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REPORT



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EPA's E&P New Owner Audit Program: Kind of Interesting—Perhaps; Kind of Practical—Perhaps Not

*By Gerald J. Pels and Andrew Davitt**

The Environmental Protection Agency recently issued its Oil and Gas Exploration and Production Facilities New Owner Audit Program, which is intended to encourage new upstream facility owners to audit, disclose, and correct violations promptly after an acquisition. The authors of this article explain the Audit Program.

The Environmental Protection Agency (“EPA”) recently issued its Oil and Gas Exploration and Production Facilities New Owner Audit Program (“Audit Program”). The Audit Program is voluntary and intended to encourage new upstream facility owners to audit, disclose, and correct violations promptly after an acquisition. In return, EPA grants penalty immunity for federal violations. Upstream facilities intended to be covered by the program include wellsites, related tank systems, and vapor control systems. EPA suggests that the Audit Program “has been tailored to address concerns regarding excess emissions from tanks and vapor control systems related to operation, maintenance, and/or design.”¹

The program is significant in several ways. First, it provides full penalty mitigation to participants who identify, disclose, and correct air emissions violations at newly acquired upstream facilities. This is a big step for EPA. Second, and importantly, it is an audit program focused specifically on air emissions compliance and targeted at a specific industry sector. This speaks directly to current and future enforcement initiatives and priorities. Finally, the Audit Program integrates a required vapor control systems evaluation, which has the potential to result in potentially unforeseen capital improvement costs for engineering, repair, and replacement of system components, including potentially tankage.

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¹ See Oil and Natural Gas Exploration and Production Facilities New Owner Audit Agreement Implementation Considerations at 2.

PARTICIPATION IN THE AUDIT PROGRAM

Participation in the Audit Program is voluntary and documented through the execution of a standard form Audit Agreement with EPA. EPA provided the Agreement's template and key terms of the Agreement include:

- *Notice of Audit:* The regulated entity must notify EPA of its intent to audit within nine months of the acquisition.
- *Audit Period:* The time period to conduct the Audit is negotiated.
- *Facilities Covered:* Facilities subject to the Audit are listed in an appendix to the Agreement. Additional facilities may be included through formal notice, subject to EPA's approval.
- *Vapor Control System² Audit:* As part of the standard form Agreement, EPA requires a detailed evaluation of existing facility vapor control systems. First, within 60 days of the Agreement's effective date, the regulated entity must develop a Modeling Guideline to determine Potential Minimum and Potential Peak Instantaneous Vapor Flow Rates for designing and sizing a vapor control system. The Modeling Guideline is intended to consider "pressurized hydrocarbon liquid and natural gas samples, equipment inventories, separation equipment, operating conditions, and well production rates."³ Second and in addition to the Modeling Guideline, the vapor systems evaluation requires regulated entities to:
 - Complete one or more Engineering Design Standards to determine if controls are adequately sized and functioning properly;
 - Develop an SOP for EPA's review and approval to establish how the entity will conduct Vapor Control Field Surveys under the Audit Agreement, including operating procedures, FLIR camera investigations, and an evaluation of all vapor control components like valves, thief hatches, and gaskets, as well as a system upgrade evaluation;

² Under the Agreement, EPA defines Vapor Control System broadly, and the definition is somewhat circular. The definition provides that it includes the tank system, piping to control devices, emission control devices, fittings, connectors, knockouts, as well as pressure relief valves and thief hatches. Based on this broad language, it appears EPA anticipates virtually any tank system subject to the audit will be evaluated for emissions control and leakage.

³ The goal is to model "process flow rates, while incorporating the volume, frequency, and duration of individual dump events or transfers to the atmospheric storage tanks." The Modeling Guideline is no doubt intended to assist facility owners with evaluating systems at multiple facilities, but in all likelihood will require at least some site-specific information to be developed, particularly regarding equipment, to ensure the model accurately represents conditions evaluated.

- Implement at each facility audited system modifications, repairs, and upgrades to address leakage identified by the FLIR camera review and/or deviation from performance standards called for by the SOP and Design Standard review; and
- Verify that the vapor control system is not causing detectable emissions leakage and that the control systems are designed and sized to handle the potential minimum and peak instantaneous flow rates determined through the Engineering Design Standards.
- *Audit Instruments Identified:* The regulated entity must provide to EPA within 60 days after the Agreement's effective date its audit protocol for EPA's review and approval. The protocol must include an outline of the planned audit, its schedule, and checklists.
- *Disclosure and Timing of Corrective Action:* Regulated entities are required to disclose deficiencies and violations identified by the results of the Vapor Control System Audit as well as other violations identified outside of the Vapor Control System Audit.
 - Vapor Control Systems Evaluation. Violations/deficiencies discovered through the Vapor Control Systems Audit must be addressed within 180 days of discovery, subject to a formal extension request made to EPA.
 - Violations Apart from the Vapor Control Evaluation. These violations are to be corrected within 60 days of discovery, subject to a formal extension request made to EPA.
 - Conditions/Violations Representing Endangerment. Conditions discovered that may present an immediate and substantial endangerment to public health or welfare must be corrected as soon as possible and reported as required by applicable law.
- *Reporting:* Semi-annual reports must be filed with EPA disclosing *all* violations discovered and the status of corrective actions at specific facilities. A Final Report must also be filed, which includes detailed facility identification information, specific violations identified and related corrective actions, as well as measures undertaken to prevent future recurrence. The EPA also requires that the Final Report contain a breakdown of costs to achieve compliance, and an estimate of pollutant reduction achieved through the corrective actions, by specific pollutant.

