

New Directions for EPA's Audit Policy: Interim Approach to Applying the Audit Policy to New Owners



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Part VII

**Environmental
Protection Agency**

Incentives for Self-Policing: Discovery,
Disclosure, Correction and Prevention of
Violations; Notice



Compliance Incentives and Auditing – EPA HQ Website

- **EPA Headquarters Website**
www.epa.gov/compliance/incentives/auditing
- **Compliance Incentives**
- **Innovations**
- **Auditing**
- **Environmental Management Systems**
- **Pollution Prevention**
- **Small Business**
- **Small Community**

Key Documents and Information at EPA Headquarters Website

- [Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations \(Original Audit Policy\); 60 Fed. Reg. 66706 \(1995\)](#)
- [Audit Policy Interpretive Guidance \(1997\)](#)
- [Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations \(Revised Audit Policy\); 65 FR 19,618 \(2000\)](#)
- [The Small Business Compliance Policy \(2000\)](#)
- [Use of Corporate Auditing Agreements for Audit Policy Disclosures – Corrected Version \(2001\)](#)
- [Audit Policy: Frequently Asked Questions \(2007\)](#)
- [EPCRA eDisclosure -- EPA's Electronic Audit Policy Self-Disclosure System Pilot \(2008\)](#)



Region 5 -- Office of Regional Counsel Audit Policies & Self-Disclosures Additional Information

○ EPA, Region 5 Website

www.epa.gov/region5/orc/audits.htm

- State Audit Privilege and Immunity Laws & Self-Disclosure Policies
- Make a Self-Disclosure
- Outline of Audit Policy (PDF)
- Region 5 Self-Disclosure Cases
- Small Business and Compliance Enforcement Web Page



EPA, Region 5

Audit Policy Contact Information

Region 5

States: Illinois, Indiana, Michigan,
Minnesota, Ohio, and Wisconsin

Contact

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Nine Audit Policy Conditions

1. **Systematic Discovery** (2 ways – audit or CMS)
2. **Voluntary Discovery** (not otherwise legally required)
3. **Prompt Disclosure** (21 Days & disclosure to EPA HQ if violations are in more than one EPA region)
4. **Independent Discovery and Disclosure** (not after federal, state or local investigation, etc.)
5. **Correction and Remediation** (within 60 days)
6. **Prevent Recurrence** (written agreement)
7. **No Repeat Violations** (3 years at same facility or 5 years if corporate pattern)
8. **Certain Violations Excluded** (2 types – serious harm, etc. or violates order or agreement)
9. **Cooperation** (provides requisite or requested information to EPA)



EPA Audit Policy to Date

- EPA continues to amend and streamline the process to improve implementation
- Has encouraged companies or persons to self-police and return to compliance
- Has provided substantial penalty mitigation

