Let's Make a Deal: Twenty Years of EPA's Audit Policy

Lawrence Culleen and Thomas Glazer

2015 marked the twentieth anniversary of the U.S. Environmental Protection Agency's (EPA's) landmark policy statement on "Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations"—or, as it is more commonly known, the Audit Policy. Since EPA issued the Audit Policy in December 1995, it has become and continues to be an important tool for private companies to address violations of federal environmental requirements proactively while achieving significant reductions in penalties they might otherwise face. While the Agency has been sharing less data on the Audit Policy in recent years, EPA records reflect that between 1995 and 2010, nearly 6,200 companies voluntarily disclosed violations at more than 17,000 facilities.

At its heart, the Audit Policy represents a bargain between the Agency and the businesses it regulates. To encourage practices intended to identify, address, and correct noncompliance, EPA promises regulated entities that come forward and promptly correct violations that the Agency will reduce penalties, generally decline to recommend criminal prosecution, and refrain from using its extensive information gathering authority to request a company's audit reports. For twenty years, companies and their counsel have asked themselves whether this is a deal worth striking. Voluntary disclosure is not always an appealing option when faced with potential penalties for one or more violations and considerable uncertainty about EPA's ultimate response—and not every company that has voluntarily disclosed has been pleased with the outcome. Nevertheless, for those entities that are willing to accept some level of uncertainty, for the past twenty years the Audit Policy has offered the opportunity to reach closure and, hopefully, remain in EPA's good graces.

Considerable concern about the Audit Policy's future arose in 2012, when, under budgetary pressures, EPA's Office of Enforcement and Compliance Assurance (OECA) announced it was reducing its investment in the Policy and thinking about potential modifications. OECA explained that it was motivated in part by its finding "that most violations disclosed under the Policy are not in the highest priority enforcement areas." Some observers believed that EPA might eliminate the Policy entirely, and the Agency received numerous comments raising these concerns even though comments had not been officially solicited. Nonetheless, after several years of relative silence, the Agency is again talking about the Audit Policy, and, for the foreseeable future at least, it appears the Audit Policy is here to stay. On the occasion of the Audit Policy's twentieth anniversary, this article looks back at the Policy, including the circumstances of its adoption, debates about its terms and conditions, some ways in which the Policy has been adapted (often in response to state-level developments), some unquantifiable benefits from the Audit Policy, and the outlook for its future.

EPA first formally articulated a position on self-audits in 1986 with the publication of its final Environmental Auditing Policy Statement (the 1986 Policy). The adoption of the 1986 Policy reflected EPA's willingness to acknowledge formally and encourage the development and implementation of environmental self-audit programs within the regulated community. Through the 1986 Policy, EPA recognized that the Agency's programmatic objectives could be well served by effective self-auditing practices, and it articulates certain basic tenets concerning how the Agency expects such audits to be undertaken and performed. According to the 1986 Policy, "Effective environmental auditing can lead to higher levels of overall compliance and reduced risk to human health and the environment."

Though it encourages the practice of self-auditing, the 1986 Policy makes no specific promises to the regulated community concerning penalty reductions for voluntarily disclosed violations. Instead, the 1986 Policy offers only general assurance that the Agency will not routinely request environmental audit reports. Lest regulated entities get any wrong ideas, the Agency included in the 1986 Policy a disclaimer that "the existence of an auditing program does not create any defense to, or otherwise limit, the responsibility of any regulated entity to comply with applicable regulatory requirements." Nor did EPA signal that the 1986 Policy would cause the Agency to lessen or modify its targets for inspections.

Like many government programs, the 1986 Policy was not fundamentally groundbreaking; it was EPA's response to the growth of voluntary environmental auditing among the regulated community. One 1995 study from Price-Waterhouse found that greater than 90 percent of respondents operating in heavily regulated sectors like petroleum refining and chemical manufacturing had adopted regular self-auditing procedures, which indicated rapid expansion even over the prior few years. It is unclear what role, if any, the 1986 Policy played in the continuation of that trend into the 1990s, but it soon became clear that EPA would need to address penalty reductions for voluntary disclosures.

