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Comment: Environmental Audits in the Americas

by Jeffrey B. Gracer, Esq.¹

Direct investment by U.S. corporations in Latin America increased from approximately \$4 billion in 1990 to \$12 billion in 1994.² Even after the Mexican Peso crisis, corporate direct investment during the first quarter of 1995 was up 46 percent from the previous year's first quarter, and many analysts expect that trend to continue.³ As U.S. companies expand their long-term business interests in Latin America through joint ventures, new facility construction, and mergers and acquisitions, they are increasingly confronting new environmental realities in the region. A broad array of environmental laws, regulations, and norms adopted in recent years apply to most business operations in Latin America.⁴ Although enforcement is still uneven, it is becoming a significant factor in several countries. Citizen groups and environmental NGOs are monitoring industrial activities,⁵ environmental litigation is taking root,⁶ and government agencies are closing plants and imposing substantial fines.⁷ In this rapidly changing climate, environmental audits are becoming a prudent and necessary part of doing business in the Americas, especially for foreign-owned companies.

I. Regional Integration & Corporate Environmental Responsibility

Responsible environmental stewardship has become an important ingredient for continued economic integration in the Americas and for businesses operating in the region. The 1992 Rio Declaration established that economic expansion must proceed in tandem with environmental protection to achieve "sustainable development."⁸ Although there is substantial debate about precisely what is meant by "sustainable development," and how it should be achieved, there is an emerging consensus in Latin America that economic expansion should include real environmental protection.⁹

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2. "US. Business Still Likes Latin America," Wall S.J. May 12, 1995, at A2.
3. *Id*
4. Jeffrey B Gracer, "A New Environmental Era In Latin America," *Focus Americas* (Mar. 1995).
5. *See, eg.*, "List of 'Dirty' Companies Published By Brazilian Environmental Group," *Environment Watch: Latin America* (Sept. 1995).
6. *See* "Vecinos contra una planta de coque," *Clarín* (2 de noviembre de 1994) (reporting that neighbors of a proposed industrial treatment facility in Argentina brought suit to block operations until an environmental impact statement could be prepared)
7. *See, eg.*, "Sao Paulo's Environmental Authority Hits Sugar Company With Record [\$1 million] Fine," *Environment Watch: Latin America*, at 7 (Sept. 1995).
8. Rio Declaration on Environment and Development, June 14, 1992, 31 I.L.M. 874.
9. *See generally* *Difficult Liaison: Trade and the Environment in the Americas* North-South Center (1993)

NAFTA's explicit linkage of trade and the environment played an important role in articulating and consolidating that consensus. Although NAFTA formally applies only to its state parties (the United States, Canada, and Mexico), its environmental provisions have had a broader impact. NAFTA's core principles -- that trade and investment should be undertaken "in a manner consistent with environmental protection and conservation," that governments should "strengthen the development and enforcement of environmental laws and regulations,"¹⁰ and that domestic health, safety and environmental measures should not be relaxed to attract increased trade and investment¹¹ -- have been embraced by governments and industry throughout Latin America. The Declaration of Principles, signed by 34 leaders at the December 1994 Summit of the Americas in Miami, called for the creation of a Free Trade Area of the Americas by the year 2005, committed each country to "guarantee sustainable development" as economic integration moves forward.¹² The summit leaders also adopted a Plan of Action to strengthen and build institutional capacity to address environmental priorities.¹³ Although the complex interplay between trade and the environment will continue to be debated, it is safe to say that environmental protection will remain a core component of continued growth.

U.S. industries occupy a unique position at the intersection of trade and environment in the Americas. Unlike some Latin American companies, U.S. corporations have operated under rigorous environmental regulations for over two decades, and are generally expected to conduct their operations abroad at comparable levels of stringency. Because U.S. companies have more direct experience with environmental management systems, pollution prevention techniques, and environmental control technologies, they are expected to know how to comply with environmental laws, and can face close scrutiny by Latin American regulators in the event of noncompliance. At the same time, Latin American companies that have been owned by U.S. parent corporations for years generally retain their own identity and culture. As U.S. industry assumes a more significant role in Latin America, it will face difficult challenges formulating and implementing regional environmental compliance strategies that are appropriate and effective.

There are two reasons why environmental audits¹⁴ are likely to play a critical role in these developments. First, Latin American governments are encouraging voluntary compliance efforts by industry, and are promoting environmental audits as a preferred means of establishing compliance. Second, emerging international environmental management standards, known as ISO 14000, are expected to create strong practical incentives for companies engaged in regional and international trade to conduct environmental audits.