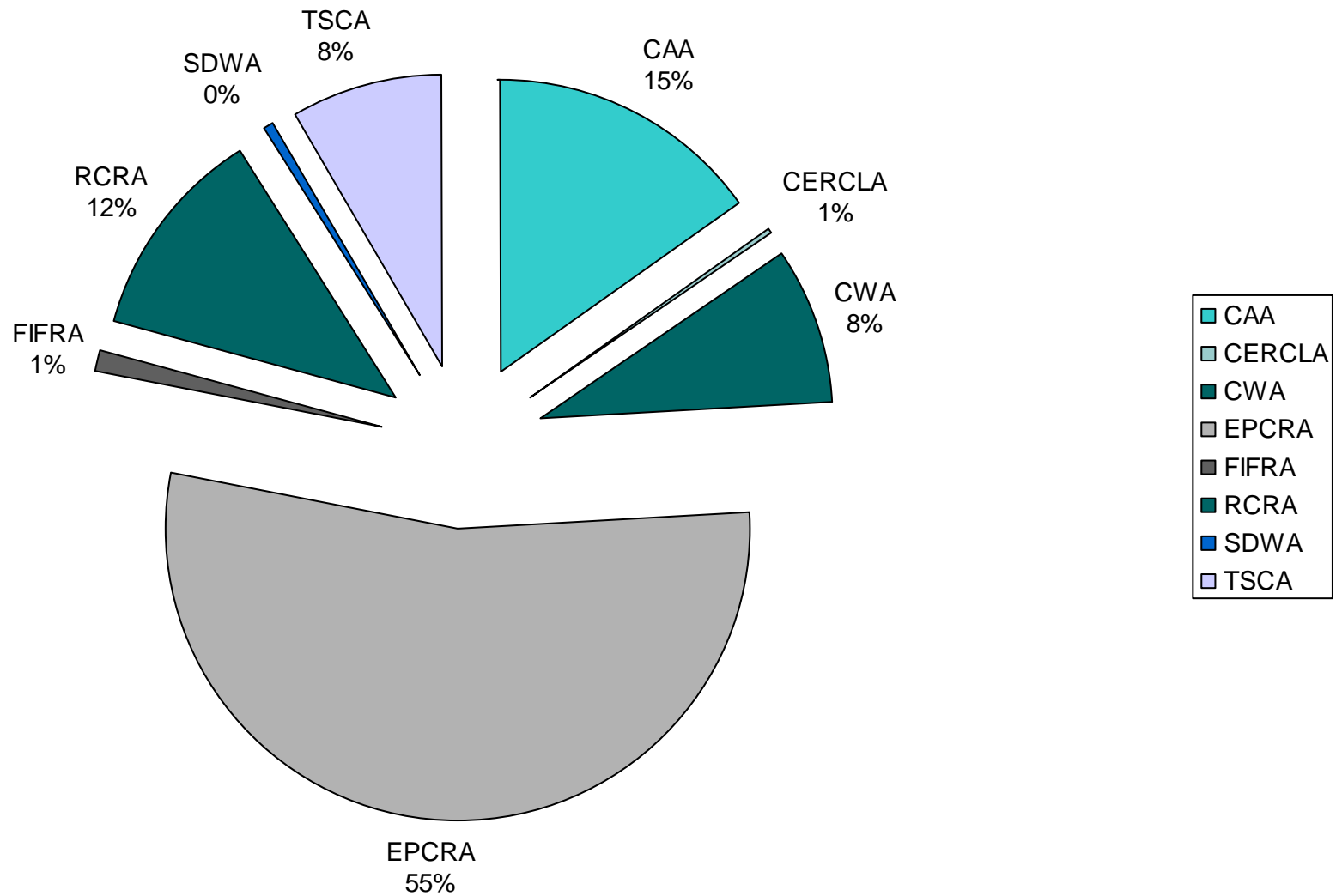
EPA's Audit Policy: Purpose and Benefits

- **Has enhanced protection of human health and the environment by encouraging regulated entities to**
 - discover
 - disclose
 - expeditiously correct and
 - prevent the recurrence of environmental violations
- **Has mitigated gravity-based penalties**
 - However EPA has the discretion to recover any economic benefit if significant

