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Environmental Audits

Kenneth C. Gold

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I. Introduction §8.1

Environmental audits are an essential part of transactional due diligence and corporate environmental compliance programs. Environmental audits in transactions enable a buyer to understand environmental liability risks before acquiring the target company or assets. Use of an environmental audit as part of a business's compliance program can help the business identify violations and other risks and take corrective action. Other environmental aspects of transactions are discussed in Chapter 7.

II. Environmental Audits in Due Diligence

A. In General §8.2

Perhaps the most significant factor that causes prospective buyers to perform environmental audits as part of their pre-acquisition due diligence is the fear that they will unknowingly assume liability under environmental laws such as CERCLA, [42 USC 9601 et seq.](#), and state analogues such as Part 201 of NREPA. [MCL 324.20101 et seq.](#) CERCLA and Part 201 are discussed in Chapter 5.

B. “All Appropriate Inquiry” §8.3

When it was enacted in 1980, CERCLA provided that the current owner or operator of contaminated real property was liable for the contamination regardless of fault. In 1986, Congress added an “innocent landowner” defense that provides that a person who acquires contaminated property but who did not know or have reason to know of the contamination will not be liable for the contamination. [42 USC 9607\(b\)](#) and [42 USC 9601\(35\)](#). A similar defense is available under Part 201. [MCL 324.20126\(3\)\(h\)](#).

To demonstrate that one did not have reason to know of contamination, the buyer must undertake, at the time of the acquisition, “all appropriate inquiry” (AAI) into the previous ownership and uses of the property consistent with good commercial or customary practice. [42 USC 9601\(35\)\(B\)](#).

Congress did not define AAI in the 1986 CERCLA amendments. But Congress did set forth five factors for courts to consider in interpreting the meaning of AAI:

- Defendant's specialized knowledge or experience.
- Purchase price relationship to property value if uncontaminated.
- Commonly known or reasonably ascertainable information about the property.
- Obviousness of contamination's actual or likely presence.
- Ability to discover the contamination by appropriate inspection.

[42 USC 9601\(35\)\(B\)\(iv\)](#). To help guide businesses through the uncertainties created by these broad factors, ASTM International (formerly known as the American Society for Testing and

Materials) published recommended best practices for what have become known as “Phase I environmental site assessments” (ESAs) to meet the requirements of AAI, known as ASTM Standard E1527, which has been revised various times over the years. The revisions can be identified by the addition of the final two digits of the year to the reference. For example, the 1997 version of the standard is known as ASTM E1527-97. Following versions are E1527-00 and E1527-05. Most environmental consultants have followed Standard E1527 when performing Phase I ESAs, either voluntarily or because their clients or their lenders require it.

C. The 2002 CERCLA Amendments §8.4

In 2002, Congress amended CERCLA in what are known as the “Brownfield Amendments.” Among other things, Congress more fully addressed the meaning of AAI and added two new defenses to CERCLA liability: the bona fide prospective purchaser and contiguous property owner defenses (discussed in Chapter 5). The Brownfield Amendments include the following significant provisions:

- A buyer must perform AAI on or before the acquisition to be able to claim the innocent landowner, bona fide prospective purchaser, or contiguous property owner defenses.
- Other “continuing obligations” are now required for these defenses to remain valid.
- EPA must promulgate rules to more fully define AAI by January 11, 2004.

[42 USC 9601\(35\)](#). Congress set forth ten specific criteria for EPA’s AAI definition, which are summarized in the discussion of the EPA’s AAI rule in [§8.5](#) and following.

The 2002 amendments also set forth the “interim” AAI standards applicable to transactions that occurred before EPA would promulgate its AAI rule. For properties bought before May 31, 1997, the five factors listed in the 1986 CERCLA amendments (discussed in [§8.3](#)) were the applicable AAI standard. For properties bought on or after May 31, 1997 and until the effective date of EPA’s AAI rule, buyers would be considered to have met AAI if they followed ASTM E1527-97. EPA later added the -00 and -05 versions as acceptable interim standards. EPA added the -00 version as an acceptable interim AAI standard by a rule published at [68 Fed Reg 24888](#) (May 9, 2003). EPA added the -05 version as an acceptable interim AAI standard. [70 Fed Reg. 66070, 66081](#) (Nov. 1, 2005).

D. EPA’s “All Appropriate Inquiries” Rule

1. In General §8.5

In 2005, EPA promulgated its AAI rule (AAI Rule) to implement Congress’s requirements in the 2002 CERCLA amendments. [70 Fed Reg 66070](#), promulgated at [40 CFR Part 312](#). The AAI Rule applies to persons seeking to establish the innocent landowner defense pursuant to CERCLA [42 USC 9601\(35\)](#) and [42 USC 9607\(b\)\(3\)](#), the bona fide prospective purchaser liability protection pursuant to CERCLA [42 USC 9601\(40\)](#) and [42 USC 9607\(r\)](#), and the contiguous property owner liability protection pursuant to [42 USC 9607\(q\)](#). [40 CFR 312.1\(b\)](#).

The AAI Rule also applies to persons conducting site characterization and assessments with the use of a grant awarded under [42 USC 9604\(k\)\(2\)\(B\)](#). Persons seeking to establish one of these liability protections must conduct investigations as required by the AAI Rule to identify conditions that indicate releases or threatened releases of hazardous substances. [40 CFR 312.1\(c\)\(1\)](#).

2. The “Environmental Professional” §8.6

An “environmental professional” (EP) must perform many elements of an AAI investigation. EPA defines an EP as “a person who possesses sufficient specific education, training, and experience necessary to exercise professional judgment to develop opinions and conclusions regarding conditions indicative of releases or threatened releases ... on, at, in, or to a property, sufficient to meet the objectives and performance factors of [the AAI Rule].” [40 CFR 312.10\(b\)](#). In addition, the EP must:

- Hold a current professional engineer’s or professional geologist’s license or registration from a state, tribe, or U.S. territory or the Commonwealth of Puerto Rico and have the equivalent of three years of full-time relevant experience; or
- Be licensed or certified by the federal government, a state, tribe, or U.S. territory or the Commonwealth of Puerto Rico to perform environmental inquiries as defined in the AAI rule and have the equivalent of three years of full-time relevant experience; or
- Have a baccalaureate or higher degree from an accredited institution of higher education in a discipline of engineering or science and the equivalent of five years of full-time relevant experience; or
- Have the equivalent of ten years of full-time relevant experience.