A high-profile incident involving the Coors Brewing Co. attracted national attention to the issue and correlated with an upsurge in efforts by the states to address other issues (specifically, privilege and immunity) that were arising in the self-audit context. In 1992, while conducting an audit related to permitting at one of its facilities, Coors discovered that the

Mr. Culleen is a partner and Mr. Glazer is an associate in the environmental practice group at Arnold & Porter's office in Washington, D.C. They may be reached at lawrence.culleen@aporter.com and tom.glazer@aporter.com.

brewing and production processes resulted in small amounts of a volatile organic compound (VOC) being released into the air during beer-making, packaging, and disposal practices. Coors' discovery shed light on a previously unknown source of VOCs that affected most major American brewers at the time. Upon identifying the release, the national brewing companies began tweaking their production processes and were able to reduce emissions. However, Coors had not done itself any favors by coming forward. The Colorado state agency overseeing Coors' VOC emissions standards hit the company with stiff civil penalties, which were only reduced after considerable effort by Coors. Though Coors was able to negotiate a reduction in penalties with the state, Colorado still collected assessments tied to the "economic benefit" of previous noncompliance.

The EPA's Interim Approach to Applying the Audit Policy to New Owners leverages new owners' desire to avoid inheriting liability by giving the acquiring company nine months from closing to disclose violations and enter into an audit agreement with EPA.

In response to high-profile stories like the Coors incident, and to trends in business and the states, EPA adopted the first version of the modern Audit Policy in 1995 following an "eighteen-month public evaluation of the optimum way to encourage voluntary self-policing while preserving fair and effective enforcement." This evaluation included "five days of dialogue with representatives from the regulated industry, states and public interest organizations" organized by what was then referred to as the American Bar Association's Section on Natural Resources, Energy, and Environmental Law.

The 1995 Audit Policy reflects what some describe as "limited amnesty" granted in exchange for the prompt disclosure and correction of environmental violations. An entity must meet certain key conditions to receive the full benefit of the Audit Policy: the violation must have been systematically and voluntarily discovered (i.e., through an environmental audit or compliance management program, rather than through required monitoring); the disclosure must be made promptly; the entity must correct the violation quickly; and the entity must make take efforts to prevent recurrence. In return, the Agency will waive any gravity-based penalties and refrain from recommending criminal prosecution. But the 1995 Audit Policy also describes aggravating circumstances under which its benefits are unavailable, including repeat violations and violations that result in "serious actual harm" or "imminent and substantial endangerment."

Criticisms

While many companies have taken advantage of the 1995 Audit Policy and its progeny, some members of the regulated community have been skeptical of EPA's approach. In response to an early version of the 1986 Policy, EPA received the most comments about whether the Agency would agree not to request, or seek discovery of, companies' environmental audit reports. Continuing to this day, companies often express concern that audit reports could provide a convenient road map for a company's biggest environmental vulnerabilities.

In the lead-up to the 1995 Audit Policy, commentators asked EPA to recognize a formal privilege for audit reports, or at least issue a binding promise that EPA would not use its expansive information gathering authority to seek audit reports. When it formally adopted the Audit Policy, EPA offered several reasons that it opposed such a privilege, including a general presumption in favor of openness, the fact that EPA in practice rarely uses such reports as evidence, and the desire to avoid extensive litigation over the precise scope of such a privilege. In light of EPA's position, some commentators have advised against conducting environmental self-audits and instead recommend internal investigations, which are easier to protect under the attorney-client privilege and work-product doctrine.

Many other criticisms of the Audit Policy have been raised over its twenty-year history. Among the most significant are those of certain environmental organizations and citizens' groups, which argue that the Audit Policy is too lenient in reducing penalties for entities that, by definition, have violated the law. In contrast, among the regulated community, some have bemoaned the Audit Policy's status as a mere guidance document lacking the force of law and thus creating no obligation that EPA uphold its end of the bargain to honor the Audit Policy's incentives. Similarly, many have called the Audit Policy's promise not to recommend criminal prosecution hollow since the decision to prosecute ultimately lies with the Justice Department over which EPA has no control. Another recurring complaint has been that the Audit Policy is vague and ultimately too subjective. Others note that the Audit Policy's incentive structure may perversely incentivize companies only to disclose minor violations, but not those that could endanger public health.

EPA's Adaptations to the Policy

Over time, the Agency has listened to these criticisms and has attempted to address some of them through guidance documents and even occasional updates to the Audit Policy itself. Thus, in 1997 and again in 2007, the Agency issued interpretive documents to identify and resolve some areas of ambiguity. For example, both documents try to clarify under what circumstances violations uncovered during mandatory certification processes—like that under Title V of the Clean Air Act—qualify as "voluntary" discoveries under the Audit Policy. In 1997, OECA also distributed a memorandum to EPA's regional offices explaining under what circumstances self-disclosures may be withheld as law enforcement materials or Confidential Business Information under exemptions to the Freedom of Information Act.

