

GAO Report—EPA Needs to Ensure That Liable Parties Meet Their Cleanup Obligations

Environmental laws, including RCRA and CERCLA, require that the parties responsible for pollution pay to clean up contaminated sites (i.e., the “polluter pays”). However, cleanup costs shift to taxpayers when a liable party abandons its contaminated property or restructures through bankruptcy.

In a recent report, the U.S. Government Accountability Office (GAO) states that, “In light of the substantial federal deficit, EPA’s management of its financial risks associated with Superfund and RCRA is increasingly important.” The report, entitled “Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations,” concludes that EPA needs to take steps to ensure that responsible parties pay for cleanups. The report reviews the impact of bankruptcies on environmental cleanups, describes the challenges EPA faces in holding businesses responsible for their cleanup obligations, and provides recommendations for agency action.

Background

Under RCRA, EPA requires that hazardous waste treatment, storage, and disposal (TSD) facilities demonstrate financial assurance for closure and post-closure activities. These facilities must also demonstrate financial responsibility for corrective action activities at their facilities. However, there are currently no RCRA financial assurance requirements for hazardous waste generators.

EPA requires responsible parties to demonstrate financial assurance for Superfund cleanups. However, the agency has not yet established financial assurance requirements for facilities that manage hazardous substances, as required by CERCLA. When a party responsible for polluting a Superfund site is unwilling or unable to pay for its

cleanup, the funds must come from elsewhere. In the past, most of the costs for these “orphan” Superfund sites came from a trust fund (i.e., the “Superfund”). Funds in the Superfund were primarily generated by a tax on crude oil and certain chemicals, and an environmental tax on corporations. However, EPA’s authority to collect these taxes expired in 1995, and the Superfund is almost depleted. As a result, cleanups at orphan Superfund sites are largely paid for with appropriations from the general fund.

GAO reports that it will cost an average of approximately \$140 million to clean up each of the 142 largest Superfund sites, for a total cost of \$20 billion. Currently, EPA is wholly or partially responsible for funding cleanups at 60 of these so-called “megsites.”

The Problem

Taxpayers are increasingly becoming responsible for cleaning up Superfund and other hazardous sites. To determine how to ensure that liable parties fulfill their cleanup obligations, Congress asked GAO to:

1. Determine how many businesses with liability under federal law for environmental cleanups have declared bankruptcy, and how many cases the government has pursued in bankruptcy court;
2. Identify the challenges faced by EPA in holding bankrupt and other financially distressed businesses responsible for their cleanup obligations; and
3. Recommend actions the EPA could take to better ensure that such businesses pay for their cleanups.

Impact of Bankruptcies

More than 231,000 businesses operating in the United States filed for bankruptcy in fiscal years (FYs) 1998 through 2003. There is an inherent

conflict between the goals of environmental cleanup laws, which require that the polluter pays, and bankruptcy laws, which are designed to erase the debts of a business and give it a fresh start. Businesses may use bankruptcy as a reorganization tool to enable them to emerge with discharged or reduced environmental liabilities.

EPA currently reviews bankruptcy notices to determine if the bankruptcy involves environmental liabilities owed to the agency. However, EPA does not maintain information on the results of the reviews due to the large number of notices and limited agency resources.

It is known that, between 1998 and 2003, the Justice Department pursued 136 bankruptcy cases in court on behalf of EPA and other agencies. Of these cases, 112 were related to hazardous waste liabilities under Superfund and RCRA. It is not known how many of the other 231,494 businesses that filed for bankruptcy during this period had environmental liabilities.

EPA has established a bankruptcy work group to help identify cases in which EPA may have a claim. Some members of the group believe that it may not be cost effective to develop a fail-safe system for identifying relevant bankruptcies. However, on May 10, 2005, EPA issued an interim protocol for bankruptcy matters under Superfund that 1) recommends actions to ensure that EPA receives relevant bankruptcy notices; and 2) identifies additional actions, other than filing claims, that may be relevant, including opposing abandonment of contaminated properties and objecting to reorganization plans or property sales.