Id. EPA defines “relevant experience” as: “participation in the performance of all appropriate inquiries investigations, environmental site assessments, or other site investigations that may include environmental analyses, investigations, and remediation which involve the understanding of surface and subsurface environmental conditions and the processes used to evaluate these conditions and for which professional judgment was used to develop opinions regarding conditions indicative of releases or threatened releases to the subject property.” *Id.*

A non-EP may assist in performing an AAI investigation as long as he or she is under an EP’s supervision or responsible charge. [40 CFR 312.10\(b\)](#). The AAI Rule requires that an EP “should” remain current in his or her field through continuing education or other activities. [40 CFR 312.10\(b\)](#). Despite the use of the word “should” in the AAI Rule, EPA’s preamble to the final rule calls this provision a “requirement” and adds that an EP must be able to “demonstrate” these efforts. [70 Fed Reg 66080](#).

3. The AAI Investigation: Basic Elements §8.7

An AAI investigation must include the following elements ([42 USC 9601\(35\)\(B\)\(i\)\(I\) and \(B\)\(ii\)](#); [40 CFR 312.21](#)):

1. Interviews with past and present owners, operators, and occupants. [40 CFR 312.23](#). In the case of abandoned properties, the interviews must include interviewing one or more owners or occupants of neighboring or nearby properties who may have been able to observe uses of or releases at the property. [40 CFR 312.23\(d\)](#).

2. Review of historical sources of information, such as chain of title documents, aerial photos, building department records, and land use records, to determine past uses. [40 CFR 312.24](#). The rule does not require that any specific type of historic information be collected. In particular, the rule does not require that a chain of title be obtained for the property. [70 Fed Reg 66091-92](#).

3. Searches for recorded environmental cleanup liens. [40 CFR 312.25](#). If the buyer chooses to obtain this information, the EP may, but is not required to, provide it.

4. Reviews of federal, state, tribal, and local governmental records. [40 CFR 312.26](#). This review should include a search for institutional controls. Institutional controls are non-engineered instruments, such as administrative and legal controls that, among other things, can help to minimize the potential for human exposure to contamination and protect the integrity of an existing remedy by limiting land or resource use. [40 CFR 312.10\(b\)](#). An example of institutional controls would be a prohibition on the drilling of a drinking water well in a contaminated aquifer or disturbing contaminated soils. Institutional controls may also be referred to as land use controls or activity and use limitations. [70 Fed Reg 66087](#).

5. Visual inspection of the property and adjoining properties. [40 CFR 312.27](#). According to EPA, this “may be the most important aspect” of AAI “and the primary source of information regarding the environmental conditions on the property.” [70 Fed Reg at 66095](#). EPA states that “[i]n all cases, every effort must be made to conduct an on-site visual inspection of a property when conducting all appropriate inquiries.” *Id.* In the rare case when an owner refuses to grant access for a site inspection, “good faith” efforts must still be made to gain access, and visual inspection is still required by other legal means, such as observation from the nearest vantage point or aerial photography. [70 Fed Reg at 66095-96](#). The EP must document efforts made to obtain access and why they were unsuccessful. [70 Fed Reg at 66096](#). The visual inspection need not be performed by the EP, but must be performed by a person who is under the supervision or responsible charge of an EP. [70 Fed Reg at 66097](#). EPA still “recommends” that the EP perform the site inspection as the person “best able to interpret such observations of a property and ascertain the probability of conditions indicative of releases or threatened releases of hazardous substances being present at the property.” *Id.* Adjoining properties may be visually inspected from nearby vantage points, although EPA recommends actual on-site access and inspection of adjoining properties. [70 Fed Reg at 66096](#).

6. The owner's specialized knowledge or experience. [40 CFR 312.28](#). The AAI Rule provides little guidance as to what this concept means. EPA's preamble refers to several cases in which courts held that persons with extensive commercial real estate or environmental experience were denied "innocent landowner" status because they had specialized knowledge or experience that should have alerted them to the potential for contamination. [70 Fed Reg at 66098](#).

7. The relationship of the purchase price to the value of the property value if the property was not contaminated. [40 CFR 312.29](#). The AAI Rule does not require that a real estate appraisal be conducted; only a general determination is necessary. [70 Fed Reg at 66099](#).

8. Commonly known or reasonably ascertainable information about the property. [40 CFR 312.30](#). Generally, this means information about a property that is generally known to the public within the community where the property is located and can be easily sought and obtained from persons familiar with the property or from easily attainable public sources of information. [70 Fed Reg at 66099-100](#). An example is an abandoned property as to which little documentation exists, but as to which the community knows was used for "midnight dumping" or other unrecorded contaminating purposes.

9. The degree of obviousness of the presence or likely presence of contamination at the property and the ability to detect the contamination by appropriate investigation. [40 CFR 312.31](#). This requires the EP to consider all the information gathered through performance of AAI elements 1 through 8 above and "assess whether or not an obvious conclusion may be drawn" about the likely presence of contamination based on the "totality of [the] information collected." [70 Fed Reg at 66101](#). The EP must include as part of the results of his or her inquiry "an opinion regarding additional appropriate investigation, if necessary." [40 CFR 312.31\(b\)](#).

10. The EP must perform or supervise the investigation. The EP is responsible for the investigation of foregoing elements 1, 2, 4, 5, 8, and 9. The owner is responsible for elements 3, 6 and 7 but the owner may share results with the EP. Alternatively, the EP may do them. [40 CFR 312.21\(b\)](#).

The AAI Rule states that the procedures of [ASTM Standard E1527-05](#) may be used to comply with AAI elements 1 through 9 above. [40 CFR 312.11\(b\)](#). In the AAI Rule's preamble, EPA states that it is "recognizing the E1527-05 standard as consistent with today's final rule. The Agency determined that this voluntary consensus standard is consistent with today's final rule and is compliant with the statutory criteria for all appropriate inquiries. Persons conducting all appropriate inquiries may use the procedures included in the ASTM E1527-05 standard to comply with today's final rule." [70 Fed Reg at 66081](#).

