IAEP At-Your-Desk Live Webinar

Preparing for Regulatory Inspections, Self-Audits and Voluntary Disclosures

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Welcome and Agenda

- Environmental Inspections
- Self-Audits
- Voluntary Disclosures

Part I

- Environmental Inspections
- Self-Audits
- Voluntary Disclosures

Today's Goals - Inspections

- Understand why inspections occur
- Know how to properly handle an inspection
- Know what NOT to do
- What happens after an inspection
- Best practices to prepare your client/team/facility for the inspection

Why are we getting inspected?

- Periodic compliance check (EPA, OSHA)
- Employee complaint ("whistleblower")
- Follow-up to prior inspection / corrective action
- Change in scope of business / expansion
- New facility / change in ownership

Who May Inspect?

Different Agencies, Different Jurisdictions

- US EPA
- State EPAs
- OSHA or State Labor Boards
- DNR or other natural resources agencies (endangered species, natural resource damages)
- Army Corps of Engineers (construction, wetlands)
- Department of Transportation (DOT)
- Department of Justice or State Attorney General
- Local Fire Department or emergency response team
- Local building code enforcement
- Local water treatment works (POTW)

Why must we allow the Inspection?

- Typically authority is given to federal or state agencies under specific environmental, labor or other laws/regulations
- Specific permits may provide for inspections
- Search warrants or other specific authority in extreme cases

Why must we allow the Inspection?

Refuse entry?

- Almost never a good idea (!)
- Typically seen as a sign there is something to hide.
- Causes more problems down the road.
- May be violation of law, your permit, or properly-issued authority.

What Happens First?

- Arrival and announcement of the Inspectors
- Check credentials
- Ask the purpose of the Inspection
- Notify facility response team
  - On-site team
  - Corporate team
  - Internal / External legal counsel
- Convene a pre-inspection conference

Pre-Inspection Conference

- Meet in Conference Room
- Ask purpose /scope of inspection
- Request citation to authority for inspection
- Identify / introduce individuals
- Lay out the ground rules
  - What areas will be inspected?
  - HIPAA concerns for photographs, video, etc.
  - Discussions with employees
  - Requests for documents, testing/sampling?
- Provide a facility diagram (if available)
- Safety Briefing

Conducting the Inspection

- Escort inspectors at all times
- Take FACTUAL, non-conclusory notes
- Take your own photos (if they do)
- Keep records of requested/provided documents
- Answer questions directly based on facts – NO GUESSING!
- Tell the truth

Documents / Records

Inspectors may ask for (and generally have a right to) copies of relevant records. These can be in paper or electronic form.

- Training logs, certifications or other records
- Safety Data Sheets or “SDS” (formerly MSDS)
- Permits (air, water, etc.), registrations (diesel tanks, etc.), EPA ID# for waste, etc.
- Waste manifests, chemical or hazmat inventories, or other operational records
- Plans, Polices and Procedures
  - Hazardous Waste Management Plan
  - Hazard Communication Program (HAZCOM)
  - Spill Prevention Control & Countermeasure (SPCC) Plan
  - SOPs for tank fueling

Post-Inspection Closing Conference

- Reconvene in conference room
- Inspectors will summarize findings
- Any violations identified?
- Needed corrective action?
- Review and acknowledge inspector's report (?)
- Discuss next steps – NOV? Letter?

Post-Inspection Closing Conference

Internally:

- Follow-up with facility and corporate management
- Discuss with legal counsel
- Note lessons learned and opportunities for improvement

Best Practices for Preparing

- Ask for or generate a written inspection checklist or guidance
- Identify specific individuals for the response team (with backups)
- Practice responding to an inspection
- Refresh the plan often (especially contact people)
- Prepare your employees (not just managers) for inspections
- Know where your documents/records are
- Make compliance an every-day priority – practice good housekeeping, proper records management and reporting, training, etc.
- Understand your operations and wastes (hazardous, universal, electronics, etc.)
- Consider pro-active compliance audits
- Ask for help!
  - Internal resources (EH&S team, supervisor, counsel)
  - External resources (consultants, counsel)

Frequently-Asked Questions

- Will I get notice of the inspection?
- Can the inspectors talk to our employees?
- Can the inspectors confiscate computers, records?
- Can the inspectors look at my notes?
- Should I admit violations?

