



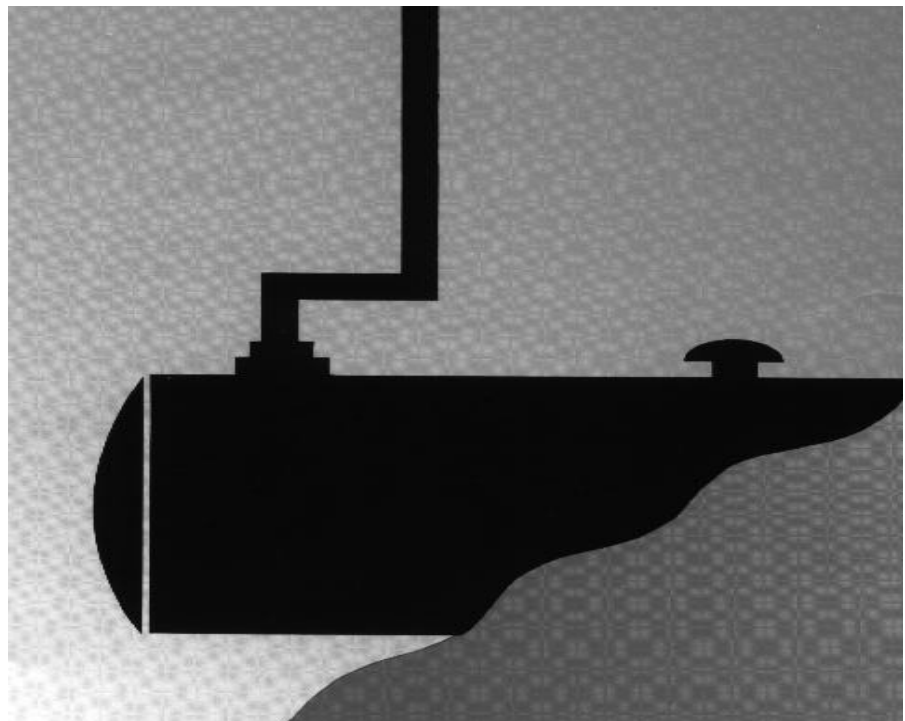
# Financial Responsibility For Underground Storage Tanks: A Reference Manual

**Overview of  
Financial  
Responsibility  
(FR)  
Requirements**

**Explanation Of  
How Each FR  
Mechanism  
Works**

**Owner And  
Implementing  
Agency  
Responsibilities  
For Each FR  
Mechanism**

**Glossary**



### **Disclaimer**

This document provides guidance to State and EPA personnel in understanding and reviewing financial responsibility documentation used to comply with the Federal financial responsibility regulations [40 CFR Part 280, Subpart H]. It is intended solely for the education and assistance of State and EPA personnel. This document is not a substitute for EPA regulations nor is it a regulation itself. This, it does not impose legally binding requirements on EPA, States, or the regulated community.

The Web sites and other non-EPA references are for informational purposes only and we cannot guarantee the accuracy of the information.

# TABLE OF CONTENTS

	<u>Page</u>
1. INTRODUCTION .....	1
2. OVERVIEW OF FINANCIAL RESPONSIBILITY REQUIREMENTS .....	5
3. FINANCIAL RESPONSIBILITY USING THE FINANCIAL TEST OF SELF-INSURANCE .....	25
4. FINANCIAL RESPONSIBILITY USING THE CORPORATE GUARANTEE .....	51
5. FINANCIAL RESPONSIBILITY USING INSURANCE .....	83
6. FINANCIAL RESPONSIBILITY USING SURETY BONDS .....	111
7. FINANCIAL RESPONSIBILITY USING IRREVOCABLE STANDBY LETTERS OF CREDIT .....	127
8. FINANCIAL RESPONSIBILITY USING STATE-REQUIRED MECHANISMS .....	147
9. FINANCIAL RESPONSIBILITY USING STATE FUNDS .....	153
10. FINANCIAL RESPONSIBILITY USING TRUST FUNDS .....	165
11. USING STANDBY TRUST FUNDS WITH OTHER MECHANISMS TO DEMONSTRATE FINANCIAL RESPONSIBILITY .....	181
12. FINANCIAL RESPONSIBILITY USING THE LOCAL GOVERNMENT BOND RATING TEST .....	193
13. FINANCIAL RESPONSIBILITY USING THE LOCAL GOVERNMENT FINANCIAL TEST .....	211
14. FINANCIAL RESPONSIBILITY USING A LOCAL GOVERNMENT OR STATE GUARANTEE .....	229
15. FINANCIAL RESPONSIBILITY USING A LOCAL GOVERNMENT FUND .....	251
16. OTHER FINANCIAL RESPONSIBILITY MECHANISMS .....	267
GLOSSARY OF TERMS RELATED TO UST FINANCIAL ASSURANCE .....	293

[THIS PAGE INTENTIONALLY LEFT BLANK]

## 1. INTRODUCTION

Subpart H of the federal underground storage tank (UST) regulations requires UST owners and operators to demonstrate financial responsibility (FR) -- the ability to pay for cleanup or third-party liability compensation that results from a release from an UST. FR ensures the timely completion of corrective action and third-party compensation and thus reduces the risk to human health and the environment posed by leaks. UST FR also may provide an incentive for operating practices that can prevent leaks. The purpose of this *Manual* is to provide a comprehensive reference on the federal UST FR program that states and EPA regions can use to learn about the various FR mechanisms. This *Manual* also can assist them in reviewing FR documentation.

State agencies are primarily responsible for ensuring compliance with all aspects of the UST regulations, including FR. State inspectors are generally technical experts with little experience in financial or legal matters. This *Manual* addresses their need for assistance in understanding and reviewing FR mechanisms. While there are some basic explanations of the various FR mechanisms available, including materials prepared by the State of Arizona, there is no published source for a comprehensive discussion of the FR mechanisms.

**NOTE: This *Manual* applies only to federal UST FR requirements under Subtitle I of RCRA.** State UST FR requirements may mirror the federal requirements or may differ from them. **Where there are similarities to the federal UST FR requirements, this *Manual* should be useful for state UST FR requirements.**

There also are several other state and federal FR programs for environmental clean-up and compensation unrelated to USTs. These programs all contain unique features. Although there may be some common elements among these FR programs, readers should not assume that this UST FR *Manual* is applicable to other FR programs.

EPA anticipates that if state funds are discontinued, questions will arise about the other options for demonstrating FR. Because most of these options are creative adaptations of mechanisms typically used in other ways, there are few sources of information about them, aside from the regulations themselves and the accompanying preambles published in the *Federal Register*. This *Manual* does more than simply compile existing information in one place. The *Manual* organizes the information according to its relevance for owners or operators, for federal and state implementing agencies, and for providers of FR, respectively. The *Manual* also draws upon FR implementation and training experience and offers opinions and perspectives.

## A. HOW TO USE THIS MANUAL

EPA prepared this *UST FR Manual* as a reference for federal and state personnel looking for FR information. The *Manual* contains this introductory chapter, followed by an overview chapter, and then 14 chapters, organized according to the federal FR regulations and in that sequence. These chapters each address one or more FR mechanisms in detail. The *Manual* concludes with a Glossary of Terms.

Chapter 2 provides an overview of the UST FR system, and how it applies to owners or operators, the implementing agencies, and providers of FR. UST owners and operators can use a variety of mechanisms to comply with the FR regulations. The mechanisms share aspects in common but also have many distinct features. **Elements common to all or most mechanisms are described in Chapter 2.** For details about specific mechanisms, readers should consult the subsequent chapters.

The remainder of this *Manual* is organized around the various options for demonstrating UST financial assurance. Each is discussed in detail. Each chapter provides background information on the mechanism(s) then describes owner or operator responsibilities, implementing agency responsibilities and oversight, and provider responsibilities. Checklists summarizing the text appear in each chapter. Technical terms are defined in the text of the chapter or can be found in the Glossary. As appropriate, sources of further information are collected at the end of each chapter. All internet addresses are correct as of late 1999 but are subject to change.

The *Manual* distinguishes between implementing agency "responsibilities" and "potential oversight activities." The former is defined narrowly to include only situations that require implementing agency response to a report or submission of evidence of FR by an owner or operator mandated **under the federal rules**. (States may have broader requirements than the federal rules for reporting and submission of FR documents.) These situations are highlighted because they require attention and, often, response from the implementing agency. Directing payment of funds and monitoring their replenishment also are included in the discussion of agency responsibilities because they are key activities for assuring corrective action and third-party compensation. Other more discretionary activities are listed under "potential oversight activities" although some states may not treat all of these activities as discretionary.

## B. WHAT IS THE PURPOSE OF FINANCIAL RESPONSIBILITY?

EPA estimates that there are about 750,000 federally regulated petroleum USTs at about 300,000 sites nationwide as of late 1999. These USTs are owned or operated by marketers (such as service stations and convenience stores) who sell gasoline to the public and nonmarketers who use USTs solely for their own needs (such as fleet service operators and local governments). Many of these USTs have released or may release petroleum into the environment through spills, overfills, or failures in the tank and piping system. Because cleaning up these leaks can be costly, Congress wanted owners and operators of USTs to demonstrate that they have the financial resources to pay for the costs of corrective action and third-party compensation that can result from leaking USTs.

As a result, when Congress amended Subtitle I of the Resource Conservation and Recovery Act (RCRA) in 1986, it directed the U.S. Environmental Protection Agency (EPA) to develop financial responsibility regulations for owners and operators of USTs storing petroleum. The funds assured through the various allowable FR mechanisms establish a safety net that finances immediate and thorough corrective action when a release is detected and before the further spread of contamination. These funds also ensure that owners or operators can compensate others for any injuries or damages from UST releases.

## C. HOW DOES FINANCIAL RESPONSIBILITY FIT INTO THE UST REGULATORY SCHEME?

Subtitle I of RCRA requires EPA to develop a comprehensive regulatory program for USTs storing petroleum. In 1984, Congress directed EPA to publish regulations that would require owners and operators of new tanks and tanks already in the ground to prevent, detect, and clean up releases. Furthermore, Congress also banned the installation of unprotected steel tanks and piping beginning in 1985.

In 1986, Congress amended Subtitle I and directed EPA to establish financial responsibility regulations that would require UST owners and operators to assure the costs of cleaning up releases and compensating third parties for resulting damages. The 1986 amendments also created the Leaking Underground Storage Tank (LUST) Trust Fund, designed to pay for cleanups at sites where the owner or operator is unknown, unwilling, or unable to respond.

In 1988, EPA issued regulations setting minimum standards for new tanks and requiring owners of existing tanks to upgrade, replace, or close their tanks. These regulations have three sections: technical requirements, financial responsibility requirements, and state program approval objectives. The three rulemakings together establish a comprehensive program to regulate USTs as required by Subtitle I of RCRA.

- The technical standards require UST owners and operators to meet standards for tank operation and design, release detection and reporting, corrective action, and closure. The operation and design standards require that USTs be protected from corrosion and equipped with devices to prevent spills and overfills. The release detection and reporting standards require owners and operators to install leak detection systems and report actual and suspected releases. The corrective action standards require owners and operators to clean up releases from UST systems.
- The financial responsibility rules require UST owners or operators to demonstrate financial responsibility for the costs of corrective action and compensation of third parties arising from releases of petroleum from underground storage tanks. The financial responsibility requirements help ensure that owners and operators can respond promptly to clean up releases and can compensate others for any associated injuries or damages.
- The state program approval rules enable states whose programs are no less stringent than the federal program and which provide for adequate enforcement of compliance, to administer the UST regulatory program in lieu of federal administration. EPA believes that regulation of the large and varied UST population is best implemented by state and local agencies, which can oversee and enforce the UST program more effectively than EPA. As of November 30, 1999, twenty-seven states, the District of Columbia, and Puerto Rico have received program approval.

The financial responsibility rules complement the other UST regulations. The FR standards complement the technical requirements to help achieve EPA's goal of overall protection of the environment. The technical and financial responsibility rules are not competing alternatives nor is financial responsibility an alternative to the technical specifications. They are both preventive in nature. Neither in itself would totally prevent harm to the public health and environment, but in conjunction they assure a high degree of protection. The direct control of leakage from USTs is obviously a preventive strategy, but is not foolproof. The funds assured through the various FR mechanisms establish a safety net that finances immediate and thorough corrective action and compensation when a release does occur.

The LUST Trust Fund (the "Fund") and the UST FR program also are closely related. Congress authorized the use of the Fund to pay corrective action costs only under limited and specifically defined circumstances. Congress did not authorize use of the Fund as a financial assurance mechanism. Rather the Fund is intended to "stand behind" owners or operators who have demonstrated financial responsibility in the required amounts. Fund monies can be used in the following situations:

- (1) An owner or operator who is required to undertake the corrective action and who is capable of carrying out corrective action properly does not exist or cannot be identified;
- (2) Prompt action by the EPA (or state) is necessary to protect human health and the environment;
- (3) The financial resources of the owner or operator, **including any UST financial assurance**, are inadequate to pay the entire cost of the corrective action, and expenditures from the Fund are necessary to assure effective corrective action; or
- (4) An owner or operator has failed or refused to comply with an order to perform corrective action.



## 2. OVERVIEW OF FINANCIAL RESPONSIBILITY REQUIREMENTS

This chapter provides an overview of the UST FR regulations and is organized as follows:

A. WHO MUST COMPLY? .....	7
A.1 Which Owners or Operators Must Be Covered? .....	7
A.2 Which Tanks Must Be Covered? .....	7
A.3 When Is Coverage No Longer Necessary? .....	8
B. WHAT SCOPE AND AMOUNTS OF COVERAGE ARE NEEDED? .....	9
B.1 What Is the Required Scope of Coverage? .....	9
B.2 What Is the Required Amount of Financial Assurance? .....	10
C. WHAT OPTIONS CAN BE USED FOR DEMONSTRATING FINANCIAL RESPONSIBILITY? .....	12
C.1 Available FR Mechanisms .....	12
C.2 Using Combinations of Mechanisms .....	13
C.3 Covering Multiple Facilities .....	15
D. WHAT ARE THE OWNER'S OR OPERATOR'S RESPONSIBILITIES? .....	16
D.1 Using One or More Acceptable Mechanisms That Are Worded as Specified in the Regulations .....	16
D.2 Demonstrating Scope and Amount of Required Financial Responsibility .....	17
D.3 Updating Coverage .....	17
D.4 Maintaining Coverage .....	17
D.5 Certifying Compliance .....	18
D.6 Recordkeeping .....	18
D.7 Notifying Implementing Agency of Failure to Secure Alternate Assurance or Being Named a Debtor in Bankruptcy Proceeding .....	18
D.8 Submitting Financial Responsibility Documents .....	19
D.9 Responding to Requests for Information from Implementing Agencies .....	19
E. OVERVIEW OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT .....	20
E.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as A Debtor in Bankruptcy .....	20
E.2 Reviewing Financial Responsibility Submissions .....	20
E.3 Drawing on Mechanisms .....	20
E.5 Responding to Requests for Release of Funds .....	21
E.6 Checking the Eligibility and Qualifications of the Provider of Assurance .....	22
E.7 Verifying the Wording of Required Documents .....	22
E.8 Verifying That the Proper Scope and Amount of Coverage Are Provided .....	22
E.9 Requesting Evidence of Financial Responsibility or Reports of Financial Condition .....	22
E.10 Custodial Care of Financial Assurance Mechanisms .....	22

F.	WHAT ARE THE FINANCIAL ASSURANCE PROVIDERS' RESPONSIBILITIES? . . . . .	23
F.1	Be Eligible and Qualified to Provide Financial Responsibility . . . . .	23
F.2	Notify Owner or Operator of Decision to Cancel or Non-Renew, If No longer Eligible or Qualified to Provide Assurance, or If Named as a Debtor in Bankruptcy Proceedings . . . . .	23
F.3	Make Payments or Perform as Directed . . . . .	23
F.4	Provide Financial Statements and Other Relevant Information . . . . .	23

## **A. WHO MUST COMPLY?**

### **A.1 Which Owners or Operators Must Be Covered?**

Either the owner or the operator of an UST containing petroleum must demonstrate financial responsibility, if the owner and operator are different individuals or organizations. It is the responsibility of the owner and operator to decide which one will demonstrate financial responsibility. Each is responsible if the FR requirements are not complied with by either party.

Federal and state governments and their agencies that own USTs are not required to demonstrate financial responsibility if their debts and liabilities are the debts and liabilities of a state or the United States. The operator of an UST owned by such a federal or state government organization also is not required to demonstrate compliance. However, some USTs on federal or state land may not be owned by the federal or state agency that is responsible for the land. Such operator-owned tanks must demonstrate FR. In addition, the terms of contracts with concessionaires may require a demonstration of FR for USTs. Local government entities, moreover, must comply with the financial responsibility requirements for any USTs they own or operate.

### **A.2 Which Tanks Must Be Covered?**

The federal UST regulations for financial responsibility apply only to underground tanks and piping that store petroleum. An UST is a tank and any underground piping connected to the tank that has at least 10 percent of its combined volume underground.

The following tanks are **NOT** covered by the financial responsibility requirements:

- Farm and residential tanks of 1,100 gallons or less capacity holding motor fuel used for noncommercial purposes;
- Tanks storing heating oil used on the premises where it is stored;
- Tanks on or above the floor of underground areas, such as basements or tunnels;
- Septic tanks and systems for collecting storm water and wastewater;
- Flow-through process tanks;
- Tanks of 110 gallons or less capacity, and tanks holding a minimal concentration of petroleum; and
- Emergency spill and overfill tanks.

Other petroleum storage sites not covered by the federal financial responsibility requirements (such as surface impoundments and field-constructed tanks) are identified in the Code of Federal Regulations, 40 CFR Part 280.

### **A.3 When Is Coverage No Longer Necessary?**

An owner or operator need not maintain financial responsibility for an underground storage tank after the tank has been properly closed or, if corrective action is required, after corrective action has been completed and the tank has been properly closed as required by 40 CFR Part 280, Subpart G.

**B. WHAT SCOPE AND AMOUNTS OF COVERAGE ARE NEEDED?**

**B.1 What Is the Required Scope of Coverage?**

Exhibit 2-1 displays the full scope of required FR coverage. The full scope includes different types of both obligations and releases. Note that coverage of both on-site and off-site corrective action and third-party compensation is needed. An owner or operator can use one or a combination of mechanisms to cover the full scope of FR obligations (see C.2 below).

Exhibit 2-1 FULL SCOPE OF FINANCIAL RESPONSIBILITY COVERAGE				
Type of Release		Type of Obligation		
		Corrective Action (on-site & off-site)	Third-Party Compensation (on-site & off-site)	
			Bodily Injury	Property Damage
Accidental Releases	Sudden	✓	✓	✓
	Non-Sudden	✓	✓	✓

Types of Obligations. Financial responsibility covers the costs of **corrective action** and **third-party compensation**. EPA has never formally defined "corrective action" although Subpart F -- "Release Response and Corrective Action for UST Systems Containing Petroleum or Hazardous Substances" -- is generally viewed as the "corrective action" section of the rules. Third-party compensation includes **bodily injury** and **property damage**. Because liability for third-party compensation is defined by courts that interpret and apply state law, the UST regulations define bodily injury and property damage to mean whatever state law says they mean.

To ensure that UST FR mechanisms will be used only for obligations associated with UST releases, the language of the FR instruments for guarantees, letters of credit, surety bonds, and trust funds contains a provision that they do not apply to the following categories of damages or obligations:

- Any obligation under a workers' compensation, disability benefits, or unemployment compensation law or other similar law;
- Bodily injury to an employee of arising from, and in the course of, employment;
- Bodily injury or property damage arising from the ownership, maintenance, use, or entrustment to others of any aircraft, motor vehicle, or watercraft;
- Property damage to any property owned, rented, loaded to, in the care, custody, or control of, or occupied by the owner or operator that is not the direct result of a release from a petroleum underground storage tank;
- Bodily damage or property damage for which the owner or operator is obligated to pay damages by reason of the assumption of liability in a contract or agreement other than a contract or agreement entered into to meet the requirements of 40 CFR 280.93.

EPA patterned these exclusions on existing standard exclusions found in insurance policies, in order to ensure that UST FR coverage is not exhausted by the payment of claims that are covered by other compensation systems or that are otherwise not intended to be included within the scope of UST FR coverage. The five exclusions do not represent all common insurance policy exclusions, but were selected because they were considered most relevant for Subtitle I.

Types of Releases. Owners or operators must demonstrate financial responsibility for taking corrective action and for compensating third parties for bodily injury and property damage caused by **accidental releases**. FR is not required for **intentional** releases. An accidental release means any release of petroleum from an underground storage tank that results in a need for corrective action and/or compensation for bodily injury or property damage **neither expected or intended by the owner or operator**. (See 40 CFR 280.92) Thus, damage from actions such as vandalism is considered accidental if the owner or operator had no intention or expectation of the damage.

An accidental release may be **sudden** or **nonsudden**. The distinction between sudden and nonsudden releases originated in the insurance market where some insurers were (and still are) willing to provide insurance only for sudden releases but not for non-sudden releases. The federal regulations do not define "sudden" and "nonsudden" accidental releases, leaving it up to the courts to continue to interpret these terms in the course of litigating insurance policies. **All releases, whether sudden or non-sudden, must be covered.** This is necessary to ensure adequate coverage for USTs in particular, because it is often difficult to determine whether an UST release is sudden or gradual. Therefore, to ensure adequate protection of human health and the environment, both types of coverage are necessary.

## **B.2 What Is the Required Amount of Financial Assurance?**

Exhibit 2-2 below displays the required coverage amounts for UST owners and operators. The required amount of coverage depends on the owner or operator's type of business, the amount of throughput, and the number of tanks. An owner or operator can use one or a combination of mechanisms to cover the full amount of FR obligations (see C.2 below).

Required amounts of financial responsibility fall into two types: **per occurrence** and **annual aggregate**.

- **Per occurrence** means the amount of money that must be available to pay the costs for each occurrence of a leaking UST. Owners or operators of USTs used in petroleum production, refining, or marketing (such as service stations and truck stops), must be able to demonstrate \$1 million of per occurrence coverage. The per occurrence amount may be less if tanks are located at a facility **NOT** engaged in petroleum production, refining, or marketing. In this case, a facility with a monthly throughput of 10,000 gallons or less needs only \$500,000 of per occurrence coverage.
- **Annual aggregate** means the total amount of financial responsibility available to cover all obligations that might occur in one year. This amount depends on the number of tanks that is owned or operated: \$1 million annual aggregate for 100 or fewer tanks; \$2 million annual aggregate for more than 100 tanks.

The required amounts of assurance described above exclude legal defense costs.

**Exhibit 2-2**  
**REQUIRED AMOUNTS OF FINANCIAL RESPONSIBILITY**

Group Of UST Owners and Operators	Per Occurrence Coverage	Aggregate Coverage
<b>Group 1:</b> Petroleum producers, refiners, or marketers	<b>\$1 million</b>	<b>\$1 million</b> for 100 or fewer tanks <b>or</b> <b>\$ 2 million</b> for more than 100 tanks
<b>Group 2:</b> Nonmarketers	<b>\$500,000</b> if throughput is 10,000 gallons monthly or less <b>OR</b> <b>\$1 million</b> if throughput is more than 10,000 gallons monthly	

At the time they were established in 1988, the per occurrence amounts were expected to be sufficient to cover 99 percent of all claims at UST facilities. Similarly, the costs of releases at UST facilities were not expected to exceed the annual aggregate more than one percent of the time. The required per occurrence and annual aggregate coverage amounts do not in any way limit the liability of the owner or operator.

**NOTE:** Demonstrating FR for the required amounts of coverage does not limit an owner or operator's liability for corrective action and third-party compensation.

## C. WHAT OPTIONS CAN BE USED FOR DEMONSTRATING FINANCIAL RESPONSIBILITY?

### C.1 Available FR Mechanisms

The UST FR program offers a large number of options that owners or operators can use to demonstrate assurance for the required scope and amounts of coverage. The following options can be used by all owners or operators:

- **A financial test of self-insurance.** A firm with a tangible net worth of at least \$10 million may demonstrate financial responsibility by passing one of the two financial tests described later in the *Manual*.
- **A corporate guarantee.** An owner or operator may secure a corporate guarantee from another eligible firm. The provider of the guarantee has to pass one of the same financial tests required for self-insurance.
- **Insurance coverage.** An owner or operator may buy insurance from an insurer or a risk retention group.
- **A surety bond.** An owner or operator may obtain surety bond, which is a guarantee by a surety company that it will satisfy financial responsibility obligations if the owner or operator does not.
- **A letter of credit.** An owner or operator may obtain a letter of credit, which obligates the issuer to provide funding for corrective action and third-party compensation.
- **A trust fund.** An owner or operator may set up a fully-funded trust fund administered by a third party to pay for corrective action and third-party compensation.
- **Other state authorized methods.** An owner or operator also may use any additional methods of coverage (e.g., certificate of deposit) specifically approved by the EPA in the state where the tanks are located or authorized under an EPA-approved state UST program.
- **State financial assurance funds.** An owner or operator may be covered by a state fund that provides all or a portion of FR to the degree it pays for cleanup and third-party compensation costs.

Local governments have four additional compliance methods tailored to their special characteristics:

- **A bond rating test.** A local government owner or operator may demonstrate (or guarantee) FR by passing a bond rating test.
- **A financial test.** A local government owner or operator may demonstrate (or guarantee) FR by passing a financial test.
- **A guarantee.** A local government owner or operator may obtain a guarantee from another local government or the state.
- **A dedicated fund.** A local government owner or operator may demonstrate (or guarantee) FR by establishing a fund.



Mechanisms must be worded as specified in the regulations without additions or omissions. Uniform wording of the mechanism minimizes the administrative burden on the implementing agency by eliminating case-by-case reviews and provides owners and operators with the assurance that the mechanism will satisfy regulatory requirements. The following chapters of the *Manual* describe each of the mechanisms in detail, including eligibility requirements for users and providers of the mechanism.

## C.2 Using Combinations of Mechanisms

An owner or operator may use any one or combination of mechanisms to demonstrate financial responsibility for:

- One or more underground storage tanks
- For different scopes of coverage, and
- For different dollar amounts of coverage.

**The only combination of mechanisms that is not allowed is combining the financial test of self-insurance and a corporate guarantee where the financial statements of the owner or operator and the guarantor are consolidated (i.e., combined).** This restriction prevents double counting of assets available to cover UST obligations.

Different Sets of Tanks. If an owner or operator uses one financial mechanism to demonstrate evidence of financial responsibility for one set of tanks and another mechanism to demonstrate evidence of financial responsibility for a different set of tanks, each mechanism must have an aggregate amount appropriate to the separate set of tanks assured. For example:

- An owner or operator has a total of 300 tanks: 140 tanks in one state and 160 tanks in another state. The 140 tanks are assured at the \$2 million aggregate level by mandatory participation in a state fund that assures tanks only in that state. The owner or operator must provide additional financial assurance at the \$2 million aggregate level for the other 160 tanks located elsewhere.
- An owner or operator has a total of 200 tanks: 140 tanks in one state and 60 tanks in another state. The 140 tanks are assured at the \$2 million aggregate level by mandatory participation in a state fund that assures tanks only in that state. The owner or operator must provide additional financial assurance at the \$1 million aggregate level for the other 60 tanks located elsewhere.

Different Scopes of Coverage. Owners or operators may use a combination of mechanisms to cover both corrective action and third-party compensation. Each mechanism must specify whether it covers "taking corrective action" and/or "compensating third parties for bodily injury and property damage caused by" either "sudden accidental releases" or "nonsudden accidental releases" or "accidental releases;" if coverage is different for different tanks or locations, the mechanism must indicate the type of coverage applicable to each tank or location arising from operating the identified underground storage tank(s).

If the owner or operator uses separate mechanisms or separate combinations of mechanisms to demonstrate financial responsibility for:

- Taking corrective action,
- Compensating third parties for bodily injury and property damage caused by sudden accidental releases, or

- Compensating third parties for bodily injury and property damage caused by nonsudden accidental releases,

the amount of assurance provided by each mechanism or combination of mechanisms must be in the full amount specified above.

For example, if separate mechanisms are used to cover third-party liability claims arising from sudden and from nonsudden accidental releases, coverage under each mechanism must be at the \$500,000 per occurrence or \$1 million per-occurrence level as described above. Similarly, each mechanism must assure the appropriate aggregate amount of coverage. Having separate mechanisms for sudden and for nonsudden accidental releases would not provide more than the required level of coverage, because sudden and nonsudden accidental releases are mutually exclusive, and therefore each release would trigger only one type of coverage.

If one mechanism (e.g., a state fund) provides coverage only for corrective action, another mechanism must provide coverage for third-party compensation. Each mechanism must have the minimum per-occurrence coverage and the appropriate aggregate coverage (based on number of tanks) for each scope of coverage. **EPA took this approach because it is difficult to predict before an UST leak is detected what portion of coverage will be needed to satisfy corrective action costs and what portion of coverage will be needed to satisfy third-party compensation claims.** The classification of costs as corrective action costs or third-party liability costs sometimes depends on the circumstances. For example, if a corrective action order specifies that alternative water supplies be provided to residents of a community—it is a corrective action cost. If, however, alternative water supplies must be provided as a result of a suit brought by third parties, it could be a third-party compensation cost. Therefore, owners and operators are required to carry the minimum per-occurrence and aggregate coverage for each separate scope of coverage.

Different Amounts of Coverage. An owner or operator can use a combination of mechanisms to demonstrate financial responsibility for the total required amount of coverage:

- If an owner with 200 tanks has insurance with a \$1 million aggregate, aggregates of additional mechanisms for these tanks must equal at least \$1 million, for a total of \$2 million in aggregate coverage.
- An owner or operator with 40 tanks can obtain insurance coverage (or use a financial test of self-insurance) for the first \$100,000 of corrective action and third-party compensation costs and use an approved state fund to cover corrective action and third-party compensation costs in excess of \$100,000 up to \$1 million.
- Or, an owner or operator with 40 tanks can obtain insurance coverage (or use a financial test of self-insurance) for the first \$100,000 of corrective action and \$300,000 of third-party compensation and use an approved state fund to cover corrective action costs above \$100,000 and third-party compensation costs above \$300,000, up to \$1 million.

### **C.3 Covering Multiple Facilities**

Under the federal rules, a single mechanism can cover any number of facilities. However, states may require separate mechanisms for in-state versus out-of-state facilities. Each mechanism requires a listing of the covered USTs including the number of tanks at each facility and the name(s) and address(es) of the facility(ies) where the tanks are located. If more than one instrument is used to assure different tanks at any one facility, the mechanism must list each covered tank by its identification number, and the name and address of the facility.

## **D. WHAT ARE THE OWNER'S OR OPERATOR'S RESPONSIBILITIES?**

Owner or operator responsibilities differ depending on the particular mechanism(s) being used for FR. This section describes those responsibilities that are common to all or most mechanisms.

### **D.1 Using One or More Acceptable Mechanisms That Are Worded as Specified in the Regulations**

An eligible UST owner or operator may use one or more of the following mechanisms to satisfy the FR requirements:

- Financial test of self-insurance
- Corporate guarantee
- Insurance or risk retention group coverage
- Surety bond
- Letter of credit
- Trust fund
- A state required mechanism, or
- A state assurance fund

An UST owner or operator that is a local government entity also may use the following mechanisms:

- Bond rating test
- Local or state government guarantee
- Financial worksheet test, or
- Local government fund

A standby trust fund must be provided when using the corporate guarantee, surety bond, letter of credit, and some government guarantees.

**NOTE:** The use of a standby trust is necessary because without such a mechanism, any funds drawn under those mechanisms that are payable to the EPA Regional Administrator would have to be paid into the U.S. Treasury and could not be used without Congressional action (see 31 U.S.C. 3302) to pay for the UST corrective action or third-party compensation for which the funds were intended. Due to similar state laws, funds payable to the state Director may have to be paid into the state treasury, unless a standby trust is used.

Mechanisms must follow the wording specified in the regulations. They should neither omit nor add any language. **Those who sign the mechanisms certify that the wording matches the requirements.**

Mechanisms must identify the USTs covered by listing the name(s) and address(es) of the facility(ies) where covered tanks are located and the number of tanks at each facility. If more than one mechanism is used to assure different tanks at any one facility, the owner or operator must list the tanks covered under each mechanism by the tank identification number.

## **D.2 Demonstrating Scope and Amount of Required Financial Responsibility**

Owners or operators must demonstrate FR for the full scope and amount of coverage as described in Section B above.

## **D.3 Updating Coverage**

An owner or operator needs to update coverage if:

- The required amount of coverage increases, or
- The mechanism requires annual updates, or
- Money is drawn from a third-party mechanism and must be replenished

Required Amount of Coverage Increases. An owner or operator must update the required amount of aggregate assurance whenever the number of USTs increases above 100. If this occurs, the owner or operator must demonstrate FR in the amount of \$2 million of annual aggregate assurance by the anniversary of the date on which the mechanism became effective. If assurance is being demonstrated by a combination of mechanisms, the owner or operator must demonstrate FR in the amount of \$2 million of annual aggregate assurance by the first occurring anniversary of any one of the mechanisms being used to provide assurance (See 40 CFR 280.93(f)).

Similarly, the required per occurrence coverage may rise due to an increase in throughput for those who are not petroleum marketers.

Mechanisms That Require Updates. Certain mechanisms such as financial tests or guarantees that depend on numbers that change from year to year, require annual updates.

Replenishment. If the amount assured falls below the full amount of assurance required, the owner or operator must, by the anniversary date of the financial mechanism from which funds were drawn, do the following:

- Replenish the value of financial assurance to equal the full amount of assurance required, or
- Acquire another financial assurance mechanism to make up the shortfall.

If a combination of mechanisms was used to provide the assurance which was drawn down, replenishment must occur by the earliest anniversary date among the mechanisms. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## **D.4 Maintaining Coverage**

An owner or operator must maintain coverage by securing an alternate mechanism if:

- The owner or operator can no longer self-insure
- The provider of assurance ceases to be eligible, no longer qualifies, loses the legal capacity to provide assurance, or is named a debtor in a voluntary or involuntary proceeding under the bankruptcy code, or

- The provider decides to cancel or non-renew the mechanism

Depending on the triggering event and the type of mechanism, an owner or operator has a specific number of days to secure alternate assurance.