10. North American Free Trade Agreement, drafted Aug 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. 605 (entered into force Jan. 1, 1994)[*hereinafter* NAFTA].
11. NAFTA, Article 1114(1)
12. Summit of the Americas: Declaration of Principles and Plan of Action, Miami, FL, Dec 9-11, 1994.
13. *Id*
14. An "environmental audit" can be a "compliance audit," which measures compliance with substantive environmental standards, or a "management audit," which measures compliance with management objectives and procedures. Some companies combine these two approaches in one unified audit.

II. Voluntary Compliance: Mexico's Supervised Environmental Audit Program

NAFTA's Environmental Side Agreement requires its signatory governments to "effectively enforce" their environmental laws.¹⁵ Such "effective enforcement" can include not only inspections, administrative orders, and monetary sanctions, but also promotion of environmental audits and other voluntary compliance efforts.¹⁶ In Mexico and other Latin American countries, governments and industry have been signing "cooperation agreements" in which they pledge to work together to promote voluntary environmental compliance.¹⁷ Environmental audits have figured prominently in those efforts. In Mexico, for example, the Attorney General's Office for Environmental Protection (PROFEPA) has been actively promoting industry participation in an ambitious voluntary audit program that enables companies to come into compliance without being subject to fines or penalties.¹⁸

The stated purpose of PROFEPA's voluntary audit program is to identify, evaluate, and control industrial processes that could threaten human health or the environment. Under written terms of reference established by the government,¹⁹ the audit addresses virtually all operational issues at the facility, including staffing and management, environmental compliance, worker health and safety, emergency preparedness, and community impacts. The audit includes a review of raw materials, equipment and processes to identify pollution prevention opportunities. It also determines whether the company has a sufficient number of qualified employees to assure environmental compliance, and whether adequate pollution control technology is in place.

PROFEPA's audit program goes well beyond compliance with legal requirements and includes a review of the facility in light of best management practices. To participate, the company must sign an agreement with PROFEPA stating that it will remedy any legal or other deficiencies identified during the audit. The company then designates an environmental consultant (or an internal auditor), who is subject to approval by PROFEPA's designated supervisor.²⁰ The company's auditor submits an audit plan, and field work begins upon the plan's approval. When the audit is completed, the company's consultant prepares an audit report identifying factors evaluated, findings and deficiencies, preventive and corrective actions, estimated times for correcting each noted deficiency, and anticipated expenditures. The audit report and corrective action plan are reviewed and approved by PROFEPA's supervising consultant. While the audited company can negotiate the scope

15. North American Agreement on Environmental Cooperation Between the Government of the United States of America, the Government of Canada, and the Government of the United Mexican States, Sept 13, 1993, 32 I.L.M. 1480, art. 5 (entered into force Jan. 1, 1994) [*hereinafter* Environmental Side Agreement].
16. *Id*
17. "Government, Industry Sign Environment and Competitiveness Agreement," Environment Watch: Latin America (Aug 1995).
18. Seminario, "La Auditoria Ambiental y Las Politicas de Cumplimiento Voluntario en Norteamerica, Procuraduria Federal de Proteccion al Ambiente, Subprocuraduria de Auditoria Ambiental, Ciudad Juarez, Mexico (7 y 8 de septiembre de 1995)
19. Terminos de Referencia Para la Realizacion de Auditorias Ambientales, Procuraduria Federal de Proteccion al Ambiente (diciembre de 1993)
20. The participating company must agree to pay costs incurred by PROFEPA's designated supervisor

and timing of corrective actions, it is required to address each noted deficiency. After the corrective action plan is approved, PROFEPA's supervising consultant monitors completion of identified tasks. According to PROFEPA, the costs of completing such an audit can be as little as \$12,000 for a small facility and more than \$200,000 for a major facility. On average, a PROFEPA voluntary audit takes less than a month for a small facility and several months for major facilities. PROFEPA estimates that for every dollar spent on the audit itself, the audited company can expect to spend approximately thirteen dollars on prevention and control measures.

In some respects, Mexico's voluntary audit program is quite innovative, and is way ahead of similar programs in the United States. To cite just a few examples, Mexican authorities sign an agreement that they will not disclose audit results to third parties. Subject to limited exceptions, plant inspections are suspended during the pendency of an audit. Fines are not imposed for identified violations so long as appropriate corrective action is taken. A plant is not expected to immediately correct all noted deficiencies, and can negotiate a schedule for addressing the most pressing issues first. Upon completion of the audit and correction of identified deficiencies, the plant obtains a closeout letter from the government which provides some measure of comfort and protection.