Part II

- Environmental Inspections
- Self-Audits
- Voluntary Disclosures

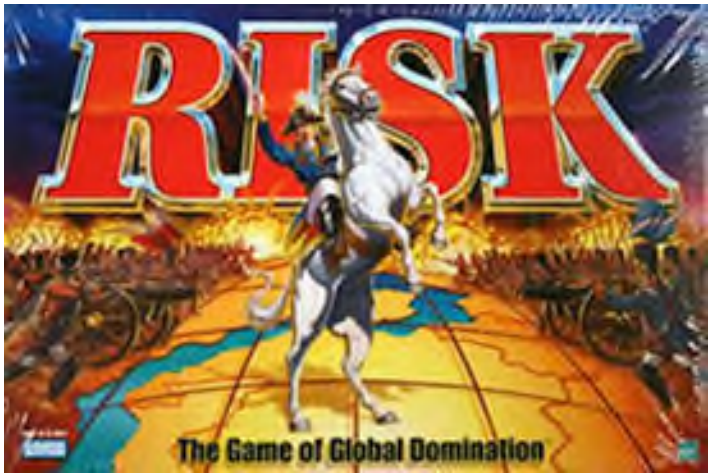
What are Environmental Self-Audits?

A. A vital tool in ensuring environmental regulatory compliance and avoiding regulatory entanglements that can affect operations.

B. A helpful tool in managing risk – often a first step towards a comprehensive risk management program.

C. A cheap "insurance policy" against penalties.

D. All of the above.



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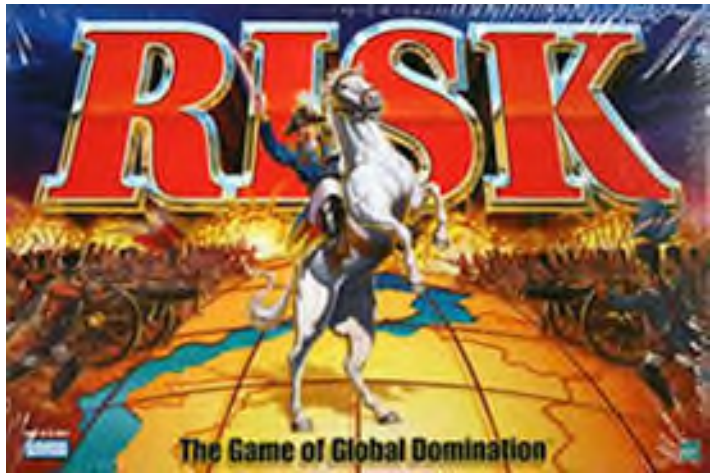


What are Environmental Self-Audits?

What is an Environmental Compliance Audit?

ASTM Practice E2107 - 06 (Reapproved 2014)

Standard Practice for Environmental Regulatory Compliance Audits

- 3.1.16 *environmental regulatory compliance audit* (audit)—a systematic, documented, and objective review of an audited entity to evaluate its compliance status relative to audit criteria.

Why Perform Environmental Self-Audits?

USEPA Audit Protocols

- Audit protocols assist the regulated community in developing programs at individual facilities to evaluate their compliance with environmental requirements under federal law. The protocols are intended solely as guidance in this effort. **The regulated community's legal obligations are determined by the terms of applicable environmental facility-specific permits, as well as underlying statutes and applicable federal, state and local law.**
- https://www.epa.gov/compliance/audit-protocols

Why Perform Environmental Self-Audits?

- Environmental Self-Audits can be performed by internal EH&S personnel, external consultants, or a combination of both.
- Self-audits are often a part of a comprehensive environmental compliance program, typically performed on an annual basis.
- Self-Audits can be used as a basis for a later self-disclosure of identified violations.

Why Perform Environmental Self-Audits?

- Legal counsel can be involved to help protect audits under attorney-client privilege and attorney work-product doctrine.

- Otherwise, sensitive audit results typically can be requested and obtained by regulators in the context of an inspection and/or enforcement action.