An owner or operator may substitute or replace a mechanism provided that at all times he or she maintains an effective financial assurance mechanism or combination of mechanisms that satisfies the UST FR requirements (see 40 CFR 280.108).

#### **D.5 Certifying Compliance**

40 CFR 280.111(b)(11) requires an owner or operator to maintain an updated copy of a properly worded certification of FR. The certification of compliance must identify the financial assurance mechanism(s) used to demonstrate FR. For each mechanism, the owner or operator must list the type of mechanism, name of issuer, mechanism number (if applicable), amount of coverage, effective period of coverage, and whether the mechanism covers "taking corrective action" and/or "compensating third parties for bodily injury and property damage caused by" either "sudden accidental releases" or "nonsudden accidental releases" or "accidental releases." The owner or operator must update this certification whenever the financial assurance mechanism(s) used to demonstrate financial responsibility change(s).

40 CFR 280.110(b) requires an owner or operator to certify FR compliance as specified in the new tank notification form when notifying the implementing agency of the installation of a new underground storage tank.

#### **D.6 Recordkeeping**

An owner or operator must maintain evidence of all financial assurance mechanisms used to demonstrate UST FR until released from the requirements of the regulations (see 40 CFR 280.111). An owner or operator must maintain that evidence at the underground storage tank site or the place of work. Records maintained off-site must be made available upon request of the implementing agency. The regulations specify which types of evidence must be maintained for each mechanism and are described in the following chapters. An owner or operator must maintain evidence of financial responsibility for an UST only until its date of closure or until corrective action is completed if a release is found at the time of closure.

#### **D.7 Notifying Implementing Agency of Failure to Secure Alternate Assurance or Being Named a Debtor in Bankruptcy Proceeding**

The federal rules were designed to minimize the reporting burden on the owner or operator. Only the following must be reported:

- Failure to obtain alternate coverage when required, and
- Being named as debtor under the U.S. Bankruptcy Code.

The regulations specify when and how an owner and operator must make such notifications. Notification of failure to obtain alternate assurance must be made within 60 days after the owner or operator receives a notice that the provider intends to cancel or fail to renew an assurance mechanism (see 40 CFR 280.109(b)). The owner or operator must notify the Director within 30 days of failing to obtain alternate assurance after the owner or operator receives a notice that the provider has been named as a debtor in bankruptcy, is incapable of providing financial assurance, or has lost its authority to issue a financial assurance mechanism (see 40

CFR 280.114(e)). The owner or operator must notify the Director of the implementing agency by certified mail within 10 days after the commencement of bankruptcy proceedings (see 40 CFR 280.114(a)).

#### **D.8 Submitting Financial Responsibility Documents**

Because **the federal rules** were designed to minimize the burden of submitting FR documents to the implementing agency, an owner or operator must submit FR documents to the Director of the implementing agency **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release from an underground storage tank required to be reported under §280.53 or §280.61
- If the owner or operator fails to obtain alternate coverage when required
- At any time, as required by the Director of the implementing agency

Some states may require routine submission of financial responsibility documentation to the implementing agency. Owners and operators should check with the appropriate state agency.

#### **D.9 Responding to Requests for Information from Implementing Agencies**

Owners or operators must respond when the Director of the implementing agency requires submittal of evidence of financial assurance as described in §280.111(b) or other information relevant to compliance. (See 40 CFR 280.110(c))

## **E. OVERVIEW OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT**

The term "Director of the Implementing Agency" refers to the person responsible for implementing the UST program under Subtitle I of RCRA. For USTs in authorized states or in states with formal agreements with EPA, this person is the Director of the state agency; for all other USTs, this person is the EPA Regional Administrator.

### **E.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as A Debtor in Bankruptcy**

When the Director receives a notice that the owner or operator has failed to secure alternate assurance or has been named a debtor in bankruptcy, the necessary activities vary depending on the financial assurance mechanism used and the circumstances that triggered the notification, as discussed in the following chapters. In addition, the Director may want to monitor the owner or operator's efforts to secure alternate assurance. This could include alerting the owner about the need for alternate assurance if the operator has been providing financial assurance, and vice versa. Most owners or operators should be able to secure alternate assurance, even if its price is more than they may wish to pay.

### **E.2 Reviewing Financial Responsibility Submissions**

Implementing agencies may review FR submissions (1) as part of an inspection or compliance assurance program and/or (2) when owners or operators submit them. In the first instance, the implementing agency's staff can ensure that the financial assurance providers and mechanisms meet all the requirements by checking eligibility, qualifications, and the required wording of the mechanisms. Information on how to do these checks is provided in the following chapters. In the second instance, depending on the situation, review of financial documents may or may not be useful, as described in the text of the following chapters.

### **E.3 Drawing on Mechanisms**

One of the most important FR responsibilities of implementing agencies is to decide whether or when to draw on FR mechanisms. This is frequently a two-step process. The first step relates to directing payments from FR providers into standby trust funds, which are established to receive money that the implementing agency cannot legally receive or does not want to hold. The second step involves directing money out of the standby trust funds to pay for corrective action and/or third-party compensation. 40 CFR 280.112 addresses both of these steps, which are described in Chapters 4 through 15 as applicable.

The requirements for directing payment into the standby trust fund vary by mechanism, but at a minimum should occur (1) when cancellation of the financial assurance mechanism coincides with the suspicion or certainty of a release from an UST or (2) when the owner or operator fails to carry out or pay for corrective action or fails to pay valid third-party claims. According to 40 CFR 280.112, the Director will require funding of (and draw) on the standby trust in three situations:



Situation	Draw on the Mechanism	Draw on the Standby Trust Fund
(1) If the owner or operator fails to establish alternative financial assurance within 60 days of receiving notice of cancellation of its financial assurance mechanism, <u>and</u>  (i) the Director of the implementing agency determines or suspects <sup>1</sup> that a release has occurred  <u>OR</u>  (ii) the owner or operator has notified the Director of a release pursuant to Subparts E or F;	✓	
(2) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, <u>and</u>  the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F;	✓	✓
(3) The Director has received either:  (i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid  <u>OR</u>  (ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.	✓	✓

<sup>1</sup> The Director's suspicion that a release has occurred must be based on objective evidence, such as failure of a tank tightness test, discovery of free product in adjacent sewer and utility lines, notice by the owner or operator, or other clear but unverified evidence. Evidence of a suspected release under §280.50 includes positive monitoring results from testing, monitoring and sampling, unusual operating conditions, or the discovery of petroleum in the environment.

**Priority of Payments.** The UST FR mechanisms and procedures for distributing funds do not require the implementing Agency or the provider of the mechanism to decide on the validity and priority of claims. If the Director of the implementing agency determines that the amount of corrective action costs and third-party liability claims eligible for payment may exceed the amount of available financial assurance, the first priority for payment should be corrective action costs necessary to protect human health and the environment. The Director should pay third-party liability claims in the order in which the Director receives certifications and valid court orders.

### **E.5 Responding to Requests for Release of Funds**

The Director may receive requests for the release of funds either in trust funds or standby trusts. For example, these funds can be released once alternate assurance is secured. See further discussion in Chapters 10 and 11.

## **E.6 Checking the Eligibility and Qualifications of the Provider of Assurance**

The following chapters describe eligibility requirements and qualifications and how you can check whether FR providers are eligible and qualified.

## **E.7 Verifying the Wording of Required Documents**

The required wording of FR documents appears in the regulations. If the wording of the financial assurance mechanism is not identical to the required wording there may be problems. You should document and evaluate any differences in terms of their impact on the effectiveness of the mechanism.

## **E.8 Verifying That the Proper Scope and Amount of Coverage Are Provided**

The Director must verify that the full scope and required amount of coverage has been provided by the owner or operator of the underground storage tanks. See B.1 and 2 above. This is straightforward unless a combination of mechanisms is being used.

## **E.9 Requesting Evidence of Financial Responsibility or Reports of Financial Condition**

The Director may request mechanisms or reports documenting current evidence of financial responsibility as provided in 40 CFR 280.110 at any time.

## **E.10 Custodial Care of Financial Assurance Mechanisms**

The federal FR mechanisms do not require extraordinary custodial care. However, the implementing agency should safeguard the following FR mechanisms by keeping them in a centralized, secure, fireproof, and waterproof location with access only by authorized individuals:

- If a state allows the **deposit of securities** or evidence of assets such as a **certificate of deposit**: Some bonds may be issued in "bearer" form. That is, they are payable to the holder rather than to an owner registered on the books of the issuer's agent. Such bonds are negotiable with no record of ownership. Other securities may be capable of being negotiable with forged endorsements. Similarly, a bank is obligated to pay the holder of a negotiable certificate of deposit upon presentation of the certificate at the bank. **Therefore, all securities and certificates of deposit should be given extraordinary custodial care to avoid problems of unauthorized access and attempts to cash them.**

Other instruments such as UST FR guarantees, insurance, surety bonds, letters of credit, and trusts pose much less risk, because they are not negotiable. Although they contain details that must be known to the person seeking to draw upon them, it is difficult for these details to be used for fraudulent purposes by persons not entitled to draw on the instruments. Drawing on them will require the involvement of the implementing agency.

## **F. WHAT ARE THE FINANCIAL ASSURANCE PROVIDERS' RESPONSIBILITIES?**

*A provider of financial assurance* means an entity such as a corporate or government guarantor, insurer, risk retention group, surety, issuer of a letter of credit, issuer of a state-required mechanism, or a state that provides financial assurance to an owner or operator of an underground storage tank. The responsibilities of FR providers arise from the mechanisms themselves or are explicit or implicit in the UST FR regulations.

### **F.1 Be Eligible and Qualified to Provide Financial Responsibility**

In order to provide a mechanism that will satisfy UST FR regulations, financial assurance providers selected by owners or operators must satisfy the eligibility requirements and qualifications of the FR mechanisms they provide, as described in the following chapters.

### **F.2 Notify Owner or Operator of Decision to Cancel or Non-Renew, If No longer Eligible or Qualified to Provide Assurance, or If Named as a Debtor in Bankruptcy Proceedings**

There are three circumstances when the FR provider should notify the owner or operator:

- A provider of financial assurance that decides to cancel or fail to renew an assurance mechanism must send a prior notice of termination by certified mail to the owner or operator.
- A provider of financial assurance should give notice to owners or operators when it is no longer eligible or qualified or it loses the capacity or authority to issue an FR mechanism.
- If named as a debtor in a bankruptcy proceeding.

### **F.3 Make Payments or Perform as Directed**

Because these requirements vary by mechanism, they are described in the following chapters.

### **F.4 Provide Financial Statements and Other Relevant Information**

Financial institutions or guarantors should be prepared to provide financial statements and other relevant information as requested or required to document or update financial assurance.

[THIS PAGE INTENTIONALLY LEFT BLANK]

### 3. FINANCIAL RESPONSIBILITY USING THE FINANCIAL TEST OF SELF-INSURANCE

This chapter describes the use of self-insurance to demonstrate UST FR as follows:

A. BACKGROUND	26
A.1 What Is the UST Financial Test of Self-insurance?	26
A.2 How Does the UST Financial Test Work?	26
A.3 Why Does the UST Financial Test Consider Hazardous Waste Obligations?	26
A.4 What Is the Alternative I Test?	27
A.5 What Is the Alternative II Test?	30
A.6 Why Is There a Difference Between the Ten and Six Times Multiples in Alternatives I and II?	33
A.7 What Are Auditors' Opinions?	33
A.8 When Is it Appropriate to Make Adjustments to the Numbers in the Financial Statements?	36
A.9 Why Can't Most Local Government Entities Use This Mechanism?	36
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING THE FINANCIAL TEST OF SELF-INSURANCE	38
B.1 Determining Eligibility to Use the Financial Test of Self Insurance	38
B.2 Satisfying the Criteria of the Financial Test for the Proper Scope and Amount of Coverage	38
B.3 Preparing a Properly Worded Letter from the Chief Financial Officer	39
B.4 Recordkeeping	39
B.5 Updating Assurance	40
B.6 Obtaining Alternate Assurance If Owner or Operator No Longer Can Pass the Financial Test	40
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings	41
B.8 Responding to Requests for Reports of Financial Condition	41
B.9 Submitting Financial Responsibility Documents	41
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	42
C.1 Responding to Notices That the Owner or Operator Cannot Satisfy the Financial Test and Has Failed to Obtain Alternate Assurance or That Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings	42
C.2 Reviewing Financial Responsibility Submissions	43
C.3 Checking Whether the Owner or Operator Is Eligible to Use the Financial Test	43
C.4 Verifying That the Owner or Operator Satisfies the Financial Test for the Proper Scope and Amount of Coverage	44
C.5 Checking the Qualifications of Accountants	47
C.6 Verifying the Wording of the CFO Letter	47
C.7 Requesting Reports of Financial Condition	48
C.8 Notifying Owners and Operators That They No Longer Meet the Financial Test Requirements	48
D. SOURCES OF FURTHER INFORMATION	49

## A. BACKGROUND

### A.1 What Is the UST Financial Test of Self-insurance?

An owner or operator may satisfy the UST FR requirements by passing a **financial test of self-insurance**. Self-insurance is a common option in many government-mandated financial responsibility programs, both environmental and non-environmental (e.g., FR for workers compensation). Self-insurance often will be the least expensive method of demonstrating FR. Large, financially viable firms can provide evidence of financial responsibility without having to pay the costs of procuring financial mechanisms from other parties. Typically, firms that use a self-insurance option demonstrate financial strength by passing a set of pass/fail criteria, termed a financial test. Although large firms may find passing a financial test easier than smaller firms do, some large firms may not be able to pass the test because it measures more than just size alone. To pass the UST FR financial test, an owner or operator must meet one of two alternative tests based on year-end financial statements for the latest completed fiscal year.

### A.2 How Does the UST Financial Test Work?

This option is termed self-insurance because it involves no source of funding other than the owner or operator itself. Those who pass the test are expected to be able to pay for their corrective action and third-party compensation obligations. How these firms arrange to pay their obligations is solely their decision. **Passing the test does not limit the owner or operator's liability for corrective action and third-party compensation.** The test is designed so that those who pass are very unlikely to experience financial distress that prevents their performance of corrective action and third-party compensation. Because the owner or operator's annual financial statements form the basis of the assurance provided, the test must be passed anew with each year's financial statements.

Within 120 days after the close of each fiscal year, the chief financial officer (CFO) of the owner or operator must sign a letter reporting the year-end financial information supporting the firm's use of the financial test. An owner or operator who no longer passes the financial test must obtain an alternate mechanism within 150 days of the end of the fiscal year. The Director of the implementing agency may disqualify use of the financial test upon a finding, based on reports of financial condition, that the owner or operator no longer meets the financial test requirements. The owner or operator has 30 days after notification of such a finding to obtain another financial assurance mechanism.

### A.3 Why Does the UST Financial Test Consider Hazardous Waste Obligations?

The UST financial test of self-insurance must include any hazardous waste FR amounts covered by the owner or operator's RCRA Subtitle C or SDWA<sup>1</sup> financial test or guarantee. Including these RCRA Subtitle C and SDWA hazardous waste costs is necessary to ensure that an UST owner or operator can meet all of its environmental obligations without jeopardizing the financial health of the firm. The financial tests used for hazardous waste facility closure and post-closure care (40 CFR 264.143 and 264.145), liability coverage (40 CFR 264.147), corrective action (40 CFR 264.101),<sup>2</sup> and plugging and abandonment (40 CFR 144.63) all rely on a multiple of a firm's net worth relative to the costs being assured. If these costs are not included in the UST financial test, owners or operators would, in effect, be "double pledging" their financial resources, thereby reducing the likelihood that UST obligations could be met.

---

<sup>1</sup> Underground injection of hazardous wastes is regulated under the federal Safe Drinking Water Act (SDWA).

<sup>2</sup> The financial test for hazardous waste corrective action FR was proposed in the *Federal Register* of October 24, 1986 (pp. 37854-37880), but was never promulgated as a final rule.

If the owner or operator has recognized hazardous waste closure, post-closure, corrective action, or plugging and abandonment costs as liabilities on its financial statements, some adjustments may be made to the financial data used in the tests. See A.8 below.

#### A.4 What Is the Alternative I Test?

Exhibit 3-1 shows the criteria for the Alternative I test and their rationales. This test relies heavily on the owner or operator's tangible net worth and is sometimes called the "net worth test." The owner or operator must have:

- (1) Tangible net worth equal to at least 10 times
  - the amount of UST aggregate assurance required (either \$1 million or \$2 million, depending on number of tanks), plus
  - the estimated costs of closure, post-closure care, liability coverage, and/or corrective action at Subtitle C hazardous waste facilities for which the owner or operator also is using a financial test or providing a guarantee to meet RCRA Subtitle C financial responsibility requirements, plus
  - the estimated costs of plugging and abandonment at all SDWA Class I hazardous waste injection wells, for which the owner or operator is using a financial test or providing a guarantee to meet SDWA FR requirements.
- (2) Tangible net worth of at least \$10 million.
- (3) The owner or operator must either:
  - file annual financial statements with the Securities and Exchange Commission (SEC), Energy Information Administration (EIA), or the Rural Utilities Service<sup>3</sup> (RUS), or
  - annually report the firm's tangible net worth to Dun & Bradstreet (D&B), which must have assigned the firm a financial strength rating of 4A or 5A.
- (4) The firm's year-end financial statements, if independently audited, can not include an adverse auditor's opinion, a disclaimer of opinion, or a "going concern" qualification.

Tangible Net Worth. The Alternative I test principally is based on a net worth measure. **Net worth** is defined as **total assets** minus **total liabilities** as reported on a firm's **balance sheet**. Net worth is the same thing as stockholder's or owner's equity. This relationship can be expressed in the following equation:

---

<sup>3</sup> The Rural Utilities Service is the successor organization to the Rural Electrification Administration (REA) which is referenced in the EPA UST FR regulations. The REA was abolished after the promulgation of the EPA FR regulations.

**Exhibit 3-1**  
**ALTERNATIVE I OF UST FR FINANCIAL TEST**

<b>REQUIREMENT</b>	<b>RATIONALE</b>
<p>(1) Tangible net worth of at least ten times the sum of the following:</p> <ul style="list-style-type: none"> <li>(i) aggregate UST coverage amount based on number of USTs, <b>AND</b></li> <li>(ii) total RCRA Subtitle C hazardous waste financial assurance covered by an owner or operator's financial test or guarantee, <b>AND</b></li> <li>(iii) total SDWA hazardous waste injection well cost estimate for plugging and abandonment covered by an owner or operator's financial test or guarantee</li> </ul>	<p>Firms with UST liabilities equal to 10 percent or less of their net worth have an associated probability of bankruptcy of approximately one percent.</p> <p>Requiring that other environmental obligations assured by an owner or operator's financial test or guarantee are aggregated with the required UST assurance when determining the required amount of net worth prevents financial test users from diluting the degree of assurance provided by the test.</p>
<p>(2) Tangible net worth of at least \$10 million</p>	<p>The incidence of bankruptcy among firms with less than \$10 million in tangible net worth is approximately two times as great as the bankruptcy rate among firms with more than \$10 million in tangible net worth.</p>
<p>(3) (i) File financial statements annually with SEC, EIA, or RUS</p> <p style="text-align: center;"><b>OR</b></p> <p>(ii) Report annually to Dun &amp; Bradstreet and receive a financial strength rating of 4A or 5A</p>	<p>The required information is publicly available and therefore easily verified by EPA or state regulators. Privately-held UST owners and operators who do not submit financial statements to the SEC, EIA, or RUS may use a D&amp;B rating as an alternative.</p> <p>D&amp;B ratings or SEC reports can be used to verify that a firm has at least \$10 million in net worth.</p>
<p>(4) If independently audited, financial statements do not include an adverse opinion, a disclaimer of opinion, or a "going concern" opinion</p>	<p>Because these opinions indicate that the reported net worth of a firm may be greater than its actual net worth, a firm receiving a disclaimer of opinion or an adverse opinion may not have sufficient resources to meet its UST obligations. Because a "going concern" qualification indicates that there is a question about the ability of a firm to stay in business, such firms are not allowed to rely on their own resources to cover their UST obligations.</p>



$$\text{Net Worth} = \text{Total Assets} - \text{Total Liabilities}$$

The equation represents the fundamental characteristic of every balance sheet: the total figure for assets always equals the total figure for liabilities and stockholder's equity (net worth).

**Tangible net worth** is **net worth** (i.e., total assets minus total liabilities) minus **intangible assets** such as goodwill and rights to patents or royalties. The formula for tangible net worth is:

$$\text{Tangible Net Worth} = (\text{Total Assets} - \text{Intangible Assets}) - \text{Total Liabilities}$$

The financial test uses tangible net worth rather than net worth in order to focus on assets that are more readily converted into cash than are such intangible assets as goodwill. Unfortunately, although financial statements typically identify some tangible assets as property, plant, and equipment, they may not identify intangible assets as such. Sometimes intangible assets are identified in the "footnotes" to the financial statements.

The net worth criteria were designed to ensure that virtually all firms able to pass the test also will be able to meet their UST obligations. The requirement that firms demonstrate a level of net worth 10 times the size of their potential UST obligations was based on an EPA analysis of failure rates among firms classified on the basis of their ratios of UST liabilities to net worth. To achieve a level of assurance such that no more than one percent of financial test users would go bankrupt as a result of their UST obligations, EPA requires that financial test users maintain their net worth at a level at least 10 times their environmental obligations.

Lowering the net worth multiple would mean that more than one percent of financial test users would be predicted to fail without funding their UST obligations -- a risk that EPA did not believe should be accepted from financial test users, particularly since owners or operators who use other financial assurance mechanisms allowable under Subtitle I pose relatively little risk of leaving UST obligations unfunded.

Inclusion of Hazardous Waste Costs. If the owner or operator is using a financial test of self-insurance or providing a guarantee to assure the costs of hazardous waste facility closure, post-closure care, corrective action, liability coverage, and/or plugging and abandonment costs at a Class I hazardous waste injection well, then the "ten times" multiple requirement of Alternative I must be applied to the sum of these costs plus the UST-required annual aggregate.

Auditors' Opinions. If firms have independently audited financial statements, they cannot pass Alternative I if the statements include an adverse auditor's opinion, a disclaimer of opinion, or a "going concern" qualification (see A.7 below).

Dun & Bradstreet Financial Strength Ratings. Firms that do not annually file financial statements with the SEC, EIA, or RUS can use Dun & Bradstreet financial strength ratings in the Subtitle I financial test. D&B issues ratings for firms in all SIC codes except the financial codes, which include banking and insurance. The firm must provide information to Dun & Bradstreet about its net worth or information that can be used to determine net worth. In turn, Dun & Bradstreet must publish a rating for the firm. There are many large firms that are privately held that have a sufficiently high tangible net worth to be able to qualify as self-insurers. A financial strength rating of 4A from Dun & Bradstreet indicates that, in Dun & Bradstreet's professional judgment, the firm is believed to have a tangible net worth of \$10,000,000 to \$49,999,999. A 5A rating indicates a net worth of \$50,000,000 or more. Dun & Bradstreet does not assign financial strength ratings to firms believed to have submitted questionable data or to be experiencing serious financial difficulties.

Although Dun & Bradstreet ratings and independent auditors' opinions are not necessarily comparable, EPA believes that a Dun & Bradstreet rating of 4A or 5A should provide at least as great a margin of safety as that ensured by prohibiting independently audited firms from using the financial test if they have received an adverse opinion, or a disclaimer of opinion, or a going concern qualification from an independent auditor.

#### **A.5 What Is the Alternative II Test?**

Exhibit 3-2 shows the criteria of the Alternative II test and their rationales. The owner or operator must have:

- (1) Tangible net worth of \$10 million and six times
  - the amount of UST aggregate assurance required (either \$1 million or \$2 million, depending on number of tanks), plus
  - the estimated costs of closure, post-closure care, liability coverage, and/or corrective action at Subtitle C hazardous waste facilities for which the owner or operator also is using a financial test or providing a guarantee to meet RCRA Subtitle C financial responsibility requirements, plus
  - the estimated costs of plugging and abandonment at all SDWA Class I hazardous waste injection wells for which the owner or operator is using a financial test or providing a guarantee to meet SDWA FR requirements.
- (2) At least 90 percent of assets in the United States, or U.S. assets at least six times the required amount of UST coverage plus hazardous waste costs (as above); and
- (3) Either:
  - Net working capital at least six times the required amount of UST coverage plus hazardous waste costs (as above); or
  - A current Standard and Poor's bond rating of AAA, AA, A, or BBB, or a current Moody's bond rating of Aaa, Aa, A, or Baa for the most recent bond issuance.
- (4) The firm's year-end financial statements **must be** independently audited, and can not include an adverse auditor's opinion, a disclaimer of opinion, or a "going concern" qualification.
- (5) If the financial statements are not submitted annually to the SEC, EIA, or RUS, an owner or operator using Alternative II must obtain a **special report** from an independent certified public accountant which contains the accountant's certification that there are no material differences between the financial data in the letter from the chief financial officer and the independently audited year-end financial statements and footnotes for the latest complete fiscal year.

**Exhibit 3-2**  
**ALTERNATIVE II OF UST FR FINANCIAL TEST**

<b>REQUIREMENT</b>	<b>RATIONALE</b>
<p>(1) Tangible net worth of at least six times the sum of the following:</p> <ul style="list-style-type: none"> <li>(i) aggregate UST coverage amount based on number of USTs, <b>AND</b></li> <li>(ii) total RCRA Subtitle C hazardous waste financial assurance covered by an owner or operator's financial test or guarantee, <b>AND</b></li> <li>(iii) total SDWA hazardous waste injection well cost estimate for plugging and abandonment covered by an owner or operator's financial test or guarantee</li> </ul>	<p>Requiring that other environmental obligations assured by an owner or operator's financial test or guarantee are aggregated with the required UST assurance when determining the required amount of net worth, prevents self-insurers from diluting the degree of assurance provided by the test.</p>
<p>(2) Tangible net worth of at least \$10 million</p>	<p>The incidence of bankruptcy among firms with less than \$10 million in tangible net worth is approximately two times as great as the bankruptcy rate among firms with more than \$10 million in tangible net worth.</p>
<p>(3) U.S. assets at least 90 percent of total assets, <b>or</b> U.S. assets at least six times the required amount of UST coverage plus hazardous waste costs.</p>	<p>This requirement is intended to ensure the accessibility of assets, should the firm require them to meet its UST costs.</p>
<p>(4) Net working capital at least six times the required amount of UST coverage plus hazardous waste costs</p> <p style="text-align: center;"><b>OR</b></p> <p>A current bond rating for the most recent bond issue of AAA, AA, A, or BBB as issued by Standard and Poor's, or Aaa, Aa, A, or Baa as issued by Moody's.</p>	<p>The net working capital requirement is designed to measure the adequacy of a firm's liquid resources, given the potential level of its environmental obligations.</p> <p>Because the level of net working capital can vary significantly by industry, firms can meet the bond rating requirement as an alternative to the net working capital requirement.</p>
<p>(5) Financial statements must be independently audited and may not include an adverse opinion, a disclaimer of opinion, or a "going concern" opinion</p>	<p>Because these opinions indicate that the reported net worth of a firm may be greater than its actual net worth, a firm receiving a disclaimer of opinion or an adverse opinion may not have sufficient resources to meet its UST obligations. Because a "going concern" qualification indicates that there is a question about the ability of a firm to stay in business, such firms should not be allowed to rely on their own resources to cover their UST FR obligations.</p>

EPA adopted the Alternative II financial test in addition to Alternative I so that more owners or operators could self-insure without jeopardizing the degree of assurance provided. The Alternative II criteria are identical to RCRA Subtitle C test for hazardous waste liability coverage as specified in §264.147(f)(1), but differ from the more demanding RCRA Subtitle C test for coverage of closure, post-closure care, and corrective action. EPA decided to base the UST Alternative II financial test on the criteria of the Subtitle C test for liability coverage because the latter was specifically designed for assurance of possible, rather than certain, costs. For this reason, the liability criteria are somewhat less stringent than the RCRA Subtitle C hazardous waste closure and post-closure test which covers costs that are certain to be incurred.

In addition to tangible net worth criteria, the Alternative II test includes criteria based on assets and net working capital.

**U.S. assets** are not provided in a company's financial statements. Rather, total assets reported in a company's balance sheet are usually divided into current assets, fixed assets, and other assets (e.g., investments). U.S. assets may be identified in accompanying notes to the financial statements under "Segment Information." However, companies may not use geography as a basis for reporting segment information.

**Net working capital** is the excess of current assets over current liabilities. **Current assets** is a balance sheet entry that identifies cash and resources expected to be sold or consumed during the normal operating cycle of a business; these represent relatively liquid assets. **Current liabilities** is a balance sheet entry that identifies obligations that are expected to be satisfied by using current assets. Net working capital identifies a firm's relatively liquid portion of total capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business. Unused borrowing capacity is not part of the standard definition of working capital. Net working capital can be expressed as a dollar amount as follows:

Computation:	Total current liabilities	-	Total current capital	=	Net working assets
Example:	\$2,000,000		\$350,000	=	\$1,650,000

**Moody's or Standard & Poor's bond ratings** in the Alternative II test allow firms to use the test that are financially strong, but do not routinely maintain high levels of working capital because of the nature of their business. The bond ratings are not, however, intended to provide evidence of the level of a firm's net worth. In the Alternative II test, this purpose is instead accomplished by the requirement that a firm either report to the SEC, the EIA, or the RUS, in which case its net worth can be verified in the reports publicly available from these agencies, or submit a special auditor's report, corroborating the firm's declaration that it has at least \$10 million in tangible net worth.

Auditors' Opinions. Firms using Alternative II must have independently audited financial statements and cannot have an auditor's adverse opinion, disclaimer of opinion, or going concern qualification (see A.7 below).

Auditors' Special Reports. Firms that do not file their financial statements with the SEC, the EIA, or the RUS, must obtain a special report from an independent certified public accountant (CPA). There is no EPA required wording for this report, but the **special report** must state that the independent CPA has compared the data in the CFO letter with the amounts in the financial statements and that no matters came to the attention of the independent certified public accountant which caused him or her to believe that the information in the chief financial officer's letter should be adjusted.

**Inclusion of Hazardous Waste Costs.** If the owner or operator is using a financial test of self-insurance or providing a guarantee to assure the costs of hazardous waste facility closure, post-closure care, corrective action, liability coverage, and/or plugging and abandonment costs at a Class I hazardous waste injection well, then the "six times" multiple requirement of Alternative II must be applied to the sum of these costs plus the UST-required annual aggregate.

#### **A.6 Why Is There a Difference Between the Ten and Six Times Multiples in Alternatives I and II?**

The two tests provide equivalent assurances of financial strength. For the purposes of the Alternative I financial test, the requirement that net worth coverage be fully 10 times all costs being assured by a financial test (and/or guarantee) is necessary to maintain the level of protection that EPA set as the standard for the Subtitle I test. The Alternative II financial test, by contrast, requires that net worth coverage be at least six times all environmental costs being assured by a financial test. This lower net worth coverage is acceptable in the Alternative II test because the test requires firms to meet other financial strength criteria (i.e., asset test, net working capital test) that are not included in the Alternative I test.

#### **A.7 What Are Auditors' Opinions?**

Audited financial statements are always accompanied by an auditor's report, which is frequently referred to as an "opinion." An auditor is an independent certified public accountant who has a duty to be independent and serve stockholders and other users of the financial statements. The auditor's opinion addresses whether a set of financial statements conform with **generally accepted accounting principles (GAAP)**. In auditing a company's financial statements, accountants follow **generally accepted auditing standards (GAAS)** in forming an opinion about whether the financial statements conform to GAAP.

The auditor's opinion has a standardized three paragraph format based on the *Statement of Accounting Standards* (SAS) 58. The opinion often will have a title such as "Independent Auditor's Report." The opening paragraph is introductory in nature. It differentiates between the responsibilities of management and the auditor. The second paragraph describes the scope of the audit, which must be performed in accordance with generally accepted auditing standards. The third paragraph presents the opinion itself. A fourth paragraph may be added to indicate any changes to accounting principles that have a material effect on comparability with prior years. For UST FR, the fourth paragraph can be ignored. The opinion paragraph is key.

Most financial statements receive an **unqualified** (or "**clean**") opinion, which usually consists of three short paragraphs (such as those shown in Exhibit 3-3) expressing no doubts about the financial statements. Large companies generally (but not always) receive unqualified opinions. Since owners or operators must have a tangible net worth of at least \$10 million to qualify for the financial test, most of them will have clean opinions. By stating that the financial statements conform to GAAP, the auditor indicates satisfaction with the accounting principles management has chosen and the estimates employed.

**Exhibit 3-3**  
**STANDARD LANGUAGE FOR UNQUALIFIED AUDITOR OPINIONS**

"We have audited the accompanying consolidated balance sheets of ABC Company as of December 31, 1997 and 1998, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries at December 31, 1999 and 1998 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 in conformity with generally accepted accounting principles."

*Source: Statement of Auditing Standards (SAS) 58, Reports on Audited Financial Statements.*

**Qualified opinions** express some reservations by the accountant that the financial statements fairly or completely represent the financial condition and operating results of the firm. The major types of qualified auditors' opinions include the following:

- A Qualified Opinion based on a "**going concern**" issue is given when the accountant has doubts that the firm can continue in business. See Exhibit 3-4 for two examples of a Qualified Opinion based on a "going concern" issue.
- An **adverse opinion** is given when the accountant believes that the financial statements do not present fairly the financial condition of the firm. The auditor will clearly state this in the third paragraph of the opinion. See Exhibit 3-5 for an example of an adverse opinion.
- A **disclaimer of opinion** is given when the accountant cannot express an opinion on the financial statements of the firm. A report on examination will still be given, but the third paragraph will state that the auditor has not expressed an opinion on the financial statements. See Exhibit 3-6 for an example of a disclaimer of opinion.
- Qualified Opinions also are given when the accountant has identified uncertainties (e.g., litigation, asset valuation, payment of liabilities) that could have a material impact but do not threaten the firm's existence, and the auditor believes that the financial statements otherwise represent fairly the economic condition of the firm. These opinions do not disqualify the owner or operator from using the test.