4. Level of Effort Required §8.8

The AAI Rule does not require exhaustive and costly efforts to be made to access all available sources of data and find every piece of data and information about a property. [70 Fed Reg at 66086](#). Rather, the EP must seek to gather the required information "that is publicly available, obtainable from its source within reasonable time and cost constraints, and which can practicably

be reviewed.” [40 CFR 312.20\(f\)\(1\)](#). Data gaps, which are “a lack of or inability to obtain information required by [AAI]”, are acceptable as long as the EP or other person used good faith efforts to obtain the missing information. [40 CFR 312.10\(b\)](#); see also discussion at [70 Fed Reg at 66088-89](#). “Good faith” is defined as “the absence of any intention to seek an unfair advantage or to defraud another party; an honest and sincere intention to fulfill one’s obligations in the conduct or transaction concerned.” [40 CFR 312.10\(b\)](#).

Simply because a data gap is permissible, however, does not mean an inquiry with data gaps necessarily meets the AAI Rule. The EP must provide an opinion about the significance of the data gap on the EP’s ability to provide an opinion as to whether the inquiry has identified conditions indicative of releases or threatened releases of a hazardous substance on, at, in or to the property. [40 CFR 312.20\(g\)](#) and [40 CFR 312.21\(c\)\(2\)](#).

5. Does AAI Require Testing? §8.9

EPA is emphatic that the AAI Rule does not require sampling and analysis. [70 Fed Reg at 66089, 66101-02](#). Although the AAI Rule does not require testing, it states that one way to address data gaps may be to conduct sampling and analysis. [40 CFR 312.20\(g\)](#); see also [70 Fed Reg at 66089](#). Further, EPA cautions that the fact that the AAI Rule does not require testing “does not prevent a court from concluding that, under the circumstances of a particular case, sampling and analysis should have been conducted to meet ‘the degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate investigation’ criterion and obtain protection from CERCLA liability.” [70 Fed Reg at 66101](#).

6. The AAI Report §8.10

The EP must document in a written report the results of the AAI investigation under his or her supervision or responsible charge. [40 CFR 312.21\(c\)](#). The report must include the EP’s opinion on whether the AAI investigation identified conditions that indicate releases or threatened releases of hazardous substances on, at, in, or to the subject property. [40 CFR 312.21\(c\)\(1\)](#). As noted in [§8.8](#), the AAI investigation must also identify data gaps that affect the EP’s ability to render the opinion, and the EP must comment on the significance of the data gaps. [40 CFR 312.21\(c\)\(2\)](#).

The EP who conducts or oversees the AAI investigation must sign the report. The report must include a declaration that he or she meets the definition of an EP and provide his or her qualifications. It must also include a declaration that the EP performed the investigation in conformance with the AAI Rule. [40 CFR 312.21\(c\)\(3\) and \(d\)](#).

The AAI Rule imposes no specific requirements on the length, structure, or format of the report, and it may be similar to past reports on the property. The AAI Rule also does not require the report to be submitted to EPA or otherwise to be disclosed, nor that the report be maintained on-site or even that it or any related documentation be retained at all, although EPA notes that the retention of the report “may be helpful should the property owner need to assert protection from CERCLA liability after purchasing a property.” [70 Fed Reg at 66077](#).

“De minimis” contamination. The report is not required to identify “quantities or amounts, either individually or in the aggregate,” of contaminants that “because of said quantities and amounts” “generally would not pose a threat to human health or the environment.” [40 CFR 312.20\(h\)](#).

7. Timing of AAI Performance and Information Shelf Life §8.11

An AAI investigation must be conducted within one year before the date of acquisition of the property. [40 CFR 312.20\(a\)](#). An even shorter time frame applies to certain information. The following components of an AAI investigation must be conducted or updated within 180 days prior to the date of acquisition:

- Interviews with past and present owners, operators, and occupants.
- Searches for recorded environmental cleanup liens.
- Reviews of federal, tribal, state, and local government records.
- Visual inspections of the facility and of adjoining properties.
- The declaration by the EP.

[40 CFR 312.20\(b\)](#). Information collected more than a year before the date of acquisition may be used, but it must have been obtained in a manner required by the AAI Rule, and it must be updated as required to meet either the one year or 180 day requirements described above, as applicable. [40 CFR 312.20\(c\)](#).

The “date of acquisition” or “purchase date” means “the date on which a person acquires title to the property.” [40 CFR 312.10\(b\)](#). Practitioners should note that when determining whether a report is still valid for use in a transaction, the AAI Rule contains not one, but two traps for the unwary – one each on both ends of the “report validity” clock, as follows:

- First, the one year or 180-day report validity clock starts ticking not on the date of the prior report, *but on the date on which the information was collected or updated*. This date can be months earlier than the date of the report. Therefore, information that may, at first glance, appear to still be valid based on the date of the report in which it is presented may, in fact, have passed its expiration date under the AAI Rule.
- Second, the validity of information expires not on the date on which the purchase agreement is signed, but *on the date on which the purchaser takes title to the property*. It is not uncommon for the closing to occur six months to more than a year after the purchase agreement was signed. This highlights the importance of performing an AAI investigation at the right time (i.e., not too early) and in performing updated AAI in the event of a delay in closing. EPA discusses this issue at [70 Fed Reg at 66083-84](#). Where a closing may occur more than six months after AAI-required information is obtained, the buyer should negotiate in the purchase agreement the right to update the investigation.

An AAI investigation may also include the results of report(s) prepared by or for other persons for the same property, provided that the report(s) meet the AAI standards, and the person seeking to use the previously collected information reviews the information and conducts the additional

inquiries to meet AAI elements 6, 7 and 8 described in [§8.7](#), and updates any other information as necessary. [40 CFR 312.20\(d\)](#). See also the discussion at [70 Fed Reg at 66084-85](#). Note that, even though the AAI Rule allows AAI to be conducted by one person and transferred to another person without any specific documentation, it may be advisable for the new person to obtain a “reliance letter” from the performing consultant. Such a letter typically provides that the consultant has given the new person permission to rely on its work, and allows recourse (albeit typically very limited) against the consultant for errors. The incoming person’s lender may also require a reliance letter.

