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State Water Resources Control Board
Underground Storage Tank Cleanup Fund

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Financial
Responsibility
Long Term Study

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BACKGROUND

Pursuant to Chapter 6.75, Article 8, Section 25299.80 of the Health and Safety Code (H&SC), the State Water Resources Control Board (SWRCB), in consultation with the Office of the Insurance Commissioner, has prepared this Long Term Study to the Legislature addressing (a) a summary of corrective action taken pursuant to Chapter 6.75; (b) summary data on claims paid out of the fund; (c) an assessment of the availability of private insurance for coverage of unauthorized releases of petroleum from underground storage tanks; (d) data on the ability of owners or operators of underground storage tanks to comply with alternative mechanisms for demonstrating financial responsibility, such as financial guarantees; (e) summary data on the low-interest loan program established pursuant to Chapter 8.5 (commencing with Section 15399.10) of Part 6.7 of Division 3 of Title 2 of the Government Code for the repair or replacement of leaking underground storage tanks; (f) recommendations for a permanent program to further the intent of this chapter, including recommendations as to the use of the insurance fund to provide coverage for owners and operators of underground storage tanks for liability under federal law arising out of unauthorized releases of petroleum into the environment from these tanks.

THE PROGRAM

HISTORY

The Barry Keene Underground Storage Tank Cleanup Fund Act of 1989 created the Underground Storage Tank Cleanup Fund Program (Fund) to help owners and operators of underground storage tanks (UST) satisfy federal and state financial responsibility requirements and to assist with the costs of cleanup of contaminated soil and groundwater caused by leaking petroleum tanks. The Fund also provides coverage for third-party liability due to releases.

Established by SB 299 in 1989, modified by SB 2004 in 1990, and other subsequent legislation, the Fund requires every owner of a petroleum underground storage tank which is subject to regulation under the H&SC to pay a six mill (\$.006) per gallon storage fee to the Fund. This fee will gradually increase over the next three years to \$.012 per gallon by January 1, 1997.

To be eligible to file a claim against the Fund, a person must be a current or past owner or operator of a petroleum underground storage tank which has released petroleum and which is subject to state regulation. Owners of small home heating oil tanks which have released petroleum are also eligible. Other eligibility conditions include compliance with applicable state permit requirements and regulatory agency cleanup orders. Claimants may receive reimbursements up to \$1,000,000.

The Fund is administered by the SWRCB. On September 26, 1991, the SWRCB adopted emergency regulations implementing the program, and the regulations became effective on December 2, 1991.

Immediately thereafter, the Fund mailed out applications to more than 10,000 interested parties. Over 6,200 applications were received by January 17, 1992. These initial applications were preliminarily reviewed by April 15, and the SWRCB adopted the initial

Priority List and authorized payments on July 16, 1992. The first Letter of Commitment (LOC) was awarded in August of 1992, and the first check was issued approximately one month later.

CLAIM PRIORITY SYSTEM

The implementing legislation sets forth a claim priority system which is based on claimant characteristics. The highest priority, Class A, is given to residential tank owners; the second priority, Class B, is given to small California businesses, governmental agencies and nonprofit organizations with gross receipts below a specified maximum; the third priority, Class C, is given to California businesses, governmental agencies and nonprofit organizations having fewer than 500 employees; and the fourth priority, Class D, is given to all other claimants.

Under statute, the Priority List must be updated at least once a year to include new claims. Since Fall 1993, the Fund has been updating the list monthly. Claims from previous updates retain their relative ranking within their priority class with new claims ranked in their appropriate class below those carried over from the previous list. New claims in a higher priority class must be processed before older claims in a lower priority class.

There is one major exception to the priority system. Legislation passed in 1993 requires the Fund to award approximately 15 percent of its funds annually to any lower priority classes that would not otherwise be funded (i.e., "C" and "D" claimants each receive at least 15 percent of the annual funding).