**For an owner or operator to qualify for self-insurance, the independently audited financial statements can not carry an adverse opinion, a disclaimer of opinion, or a "going concern" qualification by an independent certified public accountant. These types of auditor's opinions disqualify a firm from using the financial test.**

**Exhibit 3-4**  
**TWO EXAMPLES OF A QUALIFIED OPINION**  
**BASED ON A "GOING CONCERN" ISSUE**

Example 1

"The financial statements referred to previously have been prepared using generally accepted accounting principles applicable to a going concern which contemplates the realization of assets and the liquidation of liabilities in the normal course of business. However, continuation of the Company as a going concern is dependent upon its obtaining additional financing and achieving profitable operations. At December 31, 1999, adverse operating results had reduced the Company's working capital below the amounts required under long-term debt agreements. As explained in Note X, the working capital requirements under the debt agreements have been waived until December 31, 2000. Should losses continue and the lenders exercise their rights under the debt agreements to accelerate the maturities of long-term debt, the order of maturity of the liabilities and the carrying values of assets would be significantly affected.

In our opinion, apart from the possible effects of such adjustments, if any, as might have been required had the outcome of the uncertainties relating the Company's continuance as a going concern been known, the financial statements referred to above present fairly the financial position of ABC Corporation, Inc. at December 31, 1999 and 1998."

Example 2

"The financial statements referred to above have been prepared on a going concern basis and do not reflect any downward adjustments (presently not determinable) to the carrying value of assets which could be required in the event of disposal other than in the ordinary course of business. Continuation of the business is dependent on (1) consummation of debt restructuring agreements as discussed in Note X, (2) maintaining adequate financing arrangements with all lenders, (3) achieving profitable operations. Should any of these circumstances interrupt the continuity of the business, the realization of assets and order of maturity of liabilities may be adversely affected.

In our opinion, due to the possible effects of such adjustments, if any, as might have been required had the outcome of the uncertainties relating to the Company's continuance as a going concern been known, the financial statements referred to above present fairly the financial position of ABC Corporation, Inc. at December 31, 1999 and 1998."

**Exhibit 3-5**  
**EXAMPLE OF AN ADVERSE OPINION**

"As discussed in Note X to the financial statements, the Company carries its property, plant and equipment accounts at appraisal values and provides depreciation on the basis of such values. Further, the Company does not provide for income taxes with respect to differences between financial income and taxable income arising because of the use, for income tax purposes, of the installment method of reporting gross profit from certain types of sales. Generally accepted accounting principles, in our opinion, require that property, plant and equipment be stated at an amount not in excess of cost, reduced by depreciation based on such amount and that deferred income taxes be provided ....

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of X Company as of December 31, 1999, or the results of its operations and changes in its financial position for the year then ended."

**Exhibit 3-6**  
**EXAMPLE OF A DISCLAIMER OF OPINION**

"The Company did not take a physical inventory of merchandise, stated, at \$..... in the accompanying financial statements as of December 31, 1999, and at \$..... as of December 31, 1998. Further, evidence supporting the cost of property and equipment acquired prior to December 31, 1999, is no longer available. The Company's records do not permit the application of adequate alternative procedures regarding the inventories or the cost of property and equipment.

Since the Company did not take physical inventories and we were unable to apply adequate alternative procedures regarding inventories and the cost of property and equipment, as noted in the preceding paragraph, the scope of our work as not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to above."

**A.8 When Is it Appropriate to Make Adjustments to the Numbers in the Financial Statements?**

The UST financial test was designed to avoid the need to perform a more in-depth financial analysis of a company. For the most part, it uses numbers drawn directly from the firm's financial statements, as prepared by its management.

However, one type of adjustment to financial statement numbers is permissible. Because generally accepted accounting principles (GAAP) require that firms accrue as liabilities those future costs that are reasonably certain, material, and measurable, firms with known future hazardous waste obligations (i.e., site closure, post-closure care, corrective action for known releases, and well plugging and abandonment) already may have counted these obligations as part of their recognized liabilities in their financial statements. The net worth (or difference between total assets and total liabilities) of such firms will reflect the amount of the accrued liability. However, because the purpose of the net worth criteria in the EPA financial tests is to measure the resources available to a firm before it incurs an environmental cost, EPA concluded that the appropriate procedure for measuring a firm's available resources is to compute net worth before adjusting for those liabilities that the test is being used to assure. Therefore, any assured hazardous waste costs<sup>4</sup> included in the financial test (see A.3 above) that also have been accrued as part of total liabilities in a firm's financial statements may be subtracted from total liabilities, which will increase tangible net worth correspondingly. This procedure applies to both the Alternative I and the Alternative II UST financial tests. (See Line 5 in CFO letter.)

**A.9 Why Can't Most Local Government Entities Use This Mechanism?**

Because local government entities differ in several important characteristics from corporations, the application of the financial test of self-insurance is impractical for most local government entities:

- "General purpose" local governments (counties, municipalities, and townships) typically use accounting systems that do not recognize assets in a manner similar to private companies. Municipal buildings and infrastructure (e.g., streets and utility lines) and their use usually are not

---

<sup>4</sup> Note that liability coverage for hazardous waste facilities is prospective in nature, which means that there will be no accrual of required amounts of RCRA Subtitle C liability coverage and thus no corresponding adjustments to total liabilities.



reflected on local government financial statements.<sup>5</sup> Thus, a local government's tangible net worth is different in meaning than that for a corporation.

- Also, the accounting standards used by most local governmental entities are not the same as the Generally Accepted Accounting Principals ("GAAP") used by private entities. Most local governments use either cash basis accounting (if mandated by state law) or "modified accrual" accounting, which is closer to cash basis accounting than the accrual basis used by firms. Consequently, for most local governmental entities, net working capital is not equivalent in meaning to that of firms.
- Finally, local governments are not generally required to report financial information to a regulatory agency similar to the Securities and Exchange Commission (SEC), although some government-owned utilities provide financial data to the Rural Utility Service (RUS) or the Energy Information Administration (EIA).

As described elsewhere in the *Manual*, local governments have many other options for demonstrating UST FR, including a financial test designed specifically for their use.

---

<sup>5</sup> The Government Accounting Standards Board (GASB), recognizing this weakness, has released new guidelines for how state and local governments should report their finances to the public in the future, including infrastructure reporting.

## **B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING THE FINANCIAL TEST OF SELF-INSURANCE**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING THE FINANCIAL TEST OF SELF-INSURANCE</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Determining Eligibility to Use the Financial Test of Self Insurance (see Section B.1)</li><li><input type="checkbox"/> Satisfying the Criteria of the Financial Test for the Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Preparing a Properly Worded Letter from Chief Financial Officer (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Updating Assurance (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If Owner or Operator No Longer Can Pass the Financial Test (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings (see Section B.7)</li><li><input type="checkbox"/> Responding to Requests for Reports of Financial Condition (see Section B.8)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.9)</li></ul>

### **B.1 Determining Eligibility to Use the Financial Test of Self Insurance**

Only private companies reporting to credit reporting agencies, publicly-held companies reporting to the SEC, and public utilities reporting to the EIA or RUS are eligible to use the financial test of self insurance.

In addition, the financial statements used for the test must be those of the owner or operator. If the owner or operator's financial data are **consolidated** (i.e., combined) with affiliated or parent firms, the owner or operator is not eligible to use the financial test but may be eligible to demonstrate FR through the corporate guarantee (see Chapter 4, Section A.4). Typically, a parent company prepares financial statements that consolidate (combine) the position and results of all subsidiaries. However, a subsidiary may prepare financial statements that present only its own position and results (including its subsidiaries), meaning that its financial statements are not consolidated with its affiliates or parents.

### **B.2 Satisfying the Criteria of the Financial Test for the Proper Scope and Amount of Coverage**

Scope of Coverage. The financial test can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). The financial test can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the financial test can be used to cover the other scope area. The financial test must cover the full scope of UST FR (see B.2 in Chapter 2 above) unless used in combination with another mechanism that covers the remaining part of the full scope.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a financial test with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the financial test for part of the required scope of coverage, the financial test would also work for the full scope because the required amount of coverage used in the financial test stays the same whether the test is used for all or part of the scope. (Of

course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

**Amount of Coverage.** The test must be based on the required amount of UST coverage plus hazardous waste FR costs and amounts described in A.3 through A.5 above. An owner or operator should enter "0" on line 2 if no hazardous waste FR is being assured through self-insurance or by providing a guarantee. If the financial test is combined with another mechanism to demonstrate the full amount of coverage, they must together assure the amounts described in A.3 through A.5, including any hazardous waste FR costs and amounts. (The financial test may be combined with a corporate guarantee only if the financial statements of the owner or operator are not **consolidated** with the financial statements of the guarantor. See discussion in Section B.1 above)

**Financial Test Criteria.** The Subtitle I financial test of self-insurance consists of two alternative tests. An owner or operator need satisfy only one of the two tests. Within 120 days after the close of each fiscal year, the chief financial officer of the owner or operator must sign a letter reporting the year-end financial information supporting the firm's use of the financial test.

### **B.3 Preparing a Properly Worded Letter from the Chief Financial Officer**

The owner or operator must prepare a letter signed by its chief financial officer (CFO) worded as specified in §280.95(d) within 120 days of the close of each financial reporting year. The financial reporting year is defined by the twelve-month period for which financial statements used to support the financial test are prepared. By signing the CFO letter, the owner or operator certifies that the letter is properly worded.

### **B.4 Recordkeeping**

An owner or operator using the financial test for UST FR must maintain on-site or at the place of business the following documents:

- A copy of the *CFO letter* for the most recent completed financial reporting year
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5)

Although not required, an owner or operator using the financial test may also want to maintain the following information at the same location:

- Information about number of USTs owned or operated for which the UST financial test is being used to demonstrate assurance and the number of USTs for which the owner or operator also is providing a guarantee
- List of hazardous waste facilities subject to FR under RCRA Subtitle C or SDWA for which a financial test of self-insurance or guarantee is being used by the UST owner or operator, and the required amounts of coverage
- Latest financial statements (if any) filed with SEC, EIA, or RUS
- Copy of Dun & Bradstreet rating (only Alternative I users only who do not file financial statements with SEC, EIA, or RUS)
- Auditor's opinion, if financial statements are independently audited

- Accountant's special report (only Alternative II users who do not file financial statements with SEC, EIA, or RUS)

## **B.5 Updating Assurance**

An owner or operator using the financial test must update assurance as follows:

- If the required level of coverage increases above the amount assured by the financial test, the owner or operator must either (1) revise the CFO letter and satisfy the financial test to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the new coverage level and the amount covered by the financial test.
- Prepare annually an updated CFO letter demonstrating satisfaction of all of the financial test criteria of either Alternative I or II. The updated CFO letter must be signed within 120 days of the close of the owner or operator's financial reporting year. In addition, an owner or operator using Alternative II must obtain an updated special report from an independent certified public accountant if the financial statements are not submitted annually to the SEC, EIA, or REA.

From year-to-year the following data in the CFO letter can change:

- Required Amount of Coverage
  - ~ Number of covered USTs
  - ~ Cost estimates for hazardous waste facility closure, post-closure care, corrective action, plugging and abandonment
- Net Worth
- Net Working Capital
- U.S. Assets and Total Assets
- D&B Financial Strength Ratings
- Moody's or Standard & Poor's Ratings for Most Recent Bond Issuance
- Auditors' Opinions

## **B.6 Obtaining Alternate Assurance If Owner or Operator No Longer Can Pass the Financial Test**

An owner or operator must obtain alternate assurance in the following circumstances:

- Within 150 days of the end of the fiscal year, if the owner or operator finds that it is no longer qualified to use a financial test.
- Within 30 days after receiving notice of a finding by the Director of the implementing agency that disqualifies use of the financial test because the owner or operator no longer meets financial test requirements.

### **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings**

An owner or operator who uses the financial test of self-insurance must report the following to the Director of the implementing agency:

- Failure to obtain alternate assurance within 150 days after determining, or within 30 days of being informed, that it no longer passes the financial test. The owner or operator must notify the Director of the failure within 10 days.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

### **B.8 Responding to Requests for Reports of Financial Condition**

An owner or operator using the financial test must respond to requests for reports of financial condition by providing the requested documents to the Director of the implementing agency.

### **B.9 Submitting Financial Responsibility Documents**

**According to the federal reporting regulations**, an owner or operator who uses the financial test must submit a copy of the CFO's letter to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- When the owner or operator fails to obtain alternate coverage
  - ~ within 150 days after finding that he or she no longer meets financial test requirements or
  - ~ within 30 days after notification by the Director that the owner or operator does not meet financial test requirements;
- Within 10 days after the commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code naming the owner or operator as debtor;
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) reporting.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR FINANCIAL TEST OF SELF-INSURANCE</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Responding to Notices That the Owner or Operator Cannot Satisfy the Financial Test and Has Failed to Obtain Alternate Assurance or That Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Reviewing Financial Responsibility Submissions (see Section C.2)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Checking Whether the Owner or Operator Is Eligible to Use the Financial Test (see Section C.3) <input type="checkbox"/> Verifying That the Owner or Operator Satisfies the Financial Test for the Proper Scope and Amount of Coverage (see Section C.3) <input type="checkbox"/> Checking the Qualifications of Accountants (see Section C.4) <input type="checkbox"/> Verifying the Wording of the CFO Letter (see Section C.5) <input type="checkbox"/> Requesting Reports of Financial Condition (see Section C.6) <input type="checkbox"/> Notifying Owners and Operators If They No Longer Meet the Financial Test Requirements (see Section C.7)

### C.1 Responding to Notices That the Owner or Operator Cannot Satisfy the Financial Test and Has Failed to Obtain Alternate Assurance or That Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that an owner or operator that has been using the financial test is no longer qualified and cannot obtain alternate assurance. Although owners or operators may experience deterioration in their financial strength, most ought to be able to secure alternate assurance. However, following receipt of such a notice from the owner or operator, you should monitor the efforts being made to secure alternate assurance. This could include alerting the owner about the situation if the operator had been providing the financial assurance, and vice versa. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

Owner or Operator Named a Debtor in Bankruptcy. Similarly, it is unlikely that an owner or operator using the financial test will be named as a debtor in bankruptcy proceedings. If that happens, it represents a serious potential gap in coverage in the event of a release or a need for third-party compensation. The discovery of a release or appearance of a claim for compensation could, in rare cases, itself cause the owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>6</sup> Apart from that route, if the owner or operator are different parties, you could alert

---

<sup>6</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous* (continued...)

the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

Finally, users of the financial test are likely to be larger firms, which may have USTs in more than one state. Thus, implementing agencies may want to coordinate their responses to these notices.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, implementing agencies will receive unsolicited copies of the CFO letter from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release that must be reported (see 40 CFR 280.110(a)(1))
- Within 30 days after the owner or operator fails to obtain alternate assurance after finding or being notified that it no longer passes the financial test (see 40 CFR 280.110(a)(2))
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor (see 40 CFR 280.114(a))

In the first situation, the implementing agency may want to ensure that the financial test criteria have been satisfied so that, if not, the owner or operator can be instructed to obtain alternate assurance. See C.3 and C.4 below for details on performing such a review. In the second situation, there is no point in reviewing the CFO letter because failure to pass the test has already been established. Rather, efforts should focus on securing alternate assurance. Likewise, in the third situation, there is little benefit, in terms of UST FR compliance, to review of the CFO's letter because it does not represent a claim on the owner or operator's assets. Again, explore opportunities for securing alternate assurance.

**NOTE:** The CFO letter does not require extraordinary physical safeguards or care, as discussed in Section E.10 of Chapter 2.

**NOTE:** Some states may require regular annual reporting or may request evidence of FR for monitoring compliance. See Sections C.4 through C.6 below for review of such submissions.

## C.3 Checking Whether the Owner or Operator Is Eligible to Use the Financial Test

Any firm is eligible to use the financial test. Most local government entities are not eligible to use the financial test of self-insurance, with the exception of those public power authorities that file financial statements with the SEC, EIA, or RUS. If a non-profit organization can meet the criteria of a self-insurance test, it can use this mechanism to comply with FR. Otherwise, the non-profit can use one of the alternative mechanisms. A non-profit entity such as a university or hospital may be able to pass the financial test. Other non-profits that do not sell goods or services (e.g., the Red Cross) may not be able to pass the financial test.

In addition, the financial statements used for the test must be those of the owner or operator. If its financial data are consolidated with affiliated or parent firms, the owner or operator is not eligible to use the

---

<sup>6</sup> (...continued)

*Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

financial test but may be eligible to use the corporate guarantee (see Chapter 4). Normal practice is to consolidate majority owned subsidiaries and not consolidate entities that are less than majority owned.

#### **C.4 Verifying That the Owner or Operator Satisfies the Financial Test for the Proper Scope and Amount of Coverage**

Scope of Coverage. The financial test can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the financial test will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the financial test can be used to cover the other scope area. Because the owner and operator are responsible for performing corrective action and satisfying compensation obligations anyway, you need not be overly concerned with the scope of coverage of the financial test of self-insurance even when it is used in combination with other mechanisms. Rather, it is more important that you verify the amount of coverage.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a financial test with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the financial test for part of the required scope of coverage, the financial test would also work for the full scope because the required amount of coverage used in the financial test stays the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. The proper amount of UST aggregate coverage is either \$1 million or \$2 million depending on the number of tanks being covered. These are the only numbers that should appear on line 1 of the CFO letter unless the financial test is being used in combination with another mechanism. Combining the financial test with another FR mechanism to cover the full amount of required coverage is an unlikely scenario with one exception: an owner or operator may choose to use the financial test to cover amounts not assured by a state fund. For example, if a state fund provides aggregate coverage up to \$1 million, then the financial test could be used to cover an additional \$1 million if the owner or operator has over 100 USTs.<sup>7</sup>

If an owner or operator self-insures his or her own tanks and guarantees tanks belonging to a different owner or operator, the financial test must be based on the total number of tanks self-insured and guaranteed. For example, if an owner or operator is self-insuring 60 tanks and guaranteeing 60 tanks, the required amount of UST coverage used in the financial test to self-insure and guarantee these tanks is \$2 million.

As discussed in Section A.3 above, the UST financial test includes not only the UST coverage amount but the amounts of any RCRA Subtitle C and SDWA FR requirements for hazardous waste facilities for which the owner or operator is using a financial test or providing a guarantee. It is important to verify that the owner or operator has completely and accurately included any RCRA and SDWA hazardous waste financial responsibility requirements which are being met by the owner or operator's financial test or

---

<sup>7</sup> Some state funds require owners and operators to demonstrate financial responsibility for the funds' deductible amounts; states may allow owners and operators to use a special financial test for this purpose that is less stringent than the federal test described here.



guarantee. These other FR obligations can be large amounts.<sup>8</sup> You may need to coordinate with other states, EPA Regional Offices, or EPA Headquarters to identify hazardous waste facilities that have RCRA and SDWA financial responsibilities for which the owner or operator also is responsible. If the owner or operator passes the UST test by a large (e.g., 10 times) margin, however, and there is no reason to suspect any hazardous waste responsibilities, it may not be worth the effort to identify those other facilities and liabilities.

Financial Test Criteria. Checking the qualifications of the owner or operator against the requirements of Alternative I or II can be laborious. Verifying the mathematics is important for both Alternatives. However, before verifying the details of the test, you may first want to check that the CFO letter is based on the financial statements of the owner or operator and not on the financial statements of another corporate entity. If the CFO letter is based on the financial statements of another corporate entity (e.g., the parent company), you can direct the owner or operator to resubmit the letter based on its own financial statements or switch to the corporate guarantee mechanism (described in Chapter 4).

Next, you should review the auditor's opinion, if any, because if it is not "clean," you need not proceed any further in the review because the owner or operator must obtain alternate assurance. Third, you may want to review the auditor's special report, if any exists. If the special report is not "clean," you need not proceed any further in the review. These steps are described next.

Auditor's Opinions. Auditor's opinions are provided in a company's Annual Report to Shareholders and also accompany financial statement filings to the SEC, EIA, and RUS. For both Alternatives I and II, if the owner or operator has independently audited financial statements, you should review the auditor's opinion to ensure it is not adverse, a disclaimer of opinion, or a "going concern" qualification. Examples of such opinions are provided in Section A.7 above. If the opinion is not "clean," you should inform the owner or operator of the need for alternate assurance.

Use of Auditors Special Report. Verifying that the numbers in the CFO letter reflect the data in the financial statements is easy if there is an auditor's special report available. That document should exist in the following two situations:

- (1) The financial test user has reported hazardous waste obligations on line 2 of the CFO letter
- (2) The financial test user does not file financial statements with the SEC, EIA, or RUS and is using Alternative II (i.e., checks "No" on line 19)

If the owner or operator has reported hazardous waste obligations on line 2 of the CFO letter, you should request a copy of the independent CPA's special report that must be submitted with use of the financial test under RCRA Subtitle C and the SDWA. That report must state that the CPA has compared the data which the CFO letter specifies as having been derived from the independently audited, year-end financial statements for the latest fiscal year with the amounts in those financial statements. The report also must state that in connection with that procedure, no matters came to the auditor's attention which caused him or her to believe that the specified data should be adjusted.

If the owner or operator is using Alternative II and does not submit its financial statements annually to the SEC, EIA, or RUS, you should request a copy of the independent CPA's special report. The special report must state that the independent CPA has compared the data in the CFO letter with the amounts in the

---

<sup>8</sup> For example, the aggregate amount of RCRA Subtitle C liability coverage is either \$2 million or \$8 million depending on the type(s) of hazardous waste treatment, storage, or disposal facility involved. Closure costs can range from \$25,000 to \$500,000 per site. Post-closure costs can range from \$300,000 to \$500,000 per site.

financial statements and that no matters came to the attention of the independent certified public accountant which caused him or her to believe that the information in the chief financial officer's letter should be adjusted.

**You can use the auditor's special report as a basis for accepting the corresponding numbers in the UST financial test as correctly derived from the owner or operator's financial statements.** You should still verify the mathematics of the CFO letter.

If the special report is not available, you will need other documents beyond the CFO letter to determine whether the owner or operator passes the financial test:

- For Alternative I, these necessary documents will include copies of the latest annual financial statements filed with the SEC, EIA, or the RUS or a copy or confirmation of the D&B financial strength rating.
- For Alternative II, you will need a copy of the financial statements and may need information about Moody's or Standard & Poor's ratings of the most recent bonds issued by the owner or operator.

Exhibit 3-9 summarizes how you can obtain this information.

<b>Exhibit 3-9 SOURCES OF FINANCIAL TEST INFORMATION</b>	
Financial Statements and Auditor Opinions filed with Securities & Exchange Commission (SEC)	Accessible on-line through EDGAR (Electronic Data Gathering and Retrieval) at <a href="http://www.sec.gov/EDGARHP.HTM">HTTP://WWW.SEC.GOV/EDGARHP.HTM</a>
Financial Statements and Auditor Opinions filed with Energy Information Administration (EIA)	Accessible on-line at <a href="http://www.eia.doe.gov/CNEAF/ELECTRICITY/PAGE/DATA.HTML">HTTP://WWW.EIA.DOE.GOV/CNEAF/ELECTRICITY/PAGE/DATA.HTML</a>
Financial Statements and Auditor Opinions filed with Rural Utilities Service (RUS)	Accessible only through Freedom of Information Act request addressed to:  Freedom of Information Office Rural Utilities Service, Stop 0742 1400 Independence Avenue, SW Washington, DC 20250 Phone: 202-692-0031 Fax: 202-692-0034
Dun & Bradstreet (D&B) Financial Strength Ratings	Contact Customer Service Center at 800-333-0505 to request financial strength ratings.
Moody's Bond Ratings	Call 1-212-553-0377 (Ratings Desk) or consult <i>Moody's Bond Record</i> (Monthly Report) found in most public libraries
Standard & Poor's (S&P) Bond Ratings	Call 1-212-208-1146 (Ratings Desk).

As noted in Section A.4 above, you may not be able on your own to precisely verify the tangible net worth figure in the CFO's letter from the firm's financial statements. In the absence of an accountant's special report or disclosure in a footnote, all that is practical to do is to compare the reported tangible assets figure in

line 4 against the total assets figure in the financial statements. Tangible assets in line 4 should not be greater than total assets reported in the financial statements.

With respect to U.S. assets reported in line 7 of Alternative II, you have two options. First you can compare reported U.S. assets in line 7 to total assets shown on the financial statements; the former should not be greater than the latter. Second, you can look in the "notes" to the financial statements for the discussion of "segment information," which *may* display U.S. assets. The amount reported on line 7 should not be larger than the amount of U.S. assets in the notes, taking into account net corporate assets not identified with any geographic segment.

You can confirm the current assets and current liabilities numbers reported on lines 12 and 13 of Alternative II directly from the financial statements.

Acceptable Adjustments to Figures in Financial Statements. For calculating tangible net worth, firms are allowed to deduct from their total liabilities any accruals for hazardous waste costs that are being assured by a financial test or guarantee. This deduction has the effect of increasing tangible net worth. This deduction should not be counted twice: the financial test user can either reduce reported liabilities in line 5 (which will increase tangible net worth calculated in line 6) or increase the reported tangible net worth in line 6. It may be difficult or impossible to verify the amount of these accruals from the firm's financial statements. Even the footnotes to the statements are unlikely to provide sufficient detail. If the owner or operator has made such adjustments you should request to see their hazardous waste FR demonstrations, including the accountant's special report, to confirm the figures.

### **C.5 Checking the Qualifications of Accountants**

Although falsification of credentials is rare, you can confirm that the accountant responsible for preparing the opinion and special report is an independent CPA by contacting the State Board of Accountancy in the state where the accountant resides, if there is any doubt about the accountant's qualifications.

### **C.6 Verifying the Wording of the CFO Letter**

Verifying the wording of the CFO letter is a straightforward activity. The CFO letter should match the required wording. However, unlike other FR documents, minor deviations in the wording or format of the CFO letter will have little impact on the effectiveness of the financial test, unless the changes affect the substance of the financial test criteria. The following are key items to look for in the CFO's letter:

- The letter should be signed by the person who is officially designated as the Chief Financial Officer of the owner or operator. However, the CFO may not use that title. The letter might, instead, be labeled as the CFO's letter but be signed by the corporate treasurer or some other corporate official. The person signing the CFO letter must be the functional equivalent of the CFO. Sometimes it will be quite clear that the CFO has not signed the letter. For example, if it is signed by the "Assistant Treasurer," that person is unlikely to be the "chief" financial officer. An "Acting Chief Financial Officer," on the other hand, probably meets the requirements of the rule because there is no superior financial officer, at least temporarily. If there is any reason for doubt, request documentation, such as a copy of corporate by-laws or a corporate resolution, that demonstrate the person's authority to sign the CFO letter.
- The financial test portion of the CFO's letter should specify which alternative of the test is applicable and provide calculations that completely demonstrate the firm's ability to pass the test.

This information must be provided, even if the presentation format required by the rule has not been followed exactly.

### **C.7 Requesting Reports of Financial Condition**

The Director of the implementing agency may require reports of financial condition at any time from a financial test user and may disallow use of the financial test if these reports demonstrate that the financial test criteria are not being met.

Generally, requested information might include an updated financial test demonstration based on current (e.g., mid-year) financial data, or unaudited interim financial statements (such as 10-Qs submitted to the SEC), or other statements of information such as 8-Ks submitted to the SEC.

The 10-Q reports unaudited financial results for a fiscal quarter and notes any significant changes or events in the quarter. Form 8-K is used by companies to file current reports on the following events:

- Item 1. Changes in Control.
- Item 2. Acquisition or Disposition of Assets.
- Item 3. Bankruptcy or Receivership.
- Item 4. Changes in Certifying Accountant.
- Item 5. Other Materially Important Events.
- Item 6. Resignations of Directors.
- Item 7. Financial Statements and Exhibits.
- Item 8. Change in Fiscal Year.
- Item 9. Regulation S Offerings.

Information that is publicly available often can be obtained more quickly from the information sources listed in Exhibit 3-9 than by requesting it from the owner or operator. With respect to financial statements filed only with the RUS, however, it likely will be quicker to request them from the owner or operator than to file a Freedom of Information Act (FOIA) request with RUS. Any information (e.g., stock option plans) not bearing on the requirements specified in the financial test cannot be used to disqualify an owner or operator and should not be requested.

### **C.8 Notifying Owners and Operators That They No Longer Meet the Financial Test Requirements**

If you find that the owner or operator no longer meets the requirements of the financial test alternative it has been using, you should notify the owner or operator to arrange alternate assurance within 30 days.

#### D. SOURCES OF FURTHER INFORMATION

The following financial accounting books were identified by two national booksellers as among the most popular in the field in 1999:

1. **How to Read a Financial Report : Wringing Vital Signs Out of the Numbers**  
John A. Tracy, Ph.D. / John Wiley & Sons / October 1993
2. **Financial Shenanigans : How to Detect Accounting Gimmicks and Fraud in Financial Reports** Howard Mark Schilit, Ph.D. / McGraw-Hill / March 1993
3. **Keys to Reading an Annual Report** George Thomas Friedlob with Ralph E. Welton / Barrons Educational Series / August 1995
4. **The Analysis and Use of Financial Statements** Gerald I. White, et al. / John Wiley & Sons / June 1997
5. **The Guide to Understanding Financial Statements** S. B. Costales / McGraw-Hill / November 1993
6. **How to Use Financial Statements : A Guide to Understanding the Numbers** James Bandler / Irwin Professional Pub / July 1994
7. **Finance and Accounting for Non-Financial Managers: Revised and Expanded**  
Steven A. Finkler / May 1996
8. **If You're Clueless about Accounting and Finance and Want to Know More**  
Paul Lim / April 1998

[THIS PAGE INTENTIONALLY LEFT BLANK]

## 4. FINANCIAL RESPONSIBILITY USING THE CORPORATE GUARANTEE

This chapter describes the use of the corporate guarantee to demonstrate UST FR as follows:

A. BACKGROUND	53
A.1 What Is the UST Corporate Guarantee?	53
A.2 How Does The UST Corporate Guarantee Work?	53
A.3 What Are the Criteria of the Financial Tests for Guarantors?	54
A.4 Why Does the Corporate Guarantee Financial Test Include Hazardous Waste Obligations?	54
A.5 Who Can Provide A Guarantee?	54
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING A CORPORATE GUARANTEE	56
B.1 Selecting An Eligible Guarantor	56
B.2 Obtaining a Properly Worded Corporate Guarantee and Letter from Guarantor's Chief Financial Officer for the Proper Scope and Amount of Coverage	57
B.3 Determining That Guarantor Satisfies the Qualifications of the Financial Test	58
B.4 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund	58
B.5 Recordkeeping	58
B.6 Updating Assurance	59
B.7 Obtaining Alternate Assurance If Guarantor Is No Longer Eligible or Qualified to Pass the Financial Test, If Guarantor Decides to Cancel the Corporate Guarantee, or If Guarantor Named as a Debtor in Bankruptcy Proceedings	59
B.8 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings	60
B.9 Submitting Financial Responsibility Documents	60
B.10 Replenishing Assurance After Guarantee Is Used for Corrective Action and/or Third-Party Compensation	61
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	62
C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings	62
C.2 Reviewing Financial Responsibility Submissions	64
C.3 Directing Payment to Standby Trust Funds	65
C.4 Monitoring Replenishment of Assurance After Guarantee Is Used for Corrective Action and/or Third-Party Compensation	66
C.5 Checking Whether the Guarantor and Trustee Are Eligible	67
C.6 Verifying That the Guarantor Can Satisfy the Financial Test for the Proper Amount of Coverage	70
C.7 Checking the Qualifications of Accountants	73
C.8 Verifying the Wording, Scope, and Amount of Coverage of the Chief Financial Officer Letter, Guarantee, and Standby Trust Fund	73
C.9 Requesting Reports of the Guarantor's Financial Condition	75
C.10 Notifying Owners or Operators That Their Guarantors No Longer Meet the Financial Test Requirements	76

D.	CORPORATE GUARANTOR RESPONSIBILITIES .....	77
D.1	Being Eligible to Act as a Guarantor .....	77
D.2	Demonstrating Satisfaction of Financial Test for the Proper Scope and Amount of Coverage and Delivering the Chief Financial Officer Letter and Guarantee to Owner or Operator .....	77
D.3	Updating Assurance Annually .....	79
D.4	Notifying the Owner or Operator of Decision to Cancel the Guarantee; If No Longer Eligible, Qualified, or Authorized to Provide Guarantee; or If Named as a Debtor in Bankruptcy Proceedings .....	79
D.5	Funding the Standby Trust as Directed .....	80
E.	SOURCES OF FURTHER INFORMATION .....	81



## A. BACKGROUND

### A.1 What Is the UST Corporate Guarantee?

An owner or operator may satisfy the UST FR requirements by using a **corporate guarantee**. A corporate guarantee is a common option in many government-mandated financial responsibility programs, both environmental and non-environmental (e.g., FR for workers compensation).

A guarantee is a promise by one party (the "**guarantor**") to pay specified debts or satisfy the specified obligations of another party (the "**principal**") in the event the principal fails to satisfy the debts or obligations. An UST guarantee is an agreement in which a guarantor firm promises to pay up to the specified amounts for UST corrective action or third-party compensation on behalf of the owner or operator. A corporate guarantee often will be an inexpensive method of demonstrating FR. Firms that provide a corporate guarantee must both execute a **written guarantee** and also demonstrate financial strength by passing a set of criteria, termed a **financial test**. To pass the UST FR financial test, a guarantor must meet one of two alternative tests described in Chapter 3 based on year-end financial statements for the latest completed fiscal year.

### A.2 How Does The UST Corporate Guarantee Work?

If the owner or operator fails to perform corrective action or satisfy third-party compensation obligations, the guarantor funds a standby trust fund from which the implementing agency directs the payment of corrective action costs or third-party compensation. A **standby trust fund** is simply a trust fund that is not yet funded but is otherwise ready to accept monies in the event they are received from a particular source, such as a corporate guarantee. Funds in the standby trust are available to pay the costs of corrective action and third-party compensation. (See Chapter 11 for more information on standby trust funds.)

**NOTE:** The use of a standby trust is necessary because without such a mechanism, any funds drawn under the corporate guarantee that are payable to the EPA Regional Administrator would have to be paid into the U.S. Treasury and could not be used without Congressional action (see 31 U.S.C. 3302) to pay for the UST corrective action or third-party compensation for which the funds were intended. Due to similar state laws, funds payable to the state Director may have to be paid into the state treasury, unless a standby trust is used.

