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EPA Offers Clean Air Act Penalty Forgiveness for Buyers of Upstream Oil & Gas Assets under an Updated, Standardized Audit Program

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The United States Environmental Protection Agency ("EPA") is proposing a New Owner Clean Air Act Audit Program (the "Audit Program") tailored for the upstream oil and gas sector. Under EPA's proposal, if a new owner of oil and gas extraction and production facilities audits the acquired facilities under an agreement with EPA and corrects identified pre-existing Clean Air Act ("CAA") violations, then related penalties are forgiven and further claims by EPA are barred. If finalized, the Audit Program could provide parties with certainty in allocating and managing CAA compliance risk and could be an incentivizing factor for parties considering mergers and acquisitions ("M&A") involving upstream assets. A recent uptick in upstream oil and gas M&A deals was a major driver of the new Audit Program.

On May 4, 2018, EPA issued a template draft "Oil and Natural Gas Exploration and Production Facilities New Owner Audit Program Agreement" (the "Draft Agreement") that allows new owners of exploration and production facilities to conduct an audit of the facilities to determine whether any Clean Air Act violations exist. Under the Draft Agreement, EPA will not seek civil penalties or bring any claims for violations that are identified in the audit and corrected by the new owner in accordance with the terms of the agreement.

The Draft Agreement indicates that the timing of audits and corrective action will depend on the number of acquired facilities and the scope of the audit. The Draft Agreement is based on an EPA agreement with Range Resources Corporation that allowed that company to complete its audit in a three-year period. The Draft Agreement provides two different timelines for correcting existing violations: one for engineering and/or design issues (e.g., equipment or tank leaks and improperly functioning vapor control systems) and another for issues unrelated to engineering and/or design. Engineering and/or design issues are subject to a negotiated schedule to be determined by the details of the specific facilities, while all other violations are required to be corrected within 60 days of discovery; extensions of time beyond the 60 days can be requested and EPA's approval of such requests cannot be "unreasonably withheld." A key program component will require that buyers assess storage tank vapor control systems as part of the audit process; EPA reports that flash emissions from such storage tank systems at natural gas wells were a major driver of the new Audit Program. Companies are permitted to develop their own protocols for conducting the audit, pending EPA approval.

The Audit Program follows a 2008 EPA audit policy, which allows new owners of facilities in any sector to self-disclose violations and receive penalty forgiveness and a release of liability. The 2008 audit policy does not

include a template, standardized agreement like the Draft Agreement, and the 2008 audit policy requires new owners to draft, negotiate, and finalize an agreement with EPA within nine (9) months of closing on an acquisition.

The new Audit Program is intended to address the large amount of facilities changing ownership in the oil and gas sector by providing a standardised, streamlined agreement. EPA is also touting the Audit Program as providing the upstream oil and gas industry a more flexible and collaborative opportunity to address a pattern of CAA violations at upstream oil and gas operations.

To take advantage of the new Audit Program, a buyer must notify EPA within six (6) months of the later of the closing date of the acquisition or the date of the finalization of the Audit Program and the agreement must be finalized within a year of closing. Retroactively, the Audit Program will only apply to transactions that closed within one year of the finalization of the Audit Program. The buyer also must not have been responsible in any way for environmental compliance at the acquired facilities pre-closing and cannot share a common corporate parent with the seller of the acquired facilities nor can either party have the "largest ownership share of the other entity." EPA reports that the Audit Program will initially only be made to "sites where EPA and states have seen significant noncompliance."

Upon EPA determining the subject violations are satisfactorily corrected, EPA will issue a determination memorializing complete resolution of all civil claims and causes of action alleged or which could have been alleged under the CAA, its implementing regulations, and the federally-approved and enforceable requirements of applicable State Implementation Plans. The Audit Program does not resolve criminal liability and does not cover issues not identified and disclosed to EPA during the audit.

We note that the Draft Agreement requires the buyer of the facilities to correct any violations and it is unclear whether the protections of the Audit Program would apply to a buyer and seller in the case where the seller is the party correcting the violations. The Draft Agreement also does not clarify exactly what constitutes engineering and/or design violations. EPA plans to issue a Q&A document addressing commonly asked questions on the Audit Program, which document could provide clarification on these matters.

The Audit Program, if finalized, could provide parties considering transactions involving upstream oil and gas assets valuable opportunities to more easily manage CAA compliance risks.

The Draft Agreement can be found **here**. EPA is accepting comments on the draft agreement until June 4, 2018, and this deadline will likely be extended. EPA is planning for the Audit Program to be finalized by September 2018.

For an overview of recent increased oil and gas M&A activity, please see **here**.

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