

Environmental Audits: Privilege, Voluntary Disclosure and Other Legal Issues

Ensuring Compliance With Environmental Laws, Responding When Violations Are Discovered

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Strafford Webinars
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Overview

- Environmental compliance auditing
- Privileges available to protect audit-derived information
- Voluntary audit disclosures
- Audit and disclosure opportunities for new owners
- Complications for auditing and disclosure arising from recent enforcement trends
- The future of voluntary disclosures

Environmental Compliance Auditing – Designing and Implementing an Audit Program

Environmental Compliance Auditing

- What is an “environmental compliance audit”?
- What different purposes might audits serve?
- Options for structuring audits
- What is the audit process? End product?
- What are the primary benefits of auditing?
- What are the primary costs and risks?

U.S. EPA's Approach to Audits

- US EPA believes routine self-auditing is a key part of good compliance hygiene and expects companies to self-audit
- US EPA launched its voluntary self-disclosure program over 30 years ago to provide extra incentives to perform regular self-audits
- EPA believes the same incentives are not necessary because corporate auditing is more ingrained
 - EPA program has “evolved” from nationwide initiative with dedicated resources to automated system with small HQ resources overseeing it
- Newer trend: EPA staff have recently pushed for independent or third-party audits



U.S. EPA's Approach to Audits

- EPA may look more favorably upon a company that has a self-auditing program in place when determining an enforcement response
 - The US may push company to developed internal auditing procedures as injunctive relief in settlements to ensure sustained compliance
 - Routine self-auditing can identify compliance issues promptly and help correct violations, limiting injunctive relief the government can seek in enforcement
 - DOJ is not as likely to pursue penalty only cases (i.e., where noncompliance has been corrected and no/limited relief remains)
- EPA's general policy is not to request audit reports from companies
 - But EPA could seek audits in discovery, subject to privilege claims

Privileges Available to Protect Audit-derived Information

Use of “Privilege” in Compliance Audits

- Compliance audit information and reports carry significant risks as potential evidence
- Different evidentiary privileges may be available if properly structured
- Using the attorney-client communication privilege
- Using attorney work product doctrine
- Other less familiar general legal privileges
- Statutory privileges specifically for environmental audits

US EPA Position on Audit Privilege

- EPA has longstanding policy opposition to audit privilege
 - “The Agency remains firmly opposed to statutory and regulatory audit privileges and immunity. Privilege laws shield evidence of wrongdoing and prevent States from investigating even the most serious environmental violations.”
 - “Audit privilege and immunity laws are unnecessary, undermine law enforcement, impair protection of human health and the environment, and interfere with the public’s right to know of potential and existing environmental hazards.”

U.S. EPA, Audit Policy (Apr. 11, 2000), 65 Fed. Reg. 19,618, 19,623.

- EPA has “agreed to disagree” with states maintaining audit privilege (and penalty immunity) provisions



Voluntary Audit Disclosures: Leniency, Penalty Benefits, and Audit Privilege

Voluntary Audit Disclosures – U.S. EPA Program

- Key benefits provided by EPA and state programs
 - EPA and states offer leniency to disclosing companies
 - EPA Audit Policy provides penalty reduction
 - States provide penalty reductions (some provide full penalty immunity) and some provide audit privilege
- EPA Audit Policy originally launched in 1986 and amended in 1995 and 2000; New Owner policy issued in 2008
- EPA Audit Policy provides an opportunity to eliminate the gravity penalty if nine conditions are met
 - EPA may waive economic benefit (BEN) if it is insignificant, which in practice has generally been up to \$7500
 - Otherwise, Audit Policy provides that EPA will seek to collect BEN



Nine Conditions of U.S. EPA Audit Policy

1. Systematic discovery – required for 100% gravity penalty mitigation, otherwise only 75% mitigation
2. Voluntary discovery
3. Prompt disclosure – within 21 days of discovery
4. Discovery, disclosure independent of government/third-party plaintiff
5. Correction and remediation – within 60 days after discovery unless written agreement/order
6. Prevent recurrence
7. No repeat violations – can't have same or closely related violation at same facility within past 3 years
8. Other violations excluded (serious actual harm, imminent and substantial endangerment)
9. Cooperation