This option differs from **self-insurance** because it involves a source of UST financial responsibility other than the owner or operator.

Within 120 days after the close of each fiscal year, the chief financial officer (CFO) of the guarantor must sign a letter reporting the year-end financial information supporting the firm's use of the financial test. If a guarantor finds that it is no longer eligible or qualified to use a financial test, the owner or operator must obtain an alternate mechanism within 150 days of the end of the guarantor's fiscal year. The Director of the implementing agency may disqualify use of the corporate guarantee upon a finding, based on reports of financial condition, that the guarantor no longer meets the financial test requirements. The owner or operator has 30 days after notification of such a finding to obtain another financial assurance mechanism.

Also, to ensure that state insurance laws do not call into question the validity or enforceability of the guarantee, the mechanism can be used only if it is certified as valid and enforceable by the Attorney General of the state where the USTs covered by the mechanisms are located.

The contractual language specified for the guarantee explicitly limits the guarantor's obligation to the per-occurrence and aggregate amounts for UST corrective action and third-party liability compensation as stated on the face of the instrument. Exclusionary language in the terms of the guarantee clearly limit the type and circumstances of third-party liability compensation for which the guarantee can be used. A guarantor may, however, have incurred obligations outside those of the UST FR guarantee contract, under state law or other contractual agreements with the owner or operator. Such legal obligations (e.g., guarantee of workers compensation FR) are not changed by the limitations in the UST FR guarantee.

### **A.3 What Are the Criteria of the Financial Tests for Guarantors?**

The two alternative financial tests for guarantors are identical to the alternative tests for owners and operators wishing to self-insure. See Sections A.4-A.8 in Chapter 3 for a description of the tests, their components and rationales, auditor's opinions, and acceptable adjustments to the numbers in financial statements. In addition to assuring that the guarantor has an appropriate level of financial strength, the financial test also protects the guarantee from potential bankruptcy challenges.

### **A.4 Why Does the Corporate Guarantee Financial Test Include Hazardous Waste Obligations?**

The corporate guarantee financial test must include any hazardous waste FR amounts covered by the guarantor's RCRA Subtitle C or SDWA<sup>9</sup> financial test of self-insurance or guarantee. Including these RCRA and SDWA hazardous waste costs is necessary to ensure that an UST guarantor can meet all of its environmental obligations without jeopardizing the financial health of the firm. The financial tests used for hazardous waste facility closure and post-closure care (40 CFR 264.143 and 264.145), liability coverage (40 CFR 264.147), corrective action (40 CFR 264.101),<sup>10</sup> and plugging and abandonment (40 CFR 144.63) all rely on a multiple of a firm's net worth relative to the costs being assured. If these costs are not included in the UST financial test, UST guarantors would, in effect, be "double pledging" their financial resources, thereby reducing the likelihood that UST obligations could be met.

If the guarantor has recognized its hazardous waste closure, post-closure, corrective action, or plugging and abandonment costs as liabilities on its financial statements, some adjustments may be made to the financial data used in the tests. See Section A.8 in Chapter 3 above.

### **A.5 Who Can Provide A Guarantee?**

A guarantee may be provided by certain related firms or by firms that have a "substantial business relationship" with the owner or operator:

---

<sup>9</sup> Underground injection of hazardous wastes is regulated under the federal Safe Drinking Water Act (SDWA).

<sup>10</sup> The financial test for hazardous waste corrective action FR was proposed in the *Federal Register* of October 24, 1986 (pp. 37854-37880), but was never promulgated as a final rule.

The following firms are eligible to provide a guarantee

- **Parent firms** that own a controlling interest in the owner or operator,
- **Grandparent firms** that own a controlling interest in the parent firm of the owner or operator
- **Sister companies** that are controlled by a parent that also owns a controlling interest in the owner or operator.

**NOTE:** Controlling interest means direct ownership of at least 50 percent of the voting stock.

- A firm engaged in a "substantial business relationship" with the owner or operator also may provide a guarantee as an act incidental to that business relationship. A **substantial business relationship** means the business relationship necessary under applicable state law to make a guarantee issued incident to the relationship valid and enforceable, rather than an unlicensed entry into the business of insurance. A guarantee is considered incident to such a relationship if it arises from and depends on an ongoing set of economic transactions between the guarantor and the owner or operator or, while a single transaction, is of substantial importance to the owner or operator (e.g., sale of capital equipment or land). **A firm engaged in a substantial business relationship with the owner or operator can be an affiliate (e.g., a subsidiary) that does not meet the definition of parent, grandparent, or sister company.**

The reasons for these eligibility requirements are: (1) to ensure that guarantees are valid under appropriate state law; (2) to avoid running afoul of state laws relating to the business of insurance, and (3) to ensure that sufficient unity of interest exists between the guarantor and the owner or operator to provide adequate assurance of financial responsibility. The relationship requirements are those that EPA determined would most likely result in adequate and effective assurance.

Guarantors must demonstrate that they are qualified to provide financial assurance by satisfying either the Alternative I or Alternative II financial test for the required amount of coverage as described in Chapter 3. **Guarantors who pass the test are expected to be able to pay for corrective action and third-party compensation obligations if the owner or operator does not.** The test is designed so that those who pass are very unlikely to experience financial distress that prevents their funding corrective action and third-party compensation. Because the guarantor's financial statements form the basis of the assurance provided, the test must be passed anew with each year's financial statements.

Although guarantors may be spun out of the corporate family, reorganized, or otherwise rendered ineligible or may experience deterioration in their financial strength so that they cannot pass the financial test, **the guarantee itself remains effective until it is cancelled or terminated.**

## B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING A CORPORATE GUARANTEE

The following checklist summarizes owner or operator responsibilities.

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING A CORPORATE GUARANTEE</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Selecting An Eligible Guarantor (see Section B.1)</li><li><input type="checkbox"/> Obtaining a Properly Worded Corporate Guarantee and Letter from Guarantor's Chief Financial Officer for the Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Determining That Guarantor Satisfies the Qualifications of the Financial Test (see Section B.3)</li><li><input type="checkbox"/> Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund (see Section B.4)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Updating Assurance (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If Guarantor Is No Longer Eligible or Qualified to Pass the Financial Test, If Guarantor Decides to Cancel the Corporate Guarantee, or If Guarantor Named as a Debtor in Bankruptcy Proceedings (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings (see Section B.7)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.8)</li><li><input type="checkbox"/> Replenishing Assurance After Guarantee Is Used for Corrective Action and/or Third-Party Compensation (see Section B.9)</li></ul>

### B.1 Selecting An Eligible Guarantor

Any owner or operator is eligible to **use** the corporate guarantee but not all firms are able to **provide** the guarantee. A guarantor must be both **eligible** and **qualified** to provide an UST corporate guarantee to an owner or operator.

Only private companies reporting to credit reporting agencies, publicly-held companies reporting to the SEC, and public utilities reporting to the EIA or RUS are **eligible** to provide a guarantee. In addition, to be eligible, the guarantor must be a firm that:

- Possesses a controlling interest in the owner or operator -- in other words, the corporate parent; or
- Possesses a controlling interest in a firm that has a controlling interest in the owner or operator -- in other words, grandparent firms; or
- Is an affiliate which is controlled through stock ownership by a common parent firm that possesses a controlling interest in the owner or operator -- in other words, sister companies; or,
- Is engaged in a substantial business relationship with the owner or operator and is issuing the guarantee as an act incident to that business relationship.

To be **qualified**, the guarantor's financial statements and auditor opinions must pass the financial test. Most local government entities and some non-profits will rarely be able to satisfy the criteria of the financial test which must be satisfied in order to provide a corporate guarantee. However, certain public utilities that

file financial statements may be able to pass the test to qualify to provide guarantees. See discussion in Chapter 3. The financial statements used for the test must be those of the guarantor. If the guarantor's financial data are consolidated (i.e., combined) with the owner or operator's financials (see Section B.1 of Chapter 3), the owner or operator is not eligible to use self-insurance but is eligible to demonstrate FR by using the corporate guarantee.

## **B.2 Obtaining a Properly Worded Corporate Guarantee and Letter from Guarantor's Chief Financial Officer for the Proper Scope and Amount of Coverage**

The owner or operator must obtain both a properly worded (1) guarantee and also (2) letter signed by the guarantor's CFO within 120 days of the close of each financial reporting year. The financial reporting year is defined by the twelve-month period for which financial statements used to support the financial test are prepared.

Wording. The required wording for corporate guarantees and CFO letters appears in the federal regulations at 40 CFR 280.96(c). By signing the guarantee and CFO letter, the guarantor certifies that the documents are properly worded.

Scope of Coverage. The corporate guarantee can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). The guarantee can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the guarantee can be used to cover the other scope area. The CFO letter and guarantee must cover the full scope of UST FR (see B.2 in Chapter 2 above) unless used in combination with another mechanism that covers the remaining part of the full scope.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a guarantee with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the guarantee for part of the required scope of coverage, the guarantee also would work for the full scope because the required amount of coverage used in the guarantor's financial test stays the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A corporate guarantee must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when a corporate guarantee is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

**NOTE:** The corporate guarantee may be combined with a financial test of self-insurance only if the financial statements of the owner or operator are not consolidated (i.e., combined) with the financial statements of the guarantor. See discussion in Section B.1 of Chapter 3.

### **B.3 Determining That Guarantor Satisfies the Qualifications of the Financial Test**

An owner or operator who intends to use the guarantee for UST FR should do the following:

- Inform the guarantor regarding the scope and amount (i.e., the number of tanks to be assured) of required coverage,
- Verify the guarantor's eligibility and qualifications,
- Remind the guarantor to include in its financial test any other USTs and hazardous waste costs it is covering through a financial test of self-insurance or guarantee, and
- Check that the CFO letter and guarantee are properly worded..

Financial Test Criteria. The Subtitle I financial test of for guarantors consists of two alternative tests. A guarantor need satisfy only one of the two tests. A guarantor must pass the financial test based on the required amount of UST coverage plus hazardous waste FR costs and amounts described in A.4 above. An owner or operator should enter "0" on line 2 if no hazardous waste FR is being assured through self-insurance or by providing a guarantee. Within 120 days after the close of each fiscal year, the chief financial officer of the guarantor must sign a letter reporting the year-end financial information supporting the guarantee.

### **B.4 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund**

An owner or operator who uses a corporate guarantee to satisfy UST FR requirements must establish a standby trust fund when the guarantee is acquired. This standby trust fund must meet the requirements specified in § 280.103, and the trustee must be eligible to serve as an UST FR trust fund trustee. Chapter 11 describes what makes a trustee eligible and the required wording for a standby trust fund.

### **B.5 Recordkeeping**

An owner or operator who uses the corporate guarantee for UST FR must maintain on-site or at the place of business a copy of the following documents:

- Guarantor's *CFO letter* for the most recent completed financial reporting year
- Properly worded *guarantee agreement* signed by an authorized representative of the guarantor and by the owner or operator
- Signed *standby trust fund agreement* and copies of any amendments to the agreement, which was established to receive funds from the guarantee. The standby trust fund should satisfy the criteria described in Chapter 11 of this *Manual*
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5)

Although not required, an owner or operator using the corporate guarantee may also want to maintain the following information at the same location:

- Information about number of USTs owned or operated for which the UST corporate guarantee is being used to demonstrate assurance and the number of other USTs for which the guarantor is providing assurance using a guarantee or self-insurance

- List of hazardous waste facilities subject to FR under RCRA Subtitle C or SDWA for which the guarantor is providing assurance using a financial test or guarantee, and the required amounts of coverage
- Latest financial statements filed by the guarantor with SEC, EIA, or RUS
- Copy of guarantor's Dun & Bradstreet rating (only Alternative I users only who do not file financial statements with SEC, EIA, or RUS)
- Auditor's opinion, if guarantor's financial statements are independently audited
- Accountant's special report (only guarantors reporting hazardous waste obligations on line 2 of CFO letter and Alternative II users who do not file financial statements with SEC, EIA, or RUS)

## **B.6 Updating Assurance**

An owner or operator using the corporate guarantee must update assurance as follows:

- If the required level of coverage increases above the amount assured by the corporate guarantee, the owner or operator must either (1) obtain a revised corporate guarantee and accompanying CFO letter based on the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the new coverage level and the amount of the corporate guarantee.
- Every year, owners or operators must obtain an updated CFO letter from the guarantor demonstrating that it satisfies all of the financial test criteria of either Alternative I or II. The updated guarantor CFO letter must be signed within 120 days of the close of the guarantor's financial reporting year. In addition, an owner or operator whose guarantor is using Alternative II must obtain from the guarantor an updated special report from an independent certified public accountant if the guarantor's financial statements are not submitted annually to the SEC, EIA, or REA.

The guarantee remains valid until it is cancelled or terminated; it does not need to be renewed annually.

## **B.7 Obtaining Alternate Assurance If Guarantor Is No Longer Eligible or Qualified to Pass the Financial Test, If Guarantor Decides to Cancel the Corporate Guarantee, or If Guarantor Named as a Debtor in Bankruptcy Proceedings**

An owner or operator must obtain alternate assurance in the following circumstances:

- Within 150 days of the end of the guarantor's fiscal year, if the owner or operator finds (or is notified by its guarantor) that its guarantor is no longer qualified to issue a guarantee (see 40 CFR 280.96(b)).
- Within 30 days after receiving notification of a finding by the Director of the implementing agency that disqualifies a guarantor's use of the financial test because the guarantor no longer meets financial test requirements (see 40 CFR 280.110(a)(2)(iii)).
- Within 60 days of receipt of a notice that the guarantor intends to cancel or not renew the guarantee (see 40 CFR 280.109(b)).

- Within 30 days of receiving notice of the bankruptcy or incapacity of the guarantor or the suspension or revocation of its authority to issue guarantees (see 40 CFR 280.110(a)(2)(iv) and 280.114(e)).

## **B.8 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings**

An owner or operator who uses a corporate guarantee must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance
  - ~ within 30 days after being informed that its guarantor no longer passes the financial test criteria or is ineligible to issue the guarantee (see 40 CFR 280.110(a)(2)(iii) and (iv)).
  - ~ within 60 days after receiving notification that the guarantor intends to cancel or not renew the guarantee (see 40 CFR 280.109(b)). The owner or operator must notify the Director of the failure within 10 days. The notification must include
    - (a) the name and address of the guarantor
    - (b) the effective date of termination
    - (c) required records (see B.5 above)
  - ~ within 30 days after receiving notification that the guarantor has been named as a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code (see 40 CFR 280.110(a)(2)(i)).
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail (see 40 CFR 280.114(a)).

## **B.9 Submitting Financial Responsibility Documents**

**According to the federal regulations**, an owner or operator that uses the corporate guarantee must submit a copy of the corporate guarantee, the guarantor's CFO letter, and the signed standby trust fund to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release. (See 40 CFR 280.110(a)(1).)
- When the owner or operator fails to obtain alternate coverage. (See 40 CFR 280.110(a)(2) and 280.109(b).)
  - ~ within 150 days after finding that the guarantor no longer meets financial test requirements or
  - ~ within 30 days after notification by the Director that the guarantor does not meet financial test requirements;
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the owner or operator as debtor. (See 40 CFR 280.114(a).)



- At any time if requested by the implementing agency. (See 40 CFR 280.110(c).)

State regulations may require more frequent (e.g., annual) reporting.

#### **B.10 Replenishing Assurance After Guarantee Is Used for Corrective Action and/or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the corporate guarantee has been drawn upon for corrective action and/or third-party compensation. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) The owner or operator must either:

- Renew the guarantee or add to the standby trust fund so as to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust have been reduced.

This replenishment must occur on the anniversary date of the corporate guarantee. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR CORPORATE GUARANTEE</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has BEEN Named as a Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Reviewing Financial Responsibility Submissions (see Section C.2) <input type="checkbox"/> Directing Payment to Standby Trust Funds (see Section C.3) <input type="checkbox"/> Monitoring Replenishment of Assurance After Guarantee Is Used for Corrective Action and/or Third-Party Compensation (see Section C.4)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Checking Whether the Guarantor and Trustee Are Eligible (see Section C.5) <input type="checkbox"/> Verifying That the Guarantor Can Satisfy the Financial Test for the Proper Scope and Amount of Coverage (see Section C.6) <input type="checkbox"/> Checking the Qualifications of Accountants (see Section C.7) <input type="checkbox"/> Verifying the Wording, Scope, and Amount of Coverage of the Chief Financial Officer Letter, and Standby Trust Fund (see Section C.8) <input type="checkbox"/> Requesting Reports of the Guarantor's Financial Condition (see Section C.9) <input type="checkbox"/> Notifying Owners or Operators That Their Guarantors No Longer Meet the Financial Test Requirements (see Section C.10)

### C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive a notice that an owner or operator cannot obtain alternate assurance. Your response can vary depending on the reason that the owner or operator needs alternate assurance.

- If the need for alternate assurance is driven either by the bankruptcy of the guarantor or by the guarantor's decision to cancel or terminate coverage, you need to take quick action while you are still able to draw on the guarantee.
  - ~ If the bankruptcy of the guarantor has created the need for alternate assurance, this presents a serious issue because guarantor's financial difficulties may affect the owner or operator's financial situation.
  - ~ Termination or cancellation of the guarantee is almost as worrisome as bankruptcy of the guarantor. A parent, grandparent, or sister company's decision, after previously committing to provide a guarantee, to terminate or cancel the guarantee may be evidence of a reduced level of corporate support to the owner or operator's business. Termination of the guarantee

by a supplier or customer may have many motivations, but also could be a leading indicator of business troubles for the owner or operator.

- On the other hand, if the need for alternate assurance is due to the incapacity of the guarantor, you have more time because the guarantee remains valid even if the guarantor no longer is the parent, grandparent, or sister firm of the owner or operator or no longer has a substantial business relationship with the owner or operator. Even if the guarantor ceases to pass the financial test, the guarantee itself remains valid and the need for alternate assurance is tempered by the continuing effectiveness of the guarantee.

Regardless of the reason, following receipt of such a notice from the owner or operator, you may want to monitor the efforts being made by the owner or operator to secure alternate assurance. This could include alerting the owner about the need for alternate assurance if the operator had been providing the financial assurance through a guarantee, and vice versa. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

If it does not appear that alternate assurance is immediately forthcoming, you may want to draw upon the guarantee. See C.3 below which describes the conditions for drawing on the corporate guarantee. In order to draw upon the guarantee and direct payments into the standby trust fund, the Director must

- Ascertain the date, if any, that the guarantee will be cancelled by the guarantor or terminate
- Investigate whether a release has occurred or may have occurred
- Determine whether there is an effective standby trust in place, and, if not, instruct the owner or operator to establish one quickly, and
- If the Director determines or suspects that a release has occurred, notify the guarantor and direct payment into the standby trust fund.

These activities must be completed before the guarantee is cancelled. **If you suspect, have determined, or have been notified that a release has occurred, you may not want to miss your opportunity to direct payments to the standby trust fund in hope that the owner or operator will secure alternate assurance. You can always release funds from the standby trust if the owner or operator does secure alternative assurance.**

Finally, guarantees are likely to be provided by larger firms, which may have assured USTs in more than one state. Thus, you may want to coordinate responses to these notices.

Owner or Operator Named A Debtor in Bankruptcy. It is unlikely that an owner or operator using the corporate guarantee will be named as a debtor in bankruptcy proceedings. If that happens, it increases the need to avoid a gap in FR coverage in the event of a release or a need for third-party compensation. The guarantee itself is not affected by the owner or operator's entry into bankruptcy proceedings. However, if the guarantee is being provided by an affiliate, parent, or grandparent firm, the owner or operator's bankruptcy filing may have implications for the financial capability of the guarantor, which is part of the corporate family. Similarly, bankruptcy of the owner or operator also may have implications for the financial capability of a supplier or customer that has provided the guarantee.

It is very unlikely but possible that the discovery of a release or appearance of a claim for compensation would itself cause the owner or operator to seek protection under the Bankruptcy Code. If the

owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>11</sup> Apart from that route, if the owner and operator are different parties, you could alert the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, you will receive unsolicited copies of the guarantee, the guarantor's CFO letter, and the standby trust fund from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release that must be reported
- Within 30 days after the owner or operator fails to obtain alternate assurance after being notified that the guarantor:
  - ~ no longer is eligible
  - ~ fails the financial test,
  - ~ intends to cancel or non-renew the guarantee, or
  - ~ has been named as a debtor in a voluntary or involuntary bankruptcy proceeding
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor.

In the first situation, the implementing agency may want to ensure that the guarantee is properly worded, the guarantor is eligible and satisfies financial test criteria, and the standby trust is effective so that, if not, you can instruct the owner or operator to remedy the problem(s) or obtain alternate assurance. See C.5 through C.8 below for details on performing such a review. In the second situation, there is little point in reviewing the CFO letter because the key document is the corporate guarantee, which remains effective even if the guarantor is no longer eligible or can no longer pass the financial test. You should ensure that the guarantee is properly worded and the standby trust is effective so that, if not, you can instruct the owner or operator to remedy any problems or obtain alternate assurance. In the third situation, while review of the guarantee is advisable, the owner or operator may not be willing or able to remedy any problems you identify.

**NOTE:** The CFO letter and guarantee do not require extraordinary safeguards or care, as discussed in Section E.10 of Chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.5 through C.8 below for review of such submissions.

---

<sup>11</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

### C.3 Directing Payment to Standby Trust Funds<sup>12</sup>

When to Direct Payments. The guarantee clearly describes the situations in which you may draw funds; the Director does not have unlimited discretion to draw on the guarantee. You must direct payments into the standby trust fund as shown below:

<b>Exhibit 4-3 DIRECTING PAYMENTS TO THE STANDBY TRUST FUND</b>	
Situation	Direct Funds Into Standby Trust Fund
<p>(1) If the owner or operator fails to establish alternative financial assurance within 60 days of receiving notice of cancellation of its financial assurance mechanism, <u>and</u></p> <p style="padding-left: 40px;">(i) the Director of the implementing agency determines or suspects<sup>1</sup> that a release has occurred</p> <p style="text-align: center;"><u>OR</u></p> <p style="padding-left: 40px;">(ii) the owner or operator has notified the Director of a release pursuant to Subparts E or F</p>	✓
<p>(2) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, <u>and</u></p> <p style="padding-left: 40px;">the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F</p>	✓
<p>(3) The Director has received either:</p> <p style="padding-left: 40px;">(i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid</p> <p style="text-align: center;"><u>OR</u></p> <p style="padding-left: 40px;">(ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.</p>	✓
<p><sup>1</sup> The Director's suspicion that a release has occurred must be based on objective evidence, such as failure of a tank tightness test, discovery of free product in adjacent sewer and utility lines, notice by the owner or operator, or other clear but unverified evidence. Evidence of a suspected release under §280.50 includes positive monitoring results from testing, monitoring and sampling, unusual operating conditions, or the discovery of petroleum in the environment.</p>	

How Much to Direct. The amount of funds you direct to be paid into the standby trust cannot exceed the amount of coverage specified in the guarantee. You may direct a smaller amount, but should do so only in limited circumstances. If the owner or operator has failed to provide alternate assurance, it is appropriate to direct the full amount into the standby trust fund. If the owner or operator has failed to perform corrective action, you may consider, when deciding how much to direct, the following: the estimated cost of the corrective action (including a contingency factor), the potential for third-party claims, and whether the owner or operator is responsible for other USTs. The conservative course is to direct the full amount into the standby trust fund. Similarly, if the owner or operator has failed to provide third-party compensation, you

<sup>12</sup> Directing payments out of the standby trust fund is described in Chapter 11, Section C.2.

may consider, when deciding how much to direct, the following: the amount of the judgment, award, or settlement; any pending claims or litigation; and whether the owner or operator is responsible for other USTs. In this situation also, the conservative course is to direct the full amount into the standby trust fund.

How to Direct Payments. In directing payments, include appropriate language drawn from the guarantee in your instructions as follows:

- "Because the owner or operator has failed to provide alternate coverage within 60 days after receipt of a notice of cancellation of this guarantee and the Director of the implementing agency has determined or suspects that a release has occurred at an underground storage tank covered by this guarantee, you are instructed in accordance with the provisions of 40 CFR 280.112 to deposit funds in [*name and address of trustee and name and account number of the standby trust*]."
- "Because the owner or operator has failed to perform corrective action for releases arising out of the operation of the above-identified tank(s) covered by this guarantee, you are instructed in accordance with the provisions of 40 CFR 280.112 to deposit funds in [*name and address of trustee and name and account number of the standby trust*]."
- "Because the owner or operator has failed to satisfy a judgment or award based on a determination of liability for bodily injury or property damage to third parties caused by accidental releases arising from the operation of the above-identified tank(s), or has failed to pay an amount agreed to in settlement of a claim arising from or alleged to arise from such injury or damage covered by this guarantee, you are instructed in accordance with the provisions of 40 CFR 280.112 to deposit funds in [*name and address of trustee and name and account number of the standby trust*]."

For the owner or operator's failure to perform corrective action or to provide third-party compensation, the regulations require the instructions to the guarantor to be in writing. For the owner or operator's failure to obtain alternative coverage, the instructions to the guarantor need not be in writing, though written instructions are recommended to avoid misunderstandings. Send your instructions by certified mail (after verifying the proper office to be addressed) and specify the latest date that funds are to be deposited in the standby trust. You will need to provide the guarantor with the name and address of the trustee and the name and account number of the standby trust, to facilitate deposit of funds.

#### **C.4 Monitoring Replenishment of Assurance After Guarantee Is Used for Corrective Action and/or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the guarantee has been drawn upon to fund the standby trust **and** the amount in the standby trust is less than the required amount of coverage. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) (See 40 CFR 280.115) The owner or operator must either:

- Replenish the value of the guarantee or standby trust to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust fall short of the required amount of coverage.

This replenishment must occur on the anniversary date of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. You may need to remind the owner or operator of this responsibility. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

However, because the guarantee is drawn upon only when the owner or operator fails to provide alternate assurance, fails to perform corrective action, or fails to satisfy a liability judgment or award, the owner or operator also may fail to take steps to replenish the guarantee. If that happens, you could instead determine whether the owner or operator are different parties. If they are, you can seek UST FR from the party other than the one that has failed to comply.

### **C.5 Checking Whether the Guarantor and Trustee Are Eligible**

As noted in Section A.2, state insurance laws may affect the validity or enforceability of the UST corporate guarantee. If you have any concerns, check with the state Attorney General's office of the state where the covered USTs are located.

Guarantor Eligibility. Any firm is eligible to be a guarantor so long as the firm directly or indirectly controls the voting stock of the owner or operator, or is controlled by an entity that also controls the owner or operator, or is engaged in a substantial business relationship with the owner or operator. Most local government entities are not eligible to provide the corporate guarantee, with the exception of those public power authorities that file financial statements with the SEC, EIA, or RUS. If a non-profit organization can meet the criteria of a financial test, it can be a guarantor. A non-profit entity such as a university or hospital may be able to pass the financial test in order to act as a guarantor. Other non-profits that do not sell goods or services (e.g., the Red Cross) may not be able to pass the financial test or be a guarantor. The financial statements used for the test must be those of the guarantor, not the financial statements of the owner or operator. Even if it has its own financial statements, a subsidiary is not eligible to act as a guarantor for its parent unless there is a substantial business relationship between them.

You have several ways to verify whether the guarantor qualifies as a parent, grandparent, or sister corporation:

- If the parent or grandparent files with the SEC, you can check the Form 10-K. Go to the SEC EDGAR database ([HTTP://WWW.SEC.GOV/](http://www.sec.gov/)) and enter the parent or grandparent company name and look under Form-10K. Within Form-10K is Exhibit 21 which includes a list of subsidiary companies.
- Also, you can use a number of reference publications such as *America's Corporate Families* by Dun and Bradstreet. This book is updated annually and can be found in the reference section of many public libraries. It contains detailed information concerning U.S. corporations and their subsidiaries including percentage of ownership and family hierarchy. (For example, the publication rates subsidiaries as level 1, level 2, or level 3 indicating how far the subsidiary is removed from the "ultimate parent company.")
- Alternatively, request the independently audited financial statements of the firm which will list the subsidiaries of the guarantor.

Companies that file financial statements with the SEC must include a list of all significant subsidiaries,<sup>13</sup> where they are incorporated, and the names under which they do business, as Exhibit 21. Often Exhibit 21 also shows percentage ownership (if less than 100%). The list will show the level of the subsidiaries and indent them accordingly, as in the following exhibit. Although only three levels are shown above, five levels of subsidiaries are not unusual. The relationships listed in Exhibit 4-4 can be displayed graphically as in Exhibit 4-5 below.

Based on the relationships shown above:

- Company A can offer a parent guarantee to Companies B, C, D, and E.
- Company A can offer a grandparent guarantee to companies F through O
- Company B can offer a parent guarantee to Companies F, G, and H but cannot offer a parent guarantee to Companies I through O, because they are not subsidiaries of Company B
- Company B can offer a sister company guarantee to Companies C, D, and E
- Companies B, C, D, and E cannot offer a parent, grandparent, or sister company guarantee to Company A because they are subsidiaries of A
- Company C cannot offer a parent guarantee to Company J because it does not have a controlling ownership (see Exhibit 4-2)
- Company F can offer a sister company guarantee to Companies G and H but not Companies I-O because they do not share a common parent
- Companies F, G, and H cannot offer a parent guarantee to Company B because each is a subsidiary of B.

Large companies may have dozens of subsidiaries, some of which may have similar names.

If the guarantor is not a parent, grandparent, or sister corporation, you should verify that it has a "substantial business relationship" with the owner or operator. Confirm that one is a customer or supplier of the other and that the volume of business transacted is not trivial in an absolute sense. This can be done by making a specific inquiry of the guarantor and the owner or operator. Information about customers and suppliers rarely appears in financial statements and annual reports, and may even be considered confidential business information.

Trustee Eligibility. See Chapter 11, Section C, which describes how to check the eligibility of a trustee for UST FR.

---

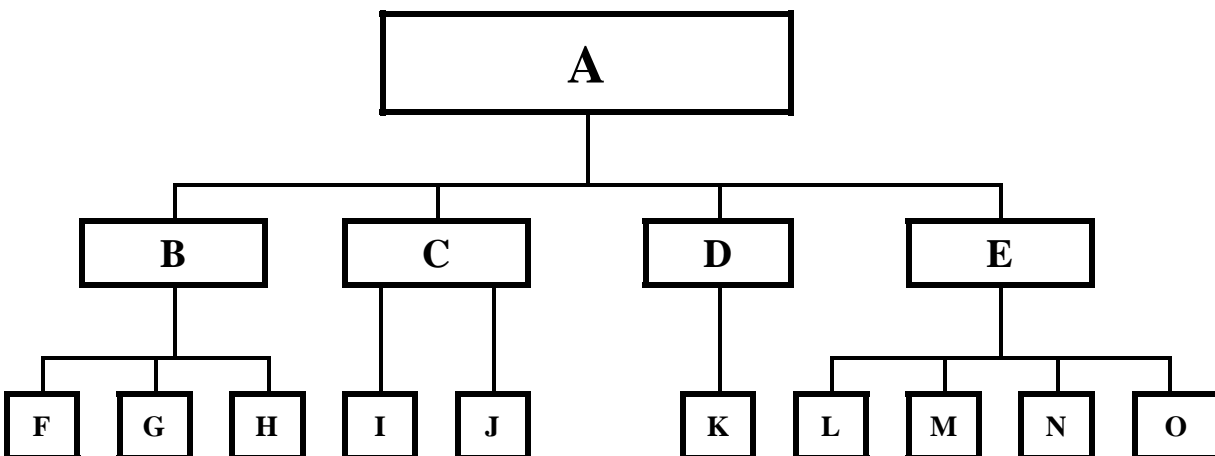
<sup>13</sup> The names of wholly-owned multiple subsidiaries carrying on the same line of business, such as chain stores, may be omitted provided that the name of the immediate parent, the line of business, and the number of omitted subsidiaries are given. See 17 CFR 229.601(b)(21).



**Exhibit 4-4  
EXAMPLE LIST OF SUBSIDIARIES**

<u>Level</u>		<u>Percentage of Voting Securities Owned by Immediate Parent</u>	<u>Organized Under Laws of</u>
1	Company A		Delaware
2	Company B		Delaware
3	Company F	80%	Delaware
3	Company G		Nevada
3	Company H		Delaware
2	Company C		
3	Company I	20%	Delaware
3	Company J		Canada
2	Company D		
3	Company K		
2	Company E		
3	Company L	50%	New York
3	Company M		Colombia
3	Company N		Delaware
3	Company O		Delaware

**Exhibit 4-5  
EXAMPLE OWNERSHIP CHART**



## C.6 Verifying That the Guarantor Can Satisfy the Financial Test for the Proper Amount of Coverage

The guarantor's financial test must be based on the total number of tanks that the guarantor is self-insuring and guaranteeing. Two different examples follow:

- If an owner or operator is self-insuring 60 tanks and guaranteeing 60 tanks belonging to a different owner or operator, the amount of UST coverage used in the financial test to self-insure and guarantee these tanks is \$2 million. However, the guarantee needs to provide for an aggregate amount of only \$1 million in coverage.
- If a guarantor guarantees 60 tanks for each of three different owners, the amount of annual aggregate assurance used in the financial test to guarantee these 180 tanks is \$2 million. Each of the three guarantees, however, needs to provide for an aggregate amount of only \$1 million in coverage.

As discussed in Section A.4 above, the UST financial test for guarantees includes not only the UST coverage amounts but the amounts of any RCRA Subtitle C and SDWA FR requirements for hazardous waste facilities for which the guarantor is using a financial test of self-insurance or providing a guarantee. It is important to verify that the guarantor has completely and accurately included any RCRA Subtitle C and SDWA hazardous waste financial responsibility requirements which are being met by the guarantor's financial test of self-insurance or guarantee. These other FR obligations can be large amounts.<sup>14</sup> You may need to coordinate with other states, EPA Regional Offices, or EPA Headquarters to identify facilities that have RCRA Subtitle C and SDWA financial responsibilities for which the guarantor also is responsible. If the guarantor passes the UST test by a large margin (e.g., 10 times), however, and there is no reason to suspect any hazardous waste responsibilities, it may not be worth the effort to identify those other facilities and liabilities.