LETTERS OF COMMITMENT

When a claim is activated from the Priority List, the eligibility requirements are verified with the appropriate regulatory agency, and a Letter of Commitment (LOC) is issued. The LOC is the mechanism by which the program awards or encumbers funds for

reimbursement of cleanup costs. A claim is removed from the Priority List when the claimant is issued a LOC. Initial LOCs are issued in an amount adequate to cover the actual eligible costs incurred to date plus additional "seed" money to allow the cleanup to proceed on schedule. However, for the purposes of projecting long term obligations, the Fund uses the median claim amount of \$150,000. As of September 1994, the Fund had issued 1,942 LOCs in the amount of \$182 million. The potential long term obligation of the 1,942 LOCs issued is estimated at \$291 million, or almost \$110 million over what was actually awarded on the LOCs.

As of September 1994, 72 "A" claimants, 1,432 "B" claimants, 311 "C" claimants, and 127 "D" claimants had received LOCs.

REIMBURSEMENTS

Once an LOC is issued, claimants may submit payment requests. Eligible costs include reasonable and necessary corrective action costs incurred after January 1, 1988 and amounts awarded in third party compensation against the claimant. Only costs paid by or on behalf of the claimant may be reimbursed.

As of September 1994, the Fund had received 2,387 reimbursement requests, 1,841 of which had been paid, for a total of \$68.8 million. The average in-house processing time for initial reimbursement requests, from receipt to payment approval, has decreased from 72 days at the end of 1993 to 34 days as of June 30, 1994. The average payment is approximately \$40,000. Monthly payment volume has averaged about \$6.2 million during recent months.

CORRECTIVE ACTION SUMMARY

As of the end of September 1994, a total of 26,346 underground storage tank leak cases were reported by the nine Regional Water Quality Control Boards (Regional Water Boards). This is an increase of 275, or approximately 1.0 percent, of total leaks since last quarter. Of the total cases reported, 6,393, or 24 percent, are listed as closed. The remaining 19,954 cases are listed as open.

The Regional Water Boards are responsible for 6,663, or approximately 33 percent, of the open cases. Of these open cases, 1,546, or 23 percent, are listed as inactive. The San Francisco and Los Angeles Regional Boards account for 65 percent and 35 percent of these inactive cases, respectively. The local agencies are responsible for 13, 087, or 66 percent, of the open cases.

The Regional Water Boards and local agencies are jointly working on 204 cases, most of which are in Orange, San Bernardino, and San Diego counties. This represents approximately one percent of the open cases.

The local agencies have closed 4,871 cases, or 76 percent of the total closed cases. The Regional Water Boards have closed 1,488 cases. Thirty-four cases have been closed jointly between the Regional Boards and local agencies.

The preceding information is contained in the Leaking Underground Storage Tank Information System (LUSTIS) July-September 1994 Quarterly Report.

CURRENT FUND STATUS

Please refer to Table 1 for a summary of the Fund's current status.

TABLE 1

**Underground Storage Tank Cleanup Fund
STATUS REPORT ¹
(Millions of Dollars)**

CASH BALANCE (September 30, 1994) ²

Funds Received:

- 6 Mill Storage Fee	\$288.61
- Net from Previous Fees	10.05

Total Funds Received: \$298.66

Funds Expended & Committed:

- Program Administration	11.59
- Local Oversight Program	24.63
- Trade & Commerce Loan Program	20.00
- Board of Equalization	2.67
- Claims Reimbursement	185.21

Total Funds Expended & Committed: \$244.10

Available Balance: \$ 54.56

APPLICATIONS

	A	B	C	D	Total
Received	122	2427	1785	4402	8736
Approved	95	2006	1584	3326	7011
Rejected	17	322	157	900	1396
Pending	10	99	44	176	329

LETTERS OF COMMITMENT (LOCs)

	A	B	C	D	Total
Issued	72	1432	311	127	1942
Amount	\$3.00	\$118.15	\$39.73	\$21.17	\$182.05

PAYMENTS

	A	B	C	D	Total
Issued	76	1596	161	8	1841
Amount	\$1.74	\$54.99	\$11.77	\$0.29	\$68.79

¹ All information current for September 1994, unless otherwise noted

² Does not include minor adjustments due to fines, penalties, or interest

FINANCIAL RESPONSIBILITY

Federal EPA regulations (Section 280.90, Subpart H-Financial Responsibility, Part 280, 40 CFR) published on October 26, 1988, requires owners and operators of USTs to demonstrate through insurance coverage or other acceptable mechanisms that they can pay for cleanup and third party damages resulting from leaks that may occur from their USTs.