8. Non-Scope Considerations §8.12

AAI focuses solely on releases and threatened releases of hazardous substances on, at, in, or to the subject property. Of course, these matters are not the only potential environmental risks at a property. Prospective purchasers may also wish to include the following other non-AAI matters of potential environmental liability in their pre-acquisition Phase I ESAs (this is not intended to be an exhaustive list):

- Compliance of operations with permits and regulatory requirements (often referred to as an “environmental compliance audit”)
- Asbestos-containing materials
- Lead-based paint
- Radon
- Wetlands
- Drinking water quality
- Threatened or endangered species
- Cultural and historic resources
- Mold
- Indoor air quality
- Health and safety
- Ecological resources
- Biological agents

Persons retaining consultants should review the consultant’s audit proposal carefully to be sure that the proposal contains or, just as importantly, excludes non-AAI tasks per the client’s wishes. Lenders should be consulted when retaining a consultant, as they often want to be involved in selecting the consultant and determining the scope of audits.

9. Continuing Obligations §8.13

The innocent landowner defense relies, in addition to conducting an AAI-compliant investigation, on compliance with “continuing obligations” if contamination is discovered. In the event of the discovery of contamination, to maintain the defense, the owner must take “reasonable steps” to:

- Stop any continuing release;

- Present any threatened future release; and
- Prevent or limit any human, environmental, or natural resource exposure to any previously released hazardous substance. The AAI Rule does not attempt to define what constitutes “reasonable steps.”

[70 Fed Reg at 66072](#). The owner must also:

- Cooperate, assist and provide access to persons authorized to conduct response activities at the property.
- Comply with any land use restriction.
- Not impede the effectiveness or integrity of any institutional controls.
- Exercise due care with respect to the contamination.
- Take precautions against foreseeable third party acts or omissions and the foreseeable consequences of such acts or omissions.

[42 USC 9601\(35\)](#); [42 USC 9607\(b\)\(3\)](#). “Bona fide prospective purchasers” must do all the foregoing and, in addition, must:

- Provide all legally required notices with respect to the discovery or release of any hazardous substance at the property.
- Comply with any EPA request for information or administrative subpoena under CERCLA.
- Not have an affiliation with a person responsible for the contamination, including familial, contractual, corporate, and financial affiliations.

[42 USC 9601\(40\)](#); [42 USC 9607\(r\)](#). Persons claiming liability protection under the “contiguous property owner” defense are subject to similar requirements. [42 USC 9607\(q\)](#).

ASTM is preparing a “continuing obligations” guidance, currently entitled “New Guide for Identifying and Complying with Continuing Obligations on Real Property Impacted by Chemicals of Concern.” According to [ASTM’s website](#), “this Standard Guide intends to suggest actions and procedures that, if completed, would help users to satisfy some of the requirements to qualify for the innocent landowner, the contiguous property owner, and the bona fide prospective purchaser protections from CERCLA liability.”

10. Practice Tips §8.14

EPs are required to be involved in an AAI investigation.

Most buyers’ staffs lack a person who meets the definition of an EP and, therefore, most buyers must use outside consultants to establish innocent landowner another defense.

Persons hiring consultants should make sure the consultant will have an EP performing or supervising the investigation. If an EP does not play the required role, the client risks dire consequences, especially ineligibility to assert a defense to CERCLA or Part 201 liability.

Client and the EP must agree on which of them will perform the several AAI tasks that the AAI Rule allows either one to perform.

Michigan has not adopted rules similar to the EPA AAI rule. Until that occurs, Michigan regulators and courts are likely to use the EPA AAI rule as persuasive guidance as to whether a person has met the AAI requirements of Part 201.

III. Michigan Audit Privilege and Immunity

A. In General §8.15

To encourage improved compliance with environmental laws, Michigan has enacted an environmental audit privilege statute under which the results of an environmental audit are protected from disclosure to the government and other third parties if certain conditions are met. In addition, immunity from civil and criminal sanctions may be obtained when advance notice of an audit is given to the DNRE and the violations found during the audit are promptly and voluntarily disclosed and corrected. Both the privilege and immunity are subject to stringent conditions and exceptions.

B. Background §8.16

On March 18, 1996, the Michigan Legislature enacted Part 148 of NREPA to create a limited evidentiary privilege for information generated as a result of “environmental audits” and limited immunity from administrative, civil and criminal penalties and fines for violations of NREPA. [1996 PA 132, codified as MCL 324.14801 et seq.](#) The purpose of Part 148 is to encourage businesses, municipalities and other regulated entities to conduct environmental audits and to promptly correct any violations found. On November 13, 1997, in response to criticism from EPA and environmental groups regarding the extent of the evidentiary privilege and immunity offered by Part 148, the legislature amended the law to limit the availability of the evidentiary privilege and to create more exceptions from immunity. [1997 PA 133](#) and [1997 PA 134](#). In addition to Michigan, at present approximately 25 other states have enacted some form of environmental audit or immunity law, with several others having administrative policies designed to encourage voluntary environmental auditing and self-disclosure. Further details are available at [the Region V website for enforcement](#).

C. Definitions of Key Terms §8.17

Under Part 148, an “environmental audit” is a voluntary, internal evaluation of a facility or activity regulated under NREPA, conducted after March 18, 1996. [MCL 324.14801\(a\)](#). To be covered by Part 148, the environmental audit must be conducted within a reasonable time, not to exceed six months, and be designed to: (1) identify past or current noncompliance; (2) prevent

noncompliance; (3) improve compliance; (4) identify an existing or potential hazard, contamination, or adverse environmental condition; or (5) improve an environmental management system or process. *Id.* Persons conducting environmental compliance audits should note ASTM has published [ASTM E-2107-06](#), "Standard Practice for Environmental Regulatory Compliance Audits."

