

Changes to the EPA Audit Policy for New Owners

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Outline of Presentation

- EPA Audit Policy history
- Interim policy for new owners
 - Who qualifies?
 - What are benefits?
 - What are requirements?
- Comparison of Texas and EPA audit rules for new owners

EPA Audit Policy History

- *“Incentives for Self-Policing: Discovery, Disclosure, Correction, and Prevention of Violations,”* 60 Fed. Reg. 66,705 (Dec. 22, 1995); 65 Fed. Reg. 19,618 (April 11, 2000)
- Qualifying disclosures are eligible for reduction in gravity-based component of civil penalty
- Applies only to violations of federal environmental laws

What Disclosures Qualify?

- Systematic discovery
 - Environmental audit
 - Comprehensive EMS
- Voluntary discovery
 - Not as a result of required monitoring
- Prompt disclosure
 - Within 21 days of discovery
 - Discovery = Objectively reasonable basis to believe that violation has or may have occurred

What Disclosures Qualify?

- Independent discovery
 - Discovered before complaint, government investigation
- Correction and remediation
 - Within 60 days unless notify EPA that more time is required
- Prevent recurrence
 - Agreement to take steps

What Disclosures Qualify?

- No repeat violations
 - Facility: No same or similar violation within last 3 years
 - Company: No pattern at other facilities within last 5 years
- Excluded violations
 - Serious actual harm to environment
 - Imminent and substantial endangerment
 - Violations of order or plea agreement
- Cooperation with EPA
 - Provide information necessary to determine if conditions met

Reduction in Gravity-Based Penalty

- EPA penalty policies consist of 2 parts
 - Gravity-based penalty
 - Usually includes extent of deviation, potential for harm considerations
 - Economic benefit of non-compliance
- Reduction of gravity-based component
 - All 9 conditions: 100% reduction
 - All except systematic discovery: 75% reduction

No Reduction in Economic Benefit Component

- EPA does not waive economic benefit component of penalty under 2000 audit policy
- Delayed compliance
 - Time value of delayed capital investment
- Avoided compliance
 - Typically avoided O & M costs associated with delayed capital investment
- Unfair competitive advantage
 - Lower cost structure because of avoided or delayed costs

Other Benefits Under Audit Policy

- No recommendation for criminal prosecution
- No routine requests for audit results

Use of Audit Policy

- > 3500 entities have made disclosures to EPA, affecting almost 10,000 facilities
- Most have involved reporting violations
 - 52% EPCRA
 - 17% Clean Air Act
 - 10% each TSCA, RCRA
- EPA has said it wants more disclosures that result in pollutant reductions

Use of Audit Policy

- EPA sector-specific initiatives
 - Perform audits and make disclosures, or
 - Face increased inspections and enforcement
- Sectors targeted
 - Telecommunications
 - Bakeries
 - Colleges and Universities (Regions 1, 2, 3, 4, and 9)
 - Healthcare (Regions 1 and 2)

Electronic Disclosure Pilot

- Applies to:
 - EPCRA violations
 - Emergency notification
 - MSDS
 - Tier 2
 - Toxic Release Inventory
 - Region 6 only: all types of violations
- Why eDisclosure?
 - Easier
 - Reduces EPA processing time
 - Assures complete information is submitted
 - Promotes consistent processing by EPA
- <http://www.epa.gov/oecaerth/incentives/auditing/edisclosure.html>

New Owners Under 2000 Audit Policy

- Previous treatment of new owners
 - Existence of earlier violations will not be considered “repeat violations” as to the new owner
 - Possible extension of 21 day disclosure period
 - 21 day period will never begin before acquisition
 - Violations disclosed before first post-closing Title V annual certification is due will be considered “voluntarily” discovered
 - Compliance history at acquiror’s other facilities not considered

“Interim” Approach for New Owners

- “*Interim Approach to Applying the Audit Policy to New Owners*,” 73 Fed. Reg. 44,991 (Aug. 1, 2008)
- Effective now
- Why an “interim” approach?
 - Test strategy of motivating new owners to disclose violations
 - Learn from experience
- Testing approach
 - Taking public comment for 90 days
 - Agreements resolving violations to be publicly available
- EPA will finalize, revise, or discontinue after sufficient experience with interim approach

Who Is a New Owner?