**Financial Test Criteria.** Checking the qualifications of the guarantor against the criteria of Alternative I or II will be more laborious. Verifying the mathematics is important for both Alternatives. However, before verifying the details of the test, you may first want to check that the CFO letter is based on the financial statements of the guarantor and not on the financial statements of the owner or operator. If the CFO letter is based on the financial statements of the owner or operator, you should direct the owner or operator to resubmit the letter based on the financial statements of a firm eligible to provide the corporate guarantee mechanism. If the financial statements of the owner or operator are consolidated with the financial statements of the guarantor, the corporate guarantee is an appropriate mechanism, as long as the guarantor is eligible and qualified.

Next, you should review the auditor's opinion, if any, because if it is not "clean," you need not proceed any further in the review because the owner or operator must obtain an alternate assurance. Third, you may want to review the auditor's special report, if any exists. If the special report is not "clean, you need not proceed any further in the review. These steps are described next.

**Auditor's Opinion.** Auditor's opinions are provided in a company's Annual Report to Shareholders and also accompany financial statement filings to the SEC, EIA, and RUS. If the guarantor has independently audited financial statements, you should review the auditor's opinion to ensure it is not adverse,

---

<sup>14</sup> For example, the aggregate amount of RCRA Subtitle C liability coverage is either \$2 million or \$8 million depending on the type(s) of hazardous waste treatment, storage, or disposal facility involved. Closure costs can range from \$25,000 to \$500,000 per site. Post-closure costs can range from \$300,000 to \$500,000 per site.

a disclaimer of opinion, or a "going concern" qualification. Examples of such opinions are provided in Section A.7 of Chapter 3 above. If the opinion is not "clean," you should inform the owner or operator of the need for alternate assurance.

Use of Auditors Special Report. Verifying that the numbers in the CFO letter reflect the data in the financial statements is easy if there is an auditor's special report available. That document should exist in the following two situations:

- The guarantor has reported hazardous waste obligations on line 2 of the CFO letter
- The guarantor does not file financial statements with the SEC, EIA, or RUS and is using Alternative II (i.e., checks "No" on line 19)

If the guarantor has reported hazardous waste obligations on line 2 of the CFO letter, you should request a copy of the independent CPA's special report that must be submitted with use of the financial test under RCRA Subtitle C and the SDWA. That report must state that the CPA has compared the data which the CFO letter specifies as having been derived from the independently audited, year-end financial statements for the latest fiscal year with the amounts in those financial statements. The report also must state that in connection with that procedure, no matters came to the auditor's attention which caused him or her to believe that the specified data should be adjusted.

If the guarantor is using Alternative II and does not submit financial statements annually to the SEC, EIA, or RUS, you should request a copy of the independent CPA's special report. The special report must state that the independent CPA has compared the data in the CFO letter with the amounts in the guarantor's financial statements and that no matters came to the attention of the independent certified public accountant which caused him or her to believe that the information in the chief financial officer's letter should be adjusted.

**You can use the auditor's special report as a basis for accepting the corresponding numbers in the UST financial test as correctly derived from the guarantor's financial statements.** You should still verify the mathematics of the CFO letter.

If the special report is not available, you will need other documents beyond the CFO letter to conduct a complete review of the guarantor's financial test status:

- For Alternative I, these necessary documents will include copies of the latest annual financial statements filed with the SEC, EIA, or the REA or a copy or confirmation of the D&B financial strength rating.
- For Alternative II, you will need copies of the guarantor's financial statements and may need information about Moody's or Standard and Poor's ratings of the most recent bonds issued by the guarantor.

Exhibit 4-6 summarizes how you can obtain this information.

**Exhibit 4-6**  
**SOURCES OF FINANCIAL TEST INFORMATION**

Financial Statements and Auditor Opinions filed with Securities & Exchange Commission (SEC)	Accessible on-line through EDGAR (Electronic Data Gathering and Retrieval) at <a href="http://www.sec.gov/EDGARHP.HTM">HTTP://WWW.SEC.GOV/EDGARHP.HTM</a>
Financial Statements and Auditor Opinions filed with Energy Information Administration (EIA)	Accessible on-line at <a href="http://www.eia.doe.gov/CNEAF/ELECTRICITY/PAGE/DATA.HTML">HTTP://WWW.EIA.DOE.GOV/CNEAF/ELECTRICITY/PAGE/DATA.HTML</a>
Financial Statements and Auditor Opinions filed with Rural Utilities Service (RUS)	Accessible only through Freedom of Information Act request addressed to:  Freedom of Information Office Rural Utilities Service, Stop 0742 1400 Independence Avenue, SW Washington, DC 20250 Phone: 202-692-0031 Fax: 202-692-0034
Dun & Bradstreet (D&B) Financial Strength Ratings	Contact Customer Service Center at 800-333-0505 to request financial strength ratings.
Moody's Bond Ratings	Call 1-212-553-0377 (Ratings Desk) or consult <i>Moody's Bond Record</i> (Monthly Report) found in most public libraries
Standard & Poor's (S&P) Bond Ratings	Call 1-212-208-1146 (Ratings Desk).

As noted in Section A.4 of Chapter 3 above, you will not be able on your own to precisely verify the tangible net worth figure in the CFO's letter from the guarantor's financial statements. In the absence of an accountant's special report or disclosure in a footnote, all that is practical to do is to compare the reported tangible assets figure in line 4 against the total assets figure in the financial statements. Tangible assets in line 4 should not be greater than total assets reported in the financial statements.

With respect to U.S. assets reported in line 7 of Alternative II, you have two options. First you can compare reported U.S. assets in line 7 to total assets shown on the financial statements; the former should not be greater than the latter. Second, you can look in the "notes" to the financial statements for the discussion of "segment information," which *may* display U.S. assets. The amount reported on line 7 should not be larger than the amount of U.S. assets in the notes, taking into account net corporate assets not identified with any geographic segment.

You can confirm the current assets and current liabilities numbers reported on lines 12 and 13 of Alternative II directly from the financial statements.

Acceptable Adjustments to Figures in Financial Statements. For calculating tangible net worth, guarantors are allowed to deduct from their total liabilities any accruals for costs that are being assured by the financial test. This deduction has the effect of increasing tangible net worth. This deduction should not be counted twice: the financial test user can either reduce reported liabilities in line 5 (which will increase tangible net worth calculated in line 6) or increase the reported tangible net worth in line 6. It may be difficult to verify these accruals from the guarantor's financial statements. Even the footnotes to the statements are unlikely to provide sufficient detail. If the guarantor has made such adjustments, you should request to see the corresponding hazardous waste FR demonstrations including the accountants' special report, to confirm the figures.

You may find it helpful to have access, on an as-needed basis, to professionals with accounting/financial expertise

### C.7 Checking the Qualifications of Accountants

Although falsification of credentials is rare, you can confirm that the accountant responsible for preparing the opinion and special report is an independent CPA by contacting the State Board of Accountancy in the state where the accountant resides, if there is any doubt about the accountant's qualifications.

### C.8 Verifying the Wording, Scope, and Amount of Coverage of the Chief Financial Officer Letter, Guarantee, and Standby Trust Fund

CFO Letter. Verifying the wording of the CFO letter is a straightforward activity. The CFO letter should match the required wording. However, unlike other FR documents, minor deviations in the wording or format of the CFO letter may have little impact on the effectiveness of financial test, unless the changes affect the substance of the financial test criteria. Because the CFO's letter is intended to provide information in support of the guarantee, but does not create the guarantee, if the wording of the CFO letter varies from the required wording, there may not be a serious problem. The following are key items to look for in the CFO's letter:

- The letter should be signed by the person who is officially designated as the Chief Financial Officer of the guaranteeing company. However, the CFO may not use that title. The letter might, instead, be labeled as the CFO's letter but be signed by the corporate treasurer or some other corporate official. The person signing the letter must be the functional equivalent of the CFO. Sometimes it will be quite clear that the CFO has not signed the letter. For example, if it is signed by the "Assistant Treasurer," that person is unlikely to be the "chief" financial officer. An "Acting Chief Financial Officer" probably, on the other hand, meets the requirements of the rule because there is no superior financial officer, at least temporarily.
- The letter should say whether the guaranteeing firm is required to file a Form 10-K and state the last day of the firm's fiscal year. If this information is omitted from the CFO letter, you can use alternative methods to determine if the firm files a Form 10-K with the SEC and/or when its fiscal year begins and ends.
- The financial test portion of the CFO's letter should specify which alternative of the test is applicable and provide calculations that completely demonstrate the firm's ability to pass the test. Although this information must be provided, use of alternative presentation formats will not undermine the effectiveness of the test or the guarantee.

Guarantee. Unlike the CFO letter, deviations in the wording of the guarantee may compromise its effectiveness. The guarantee agreement establishes the terms and conditions of the guarantee. Without certain key phrases, the financial assurance mechanism has not been established and will not be effective. Therefore, **the wording of the guarantee should be identical to the required wording in the rule, without additions or omissions.**

Guarantee mechanisms sometimes contain variations in wording from the required language for the following "recitals" (separate numbered paragraphs) in the guarantee:

- Recital 2 of the guarantee identifies the facilities, numbers of tanks at each facility, and names and addresses of the facilities. It specifies the tanks for which financial assurance is being provided. This information is needed to verify which owner or operator the guarantee covers, as well as the specific facility(ies) and/or tanks for which financial assurance is being provided. Therefore, although slight variations in the language of Recital 2 are possible, the information called for in that Recital is essential.
- Recital 3 of the required wording documents the obligation that must be guaranteed and the relationship between the guarantor and the owner or operator that supports the guarantee. This is one of the most important recitals in the guarantee mechanism. Deviations from the language of Recital 3 should not be accepted.
- Recital 4 requires the guarantor to send notice within 120 days that it no longer is qualified to provide the guarantee, which alerts the owner or operator to obtain a replacement financial assurance mechanism. The guarantee must include a promise that the guarantee will not terminate prior to 120 days from receipt of the notice, as evidenced by the return receipt.
- In Recital 6 the guarantor agrees to remain bound notwithstanding any modification or alteration of any obligation of the owner or operator. Omission of this recital could be problematic because the implementing agency normally would not notify the guarantor of amendments or modifications to the requirements for the owner or operator. If the guarantor has not expressly waived notice of any changes, the guarantor could argue that the guarantee is null and void. That is why the guarantee must include this language exactly as required.
- Recital 8 includes a listing of exceptions commonly found in insurance coverage for corrective action and/or third party compensation. Variations in the language describing these exceptions should be carefully reviewed to ensure that they do not affect the coverage of corrective action and third-party compensation from releases from USTs. You may require that the guarantee be resubmitted to match the required wording.
- Recital 9 of the recommended wording provides that the guarantor expressly waives notice of acceptance of the guarantee by the implementing agency, third parties, and the owner or operator. This is a practical provision, to avoid the need for an exchange of formal notices of acceptance. Slight variations in the language are not critical.

The person signing the guarantee must be authorized to enter into a binding agreement on behalf of the company. If there is any reason for doubt, request documentation, such as a copy of corporate by-laws or a corporate resolution, that demonstrate the person's authority to enter into the guarantee agreement.

Scope of Coverage. The guarantee can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the guarantee will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the guarantee can be used to cover the other scope area. You should ensure that the scope of coverage of the guarantee is appropriate even when it is used in combination with other mechanisms.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a guarantee with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the guarantee for part of the required

scope of coverage, the guarantee also would work for the full scope because the required amount of coverage used in the guarantor's financial test stays the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A corporate guarantee must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when a guarantee is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

The proper amount of UST aggregate coverage is either \$1 million or \$2 million depending on the number of tanks being covered. These are the only numbers that should appear on line 1 of the CFO letter unless the guarantee is being used in combination with another mechanism. Combining the corporate guarantee with another FR mechanism to cover the full amount of required coverage is an unlikely scenario with one exception: an owner or operator may choose to use the guarantee to cover amounts not assured by a state fund. For example, if a state fund provides aggregate coverage up to \$1 million, then the corporate guarantee could be used to cover an additional \$1 million if the owner or operator has over 100 USTs.<sup>15</sup>

The required amount of coverage for the guarantee may be less than the amount used in the guarantor's financial test, as described in C.6 above.

Standby Trust. See Chapter 11, Section C, with respect to verifying the wording of the standby trust agreement.

## **C.9 Requesting Reports of the Guarantor's Financial Condition**

The Director of the implementing agency may require reports of financial condition at any time from the guarantor and may disallow use of the corporate guarantee if these reports demonstrate the financial test criteria are no longer being met.

Generally, requested information might include an updated financial test demonstration based on current (e.g., mid-year) financial data, or unaudited interim financial statements (such as 10-Qs submitted to the SEC), or other statements of information (such as 8-Ks submitted to the SEC).

The 10-Q reports unaudited financial results for a fiscal quarter and notes any significant changes or events in the quarter. Form 8-K is used by companies to file current reports on the following events:

- Item 1. Changes in Control.
- Item 2. Acquisition or Disposition of Assets.
- Item 3. Bankruptcy or Receivership.
- Item 4. Changes in Certifying Accountant.
- Item 5. Other Materially Important Events.
- Item 6. Resignations of Directors.
- Item 7. Financial Statements and Exhibits.
- Item 8. Change in Fiscal Year.
- Item 9. Regulation S Offerings.

---

<sup>15</sup> Some state funds require owners and operators to demonstrate financial responsibility for the funds' deductible amounts; states may allow guarantors to use a special financial test for this purpose that is less stringent than the federal test described here.

Information that is publicly available often can be obtained more quickly from the information sources listed in Exhibit 4-6 than by requesting it from the owner or operator. With respect to financial statements filed only with the RUS, however, it likely will be quicker to request them from the owner or operator than to file a Freedom of Information Act (FOIA) request with RUS. Any information (e.g., stock option plans) not bearing on the requirements specified in the financial test cannot be used to disqualify a guarantor and should not be requested.

#### **C.10 Notifying Owners or Operators That Their Guarantors No Longer Meet the Financial Test Requirements**

If you find that the guarantor no longer meets the requirements of the financial test, you should notify the owner or operator to arrange alternate assurance within 30 days.



## D. CORPORATE GUARANTOR RESPONSIBILITIES

The following checklist summarizes the guarantor's responsibilities:

<b>CHECKLIST OF CORPORATE GUARANTOR RESPONSIBILITIES</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Being Eligible to Act as a Guarantor (see Section D.1)</li><li><input type="checkbox"/> Demonstrating Satisfaction of Financial Test for the Proper Scope and Amount of Coverage and Delivering the Chief Financial Officer Letter and Guarantee to Owner or Operator (see Section D.2)</li><li><input type="checkbox"/> Updating Assurance Annually (see Section D.3)</li><li><input type="checkbox"/> Notifying the Owner or Operator of Decision to Cancel the Guarantee; If No Longer Eligible, Qualified, or Authorized to Provide Guarantee; or If Named as a Debtor in Bankruptcy Proceedings (see Section D.4)</li><li><input type="checkbox"/> Funding the Standby Trust as Directed (see Section D.5)</li></ul>

### D.1 Being Eligible to Act as a Guarantor

The guarantor must be a parent, grandparent, or sister company of the owner or operator or have a substantial business relationship with the owner or operator. A guarantor should review the UST FR regulations, especially 40 CFR 280.96.

### D.2 Demonstrating Satisfaction of Financial Test for the Proper Scope and Amount of Coverage and Delivering the Chief Financial Officer Letter and Guarantee to Owner or Operator

Based on information from the owner or operator regarding the scope and amount (i.e., the number of tanks to be assured) of required coverage, and any other USTs or hazardous waste obligations for which the guarantor is providing assurance using a guarantee or self-insurance, the guarantor must demonstrate that it meets the financial test criteria based on its year-end financial statements. A guarantor need satisfy only one of the two Subtitle I financial tests. Within 120 days after the close of each fiscal year, the chief financial officer (CFO) of the guarantor firm must sign a letter reporting the year-end financial information supporting use of the financial test. The guarantor's letter signed by its CFO must be worded as specified in 40 CFR 280.95(d). The guarantor must deliver the letter to the owner or operator.

Alternative I. This test relies heavily on the guarantor's net worth and is sometimes called the "net worth" test. The guarantor must have:

(1) Tangible net worth equal to at least 10 times

- the amount of UST aggregate assurance required (either \$1 million or \$2 million, depending on number of tanks), plus
- the estimated costs of closure, post-closure care, liability coverage, and/or corrective action at Subtitle C hazardous waste facilities, if the guarantor is also using a financial test of self-insurance or providing a guarantee to meet RCRA Subtitle C financial responsibility requirements, plus
- the estimated costs of plugging and abandonment at all SDWA Class I hazardous waste injection wells for which the guarantor is using a financial test or providing a guarantee to meet SDWA FR requirements.

- (2) Tangible net worth of at least \$10 million.
- (3) The guarantor must either:
  - file annual financial statements with the SEC, EIA, or the RUS, or
  - annually report tangible net worth to Dun & Bradstreet (D&B), which must have assigned the guarantor a financial strength rating of 4A or 5A.
- (4) The guarantor's year-end financial statements, if independently audited, can not include an adverse auditor's opinion, a disclaimer of opinion, or a "going concern" qualification.

Further information on Alternative I appears in Section A.4 of Chapter 3.

Alternative II. Guarantors may choose to use the financial test criteria of the Subtitle C test for liability coverage, as specified in 40 CFR 264.147(f)(1), to satisfy UST FR obligations. The guarantor must have:

- (1) Tangible net worth of \$10 million and six times
  - the amount of UST aggregate assurance required (either \$1 million or \$2 million, depending on number of tanks), plus
  - the estimated costs of closure, post-closure care, liability coverage, and/or corrective action at Subtitle C hazardous waste facilities, if the guarantor is also using a financial test of self-insurance or providing a guarantee to meet RCRA Subtitle C financial responsibility requirements, plus
  - the estimated costs of plugging and abandonment at all SDWA Class I hazardous waste injection wells for which the guarantor is using a financial test or providing a guarantee to meet SDWA FR requirements.
- (2) At least 90 percent of assets in the United States, or U.S. assets at least six times the required amount of UST coverage plus hazardous waste costs (as above); and
- (3) Either:
  - Net working capital at least six times the required amount of UST coverage plus hazardous waste costs (as above); or
  - A current Standard and Poor's rating of AAA, AA, A, or BBB, or a current Moody's rating of Aaa, Aa, A, or Ba for the most recent bond issuance.
- (4) The guarantor's independently audited year-end financial statements can not include an adverse auditor's opinion, a disclaimer of opinion, or a "going concern" qualification.

Alternative II, unlike Alternative I, requires the involvement of an independent certified public accountant to examine and issue an opinion on the year-end financial statements. If the guarantor's financial statements are not submitted annually to the SEC, EIA, or RUS, an independent CPA also must prepare a special report comparing the data on the CFO's letter with the amounts in the year-end financial statements.

**Guarantee.** The guarantor also must prepare a written guarantee agreement worded as specified in the regulations at 40 CFR 280.96(c). The guarantee need only be provided one time to the owner or operator. The guarantor must sign the guarantee before a witness or notary. **By signing the guarantee, the guarantor agrees to comply with the federal requirements for UST guarantors.**

**D.3 Updating Assurance Annually**

Guarantors must update the financial test data in the CFO letter annually. From year-to-year the following items can change:

- Required Amount of Coverage
  - ~ Number of covered USTs
  - ~ Cost estimates for hazardous waste facility closure, post-closure care, corrective action, plugging and abandonment
- Net Worth
- Net Working Capital
- U.S. Assets and Total Assets
- D&B Financial Strength Ratings
- Moody's or Standard & Poor's Ratings for Most Recent Bond Issuance
- Auditors' Opinions

The guarantee itself remains effective until it is cancelled or replaced. It does not need to be updated unless the scope or amount of coverage is being changed.

**D.4 Notifying the Owner or Operator of Decision to Cancel the Guarantee; If No Longer Eligible, Qualified, or Authorized to Provide Guarantee; or If Named as a Debtor in Bankruptcy Proceedings**

There are five circumstances that require the guarantor to notify the owner or operator:

Trigger	Requirement
(1) If the guarantor decides to cancel the guarantee	Notify owner or operator by certified mail at any time, but cancellation is not effective until 120 days after receipt (see 40 CFR 280.96(c) and 280.109(a))
(2) If the guarantor fails to meet the requirements of the financial test at the end of any financial reporting year	Notify owner or operator within 120 days of the end of that financial reporting year by certified mail (see 40 CFR 280.96(b) and (c))
(3) If the guarantor receives a notification from the Director of the implementing agency that the guarantor no longer meets the requirements of the financial test	Notify owner or operator within 10 days of receiving notice from the Director (see 40 CFR 280.96(b))

Trigger	Requirement
(4) If the guarantor ceases to be eligible or loses the authority to issue a guarantee	Notify owner or operator (see 40 CFR 280.114(e))
(5) If the guarantor is named as a debtor in bankruptcy proceedings	Notify owner or operator within 10 days (see 40 CFR 280.96(c) and 280.114(b))

In Cases 1, 2, and 3, the guarantee will terminate no less than 120 days after the date the owner or operator receives the notification, as evidenced by the return receipt.

#### **D.5 Funding the Standby Trust as Directed**

The guarantor must follow the instructions of the Director of the implementing agency and deposit funds into the standby trust fund.

**E. SOURCES OF FURTHER INFORMATION**

See Section D of the Financial Test chapter for a list of popular financial accounting books.

[THIS PAGE INTENTIONALLY LEFT BLANK]

## 5. FINANCIAL RESPONSIBILITY USING INSURANCE

This chapter describes the use of insurance to demonstrate UST FR as follows:

A. BACKGROUND	84
A.1 What Is An Insurance Policy?	84
A.2 How Does Insurance for USTs Work?	84
A.3 State Regulation of Insurance	85
A.4 What Types of Insurance Products Can Be Used for UST FR?	87
A.5 What Types of Insurers Are Eligible?	96
A.6 What Special Provisions Are Necessary in UST Insurance?	97
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING INSURANCE	101
B.1 Selecting an Eligible Insurer or Risk Retention Group	101
B.2 Purchasing Proper Scope and Amount of Insurance	101
B.3 Obtaining a Properly Worded Certificate or Endorsement	102
B.4 Recordkeeping	102
B.5 Maintaining Coverage from Year to Year	102
B.6 Obtaining Alternate Assurance If the Insurer Decides to Cancel or Not to Renew the Policy or If Insurer Is No Longer Eligible to Provide Insurance	103
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy	103
B.8 Submitting Financial Responsibility Documents	103
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	104
C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as A Debtor in Bankruptcy Proceedings	104
C.2 Reviewing Financial Responsibility Submissions	105
C.3 Verifying Insurer or Risk Retention Group Eligibility	105
C.4 Verifying the Wording of the Certificate or Endorsement	105
C.5 Checking That the Correct Amounts and Type(s) of Coverage Are Provided	106
C.6 Requesting the Policy and All Endorsements	106
D. INSURER RESPONSIBILITIES	107
D.1 Being a Licensed Insurer or Eligible Excess or Surplus Lines Insurer in At Least One State	107
D.2 Notifying the Owner or Operator in Writing of Decision to Cancel or Otherwise Terminate the Insurance or If No Longer Eligible to Provide Insurance	107
D.3 Furnishing a Signed Duplicate Original of the Policy and All Endorsements Whenever Requested by the Implementing Agency	107
D.4 Providing Appropriate Coverage	107
E. SOURCES OF FURTHER INFORMATION	108

## A. BACKGROUND

### A.1 What Is An Insurance Policy?

An owner or operator may satisfy the UST FR requirements by obtaining appropriate **liability insurance** from a qualified insurer or risk retention group. Insurance is a common option in many government mandated financial responsibility programs, both environmental and non-environmental (e.g., FR for workers compensation and automobile liability). Such insurance may be in the form of a separate insurance policy or an endorsement to an existing insurance policy.

An **insurance policy** is a **contract** by an insurance company to pay for certain damages, injuries, or losses. Both **claims made** and **occurrence** forms of insurance, defined in section a.6 below, may be used to comply with UST FR. Either an **endorsement** applicable to the insurance policy, or a **certificate of insurance**, not part of the insurance policy, can serve as proof that an insurance contract has been arranged. The regulations specify the wording required for the endorsement and certificate of insurance.

Environmental insurance is readily available nationwide. For many owners and operators not covered by state funds, insurance will be the preferred mechanism because it will be less costly and more available than other commercial mechanisms. A number of insurance companies or intermediaries (e.g., agents or brokers) specialize in pollution or environmental insurance and can provide or identify policies that comply with UST FR requirements. Other insurance companies that do not specialize in pollution insurance also may offer UST coverage to their policyholders who purchase other lines of commercial liability coverage. Such policies also may be appropriate to demonstrate UST FR. Section A.4 below discusses various types of insurance products that may, or may not, satisfy UST FR requirements.

### A.2 How Does Insurance for USTs Work?

The first step in using insurance to pay for corrective action and third-party compensation is to notify the insurer about releases that may require corrective action and claims for compensation. Unlike most other providers of FR, insurers expect to be notified about relevant claims or suits on a timely basis. Because they share the risk, insurers want to be informed about and may choose to play a more or less active role in resolving any corrective action or third-party claims. Insurers typically have the legal **duty to defend** and retain the right to designate legal counsel and adjust (i.e., negotiate) any claims. The insurer often will pay on behalf of the insured, especially in cases of third-party compensation. In some cases of corrective action, the implementing agency may undertake response activities to clean up a release in a timely manner. In such cases the implementing agency would receive reimbursement by the insurer. The insurer may similarly reimburse the owner or operator for corrective action spending, although the more typical pattern is for the insurer to hire, oversee, and pay remediation contractors.

To obtain and maintain coverage, the insured must pay annual periodic **premiums**. Pollution liability policies frequently have high **deductibles** in order to keep premium costs down. The UST FR **first dollar coverage** requirement prevents delay of cleanup or payment for third-party compensation by requiring the insurer to make payments included within the deductible amount. The insurer is entitled to recover payments made within deductible limits from policyholders.<sup>16</sup> In other words, any deductible amounts must be reimbursed by the insured.

This option differs from **self-insurance** because it involves a source of UST financial responsibility other than the owner or operator.

---

<sup>16</sup> The LUST Trust Fund can not be used to guarantee payment of deductibles to the insurer.



Insurance policies do not make insurers responsible for activities that are the day-to-day responsibility of the owner or operator. Acceptable insurance policies need not cover response actions that are part of routine maintenance, upgrade, or enhancement of tank sites. Corrective action coverage is required only for those activities associated with cleanup of releases set forth at 40 CFR 280.60 to 280.66 and 280.72(b) of the technical standards, or ordered by the implementing agency.

The effective date of cancellation differs where the cancellation is due to non-payment of premium or misrepresentation as opposed to cancellation for any other cause:

- Termination of insurance coverage, except for non-payment or misrepresentation by the insured, may not occur until 60 days after the date on which the owner or operator receives the notice of termination, as evidenced by the return receipt. This provision was meant to ensure that an owner or operator whose insurance was canceled or terminated would have sufficient time to obtain an alternative assurance mechanism thereby avoiding any unacceptable gaps in coverage.
- Termination for non-payment of premium or misrepresentation by the insured may not occur until a minimum of 10 days after the date on which the owner or operator receives the notice of termination, as evidenced by the return receipt. EPA considered the 10-day period to be appropriate in the case of non-payment or misrepresentation, because the insurer is unfairly undertaking risks without rightful compensation. This 10-day period does not apply to termination for any reason other than non-payment of premium or misrepresentation. Some state insurance laws mandate a longer notice period prior to cancellation.

Insurance policies are as strong as the ability of the issuing insurer to honor them. The financial strength and liquidity of insurers is assured through state regulation and oversight, which is described in the next section.

### **A.3 State Regulation of Insurance**

The Regulated Market. The business of insurance is regulated by the states. Insurance companies not only must incorporate under the laws of a state, but to do business, an insurance company also must be licensed. Moreover, most states prohibit licensed insurers from engaging in businesses other than insurance or closely related businesses. In addition, federal bankruptcy law does not apply to insurance companies. Rather state insurance law governs insurer insolvency and liquidation.

Licensing -- also called admission -- is performed by a state agency for specific "lines" of insurance offered by an insurer. Every U.S. state has an insurance regulatory agency. Under state law, a **licensed insurer** is subject to rate filing and approval requirements, reserving requirements, and investment restrictions. These requirements are intended to protect insurance buyers from unsound or unscrupulous insurers. Typically, state insurance regulators have broad discretion in issuing and renewing licenses in order to protect the public.

A key goal of insurance regulation is maintaining the solvency of insurers. Solvency is measured in two ways: (1) assets equal to or greater than liabilities, and (2) sufficient "liquid" assets readily available to pay obligations as they are due. In addition to being reviewed by state agencies, insurers also submit copies of their annual financial statements to the National Association of Insurance Commissioners (NAIC) for analysis of actual or potential insolvency.

Policy forms, including endorsements, often are subject to state filing and approval requirements. The Insurance Services Office, Inc. (ISO) develops and files policy forms for commercial property and commercial general liability (CGL) coverage which are widely used as "standard" by insurers.

Starting in 1998, some states have enacted legislation to deregulate commercial insurance. In particular, these new laws are intended to exempt insurers from having to file for rate and form approval when selling insurance to large commercial customers. Deregulation also may remove access to state guaranty funds. Implementation is likely to be slow for a variety of reasons including concerns about effects of deregulation on the solvency of insurers, disagreements over which customers to exempt, and inconsistencies among states.

The Unregulated Market. **Excess or surplus (E&S) lines** of insurance are not subject to rate and form review and are, by definition, sold by non-admitted insurers. Excess and surplus lines carriers generally insure risks that are so new or unpredictable that admitted insurers are reluctant to cover them. They were the first to cover communications satellites and day-care centers; now they insure gene-splicing and batteries for heart pacemakers. With experience, risks migrate from the non-admitted to the admitted market. To retain that business, many surplus lines providers are members of a larger group of insurance affiliates that write standard lines. Although available from admitted carriers in a number of states, pollution or environmental liability insurance also qualifies as an "excess or surplus line" because of the unusual nature of the risk (i.e., compared to fire and auto). However, an insurer may offer UST insurance on a non-admitted basis in some states but be licensed in others.

Non-admitted insurers typically are not allowed to transact the business of insurance in a state except through specially-licensed brokers or agents. Often, three admitted carriers must decline coverage before a customer can purchase coverage from a non-admitted insurer. In some states, excess or surplus lines insurance can be placed only with non-admitted insurers who are "approved" ("white list").

Although surplus lines companies may not be regulated as closely as traditional carriers, that does not mean they are not regulated. Each company must be licensed (admitted) in the state that serves as its domicile and must meet the solvency requirements of that state. As a result, the state of domicile becomes the regulator over that insurer. Because the risks they underwrite have more opportunities for things to go wrong, minimum capital requirements for surplus lines companies may be higher than for admitted companies.

One important feature of excess or surplus lines is that non-admitted insurance is **not** covered by state insurance guaranty funds.<sup>17</sup> These funds (sometimes called "security" funds) provide for limited payments to policyholders of insolvent insurance companies after the companies' assets have been exhausted. Every state has enacted guaranty fund laws.

Regulation of Agents and Brokers. Insurance may be marketed and sold directly by insurers or through independent representatives such as **agents** or **brokers**. These representatives are often called "producers." Similarly, claims handling and related services may be conducted by the insurers themselves, agents or brokers, or other contracted entities. Every state has some form of licensing requirement for agents, brokers, and similar representatives. Producers who arrange insurance from non-admitted companies under the "excess and surplus lines" laws usually are separately licensed as excess or surplus lines brokers or agents. Although insurance professionals should understand pollution insurance, they may not be familiar with what type of coverage is necessary to comply with the UST FR requirements.

---

<sup>17</sup> Only New Jersey has a guaranty fund for E&S carriers.

#### A.4 What Types of Insurance Products Can Be Used for UST FR?

As of 1999, there are many sources of insurance that can be used to demonstrate UST FR. EPA has posted on the OUST website a document listing insurers who can provide UST FR coverage. These insurers may offer policies solely for USTs or may include USTs in policies designed to address all of the environmental or pollution liabilities of a business. Insurers not on the list also may be willing to provide UST coverage, particularly to customers purchasing commercial general liability (CGL) policies, which are designed to cover virtually all of a business' commercial liabilities. There also are many insurance products that do not satisfy UST FR requirements even though they insure commercial risks, environmental or pollution liabilities, and even USTs. The goal of this section is to describe the scope and nature of insurance that will satisfy the regulations and also identify types of policies that do not, even if they might be presented as compliant. Of course, implementing agencies can rely on properly worded insurance certificates or endorsements as evidence of FR and may choose not to review the policies themselves.

**Liability insurance** is the most appropriate insurance product for demonstrating FR for UST corrective action and third-party compensation. "Liability" refers to injury, damage, or loss to parties **other than** the insured and the insurer. That is why the term "third-party" is used. To the extent that UST owners or operators also own the property where the USTs are situated, "first party" commercial property damage insurance might be applicable to on-site corrective action. Commercial property policies cover damage to property owned by the insured. They provide very limited cleanup coverage. A typical amount is \$10,000. Commercial property policies rarely provide more than \$100,000 worth of cleanup coverage. This amount is well below the required amount of coverage for UST FR. Moreover, that type of insurance would not provide coverage for third-party compensation or off-site corrective action. Therefore, the remainder of this section focuses on liability insurance.<sup>18</sup>

There are many types of liability insurance products on the market. These policies provide liability coverage for different types of parties, activities, and losses. One broker has estimated that over 140 different environmental or pollution liability insurance products are available to U.S. companies. **Some of these products will be appropriate for demonstrating UST financial responsibility. Others will not.** Just knowing that a policy provides "pollution coverage" is not enough. The name of the product (e.g., pollution liability, environmental impairment liability, even underground storage tank insurance) can not be used alone to determine whether the coverage satisfies the UST FR rule. However, the names of some products (e.g., contractors' environmental liability, professional pollution liability) indicate that they are not appropriate for UST FR.

