EPA’S RENEWED EMPHASIS ON SELF-DISCLOSED VIOLATION POLICIES AND DEVELOPMENT OF A NEW OWNER CLEAN AIR ACT AUDIT PROGRAM FOR OIL AND NATURAL GAS PRODUCTION FACILITIES

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Topics to be Covered

• EPA Penalty Policies and Components, Generally

• The EPA Audit Policy (initial version, 1995; current version, 2000)

• The New Owner Audit Policy (2008)

• EPA’s Renewed Emphasis on Self-Disclosed Violation Policies (May 2018)

• The Proposed New Owner Clean Air Act Audit Program for Oil and Natural Gas Exploration and Production Facilities (May 2018)
EPA Penalty Policies, Generally


- Under the umbrella of this policy, EPA has developed separate penalty policies under each of the major environmental statutes.
EPA Penalty Components

• Gravity-Based Component
  – Reflects the seriousness of the violation and egregiousness of the violator’s behavior; constitutes the punitive portion of the penalty
  – Factors Considered: actual or possible harm; importance to the regulatory scheme; availability of data from other sources
  – Facts Considered: amount and toxicity of the pollutant; sensitivity of the environment; length of time of the violation; and size of the violator

• Economic Benefit Component
  – The economic benefit of delayed or avoided compliance
  – Prevents an unfair economic advantage to a violator, preserves a level playing field
  – The “BEN” computer model
  – Economic benefit can include: capital costs; operations and maintenance costs; and time value of money based on applicable interest rates
The EPA Audit Policy (2000)


• Purpose: To enhance protection of human health and the environment by encouraging regulated entities to voluntarily discover, promptly disclose, expeditiously correct and prevent violations of Federal environmental law.

• Primary incentives:
  – Entities that meet all nine of the conditions of the policy are eligible for 100% mitigation of gravity-based penalties.
  – Entities that do not meet the first condition – systematic discovery of violations – but meet conditions 2 through 9 are eligible for 75% mitigation of gravity-based penalties.
1. **Systematic Discovery.** The violation must be discovered through (a) an environmental audit, or (b) a compliance management system that reflects the entity’s due diligence in preventing, detecting, and correcting violations.

2. **Voluntary Discovery.** The violation must be discovered voluntarily and not through a legally mandated monitoring or sampling requirement prescribed by statute, regulation, permit, judicial or administrative order, or consent agreement.

3. **Prompt Disclosure.** The entity fully discloses the violation in writing to EPA within 21 days (or within such shorter period of time as may be required by law) after the entity discovered the violation.

4. **Discovery and Disclosure Independent of Government or Third-Party Plaintiff.** The entity must discover and disclose the potential violation to EPA prior to commencement of an agency inspection or investigation or information request, notice of a citizen suit, reporting of the violation by a “whistleblower” employee, or imminent discovery of the violation by the agency.
Conditions of the EPA Audit Policy (2000)

5. **Correction and Remediation.** The entity must correct the violation within 60 days of discovery (extensions may be requested), certify in writing that the violation has been corrected, and take appropriate measures as determined by EPA to remedy any environmental or human harm due to the violation.

6. **Prevent Recurrence.** The entity must agree in writing to take steps to prevent recurrence of the violation.

7. **No Repeat Violations.** The specific violation (or a closely related violation) must not have occurred within the past 3 years at the same facility, or within the past 5 years as part of a pattern at multiple facilities owned or operated by the same entity.

8. **Other Violations Excluded.** The violation must not be one which (a) resulted in serious actual harm, or may have presented an imminent and substantial endangerment, to human health or the environment, or (b) violates the terms of any judicial or administrative order, or consent agreement.

9. **Cooperation.** The entity must cooperate as requested by EPA and provide such information as is requested by EPA to determine the applicability of the Policy.
The New Owner Audit Policy (2008)

• “Interim Approach to Applying the Audit Policy to New Owners,” 73 Fed. Reg. 44991 (August 1, 2008)

• Applies to all sectors/industries

• Purposes:
  – To offer certain incentives specifically tailored to new owners of regulated facilities that want to make a “clean start” at their newly acquired facilities by addressing environmental noncompliance that began prior to acquisition
  – To motivate new owners to audit newly acquired facilities and use the Audit Policy to disclose, correct, and prevent the recurrence of violations
  – To encourage self-disclosure of violations that will, once corrected, yield significant pollutant reductions and benefits to the environment

• Incentives:
  – Penalty mitigation beyond what is provided in the Audit Policy
  – Modification of certain Audit Policy conditions
The New Owner Audit Policy (2008)

• Definition of “New Owner”: Entity must certify to EPA that:
  – Prior to the transaction, it was not responsible for environmental compliance at the facility, did not cause the violations being disclosed, and could not have prevented their occurrence;
  – The violation 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.

• Owner will be considered “new” for 9 months after the transaction closing. Within the 9-month period, the entity can:
  – Enter into an audit agreement with EPA that specifies the facilities to be audited, the programs covered, dates for completion of the audits, and when the discovered violations must be disclosed (audit agreement “stops the clock”); or
  – Disclose violations individually, as they are discovered during the 9-month period.
The New Owner Audit Policy (2008)

• Calculation and Assessment of Penalties
  – No penalties for economic benefit or gravity will be assessed for the period before the acquisition
  – Penalties for economic benefit associated with avoided operation and maintenance costs assessed only from the date of acquisition
  – No penalties for economic benefit associated with delayed capital expenditures or unfair advantage if violations are corrected in accordance with the Audit Policy (i.e., within 60 days of the date of discovery or another timeframe agreed to by EPA)
Audit Policy Conditions Applied Differently in the New Owner Context

1. **Systematic Discovery.** New owner’s pre-closing due diligence is not required to meet the “periodic” element in order to be considered for full penalty mitigation.

