



Voluntary Compliance and Due Diligence - Avoiding the Slippery Slope

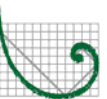
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Overview

- **What is the EPA – DOJ Audit Policy?**
- **What audits/assessments conform to the policy?**
- **How does the policy work in practice?**
- **How does the policy (and state audit privilege laws) fit into the practice of due diligence?**

EPA – DOJ Audit Policy

- **EPA’s policy, “Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations,” (“Voluntary Disclosure Policy”) first took effect on January 22, 1996 and was published in its final form effective May 11, 2000.**



Self-Policing Incentives

- **The Voluntary Disclosure Policy articulates four incentives for self-policing through environmental audits or a compliance management system:**
 - ◆ First, if the regulated entity meets all of the conditions of the policy, EPA **will not seek gravity-based penalties** for any violations.
 - ◆ Second, if violations are discovered other than through audits or a compliance management system but the company still meets all of the conditions of the policy, then EPA **will reduce gravity-based penalties by 75%**.
 - ◆ Third, EPA **will not recommend criminal prosecution** if all the conditions are met and the violation does not demonstrate or involve (i) a prevalent management philosophy or practice that concealed or condoned environmental violations or (ii) high-level corporate officials' or managers' conscious involvement in, or willful blindness to, the violations.
 - ◆ Fourth, EPA **agrees not to request or use an environmental audit report** to initiate an investigation of the company, but reserves the right to seek the report if EPA believes a violation has occurred.

Audit Policy Requirements

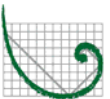
- **Voluntary disclosure**
- **Deadlines for reporting and correcting violations**
- **Prevent reoccurrence**

Audit Policy Requirements (continued)

- **No repeat violations**
- **No significant harm**
- **Cooperation**
- **[Systematic Evaluation]**

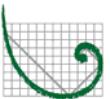
EPA Audit Policy Procedure

- **Disclose violations to EPA within 21 days of discovery**
- **Correct violations within 60 days**
- **Prepare response to document all elements of audit policy met**



EPA Audit Policy Procedure (continued)

- **Enter into consent agreement with EPA**
- **EPA places notice in Federal Register**
- **Environmental Appeals Board issues final order**
- **Pay up**



Compliance Auditing in Due Diligence – a Discourse

- **Environmental due diligence in transactions:**
 - ◆ A concerted effort to determine environmental conditions as they relate to a piece of property or a business
 - ◆ Limited or detailed compliance assessments are becoming an increasing part of transactional due diligence
- **Assessments typically occur prior to the transaction – i.e., the party for whom the report is prepared does not own the property**
- **What are the rules? How does this play out?**

Purchaser's Due Diligence

Goals of Diligence Activities

- **Evaluate compliance with applicable laws**
 - ◆ Issues of concern:
 - » Air emissions
 - » Hazardous and solid waste
 - » Wastewater
 - » Storm water
 - » PCBs
 - » Asbestos-containing materials
 - » Spill containment and control

Purchaser's Due Diligence

Goals of Diligence Activities

- **Compliance Issues (continued):**
 - ◆ Storage tanks
 - ◆ EPCRA/PSM
 - ◆ Ground water/soil contamination
 - ◆ Radiation sources
 - ◆ CFC/ODS
 - ◆ Materials storage and handling
 - ◆ Emergency response
 - ◆ Permits/licenses/consents

Purchaser's Due Diligence

Goals of Diligence Activities

- **Compliance with laws:**
- **Look at -**
 - ◆ Federal
 - ◆ Provincial/State
 - ◆ Local or Municipal
 - ◆ Guidelines
 - ◆ Directives
- **Consider anticipated regulatory changes**
- **Consider material historical problems (penalty policies)**

Purchaser's Due Diligence

- **Types of Work Product:**
 - ◆ ASTM Phase I Environmental Site Assessment
 - ◆ Compliance Assessment Report
 - ◆ Environmental Liability Assessment Report (Combo)
- **Verbal vs. written**
- **Post-Closing obligations triggered by “knowledge”**

Hypothetical for our group

- **You are the environmental manager of a company that has just completed due diligence on the purchase of three manufacturing facilities.**
- **Your environmental consultant has delivered draft environmental reports that indicate that one of the facilities was constructed in 1994 without obtaining the appropriate air quality permits**
- **Further, your consultant (and your counsel) opine that the facility would be unable to permit its current operation, but would need to install control equipment which has a current cost of about \$350,000 and an annual operating cost of about \$75,000**

Issues

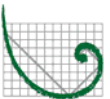
- **When do you have an obligation to disclose this audit finding?**
- **Can you reveal this information to the current owner and require them to disclose this information to the agency?**
- **If you make a disclosure following your acquisition of the property, can you qualify for the EPA policy?**

Disclosure Timing

- **Acquirer can not disclose violations prior to transaction close**
- **Best of all worlds – transaction terms requiring seller to disclose audit results to agency once terms have been agreed but prior to close**
- **If this doesn't come to pass – disclosure should follow immediately following deal close**

Successful Disclosure

- **Complete more thorough compliance assessment follow close of the transaction**
- **Prepare for successful disclosure**
- **Work with counsel and agency personnel to perfect disclosure strategy**



Disclosure Strategies

- **Disclosure (and discovery) requires different strategies depending on the suspected nature of the violations and the nature of operations**
- **Differences between disclosure for a single facility and multiples facilities with similar violations**
- **Consider an orderly review and disclosure process**
- **Consider the consequences of state disclosures**