

KIRKLAND ALERT

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EPA's New Owner Clean Air Act Audit Program Could Streamline Acquisition Process for Upstream Oil and Gas Assets

The U.S. Environmental Protection Agency (“EPA”) is in the process of developing a New Owner Clean Air Act Audit Program (the “Audit Program” or the “Program”) for the upstream oil and gas sector. If finalized, the Audit Program could streamline the process of acquiring upstream oil and gas assets and allow parties to more easily manage Clean Air Act (“CAA”) compliance risks.

Purpose

The intent of the voluntary Program is reportedly to support the dynamic oil and natural gas exploration and production sector, where upstream facilities are routinely acquired and subsequently divested.¹ In promulgating the Program, EPA does not intend to replace its existing enforcement efforts; rather, the agency hopes to encourage compliance in order to address the “significant excess emissions and Clean Air Act noncompliance” observed at upstream oil and gas exploration and production facilities.² The Audit Program does not absolve new owners from potential criminal liability and does not extend to issues that are not identified and explicitly disclosed to EPA during the audit.³

Applicability

EPA will initially extend the Audit Program to new owners of upstream oil and gas exploration and production facilities who satisfy certain conditions. Those qualifying new owners may enter into a standard agreement with EPA to audit newly acquired facilities to assess compliance with the CAA and federally approved State Implementation Plans.⁴ If the owner identifies and corrects pre-existing CAA violations, EPA will not seek civil penalties or bring claims for violations identified in the audit so long as those violations are resolved in accordance with the terms of the agreement.⁵

To qualify for the Audit Program, the following requirements must be met:

- the new owner must not have been responsible for environmental compliance at the facility prior to the date of acquisition;
- the new owner and the seller may not have had the largest ownership share of the other entity;
- the new owner cannot share a common corporate parent with the seller; and

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- the new owner must notify EPA of its intent to enter the facility (or facilities) into the Program within six (6) months of the later of (i) the date the acquisition closes or (ii) of the date EPA finalizes the Program.⁶

On June 22, 2018, EPA released a Q&A document clarifying that the Audit Program protects buyers who correct CAA violations but does not apply similarly to sellers, which clarified previous uncertainty with respect to the Program's applicability.⁷ EPA explained that sellers who do not discover, disclose, and correct violations related to their facilities will not be able to benefit from the Program when new owners decide to take such actions.⁸

Process

Upon entering the Program, a buyer may develop and implement its own protocols for conducting the audit, subject to EPA approval. The new owner must also provide EPA with semi-annual reports updating the status of any compliance corrections.⁹ Once the noncompliance matters have been corrected, the new owner must submit to EPA a final report summarizing the violations and corrective actions taken. EPA will then determine whether the new owner satisfactorily addressed the violations, and EPA may issue appropriate civil penalties for violations that might continue post-acquisition.¹⁰

Overview of Key Provisions of the Draft Agreement

Key terms of EPA's draft standard audit program agreement (the "Draft Agreement") include:

- **Violation Correction Schedule:** The timing of audits and corrective action depends on the number of acquired facilities and scope of the audit. The period for conducting the audit and discovering and correcting violations must be agreed upon between the contract parties and EPA.¹¹
- **Corrective Actions:** The Draft Agreement defines three types of CAA violations: (1) violations unrelated to engineering and/or design issues; (2) violations related to engineering and/or design issues; and (3) conditions that present immediate and substantial endangerment to public health or welfare, or the environment.¹² Violations unrelated to engineering and/or design issues must be corrected within sixty (60) days of discovery, whereas violations related to engineering and/or design issues are subject to a negotiated correction schedule.¹³ Extensions for the first category may be requested and not "unreasonably withheld" by EPA.¹⁴ The term "engineering and/or design issues" remains undefined but appears to relate to vapor control systems, given the Draft Agreement's detailed requirements for such systems, and EPA's compliance concerns regarding improperly sized and designed closed vent systems, flares, and vapor recovery units on storage tanks.¹⁵ Conditions that pose immediate and substantial endangerment to public health or welfare, or the environment must be addressed "as expeditiously as possible," and companies must notify EPA of these conditions within twenty-four (24)

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hours of discovery and propose remedial actions within five (5) business days.¹⁶

- **Vapor Control System Analysis, Field Survey and Corrective Actions:** New owners will be required to assess tank battery vapor control systems as part of the audit and develop a model to determine the potential minimum and potential peak instantaneous vapor flow rate from all vapor sources (e.g. atmospheric storage tanks and transfer and loading systems) within sixty (60) days after entering an agreement with EPA. The Draft Agreement contains detailed requirements for field surveys to detect leaks and modifications to eliminate vapor emissions.¹⁷
- **Reporting Requirements:** New owners enrolled in the Audit Program must report the following to EPA:
 - (i) Audit documents: Within sixty (60) days of the date on which EPA signs the agreement, companies must submit detailed audit protocols and checklists, to which EPA must respond within forty-five (45) days of submission.¹⁸
 - (ii) Semiannual report: Companies must disclose all violations discovered during the audit in written disclosure reports on a semi-annual basis, including a list of the facilities audited during the previous six-month period, a summary of the violations discovered, a summary of actions taken to correct the discovered violations, and a list of any changes to the list of facilities covered under the agreement.¹⁹
 - (iii) Final Report: Within sixty (60) days following the completion of the Audit Program and all corrective actions, companies must submit a summary of compliance with regard to each disclosed violation.²⁰
- **Recordkeeping Requirements:** Companies must maintain records for at least two (2) years after receiving a final determination from EPA that the audit program was completed consistent with the Draft Agreement. EPA may request records at any time during this information-retention period, and companies may assert business confidentiality claims covering part or all of EPA's requested records, consistent with 40 C.F.R. § 2.203(b).²¹