An "environmental audit report" is a document or set of documents created as a result of an "environmental audit." Documents included in the environmental audit report must be labeled "Environmental Audit Report: Privileged Document" when created. [MCL 324.14801\(b\)](#). The environmental audit report includes supporting information, such as field notes, records of observations, findings, opinions, suggestions, conclusions, drafts, memoranda, follow-up reports, drawings, photographs, computer generated or electronically recorded information, maps, charts, graphs, and surveys, if the supporting information or documents are created or prepared for the primary purpose and in the course of or as a result of an environmental audit. *Id.* An environmental audit report may also include an implementation plan that addresses correcting past noncompliance, improving current compliance, improving an environmental management system, or preventing future noncompliance. *Id.*

To be covered by Part 148, the owner or operator of the facility or an employee or agent of the owner or operator must perform an environmental audit. [MCL 324.14802\(1\)](#)

D. Privilege §8.18

An environmental audit report is privileged and protected from disclosure unless the report comes within one of the following exceptions or unless the privilege is waived:

- Documents, communications, data, reports or other information required to be collected, maintained or made available or reported to a regulatory agency or any other person by statute, rule, ordinance, permit, order, consent agreement, or as otherwise provided by law. [MCL 324.14802\(3\)\(a\)](#).
- Information obtained by a regulatory agency by observation, sampling, or monitoring. [MCL 324.14802\(3\)\(b\)](#).
- Pretreatment monitoring results that a publicly owned treatment works or control authority requires to be reported for facilities that discharge wastewater to a municipal sewer system. [MCL 324.14802\(3\)\(c\)](#).
- Information legally obtained from a source independent of the environmental audit or from a person who did not obtain the information from the environmental audit. [MCL 324.14802\(3\)\(d\)](#).
- Machinery and equipment maintenance records. [MCL 324.14802\(3\)\(e\)](#).
- Information in instances where the privilege is asserted for a fraudulent purpose. [MCL 324.14802\(3\)\(f\)](#).

- Information in instances where the material shows evidence of noncompliance and the owner or operator failed to either take prompt corrective action or eliminate any violation within a reasonable period of time, but not exceeding three years after discovery of the noncompliance, unless DNRE formally agrees to a longer period. [MCL 324.14802\(3\)\(g\)](#).

In addition to the foregoing, the privilege created by Part 148 does not apply in criminal investigations or proceedings. [MCL 324.14805](#). Where an audit report is obtained, reviewed or used in a criminal proceeding, the privilege created by Part 148, to the extent applicable to administrative or civil proceedings, is not waived or eliminated. *Id.*

The exceptions to the environmental audit privilege do not limit already existing protections that may be available under other common law privileges, such as the attorney-client privilege or attorney work product doctrine. [MCL 324.14808](#). Likewise, the availability of the privilege under Part 148 does not limit any existing rights to challenge privilege under Michigan law. *Id.*

Unless subject to an exception or the privilege is waived, a person who conducts an environmental audit and a person to whom the environmental audit results are disclosed may not be compelled to testify regarding any information obtained by that person solely through the environmental audit ([MCL 324.14802\(4\)](#)), and the privileged portions of an environmental audit report are not subject to discovery and are not admissible as evidence in any civil, criminal or administrative proceeding. *Id.*

The person for whom the environmental audit report was prepared may waive the privilege under Part 148. [MCL 324.14803\(1\)](#). The waiver applies only to the portion(s) of the environmental audit report as to which the privilege is specifically waived. *Id.*

Disclosure of an environmental audit report and information generated by the environmental audit by the person for whom the environmental audit report was prepared or by the person's employee or agent to any of the following does not waive the privilege under Part 148: (1) an employee of the person; (2) a legal representative of the person; and (3) an agent of the person retained to address issue(s) raised by the environmental audit. [MCL 324.14803\(2\)](#).

Disclosure of the environmental audit report or any information generated by the environmental audit under either of the following circumstances does not waive the privilege:

- A disclosure made under the terms of a confidentiality agreement between the person for whom the environmental audit report was prepared and a partner or potential partner, a transferee or potential transferee, a lender or potential lender, or a trustee of or for the business or facility audited, or a disclosure made between a subsidiary and a parent corporation or between members of a partnership, joint venture, or other similarly related entities. [MCL 324.14803\(3\)\(a\)](#).
- A disclosure made under the terms of a confidentiality agreement between governmental officials and the person for whom the environmental audit report was prepared. [MCL 324.14803\(3\)\(b\)](#).

E. Disclosure of Privileged Material §8.19

Part 148 establishes a procedure by which state or local law enforcement authorities may seek disclosure of privileged material. To obtain privileged information, the authorities must make either a written request delivered by certified mail or a demand by lawful subpoena. [MCL 324.14804\(1\)](#). The person asserting the privilege has 30 days to make a written objection to the disclosure. *Id.* Failure of a person to make such an objection waives the privilege as to that person. *Id.* After receipt of such an objection, the authorities may file with the circuit court, and serve upon the person asserting the privilege, a petition requesting an *in camera* hearing on whether the environmental audit report or portions thereof are privileged or subject to disclosure. *Id.* Upon the filing of such a petition, the person asserting the privilege must provide a copy of the environmental audit report to the court and must demonstrate in the *in camera* hearing all of the following: (1) the year the environmental audit report was prepared; (2) the identity of the person conducting the audit; (3) the name of the audited facility or facilities; and (4) a brief description of the portion(s) of the environmental audit report for which privilege is claimed. [MCL 324.14804\(2\)](#).

A person asserting the privilege under Part 148 has the burden of proving a prima facie case as to the privilege. [MCL 324.14806\(1\)](#). A person seeking disclosure of an environmental audit report has the burden of proving by a preponderance of the evidence that privilege does not exist under Part 148. *Id.*

The court, after the *in camera* review, must require disclosure of material for which privilege is asserted if the court determines that either of the following exists: (1) the privilege is asserted for a fraudulent purpose; or (2) even if otherwise subject to the privilege, the material shows evidence of noncompliance with state, federal, regional or local environmental requirements and the owner or operator failed to either take prompt corrective action or eliminate any violation identified within a reasonable time, but not exceeding three years unless DNRE formally agrees to a longer period. [MCL 324.14804\(4\)](#).

F. Immunity §8.20

In addition to an evidentiary privilege, Part 148 offers immunity from administrative and civil penalties and fines and from criminal penalties and fines for negligent acts or omissions related to a violation of NREPA Article II (pollution control) and Chapters 1 (habitat protection) and 3 (management of nonrenewable resources) of Article III of NREPA for certain violations discovered as a result of an environmental audit, provided that all of the following conditions are met:

- The person gives prior notice to DNRE of his or her intent to perform an environmental audit. [MCL 324.14809\(7\)](#). The notice should be on a form that is available from DNRE at [their website pages on Environmental Audit](#). The notice must specify: (1) the facility or portion of the facility to be audited; (2) the anticipated time the audit will begin; and (3) the general scope of the audit. The notice may provide notification of more than one scheduled environmental audit at a time.