Why Perform Environmental Self-Audits?

- When identified by regulators, penalties for environmental violations can be severe, including paying large monetary penalties, taking corrective action, or even shutting down operations.
- In the most extreme cases, criminal penalties may be asserted against individuals who willfully violate environmental laws or regulations—or even corporate officers who may have had no direct knowledge of intentional environmental violations but nevertheless ultimately were the ‘‘responsible corporate official’’ in the eyes of the regulators.

Why Perform Environmental Self-Audits?

- Self-Audits are equally advisable when acquiring a company or business unit that engages in any type of manufacturing or industrial operations.
- Without such an inquiry, it is difficult to assess whether a newly acquired business is prepared to successfully withstand an environmental inspection or only a few weeks away from a shutdown or penalties if the inspectors come knocking post-acquisition.

Why Perform Environmental Self-Audits?

- It also often is much easier to include a budget for pre-acquisition due diligence into the scope of the overall deal than try to find money for such an investigation later on, when such costs usually are allocated to each facility's financial performance criteria.
- Perhaps most importantly, however, without a pre-acquisition audit, if significant future costs are involved in bringing the facility into compliance, the chance to price the cost of such latent environmental compliance into the deal probably will be lost.

Frequently-Asked Questions *a/k/a "pushback"*

"If we perform a self-audit and discover non-compliance issues, that will just cause problems that will have to be fixed, which costs money."

"We've been doing the same thing in the same place, the same way, for (10 years? 20 years? Longer?) and we've never had any problems, so why worry?"

"Management doesn't care, and doesn't want to know. I don't want to get fired for making waves."

Phase I vs. ECA

What's the Difference Between a Phase I Environmental Site Assessment and an Environmental Compliance Audit?

- A Phase I is typically used to perform environmental due diligence prior to acquiring title to a piece of real property that may or may not be improved with a building or other structures. *See ASTM Practice E1527-13.* Performing a Phase I often is used to establish ''All Appropriate Inquiry,'' which is a requirement for asserting certain defenses under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA")(42 U.S.C. § 9601 et seq.), such as the ''Bona Fide Prospective Purchaser'' defense.

- However, it is dangerous to assume that performing a Phase I on a facility is equivalent to an Environmental Compliance Audit when there is an operating facility on the parcel of real estate that is the subject of the Phase I.

Phase I vs. ECA

- Typically, the scope of a Phase I is limited to identifying ‘‘Recognized Environmental Conditions’’ (RECs) that would suggest the release of hazardous substances and/or petroleum on the property.
- While a consultant performing a Phase I on a property that includes a facility operating as a going concern generally would walk through the facility looking for evidence of RECs, such a consultant normally isn’t expected to review facility environmental records, evaluate the sufficiency and scope of required environmental permits or make recommendations with respect to identified regulatory noncompliance issues.
- Thus, for any acquisition of real property that includes an operating industrial or manufacturing facility, performance of an ECA in addition to a standard Phase I is essential.

Why do we need an Outside Consultant?

- While some companies may have experienced environmental consulting and/or EH&S capability in-house, there are distinct advantages to using an outside consultant, at least for an initial audit:
  - Availability of internal resources
  - Objectivity
  - Conflict of interest / defensiveness of plant personnel
  - Retaining consultant through legal counsel

Why do we need Outside Environmental Counsel?

- While some companies may have experienced environmental counsel in-house, it has proved difficult for some courts to distinguish the activities of in-house counsel between acting as a legal advisor to the company and as a ‘‘business consultant.’’
- Judges increasingly may be uncomfortable ruling that an internal lawyer is acting as a legal advisor when arranging for an ECA (in which case the conventions of attorney-client privilege and attorney work-product apply), as opposed to acting as a business advisor (in which case such protections typically do not).

Why do we need Outside Environmental Counsel?

- At least one court has rejected a claim of privilege for a third-party consultant's technical report, even though the company's GC (general counsel) had ordered the report. ***MediaTek Inc. v. Freescale Semiconductor, Inc.,* 2013 WL 5594474 (N.D. Cal. Oct. 10, 2013)**
- Thus, the safer course of action is first to retain experienced outside environmental counsel (even if they closely coordinate with inside environmental counsel), who then will retain the environmental consultant.
- Who pays the consultant bill?

