, a policy offers guidance while binding neither side. The key determinative factors in the Force of Law test involve whether: (1) the policy statement establishes a "binding norm,"¹²¹ and (2) whether the Agency relies on the policy as a general statement of law.¹²² Then, to qualify as a policy rather than a rule, the Agency must (3) "be prepared to support the policy just as if the policy statement had never been issued."¹²³

118. See *id.* at 41.

119. See, e.g., *Community Nutrition Inst. v. Young*, 818 F.2d 943, 945 (D.C. Cir. 1987) ("[A]ction levels" established by the FDA for contaminants in food amounted to a rule rather than policy because the agency guidelines "set a precise level of contamination that the FDA deems permissible.").

120. See *Aman & Mayton*, *supra* note 93, at § 4.3 (noting that since the early seventies, courts have begun to turn away from the "facile semantic distinctions" of the force of law approach).

121. See *Pacific Gas & Elec. Co. v. Federal Power Comm'n*, 506 F.2d 33, 49 (D.C. Cir. 1974); see also *United States Telephone v. Federal Communications Comm'n*, 28 F.3d 1232, 1234 (D.C. Cir. 1992).

122. See *Pacific Gas & Elec. Co. v. Federal Power Comm'n*, 506 F.2d 33, 49 (D.C. Cir. 1974).

It seems doubtful that the audit policy creates a binding norm. The text of the Final Policy Statement expressly declines to bind affected parties,¹²⁴ though it does spell out with some specificity the particular procedures for voluntary disclosure of environmental violations in order to lessen the Agency's enforcement response.¹²⁵ Nonetheless, neither the Final Policy Statement nor the Interim Policy demands specific behavior from regulated entities. The decision to self-audit is entirely voluntary. This poses a stark contrast to the examples offered by Professor Anthony wherein the Agency attempted to use policy statements to dictate the behavior of regulated entities.¹²⁶

The audit policy also leaves room for Agency discretion. As noted earlier, EPA can decline to seek restitution depending on the amount of economic benefit derived from a particular violation.¹²⁷ It thus remains an open question as to whether the policy creates a "binding norm" even with respect to Agency behavior.

Some critics and state legislatures contend that the audit policy binds states, preventing them from using their own methods for environmental enforcement. They point to the Agency's stated opposition to state laws granting privilege and immunity to violators.¹²⁸ They reason that if the Agency can threaten to disapprove a State Implementation Plan (SIP) for enforcing federal environmental law by alleging incompatibility with the audit policy, then the audit policy must have the force of law. This

123. *Id.*

124. Final Policy Statement *supra* note 2 at 66.712 ("The policy is not a final agency action and is intended as guidance. It does not create any rights, duties, obligations, or defenses implied or otherwise, in any third parties.")

125. See Final Policy Statement *supra* note 2 at 66.711 and accompanying text.

126. See *Community Nutrition Inst. v. Young*, 818 F.2d 943 (D.C. Cir. 1987).

127. Final Policy Statement *supra* note 2 at 66.707.

128. Final Policy Statement *supra* note 2 at 66.712 ("EPA remains firmly opposed to statutory environmental audit privileges that shield evidence of environmental violations as well as to blanket immunities for violations.")

argument has merit, but close examination reveals that the Final Policy Statement leaves considerable room for state statutory discretion.

EPA has not objected to the majority of state statutes that allow some form of privilege and/or immunity, and in other cases has merely asked for clarification from the states' attorneys general.¹²⁹ Additionally, if the test for determining whether a policy is actually a camouflaged rule lies in whether the Agency can "support the policy just as if the policy statement had never been issued,"¹³⁰ then one could convincingly argue that it is not the audit policy but the federal statutes themselves that void state laws that impede enforcement. EPA need not rely on the audit policy to nullify a SIP. Indeed, since the audit policy is not a rule, it lacks the statutory authority to do so. To void a SIP, the Agency must show that a particular state law creating an evidentiary privilege and/or immunity for violators interferes with the efficient enforcement of federal law.

