

EPA Unveils Interim Audit Policy for New Owners of Regulated Facilities

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On August 1, 2008, the Environmental Protection Agency (“EPA”) announced its interim approach for applying the Audit Policy to new owners of regulated facilities. The interim approach is designed to give additional incentives to new owners of facilities to participate in the audit program. The key elements of the interim approach that EPA unveiled last week are: 1) the definition of “new owner” under the policy; 2) the duration of new owner status; 3) penalty calculation for new owners; and 4) the application of normal Audit Policy conditions to new owners.

The Audit Policy, formally known as EPA’s policy on “Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations” was last issued in 2000. The Audit Policy’s purpose is to encourage owners of facilities to conduct self-audits of environmental compliance in exchange for reduced penalty assessments. Facilities conducting an audit review their own environmental compliance, disclose violations, and take steps to remedy non-compliance. EPA’s announcement of the interim approach for new owners is part of a larger initiative to increase participation in audit programs. The interim approach is effective as of August 1, 2008.

Eligibility for New Owner Status

EPA announced that an entity will be considered a “new owner” if the following conditions are met: 1) prior to the transaction the new owner was not responsible for environmental compliance at the facility, did not cause the violations being disclosed, and could not have prevented the violation; 2) the violation originated with the prior owner; and 3) prior to the transaction neither the buyer nor the seller had the largest ownership share of the other entity, and they did not have a common corporate parent. The last of these was designed to prevent corporate spin-offs from taking advantage of the benefits offered to new owners. New owners will be required to self-certify that they meet these requirements. EPA determined that it would be too costly and burdensome to analyze corporate transactions to determine new owner eligibility.

Duration of New Owner Status

With respect to the duration of new owner status, entities will be eligible for new owner status for nine months after the date of the transaction closing. New owners can make disclosures within the first nine months in two different contexts. The first of these would be for the new owner to enter into a formal audit agreement with EPA within the first nine months following the transaction. This approach is recommended by EPA because it will effectively stop the nine-month clock on new owner status. If an owner elects for this option, they will have the ability to negotiate the scope of facilities, regulatory programs, and time frames for audits and disclosure of violations. The second option is for new owners to report violations individually so long as each violation is reported with 21 days of discovery or within 45 days of closing, whichever is longer. This option offers new owners more flexibility with respect to disclosures and correcting violations, but offers them less time to take advantage new ownership status.

Penalty Assessments for New Owners

New owners will also be subject to a different approach for penalty assessment. New owners will not be subject to economic benefit or gravity penalties for the period preceding the date of the acquisition. However, penalties for economic benefit associated with avoided operation and maintenance costs will be assessed against new owners starting on the date of the transaction closing. New owners will not be assessed penalties for economic benefit associated with delayed capital expenditures or with unfair competitive advantage if the violation is corrected within 60 days of the discovery of the violation, or another reasonable timeframe to which EPA has agreed.

Application of Audit Policy Conditions to New Owners

Under the interim approach, normal Audit Policy conditions will not be applied wholesale to new owners. The conditions will apply as follows:

- **Systematic Discovery Condition.** This condition requires participants to discover violations through a systematic, documented, periodic and objective review or audit process. EPA recognizes that environmental due diligence conducted prior to a transaction meets all of these elements except the requirement that there be periodic reviews or audits. Therefore, EPA is waiving the requirement for new owners that the audit or review be conducted on a periodic basis.
- **Voluntary Discovery Condition.** Under the Audit Policy, a violation must be discovered during a voluntary monitoring, sampling, or auditing procedure, and not a legally mandated procedure. EPA is eliminating this condition for new owners in order to encourage new owners to conduct a broad compliance survey and correct violations.
- **Prompt Disclosure Condition.** Normally entities must disclose a violation within 21 days of discovery. Recognizing the often frenetic nature of changes in ownership, EPA will require new owners to report violations within 21 days of discovery or within 45 days after the transaction closing, whichever is longer.
- **Discovery and Disclosure Independent of Government or Third Party Plaintiff Condition.** The Audit Policy requires that violations be discovered before a governmental agency would have discovered them, or before a third party complaint has been filed. EPA is not altering this requirement.
- **Correction and Remediation.** EPA requires that once disclosed, a violation must be corrected within 60 calendar days of the date of discovery. EPA is not changing this condition for new owners other

than providing that for violations that are discovered prior to acquisition, the date of the transaction closing will be considered the date of discovery.

- **Prevent Recurrence.** The Audit Policy requires the disclosing entity to agree in writing to take steps to prevent a recurrence of the violation. This condition will still apply to new owners.
- **No Repeat Violations Condition.** Repeat violations or similar violations are not normally eligible for Audit Policy benefits such as penalty mitigation. The Audit Policy already states that this condition does not apply if a facility has been newly acquired and the violation pre-existed the acquisition. EPA is not changing this condition for new owners.
- **Other Violations Excluded Condition.** In order for a violation to be eligible for Audit Policy benefits the violation cannot have resulted in serious actual harm, presented imminent danger to human health or the environment, or have violated the specific terms of an administrative or judicial order. EPA is waiving this condition for new owners if the violation began before the new owner acquired the facility, unless the violation results in a fatality, community evacuation, or other seriously injurious or catastrophic event.
- **Cooperation.** This condition simply requires the regulated entity to cooperate with EPA throughout the audit process. EPA is modifying this condition to require new owners to provide information to EPA, as requested, to ensure that the entity qualifies for new owner status. Prior and current disputes and/or litigation with EPA at other locations will not be considered.

Web-Based Pilot Program for Self-Disclosure

EPA also announced the launch of a web-based self-disclosure pilot program this week. The pilot program will allow regulated facilities to electronically disclose violations of the Emergency Planning and Community Right-to-Know Act ("EPCRA"), 42 U.S.C. §11001 *et seq.*, pursuant to the Audit Policy. Among the violations that can be reported are those related to Emergency Notification, Material Data Safety Sheets, Hazardous Chemical Inventory Forms, and Toxic Chemical Release Forms. Facilities located in EPA Region 6 States (AR, LA, NM, OK, and TX) can use the web-based disclosure project to disclose violations of any federal environmental law. For more information on this program visit:

<http://www.epa.gov/compliance/incentives/auditing/edisclosure.html>.

Conclusion

EPA will conduct an ongoing assessment of the effectiveness of the approach towards new owners. The agency solicited comments on the outlined interim approach; comments are due on October 31, 2008. Additionally, EPA intends to assess this approach by tracking the number of new owner disclosures, the pounds of pollutants estimated to have been reduced or eliminated, the dollars invested in improved environmental performance, and EPA will identify regulated facilities whose new owners did not participate in the audit program. Despite fears that the new policy will have a chilling effect on mergers and acquisitions, EPA policymakers speculate that incentives for new owners could have a beneficial effect on negotiations.

Live Links

United States Environmental Protection Agency; Electronic Self-Disclosure under the EPA Audit Policy

United States Environmental Protection Agency; Interim Approach to Applying the Audit Policy to New Owners; Federal Register: August 1, 2008 (Volume 73, Number 149)

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