ANOTHER SEASON OF CHANGE IN NORTH CAROLINA ENVIRONMENTAL LAW – PART I

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Environmental, Land and Natural Resources Alert

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The 2015 North Carolina legislative session resulted in a great deal of change for the state's environmental agency and for the statutory programs it administers. The legislative session saw fundamental organizational changes to the former North Carolina Department of Environment and Natural Resources ("DENR"), and on the last day of the session, the North Carolina General Assembly ratified legislation that made several significant and far-reaching amendments to North Carolina environmental programs, as well as a number of minor revisions and changes.

The North Carolina House and Senate both ratified House Bill 765, known as the Regulatory Reform Act of 2015, on September 30, 2015, and Governor Pat McCrory signed this bill into law as Session Law 2015-286 (the "Act") on October 22, 2015. Together with the 2015 state budget law (Session Law 2015-241), which was ratified and signed into law on September 18, 2015, the Act changed DENR's name, transferred a large portion of the agency's portfolio to another state agency, established a self-audit privilege and limited immunity for certain self-disclosed environmental violations, broadened the applicability of the North Carolina Brownfields Program (the "Brownfields Program") and risk-based remediation, and altered the rules for cleanup of some petroleum releases from underground and aboveground petroleum storage tanks. We will discuss these changes in a two-part alert. This Part I discusses the changes at DENR, and several developments related to legal compliance and litigation -- the new environmental self-audit law, new provisions providing limited immunity from administrative and civil penalties, and provisions affecting litigation before the Office of Administrative Hearings and sedimentation civil penalties.

DENR NO MORE

The 2015 legislative session brought more change for DENR at the departmental level, this time significant and fundamental restructuring. DENR has been renamed and will now be known as the North Carolina Department of Environmental Quality ("DEQ"). In addition, what had been casually known as the "fun" part of DENR — state parks, aquariums, the North Carolina Zoo, and the North Carolina Museum of Natural Sciences — was all transferred to the newly branded Department of Natural and Cultural Resources (formerly the Department of Cultural Resources), along with the Clean Water Management Trust Fund and the National Heritage Program. The Clean Water Management Trust Fund provides grants to local governments, state agencies, and conservation nonprofits for the restoration of degraded waters, protection of unpolluted waters, support of riparian buffers and greenways, and similar projects.

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ENVIRONMENTAL SELF-AUDIT PRIVILEGE AND LIMITED IMMUNITY

Section 4.1 of the Act adds a new Part 7D to the North Carolina evidence statutes (N.C. Gen. Stat., Chapter 8), entitled "Environmental Audit Privilege and Limited Immunity." This new Part 7D has two functions: first, to protect certain environmental audit reports from disclosure in a court or administrative proceeding; and second, to provide immunity from civil penalties for certain environmental law violations discovered in the course of environmental audits. Although the new protections provided by Part 7D are significant developments in North Carolina environmental regulation, each has significant limitations.

Audit Privilege

First, Part 7D protects a relatively broad range of documents in a relatively narrow range of cases. Specifically, it shields from involuntary production in civil or administrative proceedings[1] any "environmental audit reports" [2] related to voluntary environmental audits[3] and prevents persons who conduct or participate in environmental audits from being compelled to testify regarding a privileged report.[4] Part 7D also expressly protects disclosure to certain third parties (including certain employees, legal representatives, and independent contractors) and states that the privilege is not waived by disclosure of the report under the terms of a confidentiality agreement with a potential purchaser, the government, or a customer or lender.

However, the privilege only applies in civil or administrative proceedings and may not be used in criminal matters or in certain employment matters (such as federal employee protection laws or workers' compensation matters). In addition, the owner or operator of a facility that undergoes an enforcement agency inspection must notify the agency of the existence of any audit relevant to the inspection within 10 days.[5]

There are also several exemptions from the privilege, including the following:

- Information showing evidence of noncompliance where the owner or operator fails to promptly take corrective action or eliminate the violation;[6]
- Audits that are designed to obfuscate or deceive, such as when the audit is part of a program of self-audits designed to intentionally avoid liability; where information is knowingly misrepresented, misstated, deleted, or withheld; or where a court finds that the privilege was asserted for purposes of deception or evasion; and
- Information obtained by the enforcement agency independently from the audit report or information that the agency otherwise has the authority to obtain under federally delegated environmental programs, even if the information is similar to information found in the audit report.

While an audit privilege should encourage more North Carolina facility owners and operators to perform environmental compliance audits, there are a number of loopholes and traps for the unwary as described above. Facility owners and operators are well advised to consult an expert to examine the above provisions carefully and to understand the relevant limitations before undertaking an environmental audit that the owner or operator expects to be covered by this privilege.

Limited Immunity

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Part 7D also provides a limited immunity from civil and administrative penalties and fines[7] for violations of environmental law that (i) are voluntarily disclosed under certain circumstances and (ii) are corrected within a reasonable period of time, as certified by the enforcing agency. Again, although the immunity is broad — no civil fines or penalties may be imposed on those who qualify — there are a number of important qualifications and limitations.

First, in order to qualify for the limited immunity provided by Part 7D, the person making the disclosure must prove that the disclosure meets all of the following criteria, as provided by N.C. Gen. Stat. 8-58.61(c):

1. The disclosure is made within 14 days following a reasonable investigation of the violation's discovery through the environmental audit.
2. The disclosure is made to an enforcement agency having regulatory authority over the violation disclosed.
3. The person or entity making the disclosure initiates an action to resolve the violation identified in the disclosure in a diligent manner.
4. The person or entity making the disclosure cooperates with the applicable enforcement agency in connection with investigation of the issues identified in the disclosure.
5. The person or entity making the disclosure diligently pursues compliance and promptly corrects the noncompliance within a reasonable period of time.