The audit policy satisfies the second prong of the analysis in that EPA relies on it as a statement of law. The policy outlines the Agency's response to violations discovered through self-audits¹³¹ and the Agency acknowledges that the policy sets "minimum statutory guidelines."¹³² As one Agency official noted, "Practically speaking, we're applying it like a rule."¹³³

Regarding the third question, whether EPA can, when enforcing the policy, support it just as if the policy statement had never been issued, the answer appears to be yes. Since the policy binds no one but EPA, the Agency need only justify its own actions. The actions at

issue involve a mitigated enforcement response to a voluntary disclosure of a violation. Under any circumstances, the Agency would wish to encourage voluntary disclosure and remediation. It would not require a published policy to justify a mitigated response intended to achieve that aim.¹³⁴ By this reasoning, the Agency guidance more resembles a policy than a rule.

In the final analysis, the audit policy withstands the Force of Law test. First, the policy may or may not create a binding norm. Even if it did, it would bind the Agency alone, and only in the sense that it stipulates certain Agency responses to voluntary behavior on the part of regulated entities. Second, EPA apparently relies on the audit policy as a statement of law, thereby suggesting a rule rather than a policy. Third, the Agency can support its policy as if the policy statement had never been issued.

The audit policy likely clears the first hurdle, stumbles on the second, and clears the third. Since all three components are necessary for a policy to have the force of law, the audit policy lacks the force of law. Consequently, under the Force of Law standard, a rulemaking is not necessary.

3. Substantial Effects Test

The Substantial Effects test looks less at the letter of the Agency dictate than at its impact. In deciding whether a policy has a substantial effect and should therefore be a rule, courts use a two-pronged analysis. First they look to whether the purported policy imposes any rights or obligations upon the public. Second, they attempt to determine whether the policy limits an Agency's discretion in later determinations.¹³⁵

129. See *State Immunity, Privilege Laws Examined for Conflicts Affecting Delegated Programs*, DAILY ENVIRONMENT REPORT, Sep. 18, 1996, available in LEXIS, BNA Library, BNAED file (finding that "most states with audit laws are facing no threat to their federally delegated environmental programs" and that often, letters of clarification from state attorneys general have laid EPA's concerns to rest).

130. See *Pacific Gas & Elec. Co. v. Federal Power Comm'n*, 506 F.2d 33, 49 (D.C. Cir. 1974).

131. See Final Policy Statement, *supra* note 2.

132. See Herman, *supra* note 5.

133. See Riedel, *supra* note 80.

134. See also *Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) (agency interpretations of statutes deserve great judicial deference unless they are arbitrary or capricious).

135. See, e.g., *Alaska v. Department of Transp.*, 868 F.2d 441, 446-47 (D.C. Cir. 1989); *American Hosp. Ass'n v. Bowen*, 834 F.2d 1037, 1046 (D.C. Cir. 1987); *Community Nutrition Inst. v. Young*, 818 F.2d 943, 946 (D.C. Cir. 1987);

The lodestar case for the Substantial Effects test is *Community Nutrition Institute v. Young*.¹³⁶ In *Young*, the D.C. Circuit held that the "action levels" for allowable levels of aflatoxin in foods set forth in a policy statement by the Food and Drug Administration (FDA) constituted a rule rather than a policy statement. Consequently, the court found that the setting of action levels required a rulemaking.

Under the FDA policy, producers who sold food containing aflatoxin levels higher than specified were subject to enforcement action. Furthermore, the policy's language was stated in mandatory terms: contaminants in excess of the action levels "will be deemed to be adulterated."¹³⁷ In the court's view, the threat of enforcement created a new obligation for the public while the mandatory nature of the policy language limited the FDA's discretion as to when to initiate enforcement proceedings. Since the FDA's action had a substantially similar effect to a rule, it needed to undergo the rulemaking process.¹³⁸

4. Applying the Substantial Effects Test to the Audit Policy

Applying the two-pronged Substantial Effects test to the audit policy yields a similarly mixed result to that in the Force of Law analysis. The first prong involves inquiring whether the Agency statement imposes any rights or obligations upon the public. The second prong requires assessing whether the policy improperly limits Agency discretion in later determinations.¹³⁹