EPA took a more substantive step in 2000, when it revised and reissued the Audit Policy. The key changes in that update included extending the deadline for a "prompt" disclosure from

ten days to twenty-one days, clarifying that a facility may take advantage of the Audit Policy even if another facility owned by the same company is currently under investigation and giving owners twenty-one days from the acquisition of a new facility to disclose any violations even if the violation existed prior to the acquisition.

In 2008, EPA issued its Interim Approach to Applying the Audit Policy to New Owners (New Owner Policy), which offers even greater flexibility to owners of newly acquired facilities with additional encouragement for voluntary disclosures. The New Owner Policy leverages the desire of new owners to avoid inheriting any liability by making disclosure for existing violations less threatening. Under the New Owner Policy, the acquiring company is given nine months from the transaction closing to disclose any violations and enter into an audit agreement with EPA. The New Owner Policy also loosens some of the eligibility criteria that otherwise apply under the Audit Policy. For example, violations uncovered during the due diligence process will nonetheless be eligible for full penalty mitigation, even though the violations may not have been technically uncovered by a systemic or recurring self-audit program.

The Significant Role of the States

While EPA's Audit Policy captures a lot of the attention, it is not the only show in town. The states have long experimented with their own methods for incentivizing environmental self-audits and self-disclosures, starting with a state statute that Oregon enacted in 1993. In fact, efforts by Oregon and other states arguably provided the impetus for EPA's Audit Policy. By the time EPA adopted the final version of the 1995 Audit Policy, thirteen states had already undertaken programs to encourage environmental self-assessment and self-disclosure. Today, nearly every state has some form of this program in place.

State incentive programs vary in several important ways. Some states have adopted administrative enforcement policies like EPA's Audit Policy or Attorney General statements, sometimes with minimal variations from EPA's approach. For example, California's "Unified Cal/EPA Policy on Incentives for Self-Evaluation" applies the same criteria for a penalty reduction as EPA, although companies voluntarily reporting violations under California's program can obtain a 90 percent penalty reduction even if they lack a routine environmental self-audit program instead of the 75 percent reduction that EPA's Audit Policy allows under similar circumstances.

Other states have gone further than EPA and have enacted statutes that codify the benefits and limits of self-disclosure. As mentioned above, Oregon enacted the first state environmental self-disclosure law in 1993. Oregon created a guaranteed environmental audit privilege that businesses have long sought from EPA. Under Oregon law, environmental audit reports are privileged and inadmissible in any civil or administrative proceeding absent certain narrow exceptions.

Many states have created an even stronger incentive in the form of statutory penalty reduction and immunity provisions. Colorado became the first state to do this in 1994, but now eighteen have implemented similar programs. In Colorado, companies that meet certain criteria—including voluntary self-evaluation, prompt disclosure, and adequate efforts to return to compliance—are entitled to a waiver of all state civil penalties as well as penalties for criminally negligent violations of state law.

In many ways, EPA's Audit Policy updates have represented an ongoing dialogue with the states that have been active in the same space. In the 1995 version, EPA encouraged states "to experiment with different approaches that do not jeopardize the fundamental national interest in assuring that violations of federal law do not threaten the public health or the environment, or make it profitable not to comply." The Agency expressly noted its opposition to "state legislation that does not include these basic protections."

When EPA revisited the Audit Policy in 2000, it took an even firmer stance against

> statutory environmental audit privileges that shield evidence of environmental violations and undermine the public's right to know, as well as to blanket immunities, particularly immunities for violations that reflect criminal conduct, present serious threats or actual harm to health and the environment, allow noncomplying companies to gain an economic advantage over their competitors, or reflect a repeated failure to comply with Federal law.

At times, EPA has been willing to directly oppose states that it saw as adopting overly lenient self-disclosure policies. In 1995, before the Audit Policy was even finalized, EPA Region 10 rejected Idaho's air operating permit program under Title V of the Clean Air Act. The regional office specifically cited that state's immunity law, explaining, in the words of one EPA spokesman, that the law could "impermissibly interfere with Idaho's enforcement requirements." EPA conditioned final approval of the state permitting program on "either changing its immunity law or demonstrating why the program would not undercut the state's enforcement authority." Shortly after issuing the 1995 Audit Policy, EPA wrote lawmakers in several states that were considering adopting self-disclosure immunity legislation, including New Hampshire and Virginia, warning them that such laws could lead EPA to increase federal enforcement in those states.