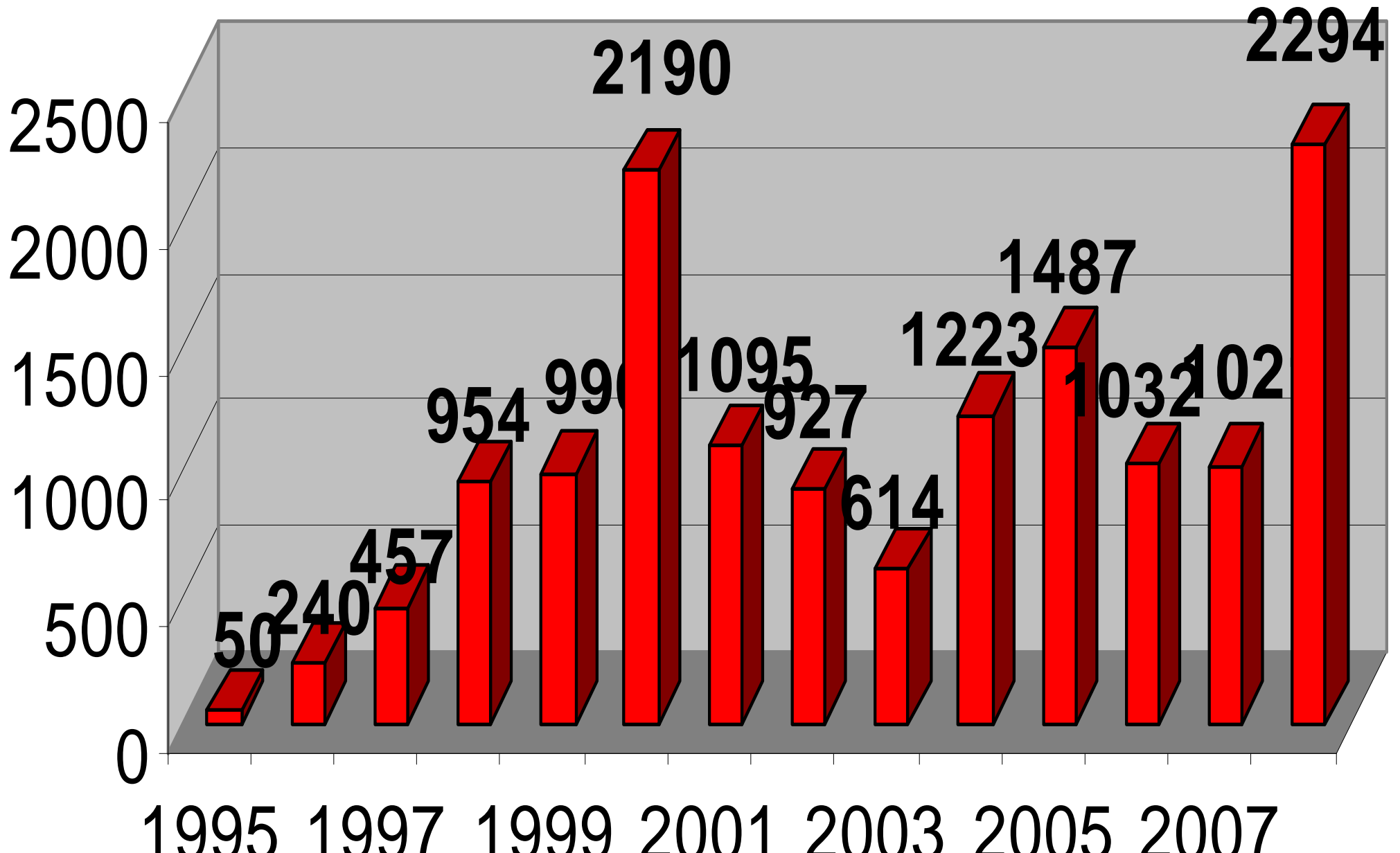
Audit Policy: Results

- Highly successful – resolved disclosures at over 4,000 entities
- However, the majority of disclosures have been of reporting violations
- While these disclosures are important, they have not directly resulted in many pounds of pollutants being reduced or removed from the environment

Resolved Disclosures (by Primary Law in ICIS) FY 96 - FY 08



Facilities Disclosing under the Audit Policy



Compliance Incentives for Proactive Behavior: EPA's Audit Policy and eDisclosure System

EPA provides incentives to companies that voluntarily discover, promptly disclose, correct, and prevent future environmental violations through the Audit Policy. EPA may reduce or waive penalties for violations if the facility meets the conditions of the policy. EPA will not waive or reduce penalties for repeat violations, or violations that resulted in serious actual harm.

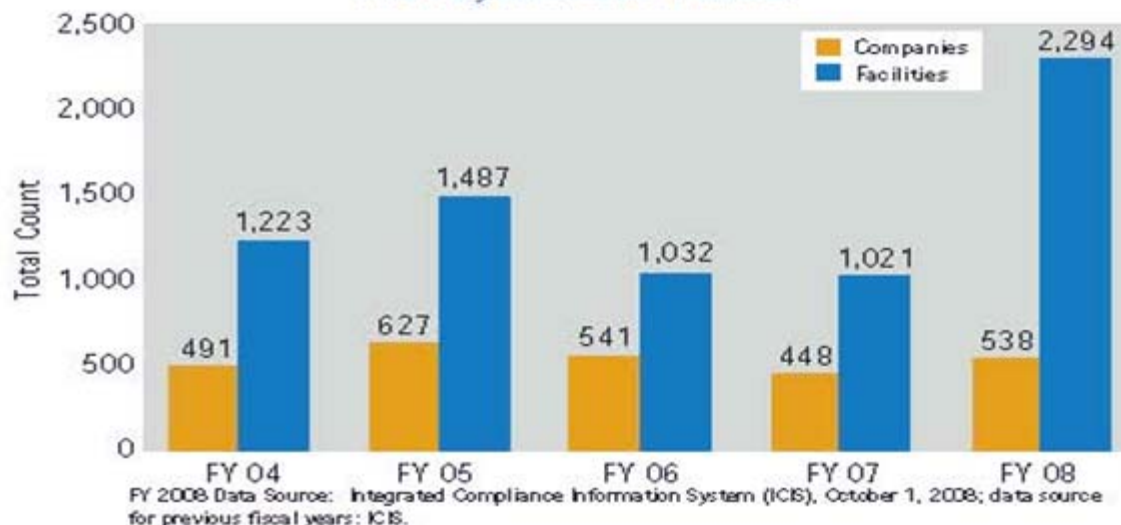
The Audit Policy has yielded great results. Since 1995 more than 3,500 companies have disclosed and resolved violations at nearly 10,000 facilities under the policy. FY 2008 marks the highest total of facilities that disclosed violations in a single year—2,294 facilities.