Limitations on Privilege

- Claim of attorney-client or work product doctrine cannot protect "facts" – e.g., test results – from disclosure in litigation or enforcement actions.
- Also, a claim of attorney-client or work product doctrine cannot shield an entity from reporting requirements under state or federal law. For example, if exceedences or contamination is identified that is reportable in the particular state, performing the audit under the guise of attorney-client privilege does not affect that legal obligation to report.
- Audits may also have to be provided in the context of a merger or acquisition, depending on the terms of the contract.

Performing the ECA

- After retention of a competent consultant through experienced environmental counsel, the consultant will provide the plant manager or other responsible corporate official with a **"pre-inspection checklist."**

Performing the ECA

This checklist provides the consultant with basic information, such as:

- the environmental permits that a facility has, e.g., air permits, water pre-treatment permits, hazardous waste storage or management, etc.);
- what laws and regulations it is presumed are relevant to that facility (e.g., hazardous chemical storage reporting and disclosure); documentation maintained and/or submitted by the facility (e.g., ‘‘Tier II’’ reporting for storage of large amounts of chemicals, Safety Data Sheets (SDSs) (formerly known as Material Safety Data Sheets (MSDSs));
- spill plans; and emergency response plans.

Performing the ECA

After review of the completed pre-inspection checklist, the consultant will conduct a **walk-through** and **document revie**w at the facility. During the walkthrough, the consultant will look for circumstances of compliance and noncompliance based on their experience in assessing compliance at industrial facilities.

Performing the ECA

For example, some of the many issues a consultant commonly will investigate are:

- Does the facility have operations that generate hazardous waste?
- Are environmental records and information properly maintained and submitted to regulators (where appropriate)?
- Does the facility have industrial equipment or operations that emit gases or vapors?
- Can/will the facility easily be expanded in the future?

Performing the ECA

Document inspection:

- Many times the facility looks very clean, but failure to file and maintain the proper paperwork to comply with permitting and reporting requirements can result in problems and penalties just as severe as for mismanaging waste or other, more obvious issues.
- The consultant will review the facility's operations and ensure any reporting obligations, as well as permits, properly have been fulfilled and adhered to.
- Know where your documents are, and how to find them!!!

Performing the ECA

Writing the report:

- After the site visit, the consultant will write up an audit report that will summarize the tasks performed, including the results of the site visit and document review, and provide a set of conclusions and recommendations.
- The best practice is first to request a draft report to be reviewed by the environmental attorney. The draft clearly should be labeled **"Confidential and Privileged: Attorney Work-Product Produced at Request of Counsel in Anticipation of Litigation"** or something similar, according to your attorney's specific advice.

Post-Audit Considerations

- Post-audit, the recommendations and conclusions should be assessed to determine if corrective action needs to be taken. Consider:
  - Self-disclosure of identified violations?
  - Coming into compliance "quietly"?
- After the facility has come into compliance, it is a good idea to set up a periodic environmental audit schedule, typically on a yearly basis.
- If problems do arise in the future, not only will you be able to identify and address them more quickly, but regulatory authorities typically are more lenient with operations that have a robust environmental management and audit protocol.
- The best news is that once the initial audit has been performed and the major problems addressed, it is generally less critical to involve an environmental attorney in subsequent periodic audits.

Bonus Tip: Beware of Zombies!

Beware of Zombies!

What are "Zombies"?

- In the M&A context, not only does an acquiring entity have to worry about environmental compliance for current operating facilities, but sometimes facilities that have been closed and/or sold off for years also may come into play.
- Typically, this situation arises when the stock of an entire larger industrial company is being purchased, because such companies often have a long history of operation at multiple plant sites, some or many of which now are defunct and no longer owned by the company.
- Such sites, known as "zombies," may in fact come back to "haunt" the purchaser of the target company, as the target company still can be legally responsible for its historic operations on such sites to the extent such operations caused pollution or violated environmental laws.

Beware of Zombies!