On June 9, 1993, the United States Environmental Protection Agency (EPA) approved California's Fund as a mechanism for meeting the federal financial responsibility requirements for underground storage tanks containing petroleum.

UST owners and operators must demonstrate financial responsibility in the amounts required by the Federal Act. Currently, the federally required minimum amounts are:

1. \$1 million per occurrence - Owners and operators of USTs located at a petroleum marketing facility (for example, service stations and truck stops), used in production or refining or which handle an average of more than 10,000 gallons of petroleum per month based on annual throughput for the previous calendar year; or
2. \$500,000 per occurrence - Owners and operators not included in the preceding paragraph.

In addition, coverage must be shown for an annual aggregate amount. The annual aggregate amount is the total amount of financial responsibility that an owner or operator must have to cover all leaks that might occur in one year. The amount of aggregate coverage is based on the number of tanks owned or operated. The annual aggregate limits are (1) 1 to 100 tanks - \$1 million annual aggregate; or (2) 101 or more tanks - \$2 million annual aggregate.

As an alternative to the use of the mechanisms as authorized by the federal regulations, an owner or operator may demonstrate financial responsibility of up to \$1 million through the use of the Fund. Senate Bill 1764, signed by Governor Wilson on September 30, 1994, allows the use of the Fund to provide coverage for up to \$1,000,000 per occurrence (original coverage was for \$990,000) with no deductible for those claimants eligible for Priority Class A. Claimants in Priority Class B and C have a \$5,000 deductible, and Priority Class D claimants have a \$10,000 deductible.

In order for the Fund to be used as a financial responsibility mechanism, the law requires that the claimant must (1) be the owner or operator of a petroleum UST as defined in Section 25281(x) of the H&SC; (2) be in compliance with applicable financial responsibility requirements; and (3) be in compliance with UST laws and regulations.

AVAILABILITY OF PRIVATE INSURANCE

The Fund has found that at least seven companies provide pollution liability coverage for petroleum UST owners or operators in California. The companies are:

Agriculture Excess & Surplus Insurance Company (AESIC)
Agriculture Insurance Company
AIG through Commerce and Industry Insurance Company
ECS Underwriting Services, Inc. through Reliance National Indemnity
Insurance Company
Front Royal
Illinois Insurance Exchange through local insurance brokers
Zurick-American Insurance through Steadfast

Our research shows that an environmental policy must usually be purchased separately because pollution coverage is excluded from most commercial general liability policies. This information is confirmed by the report of the California Insurance Commissioner's Environmental Insurance Issues Task Force dated March 1994. Premiums and coverage vary, therefore, the owner and operator need to make inquiries of the various companies to ensure they are getting the desired coverage at an appropriate fee.

The Fund made inquiries of various insurance companies from the above list plus other experts in the field regarding incentives for insurance companies to provide coverage for UST owners and operators. The responses indicate the Fund is a hinderance to insurance providers. Reasons for the use of the Fund over insurance coverage include:

1. UST owners are already required to pay into the Fund with a per gallon fee, therefore use of the Fund would not require UST owners to pay additional costs for other coverage.

2. UST owners and operators want to meet financial responsibility requirements with the least out-of-pocket cost.
3. The Fund meets the minimum federal EPA financial responsibility requirements when the owner or operator assures the remaining deductible with an approved mechanism.
4. The Fund is available to petroleum UST owners and operators that are in compliance with local regulators.
5. The Fund eliminates a likely competitive advantage to UST owners or operators who would otherwise choose not to be in compliance if it were not available.

The March 1994 Insurance Commissioner's Report covers the broad environmental insurance market, including the petroleum UST market as well. The following points included in the report, pertain to the UST market.