Even if the above criteria are met, the disclosure is not considered voluntary under a number of conditions, including the following:

- If monitoring or sampling is required by specific permit conditions;
- If notice of a release to the environment is required;
- If the violation was intentional, willful, or criminally negligent;
- If it "was not corrected in a diligent manner";
- If it poses a significant threat to natural resources, the environment, or public health, safety, and welfare;
- If a similar violation occurred (and immunity was granted for that violation) within a year; or
- If the violation results "in a substantial economic benefit to the owner or operator of the facility" or if the violation is of a specific term of the judicial or administrative order. [8]

In addition, the frequency of use of the immunity is limited: the owner or operator may only "exercise" the audit privilege or the limited immunity once in a two-year period, twice in a five-year period, and three times in a 10-year period.[9] Finally, it is important to note that the statute subjects a voluntary disclosure made pursuant to the limited immunity to disclosure under the North Carolina Public Records Act. This provision would in effect force a facility owner or operator to choose between the confidentiality offered by the audit privilege and the protection from civil penalty provided by the immunity.

Implementation and EPA Approval

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Those seeking to take advantage of the privilege and immunity provided by Part 7D in the short term may find themselves disappointed, as the Act prevents Part 7D from becoming effective until approved by the U.S. Environmental Protection Agency ("EPA"). DEQ is required to submit Part 7D to EPA within 30 days and to request approval to implement the law with North Carolina's delegated, approved, or authorized authority to administer federal environmental programs. DEQ would be required to report to the legislature annually on its activity in pursuit of EPA approval, but EPA approval is not automatic and has the potential to significantly delay implementation of this legislation.

CIVIL PENALTY CAP FOR CORRECTED SEDIMENTATION VIOLATIONS

The 2015 North Carolina budget included provisions ostensibly to reform the civil penalty provisions of the Sedimentation Pollution Control Act, N.C. Gen. Stat. 113A-50 et seq. While the maximum civil penalty per violation remains at $5,000, the new provisions establish that a person who has not previously been assessed a civil penalty and who has abated any continuing environmental damage resulting from the violation within 180 days of receiving the notice of violation may not be assessed a cumulative penalty of more than $25,000 for all violations associated with the same land-disturbing activity. Additionally, any notice of violation for a first-time sedimentation violation must be delivered in person by the agency, and the agency must offer assistance to the violator in developing corrective measures. The amendments also provide a procedure for remission of civil penalties and factors for consideration in remission proceedings.

BURDEN OF PROOF IN CIVIL PENALTY CONTESTED CASES

The Regulatory Reform Act also made tweaks to the North Carolina Administrative Procedure Act, N.C. Gen. Stat. ch. 150B ("APA"), which governs appeals of agency actions in environmental and other administrative matters. The amendments clarify that the petitioner in contested cases under the APA generally has the "burden of proving the facts alleged in the petition by a preponderance of the evidence." At the same time, however, in civil penalty appeals, the burden is now squarely on the agency to show — by clear and convincing evidence — that the person against whom the penalty was assessed actually committed the act on which the penalty was based. These provisions are not limited to environmental cases and generally apply to contested cases under the APA. State agencies likely will find it much more difficult to impose (and recover) civil penalties, and the fact that the state agency will have the burden of proof may make civil penalty cases easier to settle early in the litigation.

Each session of the General Assembly seems to produce significant changes in the landscape of environmental regulation in North Carolina, and the environmental team at K&L Gates will continue to monitor these changes. In Part II of our legislative update, we will discuss the broadening of the Brownfields Program and the use of risk-based remediation, as well as new rules for cleanup of petroleum releases from aboveground storage tanks and noncommercial underground tanks.

NOTES:

[1] N.C. Gen. Stat. 8-58.53(a) provides that "[a]n environmental audit report or any part of an environmental audit report is privileged and, therefore, immune from discovery and is not admissible as evidence in civil or administrative proceedings." Note that the privilege is explicitly not available in criminal investigations or proceedings. N.C. Gen. Stat. 8-58.57.

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[2] Part 7D defines "environmental audit report" as "a document marked or identified as such with a completion date existing either individually or as a compilation prepared in connection with an environmental audit." N.C. Gen. Stat. 8-58.51(4). This definition also includes a number of ancillary materials, such as field notes, records of observations, recommendations, conclusions, drafts, photographs, maps, charts, and graphs, as well as documents analyzing the report and implementation plans related to compliance issues and improvement. *Id*.

[3] Part 7D in turn defines an "environmental audit" to include "a voluntary, internal evaluation or review of one or more facilities or an activity at one or more facilities regulated under federal, State, regional, or local environmental law, or of compliance programs or management systems related to the facility or activity if designed to identify and prevent noncompliance and to improve compliance with these laws." N.C. Gen. Stat. 8-58.51(3).

[4] N.C. Gen. Stat. 8-58.53(b).

[5] N.C. Gen. Stat. 8-58.55.

[6] N.C. Gen. Stat. 8-58.53(a)(7).

[7] As with the audit privilege, immunity is not available for criminal violations. N.C. Gen. Stat. 8-58.61(b).

[8] N.C. Gen. Stat. 8-58.61(d).

[9] N.C. Gen. Stat. 8-58.62.

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