- Functional Definition
 - Before transaction, new owner
 - Not responsible for environmental compliance at facility
 - Did not cause the violations being disclosed
 - Could not have prevented violations
 - Violation originated with the prior owner
 - Before transaction
 - Neither buyer or seller had largest ownership share of the other entity
 - Either shares or voting rights
 - Buyer and seller did not have common corporate parent

Examples: Who Is a New Owner?

- Company merges owner of audited facility into a sister subsidiary
 - Not new owner: common corporate parent
- Acquiror merges newly created subsidiary with target, target is surviving entity
 - Probably new owner as long as acquiror did not also control merger target or target's parent
- “Silent” limited partner buys out other partners
 - New owner as long as did not control compliance, had minority interest/voting rights before buyout

Benefits of Interim Approach

- New owner benefits available for 9 months after closing
- New owner penalty benefits
 - No penalties, including economic benefit, for pre-closing periods
 - If violations are corrected within 60 days or other period agreed to by EPA, no post-closing economic benefit penalties for:
 - Delayed capital expenditures
 - Unfair competitive advantage

So What Penalties Can Be Assessed?

- Penalties for economic benefit associated with avoided O & M costs from the date of acquisition until corrective action is completed
- Rationales
 - New owner benefits from not having to operate and maintain controls until they time that they are installed
 - Encourages prompt performance of audit and corrective action

Requirements of Interim Approach

- **Systematic Discovery**
 - Can be satisfied by “one time” pre-closing due diligence
 - No particular level of inquiry required
 - Audit may also be performed post-audit
 - Pursuant to agreement with EPA before audit undertaken, or
 - Audit and disclose as violations are discovered
- **Voluntary Discovery**
 - Discovery can be voluntary as long as before next required monitoring event, the new owner either
 - Discloses violation
 - Enters into agreement with EPA with an auditing and disclosure schedule

Requirements of Interim Approach

- Prompt Disclosure
 - Discovered during pre-closing due diligence: 45 day after closing
 - Discovered post-closing:
 - Later of
 - 21 days after discovery
 - 45 days after closing
 - If agreement, pursuant to agreement
 - As otherwise provided by law (audit doesn't trump)

Requirements of Interim Approach

- Excluded Violations
 - New owner gets penalty mitigation even if violation involves serious harm, provided
 - No fatality, serious injuries, evacuation, or catastrophic event
 - Violation began before closing
- Cooperation
 - New owner must cooperate to demonstrate it qualifies as new owner

Requirements of Interim Approach

- Other 4 conditions unaffected, existing guidance applies
 - Independent discovery
 - Must be discovered and disclosed before agency likely would have identified problem
 - Correction and remediation
 - 60 days or
 - As agreed with EPA
 - Prevent recurrence
 - No repeat violations
 - New owner continues to get exemption

Miscellaneous Details

- No consideration of purchase price adjustments
- No consideration of indemnities
- No enforcement protection to prior owners

Comparison of Audit Policy Benefits

- EPA (interim new owner policy)
 - 100% penalty reduction for disclosed violations
 - Exception: Economic benefit penalty component for avoided post-closing O & M costs
 - 9 months after closing to qualify as new owner
 - No requirement to tell EPA before beginning the audit unless you want more than the default time to disclose violations
- Texas
 - No benefits specific to new owners
 - 100% penalty reduction for disclosed violations with limited exceptions
 - No limitations on time when audit has to be performed
 - Must notify TCEQ before beginning audit if you want penalty immunity

Questions