Insurance for UST FR must cover:

- corrective action (both on-site and off-site)
- third-party compensation (both on-site and off-site)
- from sudden and nonsudden accidental releases

---

<sup>18</sup> Homeowners can buy limited first and third-party coverage for escaped fuel remediation. This insurance applies when liquid fuel escapes from its storage system. Up to \$10,000 of coverage (a higher limit may be purchased) is provided for: temporary repairs to prevent further escape or to stop the spread of fuel; expenses to test, monitor, or assess the effects of escaped fuel that is required by an outside source (other than the insured); additional living expenses; and loss or damage to shrubs, trees, and plants not grown for business. The third-party coverage applicable to escaped fuel liability caps the limit available to a \$50,000 aggregate (higher limits may be purchased) for all claims against the insured from damage or injury because of escaped fuel contamination. This policy provides limits that are far too low for UST FR and may not cover off-site remediation. Further, as a homeowner policy, this coverage is not designed for the regulated business community covered by RCRA Subtitle I.

- arising from the operation of petroleum USTs

Thus, insurance that covers corrective action but not third-party compensation is not alone sufficient to demonstrate UST FR. Insurance that covers corrective action and third-party compensation but only from sudden releases is not alone sufficient to demonstrate UST FR. Insurance that covers corrective action and third-party compensation from sudden and nonsudden accidental releases from hazardous waste disposal facilities does not satisfy UST FR requirements. A policy issued to a manufacturer, installer, or tester of petroleum USTs that covers corrective action and third-party compensation from sudden and non-sudden accidental releases from USTs does not satisfy FR requirements. Coverage limited to "the existence of imminent and substantial danger to third parties resulting from a pollution condition" would not be sufficient for Subtitle I FR. **The scope of coverage must correspond with UST FR requirements.** See Section A.1 in Chapter 2 above.

Some liability insurers are reluctant to provide coverage for on-site damage because of the "moral hazard" involved.<sup>19</sup> In other words, liability insurers fear that coverage of on-site corrective action could provide a disincentive to the owner or operator of an UST to operate properly or may encourage negligence resulting in more releases and more claims to the insurance provider. Insurers may also fear that coverage for on-site cleanup might make them responsible for the costs of routine maintenance or site restoration. Some liability insurers, however, provide on-site coverage in order to limit their exposure to potentially more expensive third-party claims. On-site coverage generally must be added to policies covering pollution liability or environmental impairment liability (EIL) but is typically included in insurance for UST coverage, as discussed further below.

The insurance industry offers insurance "programs" or "packages" to industry groups that may own or operate USTs, such as petroleum distributors, service stations, marinas, truck terminals, construction companies, automobile dealers, petroleum and convenience store marketers, golf courses and country clubs, agricultural dealers, even real estate investment trusts. Such programs may (1) automatically include UST coverage, (2) make it available as a purchase option, or (3) not include UST coverage. To satisfy FR requirements, the insurance program must include the full scope and amount of UST coverage.

Many owners or operators who buy insurance rely on agents or brokers. **Because environmental insurance is a specialized line of business, not all insurance brokers or agents themselves may understand which coverage is required for UST FR compliance.** Environmental insurance professionals emphasize the importance of analyzing each coverage and exclusion item, not just the certificate of insurance, when procuring insurance coverage. The required UST endorsement or certificate should ensure conformance with the UST regulations, but may not due to ignorance, misunderstanding or negligence on the part of agents, brokers, insurers, or insureds.

Exhibit 5-1 lists major types of insurance products and comments on their suitability for UST FR purposes. The following text elaborates on the comments in the exhibit.

---

<sup>19</sup> First party coverage (i.e., coverage of damages to the insured) has traditionally been offered separately from liability coverage.

**Exhibit 5-1**  
**MAJOR TYPES OF INSURANCE THAT MAY PROVIDE ENVIRONMENTAL  
OR POLLUTION LIABILITY COVERAGE**

Type of Coverage	Applicability to UST FR
Underground (or Combined Underground and Aboveground) Storage Tank Insurance	Usually provides UST FR coverage. Some policies may not cover on-site compensation or cleanup
Petroleum Dealers Insurance	May need to add appropriate pollution coverage
UST Warranty Coverage	Coverage too narrow for UST FR
Commercial General Liability (CGL)	Must be specially endorsed to provide UST FR coverage
Business Auto Policy	Not relevant for releases from the operation of USTs
Garage Insurance	Must be specially endorsed to provide UST FR coverage
Contractors Pollution or Environmental Impairment Liability Insurance	Not relevant for releases from the operation of USTs
Engineers, Consultants, or Professionals Environmental Liability or "Errors and Omissions" (including Pollution)	Not relevant for releases from the operation of USTs
Directors and Officers Environmental Liability	Not relevant for releases from the operation of USTs
Motor Carrier, Hazardous Materials Transporters, or Vessel Spill Liability	Not relevant for releases from the operation of USTs
Third-Party Owned Disposal Site Coverage	Not relevant for releases from the operation of USTs
RCRA Hazardous Waste Closure/Post-Closure or Liability Insurance	Not relevant for releases from the operation of USTs
Product Liability Environmental Insurance	Not relevant for releases from the operation of USTs
Remediation Cost Overrun (or "Stop-Loss") Coverage	May provide partial coverage of corrective action costs. No third-party coverage. Not designed for UST FR
Remediation Warranty Coverage	Not relevant for UST FR because it applies after the completion of corrective action
Real Property Transfer Environmental Insurance	May cover third-party compensation and cleanup costs. Verify that policy was issued to buyer and check policy period
First Party Environmental Remediation	May be endorsed to provide third-party coverage. Lack of extended reporting period may be a problem
Pollution Legal Liability or Site-Specific Environmental Impairment Liability Insurance	Usually covers compensation to third parties for off-site bodily injury or property damage and cleanup costs from off-site releases. Covers sudden as well as non-sudden releases. Generally does not include on-site cleanup or third-party compensation. Can be enhanced to include on-site cleanup and third-party compensation for UST FR

Underground Storage Tank Insurance. In addition to the UST endorsement to the CGL policy described below, other insurance products have been developed specifically for releases associated with owning or operating USTs. These products also are designed to satisfy UST FR requirements. Coverage may include aboveground tanks, which would not disqualify using this insurance for UST FR as long as separate limits are established in the policy (see "Declarations" page) for USTs that satisfy the FR requirements. Some UST policies, however, do not cover on-site cleanup and on-site third-party compensation, which means they would not alone be sufficient for UST FR compliance.

Petroleum Dealers Insurance. This type of insurance package is designed to meet the insurance needs of petroleum dealers. However, UST coverage may not be included in the package or may be offered as an option. UST coverage is necessary to satisfy FR requirements.

UST Warranties. If an UST owner or operator receives a warranty from a tank manufacturer that provides up to \$2 million of third-party liability coverage, including site cleanup and defense costs, for 10 years, is that sufficient evidence of FR? Unfortunately, no. Because contamination may result from causes other than tank defects, this coverage is too narrow in scope. For the same reason, UST FR requirements would not be satisfied by having the UST owner or operator added as "an additional insured" to an UST manufacturer's product liability policy, even if that policy did not have a pollution exclusion.

Commercial General Liability (CGL), Garage, and Auto Policies. CGL and auto are the most common insurance products that companies buy. The Garage policy is discussed here because it is a hybrid of the CGL and auto forms. ("Commercial multiperil" is simply a combination of CGL and property coverage.) The Insurance Services Office (ISO) has developed "standard forms" that insurers can use (and modify) in selling these types of policies. The following discussion is based on the current ISO standard policy language.

CGL, Garage, and Auto policies typically will not be appropriate for demonstrating UST FR because they include "**pollution exclusions**," often termed "**total pollution exclusions**." These exclusions mean that the policies do not cover some or all claims for injury or damage resulting from pollution nor the costs of cleaning up releases. These exclusions are standard in CGL, Garage, and Auto policies. They are commonly listed in an "Exclusions" section of a policy, but may appear in a "Definitions" section or under "Limits." These policies also state that coverage is not provided for any premises owned, occupied, or rented by the insured.

Even if a CGL policy lacks the "total pollution exclusion" endorsement, at most it will cover bodily injury and property damage compensation claims related to petroleum releases but it will not cover cleanup costs. Such a policy could be used to demonstrate UST FR only in combination with another mechanism that covers cleanup costs. For example, if an owner or operator has USTs in a state where a state fund provides assurance for cleanup costs but not bodily injury or property damages, a CGL policy without a total pollution exclusion could provide the missing coverage.

Owners or operators may be able to add pollution coverage endorsements to standard CGL forms. This is far from routine because most of the insurers who sell commercial liability insurance do not want to add pollution coverage. When they do, the coverage usually does not include claims for damage to soil or groundwater. The extended coverage typically is limited to sudden releases only. Such coverage extensions do not satisfy UST FR requirements. For example, one common approach requires that the pollution release be discovered within 7 days of its commencement and reported to the insurer within 30 days of discovery in order to be covered. Some CGL policies may limit pollution coverage to events that begin and end within a 72-hour period.

Garage Insurance. Auto dealers, auto service operations, tow truck operators, parking lots, and similar businesses often purchase so-called "garage insurance." This type of policy is a hybrid of the CGL and the business auto forms. An UST owner or operator might want to use its garage insurance to demonstrate UST financial responsibility. However, garage liability coverage includes pollution exclusions similar to those described above. The garage policy does refer to "covered pollution cost or expense" but that coverage is very narrowly defined (e.g., off premises discharges, gasoline escaping from automobile gas tanks). For UST FR, the owner or operator would need to purchase an UST endorsement or a separate policy.

Exhibit 5-2 lists standard endorsements that may be applied to CGL or Garage policies. Some of these endorsements may allow the policy to provide all or part of the required UST scope of coverage.

UST Endorsement. The ISO underground storage tank coverage form -- CG 00 42 -- is a self-contained, claims-made liability coverage policy. It covers tanks either owned or operated by the insured. To be covered each tank must be listed in the policy declarations.

- The ISO UST endorsement has two coverage parts:
  - ~ Coverage A provides bodily injury and property damage coverage for liability caused by a UST incident. The policy defines an UST incident as a release (further defined as any spilling, leaking, emitting, discharging, escaping, leaching, or disposing of petroleum from an UST into ground or surface water or subsurface soils) from an insured tank. A continuous or repeated release from the same insured tank is considered to be one incident.
  - ~ Coverage B is for corrective action costs the insured must pay because of an UST incident. The UST incident must be confirmed and reported to the insurer and/or the EPA. On-premises incidents are covered, not just off-site cleanup.
- Limits -- Two limits are shown in the policy. The first is the UST incident limit, equivalent to the per occurrence amount. The second is an aggregate limit, the total that will be paid for the sum of all UST incidents.
- Defense expense -- The ISO UST policy limits the total amount of defense expense that will be provided by the insurer in any one policy period regardless of how many incidents, claims, or suits may be made. Once the defense expense amount is exhausted in any one policy period, the insurer's obligation to defend ends. Any additional defense expense from that point on must be borne by the insured. The insurer's obligation to defend also ends when the applicable UST incident limit or aggregate limit is exhausted. The ISO policy explains in depth how the duties of defense will be transferred to the insured when the defense expense amount or the limits of insurance are reached.
- Cancellation -- The cancellation conditions in the basic UST policy reflect the federal EPA regulations. State-specific cancellation and nonrenewal endorsements are available to modify the federal cancellation conditions in order to comply with individual state requirements.

**Exhibit 5-2**  
**CGL ENDORSEMENTS RELATING TO POLLUTION COVERAGE**

Total Pollution Exclusion Endorsement <sup>1</sup> (CG 21 49)	Eliminates all environmental/pollution coverage from CGL form
Exclusion of Specific Accident(s), Products, Work, or Location(s) (CG 27 02)	Often called the "laser beam endorsement," it can be used to exclude certain locations or releases from coverage
Pollution Liability Coverage Extension (CG 04 22)	Extends coverage to bodily injury or property damage from both sudden and nonsudden pollution, but not to cleanup costs.
Limited Pollution Liability Extension Endorsement (CG 24 15)	Provides limited protection for bodily injury and property damage due to pollution but typically excludes discharges from underground storage tanks
Pollution Liability Coverage Form [Designated Sites] (CG 00 39)	Provides both bodily injury and property damage coverage and off-site cleanup costs for designated locations
Pollution Liability Limited Coverage Form [Designated Sites] (CG 00 40)	Provides only bodily injury and property damage coverage for designated locations; no off-site cleanup cost coverage
Voluntary Cleanup Costs Reimbursement (CG 28 33)	Modifies the Pollution Liability Coverage Form (CG 00 39) to cover reasonable and necessary on-site cleanup costs incurred to prevent or reduce off-site injury or damage, but only with the consent of the insurer
Underground Storage Tank (UST) Coverage Form (CG 00 42)	Provides UST coverage
Exclusion-Underground Storage Tank Incidents (CG 29 78)	Excludes coverage of UST releases from pollution liability coverage. Designed to prevent duplicate coverage with the UST Liability Coverage Part
Extended Reporting Period Endorsement (CG 28 01)	Extends the reporting period for claims made pollution liability coverage for one year
Supplemental Extended Reporting Period Endorsement (CG 27 10)	Provides extended reporting period for claims made policy with no time limitation
Supplemental Extended Reporting Period Endorsement (CG 30 57)	Only available with UST coverage, provides extended reporting period for claims made policy with no time limit

---

<sup>1</sup> Two exclusions (CG 21 55 and CG 21 65) allow very limited exceptions to the total pollution exclusion.



- Endorsements -- Other than the state-specific cancellation endorsements, only a few additional endorsement options are available. They include:
  - ~ Coverage for injury to leased workers, which extends coverage to leased workers in the same manner as employees of the insured.
  - ~ Two endorsements regarding arbitration that set the framework and procedures involved when arbitration is deemed necessary. One is for binding arbitration and the other is for non-binding arbitration.
  - ~ Exclusion of UST incidents. This endorsement may be found whenever an insured has any type of pollution coverage in addition to the UST policy. This exclusion is intended to prevent any duplication or overlap between the two coverages by excluding any UST coverage from the pollution policy or endorsement.
- The ISO UST policy provides an automatic, no additional cost, six month extended reporting period any time the coverage is canceled, non-renewed, replaced with a policy containing an advanced retroactive date, or replaced with coverage that is not claims-made. The ISO program further provides an endorsement option for a supplemental extended reporting period, if the insured chooses this option and pays the additional cost.

Motor Carrier Insurance. Some motor carriers may also be UST owners or operators even though their primary business is using trucks to transport property owned by others. These businesses might want to use their "Truckers Coverage" or "Motor Carrier Coverage" policies to demonstrate UST financial responsibility. Certain trucks are required by the Motor Carrier Act of 1980 to provide public liability coverage and typically purchase the "MCS 90 endorsement" to comply. This endorsement covers property damage, bodily injury, and cleanup coverage resulting from the operation, maintenance, or use of motor vehicles. It is not intended to provide coverage for property damage, bodily injury, or cleanup due to releases of petroleum from USTs owned or operated by the trucker.

Contractors and Professionals Environmental/Pollution Liability Insurance. Environmental insurance products designed for contractors, environmental consultants or professionals, testing labs, or senior business managers (i.e., directors and officers) are not appropriate for demonstrating UST FR.

Third-Party Owned Disposal Site Coverage. This type of insurance is designed to cover the potential liability of those who send their wastes to disposal sites that they do not own themselves. It has nothing to do with the insured's ownership or operation of USTs.

RCRA Hazardous Waste Closure/Post-Closure or Liability Insurance. These types of insurance can be used by hazardous waste storage, treatment, and disposal facilities to demonstrate FR for RCRA Subtitle C closure and post-closure care and liability coverage. They have nothing to do with the insured's ownership or operation of USTs.

Products Pollution Liability Coverage. Products pollution liability coverage is available as a stand-alone policy that is often issued without a pollution exclusion. However, products liability coverage is not appropriate for UST FR despite the fact that the focus of the FR rule is on releases of petroleum product from USTs. Such releases do not fall within the scope of coverage of products liability. That coverage includes damage arising out of goods or products manufactured, sold, handled, distributed, altered, or repaired by an insured but only if the bodily injury or property damage occurs away from premises owned, operated, or

leased to the insured or after physical possession has been relinquished to others. Thus, this type of coverage would not cover third-party compensation (nor corrective action) due to releases from USTs.

Pollution Legal Liability or Site-Specific Environmental Impairment Liability (EIL) Insurance. This type of insurance typically covers claims due to both sudden and non-sudden releases. It includes bodily injury, property damage, and cleanup costs only from **pollution that has passed the property boundaries** listed in the policy declarations. Therefore, to demonstrate UST FR, these policies must be enhanced to cover costs of on-site cleanup and on-site third-party compensation also. In addition, these policies must provide separate limits (see "Declarations" page) for USTs that satisfy the FR requirements.

Some EIL policy forms define bodily injury to require physical injury or actual exposure to pollutants; this means that the policy will not cover claims based on fear of future disease. Such restrictions would not disqualify the policy from complying with UST FR rules. Likewise, coverage for bodily injury that is not limited to physical injury or disease also is acceptable.

EIL policies vary in their coverage of on-site cleanup and must be reviewed carefully to determine the presence of this coverage. If an EIL policy excludes on-site cleanup expenses or applies only to pollution that has migrated beyond the boundaries of the sites covered by the policy, it would not provide adequate UST FR corrective action coverage.

EIL policies may include defense costs within the dollar limits of coverage, which is inconsistent with UST FR rules. Defense costs can be substantial, exceeding \$100,000 for major groundwater contamination incidents.

EIL policies include extended reporting periods for pollution releases that occur (in whole or part) before the termination date of the policy but are not discovered until after the policy has ended. The typical extended reporting period is one year. The UST FR rules require only a six month extended reporting period. (EIL policies may or may not include retroactive dates.)

EIL policies contain a number of common exclusions. Most important is the exclusion for known pre-existing conditions. If a facility that needs to demonstrate UST FR is excluded, then the insurance policy can not be used to demonstrate UST FR for that site.

Combined CGL/EIL Policies. Combined CGL/EIL pollution insurance policies offer a menu of coverages that allows the insured to tailor insurance coverage to meet its specific needs. Some of these policies allow the insured to elect from many coverage options, such as the following:

1. Discovery of a pre-existing pollution condition (on-site coverage)
2. Discovery of a new pollution condition (on-site coverage)
3. Third-party claims for onsite cleanup of pre-existing pollution conditions
4. Third-party claims for onsite cleanup of new pollution conditions
5. Third-party claims for onsite property damage
6. Third-party claims for onsite bodily injury
7. Third-party claims for off-site cleanup of pre-existing pollution conditions
8. Third-party claims for off-site cleanup of new pollution conditions
9. Third-party claims for off-site property damage
10. Third-party claims for off-site bodily injury

11. Third-party claims for bodily injury, property damage, or cleanup costs at nonowned locations
12. Third-party claims for on-site cleanup costs at nonowned locations
13. Pollution releases from transported cargo carried by covered autos
14. Third-party claims arising from transportation of the insured's product or waste
15. Business interruption resulting from a release of pollution (third-party claim)

All coverages selected are subject to a single policy aggregate limit but deductibles can be varied for the different coverages. The flexibility of these policies allows the insured to protect against pollution claims arising from a broad range of exposures. However, coverage forms are relatively long and may require careful reading to understand the various coverage options. For UST FR purposes, the policy should include on-site and off-site clean-up and third-party claims for property damage and bodily injury (both on-site and off-site). The policy must provide separate limits (see "Declarations" page) for USTs that satisfy the FR requirements. Coverage numbers 11 through 15 in the list above are not relevant for UST FR compliance.

Environmental Remediation Insurance. There are several types of remediation policies that address different concerns. For example, one type of remediation coverage addresses the risk that the remediation will cost more than a specified amount ("overrun," "cost cap," or "stop-loss" coverage). Only rarely could such coverage be useful in demonstrating UST FR. Another type of remediation insurance applies only after a remediation is completed. It would not apply to releases from USTs at ongoing operations but is like a warranty for a remediation. A property seller might purchase such a policy on land it has sold. Conversely, a property buyer or owner might acquire first party remediation coverage. This type of insurance is not relevant to releases from the ongoing operation of USTs. If the remediation insurance applies to new (unknown) conditions, however, it could be used to cover the corrective action scope of coverage, as long as its other provisions satisfy UST FR requirements.

Real Property Transfer Insurance. This type of insurance usually covers only investigation, defense, and remediation costs associated with the cleanup of contamination on the property and any migration of contaminants from the insured's property onto adjacent land. **Typically, only those releases that occur prior to policy inception and are not discovered until after policy inception are covered (i.e., discovery of contamination existing but undetected at the time of the sale).** However, some policies provide coverage for contamination arising after policy inception (e.g., midnight dumping and tenant-caused releases). This type of insurance may be bought by a seller, buyer, or lender in connection with the sale of real property (i.e., land). It may or may not cover third-party bodily injury and property damage. If the buyer has purchased this coverage for UST facilities and the policy satisfies UST FR requirements, it can be used for compliance. However, if the policy was purchased by the seller or the lender, there may be greater risks (e.g., failure to pay any annual premium, no requirement to notify owner or operator of receipt of notice of cancellation from insurer or other significant events, outside jurisdiction of UST regulations) in accepting this insurance as evidence of the owner or operator's financial responsibility, even if he or she is listed as an additional insured on the policy. Lack of coverage for third-party compensation would be another problem for using these policies for UST FR.

Conclusion. This section reviewed the types of insurance that are most likely to be considered for demonstrating UST FR. Some types are appropriate, others are not. To avoid the need for case-by-case review of insurance policies, the UST regulations require an owner or operator to prepare a properly worded certificate or endorsement as evidence of appropriate coverage: corrective action and/or third party compensation (on-site and/or off-site) from sudden and/or non-sudden accidental releases arising from the operation of petroleum USTs. With a properly worded certificate or endorsement, either alone or in combination with other mechanisms, an owner or operator can demonstrate complete coverage without the need for case-by-case review of insurance policies.

## A.5 What Types of Insurers Are Eligible?

For UST FR, there is no need to describe all the different types of insurers except to note that the regulations allow qualifying insurance obtained from an eligible insurer or risk retention group (RRG). To be eligible, an insurer or RRG must be licensed to transact the business of insurance or be eligible to provide insurance in one or more states as an excess or surplus lines insurer. Licensing of insurers and the status of excess and surplus lines insurers were described in A.3 above in the discussion of insurance regulation. This section describes risk retention groups and captive insurers.

Risk Retention Groups. In 1986 Congress passed the Liability Risk Retention Act (LRRRA) in response to the "liability crisis" of the mid 1980's. One primary goal of the LRRRA was to provide businesses, local governments, and professionals with an alternative source for liability insurance. To accomplish this goal, the act created risk retention groups. A risk retention group is a liability insurance company owned by its members, which offers insurance coverage for "liability" as defined in the act. Some examples of liability coverage by risk retention groups include general liability, third party liability, errors and omissions, directors and officers, products liability, and medical malpractice. The LRRRA requires the members of a risk retention group to be engaged in similar business activities and therefore exposed to the same risks and liabilities. A risk retention group must be domiciled, registered, and licensed in a state before it is allowed to issue coverage. State insurance departments have primary regulatory authority over registered risk retention groups.

The market for risk retention groups has grown steadily since the LRRRA was enacted. For example, the number of risk retention groups has increased from 54 in 1988 to 70 in 1998.<sup>20</sup> Risk retention groups are dominated by three business sectors, which together comprise over 90% of the market: professional services, healthcare, and government and institutions. Property development, manufacturing, and commerce also make up important business sectors for risk retention groups.

Captive Insurers. Captives are insurance companies that provide insurance primarily to their owners. More than 75 percent of captive insurers are owned by a single parent. The others are group or association captives, which are owned by multiple parents that primarily are not engaged in the business of insurance. A risk retention group is a group captive. Large corporations often own a captive. A captive differs from a mutual insurer in the active participation of its owner(s) in managing the captive.

Captive insurers tend to be domiciled in states and countries that have the least restrictive regulations and low taxes. Many captives are based in Bermuda. The State of Vermont is home to many U.S. captives. Captives may or may not be licensed; generally they are not admitted in any of the U.S. states. As long as a captive is licensed in any state, it satisfies UST FR eligibility requirements.

Captive insurers (1) are less strictly regulated than commercial insurers, (2) may not be monitored closely once their operations have been approved, and (3) usually do not have access to guarantee funds that pay claims in the event the insurer is not able to do so. Due to factors including narrow spread of risk, lack of business diversification, and potential financial instability of the parent, it may be more difficult for single-parent captives to be rated comparably to other insurers. Some state regulators seek formal parental commitments from single-parent captives due to similar concerns.

Some state environmental agencies and EPA Regions are not comfortable with use of insurance written by a single-parent captive to demonstrate financial responsibility. Since a single-parent captive is, basically, a sophisticated self-insurance fund, there is no risk sharing or risk transfer, which is one of the

---

<sup>20</sup> From the *Risk Retention Reporter* website: [HTTP://WWW.RRR.COM](http://www.rrr.com).

goals of FR mechanisms other than self-insurance. Although captives have capital and loss reserve requirements, a single-parent captive may be able to loan a majority of those funds back to its parent for use in operations. Because a single-parent captive is not selling insurance to others, it may not need to be licensed or admitted in any state to conduct the business of insurance. Such a captive does not meet UST FR eligibility requirements.

Many group and single parent captives use a U.S. licensed/admitted insurer as a "fronting carrier" in order to offer coverage in states where they are not licensed. Fronting occurs when a licensed insurer reinsures from 90 to 100 percent of the policy limit with a non-admitted insurer. The insureds/owners of the captive pay a fee to the fronting insurance company. The fronting insurance company issues the policy, makes the filings required by state laws, pays premium tax and assessment fees, and retains a portion of the risk or cedes the entire risk to the captive. The range of services provided by a fronting company is negotiable and is reflected in the fronting cost. Because fronting does not pose a significant problem for UST FR, a fronting policy can be used for compliance.

#### **A.6 What Special Provisions Are Necessary in UST Insurance?**

To satisfy UST FR requirements, insurance must have several provisions that are common but not universal to general insurance industry practices. In developing the federal rules, EPA wanted to encourage the availability of insurance by offering flexibility to insurers and conforming to industry practices. On the other hand, the federal rules had to be consistent with RCRA Subtitle I and provide a sufficient degree of assurance. In balancing these goals, EPA identified certain provisions as necessary and determined that others could be left open for the marketplace to decide. The required provisions under the federal FR rule are the following:

- **Legal defense costs** must be excluded from the required amount of coverage
- **First dollar** coverage must be provided
- An **extended reporting period** must be provided for **claims made** policies

These requirements are explained in the following subsections.

Why Must Legal Defense Costs Be In Addition to the Limits of Liability? This requirement was originally proposed for several reasons: (1) to ensure that legal defense costs would not absorb too great a portion of coverage limits and thus leave little coverage available for corrective action and third-party compensation; (2) to conform to the general insurance industry standard practice for CGL policies of paying all legal defense costs outside policy limits until the indemnity limits have been exhausted by indemnity payments;<sup>21</sup> and (3) to provide the same amount of financial assurance to cover both third-party claims and corrective action as the other mechanisms (none of the other UST FR mechanisms covers legal defense costs). Exclusion of legal defense costs from policy limits is also consistent with RCRA Subtitle C liability coverage regulations.

Finally, because RCRA Subtitle I requires \$1 million of per-occurrence coverage for the costs of corrective action and third-party compensation for USTs at facilities engaged in petroleum production, refining, or marketing, legal defense costs had to be excluded from a policy's required amount of coverage for this group of insureds.

---

<sup>21</sup> This standard practice has since changed; defense costs still are outside the policy limits but frequently have their own limit.

The insurance industry standard for commercial general liability (CGL) coverage is payment for all legal defense costs outside general liability policy limits until the limits have been exhausted by indemnity payments. ISO's standard CGL policy includes a clause obligating the insurer to provide payment for legal defense until coverage is exhausted by indemnity payments. On the other hand, some CGL policies include payment of legal defense costs within policy limits. EIL policies are more likely than CGL policies to include legal defense costs within policy limits; however, industry practice even within the smaller universe of EIL policies is not uniform. EIL policies are available that provide indemnity limits exclusive of legal defense costs.

Why Must "First Dollar" Coverage Be Provided? First dollar coverage ensures that disputes between the insurer and the insured over who is responsible for paying amounts within deductible limits will not interfere with prompt performance of corrective action measures or with third-party compensation. If an owner or operator is in bankruptcy at the time of a release and therefore cannot reimburse the insurer for the deductible, the insurer, as a creditor, can pursue its claim through the bankruptcy proceeding, just as any other creditor can.

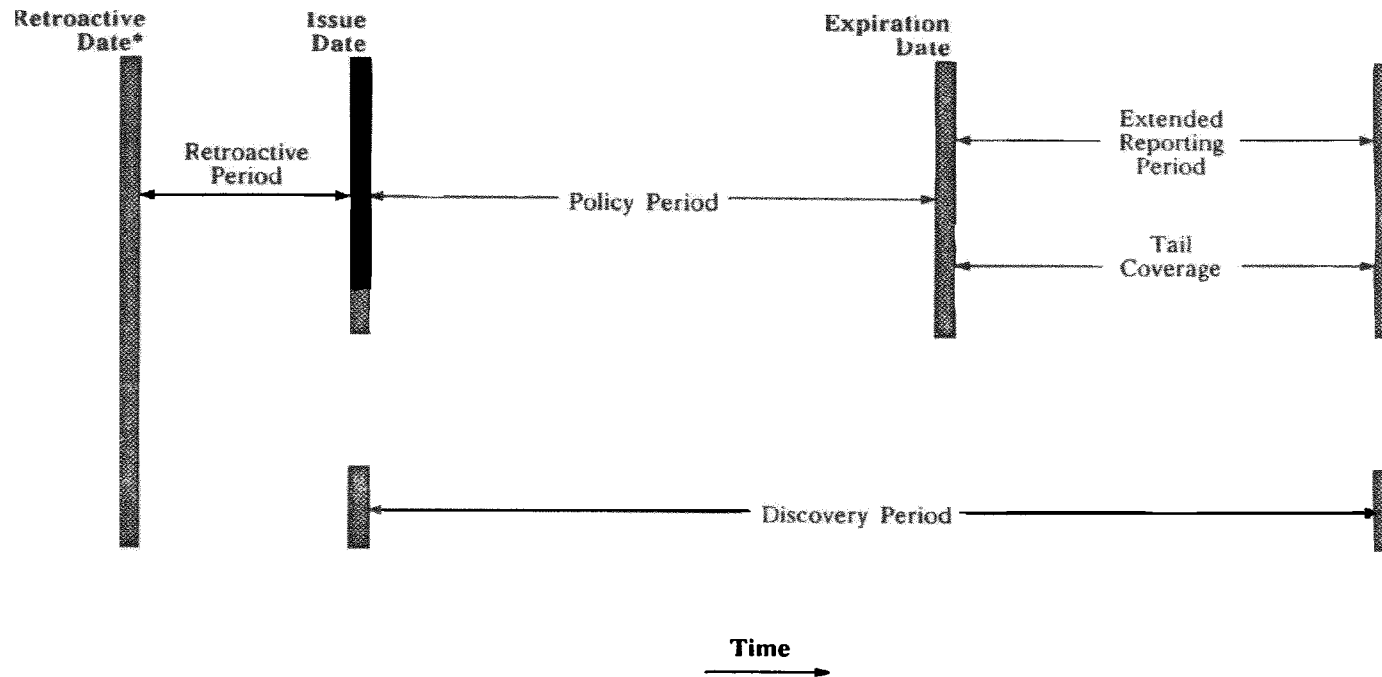
Why Must Extended Reporting Coverage Be Provided for "Claims Made" Coverage But Not "Occurrence" Coverage? The requirement for a six-month extended reporting period following cancellation for non-payment of premium or misrepresentation is mandatory for all claims-made insurance contracts used to demonstrate financial assurance. The insurance must cover claims otherwise covered by the policy that are reported to the insurer within six months of the effective date of cancellation or non-renewal of the policy -- except where the new or renewed policy has the same retroactive date or a retroactive date earlier than that of the prior policy -- and which arise out of any covered occurrence that commenced after the policy retroactive date, if any, and prior to the policy renewal or termination date. The policies described in Section A.3 may be available on an occurrence basis, a claims made basis, or both:

- **Occurrence-based** insurance provides protection when what is covered (i.e., loss, damage, injury, or release) occurs during the policy period, regardless of when it was discovered and when the insurer was notified. The key to coverage is the time of the occurrence.
- **Claims made** insurance provides coverage that depends on both the time of the occurrence and the date of filing or receipt of the claim. The policy often includes a **retroactive date** that is the point in time that coverage first begins. The insurance handles any covered occurrence that happens after the retroactive date for which a claim is filed within the policy period and any extended reporting period.

A claims-made contract may leave gaps in coverage if, for example, a claim is reported after the expiration of a policy for a release that began prior to the expiration date. Such claims may not be covered by a replacement financial assurance mechanism. The "extended reporting period" addresses this concern. Under this provision, claims made during the six month extended reporting period for releases that occurred during the policy period would be covered. An extended reporting period of six months is mandatory for all claims-made policies used for UST FR. See Exhibit 5-3.

A "gap" in coverage will not always exist at the termination or non-renewal of a claims made insurance policy. For instance, a "gap" in coverage will not normally occur where an existing policy is renewed. According to standard insurance industry practice, a renewed policy incorporates the

Exhibit 5-3  
**STRUCTURE OF CLAIMS-MADE INSURANCE POLICY**



\* The Retroactive Date is often the date the policy is first issued, in which case there is no retroactive period.

retroactive date of the previous policy. Thus should the insured who renews his policy report a release that occurred during the time period of the previous policy, the release would be covered by the renewed policy. No "gap" may arise even when the insured purchases a new policy from a different insurance company. Many companies will incorporate the retroactive date of the insured's previous policy (as well as the same type of insurance coverage as provided by the previous policy) for releases that are reported during the time period of the new policy but which occurred during the time of the previous policy. Here, as in the case of renewed policies, an extended reporting period at the end of the first policy period would not be of any benefit since the new policy provides the same coverage as that provided by the extended reporting period.

In order to avoid overlapping coverage, the extended reporting period does not apply when the renewed or new policy has the same retroactive date or a retroactive date earlier than that of the insured's previous insurance policy.