- Typically, an ECA only will cover current operating facilities, but the scope of an ECA can be expanded to include research of information regarding former facilities as well. However, such research can be expensive and time-consuming, which may render such an expanded scope a fairly impractical option.
- In such cases, environmental insurance commonly known as ‘‘zombie insurance’’ can provide unscheduled coverage for formerly owned and operated locations that ‘‘come back from the dead’’ after the transaction due to recently discovered environmental issues.

Part III

- Environmental Inspections
- Self-Audits
- Voluntary Disclosures

Voluntary Violation Disclosures

The U.S. Environmental Protection Agency and many state environmental protection authorities provide (through statute, regulation or policy) a pathway to significantly mitigate or eliminate the typical penalties that otherwise would be assessed, based on self-disclosure of violations discovered through the course of an environmental compliance audit.

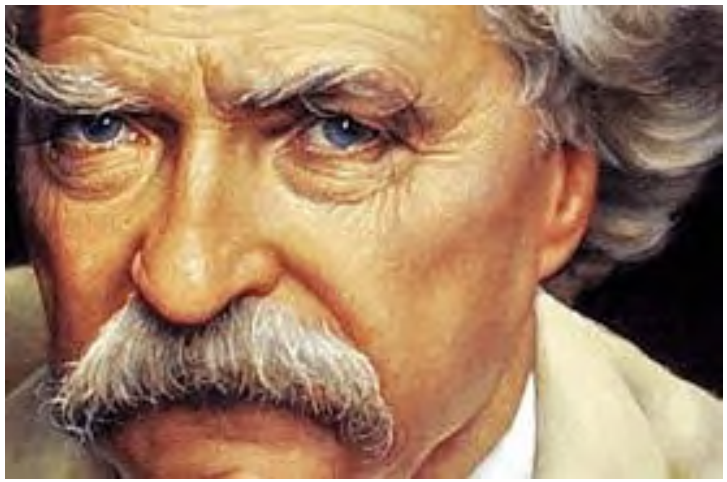
Voluntary Violation Disclosures

Why self-disclose?

- Avoid penalties
- Can go forward with a clean slate –

If you tell the truth, you don't have to remember anything.

-- Mark Twain



Voluntary Violation Disclosures

- While the specific rules vary from jurisdiction to jurisdiction, among other criteria,
  - the noncompliance issue typically must be discovered in the course of a voluntary self-audit;
  - the discovery of the violation must not have been the result of a statutorily required or court-ordered inspection;
  - and the violation promptly must be disclosed to the applicable regulatory authority.

  After disclosure, the violations promptly must be rectified to qualify.

Federal Disclosures

The EPA Audit Policy (April 2000) 65 FR 19,618 (04/11/00), formally titled “Incentives for Self- Policing: Discovery, Disclosure, Correction and Prevention of Violations,” safeguards human health and the environment by providing several major incentives for regulated entities to voluntarily discover and fix violations of federal environmental laws and regulations.

Federal Disclosures

Summary of USEPA Incentives

- **Significant penalty reductions**. Civil penalties under the environmental laws generally have two components: (1) an amount assessed based upon the severity or "gravity" of the violation; and (2) an amount assessed to recapture the economic benefit a violator received from failing to comply with the law.
  - Reduction of 100% of gravity-based penalties if all nine of the Policy's conditions are met. EPA retains its discretion to collect any economic benefit that may have been realized as a result of noncompliance.
  - Reduction of gravity-based penalties by 75% where the disclosing entity meets all of the Policy's conditions except detection of the violation through a systematic discovery process.

  Note that the policy only mitigates gravity-based penalties, not economic-based penalties.
- **No recommendation for criminal prosecution** for entities that disclose criminal violations if all of the applicable conditions under the Policy are met. "Systematic discovery" is not a requirement for eligibility for this incentive, although the entity must be acting in good faith and adopt a systematic approach to preventing recurring violations.
- **No routine requests for audit reports.** EPA reaffirms its Environmental Auditing Policy Statement, in effect since 1986, to refrain from routine requests for audit reports. (*i.e.,* EPA has not and will not routinely request copies of audit reports to trigger enforcement investigations.