ANALYSIS

The Audit Program presents a very detailed and regimented approach to facility auditing. In addition to auditing for express regulatory compliance, the

Audit protocol requires a detailed evaluation of existing Vapor Control Systems. As pointed out above, EPA's broad definition of Vapor Control System appears to include a tank system regardless of whether emissions are controlled through a combustion device. Arguably, the mandated Vapor Control System evaluation exceeds current regulatory requirements, and in some ways will likely result in the imposition of standards akin to new source performance standards on existing sources. Because the Vapor Control System evaluation includes a review of relief valves, thief hatches and an infrared camera investigation, regulated entities should contemplate the potential for equipment repair and replacement to address volatile organic compounds ("VOC") leakage. This could include tank replacement for older units. These costs may far exceed those anticipated and those related to permitting and/or related to obtaining and installing combustors/flares. Moreover, regulated entities should contemplate the potential for additional capital costs for control devices and the imposition of additional regulatory requirements should the evaluation lead to certain equipment and/or tank replacement leading to new source performance standards ("NSPS") Quad O/Oa applicability. In all events, regulated entities should contemplate an increased administrative function to address reporting and recordkeeping that will likely be triggered by bringing facilities into compliance with varying rules packages.

Regulated entities will also likely face challenges in seeking to adhere to the Audit Program's timetables. For example, completion of the above-described Modeling Guidelines, which will likely require the integration of certain site-specific information, will be difficult within the proposed 60-day window. This will especially be the case where an acquisition involves many facilities, perhaps hundreds, which is not uncommon in the exploration and production ("E&P") industry.

Further challenges may be encountered in seeking to develop and adhere to checklists and timetables called for in the Audit Instruments, especially where an acquisition involves a large number of facilities that are largely unknown and may be located in remote locations. Given the unknowns, it may prove difficult to provide well-defined guideposts at the beginning of an audit, where little may be known about a significant number of facilities.

The deadlines for corrective action are also very aggressive given practical considerations, including market conditions. Regulated entities will likely find corrective action deadlines to be restrictive. In a vacuum, 180 days to correct vapor control deficiencies, and 60 days for other corrective actions may seem achievable, but the practical logistics of conducting site-specific sampling, repair, replacement, engineering, and procurement of vapor control devices at a significant number of facilities within 180 days will pose challenges to the

regulated community. As a practical matter, the regulated community may even find it difficult within that time period to secure tankage or even for manufacturers to keep up with demand for control devices. Securing correctly sized EPA certified Quad O/Oa combustors for more than a handful of facilities at a given time can be difficult. Moreover, the time to evaluate and engineer appropriate controls for multiple existing facilities may take far longer when needing to take into account gas composition and flow rate, back pressure on tanks, H₂S control and other factors. Typically, there is not a cookie-cutter solution that allows for resolution of these issues at the many facilities that may be acquired in a large acquisition.

CONCLUSION

In conclusion, the Audit Program is a step forward for EPA. The media-specific and industry-specific focus are interesting and signal EPA priorities. Based on the manner in which the program is structured, auditing and securing compliance may be more time-intensive than anticipated. The Audit Program may have its greatest utility for those facilities that are acquired on federal or Native American lands, and where more streamlined state programs are not available. The Audit Program provides a basis to avoid penalties, including where permitting likely will be required, but, as stated previously, the program's structure may present timely completion challenges when dealing with a large acquisition.

In the context of facility acquisition on non-federal lands, state programs may allow greater flexibility to achieve compliance. EPA, however, notes in its Audit Program documents that while the regulated community has the option to work under state programs, EPA retains the right to independently seek penalties.

Finally, given the potential for significant costs associated with achieving compliance, buyers of E&P assets should recognize that even with penalty immunity, significant capital expenditures may be encountered. Further, E&P asset buyers should carefully negotiate acquisition documents to ensure the greatest likelihood of indemnity coverage for air emissions compliance costs. It is not unusual for standard "environmental defect" language to not encompass air emissions compliance as an "environmental defect."