Takeaways

The Audit Program follows the issuance of a 2008 EPA policy (the “2008 EPA Policy”), which allows new owners of facilities in any sector to self-disclose violations and receive reductions in, or forgiveness of, civil penalties.²² Unlike the Audit Program, the 2008 EPA Policy does not include a standardized agreement template, but rather requires new owners to develop and finalize an agreement with EPA within nine (9) months of closing on an acquisition.²³ According to EPA, the Audit Program reflects the agency's renewed emphasis on self-disclosing and correcting environmental violations.²⁴

While the Audit Program may provide greater certainty for companies pursuing upstream oil and gas acquisitions, the Program does not protect sellers from liability for violations that occurred while they operated the facilities. Sellers do not receive

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credit for audits or corrective actions conducted as part of a new owner's agreement with EPA, and EPA reserves the right to take enforcement actions against sellers for violations that occurred when they operated the facility.²⁵

In addition, certain ambiguities do exist in the currently contemplated Draft Agreement. First, EPA has not clearly defined the types of violations that might stem from "engineering and/or design issues," a term used in the Draft Agreement to determine scheduling and corrective action requirements.²⁶ Second, EPA has not yet clarified its process and criteria for determining whether a violation has been "satisfactorily corrected" such that new owners might have increased certainty with respect to how they must appropriately correct identified violations.²⁷

Next Steps

The Audit Program may help new owners achieve prompt and cost-effective CAA compliance with added certainty. By allowing the regulated community to self-disclose and correct violations, EPA intends for the program to streamline mergers and acquisitions involving upstream assets, while protecting public health and the environment.

EPA is reviewing comments submitted to EPA on the Draft Agreement, and may issue a final policy in the coming months, either in the same form or with revisions based on the comments received. Investors and operators in the upstream oil and gas sector should monitor comments on the Draft Agreement and consider working with counsel to determine the legal, technical, and cost implications of participation in the Audit Program for future transactions.

The Audit Program may help new owners achieve prompt and cost-effective CAA compliance with added certainty; investors and operators in the upstream oil and gas sector should monitor comments on EPA's draft standard audit program agreement and consider working with counsel to determine the implications of participation in the Audit Program for future transactions.

1 U.S. EPA, "New Owner Clean Air Act Audit Program for Oil and Natural Gas Exploration and Production Facilities Questions and Answers Questions and Answers" at 5. (June 22, 2018,) available at <https://www.epa.gov/sites/production/files/2018-06/documents/qaoilandnaturalgasnewownerauditprogram.pdf>

2 *Id.* at 4.

3 U.S. EPA, "Oil and Natural Gas Exploration and Production Facilities New Owner Audit Program Agreement," ("Draft Agreement") § 14. (May 4, 2018,) available at https://www.epa.gov/sites/production/files/2018-05/documents/oil_and_gas_new_owner_program_audit_agreement_may_4_2018_draft.pdf

4 U.S. EPA, *Draft Agreement* § 3.

5 *Id.* § 14.

6 U.S. EPA, *Draft Agreement* § 4.

7 U.S. EPA, *Questions and Answers* at 5.

- 8 *Id.*
- 9 U.S. EPA, *Draft Agreement* Appendix C.
- 10 See *id.*
- 11 U.S. EPA, *Draft Agreement* § 8-9.
- 12 U.S. EPA, *Draft Agreement* § 10-12.
- 13 *Id.*
- 14 *Id.* § 10.
- 15 U.S. EPA, “EPA Observes Air Emissions from controlled Storage Vessels at Onshore Oil and Natural Gas Production Facilities,” (September 2015), *available at* <https://www.epa.gov/sites/production/files/2015-09/documents/oilgascompliancealert.pdf>
- 16 U.S. EPA, *Draft Agreement* § 12.
- 17 U.S. EPA, *Draft Agreement* Appendix B.
- 18 *Id.* Appendix C.
- 19 *Id.*
- 20 *Id.*
- 21 *Id.*
- 22 Kerschner, Seth and Mulry, Laura. “EPA Offers Clean Air Act Penalty Forgiveness for Buyer of Upstream Oil & Gas Assets under an Updated, Standardized Audit Program,” (June 1, 2018,) *available at* <https://www.whitecase.com/publications/alert/epa-offers-clean-air-act-penalty-forgiveness-buyers-upstream-oil-gas-assets-under>
- 23 U.S. EPA, “EPA’s Interim Approach to Applying the Audit Policy to New Owners,” (Aug. 1, 2008,) *available at* <https://www.epa.gov/compliance/epas-interim-approach-applying-audit-policy-new-owners>
- 24 See U.S. EPA, “EPA Announces Renewed Emphasis on Self-Disclosed Violation Policies,” (May 15, 2018,) *available at* <https://www.epa.gov/sites/production/files/2018-05/documents/refresh-announcementfordisclosures.pdf>
- 25 U.S. EPA, *Questions and Answers* at 5.
- 26 U.S. EPA, *Draft Agreement* § 10-11.
- 27 U.S. EPA, *Draft Agreement* § 22.

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