According to PROFEPA, over 600 companies had participated in the voluntary audit program as of September 1995. While some major multinationals are participating,²¹ environmental consultants and industry have expressed reservations about the program's scope and cost.²² Its ultimate success will depend on PROFEPA's willingness to focus each audit on core environmental compliance issues. PROFEPA has indicated that it is drafting terms of reference for particular industries that will simplify the audit process based on industry-specific considerations. Additional efforts to make the process more adaptable would create greater incentives for widespread industry participation.

III. Environmental Auditing & Regional Trade: ISO 14000

Even if an environmental audits are not undertaken under government auspices, there are compelling business reasons to implement internal environmental audit programs in Latin America. International environmental management standards being developed by the Geneva-based International Standards Organization (ISO) are expected to have a major impact throughout the world.²³ Those standards, known collectively as ISO 14000, are expected to go into effect in mid-1996.²⁴ Although purely voluntary, certification under the ISO 14000 standards is likely to become a practical requirement for businesses engaged in regional and international trade. Some companies with international operations are assembling the basic elements for ISO 14000 certification of their Latin American facilities

21. "Ford de Mexico Begins Environmental Audits on Mexican Plants," *Environment Watch: Latin America* (Jan 1995).
22. "Pollution Audits Vex Mexican Firms, Their Paid Environmental Consultants," *Western Environmental News* (July 1995)
23. See S Kass and J. McCarrroll, "Environmental Integration in the Americas," *New York Law Journal* (Dec. 23, 1994).
24. See Draft International Standard, ISO/DIS 14001, "Environmental Management Systems-Specification with Guidance for Use," ASTM (August 1995)

even before the standards go into effect. ISO 14000 is an outgrowth of the corporate Global Environmental Management Initiative (GEMI), which has already taken root in Latin America.

It is important to emphasize that ISO 14000 does not create substantive environmental standards. For example, it contains no numerical standards for air or water emissions. Nor does it define what is and is not hazardous waste. To the contrary, ISO 14000 recognizes that companies operating in different countries will be subject to different substantive standards based on the applicable laws and regulations of each jurisdiction. Accordingly, environmental audits can and should continue to assess compliance with national and sub-national environmental laws.

Instead of creating one uniform set of substantive environmental standards, ISO 14000 requires a systematic approach to management of environmental issues. The emphasis is on consistency of process, not end results.²⁵ To obtain certification under ISO 14000, a company will be required to adopt an environmental policy and make a public commitment to comply with relevant environmental legislation and regulations. After examining the environmental impacts of its operations, the company will formulate a plan which identifies environmental objectives and targets. The company will be required to conduct environmental training and create a competent management structure to implement its plan. The plan must include procedures for identifying non-conformance with management objectives, including periodic audits of the management system's performance. The goal of periodic audits under ISO 14000 is to foster continual improvement in the management of environmental issues, not to measure whether a company is in compliance at any particular moment.

Certain Latin American companies have expressed reservations about ISO 14000, largely based on the anticipated costs of implementing its requirements. Nonetheless, industry delegates from Mexico, Brazil and Chile are actively participating in ISO 14000's development.²⁶ U.S. companies that obtain ISO 14000 certification for their facilities in the United States will be hard-pressed not to do so for their Latin American facilities, especially if the company's products are wholly or partially produced in Latin America for regional or international export.

IV. Special Considerations For Environmental Audits In Latin America

Once a company decides to implement an audit program for its Latin American operations, it must carefully plan that program's implementation. Many U.S. companies with international operations decide that they are going to measure the performance of all of their facilities against U.S. standards and uniform corporate environmental standards. The rationale for that decision is that corporations do not want to be charged with applying lesser standards to their foreign operations. That is often a valid judgment, however, it does not eliminate the need for careful analysis of the regulatory climate in which the audit is conducted, especially in Latin America.

25. Comment of Joseph Cascio, Chair, US. Technical Advisory Group for ISO 14000; Director, Environmental Health & Safety Standardization, IBM at a conference on ISO 14000 sponsored by the Association of the Bar of the City of New York (October 11, 1995).
26. "Industry Groups Create Mexican ISO 140000 Committee," *Environment Watch: Latin America* (August 1995); "Brazil Becomes Latin American Leader on International Standards," *Environment Watch: Latin America* (Dec 1995).