The extended reporting period (during which insureds may report releases that occurred while their policy was in effect) is not an extended coverage period during which insurers would be liable for releases occurring after the policy's termination. Insureds who voluntarily cancel their policies, therefore, do not receive "free" coverage for any period of time. Claims reported to the insurer during the six-month reporting period are subject to all of the terms, limits, exclusions, and conditions that existed during the policy period itself.

It is unnecessary to include an extended reporting period clause in an occurrence-based contract because by definition, such policies cover losses occurring during the policy period regardless of when they are reported. Therefore paragraph 2(e) of the endorsement and certificate of insurance (§§280.97(b)(1) and 280.97(b)(2)) are required only in the case of a claims-made contract.

Where extended reporting period coverage is necessary, it must be obtained before the prior policy terminates. Insurers may charge a fee for the extended reporting period. Insureds who fail to obtain such coverage due to non-payment of this added cost will be out of compliance with EPA's financial responsibility requirements.



## B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING INSURANCE

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING INSURANCE</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Selecting an Eligible Insurer or Risk Retention Group (see Section B.1)</li><li><input type="checkbox"/> Purchasing Proper Scope and Amount of Insurance (see Section B.2)</li><li><input type="checkbox"/> Obtaining a Properly Worded Certificate or Endorsement (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Maintaining Coverage from Year to Year (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If the Insurer Decides to Cancel or Not to Renew the Policy or If Insurer Is No Longer Eligible to Provide Insurance (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy (see Section B.7)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.8)</li></ul>

### B.1 Selecting an Eligible Insurer or Risk Retention Group

Insurers eligible to provide policies in compliance with UST financial responsibility requirements must be licensed to transact the business of insurance or eligible to provide insurance as an excess or surplus lines insurer in one or more states. Owners or operators may purchase insurance from an insurer licensed or approved by foreign government as long as the insurer also is licensed in any state or eligible to provide insurance as an excess or surplus lines insurer. Insurance policies issued by “captive” insurers (insurers owned by at least one of the parties for which they provide coverage) are not eligible to provide financial assurance unless they meet this requirement.<sup>22</sup>

Individual service station dealers and other UST owners and operators can form or join a group to facilitate purchase of UST coverage or the formation of an RRG. To establish an RRG, owners or operators must organize into a group and raise the necessary capital. Regulations in some states may also limit the formation of such groups.

### B.2 Purchasing Proper Scope and Amount of Insurance

Application. An owner or operator can expect to complete a detailed application form to obtain environmental/pollution insurance. Often the insurance underwriter will request permission to speak with persons who are familiar with the owner or operator’s environmental matters. Applicants for pollution or environmental coverage also may be asked to describe operations at each location, gross production (e.g., revenue, tons, gallons, acres) and site history. Frequently, a coverage **binder** is issued without physical inspection. The application also will include statements (termed “warranties”) about the owner or operator’s knowledge of existing pollution conditions, past claims, and compliance with environmental laws and regulations. Failure to provide honest or accurate information in the warranties could nullify coverage in the event of a loss.

The application for UST coverage is likely to require storage tank data for all tanks at each site to be insured: tank ID; product contained; capacity; tank and piping construction, leak detection method,

---

<sup>22</sup> See discussion of captive insurers in A.5.

secondary containment, and year installed; pump type; whether the tanks are original or replacement; compliance status; and history of pollution. The applicant for UST coverage must sign a warranty statement.

Amount of Coverage. An insurance policy must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when an insurance policy is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

Scope of Coverage. Insurance policies may cover all or part of the required scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that an insurance policy will be used to complement another mechanism that covers part of the full scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), insurance can be used to cover the other scope area. If an owner or operator can not obtain insurance for non-sudden releases, a separate mechanism can be used. Each mechanism, however, must provide \$1 million worth of coverage.

Special Provisions. See discussion of legal defense costs, first dollar coverage, and extended reporting periods in A.6 above.

### **B.3 Obtaining a Properly Worded Certificate or Endorsement**

The required wording for endorsements and certificates of insurance is specified in the regulations at 40 CFR 280.97(b)(1) and (2) respectively. The authorized representative of the insurer, in signing the endorsement or certificate of insurance, certifies that the wording is identical to the required wording on the date the endorsement or certificate of insurance was signed.

### **B.4 Recordkeeping**

Owners or operators using insurance to provide UST financial assurance must maintain on-site or at their place of business a copy of the following documents:

- The *policy* and any *amendments* or *endorsements*.
- Properly worded UST FR *insurance endorsement* or *certificate* signed by an authorized representative of the insurance company.
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5).

### **B.5 Maintaining Coverage from Year to Year**

Owners or operators must either pay the premiums required to maintain the policy in effect or arrange for a substitute FR mechanism.

If the amount of required coverage increases to a level above the amount assured by the insurance policy, the owner or operator must either (1) revise the insurance policy to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the new coverage level and the amount of the insurance policy.

## **B.6 Obtaining Alternate Assurance If the Insurer Decides to Cancel or Not to Renew the Policy or If Insurer Is No Longer Eligible to Provide Insurance**

The owner or operator must obtain alternate assurance in the following circumstances:

- Within 60 days of receipt of a notice that the insurer intends to cancel or not renew the policy
- Within 30 days of receiving notice of the incapacity of the insurer or the suspension or revocation of its authority to issue insurance

## **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy**

The owner or operator must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 60 days of receipt of notice of termination from the insurer. The notification must include
  - ~ the name and address of the insurance provider
  - ~ the effective date of termination
  - ~ required records (see B.4 above)
- Failure to obtain alternate assurance within 30 days of receiving notice of the incapacity of the insurer or the suspension or revocation of its authority to issue insurance.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

## **B.8 Submitting Financial Responsibility Documents**

**According to the federal regulations**, an owner or operator that uses insurance to demonstrate FR must submit a copy of the signed *insurance policy* (along with any amendments) and the required *endorsement* or *certificate of insurance* signed by an authorized representative of the insurer **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- When the owner or operator fails to obtain alternate coverage;
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the owner or operator as debtor;
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) reporting.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR INSURANCE</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Respond to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as A Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Review Financial Responsibility Submissions (see Section C.2)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Verifying Insurer or Risk Retention Group Eligibility (see Section C.3) <input type="checkbox"/> Verifying the Wording of the Certificate or Endorsement (see Section C.4) <input type="checkbox"/> Checking That the Correct Type(s) and Amounts of Coverage Are Provided (see Section C.5) <input type="checkbox"/> Requesting the Policy and All Endorsements (see Section C.6)

### C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as A Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that the owner or operator cannot obtain alternate assurance. However, following receipt of such a notice from the owner or operator, you may want to monitor the efforts being made by the owner or operator to secure alternate assurance. This could include alerting the owner about the need for alternate assurance if the operator had been providing the financial assurance through insurance and vice versa. One drawback of insurance is that if it does not appear that alternate assurance is immediately forthcoming from the owner or operator, you cannot draw upon the policy. Termination of the policy for failure to pay a premium is worrisome because it indicates inability or unwillingness to comply with FR, unless failure to pay was an oversight or was due to use of a substitute FR mechanism. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

Owner or Operator Named A Debtor in Bankruptcy. Similarly, it is unlikely that an owner or operator using insurance will be named as a debtor in bankruptcy proceedings. If that happens, it represents a serious potential gap in coverage in the event of a release or a need for third-party compensation even though UST insurance specifies that bankruptcy or insolvency of the insured does not relieve the insurer of its obligations under the policy. The problem is that the insurer can cancel the policy if the owner or operator stops making premium payments.

The discovery of a release or appearance of a claim for compensation could, in rare cases, cause the owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental

interests in bankruptcy.<sup>23</sup> Apart from that route, if the owner and operator are different parties, you could alert the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, you will receive an unsolicited copy of the insurance policy and endorsement or certificate from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identified a release that must be reported
- After the owner or operator fails to obtain alternate assurance after being notified that the insurer intends to cancel or non-renew the insurance
- After the owner or operator fails to obtain alternate assurance after being notified that the insurer is no longer eligible to issue insurance
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor

In the first situation, the implementing agency may want to ensure that the insurance is effective so that, if not, the owner or operator can be instructed to remedy the problem or obtain alternate assurance. See Sections C.3 through C.5 for details. In the second and third situations, there is little environmental and public health value to reviewing the insurance documents because insurance will soon be terminated and you cannot draw upon it. Finally, in the fourth situation, while review of the FR documents is advisable, the owner or operator may not be willing or able to remedy any problems you identify.

**NOTE:** An insurance policy, certificate, or endorsement does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular annual reporting or may request evidence of FR for monitoring compliance. See Sections C.3 through C.5 below for review of such submissions.

## C.3 Verifying Insurer or Risk Retention Group Eligibility

To verify that an insurer is licensed or eligible as an excess or surplus lines insurer, you can contact the insurance department(s) of the state(s) where the insurer claims to be licensed. See Section E below for information on how to reach insurance departments.

## C.4 Verifying the Wording of the Certificate or Endorsement

The required wording for UST insurance certificates and endorsements is specified in the regulations. In signing the certificate or endorsement, the authorized representative of the insurer certifies that the wording

---

<sup>23</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

of the certificate or endorsement is identical to the required wording on the date the certificate or endorsement was executed. Deviations in the wording of the certificate or endorsement including additions or omissions may compromise its effectiveness.

Note that **standard industry practice is to include on insurance certificates a statement that the certificate does not amend, extend, or alter the coverage afforded by the policy.** This language **must not** appear on an insurance certificate used for UST FR compliance.

### **C.5 Checking That the Correct Amounts and Type(s) of Coverage Are Provided**

Scope of Coverage. The scope of coverage provided by insurance depends on the wording of the policy and all its endorsements. If you do not want to rely on the UST FR insurance certificate or endorsement as evidence of coverage, refer to the discussion of insurance products in Section A.4 above.

It is unlikely but possible that insurance will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation, a policy covering third-party compensation can be used to cover the other scope area. You should ensure that the scope of coverage of the policy is appropriate whether used alone or in combination with other mechanisms.

Amount of Coverage. Insurance must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when insurance is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

Exclusions for Pre-Existing Conditions. Insurance policies typically exclude identified leaks from coverage as "pre-existing conditions." A facility so excluded from insurance coverage must be covered by another FR mechanism.

Retroactive Dates. You should check for any retroactive date in the current policy. Some insurers issue policies with a retroactive date several years prior to the inception date of the current policy. If the retroactive date does not extend several years back in time, you can request a copy of the prior policy to see if there is any gap in coverage. If the prior policy terminated before the retroactive date of the current policy, there was a gap. You should encourage the owner or operator to have the current policy amended so that the retroactive date leave no gap. That is the most practical way to eliminate the gap. Having current coverage in place with a gap is certainly better than not having FR in place at all. Further, in time, the problem posed by the gap will diminish in importance. Nevertheless, during the gap the owner and operator were not in compliance with the UST FR rule.

### **C.6 Requesting the Policy and All Endorsements**

If you decide to review the insurance policy itself, you should request the policy and all endorsements. The policy should include the "Declarations" page, which often serves as a cover page and contains important information. As noted in C.5, you also may need to request the prior policy to determine whether there has been any gap in coverage.

## **D. INSURER RESPONSIBILITIES**

The following checklist summarizes the insurer's responsibilities:

<b>CHECKLIST OF INSURER RESPONSIBILITIES</b>	
<input type="checkbox"/>	Being a Licensed Insurer or Eligible Excess or Surplus Lines Insurer in at Least One State (see Section D.1)
<input type="checkbox"/>	Notifying the Owner or Operator in Writing of Decision to Cancel or Otherwise Terminate the Insurance or If No Longer Eligible to Provide Insurance (see Section D.2)
<input type="checkbox"/>	Furnishing a Signed Duplicate Original of the Policy and All Endorsements Whenever Requested by the Implementing Agency (see Section D.3)
<input type="checkbox"/>	Providing Appropriate Coverage (see Section D.4)

### **D.1 Being a Licensed Insurer or Eligible Excess or Surplus Lines Insurer in At Least One State**

By signing the endorsement or certificate, the insurer certifies being licensed to transact the business of insurance or eligible as an excess or surplus lines insurer in one or more states. An insurer should review the UST FR regulations, especially 40 CFR 280.97.

### **D.2 Notifying the Owner or Operator in Writing of Decision to Cancel or Otherwise Terminate the Insurance or If No Longer Eligible to Provide Insurance**

Mandatory language in the endorsement and certificate of insurance requires that cancellation or any other termination of the insurance by the insurer will be effective only upon written notice and only after expiration of 60 days after the written notice is received by the insured.

Similarly, the endorsement and certificate specify that an insurer may terminate an insurance contract for non-payment of premium or misrepresentation by the insured only upon written notice and only after a minimum of 10 days after the written notice is received by the insured.

An insurer should notify the owner or operator if the insurer is no longer eligible or has lost its authority to issue insurance policies.

### **D.3 Furnishing a Signed Duplicate Original of the Policy and All Endorsements Whenever Requested by the Implementing Agency**

By signing the certificate or endorsement, the insurer agrees to furnish a signed duplicate original of the policy and all endorsements to the Director, upon request.

### **D.4 Providing Appropriate Coverage**

Insurers should be familiar with 40 CFR 280 Subpart H, especially §280.97. Insurance providers should clearly explain to the owner or operator how or to what degree the policy provides the scope and amount of required UST coverage. The insurance also should comply with UST FR requirements for legal defense costs, first dollar coverage, and extended reporting described above.

## E. SOURCES OF FURTHER INFORMATION

This list of information sources is not intended to be all inclusive, but is intended to provide some commonly accepted sources of information.

State Insurance Departments. The insurance department of the state in which the insurer is domiciled will usually have the most information about the insurance company. Insurance departments are located in state capitals and, in some instances, have offices in larger cities of states. The telephone numbers can be found under the state listing in telephone directories. State Insurance Commissioners' names, addresses, and phone numbers also can be found on-line at [HTTP://WWW.NAIC.ORG/CONSUMER/STATE/MEMBERSHIPLIST.HTM](http://www.naic.org/consumer/state/membershiplist.htm). State insurance department websites are posted at [HTTP://WWW.NILS.COM/LINKS.HTM](http://www.nils.com/links.htm). Any citizen may call the department and request to speak to someone who can provide information on a particular insurance company.

- The National Association of Insurance Commissioners (NAIC) is the organization of insurance regulators from the 50 states, the District of Columbia, and the four U.S. territories. The NAIC provides a forum for the development of uniform policy when uniformity is appropriate. For further information see [HTTP://WWW.NAIC.ORG](http://www.naic.org).

*Insurance Regulation in the United States: An Overview for Business and Government* by Peter M. Lencis (1997) provides a good introduction to the subject of insurance regulation.

Insurance Providers. See *List of Known Insurance Providers for Underground Storage Tanks* (EPA 510-B-99-003), July 1999, available online at OUST website. See also "Markets for Environmental Liability" by Wallace L. Capp, Jr., *The Rough Notes Magazine* (July, 1998), available at [HTTP://WWW.ROUGHNOTES.COM/RNMAG/JULY98/07P48.HTM](http://www.roughnotes.com/rnmag/july98/07p48.htm). And also see "UST Regs Pump New Life Into the EIL Market," by Keith Cannon, *American Agent and Broker* (February, 1999). Also see "Agents and Brokers" below.

Agents and Brokers. Most insurance policies are issued through insurance agents and brokers who in many instances can provide information about specific insurance companies and policies. Professional agents or brokers specializing in providing environmental insurance may be able to assist in reviewing policies for proper scope. Names of agencies specializing in environmental insurance may be obtained from The Rough Notes Company at [HTTP://WWW.ROUGHNOTES.COM](http://www.roughnotes.com) (market categories include "Underground Fuel Tank Pollution Liability" and "Environmental Impairment Liability"), American Agent and Broker at [HTTP://WWW.AGENTANDBROKER.COM/EDITORIAL/DIRECTORIES/POLL.HTML](http://www.agentandbroker.com/editorial/directories/poll.html) (see "Pollution Insurance Directory"), and other sources/directories.

Excess and Surplus Lines Insurers. National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) is a national trade association representing the surplus lines insurance industry and the wholesale insurance marketing system. Excess and surplus lines insurers must meet financial and conduct standards in order to join the association, and NAPSLO members must follow a code of ethics in dealing with customers and companies. You can contact NAPSLO at 6405 N. Cosby Avenue, #201, Kansas City, MO 64151, phone: (816) 741-3910, fax: (816) 741-5409. Its Internet address is [HTTP://NAPSLO.ORG](http://napslo.org).

- The *Insurance Journal, Inc.* has started an on-line directory of excess, surplus, and specialty markets which you can access at [HTTP://WWW.INSURANCEMARKETFINDER.COM/](http://www.insurancemarketfinder.com/). Market categories include "Underground Fuel Tank Pollution Liability" and "Underground Storage Tanks."



Captive Insurers. Information on captives can be found on CAPTIVE.COM and the *Captive Insurance Company Directory* published by Tillinghast-Towers Perrin.

Risk Retention Groups. Information on risk retention groups can be found in *Risk Retention Group Directory and Guide*, available through the Risk Retention Reporter. See [HTTP://WWW.RRR.COM/EDUCATION/FAQ.HTM](http://www.rrr.com/education/faq.htm).

Regulations. Interim Final Rule on UST FR discussing extended reporting period and cancellation or termination of insurance. *54 Federal Register* 47077-47082 (Nov. 9, 1989).

[THIS PAGE INTENTIONALLY LEFT BLANK]

## 6. FINANCIAL RESPONSIBILITY USING SURETY BONDS

This chapter describes the use of surety bonds to demonstrate UST FR as follows:

A. BACKGROUND	112
A.1 What Is A Surety Bond?	112
A.2 How Does the UST Bond Work?	113
A.3 How Does A Surety Bond Compare to Insurance?	114
A.4 How Does a Surety Bond Compare to a Letter of Credit?	114
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING SURETY BONDS	115
B.1 Selecting an Eligible Surety Company	115
B.2 Obtaining a Properly Worded Surety Bond for the Proper Scope and Amount of Coverage	115
B.3 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund	116
B.4 Recordkeeping	116
B.5 Updating Assurance	117
B.6 Obtaining Alternate Assurance If the Surety Decides to Cancel or to Not Renew the Bond, or Is No Longer Eligible, Capable, or Authorized to Provide a Bond	117
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings	117
B.8 Submitting Financial Responsibility Documents	118
B.9 Replenishing Assurance after Bond Is Used for Corrective Action and/or Third-Party Compensation	118
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	119
C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or That the Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings	119
C.2 Reviewing Financial Responsibility Submissions	120
C.3 Directing Performance or Payments to the Standby Trust Fund	121
C.4 Monitoring the Replenishment of Assurance after Bond Is Used for Corrective Action and/or Third-Party Compensation	122
C.5 Checking Whether the Surety and Trustee Are Eligible	123
C.6 Verifying the Wording, Scope, and Amount of Coverage of the Bond and Standby Trust Fund	123
C.7 Checking the Authenticity of the Bond	124
D. SURETY RESPONSIBILITIES	125
D.1 Being Listed as Acceptable Surety on Federal Bonds in the Latest Circular 570	125
D.2 Notifying Owner or Operator of Decision to Cancel the Bond or If No Longer Eligible, Capable, or Authorized to Issue Bonds	125
D.3 Performing or Placing Funds as Directed	125
E. SOURCES OF FURTHER INFORMATION	126

## A. BACKGROUND

### A.1 What Is A Surety Bond?

An owner or operator may satisfy the UST FR requirements by obtaining an appropriate surety bond. A surety bond is a common option in many government-mandated financial responsibility programs, both environmental and non-environmental.

**Surety bonds** are used in business when one party, in order to protect itself in a transaction, insists that another party obtain such a bond. A surety bond is a contract which an organization (sometimes called the **principal**) can enter into with a qualified **surety company** (called the surety). Under the surety contract, the surety guarantees to the **beneficiary** (sometimes called the **obligee**) that the obligations of the principal will be fulfilled. Of course, the principal must pay the surety for this guarantee, because the surety will be liable for these obligations should the principal fail to fulfill them. Thus, there are three parties to the surety agreement.

- The principal is the party responsible for the obligation.
- The surety guarantees that the obligation will be performed.
- The obligee is the party who receives the benefit of the bond.

In an UST surety bond, the owner or operator is the principal, a financial institution is the surety, and the director of the implementing agency is the obligee.

There are many different types of surety bonds, but the two general categories are (1) payment or financial guarantee bonds and (2) performance bonds. **Payment bonds**, as the name implies, assure that, if the principal fails to make obligated payments (such as to subcontractors and suppliers), the surety will make those payments. **Performance bonds**, on the other hand, may be carried out either by paying for or actually performing the obligation. Both types of bonds limit the liability of the surety to the face amount of the bond, called the penal sum. The UST bond is a performance bond, which allows the most flexibility to the surety (A payment bond that otherwise satisfies the UST FR requirements also should be acceptable to demonstrate compliance.).

Most surety bonds are sold through insurance agents or brokers. Most large property and casualty insurance companies have surety departments. There also are some companies whose primary business is surety bonds.

A surety company must be licensed in the state in which it provides a bond, but need not be licensed in the state in which the owner or operator is incorporated or where the USTs are located. A surety company may be an approved surplus line carrier in various states, which means that the company is authorized to write surety bonds in those particular states, even though the company is not licensed there. Questions related to license status may be directed to the appropriate state insurance department. (See Section E below for information on locating state insurance departments.)

Surety bonds are as strong as the ability of the issuer to honor them. To ensure the security of the mechanism, only sureties approved as acceptable sureties on federal bonds are eligible to issue UST bonds. Those sureties are not only regulated in the state(s) where licensed but also are reviewed for legal authority and fiscal soundness by the U.S. Treasury Department.

## A.2 How Does the UST Bond Work?

An UST FR bond assures availability of funds for corrective action and/or third-party compensation. The surety offers this assurance in exchange for a fee paid by the owner or operator. The owner or operator also agrees to repay any funds drawn through the bond.

If the owner or operator fails to perform corrective action or satisfy third-party compensation obligations, the surety **can either** perform those obligations **or** fund a standby trust fund from which the implementing agency directs the payment of corrective action costs or third-party compensation.

If the owner or operator fails to obtain alternate assurance within 60 days after he or she receives notice of cancellation and the Director has determined or suspects that a release has occurred, the surety **must** fund the standby trust fund as directed up to the amount of the annual aggregate. Without this provision, sureties could cancel coverage when a release is suspected and the costs could conceivably be unfunded.

A **standby trust fund** is simply a trust fund that is not yet funded but is otherwise ready to accept monies in the event they are received from a particular source (such as a surety bond). Funds in the standby trust are available to pay the costs of corrective action and third-party compensation. (See Chapter 11 for more information on standby trust funds.)

**NOTE:** The use of a standby trust is necessary because without such a mechanism, any funds drawn under a surety bond that are payable to the EPA Regional Administrator would have to be paid into the U.S. Treasury and could not be used without Congressional action (see 31 U.S.C. 3302) to pay for the UST corrective action or third-party compensation for which the funds were intended. Due to similar state laws, funds payable to the state Director may have to be paid into the state treasury, unless a standby trust is used.

This option differs from self-insurance because it involves a source of UST financial responsibility other than the owner or operator.

A surety bond used for financial responsibility must be open-ended or, if written for a specified term (such as five years), must be renewed automatically unless the surety notifies the owner or operator of its intention not to renew 120 days or more prior to the renewal date.

The surety's liability is limited to the per-occurrence and annual aggregate penal sums. The bond allows the parties to specify the purpose for which it is being issued ("corrective action" and/or "compensating third-parties for bodily injury and property damage"). Exclusionary language in the terms of the bond clearly limit the type and circumstances of third-party compensation for which this mechanism can be used.

In issuing a surety bond, the surety company becomes **jointly and severally** liable for the guaranteed payment, meaning that the surety assumes the obligation to fund corrective action and third-party compensation as its own and can be sued together with the owner or operator for the obligation. Consequently, most sureties require an indemnification from the principal to reimburse the surety for costs incurred in satisfaction of the principal's obligations.

### **A.3 How Does A Surety Bond Compare to Insurance?**

Suretyship is a very specialized line of insurance that is created whenever one party guarantees performance of an obligation by another party. A surety relationship differs from more common lines of insurance in three ways:

- In traditional insurance, the insured's risk is transferred to the insurance company. In suretyship, the principal does not transfer any risk. The protection of the bond is for the obligee.
- In traditional insurance, the insurance company expects that a certain portion of the premium for the policy will be paid out in losses. In true suretyship, the premiums paid are "service fees" charged for the use of the surety company's financial backing and guarantee. The surety expects no losses.
- In underwriting traditional insurance, the goal is to screen and spread risk. In suretyship, underwriting is a form of credit evaluation and the goal is to avoid risk.

Most large property and casualty insurance companies have surety departments. In addition, there are some companies for which surety bonds make up all or most of their business. In either case, in order for a company to write a surety bond in the United States, it must be licensed by the insurance department of one or more states.

### **A.4 How Does a Surety Bond Compare to a Letter of Credit?**

A surety bond differs in certain respects from a letter of credit as a mechanism for FR:

- The bank issuing the letter of credit has no interest in the option of performing the principal's obligation to conduct corrective action and compensate third-parties, whereas the surety may want to choose that option
- The surety bond does not need to be renewed whereas a letter of credit is usually issued for a specified term (however, an UST letter of credit is automatically renewed, as described in Chapter 7)

From the point of view of UST FR, both mechanisms are acceptable and provide comparable assurance.

## B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING SURETY BONDS

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING SURETY BONDS</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Selecting an Eligible Surety Company (see Section B.1)</li><li><input type="checkbox"/> Obtaining a Properly Worded Surety Bond for the Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Updating Assurance (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If the Surety Decides to Cancel or to Not Renew the Bond, or Is No Longer Eligible, Capable, or Authorized to Provide a Bond (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy Proceedings (see Section B.7)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.8)</li><li><input type="checkbox"/> Replenishing Assurance after Bond Is Used for Corrective Action and/or Third-Party Compensation (see Section B.9)</li></ul>

### B.1 Selecting an Eligible Surety Company

To determine whether a surety company is eligible to issue an UST bond, owners or operators can consult the most recent edition of the U.S. Department of the Treasury's *Circular 570*, which is published annually on approximately July 1 and is updated periodically in the *Federal Register*. *Circular 570* also can be found on the World Wide Web at <http://www.fms.treas.gov/c570/index.html>. Over 300 acceptable companies are listed as of 1999.

**NOTE:** Although *Circular 570* specifies each surety's underwriting limitation, a surety bond may be issued for an amount greater than the limit shown. When the penal sum exceeds the underwriting limitation the surety must bring another surety or insurance company into the agreement to share the risk.

### B.2 Obtaining a Properly Worded Surety Bond for the Proper Scope and Amount of Coverage

Application. Typically, anyone applying for a surety bond must complete an application form and provide the following: a copy of the business' financial statements for the current year, previous year, and interim results; a personal financial statement; a signed, notarized indemnity agreement; a broker or agent service agreement; and possibly other information such as letters of reference and borrowing capacity and/or lines of credit.

According to the Surety Association of American (SSA), it is common for a surety to request indemnification by the owners of a closely held corporation (not just by the corporation itself). Typically, the surety requires the spouse's indemnity because personal assets often are jointly owned. Sureties require all personal assets to be available to back the guarantee because they believe that there is less chance a principal will avoid its responsibilities if its personal assets are at stake.

If the surety is unable to approve a bond request based on the qualifications given by the owner or operator, the surety company may suggest depositing some form of **collateral** as an inducement to write the bond. In practice, many bonds are written on this basis.

Sureties give brokers and agents authority to sell surety bonds for them in a written document called a **power of attorney**. If the owner or operator has any doubt about the authority of the broker to act on the surety's behalf, to issue RCRA UST bonds, or to issue bonds in the amount needed, he or she should ask for a copy of the power of attorney.

Wording. The required wording for surety bonds appears in the federal regulations at 40 CFR 280.98(b). Both the owner or operator and the surety, in signing the bond, certify that the wording of the bond is identical to the required wording on the date the bond was executed.

Scope of Coverage. The surety bond can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). It is unlikely but possible that the surety bond will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the surety bond can be used to cover the other scope area.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a surety bond with an insurance policy that covers only third-party liability but not corrective action (or vice versa). In such a situation, if the owner or operator can use the bond for corrective action FR, the bond would also work for third-party compensation FR because the penal amount stays the same. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A surety bond must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when a surety bond is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

### **B.3 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund**

The owner or operator who uses a surety bond to satisfy UST FR requirements must establish a standby trust fund when the surety bond is acquired. This standby trust fund must meet the requirements specified in § 280.103, and the trustee must be eligible to serve as an UST FR trust fund trustee. Chapter 11 describes what makes a trustee eligible and the required wording for a standby trust fund.

### **B.4 Recordkeeping**

An owner or operator using a surety bond for UST FR must maintain on-site or at the place of business a copy of the following documents:

- Properly worded *surety bond* signed by an authorized representative from the surety company and by the owner or operator.
- Signed *standby trust fund* agreement and copies of any amendments to the agreement, which was established to receive funds from the surety bond. The standby trust fund should satisfy the criteria described in Chapter 11 of this *Manual*



- Updated copy of *certification of FR* (described in Chapter 2 Section D.5)

For its own protection, an owner or operator obtaining the bond through a broker or agent also may want to have on file a copy of the broker/agent's power of attorney authorizing the broker/agent to issue bonds on behalf of the surety company.

### **B.5 Updating Assurance**

If the required level of coverage increases above the amount assured by the surety bond, the owner or operator must either (1) revise the surety bond to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the new coverage level and the amount of the surety bond.

The bond remains valid until it is cancelled or terminated; it does not need to be renewed annually.

### **B.6 Obtaining Alternate Assurance If the Surety Decides to Cancel or to Not Renew the Bond, or Is No Longer Eligible, Capable, or Authorized to Provide a Bond**

The owner or operator must obtain alternate assurance in the following circumstances:

- Within 60 days of receipt of a notice that the surety intends to cancel or not renew the bond (see 40 CFR 280.109(b))
- Within 30 days of receiving notice of the incapacity of the surety or the suspension or revocation of its authority to issue bonds

### **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings**

An owner or operator who uses a surety bond must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 60 days of receipt of notice of termination from the surety. The notification must include
  - ~ the name and address of the surety bond provider
  - ~ the effective date of termination
  - ~ required records (see B.4 above)
- Failure to obtain alternate assurance within 30 days of receiving notice of the incapacity of the surety or the suspension or revocation of its authority to issue bonds.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail (see 40 CFR 280.114(a)).

## **B.8 Submitting Financial Responsibility Documents**

**According to the federal regulations**, an owner or operator that uses the surety bond must submit a copy of the surety bond and the signed standby trust fund to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- When the owner or operator fails to obtain alternate coverage:
  - ~ within 60 days after receipt of notice of termination of the bond; and
  - ~ within 30 days after receiving notification of suspension or revocation of the authority of the surety to issue surety bonds.
- Within 10 days after commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code, naming the owner or operator as debtor (see 40 CFR 280.114(a)).
- At any time if requested by the implementing agency (see 40 CFR 280.110(c)).

State regulations may require more frequent (e.g., annual) reporting.

## **B.9 Replenishing Assurance after Bond Is Used for Corrective Action and/or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the surety bond has been drawn upon to fund corrective action and/or third-party compensation. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) The owner or operator must either:

- Renew the bond or replenish the standby trust fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust have been reduced.

This replenishment must occur on the anniversary date of bond execution. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR SURETY BONDS</b>	
<b>Implementing Agency Responsibilities</b>	
<input type="checkbox"/>	Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or That the Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings (see Section C.1)
<input type="checkbox"/>	Reviewing Financial Responsibility Submissions (see Section C.2)
<input type="checkbox"/>	Directing Performance or Payments to the Standby Trust Fund (see Section C.3)
<input type="checkbox"/>	Monitoring the Replenishment of Assurance after Bond Is Used for Corrective Action and/or Third-Party Compensation (see Section C.4)
<b>Implementing Agency Oversight</b>	
<input type="checkbox"/>	Checking Whether the Surety and Trustee Are Eligible (see Section C.5)
<input type="checkbox"/>	Verifying the Wording, Scope, and Amount of Coverage of the Bond and Standby Trust Fund (see Section C.6)
<input type="checkbox"/>	Checking the Authenticity of the Bond (see Section C.7)

### C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or That the Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that the owner or operator cannot obtain alternate assurance. Termination of the bond by the surety is almost as worrisome as bankruptcy of the owner or operator (discussed below). After previously committing to provide a bond, a surety's decision to terminate or cancel the bond may be evidence of a reduced level of confidence in the owner or operator's business. Nevertheless, following receipt of a notice from the owner or operator of failure to obtain alternate insurance, you may want to monitor the efforts being made by the owner or operator to secure alternate assurance. This could include alerting the owner about the need for alternate assurance if the operator had been providing the financial assurance through the bond, and vice versa. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

If it does not appear that alternate assurance is immediately forthcoming, you may want to draw upon the bond. In order to draw upon the bond and direct payments into the standby trust fund, the Director must

- Ascertain the date the bond will be cancelled by the surety or will terminate
- Investigate whether a release has occurred or may have occurred
- Determine whether there is an effective standby trust in place, and, if not, instruct the owner or operator to establish one quickly, and
- If the Director determines or suspects that a release has occurred, notify the surety and direct payment into the standby trust fund.

These activities must be completed before the bond is cancelled. **If you suspect, have determined, or have been notified that a release has occurred, you may not want to miss your opportunity to direct payments to the standby trust fund in hope that the owner or operator will secure alternate assurance. You can always release funds from the standby trust if the owner or operator does secure alternative assurance.**

Owner or Operator Named A Debtor in Bankruptcy. It is unlikely that an owner or operator using the surety bond will be named as a debtor in bankruptcy proceedings. If that happens, it represents a serious potential gap in coverage in the event of a release or a need for third-party compensation. Bankruptcy of the owner or operator does not allow you to draw upon the bond unless the owner or operator has failed to perform corrective action or third-party compensation and the surety has chosen not to do so either.