Recognizing the success of the program, EPA decided to maximize results by taking the Audit Policy in some new directions. In FY 2008, EPA launched a new approach that offers incentives to new owners of facilities who correct environmental violations at recently-acquired facilities. Under the new approach, new owners may be eligible for reduced penalties. The new approach encourages owners of recently-acquired facilities to come forward, make a clean start by addressing environmental noncompliance, and promptly make changes to ensure they stay in compliance.

EPA made additional changes to streamline the process for everyone. Now, regulated entities can submit self-disclosures online through a new Web-based system, "eDisclosure." The new system allows facilities to submit their information securely on EPA's Web site, and should reduce transaction costs by ensuring that each disclosure contains complete information. The eDisclosure Web site can be found at www.epa.gov/compliance/incentives/auditing/edisclosure.html.



EPA Voluntary Disclosure Programs
Voluntary Disclosures Initiated





**1997 EPA Audit Policy Interpretive Guidance
Q&A #15
New Owner/Operator Eligibility under the Audit Policy
[Background]**

- **A new owner may obtain penalty mitigation if it meets all of the policy's 9 conditions, including prompt disclosure to EPA, as soon as it discovers the violation**
- **Except where the discovery was via a legally mandated monitoring or sampling requirement prescribed by statute or regulation**
- **A prior owner's actions will not be imputed to the successor, except where the relationship between the companies makes imputing such actions appropriate, e.g. if there has not been an arm's length transaction between the old and new entities**
- **Thus, separate entities are considered independently, and applicability of the policy is based on the merits of each individual entity's actions**

2007 Audit Policy Frequently Asked Questions
Q&A #5:
New Owner Disclosure Repeat Violations (Condition 7)
[Background]

- **EPA generally considers successors that undertake examinations of newly acquired facilities to be eligible irrespective of the successor's history of violations at other facilities**
- **EPA's primary interest is to encourage newly acquired facilities to undergo a comprehensive examination of, and improvements to, its environmental compliance and management systems**
- **Notwithstanding a successor's history of violations at their other facilities, if its efforts to examine and improve upon an acquired facility's environmental operations are thorough and are likely to result in improved compliance, EPA's intent is to encourage such examinations**

2007 Audit Policy Frequently Asked Questions

Q&A #2:

New Owners and Title V of the Clean Air Act [Background]

- Generally, CAA violations discovered as part of Title V certification are not eligible for penalty mitigation under the Policy
- Because the CAA Title V permit program (40 C.F.R. § 70.5) establishes a legal duty for permit holders to comprehensively review the source's compliance status and certify annually as to such status, the discovery and disclosure of Title V violations is typically not voluntary
- Because Condition 2 of the Audit Policy requires that disclosed violations must not be discovered through a legally mandated monitoring or sampling requirement prescribed by statute or regulation, such discoveries are not generally available for credit under the Audit Policy

2007 Audit Policy Frequently Asked Questions

Q&A #2:

New Owners and Title V of the Clean Air Act 2007 Audit Policy [Background] (Continued)

- In 1999, EPA clarified that in some instances, certain CAA violations discovered, disclosed, and corrected by a company prior to the issuance of a CAA Title V permit may be eligible for penalty mitigation
- In 2007, EPA also clarified that for new owners, which in good faith undertake such efforts and inform the Agency of such actions, either by disclosure in writing or entry into an Audit Agreement, prior to submission of its first annual Title V certification, the violations disclosed would be considered voluntarily discovered for purposes of the Audit Policy

2007 Audit Policy Frequently Asked Questions

Q&A #2:

New Owners and Title V of the Clean Air Act 2007 Audit Policy [Background] (Continued)

- **EPA considers such violations on a case-by-case basis to ensure that the disclosing entity is truly a “new owner” and qualifies for consideration under the Audit Policy**
- **In addition, in these situations, as with all Audit Policy disclosures, if a particular disclosure does not qualify for credit under the Audit Policy, it may still be eligible for penalty mitigation pursuant to the applicable enforcement response or penalty policy**

New Audit Policy Directions in 2007

- EPA wanted to increase self-disclosures that result in direct pollutant reductions when the violations were corrected
- In 2007, EPA began to explore ways to encourage new owners of regulated entities to look closely at compliance issues at their recently acquired facilities, self-disclose and, most importantly, fix the environmental problems they found

Why Focus on New Owners?