Application of the Policy

Looking back over the Audit Policy's history, it is clear there have been successes and failures. Early on, EPA confidently touted the effectiveness of the Audit Policy. In 1999, EPA published the results of an evaluation of the Audit Policy at 64 Fed. Reg. 26745. Among its findings, EPA said that the Policy had "removed pollutants from the air and water, reduced health and environmental risks and improved public information on potential environmental hazards." 64 Fed. Reg. 26745. The Agency also reported "a very high satisfaction rate among the users of the Policy, with 88% of the respondents stating that they would use the Policy again and 84% stating that they would recommend the Policy to clients/counterparts." 64 Fed. Reg. 26747.

EPA also touted specific cases, such as the disclosure in 1998 from American Airlines of Clean Air Act violations at ten different facilities that resulted in a 100 percent waiver of gravity-based penalties and a fine of only $95,000 to recoup

the economic benefit of noncompliance. That same year, in a congressional hearing, the Agency promoted another incident where the disclosure of 600 Clean Water Act violations at 314 GTE facilities resulted in a $52,000 penalty, which again was based solely on economic benefit.

The best internal compliance management programs have a built-in strategy for addressing voluntary disclosures and taking timely corrective actions.

EPA also sought to use the Audit Policy proactively to encourage audits and disclosures from specific industries. For example, shortly after issuing the 2000 revisions to the Audit Policy, EPA sent letters to forty-one steel mini-mills—secondary steel producing facilities that recycle scrap—encouraging them to take advantage of EPA's Audit Policy. This followed a similar effort by Region 5 in 1997, which resulted in penalty mitigation for those facilities that responded with self-audit reports and inspections and citations for those facilities that chose not to participate. Such targeted enforcement pushes were a way for EPA to promote participation in the Audit Policy and to identify systemic issues in a particular industry.

Participation in the Audit Policy started relatively slowly but grew steadily with time. In its 2000 revisions, EPA reported that, by October 1, 1999, "approximately 670 organizations had disclosed actual or potential violations at more than 2700 facilities." The rate of participation increased considerably through the 2000s: between 2007 and 2012, an average of 1,315 facilities per year initiated voluntary disclosures with EPA. Nevertheless, participation in the program remains limited to a fraction of entities within the Agency's overall enforcement portfolio. For context, in 2005, approximately 1,500 facilities self-disclosed a violation under the Audit Policy. During this same period EPA inspected 21,000 facilities out of approximately 1.1 million that were subject to EPA requirements.

It is unclear whether the Audit Policy has resulted in material reductions to pollution and corresponding improvements to environmental quality and public health. One 2004 study concluded that more than 90 percent of violations reported under the Audit Policy fundamentally related to reporting and record-keeping. That study also compared fines issued under the Audit Policy (prior to any downward adjustment) with those issued under other EPA enforcement mechanisms, like inspections, to conclude that self-reported violations were generally less significant. Another study from 2005, published in the *Vermont Law Journal*, compared the rates of compliance with hazardous waste regulations before and after the creation of the Audit Policy and found the Policy had little impact on overall compliance.

These findings suggest that incentives for voluntary disclosures may not be an adequate replacement for traditional enforcement and inspection strategies. However, measuring the pollution-reduction benefits of EPA's own enforcement activities has always been a challenge for EPA. Such concerns may be irrelevant to a company considering whether to take advantage of the Audit Policy. Furthermore, the finding overlooks a more subtle benefit served by audit policies to promote self-disclosure, whether those policies are administered by EPA or the states.

Given the complexity of U.S. environmental regulations, successful businesses that operate here have learned the value of internal environmental compliance management programs. The best examples of such programs are designed with a built-in strategy for addressing voluntary disclosures and taking timely corrective actions. To be successful, an internal audit program must have real commitment and complete support from the very top of the organization—because implementing timely corrective actions can sometimes lead to business interruptions and customer dissatisfaction. Successfully implementing such a program helps to create a culture of compliance throughout the organization, although this may require time, as otherwise independent business units may need to learn to collaborate across organizational lines if they all rely on a single integrated resource for regulatory compliance management support.

But the opportunity for significant, even complete, reductions of gravity-based penalties that such a program creates may outweigh such difficulties and concerns. Indeed, one study found that, between 2001 and 2005, at least two-thirds of all self-disclosed violations resulted in a complete waiver of all gravity-based penalties. Furthermore, a 2010 empirical analysis from the Harvard Business School found that facilities that voluntarily disclosed faced a meaningful 17 percent reduction in the likelihood of being inspected compared to facilities that did not take advantage of the Audit Policy.