2. **Voluntary Discovery.** Disclosures will not be disqualified if the new owner (a) promptly discloses the violations or (b) enters into an audit agreement with an auditing and disclosure schedule before the date the monitoring, sampling, or auditing would be required by law or an order or consent agreement.

3. **Prompt Disclosure.** Violations discovered in pre-closing due diligence must be disclosed within 45 days after the closing. Violations discovered post-closing must be disclosed within 21 days after discovery or within 45 days after the closing, whichever time period is longer.

8. **Other Violations Excluded.** Absent a fatality, community evacuation, or other seriously injurious or catastrophic event, where the violation that gave rise to serious actual harm or imminent and substantial endangerment began before the acquisition, violations will not be excluded from consideration under the Other Violations Excluded condition.

9. **Cooperation.** EPA will only look to whether the entity cooperated with EPA with respect to the determination of the applicability of the Audit Policy, not in past matters or whether the entity is in litigation with EPA on other matters.
EPA’s Renewed Emphasis on Self-Disclosed Policies (May 2018)

• For several years, it had been questionable whether EPA would continue its audit policies at all.

• In May 2018, EPA announced a renewed emphasis on its audit policies.

• EPA reminded the regulated community of key aspects of the Audit Policy (2000).
  – Elimination of 100% of gravity-based penalty
  – Discretion to waive economic benefit component of penalty
  – No admission of violation (may state that violations “may have” occurred)

• EPA also said it will encourage greater use of the New Owner Audit Policy (2008).
  – Expand outreach and education efforts in the regulated community
Proposed New Owner CAA Audit Program for O&G Exploration and Production Facilities (May 2018)

• Initially offered to new owners of *upstream* O&G E&P sites
  – Well sites and associated storage tanks and pollution control equipment

• Offers penalty reductions beyond those provided in the Audit Policy (2000) and New Owner Audit Policy (2008)

• Separate from and does not alter the Audit Policy (2000) and New Owner Audit Policy (2008)

• EPA has received and is reviewing public comments.
EPA’s Reasons for Proposing the New Program

• Significant excess emissions and CAA noncompliance at upstream facilities
  – Excess emissions can decrease air quality and contribute to area’s failure to meet air quality standards for ozone

• Unique compliance challenges
  – Numerous small, relatively similar types of facilities across the country, including remote areas

• Frequent transfers of ownership, typically involving many facilities in an O&G field or geographic area
  – New owners have an opportunity for a “clean start”
  – Noncompliance and causes of excess emissions may not be identified in pre-closing due diligence or post-closing assessments
  – New owners already be assessing facilities to manage risks, and may have funding available to fix problems
New Owner Eligibility

• Prior to the acquisition:
  – New owner was not responsible for environmental compliance at the facilities prior to the acquisition
  – Seller and new owner did not have the largest ownership share of the other, or a common corporate parent

• New owner must notify EPA within 6 months of the acquisition that it intends to participate in the program.
Audit Requirements

• EPA has provided a draft of a standard, template agreement for the audit program.
  – Standard agreement recognizes that the timing of the audit and corrective action should be based on the number of acquired facilities and the scope of the audit.

• New owner must undertake a comprehensive engineering analysis of storage tank vapor control systems to ensure compliance with CAA requirements
  – Must perform any needed corrective actions to the systems
  – May develop its proposed protocols for the audit, subject to EPA approval

• Timelines for correcting violations
  – Violations Unrelated to Engineering and/or Design Issues – within 60 days of discovery (subject to extension)
  – Violations Related to Engineering and/or Design Issues – to be negotiated and specified in the agreement
Some Key Advantages

• Having the standard agreement may significantly reduce transaction costs in negotiating and drafting an agreement with EPA.

• Violations discovered during the audit can be reported semi-annually, rather than upon discovery.

• If the audit and corrective actions are completed, as evidenced by EPA’s issuance of a Final Determination, all of EPA’s civil claims for CAA violations addressed in the agreement are resolved.

• May help simplify allocation of liability between the seller and the new owner (releases, indemnities, etc.).

• The agreement is fully transferrable to a subsequent owner.
Limitations

- Does not resolve the seller’s liability for pre-closing violations.
- Does not resolve violations that are outside the scope of the agreement, or are not found during the audit and corrected.
- Does not resolve any criminal liability.
Risks or Concerns

- What constitutes “Engineering and/or Design Issues” is not defined.

- Concern that the vapor control system engineering and design analysis and guidelines for corrective action in Appendix B of the standard agreement are more stringent than any CAA requirements.

- How EPA will determine what constitutes satisfactory corrective action is not specified.
Risks or Concerns

• If violations are disclosed and not corrected to EPA’s satisfaction, the new owner’s CAA liability to EPA is not resolved.
  – Disclosures likely are available to the public.
  – Could lead to or support government enforcement actions, citizen suits, personal injury or property damage claims, or negative publicity.

• Potential liability to the state is not resolved.
  – The standard agreement says EPA will notify state environmental agencies of the disclosed and corrected violations. Louisiana and many other states do not have an audit policy.
  – However, new owner perhaps could negotiate a parallel agreement with the state agency.
  – Also, voluntary disclosure would likely be a factor favoring a reduced penalty under state law.
Takeaways

• The EPA audit policies are alive and well and favored by the agency.

• They offer many potential advantages to current owners and operators and new owners (purchasers) of facilities.

• However, there are potential concerns or risks in self-audit and self-disclosure, which should be carefully considered in light of the particular circumstances or transaction.
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