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VOLUNTARY DISCLOSURE OF ENVIRONMENTAL VIOLATIONS IN THE TRANSACTIONAL CONTEXT

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It is not uncommon for a Buyer's pre-acquisition due diligence of a facility to ferret out actual or suspected violations of federal environmental requirements. Depending on the terms of the deal, Buyer's counsel may be comfortable with their client accepting the post-closing responsibility to address some or all of the identified issues, and the associated risk of an enforcement-related penalty. In these cases counsel should be aware that the U.S. Environmental Protection Agency ("EPA") has developed a policy that offers favorable treatment to entities that identify, correct and disclose violations to EPA under certain circumstances, including the transactional context.

EPA's policy entitled, "Incentives for Self-Policing: Discovery, Disclosure, Corrective Action and Prevention of Violations," published at 65 Fed. Reg. 19,618 (April 2000), as supplemented by EPA's policy entitled, "Interim Approach to Applying the Audit Policy to New Owners," published at 73 Fed. Reg. 44991 (August 1, 2008) (collectively, the "Audit Policy") may provide the new owner an opportunity to address the identified violations in manner that may result in a significantly reduced penalty assessment, and provide a "clean start" with the agency. The Audit Policy offers three main incentives: (i) up to 100 percent mitigation of the gravity-based component of the penalty that otherwise could be assessed by EPA for the identified violation(s) (EPA may still impose a penalty for the economic benefit that may have been realized as a result of the facility's prior noncompliance(s)), (ii) EPA will not recommend criminal prosecution for the disclosing entity, and (iii) EPA will not request the related audit report that may have been prepared by the disclosing entity.

New owners that voluntarily identify, correct and disclose violations may qualify for the benefits listed above provided the disclosing entity meets the requisite conditions of the Audit Policy. Principally, the disclosing entity must be a "new owner," as that term is defined in the Audit Policy. The disclosing entity must also comply with the Audit Policy's nine conditions -- (i) the violation(s) must have been discovered through a systematic audit or a compliance management system, (ii) the violation(s) must have been identified voluntarily, (iii) the violation(s) must be promptly disclosed to EPA, (iv) discovery and disclosure must have been independent of a pending government or third-party action, (v) the disclosing entity must remedy the harm caused by the violation(s) and (vi) take steps to prevent recurrence of the violation(s),

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(vii) the disclosed violation(s) cannot be repeat offenses or (viii) certain excluded violation(s), and (ix) the disclosing entity must cooperate with EPA. Notably, new owners retain "new owner" status under the Audit Policy for nine months after the closing, so even violations discovered post-closing, but attributable to pre-closing operations, may be entitled to relief. Prompt disclosure, as applied to new owners, requires the disclosure of violation(s) that were discovered pre-closing within 45 days after the closing. Violation(s) that were discovered post-closing must be disclosed to EPA within 21 days after discovery or within 45 days after the closing, whichever time period is longer. In general, disclosed violations must be corrected within 60 days of discovery.

The subjective nature of the Audit Policy's nine criteria, coupled with the fact that a disclosing entity will not know if it qualifies for the benefits of the Audit Policy until after the disclosure is made, may limit the utility of the Audit Policy in certain circumstances. Counsel should also keep in mind that disclosure policies or privileges offered at the state level may not apply in the transactional context, so a transaction-related disclosure to EPA under the Audit Policy could expose the disclosing entity to potential enforcement risk at the state level.

Clients involved in a transaction may find the Audit Policy to be a useful risk management tool, and counsel should structure due diligence activities in manner that may allow clients to maximize its benefits.

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