Challenges Faced by EPA

GAO reports that EPA faces significant challenges in ensuring that responsible businesses meet their environmental cleanup obligations.

According to GAO, a “significant management challenge for EPA” is “determining whether businesses have resources available to meet their environmental obligations.”

Bankruptcy Cases

The intent of bankruptcy law is to give debtors a fresh start, which makes it difficult for EPA to hold parties responsible for their cleanup obligations. GAO states that, under EPA’s current process for identifying and reviewing bankruptcies, the agency cannot be confident that companies with EPA liabilities are held responsible for their cleanup obligations to the maximum extent practicable. The agency lacks timely, complete, and reliable information on the thousands of businesses filing for bankruptcy each year.

GAO also reports that EPA cannot ensure that it has identified those bankruptcies for which it should request the Justice Department to file claims with the bankruptcy courts for cleanup funds. It may be difficult for the agency to determine if it should request the Justice Department to pursue a case because agency personnel may not recognize the name used in the bankruptcy filing, or may not be able to identify which companies have large liabilities.

Further, the agency may not be able to identify any existing rights it has that could give its bankruptcy claims a priority status (e.g., liens on Superfund properties). Since many of EPA’s claims may be considered general unsecured claims, which are the last to be paid after secured claims and priority unsecured claims are paid, identifying claims with a priority status would significantly improve the agency’s chances of recovering funds under bankruptcy proceedings.

Bankruptcy cases also present the following additional challenges:

- By the time a business files for bankruptcy, it may have few, if any, assets remaining to distribute among creditors.

- Providing timely estimates of cleanup costs to form the basis for claims in bankruptcy court is difficult.
- Lack of information about sites can present challenges to EPA in negotiating bankruptcy settlements with large companies.
- EPA lacks the information to identify those instances in which fraudulent transfers of assets may have occurred that a bankruptcy court could nullify if such transfers were brought to its attention.

Company Structure

Businesses can legally organize or restructure in ways that can limit their future expenditures for cleanups. For example, a company can protect its assets by separating them from its liabilities through both traditional corporate parent/subsidiary structure and new business forms (e.g., limited liability companies, partnerships). GAO notes that the long-term nature of cleanups provides businesses with plenty of time to establish complex, multi-layered organizational structures that protect assets and limit the amounts they may be required to pay for environmental cleanups.

While many such actions are legal, transferring assets to limit liability may violate federal law in some cases. However, such cases are difficult for EPA to identify, and for the Justice Department to prosecute successfully. GAO expresses the concern that current allowable business structures may actually encourage businesses to be environmentally irresponsible, as follows:

“The ease with which companies can protect their assets can actually encourage businesses to take more risks in their operations, thereby increasing the risks of environmental contamination.”

Recommendations

According to GAO, “[I]t is imperative for EPA to increase its focus on financial management and to fully use

its existing authorities to better ensure that those businesses that cause pollution also pay to have their contaminated sites cleaned up.” GAO recommends that the agency make greater use of its existing authorities and enforcement tools to pursue hazardous waste cleanup costs from bankrupt and other financially distressed businesses.

Superfund Authority Should Be Implemented

CERCLA Section 108(b)(1) mandates that EPA require businesses that handle hazardous substances to demonstrate their ability to pay for potential environmental cleanups by providing financial assurances. According to EPA, this mandate has not yet been implemented due to “competing priorities and lack of funds.” GAO asserts that EPA’s inaction “has exposed the Superfund program and U.S. taxpayers to potentially enormous cleanup costs at gold, lead, and other mining sites and at other industrial operations, such as metal-plating businesses.”

According to GAO, using this Superfund authority would help close gaps in EPA’s existing financial assurance requirements since it would require some businesses not subject to RCRA’s financial assurance requirements to obtain financial assurance. These businesses include producers of certain mining wastes, hazardous waste generators, and other businesses whose operations have caused, or may cause, environmental problems.

GAO believes that EPA can “expeditiously” implement this requirement using relevant data from the Superfund and RCRA programs. As required by CERCLA, the agency should prioritize the environmental risk posed by businesses and address those presenting the highest risk first.