U.S. EPA Audit Policy – Track Record

- Majority of disclosures to EPA are for minor violations
- Approximately 50% of disclosures have been for EPCRA (the rest scattered across several other statutes—Clean Air Act, Clean Water Act, FIFRA, TSCA)
- Obstacle is risk of having to pay a penalty and go through extensive formal enforcement action including a consent decree
 - Perception of “no takebacks” with disclosures can be disincentive to disclose
- EPA scaled back resources for Audit Policy and developed electronic reporting system in late-2015



U.S. EPA's eDisclosure System

- With eDisclosure, electronic Notices of Determination are automatically issued for certain qualifying EPCRA disclosures (Category 1)
- All other disclosures receive an electronic acknowledgment letter (Category 2)
 - EPCRA/CERCLA chemical release reporting violations
 - EPCRA violations with significant economic benefit
 - Violations under all other statutes
 - Violations where discovery was not systematic
 - Category 2 disclosed violations will be considered for Audit Policy eligibility only if EPA elects to take an enforcement action later
- Note that “new owners” may still submit disclosures outside of the eDisclosure system and negotiate audit agreements
 - All other disclosures must “generally” go through eDisclosure (EPA retained flexibility)



When Would I use EPA's Audit Policy Today?

- Violations of federal programs such as EPCRA and CAA fuel provisions (i.e., where disclosure to state is not an option)
- To achieve resolution of any EPA claims if the Agency investigates the company later and finds company meets the Audit Policy
 - Note that as matter of policy, EPA and states generally respect each other's resolution of disclosed violations
 - But self-disclosing violations to a state with an authorized federal program does not resolve legal claims for those violations, and vice versa
- Disclosures under EPA's New Owner Policy allowing companies to negotiate audit agreements with EPA

When Would I use EPA's Audit Policy Today?

- Likelihood of EPA following up on any particular disclosure is very low
 - EPA follows up in ~5-10% of disclosures made to eDisclosure
 - EPA has been asked to publish % of disclosures made via eDisclosure resulting in follow-up
- EPA says it is spot checking disclosures for imminent and substantial endangerment issues and to maintain integrity of system
- EPA program = eDisclosure system + very small number of staff who address policy issues and monitor and trouble-shoot the system
 - Cutback on EPA Regional staff working on Audit Policy disclosures
- \$64 million question: is EPA amenable to policy change to provide full penalty immunity for self-disclosures?

State Voluntary Disclosure Programs

- A number of states have voluntary disclosure programs that provide audit privilege and/or penalty immunity for self-disclosed violations
 - See <https://www.epa.gov/compliance/state-audit-privilege-and-immunity-laws-self-disclosure-laws-and-policies>
- State programs include privilege laws, penalty immunity laws, and statutes providing both privilege and immunity
 - Example: Texas audit privilege and immunity law
- EPA worked with states in 1990s to ensure state programs met minimum federal criteria for enforceable programs
- EPA engages with state if there are further audit program changes to ensure consistency with federal requirements

State Voluntary Disclosure Programs

- Logistics for using different state programs
 - Policies v. Statutes
 - Active v. Inactive programs
 - Special instructions for eligibility or submittal
- Build your audit to cover the applicable information needs, timelines, etc.
- Scope your audit and your disclosure to the jurisdiction of the relevant agency
- Texas perspective

Audit and Self-disclosure Opportunities for New Owners

Voluntary Disclosure Opportunities for New Owners

- In 2008, EPA launched the “Interim Approach to Applying the Audit Policy to New Owners”
- New Owner Policy offers tailored incentives to companies acquiring new facilities if they:
 - Certify they meet the definition of “new”
 - Prior to the transaction, owner was not responsible for environmental compliance at the facility which is the subject of the disclosure, did not cause the violations being disclosed and could not have prevented their occurrence;
 - The violation which is the subject of the disclosure originated with the prior owner; and
 - 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.
 - Disclose violations or enter into an audit agreement with EPA no later than 9 months of the transaction closing