A full range of environmental insurance products are marketed, however, despite the fact that it is legally required for some businesses, environmental insurance is not widely available at present. This results from at least four factors. First, the products offered have many pre-insurance requirements and numerous policy exclusions so that the coverage desired is often not the coverage offered. Second, the policy coverage offered often does not match necessarily the type of coverage legally required. Third, the available policies are often affordable or practical only for an extremely limited number of prospective purchasers because of high premiums and high self-insured retentions. Finally, sporadic enforcement of environmental laws and regulations tends to dampen the demand for these insurance products.

The Report further states that according to the insurance industry, premium levels remain high for two main reasons. First, for the insurer to determine the risk, a high level of expertise is necessary, such as scientists, environmental engineers and other experts. Second,

the pool of environmental actuarial data is just beginning to be collected. The industry argues that an increased data pool, a greater access to this knowledge and a higher number of reputable experts in the field will decrease future premiums.

ALTERNATIVE MECHANISMS

Owners or operators have a choice of several mechanisms to show financial responsibility requirements for their UST's. These mechanisms may be used alone or in combination. The list of approved mechanisms follows:

SELF-INSURANCE

Self-insurance is a mechanism by which a UST owner or operator and or guarantor passes a financial test of self-insurance and meets the requirements as specified in Section 280.95 of the federal regulations. The owner or operator must have a tangible net worth of at least \$10 million. The owner or operator must also have a letter signed by the designated chief financial officer indicating all requirements of self-insurance have been met. An owner or operator may use self-insurance in combination with a guarantor only if, for the purposes of meeting the requirements of the financial test under this rule, the financial statements of the owner or operator are not consolidated with the financial statements of the guarantor.

A copy of the chief financial officer's letter based on year-end financial statements for the most recent completed financial reporting year must be maintained by the owner or operator of the USTs. Such evidence must be on file no later than 120 days after the close of the financial reporting year.

GUARANTEE

A guarantee is a promise by a third party to fund a standby trust fund if ordered by the SWRCB. A guarantee is issued by a third party who has a significant business interest in the operations of the owner or operator. The guarantee mechanism does not include provisions for repayment, although the owner or operator and the guarantor may have an agreement outside of the guarantee. Guarantees will probably be called only when and if the owner or operator is

insolvent. Guarantors must qualify for self-insurance using the financial test specified in Section 2980.95 of the federal regulations.

If a leak is known or suspected, a guarantee may be called under the following circumstances; the UST owner or operator has entered bankruptcy or otherwise failed to meet the obligations; the guarantor has warned of forthcoming cancellation of the guarantee; and the owner or operator is unable to obtain an alternative mechanism. The guarantor must then put the full value of the guarantee into the required standby trust fund.

A copy of the chief financial officer's letter based on year-end financial statements for the most recent completed financial reporting year must be maintained by the owner or operator of the USTs. Such evidence must be on file no later than 120 days after the close of the financial reporting year. A copy of the signed standby trust fund agreement, along with any amendments, must also be maintained by the owner or operator.

INSURANCE AND RISK RETENTION GROUP

An owner or operator may choose to use insurance to show financial responsibility. The owner or operator must obtain liability insurance that conforms to federal requirements from a qualified insurer or risk retention group. Such insurance may be in the form of a separate insurance policy or an endorsement to an existing insurance policy. Each insurance policy must be issued by an insurer or a risk retention group that, at minimum, is licensed to transact the business of insurance or eligible to provide insurance as an excess or surplus lines insurer in California.

A copy of the current signed/executed insurance policy or risk retention group coverage policy, with the endorsement or Certificate of Insurance, and any amendments to the agreements must be maintained by the UST owner or operator.

SURETY BOND

A Surety Bond is a guarantee by a surety company that it will meet the applicable obligations of the UST owner or operator. The surety company issuing the bond must be among those listed as acceptable sureties on federal bonds in the latest circular 570 of the U.S. Department of the Treasury.

The use of a surety bond is similar to the use of a letter of credit. The major differences are that surety bonds are issued by a licensed surety rather than by a bank or other authorized entity; generally issued to cover a lack of performance (e.g. failure to perform a clean-up), rather than default on financial obligation.