Improved Enforcement of Existing Authorities Needed

EPA currently requires financial assurances under the RCRA and Superfund corrective action programs. According to GAO, EPA’s inability to “even readily identify the financial

assurances that should be in force is a clear indication of inadequate oversight and enforcement.” This lack of oversight and enforcement puts taxpayers at an increased risk of having to pay for cleanups. Therefore, the agency needs to improve its oversight and enforcement of these assurances to ensure that they will actually provide funding if a liable party defaults on its cleanup obligations.

GAO acknowledges that EPA has initiated efforts to increase its oversight and enforcement of financial assurances. However, the agency needs to maintain and increase these efforts to ensure that responsible parties, and not taxpayers, ultimately pay to clean up hazardous waste sites.

EPA’s Initiatives to Improve Enforcement

EPA acknowledges that its limited enforcement of the financial assurance requirements for RCRA and Superfund cleanups and closure and post-closure activities at TSD facilities increases the risk that taxpayers will have to pay cleanup costs at current and future contaminated sites. To improve its management and enforcement of the financial assurance requirements, the agency has started the following initiatives:

- EPA has added financial assurances to its national enforcement priorities beginning in fiscal year 2006.
- EPA has taken steps to evaluate the addition of data elements (e.g., the type of financial assurance provided, the name of the company providing the assurance) to its Superfund and RCRA databases. EPA expects that the revisions to the Superfund database will be complete by the end of FY 2005. However, only information about financial assurances in new Superfund settlements and consent decrees will be added to the database; information about existing financial assurances will probably not be added. The RCRA database additions will take longer since they require coordination with authorized states and tribes.

- EPA is taking steps to improve the expertise of officials who enforce the financial assurance requirements. For example, the agency has developed a course on financial assurance mechanisms for officials who enforce RCRA financial assurance requirements.
- In 2004, EPA issued three cost-estimating tools to help regulators estimate the appropriate level of financial assurances needed in the RCRA corrective action program. The agency has also started to provide training in the use of cost-estimating software for its staff and state agency personnel.
- EPA has initiated a study that, in part, will assess the extent to which facilities that had been required to have financial assurances under the RCRA hazardous waste program have become taxpayer-funded Superfund cleanups. Also, EPA’s Office of Inspector General initiated a review in late 2004 on the effectiveness of the RCRA financial assurance requirements.

Evaluation of Financial Assurance Mechanisms Needed

EPA currently imposes financial assurance requirements on businesses to ensure that environmental cleanups are paid for by the party responsible for the contamination, and to avoid passing a company’s environmental liabilities to the general public. Information on the financial assurance mechanisms generally accepted by EPA is provided in Table 1 (pages 2.24–2.25).

Financial assurance mechanisms vary in:

- The financial risks they pose to the government, and thus to taxpayers, who may ultimately have to pay for environmental cleanups if the responsible parties default on their obligations;
- The oversight and enforcement challenge the mechanisms pose to the regulators (e.g., EPA, state agen-

cies) who are responsible for enforcing them; and

- The costs companies incur to obtain financial assurance mechanisms.

Those financial assurance mechanisms that are the least costly for companies tend to pose the highest financial risks to the government. The corporate financial test and corporate guarantee are essentially promises to pay. In addition, the financial test is only as sound as the data used to calculate the financial ratios, and EPA must rely on the accuracy and reliability of the company’s financial disclosures.

GAO, EPA’s Inspector General, state regulators, and others have identified other problems with the corporate financial test, including:

- The corporate financial test is based on the assumption that a company’s recent financial performance is a reasonable predictor of its financial future. However, the test cannot anticipate sudden changes in market conditions or other factors that can dramatically change a company’s financial picture, and a company’s ability to meet its environmental obligations.
- If a company’s financial condition deteriorates to the point that the company can no longer pass the financial test, it can be very difficult and expensive for the company to obtain an alternative form of financial assurance.