As noted above, the audit policy does not directly impose obligations on the public.¹⁴⁰ It simply outlines the Agency's likely response to voluntary actions (self-audit and disclosure) by regulated entities. States are arguably burdened because the policy obstructs their ability

to legislate privilege and immunity laws. Yet, this is hardly a burden. SIPs enforce federal law and are approved or disapproved at the discretion of the federal government. It stands to reason that the federal Agency overseeing the SIP should have the authority to determine if the SIP is being effectively administered. If a state's laws interfere with its obligations to carry out federal law, then the burden on the state does not derive from the audit policy but from federalism itself. In other words, the only constraint arising from the audit policy is one that already existed; that states not pass laws that impede the enforceability of federal statutes.

The second question, whether the policy improperly limits Agency discretion, is slightly more problematic. The policy does limit Agency discretion by requiring it to forego seeking gravity-based penalties from qualifying entities. The policy also prevents the Agency from recommending criminal prosecution based on audit results.¹⁴¹ It remains an open question, however, whether these limitations are improper. The Agency has a clear policy goal of encouraging self-audits and disclosure. The audit policy accomplishes this goal without forfeiting EPA's discretion with regard to serious violators or those entities that choose not to self-audit. The only strictures placed on the Agency's behavior concern specific mitigation measures for those entities that choose to audit.

Furthermore, even if the limitations seem severe, EPA could argue that they still are appropriate. As one Agency official noted, the publication of the interim and final policy statements met all the APA procedural safeguards for a rulemaking,¹⁴² including publication in the Federal Register and solicitation of public comment.¹⁴³ Neither of these steps is required for policies. If EPA decides to issue the audit policy as a rule (which it reserves the right to do at

American Bus. Ass'n v. United States, 627 F.2d 525, 529 (D.C. Cir. 1980); see also Royal C. Gardner, *Public Participation and Wetlands Regulation*, 10 UCLA J. ENVT'L. L. & POL'Y 1, 10 (1991) (comparing the substantial effects and force of law tests).

136. See *Community Nutrition Inst. v. Young*, 818 F.2d 943 (D.C. Cir. 1987).

137. *Id.* at 947 (emphasis added).

138. See *id.* at 945-48.

139. See *id.* at 946.

140. See Final Policy Statement, *supra* note 124, at 66,712 and accompanying text.

141. See Final Policy Statement, *supra* note 2, at 66,706.

142. Riedel, *supra* note 79.

143. See 5 U.S.C. § 553 (1994).

a later date),¹⁴⁴ it would involve little more than proposing the policy in the Federal Register.¹⁴⁵ In light of these extraordinary lengths the Agency went to in formulating the policy, it would be difficult to argue that a few limits on Agency discretion regarding response to a voluntary disclosure from a regulated entity are inappropriate.

The two components of the Substantial Effects test are whether a policy burdens the public and/or inappropriately limits Agency discretion. The foregoing discussion has shown that the audit policy does neither and that it consequently passes the Substantial Effects test. Therefore, under either standard, Force of Law or Substantial Effects, the audit policy does not require a rulemaking.

5. EPA Attempts to Legislate Through Policy Memoranda Have Decreased

EPA has, over the years, acquired the reputation of a "champion in the game of 'rule by memorandum.'"¹⁴⁶ Recently, though, the Agency has become more sensitive to the differences between policies and rules. That sensitivity arose of necessity, due to a growing negative public response to Agency attempts at governing by policy statement. Professor Robert Anthony points to two instructive examples of EPA initially attempting to legislate through policy memoranda, then later agreeing either to clarify its policy or to issue a rule.¹⁴⁷

In the first case, EPA stated in the preamble to its Notice of Clarification approving Kentucky's State Implementation Plan (SIP) under the Clean Air Act¹⁴⁸ that EPA approval of

revisions to a SIP had the effect of "requiring the State to follow EPA's current and future interpretations of the Act's provisions as well as EPA's operating policies and guidance."¹⁴⁹ In the wake of protests and the commencement of litigation,¹⁵⁰ EPA issued a second Notice of Clarification¹⁵¹ declaring that interpretations and guidances do not have the force of law and that failure to obey them did not, in and of itself, violate the Clean Air Act.¹⁵²

