# CEEC

**Corporate Environmental Enforcement Council, Inc.**

## EPA Issues Revised Audit Policy Applicable to Mergers and Acquisitions

In 2007, EPA proposed modifications to its April 11, 2000 policy on ñIncentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violationsò (ñAudit Policyò) to provide tailored incentives to encourage new owners, in connection with corporate mergers and acquisitions, to look closely at compliance issues at their recently acquired facilities, self-disclose and, most importantly, fix the environmental problems they find.

CEEC has been working with EPA since before the adoption of the original Audit Policy in 1995, and has been a partner that EPA has relied upon to help identify ways to improve and ensure the success of the Policy. One of the issues EPA was focused on was whether the Policy could be amended or supplemented in a manner that would lead to more compliance audits in the course of corporate transactions.

Over the course of several years CEEC and other organizations had discussed with EPA how the requirements and pre-conditions for penalty mitigation under the existing audit policy (designed with ordinary operations in mind) often could not be met in the M&A context. After several meetings and exchanges of ideas, EPA decided to formally address these issues by developing the so-called ñtailored incentivesò ï a decision that in and of itself represented a success. After attending one of EPAôs Audit Policy ñWorkshopsò where a CEEC representative presented CEECôs preliminary views to the Agency, in July 2007, CEEC prepared and submitted a detailed set of written comments on the Agencyôs new proposals. In addition, CEEC worked with the American Chemistry Council to retain economist Bob Fuhrman (Seneca Economics and Environment) to develop a complex financial analysis and technical support document supporting several of CEECôs policy suggestions. This document was submitted to EPA as well.

After submission of these documents, CEEC again met with Agency audit policy and enforcement staff to discuss CEECôs comments, and to provide more detailed information CEECôs perspective on the dynamics of environmental compliance issues in the M&A context.

On August 1, 2008, the Agency issued revisions to the Audit Policy, ñInterim Approach to Applying the Audit Policy to New Owners (ñInterim Approachò). In the Interim Approach the Agency adopted a number of changes proposed including:

1. The benefits of the policy will be available to new owners in a variety of different transactional settings including asset purchases, stock purchases, and mergers.

2. The new ownerôs eligibility for waived penalties and other benefits of the policy will not depend on the terms of the purchase. EPA will not inquire into either the amount of the purchase price or the existence of an indemnity from a prior owner.

3. Whether an owner is ñnewò for purposes of the policy will be determined based on traditional and predictable principles of corporate authority.

4. Companies will be permitted to self-certify compliance with the audit policyôs factual prerequisites;

5. EPA will not create a "recognition" program for auditing new owners.

6. Companies will have a generous, nine-month window post-closing to conduct compliance audits and make any relevant disclosures. Alternatively, companies can enter into a comprehensive audit agreement with the Agency within that period.

7. Benefits of the policy will apply to compliance issues discovered during due diligence (prior to closing) that are not disclosed until after the closing, and the new owner will have an extended 45 days after closing to make the disclosure.

8. Benefits of the policy will apply to the ñvoluntaryò disclosure of certain violations (Clean Air Act Title V) that companies are otherwise legally *required* to disclose. Outside the M&A context, EPA policy does not give penalty mitigation for such ñrequiredò disclosures.

9. The new owner will be able to claim the benefits of the policy even if the acquired facility had a history of prior violations similar to those discovered and disclosed by the new owner, or if the new owner itself had such a history at its other locations (prior policy would have precluded this);

10. The Agency will not seek to recover ñeconomic benefitò deemed to arise from either noncompliance occurring prior to closing, or from the deferred costs of capital improvements during the post-closing period.

CEEC will submit comments in late October 2008 endorsing constructive changes reflected in the Interim Approach, and identifying a few additional areas where policy improvements still could be made to remove impediments to post-acquisition environmental compliance auditing and correction.

The Agencyôs decision to issue the Interim Approach, and their adoption of many of the specific changes sought proposed, represent the latest in a series of successes in the context of working with the Agency to ensure the continued success of the Audit Policy as well as its continued improvement.