According to GAO, EPA allows companies to choose among financial assurance mechanisms that carry varying degrees of financial risk to the government, rather than taking into account information on the extent of default risk that companies may pose. For example, the agency continues to accept the corporate financial test and corporate guarantee, even though guidance issued by the agency in 2003 states that it is important to have resources available “in the event a company hits a financial decline.”

TABLE 1
Financial Assurance Mechanisms Generally Accepted by EPA

<i>Financial assurance mechanism description</i>	<i>Relative financial risk to the government</i>	<i>Oversight and enforcement effort needed</i>	<i>Cost to the company</i>
<p>Corporate financial tests A company may demonstrate its ability to meet its obligations by passing one of two financial tests, one of which evaluates certain financial ratios, and one of which requires a minimum bond rating. Both tests require that the company have at least \$10 million in tangible net worth and demonstrate that this tangible net worth is equal to at least 6 times the sum of the current estimates of the cleanup, closure/post-closure, or other costs for which the company is using the financial test as its financial assurance. Use of the corporate financial test is also called self-insurance.</p>	<p>High—If a company that passed the financial test later files for bankruptcy or becomes insolvent, the company in essence is no longer providing financial assurance because it may no longer have the financial capacity to meet its obligations. Such financial deterioration can occur quickly. While companies no longer meeting the financial test are to obtain other financial assurance, they may be unable to get or afford such assurance.</p>	<p>High—The financial test requires regulators to have expertise in financial analysis, and to monitor companies' financial condition. For example, the regulator is expected to review companies' annual financial submissions showing that it continues to pass the test. Regulators should also monitor the business press for adverse news about the company, which may indicate that it can no longer pass the test.</p>	<p>Low—The corporate financial test and the corporate guarantee (discussed below) are the lowest-cost options for companies because they do not have to set aside funds for future payments or pay fees or premiums to third parties, such as banks.</p>
<p>Corporate guarantee A company may demonstrate its ability to meet its obligations by obtaining a written guarantee from an affiliated entity (e.g., a parent corporation). For EPA to accept this guarantee, the affiliated entity must meet one of the two corporate financial tests described above.</p>	<p>High—Same issues as with the corporate financial test.</p>	<p>High—Same issues as with the corporate financial test.</p>	<p>Low—See discussion concerning the corporate financial test.</p>
<p>Insurance Ability to meet obligations may be demonstrated by an insurance policy covering the estimated cost of these obligations.</p>	<p>Varies—Several factors affect financial risk. For example, "captive" insurance companies (i.e., those not independent of the liable business) can pose greater risk than independent insurance providers. Also, if there is conflicting language between an insurance policy and EPA's regulatory requirements, recovery on the policy may be delayed.</p>	<p>Moderate—However, extent of oversight needed can vary based on the type of insurance. Captive insurance, in particular, poses many of the same challenges as the corporate financial test and corporate guarantee (see above) because the captive insurer is not a true third-party provider of assurance. Even with an independent insurance provider, however, significant oversight is needed.</p>	<p>Moderate—However, cost can vary based on the type of insurance (e.g., captive insurance can pose lower costs than insurance from an independent provider). Many independent providers underwrite environmental insurance using finite or fully funded policies, which limit their risk. Such policies resemble trust funds and, like trusts, present higher costs than do conventional insurance policies.</p>