- The person makes a voluntary disclosure of the violations to the appropriate state or local agency.

[MCL 324.14809\(1\)](#). To be considered a “voluntary” disclosure, all of the following conditions must be met:

- The disclosure of the information arises out of an environmental audit.
- The audit occurred before the person was aware that he or she was under investigation by a regulatory agency.
- The disclosure was made promptly after knowledge of the violation was obtained by the person.
- The person initiates an appropriate and good-faith effort to achieve compliance, pursues compliance with due diligence, and promptly corrects the violation after its discovery. If the noncompliance is the failure to obtain a permit, the person must submit a complete permit application within a reasonable time.

Id. The person making the voluntary disclosure must provide information showing that the foregoing conditions are met. *Id.* Disclosure of the environmental information to DNRE waives the privilege otherwise available under Part 148 unless the disclosure is made under the terms of a confidentiality agreement. To preserve the availability of the privilege for the disclosing person, DNRE Office of Pollution Prevention and Compliance Assistance has created a “nonwaiver of privilege confidentiality agreement,” which is available from the DNRE for such disclosures. DNRE also has prepared a “voluntary disclosure” form, the use of which is not mandatory but which may assist persons in making disclosures properly and to the correct DNRE office. Both forms are currently available on [DNRE’s website](#) and should be reviewed carefully before being submitted. .

There is a rebuttable presumption that a disclosure made in compliance with Part 148 is “voluntary.” [MCL 324.14809\(2\)](#). The state or local agency bears the burden of rebutting such presumption. *Id.* An agency determination that a disclosure was not voluntary is considered “final agency action” subject to judicial review. *Id.*

No immunity applies to any criminal fines and penalties for gross negligence or to any criminal penalties or fines for violations of Parts 301 (inland lakes and streams), 303 (wetlands protection), 315 (dam safety), or 325 (Great Lakes Submerged Lands) or Sections 3108 (use of floodplains, stream beds or stream channels), or 3115a (alteration of floodplains) of NREPA. *Id.*

In addition, immunity does not apply if any of the following is found to exist by the trier of fact:

- The person has knowingly committed a criminal act.

- The person has committed significant violations that constitute a pattern of continuous or repeated violations within the three-year period prior to the date of the disclosure.
- The violation has resulted in a substantial economic benefit which gives the violator a clear advantage over its business competitors.
- The noncompliance resulted in serious harm or in imminent and substantial endangerment to human health or the environment.
- The noncompliance is a violation of the terms of an administrative or judicial order.

[MCL 324.14809\(4\)](#). Where the conditions of a “voluntary disclosure” are not fully met but a good faith effort was made to voluntarily disclose and resolve a violation found as a result of a voluntary environmental audit, the state and local environmental and law enforcement authorities must consider the nature and extent of any good faith effort in determining their enforcement response and must mitigate any civil penalties based on a showing that one or more of the conditions for “voluntary disclosure” have been met. [MCL 324.14809\(5\)](#).

Part 148 does not provide immunity from federal or local laws or regulations. Where federal law is involved, the EPA environmental audit policies may apply: “Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations,” [65 Fed Reg 19618](#) (Apr. 11, 2000) (the “Audit Policy”); and EPA’s “[Small Business Compliance Policy](#)”. EPA publishes periodic "audit policy updates" listing disclosures and settlements under the Audit Policy and EPA's Office of Regulatory Enforcement has prepared an “Audit Policy Interpretive Guidance,” dated January 1997 and a 2007 Frequently Asked Questions. Both documents are available at links on EPA’s [auditing website](#). Nor does immunity under Part 148 eliminate or affect a person's duties to correct violations, conduct any necessary remediation, or pay damages for injury to person or property.

IV. EPA Audit Policy

A. In General §8.21

The EPA has published an audit policy (Audit Policy) providing that EPA generally will not seek civil penalties for violations found as a result of a voluntary environmental audit, which are voluntarily reported and promptly corrected, and provided that certain other conditions are met. Significant exceptions exist which may render the policy inapplicable, in whole or in part, depending on the facts.

Unlike Michigan’s Part 148, EPA’s Audit Policy does not provide environmental audits with privilege or other protection from disclosure. To the contrary, the Audit Policy offers potential penalty relief only if, among other conditions, violations discovered through an environmental audit are disclosed to the agency.

The Audit Policy is intended by EPA to provide incentives for regulated entities to detect, promptly disclose, and expeditiously correct violations of federal environmental requirements. The Audit Policy, both in its original form ([60 Fed Reg 66706](#) (Dec. 22, 1995)) and as subsequently revised and still in force ([65 Fed Reg 19618](#)), contains nine conditions, and entities that meet all of them are eligible for 100% mitigation of any gravity-based penalties that could otherwise be assessed. “Gravity-based” refers to that portion of the penalty over and above the portion that represents an entity’s economic gain from noncompliance. The Audit Policy offers no mitigation of the “economic gain” portion of any penalty.

B. Conditions for Penalty Mitigation §8.22

The nine conditions in the Audit Policy for full mitigation of gravity-based penalties are:

1. *Systematic Discovery*: The violation must be discovered through an environmental audit, which is defined as a “systematic, documented, periodic and objective review of facility operations and practices related to meeting environmental requirements,” or through a “compliance management system,” which is defined in the Audit Policy.