Failure to adequately analyze national and sub-national environmental laws and local enforcement trends is the most frequent, and potentially most costly, error made in environmental audits of Latin American facilities. Civil law systems in most Latin American countries are fundamentally different from the common law system most U.S. companies are accustomed to, and those differences can be material in the environmental context. In addition, there are significant cultural differences which must be taken into account. Here are a few key examples:

1. Most environmental agencies in Latin America have the power to close facilities that are not in compliance with applicable laws through unilateral administrative action ("clausura"), a step seldom taken by enforcement agencies in the United States. In many Latin American countries, when a local inspector shuts down a facility (even for a relatively minor violation), it can take weeks and even months for a facility to be reopened.²⁷ The avenues for effective appeal of an arbitrary agency decision are far more limited, and often counterproductive.
2. A practice consistent with U.S. standards may be unacceptable in Latin America unless it is also consistent with local standards. In Argentina, the definition of "hazardous waste" under federal law is broader in some respects than the applicable U.S. definition.
3. It is critically important to identify the environmental paperwork that local inspectors will be looking for and ensure that such paperwork is properly maintained.
4. Environmental audits should consider not only potential actions by regulators, but also the level of judicial oversight of industry. In Latin America, judges have the power to conduct their own investigations of environmental violations, and have been known to do so. For example, in Argentina, a federal judge investigated the alleged accumulation of hazardous waste at an industrial park in northern Buenos Aires. Upon completion of the investigation, he ordered eleven industrial facilities closed within a year unless they cured the violations.²⁸

27. See "Sao Paulo's Environmental Agency Closes Down Battery Manufacturer," *Environment Watch: Latin America* (Apr, 1995); D Medina, "For a Company in Compliance, Spotty Enforcement in Mexico is no Boon," *The Environmental Corporate Counsel* (June 1994).

28. "Once empresas con clausura para el ano que viene a la misma hora," Pagina 12 (11 de febrero de 1994)

5. Most Latin American environmental statutes do not contain citizen suit provisions. However, environmental public interest litigation is taking place. The constitutions of many Latin American countries create explicit environmental rights that are enforceable through an expedited "amparo" or "tutela" petition. Constitutional litigation based on such provisions has been utilized in Argentina, for example, to challenge an industrial permit after it was issued by a competent environmental authority,²⁹ and in Colombia to seek reforestation of a rainforest based on alleged clear cutting.³⁰
 6. Latin American civil codes recognize causes of action for personal injury and property damage.³¹ Standing to bring such actions has been more tightly drawn in Latin America than it has in the United States. Persons who allege personal injury caused by pollution have generally been granted standing to sue, as have adjacent landowners alleging property damage.³²
 7. Offsite impacts of industrial activity can be more severe in Latin America than they are in the United States because of the lack of adequate infrastructure. Even if industrial discharges meet U.S. Clean Water Act standards, they may pose threats to public health because there is no secondary treatment of sewage prior to its release into surface waters.
 8. In many Latin American countries, environmental standards and the degree of enforcement are changing at a rapid pace. Accordingly, longstanding practices which met regulatory requirements in the past may no longer be acceptable. Auditors should identify environmental reform initiatives that may have an impact on current operations or future compliance. Procedures should be implemented to ensure that plants are keeping up with environmental reforms.
 9. U.S. companies should take steps to assure that their environmental management and audit strategies in Latin America are appropriate for the corporate culture of each audited facility. While plant managers in the United States are accustomed to environmental audits, that may not be the case in Latin America. More groundwork will be necessary to make these programs successful. Audit teams should include at least one native speaker of Spanish (or Portuguese), and should preferably include an in-country representative of the company.
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29. *Schroder, Juan c Estado Nacional*, 92.711 (CN Fed), La Ley, 6 de diciembre 1994 (holding that a private citizen has standing to file an "amparo" petition under Article 43 of the Argentine Constitution challenging the issuance of a permit for a hazardous waste treatment facility).
30. "Legal Tools for Environmental Attention Getting Attention in Colombia," *Environment Watch: Latin America* (Aug 1995).
31. *See, eg.*, A. Rowley, "Mexico's Legal System of Environmental Protection," 24 ELR 10431, 10435 (Aug. 1994).
32. *Id*
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V. Conclusion

Although environmental audits of foreign operations can be expensive, many companies report that audits have resulted in long-term economic benefits. Properly done, environmental audits can identify how plant managers and division presidents can increase production efficiency, decrease raw material usage and waste production, and increase profitability. They provide upper management with confidence that operations are meeting internal corporate standards as well as local standards, and that the company's regional reputation is being protected. Environmental audits also provide opportunities for the prevention and correction of violations before they are elevated to the level of regulatory fines, civil and/or criminal enforcement actions, and/or harmful adverse publicity. By implementing effective environmental management and audit plans in Latin America, U.S. companies can improve their bottom line while simultaneously demonstrating their commitment to responsible economic integration in the region.