TABLE 1
Financial Assurance Mechanisms Generally Accepted by EPA—Continued

<i>Financial assurance mechanism description</i>	<i>Relative financial risk to the government</i>	<i>Oversight and enforcement effort needed</i>	<i>Cost to the company</i>
<p>Letter of credit To demonstrate its ability to meet its obligations, a company may provide an irrevocable standby letter of credit issued by a financial institution guaranteeing payment of the obligations up to a specified amount.</p>	<p>Low—Financial institutions issuing letters of credit are required to pay the amounts specified if EPA requests such payments within the periods of time specified in the letters.</p>	<p>Low—Requires periodic monitoring to verify that the letter of credit remains in force and is maintained in a secure place and that the financial institution issuing the letter of credit is still viable.</p>	<p>High—Companies typically pay fees to obtain letters of credit, and may be required to set aside substantial collateral. Fees may be up to 1% of the amount guaranteed, depending on the company's creditworthiness, according to EPA.</p>
<p>Surety bond A company may obtain a bond from an approved surety company guaranteeing that its obligations will be met. To be approved, a surety company must be listed on the U.S. Department of the Treasury's Circular 570.</p>	<p>Low to moderate—Surety companies are required to pay the amounts specified in the bonds upon receipt of demand letters by the regulator. In some cases, EPA allows performance bonds to be used; the surety guarantees that it will either perform the required work, or will pay out the amount specified in the bond upon receiving notification from the regulator that the company for which the surety has provided a performance bond has failed to carry out its obligations.</p>	<p>Low to moderate—Periodic monitoring is required to verify that the bond remains in force and that the surety company is still approved.</p>	<p>Moderate to high—Companies pay annual premiums to surety companies and generally are required to provide substantial cash collateral.</p>
<p>Trust fund A company may establish a trust fund with a financial institution to demonstrate its ability to meet its obligations. The release of funds from the trust fund may be directed only by EPA or another regulator.</p>	<p>Low—There is a risk that the trust may not be fully funded if the company is allowed the flexibility of paying over time.</p>	<p>Low to moderate—Periodic monitoring is required to ensure, among other things, that the financial institution has the authority to act as trustee.</p>	<p>High—The company must set aside funds into the trust to cover its anticipated obligations. In addition, the company usually pays a fee for the administrative services provided by the trustee.</p>

Source: GAO.

GAO recommends that EPA evaluate the adequacy of the financial assurances accepted by the agency based on:

- The financial risks EPA faces if liable parties do not meet their cleanup obligations,
- The varying financial risks posed by the different financial assurance mechanisms,
- EPA's ability (e.g., number and expertise of federal and state staff) to effectively manage the different financial assurance mechanisms,
- Information gaps the agency faces in overseeing the various financial assurances, and
- Concerns about the reliability of certain financial assurances (i.e., corporate financial tests, corporate guarantees, and captive insurance).

GAO believes that this evaluation is especially important, considering the problems identified with some of the assurance mechanisms by GAO, EPA's Inspector General, state regulators, and others. For example, EPA has not taken into account the high level of expertise in financial management and insurance that is required to oversee the corporate financial test, corporate guarantee, and captive insurance.

If EPA stopped accepting the corporate financial test, corporate guarantee, and captive insurance, both government costs and the government's financial risk for environmental cleanups would be reduced. GAO noted that the U.S. Bureau of Land Management (BLM) decided to stop accepting corporate guarantees when it had to decide between allocating staff to oversee unsecured financial assurances, or to meet other agency responsibilities. As a result, more of the financial risk was shifted to the businesses regulated by BLM since they now have to purchase financial assurances from independent third parties (e.g., banks).

GAO believes that EPA should continue to accept the corporate financial tests and corporate guarantees as

financial assurance for the RCRA and CERCLA corrective action programs only if these tests are revised to address the identified deficiencies. GAO supports its position that EPA should not accept unsecured financial assurance mechanisms, as follows:

“Considering the often very long-term nature of the cleanups—during which time it would be reasonable to expect businesses to set aside increased resources—as well as the resources and skills necessary to oversee the unsecured financial assurances, continuing to, in effect, subsidize businesses by accepting unsecured assurances may be a luxury the government can no longer afford.”

GAO recommends that EPA ensure that liable parties provide solid financial assurances that will be available when needed. According to GAO, risk factors that affect a liable party's ability to fulfill their cleanup obligations include: 1) the financial histories of liable parties, 2) any existing agreements that have reduced the amounts businesses are required to pay on the basis of the ability-to-pay analyses, and 3) the estimated total environmental liability of individual parties. GAO suggests that the agency consider these factors, as well as the risk to the government associated with the mechanism itself, when EPA or a state regulator agrees to a liable party's use of a financial assurance mechanism.