EPA's New Owner Policy

- New owners may still approach EPA the “old fashioned way” - outside the eDisclosure system and may negotiate audit agreement
- Expanded benefits under New Owner Policy
 - No penalties for activities before date of acquisition
 - Economic benefit is limited to O&M costs from closing (no BEN for capital costs)
- Modified Audit Policy conditions for new owners include:
 - New owner must come in, and enter into an audit agreement or disclose violations, before the first instance when the monitoring, sampling or auditing is required
 - “Periodic review” requirement is waived for what is, by its nature, a one-time event - and new owners can get full penalty mitigation
 - New owners will have 45 days after closing to disclose violations they find before acquisition

Considerations with Using New Owner Policy

- New owners may already be well-situated and motivated to use the Audit Policy:
 - Were not responsible for the facility when the noncompliance began
 - May already be assessing and auditing new facilities to manage and reduce risk
 - May have funding available to fix problems, or have budget commitments which are still relatively flexible
- Possible disincentives to use the New Owner Policy
 - Potentially significant penalties for economic benefit (e.g., NSR/PSD relief)
 - Ineligibility for certain violations
 - Uncertainty about treatment by EPA (e.g., Consent Decree with DOJ?)



New Owner Policy Track Record

- Many disclosures have been submitted that span multiple statutes
- Companies still nervous about disclosing violations with potentially significant BEN and injunctive relief (e.g., NSR/PSD)
- Remains an opportunity to interact with EPA staff and negotiate flexible audit framework to disclose noncompliance on prior owner's watch
- EPA staff are very experienced with New Owner disclosures
- \$64 million question: is EPA amenable to providing full penalty immunity for new owner disclosures?



New Owner Policy – Which Deals?

- Lots of different transactional models
 - Stock purchase or merger versus asset purchase
 - EPA’s “new owner” test disqualifying in many transactional circumstances
 - What about EPA’s reservation of option to go after seller?
- When is a new owner audit potentially most valuable?
- When is a new owner audit potentially least useful?

Complications for Auditing and Disclosure Arising from Recent Enforcement Trends

Enforcement Trends to Consider in Audit Approach

- EPA position that disclosures will now be released under FOIA “within a few months” after receipt
 - But not clear that there has been increase in FOIAs
- Smaller EPA staff and risk of “boots on the ground” inspection
- Mailbox enforcement expanding due to resource declines (i.e., information requests)
- Lower overall risk of EPA follow-up after voluntary disclosure

Enforcement Trends to Consider in Audit Approach

- Next Generation technologies are more widely used
 - Remote sensing (FLIR cameras, Geospatial Measurement of Air Pollution)
 - Mobile technologies (e.g., iPhones)
 - Fenceline and real-time monitoring and reporting
 - GIS software tools to identify higher risk facilities
 - Use of overflights and . . . drones?
- Heightened citizen monitoring of facilities and use of Next Gen technologies
 - “Privatized enforcement”
- Clean Air Act 112(r) issues: expanded use

Enforcement Trends and Auditing

- Traditional “checkbox” auditing poor preparation and prevention against “next generation” enforcement approaches
- “When in Rome?” Do you self-audit using those approaches? If so, how?
- How do you write up audit findings when using Audits 2.0?
- How do you write an audit disclosure when using Audits 2.0?
- What are the legal and practical implications for disclosures based on advanced monitoring or general duties?

Future of Voluntary Disclosures

What will the Future Hold?

- Will states adopt electronic disclosure platforms like eDisclosure?
- Will US EPA realign its Audit Policy with state programs such as Texas?
 - EPA is seeking policy reforms to declare victories in next 1-2 years (before 2020 elections)
 - EPA is committed to streamlining compliance process using nontraditional programs (see EPA Smart Sectors program)
- How will cooperative federalism affect voluntary disclosure programs?