Under the terms of the surety bond, the surety will become liable on the bond obligation when the owner or operator fails to perform as guaranteed by the bond. The State of California requires the surety's signature to be under oath. The surety must be an admitted surety insurer, an entity to which the California Insurance Commissioner has issued a Certificate of Authority to transact surety insurance in this State.

A surety is called by demonstrating to the surety that the obligation has not been met, at which time the surety makes payments as called for in the surety agreement. For UST financial responsibility, the agreement calls for immediate funding of a standby trust fund. Unlike insurance, the use of a surety does not transfer the obligation from the UST owner or operator to the surety. Instead the owner or operator must repay any amounts advanced under the surety.

IRREVOCABLE LETTER OF CREDIT

A letter of credit is a contract between three parties; the issuer (typically a bank), the principal (the UST owner or operator demonstrating financial assurance), and the third party (the implementing agency). The letter of credit must be irrevocable as indicated in Section

280.99(d) of the federal regulations. An owner or operator who uses a letter of credit to satisfy requirements of the federal regulations must also establish a standby trust fund when the letter of credit is acquired.

The letter of credit is typically issued by banks. Under banking regulations, letters of credit are counted as deposits of the issuing banks. They also count as part of the total amount of credit extended to a company. If a company has outstanding lines of credit or loans, the amount of credit available for a letter of credit may be decrease.

A letter of credit is "called" when a claim is made by the third party, rather than at the direction of the principal. If the letter of credit is called, the principal must repay the letter of credit according to lending terms agreed to by the owner or operator and the bank. Regardless of any repayment provisions, however, the issuer of the letter of credit must provide the funds as called for by the letter.

TRUST FUND

Under a fully funded trust fund, money for corrective action and third-party liability costs are held and administered by an impartial third party. The fully funded trust fund can be used by itself or may be combined with other mechanisms to demonstrate financial responsibility.

The funds are administered by trust departments, typically of banks. The trustee assumes no risk as all the money in the trust must be supplied by the owner or operator (grantor). Payments from the fund are directed to the SWRCB which must determine which of the costs associated with a release are eligible for payment from the Fund. As appropriate, the Fund can reimburse either the grantor or third party.

STANDBY TRUST FUND

A standby trust is a means by which the funds for corrective action and third-party liability are administered by an impartial third-party. A standby trust cannot be used alone as a financial responsibility mechanism, but must be combined with another third-party mechanism that will be used to fund the trust. A letter of credit, guarantee, or surety bond requires a standby trust to be established at the time the financial mechanism is initiated.

The funds are administered by trust departments, typically of banks. The "trustee" is a third-party whose obligation is to ensure that money in the trust is spent in accordance with the terms of the trust. The trustee's obligations are to the trust rather than to the principal.

Standby trust funds are funded when other third-party financial assurance mechanisms are called. If the owner or operator fails to perform, the SWRCB notifies the guarantor, surety, or bank of the amount to be placed into the trust fund, up to the full amount of the financial mechanism being utilized by the UST owner or operator.

STATE FUND

In order to use the Fund as a basis for demonstration of financial responsibility, an owner or operator must at all times:

- a) Demonstrate financial responsibility of up to \$10,000 per occurrence and annual aggregate exclusive of the Fund. This demonstration can be done by using one or a combination of the mechanisms listed in the federal regulations or by use of the state approved mechanisms described below.
- b) Demonstrate financial responsibility for any required amount above \$1 million exclusive of the Fund for those owners and operators required to have \$2

million annual aggregate. This demonstration can be done by using one or a combination of the mechanisms listed in the federal regulations.

- c) Maintain eligibility to participate in the Fund.

The SWRCB has developed two additional mechanisms that UST owners/operators can use in support of the Fund. The federal EPA has approved these mechanisms.

1. "Letter from the Chief Financial Officer" - (Currently, the entity must have tangible net assets of at least \$100,000, however, effective July 1, 1995, this amount will be lowered to tangible net assets of at least \$50,000 for priority classes B and C. Priority class D will remain at the \$100,000 tangible net assets).
2. At the request of some of California's UST owners/operators, the SWRCB developed a Certificate of Deposit (CD) Agreement. The owner or operator would purchase a CD from a bank naming the SWRCB as the payee. The owner or operator completes an agreement, which the Fund supplies. This agreement is between the owner or operator and the SWRCB.