- In recent years, EPA has entered into corporate auditing agreements with new owners after mergers or acquisitions valued at over \$1 billion, which offer promising opportunities for significant environmental outcomes
- There are equitable and policy reasons to offer a new owner tailored incentives - where a new owner fixes violations that arose before a facility was under its control, and makes changes to ensure future compliance
- **Active M&A Market**
 - Estimated 80 M&As over \$25 million annually in Chemical Industry (source: Young & Partners)

Why Focus on New Owners? (Continued)

- New owners have a unique opportunity to invest in making a “clean start” at recently acquired facilities, by addressing environmental issues
- EPA may be able to secure high quality environmental improvements more quickly and effectively

Why Might New Owners Want to Use the Audit Policy?

New owners may already be well-situated and motivated to use the Audit Policy because they:

- 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

Why Might New Owners Not Want to Use the Audit Policy? (Continued)

- Possible disincentives to use the Audit Policy
 - **Significant penalties for economic benefit**
 - **Ineligibility for certain violations**
 - **Uncertainty about treatment by EPA**

Interim Approach to Applying the Audit Policy to New Owners (“Interim Approach”)

- **On August 1, 2008, EPA launched and sought public comment on its Interim Approach, which offers incentives tailored to encourage new owners to use the Audit Policy**
 - Published in Federal Register (73 FR 44991)
 - Comment period ended on October 30, 2008
- **EPA had sought public comment on this concept in 2007:**
 - Comments were generally very supportive with helpful ideas about ways to motivate new owners

What Are the Tailored Incentives?

Incentives include (described more fully below):

- **Clear statement about mitigating some portion of penalty for economic benefit**
- **Expanded range of violations that may be eligible for Audit Policy consideration (more than CAA Title V violations)**

Who Is a New Owner for Purposes of These Tailored Incentives?

An eligible new owner must certify that:

- Prior to the transaction, it 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 (no spin-offs).

What Must a New Owner Do to Qualify for These Tailored Incentives?

Within 9 months of the transaction closing, a new owner must:

- Promptly disclose violations to EPA
- or
- Enter into an audit agreement with EPA

Tailored Incentives: Enhanced Penalty Mitigation

If a new owner meets all the conditions of the Audit Policy, as modified for new owners:

- **No penalties for the period before the date of acquisition;**
- **No penalties for economic benefit associated with delayed capital expenditures, one-time non-depreciable costs or unfair competitive advantage, if the violations are properly corrected; and**
- **Penalties for economic benefit associated with avoided operation and maintenance (O&M) costs only assessed from the date of acquisition**

Tailored Incentives: Modifications to Audit Policy Conditions

- EPA is modifying 5 of the 9 Audit Policy conditions, in the context of new owners and the Interim Approach
- This will make more violations eligible for Audit Policy consideration and enhanced penalty mitigation

Modifications to Audit Policy Conditions:


Voluntary Discovery – Condition 2

- Some violations are already required to be identified through a legally mandated monitoring, sampling or auditing protocol and. Therefore, would usually not be eligible for Audit Policy consideration because their discovery is *not* “voluntary”
- New owners have a one-time “catch up” opportunity to disclose these violations under the Audit Policy and get penalty mitigation
- Must come in, and enter into an audit agreement or disclose violations, before the first instance when the monitoring, sampling or auditing is required

Modifications to Audit Policy Conditions:

Other Violations Excluded -- Condition 8

- Violations that resulted in serious actual harm or may have presented an imminent and substantial endangerment are usually ineligible
- For new owners, violations that began before the new owner acquired the facility will not be excluded under the Interim Approach, even if they gave rise to serious actual harm or an imminent and substantial endangerment
 - Unless there was a fatality, community evacuation or other seriously injurious or catastrophic event
- This should encourage new owners to come forward and correct significant violations, which is one of the goals of this approach



Modifications to Audit Policy Conditions: *Systematic Discovery - Condition 1 and Prompt Disclosure – Condition 3*

For violations found during pre-closing due diligence:

- “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

Other Audit Policy Conditions: Slight or No Modification

- Cooperation – Condition 9
 - Modified only to clarify that new owners must give EPA any info relevant to analyzing whether disclosure meets Interim Approach
- Independent Discovery and Disclosure – Condition 4
 - Must still find and disclose violations before EPA or government agency would likely have found them

Other Audit Policy Conditions: No Change to Current Interpretations

- **Correction and Remediation – Condition 5**
 - Must still correct within 60 days of discovery (or within reasonable time EPA which allows)
- **Prevent Recurrence – Condition 6**
 - Must still agree in writing to take steps to stay in compliance
- **No Repeat Violations – Condition 7**
 - For newly acquired facilities, neither previous violations at the facility, nor the new owner's history of violations at other facilities, triggers this exclusion

New Owner – INVISTA Makes "Clean Start" to the Benefit of the Environment

- **INVISTA is making a clean start, and EPA encourages other new owners to do the same**
- **EPA's experience with INVISTA guided the development of the New Owner Interim Approach**
- **On April 13, 2009, EPA announced the INVISTA settlement, the largest ever under the Audit Policy**
- **INVISTA conducted 45 separate audits of environmental practices and compliance at facilities**
- **Settlement will reduce nearly 20 million pounds. Between FY05 & FY08 only 8.55 million pounds of pollutants were reduced, treated, or eliminated as a result of audits**
- **\$1.7 million civil penalty; up to \$500 million in injunctive relief**

State Environmental Audit Privilege & Immunity Laws

- Many states have laws that consider certain information contained in an environmental audit report to be privileged, i.e. protected from disclosure.
- Many states also have laws that grant immunity from civil prosecution (in both civil judicial and administrative forums) and the imposition of penalties and fines for violations of environmental laws that were discovered during a voluntary environmental assessment or audit.

Region 5 States with Environmental Audit Privilege & Immunity Laws

- **Region 5 States with Self-Disclosure Policies**
 - Indiana (1999) [AP]
 - Wisconsin (2004) [AP]
- **Region 5 States with Audit Privilege and/or Immunity Laws**
 - Michigan (1996 & 1997) [P&I]
 - Minnesota (1995) [I]
 - Ohio (1996 & 1998) [P&I]
 - Illinois (2004) [P & Civil Penalty Mitigation Law] (1995 IL Immunity Law repealed in 2005)

State Privilege & Immunity Laws

v.

Federal Audit Policy

- EPA recognizes that States are partners in implementing the enforcement and compliance assurance program.
- When consistent with EPA's policies on protecting confidential and sensitive information, the Agency will share with State agencies information on disclosures of violations of Federally-authorized, approved or delegated programs.

State Privilege & Immunity Laws

v.

Federal Audit Policy (Continued)

- **In addition, for States that have adopted their own audit policies in Federally-authorized, approved or delegated programs, EPA will generally defer to State penalty mitigation for self-disclosures as long as the State policy meets minimum requirements for Federal delegation.**
- **Whenever a State provides a penalty waiver or mitigation for a violation of a requirement contained in a Federally-authorized, approved or delegated program to an entity that discloses those violations in conformity with a State audit policy, the State should notify the EPA Region in which it is located. This notification will ensure that Federal and State enforcement responses are coordinated properly.**

For More Information

- **New Owner Information on EPA's website:**
 - <http://www.epa.gov/compliance/incentives/auditing/newowners-incentives.html>
- **Questions about Interim Approach, contact Caroline Makepeace at:**
 - makepeace.caroline@epa.gov
- **Questions about the Audit Policy, contact Phil Milton, National Audit Policy Coordinator, at:**
 - milton.philip@epa.gov
- **Note -- Disclosures Under Interim Approach need to be made to EPA Headquarters**

EPA's Audit Policy Coordination Team (ACT)

- **HQ:** **Phil Milton, Chair (OCE)**
 J.T. Morgan (OCEFT)
- **DOJ:** **Anna Thode**
- **Region 1:** **Joel Blumstein**
- **Region 2:** **John Gorman/Diane Fiorito**
- **Region 3:** **Betty Barnes/Cheryl Jamieson**
- **Region 4:** **Kelly Sisario/Kevin Smith**
- **Region 5:** **Jodi Swanson-Wilson/John Steketee**

- **Region 6:** **Marcia Moncreiffe/Eli Martinez**
- **Region 7:** **Becky Dolph**
- **Region 8:** **David Rochlin**
- **Region 9:** **Daniel Reich**
- **Region 10:** **Meg Silver**