The second example involved EPA agreeing to use a rulemaking to set emission standards for new facilities or modification of existing facilities in regions currently in compliance with national air quality standards. For years, EPA had utilized a "bottom-up" approach to its requirement that emissions limitations be based on "best available control technology" (BACT).¹⁵³ BACT meant that the permitting authority weighed several factors to determine what technology was achievable and attainable under the circumstances. Permittees need not install the most effective methods of emission control if they could demonstrate that its costs outweighed its benefits. In 1987-88, some offices within EPA began implementing a "top-down" approach, requiring applicants to use the most effective technology unless they could show it to be infeasible. In 1988, EPA issued a memorandum stating that those not using "top-down" approach to BACT would be deemed permit deficient and potentially subject to enforcement action.¹⁵⁴

Litigation ensued challenging EPA's authority to implement the top-down approach without going through a legislative rulemaking.¹⁵⁵ In

144. See Final Policy Statement, *supra* note 2, at 66,710 ("[EPA] will consider this issue and will provide notice if it determines a rulemaking is appropriate.").

145. See Riedel Interview, *supra* note 80.

146. See Robert A. Anthony, *Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them to Bind the Public?*, 41 DUKE L.J. 1311, 1346 (1992).

147. See *id.* at 1346-49.

148. Notification of Clarification, 54 Fed. Reg. 36,307 (1989).

149. See *id.* at 36,307-08.

150. *Westvaco v. EPA*, No. 89-3975 (6th Cir. filed Oct.

31, 1989).

151. 55 Fed. Reg. 23,547-48 (1990).

152. 42 U.S.C. § 7402 (1998).

153. 42 U.S.C. §§ 7470-7479 (1998).

154. See Anthony, *supra* note 146, at 1349 n.221, citing Memorandum from Michael S. Alushin, Associate Enforcement Counsel for Air, Office of Enforcement and Compliance Monitoring, and John S. Seitz, Director, Stationary Source Compliance Division, Office of Air Quality Planning and Standards, to various recipients (July 15, 1988).

155. The principal case in this dispute was *American Paper Inst. v. Reilly*, No. 89-2030 (D.D.C. filed July 18, 1989). See Anthony, *supra* note 146, at 1389.

1991, EPA and the plaintiffs settled the suits. EPA agreed to submit the BACT directive to a formal rulemaking and acknowledged that the "EPA BACT policy statement is not intended to create binding legal rights or obligations and does not have the force and effect of law."¹⁵⁶

In both of the preceding examples, EPA attempted to create a binding Agency directive without undergoing the proper rulemaking procedure.¹⁵⁷ Each time, widespread protest and the commencement of litigation forced the Agency to reconsider. Taken together these examples indicate that EPA has, of necessity, acquired an increased sensitivity to the need for a rulemaking when the Agency expects expecting universal compliance with one of its directives.¹⁵⁸ It bears noting, however, that this newfound sensitivity came grudgingly, could be episodic, and might well vanish with the next presidential election.

V. Should the Audit Policy be a Rule Instead?

Though the audit policy is not a rule in disguise, the question remains whether it might prove more effective and less controversial if it were made into a rule. An audit rule would conclusively set forth EPA's position on what constitutes legal encouragement for entities that wish to audit. It would also reduce ambiguity and misunderstandings concerning possible Agency reactions to audit results. States and regulated entities would enjoy the security of knowing with certainty what behavior is acceptable.

These proposed benefits to an audit rule, however, could just as easily be viewed as detriments. Specifying the parameters on state audit laws removes a great deal of the states' discretion in enforcing federal environmental laws. Even if the rule were flexible, it would still create constraints, otherwise it would offer no greater

clarity than a policy while offering a greater threat of enforcement. Under the current policy, EPA can negotiate with states regarding the scope and impact of state statutes. If the policy were a rule, it would mandate a particular Agency response (i.e., suspending a state's ability to implement its SIP) if a given state law did not conform to the rule's specifications. Currently, both states and EPA have the flexibility to craft agreements that may not necessarily conform to a rigid interpretation of the policy. Often the negotiations leading to such agreements dispel any cloud of Agency disapproval. If the policy were a rule, that flexibility would likely disappear. Citizens' groups would file suit to force the rule's enforcement and the Agency would have no choice but to adhere strictly to the letter of the law.