There are also signs that critics may have been overly concerned about some of the Policy's risks to individual businesses. According to an OECA representative, EPA has never requested that a company undertaking a voluntary disclosure of a civil violation submit underlying, confidential internal audit reports. And over the life of the Policy, there have been only six instances of criminal prosecution, out of approximately fifty criminal matter disclosures. In each of the cases where prosecution occurred, the disclosing companies failed to satisfy one or more conditions of the Policy.

Outlook and Projections

Given some of the shortcomings of the Audit Policy, and the different perspective on environmental policy brought to the Agency when President Obama's appointees ascended to leadership roles commencing in 2009, it should come as no surprise that EPA eventually began to question the merits of continuing the Audit Policy. Thus, OECA, on page 15 of its National Program Manager Guidance for FY 2013, suggested that the incentives of the Audit Policy may no longer be necessary given that environmental self-audit programs had become widely accepted by the regulated community "as part of good management." http://nepis.epa.gov/Exe/ZyPDF.cgi?Dockey=P100F6FG.PDF. OECA explained that "most violations disclosed under the Policy are not in the highest priority enforcement areas for protecting human health and the environment," which was likely an oblique reference to the frequency with which the Audit Policy is used to disclose

reporting deficiencies as opposed to accidental releases and permit violations. OECA noted that it was reducing investment in the Audit Policy program and concluded its short statement by noting cryptically that it was "considering several options, including a modified Audit Policy program that is self-implementing." *Id*.

Following this statement and similar comments by OECA during an Environmental Law Institute webinar in April 2013, many members of the regulated community expressed concern that EPA was considering scaling back or possibly even ending the Audit Policy. Some suspected that OECA was reconsidering the Audit Policy for philosophical reasons—reflecting sensitivities to historical criticisms from environmental groups that the Policy lets violators off the hook too easily.

Despite these concerns, in 2015, EPA unambiguously expressed its continuing commitment to the Audit Policy with the introduction of a new eDisclosure portal. The eDisclosure portal, which officially launched in December, is an online platform for companies to disclose violations under the Audit Policy. With the portal, EPA aims to intelligently manage its resources by making some features of the Audit Policy self-implementing. For the purposes of administering the portal, EPA has divided violations into two categories. Category 1 violations are routine EPCRA violations, which, according to EPA, comprise "about half" of the Audit Policy disclosures it receives. When these are submitted through the portal, along with a certification that the violations have been resolved, the system will automatically issue an electronic Notice of Determination with no assessment of civil penalties.

Category 2 violations are more significant. When these are submitted via the portal, EPA will generate an acknowledgment letter promising to make a determination regarding the Audit Policy penalty mitigation factors if and when EPA initiates an enforcement action. The submitter will also have sixty days to certify that the facility has come into compliance—though the portal will automatically grant extension requests up to thirty days and potentially longer with a written justification. EPA currently plans to continue to administer the New Owner Policy—but on a case-by-case basis outside the eDisclosure portal.

The eDisclosure portal is only one part of EPA's "Next Generation Compliance" strategy representing EPA's more "modern approach" to regulatory compliance, which includes a greater reliance on data analytics, electronic reporting, and advanced monitoring. While it may be too soon to assess the success of "Next Generation Compliance," it is clear that EPA is moving away from a heavy reliance on traditional enforcement techniques like boots-on-the-ground inspections. For example, in its 2014–2018 Strategic Plan, EPA aims to conduct 79,000 inspections over a five-year period, representing a 25 percent reduction compared to the Agency's 2011–2015 Strategic Plan to conduct 105,000 inspections.

The Policy Benefits EPA and the Regulated Community

The central bargain of EPA's Audit Policy remains sound, and it explains why so many states with vastly differing politics have adopted their own version. The Audit Policy continues to create an opportunity for good-faith cooperation between regulated entities and their regulators. The Audit Policy's development reflects EPA's willingness to recognize and adapt to the needs and concerns of the regulated community and to recognize the important role of the states in establishing policy in the same arena.

What often goes unrecognized by Audit Policy critics is that for more than twenty years it has not only reflected but also further encouraged and incentivized corporate culture, which recognizes the significant benefits of strong environmental oversight and leadership. As the Agency proceeds with its "Next Generation Compliance" strategy, it appears EPA remains invested in the Audit Policy. An invigorated Audit Policy that rewards entities with a demonstrated cultural commitment to environmental compliance represents good news for the regulated community, good news for the Agency, and good news for the environment.