Federal Disclosures

Conditions for Penalty Mitigation

- **Systematic discovery** of the violation through an environmental audit or the implementation of a compliance management system.
- **Voluntary discovery** of the violation was not detected as a result of a legally required monitoring,sampling or auditing procedure.
- **Prompt disclosure** in writing to EPA **within 21 days of discovery** or such shorter time as may be required by law. Discovery occurs when any officer, director, employee or agent of the facility has an objectively reasonable basis for believing that a violation has or may have occurred.
- **Independent discovery and disclosure** before EPA or another regulator would likely have identified the violation through its own investigation or based on information provided by a third- party.
- **Correction and remediation** within 60 calendar days, in most cases, from the date of discovery.
- **Prevent recurrence** of the violation.
- **Repeat violations are ineligible**, *i.e.*, the specific (or closely related) violations have occurred at the same facility within the past 3 years or those that have occurred as part of a pattern at multiple facilities owned or operated by the same entity within the past 5 years; if the facility has been newly acquired, the existence of a violation prior to acquisition does not trigger the repeat violations exclusion.
- **Certain types of violations are ineligible** such as those that result in serious actual harm, those that may have presented an imminent and substantial endangerment, and those that violate the specific terms of an administrative or judicial order or consent agreement.
- **Cooperation** by the disclosing entity is required.

Federal Disclosures

- The EPA also provides a specific self-disclosure option when a company is acquired by "new owners," which gives the acquiring entity a chance to start with a "clean slate" by disclosing the environmental noncompliance issues and setting up a corrective action plan.
- A specific window for such investigation and disclosure is available that spans both the pre-acquisition and post-acquisition period, but it is limited and finite. Acquiring entities even can approach the EPA prior to acquiring a company and negotiate customized timing and scope of an ECA specific to the transaction, which can be especially helpful.

Federal Disclosures

U.S. EPA'S AUDIT POLICY – NEW 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).**

Category 1 disclosures include: (1) violations of Emergency Planning and Community Right-to-Know Act (EPCRA) that meet all Audit Policy conditions; and (2) EPCRA violations that meet all Small Business Compliance Policy conditions.

Category 1 disclosures do *not* include:

- Chemical release reporting violations under section 304 of EPCRA or section 103 of Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); or
- Violations of EPCRA with significant economic benefit as defined by EPA.

Category 2 disclosures include: (1) all non-EPCRA violations; (2) EPCRA violations where the discloser can only certify compliance with Audit Policy Conditions 2-9 (*i.e.*, discovery was not systematic); and (3) EPCRA and CERCLA violations excluded from Category 1 above.

- 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.**

State Disclosures

- 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#audit-privilege
- State programs include privilege laws, penalty immunity laws, and statutes providing both privilege and immunity.

State Disclosures

Caution!!!

The prerequisites and procedures that must be followed under each of the federal and (where available) state schemes are complex and require strict adherence to ensure a voluntary self-disclosure will qualify for the penalty mitigation benefits.

State Disclosures

- Among other issues, it should be noted that some states don't require submission of the ECA to reap the benefits of the self-disclosure policy. Those that do may provide statutory confidentiality, confidential business information (CBI) exceptions, etc.
- Some states (e.g., Texas) require that the audit can't be conducted until a **"Notice of Audit"** (as defined in the law) as been submitted.
- Other states (e.g., Nevada) require a state-certified environmental consultant to conduct the audit.
- Many states have different timing requirements for submitting the self-disclosure.
- Some states have specific paperwork (i.e., forms) that must be filled out and submitted.

State Disclosures

- Self-disclosing violations to a state with an authorized federal program does not resolve federal claims for those violations, and vice versa.
- Risk of EPA enforcement after resolution through state audit program is generally very low because "overfiling" after state audit disclosure (and management of the issues under the state's program) is rare.
- The state may open and then close a formal enforcement action to manage the violation(s) in their system. The facility may still be listed on a federal (or state) website as a "violator" even after self-disclosing and coming into compliance.

A complete discussion of the intricacies of the self-disclosure policies of the federal government and applicable states is beyond the scope of this presentation, so experienced environmental counsel should be consulted before an audit is disclosed to regulatory authorities.

QUESTIONS?

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