As of February 18, 1994, local government entities had to demonstrate financial responsibility for UST's. The federal EPA regulations added four mechanisms specifically for local government's use in addition to the above listed methods. The four mechanisms are local government bond rating test, local government financial test, local government guarantee, and the local government fund.

LOW-INTEREST LOAN PROGRAM

Chapter 8.5 (commencing with Section 15399.10) of Part 6.7, Division 3, Title 2, of the California Government Code created a loan program, to be administered by the California Trade and Commerce Agency, to assist small businesses in upgrading, replacing, or removing tanks to meet applicable local, state or federal standards.

Small businesses with USTs who wish to remove or replace such tanks can find financing through the Trade and Commerce's Replace Underground Storage Tank (RUST) Direct Loan Program. Through this program, applicants who meet all necessary requirements may receive financing with a maximum of \$350,000 per borrower. The minimum loan amount is \$10,000. Loans collateralized by real property for security can have a maturity of up to 20 years. Loans collateralized by other (non-real estate) assets have a maturity of up to 10 years. The interest rate is tied to the California State Treasurer's Surplus Money Investment Fund rate. Currently, that rate is 4.5% per annum. Borrowers must pay an origination fee of two percent of the loan amount. Commerce's loan covers 100% of the project costs. These loans can be used to fund tank removal, replacement, as well as minor corrective action.

Trade and Commerce receives \$4 million annually to operate the RUST loan program from the SWRCB's UST Cleanup Fund Program. The Fund's program does not cover the costs of tank removal or tank replacement but those costs can be financed by the RUST loan program. Small business applicants to the Fund are classified as Priority Class B and currently the RUST program is only available to those in this priority class.

As of the end of October, 1994, 86 loans were approved with \$11.5 million encumbered; 16 loan applications are pending for an amount of \$2.4 million; and, 70 applications totalling \$9.8 million were either declined or withdrawn by the applicant.

RUST has had a slow beginning due to owners and operators of single walled tanks having been given until 1998 to bring their tanks into compliance with the new regulations. As this deadline approaches, activity in the loan program is increasing. Since the beginning of Fiscal Year 1994-95, applications have been submitted for 16 loans for an amount of \$2.3 million. Since January 1994, a monthly average of 120 inquiries on the RUST Program have been received.

PROGRAM RECOMMENDATIONS

ISSUE 1

Should the Fund become more aggressive in requiring a copy of the various mechanisms used by UST owners or operators to demonstrate financial responsibility?

For compliance with state and federal regulations, owners or operators are required to complete a Certification of Financial Responsibility form and submit it to their local implementing agency indicating the mechanisms used. This certificate is required to be posted and available for inspection purposes at the site of the UST.

Some of the approved mechanisms name the SWRCB as the payee in case of default by the owner or operator to pay for corrective action and/or third party costs (see above for explanation of mechanisms). The Fund has not directed owners or operators to send an original of these mechanisms to us even though the Fund is the designated payee.

Recommendation:

The Fund, as the payee, should obtain the original document designating the SWRCB as the payee. This would be accomplished by updating current Fund guidelines and notifying all California tank owners and operators, as well as acquiring from the local implementing agencies copies of all Certification of Financial Responsibility forms using a letter of credit, guarantee, surety bond or certificate of deposit as a mechanism. The Fund would then be responsible to get the required document.

ISSUE 2

Should the Fund work more closely with the insurance and banking industries in explaining financial responsibility and providing assistance to tank owners or operators on how to meet financial responsibility requirements?

Recommendation:

The Fund should meet with representatives from insurance and banking industries to: 1) explain the financial responsibility requirements that UST owners and operators must meet; 2) work with the insurance and banking industries to encourage their participation with UST owners and operators in meeting financial responsibility requirements; and 3) co-sponsor statewide workshops and seminars to educate owners and operators of financial responsibility requirements.