2. *Voluntary Discovery*: The violation must be discovered voluntarily and not through a legally mandated monitoring or sampling requirement prescribed by statute, regulation, permit, judicial or administrative order, or consent agreement. EPA clarifies that violations discovered pursuant to an audit or compliance management system may still be considered voluntary if required under an EPA “partnership” program in which the entity voluntarily participates or even if required under a settlement agreement with EPA. [65 Fed Reg 19621](#). Further, EPA states that “any violation that is voluntarily discovered is generally eligible for Audit Policy credit, regardless of whether reporting of the violation was required after it was discovered.” *Id.*

Special discovery rule for Title V permits. Generally, Clean Air Act (CAA) violations discovered during activities supporting Title V certification requirements would not be eligible for penalty mitigation under the Audit Policy because EPA regulations impose a legal duty for permit holders to comprehensively analyze their compliance status and certify annually as to CAA compliance. This certification would render the discovery not “voluntary.” In 1999, EPA stated that the “voluntary discovery” requirement would be relaxed in the Clean Air Act Title V context prior to issuance of a Title V permit. This policy is incorporated into the Audit Policy’s preamble. *Id.*

3. *Prompt Disclosure*: The regulated entity must fully disclose the specific violation in writing to EPA within 21 days (expanded from ten days under the original Audit Policy) after the entity discovered that a violation has, or may have, occurred. In the preamble to the revised Audit Policy, EPA provides guidance on when the disclosure clock starts ticking, explaining that the 21-day disclosure period begins “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.” EPA states that “[t]he ‘objectively reasonable basis’ standard is measured against what a prudent person, having the same information as was available to the individual in question, would have believed.” EPA cautions that the standard “is not measured against what the individual in question thought was reasonable at the time the situation was encountered.” If in doubt as to

whether a violation exists, EPA advises that “the recommended course is for the entity to proceed with the disclosure and allow the regulatory authorities to make a definitive determination.” In the multi-facility context, EPA states that it “will ordinarily extend the 21-day period to allow reasonable time for completion and review of multi-facility audits where: (a) EPA and the entity agree on the timing and scope of the audits prior to their commencement; and (b) the facilities to be audited are identified in advance.” In the acquisition context, EPA states that it “will consider extending the prompt disclosure period on a case-by-case basis. The 21-day disclosure period will begin on the date of discovery by the acquiring entity, but in no case will the period begin earlier than the date of acquisition.”

4. *Discovery and Disclosure Independent of Government or Third-Party Plaintiff:* The regulated entity must discover and disclose the violation to EPA prior to a government inspection, investigation or information request, notice of a citizen suit, the filing of a complaint by a third party, the reporting of the violation to the government by a “whistleblower,” or imminent discovery of the violation by the government. EPA states that the “independent discovery” condition does not automatically preclude Audit Policy credit in the multi-facility context. As noted above in condition 3, the Audit Policy does not apply where the regulated entity discovers and discloses a potential violation where the violation has been or is about to be discovered by the government or other third parties. The Audit Policy states, however, that “[f]or entities that own or operate multiple facilities, the fact that one facility is already the subject of an investigation, inspection, information request or third-party complaint does not preclude [EPA] from exercising its discretion to make the Audit Policy available for violations self-discovered at other facilities owned or operated by the same regulated entity.”

5. *Correction and Remediation:* The regulated entity must correct the violation within 60 days and certify such correction in writing, subject to extension, in advance of the deadline expiring, in certain circumstances.

6. *Prevention of Recurrence:* The regulated entity must agree in writing to take steps to prevent a recurrence of the violation.

7. *No Repeat Violations:* The specific violation, or a closely related violation, must not have occurred within the past three years at the same facility, or within the past five years as part of a pattern at multiple facilities owned or operated by the same entity. However in the acquisition context, EPA states, “if a facility has been newly acquired, the existence of a violation prior to acquisition does not trigger the repeat violations exclusion.”

8. *No Serious Harm or Risk and No Violation of Order or Consent Agreement:* The Audit Policy does not apply where the violation: (a) results in serious harm or “may have presented an imminent and substantial endangerment;” or (b) violates a judicial or administrative order or consent agreement.

9. *Cooperation:* The regulated entity must cooperate as requested by EPA and provide such information as is necessary and requested by EPA to determine the applicability of the Audit Policy.

If all conditions are met except for the first one (systematic discovery), EPA will still reduce gravity-based penalties by 75%. EPA in the Audit Policy also reiterates that it will not recommend that violations disclosed in accordance with the Audit Policy be subject to criminal enforcement as long as EPA determines that the violation is not part of a pattern or practice involving a “prevalent management philosophy or practice that conceals or condones environmental violations” or “[h]igh-level corporation officials’ or managers’ conscious involvement in, or willful blindness to, violations of Federal environmental law.” In the Audit Policy, EPA further repeats that it generally will not request or use an environmental audit report to initiate a civil or criminal investigation, and clarifies that this “no recommendation” policy applies even where the facility has not met the “systematic discovery” condition, but has met all other conditions (the original Audit Policy required all nine conditions to be met for the “no recommendation” policy to apply).

Penalty relief may be available even where the disclosing entity does not meet any of the conditions of the Audit Policy. For example, an entity that does not qualify for penalty relief under the Audit Policy may still be entitled to relief under other EPA media-specific enforcement policies that recognize good-faith efforts.

C. Should Disclosure Be Made to EPA or the State in Which the Violation Occurred? **§8.23**

EPA’s 2007 Frequently Asked Questions document states as follows:

- For violations of federal law for which the state is not authorized, disclosures should be made to EPA. This is because the states possess no legal authority to resolve violations under those statutes. Of course, if the state has a similar law (albeit not authorized as a means to implement the federal program), the violator should determine whether it should also disclose the violation to the state.
- For violations of federal statutes for which a state-authorized program exists (e.g., the Clean Water Act), the violator may choose to disclose to either or both the federal and state regulators. If a resolution of the federal claim for the violation is desired, however, EPA states that disclosure to EPA is the only means to obtain it.
- EPA and states may enter into reciprocal agreements under which each generally agrees to defer to the other’s resolution of disclosed violations. In such cases, disclosure to one or the other agency, instead of both, may suffice.

D. EPA New Owner Policy §8.24

EPA has published an “Interim Approach to Applying the Audit Policy to New Owners” (New Owner Interim Audit Policy). [73 Fed Reg 44991](#) (Aug. 1, 2008). EPA published the New Owner Interim Audit Policy “to encourage new owners to look closely at compliance issues at their recently acquired facilities, self-disclose and, most importantly, fix the environmental problems they find.” As described more fully in [§8.26](#), these incentives include penalty

mitigation beyond what the Audit Policy offers and an expanded range of violations that may be eligible for Audit Policy consideration.

1. Definition of New Owner §8.25

To benefit from the New Owner Interim Audit Policy, an eligible new owner must certify that:

- Prior to the transaction, it was not responsible for environmental compliance at the facility which is the subject of the disclosure, did not cause the violations being disclosed and could not have prevented their occurrence;
- The violation that is the subject of the disclosure originated with the prior owner; and
- Prior to the transaction, neither the buyer nor the seller had the largest ownership share of the other entity, and they did not have a common corporate parent.