GAO made the following additional recommendations relevant to financial assurance mechanisms:

- Individuals or companies with a history that indicates that they are unlikely to have the financial resources, or the willingness to carry out their cleanup responsibilities, could be required to obtain strong financial assurances.
- Businesses with large liabilities (e.g., Superfund megasites, several RCRA sites) could be required to provide financial assurance mecha-

nisms with low relative risk to the government.

- The RCRA and Superfund databases should be updated to include EPA's portfolio of financial assurances. The databases should provide information on all financial assurances that liable parties should have in force. In addition, quality controls should be developed to ensure data reliability.
- EPA should develop a strategy to oversee agency and state portfolios of financial assurances to ensure that all required assurances are in place and sufficient in the event related businesses encounter financial difficulties, including bankruptcy. Such a strategy should include ensuring the availability of adequate staff with relevant expertise.
- According to EPA, the agency's focus in the Superfund program has been on the environmental issues associated with cleanups (e.g., ensuring that appropriate cleanup remedies are chosen and liable parties begin work). As a result, the financial assurance requirements typically are not a primary concern when the agency negotiates and enforces cleanup settlements. To decrease the risk posed to the government, GAO recommends that EPA require that financial assurances be in place before the agency and liable parties finalize Superfund settlement agreements.

Other Authorities—Administrative Offsets and Superfund Liens

GAO suggests that EPA use other existing authorities to generate additional payments for cleanups from financially distressed businesses. These authorities include administrative offsets and property liens. Offsets and liens may be used regardless of whether a party is in bankruptcy. For a bankruptcy case, offsets and liens are considered secured claims, which must be paid first. Thus, they can greatly increase the likelihood that EPA will recover at least some of its cleanup costs in bankruptcies.

Administrative Offsets

An administrative offset is a procedure that allows a federal agency to obtain monies owed to it by a party from payments that the federal government owes that party, including tax refunds and payments under government contracts. GAO recommends that EPA seek opportunities to use tax and other offsets. For example, EPA should routinely take advantage of tax offsets when liable parties are not meeting their obligations—not just when parties file for bankruptcy.

GAO notes that EPA has provided minimal guidance to its staff on its offset authority. GAO recommends that EPA develop guidance on how and when to use administrative offsets. To determine if any federal payments are due to a business, EPA should develop processes for obtaining information on government contracts or grants, and identifying tax payments due to businesses. These processes would allow the agency to routinely check if businesses are owed any government payments or tax refunds.

Superfund Liens

Under Superfund, EPA can file a lien on a property if the government

has incurred costs associated with cleanup at the property. In one bankruptcy case, the agency recovered \$10 million to satisfy its lien on a property that was sold at auction for \$24 million.

Dealing with Bankruptcy Cases

To ensure that EPA identifies relevant bankruptcy filings to pursue, GAO recommends that EPA formalize its existing informal processes for monitoring bankruptcy proceedings. EPA should routinely collect and maintain information on the bankruptcy cases it reviews. This information would be helpful in identifying: 1) the types of businesses that have avoided or limited their environmental liabilities by filing for bankruptcy protection, and 2) individual business owners who have a history of filing for bankruptcy protection. GAO suggests that EPA's Intranet site could contain a data sheet on each identified bankruptcy case and key court documents, which would be accessible to EPA staff to review and update.

In addition, EPA should revise and update its guidance on participation in bankruptcy cases to specify additional actions needed to protect the govern-

ment's interest. The guidance should specify that the staff evaluating new bankruptcy filings should routinely determine whether EPA has any existing liens related to the filings. Additionally, the agency should develop procedures to identify contaminated sites included in bankruptcy filings that EPA has not previously identified. Once identified, the agency can take steps to ensure that courts do not inappropriately discharge the environmental liability.

GAO also recommends that EPA review the specific sites identified in bankruptcy proceedings for purposes other than filing claims. The agency could ensure that discharges for businesses reorganizing under bankruptcy proceedings are not approved for contaminated sites that were previously unknown by EPA.

Reference: U.S. GAO, "Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations," GAO-05-658, August 2005. Available via the Internet at <http://www.gao.gov>. RWC