Perhaps the most important constituency in the rule/policy debate is the regulated community. Yet, even here, the choice between a rule and a policy offers no clearly superior option. If the audit policy were a rule, it would present clearly delineated dictates that an entity could follow, or disregard at its peril. The entity could also challenge the rule in court, an option that presents considerably fewer complications than challenging a policy.¹⁵⁹

A rule designating criteria for enforcement actions would create the potential for voluminous litigation. The affected entity could litigate whether it has met every criterion for triggering an enforcement action. For example, if the Agency decided to seek gravity-based penalties from an entity under the current policy regime, the entity could not challenge its decision based on a supposed lack of adherence to the audit policy. If the policy were a rule, however, the entity could litigate its non-compliance with each of the nine delineated factors before paying the penalty. This opportunity to litigate the mechanics of the rule's enforcement would arguably benefit the regu-

156. Anthony, *supra* note 146, at 1389, quoting settlement agreement for cases cited above, *supra* note 128 (July 9 and 10, 1991).

157. The procedure for rulemaking in most cases is set forth in the APA, 5 U.S.C. § 553 (1994). The Clean Air Act, however, has its own rulemaking procedure, which is untethered to the APA. See 42 U.S.C. § 7607(d) (1994).

158. See Anthony *supra* note 146, at 1349.

159. See Anthony *supra* note 100 and accompanying text (discussing nebulous standards presented by the Force of Law and Substantial Impact test). With rules, the guidelines for judicial review are built into the APA. 5 U.S.C. § 704 (1994).

lated community. The torrent of litigation and resulting ill will with the Agency could, however, also work to industry's detriment.

Furthermore, for entities, just as for states, the clarity offered by a rule comes with a price. Just as clothing labeled "one size fits all" fits no one particularly well, so too does a rule designed for universal applicability lose its ability to customize itself to suit a particular entity. Lastly, regulated entities, like state and federal agencies, might find themselves the target of citizen enforcement suits designed to force the rule's enforcement. That could result in unnecessary enforcement actions and/or needless expenditures of time and resources in litigation.

VI. Conclusion

Sound policy reasons exist for an audit policy that encourages self-audits and voluntary disclosure. EPA's audit policy adequately meets those needs. State laws seeking to strengthen the allure of self audits by privileging audit results and/or immunizing the violator seem gratuitous and potentially detrimental. There exists no evidence to suggest that the federal policy's lack of privilege or immunity has deterred industry from auditing, or violators from coming forward. Furthermore, granting privilege or immunity to violators allows an unfair advantage over industries that comply with environmental laws.

Second, though in some respects the audit policy skirts dangerously close to a disguised rule, it does not require a rulemaking under either the Force of Law or the Substantial Effects tests. The judicial standard for determining a rule from a policy remains ambiguously drawn. Nonetheless, given that the audit policy merely sets forth guidelines for Agency response to voluntary behavior from the regulated sector, and since the Final Policy Statement was issued after extensive public comment and debate, this does not appear to be an example of the Agency governing by policy rather than by APA approved rules.

Lastly, while rules offer clarity, they also diminish flexibility on all sides while increasing the likelihood of litigation. The advantages offered to states and the regulated community do not appear to outweigh the potential detriments. Probably the most important indicator of the appropriateness of a policy rather than a rule is that no state or regulated entity has challenged the policy's validity or claimed that it is a rule in disguise. Instead, statistics show an increasing amount of self-audits and conformity with the audit policy even though the majority of states have declined to create a statutory privilege or immunity for auditors. Furthermore, most of the states that do have privilege or immunity statutes have negotiated the statutes' parameters with EPA and do not fear Agency reprisal.

The policy works; a rule may not work as well. Why disturb a good thing?