2. Penalty Mitigation §8.26

Penalty mitigation is available to new owners who, within nine months of the transaction closing promptly disclose violations to EPA or enter into an audit agreement with EPA, and meet all the conditions of the Audit Policy, as modified for new owners, as follows:

- No penalties will be assessed against the new owner for the period before the date of acquisition;
- Penalties for economic benefit associated with avoided operation and maintenance costs will be assessed against the new owner, but only from the date of acquisition; and
- No penalties for economic benefit associated with delayed capital expenditures or with unfair competitive advantage will be assessed against the new owner if the violations are corrected in accordance with the Audit Policy (i.e., within 60 days of discovery or another reasonable timeframe to which EPA has agreed).

3. Modifications to Audit Policy Conditions for New Owners §8.27

Modifications, in the new owner context, to the following five of the nine conditions of the Audit Policy will make more violations eligible for Audit Policy penalty mitigation, as applied to new owners:

Systematic Discovery – Condition 1: Because EPA recognizes that a new owner's pre-closing due diligence is by its nature a one-time event, EPA stated that it will waive the “periodic” element of this condition for violations discovered through pre-acquisition due diligence, and allow such disclosures to be considered for full penalty mitigation.

Voluntary Discovery – Condition 2: EPA stated that it will expand its interpretation of the voluntary discovery condition in the new owner context, currently limited to compliance with

Title V of the Clean Air Act, to allow consideration of all violations which would otherwise be ineligible for Audit Policy consideration because they are already required to be identified through a legally mandated monitoring, sampling or auditing protocol, and thus not “voluntarily discovered.” New owners that enter into an audit agreement or disclose violations before the first instance when the monitoring, sampling or auditing is required, would not be disqualified based on this condition.

Prompt Disclosure – Condition 3: The Audit Policy provides that violations must be promptly disclosed in writing, within 21 days of discovery. For violations discovered pre-closing, a new owner would have up to 45 days after closing to disclose violations. For violations discovered post-closing, a new owner would have to disclose violations within 21 days after discovery or within 45 days after the transaction closing, whichever time period is longer. EPA stated that, in the busy period just after acquisition, this will give new owners a little more time to decide and prepare to come forward with due diligence findings.

Other Violations Excluded – Condition 8: The Audit Policy excludes violations that resulted in serious actual harm or may have presented an imminent and substantial endangerment. Where violations that gave rise to serious actual harm or an imminent and substantial endangerment began before the new owner acquired the facility, EPA will allow such violations to be eligible under the New Owner Interim Audit Policy, absent a fatality, community evacuation, or other seriously injurious or catastrophic event. EPA stated that this should encourage new owners to come forward and correct significant violations, which is one of the goals of this approach.

Cooperation Condition – Condition 9: EPA modified the cooperation condition of the Audit Policy only to make clear that the disclosing entity must cooperate with EPA in determining whether all Audit Policy conditions – as they have been modified by the New Owner Interim Audit Policy – have been met. Further information about the New Owner Interim Audit Policy is available at [the new owners incentive summary page on the EPA website](#) .

E. Additional Audit Policy Resources §8.28

EPA’s [audit website](#), contains useful information and links regarding matters including the following:

[eDisclosure](#) – *EPA’s electronic Audit Policy Self-Disclosure System.* This is a web-based system to allow companies to electronically self-disclose violations under EPA’s Audit Policy. eDisclosure makes it easier and faster to self-report environmental violations. It also speeds up EPA’s processing of self-disclosures by ensuring that each disclosure contains complete information.

[Corporate Audit Agreements.](#) A Corporate Audit Agreement allows an entity (such as corporation, university or other organization with many facilities or facility locations within its authority) to plan a corporate-wide or facility-wide audit with an advanced understanding between the entity and EPA regarding schedules for conducting the audit and disclosing violations beyond the current 21-day disclosure requirement for single-facility disclosures. In

return for the advanced agreement of an audit and disclosure schedule, the facility would receive the benefits of EPA's Audit Policy as applicable.

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. The regulated community's legal obligations are determined by the terms of applicable environmental facility-specific permits, underlying statutes and applicable state and local law.

Audit Policy Self-Disclosure and Regional Contacts. Once a violation has been discovered, a company has 21 days from the time of that discovery to disclose in writing the violation to EPA. The initial disclosure should identify the means of discovery, type of violation, and facility location.

"Audit Policy Update" Newsletter. The Audit Policy Update Newsletters, published between 1996-2001 by EPA's Office of Regulatory Enforcement, Office of Enforcement and Compliance Assurance, provide information on the changes to the Audit Policy and other information relating to its use.

"Enforcement Alert" Newsletter. This informational newsletter is published by EPA's Office of Civil Enforcement, Office of Enforcement and Compliance Assurance. The newsletter is intended to inform and educate the public and the regulated community about important environmental enforcement issues, recent trends, and significant enforcement actions. It calls attention to such matters as the need for voluntary corporate audits.

Sample Status Report. Some companies have used the Sample Status Report to provide information to EPA during the course of conducting an audit. The initial report, and subsequent periodic progress reports, have helped identify issues early in the auditing process and assisted in the overall progress of the audit.

Sample Disclosure Follow-up Letter. This sample letter is an example of what the Agency sends a company after receiving a self disclosure pursuant to EPA's Audit Policy. The letter provides companies with guidance on the kind of information needed by EPA to better understand the potential violations and determine whether a company's disclosure meets the conditions of the Audit Policy.

F. Practice Tips §8.29

Disclosure of a violation pursuant to the EPA Audit Policy is reviewed by enforcement personnel and may trigger an inquiry into whether all of the policy's applicable conditions were met. This may result in a burdensome and costly process that may, in effect, be as or more punitive as the penalty that is sought to be avoided. If the disclosing company declines to participate in the process, an enforcement action seeking penalties may result.

The Audit Policy applies only to EPA, not to other federal agencies or state or local regulators, who may have independent enforcement authority over a disclosed violation.

The Audit Policy is only a guidance. It creates no legal rights and is not enforceable against EPA.

The Audit Policy, more information and forms are available on EPA's [auditing website](#). EPA [Region 5's auditing website](#) also contains links to additional documents.

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