The discovery of a release or appearance of a claim for compensation could, in rare cases, cause the owner or operator to seek protection under the Bankruptcy Code. If that happens, however, you may be able to activate the bond if the owner or operator does not respond to the release or claim. See C.3 below. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>24</sup> Apart from that route, if the owner and operator are different parties, you could alert the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

## **C.2 Reviewing Financial Responsibility Submissions**

**Based on the federal reporting rules,** you will receive unsolicited copies of the surety bond and standby trust fund from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release that must be reported (see §280.110(a)(1))
- After the owner or operator fails to obtain alternate assurance after being notified that the surety:
  - (a) intends to cancel or non-renew the bond (see §280.109(b)(3)), or
  - (b) is no longer capable or authorized to issue surety bonds (see §280.110(a)(2)(ii))
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor (see §280.114(a))

In each situation, you may want to ensure that the surety bond is properly worded, the surety is or was eligible, and the standby trust is effective so that the owner or operator can be instructed to remedy any problems or obtain alternate assurance (see C.5 through C.7 below for details on reviewing sureties and surety bonds). In the second situation, also see the discussion in C.1 above. In the third situation, while review of the FR documents is advisable, the owner or operator may not be willing or able to remedy any problems with the bond and standby trust you identify.

---

<sup>24</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

**NOTE:** A surety bond does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular annual reporting or may request evidence of FR for monitoring compliance. See Sections C.5 through C.7 below for review of such submissions.

**C.3 Directing Performance or Payments to the Standby Trust Fund<sup>25</sup>**

When to Direct Performance or Payments. The bond clearly describes when you may draw on it; the Director does not have unlimited discretion to draw on the bond. You can direct payments into the standby trust fund as shown in Exhibit 6-1 below:

<p align="center"><b>Exhibit 6-1</b>  <b>DIRECTING PERFORMANCE OR PAYMENTS</b>  <b>TO THE STANDBY TRUST FUND</b></p>	
Situation	Direct Performance or Funding of Standby Trust Fund
<p>(1) If the owner or operator fails to establish alternative financial assurance within 60 days of receiving notice of cancellation of its financial assurance mechanism, <u>and</u></p> <p align="center">(i) the Director of the implementing agency determines or suspects<sup>1</sup> that a release has occurred</p> <p align="center"><u>OR</u></p> <p align="center">(ii) the owner or operator has notified the Director of a release pursuant to Subparts E or F</p>	<p>✓  (Funding Only)</p>
<p>(2) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, <u>and</u></p> <p>the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F</p>	<p>✓</p>
<p>(3) The Director has received either:</p> <p align="center">(i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid</p> <p align="center"><u>OR</u></p> <p align="center">(ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.</p>	<p>✓</p>
<p><sup>1</sup> The Director's suspicion that a release has occurred must be based on objective evidence, such as failure of a tank tightness test, discovery of free product in adjacent sewer and utility lines, notice by the owner or operator, or other clear but unverified evidence. Evidence of a suspected release under §280.50 includes positive monitoring results from testing, monitoring and sampling, unusual operating conditions, or the discovery of petroleum in the environment.</p>	

<sup>25</sup> Directing payments out of the standby trust fund is described in Chapter 11, Section C.2.

How Much to Direct. The amount of funds you direct to be paid into the standby trust cannot exceed the amount of coverage specified in the bond. You may direct a smaller amount, but should do so only in limited circumstances. If the owner or operator has failed to provide alternate assurance, it is appropriate to direct the full amount into the standby trust fund. If the owner or operator has failed to perform corrective action, you may consider, when deciding how much to direct, the following: the estimated cost of the corrective action (including a contingency factor) and whether the owner or operator is responsible for other USTs. A conservative course is to direct the full amount into the standby trust fund. Similarly, if the owner or operator has failed to provide third-party compensation, you may consider, when deciding how much to direct, the following: the amount of the judgment, award, or settlement; any pending claims or litigation; and whether the owner or operator is responsible for other USTs. The conservative course is to direct the full amount into the standby trust fund.

How to Direct Payments. In directing payments, include appropriate language drawn from the bond in your instructions as follows:

- "Because the owner or operator has failed to provide alternate coverage within 60 days after receipt of a notice of cancellation of this bond and the Director of the implementing agency has determined or suspects that a release has occurred at an underground storage tank covered by this bond, you are instructed to deposit funds in [*name and address of the trustee and the name and account number of the trust*]."
- "Because the owner or operator has failed to take corrective action in accordance with 40 CFR Part 280 Subpart F and the Director's instructions for releases arising out of the operation of the above-identified tank(s) covered by this bond, you are instructed to either perform corrective action or deposit funds in [*name and address of the trustee and the name and account number of the trust*]."
- "Because the owner or operator has failed to compensate insured third parties for bodily injury or property damage caused by accidental releases arising from operating the tank(s) identified above, covered by this bond, you are instructed to either perform third-party compensation or deposit funds in [*name and address of the trustee and the name and account number of the trust*]."

Send your instructions by certified mail (after verifying the proper office to be addressed) and specify the latest date when funds are to be deposited in the standby trust. You will need to provide the surety with the name and address of the trustee and the name and account number of the trust, to facilitate deposit of funds.

#### **C.4 Monitoring the Replenishment of Assurance after Bond Is Used for Corrective Action and/or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the bond has been used for corrective action and/or third-party compensation. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) The owner or operator must either:

- Renew the bond or the standby trust fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust have been reduced.

This replenishment must occur on the anniversary date of the bond. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment ensures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

However, because the bond is drawn upon only when the owner or operator fails to provide alternate assurance, fails to perform corrective action, or fails to satisfy a liability judgment or award, the owner or operator also may fail to take steps to replenish the bond. If that happens, you could instead determine whether the owner or operator are different parties. If they are, you can seek UST FR from the party other than the one that has failed to comply.

### **C.5 Checking Whether the Surety and Trustee Are Eligible**

Surety Eligibility. To determine whether a surety company is eligible, you should consult the most recent edition of the U.S. Department of the Treasury's *Circular 570*, which is published annually on approximately July 1 and is updated periodically in the *Federal Register*. *Circular 570* also can be found on the World Wide Web at <http://www.fms.treas.gov/c570/index.html>. The surety must be listed in *Circular 570*. **Take care in consulting Circular 570 as many sureties have similar names.**

If the surety's underwriting limitation (also specified in *Circular 570*) is less than the penal sum of the bond you may want to inquire whether the surety had brought another surety company or reinsurer into the agreement to share the risk. *Circular 570* identifies acceptable reinsurers. Look for the "subscription sheet" which shows the participants and their authorizing signatures.

Trustee Eligibility. See Chapter 11, Section C.4 which describes how to check the eligibility of a trustee for UST FR.

### **C.6 Verifying the Wording, Scope, and Amount of Coverage of the Bond and Standby Trust Fund**

Wording. The required wording for surety bonds is specified in the regulations. Both the owner or operator and the surety, in signing the bond, certify that the wording of the bond is identical to the required wording on the date the bond was executed. Deviations in the wording of the bond may compromise its effectiveness.

See Chapter 11 Section C.5 which describes how to verify the wording of the standby trust fund.

Scope of Coverage. The surety bond can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the surety bond will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the surety bond can be used to cover the other scope area. You should ensure that the scope of coverage of the surety bond is appropriate even when it is used in combination with other mechanisms.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a bond with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the bond for part of the required scope of coverage, the bond also would work for the full scope because the required amount of coverage stays the same whether the bond is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

**Amount of Coverage.** A surety bond must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when a surety bond is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

### **C.7 Checking the Authenticity of the Bond**

The authenticity of surety bonds is an issue in the United States. The most reliable way to authenticate a surety bond is to contact the issuing surety company directly. However, according to the Surety Association of America (SAA), it often is difficult to ascertain the correct address, telephone number, or person to contact at the surety. Accordingly, the SAA provides a list of surety companies that have volunteered to be included together with information as to how they can be contacted for the purposes of authenticating a bond. Since participation in this program is voluntary, not every surety company is listed.

The effort to authenticate a bond may take a few days because surety bonds are frequently executed by agents or in field offices of the surety company. However, if an inquiry is not answered within two weeks, a follow up is in order.

When making an inquiry to authenticate a bond, the SAA recommends that you enclose a photocopy of the bond with your inquiry. If the bond itself can not be located, the following information should be provided if available:

1. Bond number (if any).
2. Name and address of principal (owner or operator).
3. Name and address of obligee (Director of implementing agency).
4. Penal amount of bond (per occurrence and annual aggregate).
5. Date bond executed.
6. Name of person signing bond for the surety.
7. Brief description of bond (e.g., bond issued for UST FR).

SAA has developed a suggested format for this information at [HTTP://WWW.SURETY.ORG/OBLIGEUS.HTM](http://www.surety.org/OBLIGEUS.HTM).

The name of the surety company appearing on the surety bond should be identical to the name of the surety company appearing in the *Obligees Guide*. If there is **any** discrepancy, that fact should be called to the attention of the surety company when making an inquiry. If the surety company is not listed in the *Obligees Guide*, you might want to consider other information sources such as telephone directories, the State Insurance Department, and/or insurance agents or brokers who handle surety bonds. If these sources fail, contact the SAA directly for assistance in authenticating a bond. (See Section E below for sources of further information.)



## D. SURETY RESPONSIBILITIES

The following checklist summarizes the surety's responsibilities:

CHECKLIST OF SURETY RESPONSIBILITIES	
<input type="checkbox"/>	Being Listed as Acceptable Surety on Federal Bonds in the Latest Circular 570 (see Section D.1)
<input type="checkbox"/>	Notifying Owner or Operator of Decision to Cancel the Bond or If No Longer Eligible, Capable, or Authorized to Issue Bonds (see Section D.2)
<input type="checkbox"/>	Performing or Placing Funds as Directed (see Section D.3)

### D.1 Being Listed as Acceptable Surety on Federal Bonds in the Latest Circular 570

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. Sureties that are not familiar with UST FR should review the regulations at 40 CFR Part 280, especially §280.98.

### D.2 Notifying Owner or Operator of Decision to Cancel the Bond or If No Longer Eligible, Capable, or Authorized to Issue Bonds

There are two circumstances when the surety should notify the owner or operator:

- If the surety decides to cancel the bond (use certified mail)
- Incapacity, suspension, or revocation of authority to issue surety bonds

The bond will terminate no less than 120 days after the date the owner or operator receives the notification of cancellation, as evidenced by the return receipt.

### D.3 Performing or Placing Funds as Directed

In signing the bond, the surety commits to:

- Performing corrective action and/or third-party compensation or depositing funds up to the annual aggregate penal sum directly into the standby trust fund as instructed by the Director of the implementing agency, if the Director notifies the surety that the owner or operator has failed to take corrective action and/or compensate injured third parties.
- Funding the standby trust as instructed, if the Director notifies the surety that the owner or operator has failed to provide alternate assurance (after receiving a cancellation notice from the surety) and that the Director has determined or suspects that a release has occurred.

## E. SOURCES OF FURTHER INFORMATION

This list of information sources is not intended to be all inclusive, but is intended to provide some commonly accepted sources of information.

State Insurance Departments. The insurance department of the state in which the surety company is domiciled will usually have the most information about a surety company. Insurance departments are located in state capitals and, in some instances, have offices in larger cities of states. The telephone numbers can be found under the state listing in the local telephone directory and also are listed at the end of *Circular 570*. State Insurance Commissioners' names, addresses, and phone numbers also can be found on-line at [HTTP://WWW.NAIC.ORG/CONSUMER/STATE/MEMBERSHIPLIST.HTM](http://www.naic.org/consumer/state/membershiplist.htm). State insurance department websites are posted at [HTTP://WWW.NILS.COM/LINKS.HTM](http://www.nils.com/links.htm). Any citizen may call the department and request to speak to someone who can provide information on a particular surety company.

Agents and Brokers. Most surety bonds are issued through insurance agents and brokers who in many instances can provide information about specific surety companies. Professional agents or brokers specializing in providing surety bonds may be able to assist in reviewing surety bonds for proper execution. Names of agencies specializing in surety bonds may be obtained from the **National Association of Surety Bond Producers** (NASB) and other sources/directories. Most NASB member firms offer general expertise in surety bonding in addition to specialized knowledge of construction contract bonds.

U.S. Treasury. The most current list of U.S. Treasury authorized companies is always available through the Internet at [HTTP://WWW.FMS.TREAS.GOV/C570/INDEX.HTML](http://www.fms.treas.gov/c570/index.html). Other information about federal sureties may be obtained from the U.S. Department of the Treasury, Financial Management Service, Surety Bond Branch, 3700 East West Highway, Room 6A04, Hyattsville, MD 20782, Telephone (202) 874-6850 or Fax (202) 874-9978.

Sureties. **The Surety Association of America** (SAA) is a voluntary, non-profit, unincorporated association of companies engaged in the business of suretyship. It has approximately 650 member companies, which collectively underwrite the majority of surety bonds written in the United States. The SAA has posted an *Obligees Guide* to assist in verifying the authenticity of surety bonds. See [HTTP://WWW.SURETY.ORG/OBLIGUID.HTM](http://www.surety.org/obliguid.htm). The mailing address is 1101 Connecticut Avenue, N.W., Suite 800, Washington, D.C. 20036. Its web address is [HTTP://WWW.SURETY.ORG](http://www.surety.org).

Other Organizations. The NASB and the SAA support the **Surety Information Office** (SIO). SIO's mission is to increase the use of surety bonds and foster dissemination of positive information on the role of suretyship, especially in public and private construction. SIO works with a network of 46 local surety associations nationwide. Many of these local associations have formed public information task forces to promote the surety industry and the use of surety bonds. These local associations may be willing to provide assistance in matters relating to surety bonds. SIO is headquartered in Washington, D.C. at 5225 Wisconsin Avenue, N.W., Suite 600, 20015-2014. Its web address is [HTTP://WWW.SIO.ORG](http://www.sio.org).

## 7. FINANCIAL RESPONSIBILITY USING IRREVOCABLE STANDBY LETTERS OF CREDIT

This chapter describes the use of letters of credit to demonstrate UST FR as follows:

A. BACKGROUND	128
A.1 What Is An Irrevocable Standby Letter of Credit?	128
A.2 How Does An UST Letter of Credit Work?	128
A.3 Regulation of Letter of Credit Issuers	129
A.4 How Does a Letter of Credit Compare to a Surety Bond?	132
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LETTERS OF CREDIT	133
B.1 Selecting an Eligible Issuing Institution	133
B.2 Obtaining a Properly Worded Letter of Credit for the Proper Scope and Amount of Coverage	133
B.3 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund	134
B.4 Recordkeeping	134
B.5 Updating Assurance	134
B.6 Obtaining Alternate Assurance If the Issuer Decides to Cancel or to Not to Renew the Letter of Credit or Is No Longer Eligible, Capable, or Authorized to Issue A Letter of Credit	135
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy	135
B.8 Submitting Financial Responsibility Documents	135
B.9 Replenishing Assurance After Letter of Credit Is Used for Corrective Action and/or Third-Party Compensation	136
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	137
C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings	137
C.2 Reviewing Financial Responsibility Submissions	138
C.3 Directing Payments to the Standby Trust Fund	139
C.4 Monitoring the Replenishment of Assurance After Letter of Credit Is Used for Corrective Action and/or Third-Party Compensation	141
C.5 Checking Whether the Issuer and Trustee Are Eligible	141
C.6 Verifying the Wording, Scope, and Amount of Coverage of the Letter of Credit and the Standby Trust Fund	141
C.7 Checking the Authenticity of the Letter of Credit	142
D. FINANCIAL INSTITUTION RESPONSIBILITIES	143
D.1 Being Authorized to Issue Letters of Credit in Each Relevant State and Being Regulated and Examined by a Federal or State Agency	143
D.2 Notifying Owner or Operator of Decision to Cancel or Not to Renew the Letter or If No Longer Eligible, Capable, or Authorized to Provide Letter of Credit	143
D.3 Depositing Funds as Directed	143
E. SOURCES OF FURTHER INFORMATION	144

## A. BACKGROUND

### A.1 What Is An Irrevocable Standby Letter of Credit?

An owner or operator may satisfy the UST FR requirements by obtaining an **irrevocable standby letter of credit**. A letter of credit is a common option in many government-mandated financial responsibility programs, both environmental and non-environmental.

A **letter of credit** is a mechanism by which the credit of one party, a bank or other financial institution, is extended on behalf of a second party, called the **account party**, to a third party, the **beneficiary**. The first party, the **issuer**, allows the beneficiary to draw funds upon the presentation of documents in accordance with the terms of the letter of credit. While commercial letters of credit are used as payment instruments, the **standby letter of credit** typically is used as a **guarantee** of payment if the account party fails to fulfill its obligations. The parties do not expect that the standby letter of credit will ever be drawn upon because the account party is expected to perform its obligations. A letter of credit may be revocable or **irrevocable**, but most letters of credit are irrevocable because they would not serve their purpose if the issuer could revoke or modify the letter of credit at any time without notice to or consent of the account party or beneficiary.

Thus, there are three parties to the standby letter of credit.

- The account party is responsible for the obligation.
- The issuer guarantees payment of the obligation.
- The beneficiary is the party who receives the benefit of the letter of credit.

In an UST FR standby letter of credit, the owner or operator is the account party, the financial institution is the issuer, and the Director of the implementing agency is the beneficiary.

There are many types of letters of credit, but two general categories are (1) financial standby letters and (2) performance standby letters. Financial standby letters, as the name implies, assure payments when the account party fails to make obligated payments (such as repaying a loan or debt). Performance standby letters, on the other hand, assure payments when the account party fails to perform a nonfinancial obligation. The UST letter of credit is a hybrid which guarantees obligations both to pay for third-party compensation and perform corrective action.

### A.2 How Does An UST Letter of Credit Work?

An UST FR letter of credit guarantees availability of funds for corrective action and/or third-party compensation in the event of the owner or operator's default. The issuer offers this assurance in exchange for a fee paid by the owner or operator. The owner or operator also agrees to repay, with interest, any funds drawn through the letter of credit. The terms of the credit arrangement (e.g., rate of interest, payment terms) between the owner or operator and the issuer depend on individual circumstances and negotiations and do not affect the letter of credit itself.

The standby letter of credit specifies the documents necessary to establish the fact of the account party's default. The issuer must pay the beneficiary upon presentation of two documents:

- a **sight draft** and
- a signed statement certifying that the letter is payable pursuant to UST FR regulations.

A **draft** is a written demand for payment, prepared to conform to legal requirements for **commercial paper** such as checks, certificates of deposit, and promissory notes. The draft facilitates the unconditional transfer of a definite sum of money on a definite date to a named party. A **sight draft** must be paid when presented, in contrast to a **time draft**, which need not be paid until a future date.

The letter of credit does not require the issuer to determine whether the owner or operator has failed to take corrective action, compensate third parties, or obtain alternate assurance when required. And the issuer does not intend to make any such inquiry. The issuer also is not required to determine how the funds are to be spent. The issuer's duty is simply to pay when presented with the proper documents. The demand or draft must be in **precise** accordance with the terms of the letter (i.e., substantial compliance is not good enough). In most jurisdictions, banks have virtually no discretion but to match the terms and conditions of the letter of credit to the documents presented. **Apparently trivial variations can cause documents to be rejected.**

Standby letters of credit typically are issued for periods up to 12 months. The UST FR letter of credit must be "irrevocable" with a term specified by the issuing institution. The letter of credit must provide that credit be automatically renewed for at least the same term as the original term, unless, at least 120 days before the current expiration date, the issuing institution notifies the owner or operator by certified mail of its decision not to renew the letter of credit. Under the terms of the letter of credit, the 120 days will begin on the date when the owner or operator receives the notice, as evidenced by the return receipt.

Under the terms of the UST FR letter of credit, all amounts paid pursuant to the sight draft must be deposited by the issuing institution directly into the **standby trust fund** in accordance with instructions from the Director of the implementing agency. A standby trust fund is simply a trust fund that is not yet funded but is otherwise ready to accept monies in the event they are received from a particular source (such as the issuer of a letter of credit). Funds in the standby trust can then be used to pay the costs of corrective action and third-party compensation. This standby trust fund must meet the requirements specified in § 280.103. (See Chapter 11 for more information on standby trust funds.)

**NOTE:** The use of a standby trust is necessary because without such a mechanism, any funds drawn under the letter of credit that are payable to the EPA Regional Administrator would have to be paid into the U.S. Treasury and could not be used without Congressional action (see 31 U.S.C. 3302) to pay for the UST corrective action or third-party compensation for which the funds were intended. Due to similar state laws, funds payable to the state Director may have to be paid into the state treasury, unless a standby trust is used.

The issuer's liability is limited to the per-occurrence and annual aggregate amounts. The letter of credit allows the parties to specify the purpose for which the letter is being issued ("corrective action" and/or "compensating third-parties for bodily injury and property damage"). In addition, certain exclusionary language in the terms of the instrument clearly limit the type and circumstances of third-party liability for which this mechanism can be used; although not intended by the regulations, an issuer may require a statement that the funds will not be used for such payments when the letter is drawn upon.

### **A.3 Regulation of Letter of Credit Issuers**

Letters of credit are as strong as the ability of the issuing bank to honor them. Banking has traditionally been viewed as being unacceptably unstable if left unregulated. As a result, it has long been subject to regulation in order to ensure that banks are "safe and sound." The financial strength and liquidity

of banks is assured through state and federal regulation and oversight. This section summarizes the system for authorizing, regulating, and examining depository institutions in the United States.

Several different types of regulated financial institutions in the United States may offer standby letters of credit, including depository institutions such as commercial and savings banks, savings and loan associations, credit unions, and agencies and branches of foreign banks. Each of these institutions is subject to supervision and regulation by federal as well as state agencies. Unlike any other type of financial institution or other type of business, commercial banks and thrift institutions are chartered by both the federal and state governments; this is called a "dual banking system." **Once chartered, depository institutions do not need separate approval to issue standby letters of credit because that activity falls within "the business of banking."** (Depository institutions must seek and receive separate approval to offer trust services, as described in Chapter 10.)

The federal government regulates the financial operations of both federal- and state-chartered depository institutions through federal bank regulatory agencies. There is more federal regulation of federally-chartered institutions than state-chartered institutions. States have regulatory power only over state-chartered institutions.

Federal Regulatory Agencies. There are two major types of depository institutions in the U.S.: **commercial banks** and **thrifts** (savings and loan associations, savings banks, and credit unions). Recent changes in the law and regulatory policy largely have eliminated differences in the nature of commercial banks and thrifts. Exhibit 7-1 displays which federal agencies regulate which depository institutions. The **Federal Reserve System (FRB)**, the **Office of the Comptroller of the Currency**, and the **Federal Deposit Insurance Corporation (FDIC)** are responsible for examining commercial banks and savings banks. The **Office of Thrift Supervision (OTS)** performs for savings and loan associations the functions the Comptroller performs for commercial banks with federal charters. OTS charters, regulates, examines, and supervises all thrifts with federal charters and regulates many state-chartered thrifts. The functions of the OTS are handled for federally-chartered credit unions by the **National Credit Union Administration (NCUA)**. These five agencies all are members of the **Federal Financial Institutions Examination Council (FFIEC)**, a coordinating body.

Some commercial banks -- termed **national banks** -- are chartered by the federal government. National banks' charters are issued by the Office of the Comptroller of the Currency (OCC), an independent bureau of the Department of the Treasury. These banks have the word "national" or carry the abbreviations of "N.A." or "N.S.&T." in their names. The OCC also can charter trust companies. National banks that limit their services solely to fiduciary services sometimes are called "national trust banks" or "national trust companies." About 2,800 national banks are supervised by the OCC.

About 7,000 commercial banks are chartered by states. **State banks** require state authorization to conduct trust operations. The easiest way to identify state-chartered banks is by the lack of national bank identifiers in their names. State-chartered banks that are members of the Federal Reserve System (FRS) are regulated, at the federal level, by the Board of Governors of the Federal Reserve System (FRB), an independent agency; around 5,800 state-chartered banks that are not members of the FRS are regulated by the Federal Deposit Insurance Corporation (FDIC), an independent agency that also insures the deposits of banks. State chartered banks are supervised and regulated at the state level by state banking agencies, which are members of the Conference of State Bank Supervisors (CSBS). The FDIC also regulates federally-chartered savings banks and around 600 state-chartered savings banks. The FDIC periodically examines the trust operations of banks or savings institutions that it regulates.

**Exhibit 7-1**  
**FEDERAL AGENCIES RESPONSIBLE FOR REGULATING FINANCIAL**  
**INSTITUTIONS THAT CAN SERVE AS UST TRUSTEES**

Type of Institution	Federal Supervisor
<u>Commercial Banks</u>  Federally Chartered National Banks  State-Chartered Commercial Banks  - member of Federal Reserve System - not member of Federal Reserve System	Office of the Controller of the Currency (OCC)   Federal Reserve Board (FRB) Federal Deposit Insurance Corporation (FDIC)
<u>Thrifts</u>  Federally Chartered Savings Banks State-Chartered Savings Banks Federally Chartered Savings (and Loan) Associations State-Chartered Savings (and Loan) Association Federally Chartered Credit Unions State-Chartered Credit Unions	Office of Thrift Supervision (OTS) FDIC or OTS OTS FDIC or OTS National Credit Union Administration (NCUA) N/A
<u>U.S. Branches of Foreign-Chartered Institutions</u>  Federal License State License Covered by Deposit Insurance	OCC FRB FDIC

**Savings (and loan) associations**, also known as thrifts, have either federal or state charters. Thrifts chartered by the federal government must have the word "federal" in their names. Regardless of charter type, the Office of Thrift Supervision (OTS), an independent Treasury bureau, regulates savings and loan associations.

**Credit unions** have either federal or state charters. Over 6,700 federal credit unions are supervised and examined by the National Credit Union Administration (NCUA), which also insures credit union deposits. Over 4,000 state-chartered credit unions are supervised by state banking authorities.

Agencies and branches of **foreign banks** may be licensed to conduct banking business in the United States by either the federal government or the states. As of 1999, 66 agencies or branches hold federal licenses and were supervised by the OCC. About 430 agencies or branches of foreign banks hold a state license; they are supervised by the FRB. A small number of branches of foreign banks are permitted to accept insured deposits; these branches are supervised by the FDIC. By statute, the FRB has overall responsibility for foreign banks operating in the United States. **Chartered U.S. branches and agencies of foreign banks are the only types of foreign bank entity that are regulated and examined by Federal or State agencies. Therefore, these branches and agencies are the only types of foreign bank entity that may provide letters of credit for financial assurance.** Letters of credit issued by a foreign bank, rather than by the U.S. branch or agency of a foreign bank, would not meet UST FR requirements.

#### **A.4 How Does a Letter of Credit Compare to a Surety Bond?**

A letter of credit differs in certain respects from a surety bond as a mechanism for FR:

- The bank issuing the letter of credit has no interest in the option of performing the principal's obligation, whereas that option is desired and may be chosen by the surety
- The surety bond does not need to be renewed whereas a letter of credit is usually issued for a specified term (however, an UST letter of credit is automatically renewed)

From the point of view of UST FR, both mechanisms are acceptable and provide comparable assurance.



## **B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LETTERS OF CREDIT**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LETTERS OF CREDIT</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Selecting an Eligible Issuing Institution (see Section B.1)</li><li><input type="checkbox"/> Obtaining a Properly Worded Letter of Credit for the Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Updating Assurance (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If the Issuer Decides to Cancel or to Not to Renew the Letter of Credit or Is No Longer Eligible, Capable, or Authorized to Issue A Letter of Credit (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy (see Section B.7)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.8)</li><li><input type="checkbox"/> Replenishing Assurance After Letter of Credit Is Used for Corrective Action and/or Third-Party Compensation (see Section B.9)</li></ul>

### **B.1 Selecting an Eligible Issuing Institution**

The issuing institution must be an entity (e.g., a bank or other financial institution) which has the authority to issue a letter of credit in each state where used, and whose letter of credit operations are regulated and examined by a federal or state agency. All domestic commercial banks and most savings banks, foreign banks, credit unions, and savings and loan associations satisfy this requirement. Owners or operators can confirm the eligibility of a prospective issuer with the appropriate regulatory authority. See Section E of this chapter.

The UST FR letter of credit mechanism is different in two major respects from standard commercial versions: (1) the UST version can be cancelled only with 120 days notice, and (2) the UST version must be extended automatically at least one year if it is not cancelled. Therefore, although many financial institutions will be eligible, some may not be willing to provide a letter of credit for UST financial assurance.

### **B.2 Obtaining a Properly Worded Letter of Credit for the Proper Scope and Amount of Coverage**

Application. Owners or operators that apply for a letter of credit can expect the bank to request financial information to evaluate creditworthiness. If the owner or operator currently borrows from the bank, it may find that the bank will lower its lending limits to offset the amount in the letter. The fee for the letter of credit may be negotiable, depending on the business history of the parties and particularly on the COLLATERAL required (if any) to secure the credit. Banks may provide letters of credit for certain owners or operator who otherwise would not qualify, if collateral is deposited with the bank. Collateral may be required up to a value of 100 percent (or more) of the letter of credit.

Wording. The required wording for letters of credit is specified in the regulations at 40 CFR 280.99(b). In signing the letter of credit, the issuing institution certifies that the wording of the letter is identical to the required wording on the date the letter was signed.

Scope of Coverage. The letter of credit can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the letter of credit will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the letter of credit can be used to cover the other scope area.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a letter of credit with an insurance policy that covers only third-party liability but not corrective action (or vice versa). In such a situation, if the owner or operator can use the letter of credit for corrective action FR, the letter of credit would also work for third-party compensation FR (and vice versa) because the aggregate amount stays the same. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A letter of credit must be in an amount that is at least equal to the required amount of coverage. The exception to this rule is when a letter of credit is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

### **B.3 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust Fund**

An owner or operator using a letter of credit for UST FR must establish a standby trust fund when the letter of credit is acquired. If the bank issuing the letter of credit does not want to establish a standby trust until the letter is drawn upon, the owner or operator must find another financial institution eligible and willing to set up the standby trust. The standby trust fund must meet the requirements specified in § 280.103, and the trustee must be eligible to serve as an UST FR trust fund trustee. Chapter 11 describes what makes a trustee eligible and the required wording for a standby trust fund.

### **B.4 Recordkeeping**

An owner or operator using a letter of credit for UST FR must maintain on-site or at the place of business the following documents:

- Properly worded *letter of credit* signed by an authorized representative of the issuing institution
- Signed *standby trust fund* agreement and copies of any amendments to the agreement, which was established to receive funds from the letter of credit. The standby trust fund must satisfy the criteria described in Chapter 11 of this *Manual*.
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5)

### **B.5 Updating Assurance**

The letter of credit remains valid until it is cancelled or terminated; it is automatically renewed.

If the required amount of coverage increases to a level above the amount assured by the letter of credit, the owner or operator must either (1) revise the letter of credit to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the new coverage level and the amount of the letter of credit.

## **B.6 Obtaining Alternate Assurance If the Issuer Decides to Cancel or to Not to Renew the Letter of Credit or Is No Longer Eligible, Capable, or Authorized to Issue A Letter of Credit**

An owner or operator must obtain alternate assurance in the following circumstances:

- Within 60 days of receipt of a notice that the issuer intends to cancel or not renew the letter of credit
- Within 30 days of receiving notice of the incapacity of the issuer or the suspension or revocation of its authority to issue letters of credit

## **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy**

An owner or operator must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 60 days of receipt of notice of termination from the issuer. The notification must include
  - ~ the name and address of the letter of credit provider
  - ~ the effective date of termination
  - ~ required records (see B.4 above)
- Failure to obtain alternate assurance within 30 days of receiving notice of the incapacity of the issuer or the suspension or revocation of its authority to issue letters of credit.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

## **B.8 Submitting Financial Responsibility Documents**

**According to the federal regulations,** owner or operator that uses the letter of credit must submit a copy of the letter of credit and signed standby trust fund to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- When the owner or operator fails to obtain alternate coverage:
  - ~ within 60 days after receipt of notice of termination of the letter;
  - ~ within 30 days after receiving notification of suspension or revocation of the authority of the issuer to issue letters of credit
- Within 10 days after commencement of a voluntary or involuntary proceeding under the U.S. Code Bankruptcy, naming the owner or operator as debtor (see 40 CFR 280.114(a))
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) reporting.

## **B.9 Replenishing Assurance After Letter of Credit Is Used for Corrective Action and/or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the letter of credit has been used for corrective action and/or third-party compensation. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) The owner or operator must either:

- Renew the letter of credit or standby trust fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust have been reduced.

This replenishment must occur on the **anniversary date** of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR LETTERS OF CREDIT</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Reviewing Financial Responsibility Submissions (see Section C.2) <input type="checkbox"/> Directing Payments to the Standby Trust Fund (see Section C.3) <input type="checkbox"/> Monitoring the Replenishment of Assurance After the Letter of Credit Is Used for Corrective Action and/or Third-Party Compensation (see Section C.4)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Checking Whether the Issuer and Trustee Are Eligible (see Section C.5) <input type="checkbox"/> Verifying the Wording, Scope, and Amount of Coverage of the Letter of Credit and the Standby Trust Fund (see Section C.6) <input type="checkbox"/> Checking the Authenticity of the Letter of Credit (see Section C.7)

### C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that the owner or operator cannot obtain alternate assurance. Termination of the letter of credit by the issuer is almost as worrisome as bankruptcy of the owner or operator. After previously committing to provide a letter of credit, an issuer's decision to terminate or cancel the guarantee may be evidence of a reduced level of confidence in the owner or operator's business. Nevertheless, following receipt of a notice from the owner or operator of failure to obtain alternate assurance, you may want to monitor the efforts being made by the owner or operator to secure alternate assurance. This could include alerting the owner about the need for alternate assurance if the operator had been providing the financial assurance through the letter of credit and vice versa. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

If it does not appear that alternate assurance is immediately forthcoming, you may want to draw upon the letter. In order to draw upon the letter of credit and direct payments into the standby trust fund, the Director must

- Ascertain the date the letter will be cancelled by the issuer or will terminate
- Determine whether there is an effective standby trust in place, and, if not, instruct the owner or operator to establish one quickly, and
- Present a draft to the issuer and direct payment into the standby trust fund.

These activities must be completed before the letter of credit is cancelled or terminates. **If you suspect, have determined, or have been notified that a release has occurred, you may not want to miss your opportunity to direct payments to the standby trust fund in hope that the owner or operator will secure alternate assurance. You can always release funds from the standby trust if the owner or operator does secure alternative assurance.**

Owner or Operator Named A Debtor in Bankruptcy. It is unlikely that an owner or operator using the letter of credit will be named as a debtor in bankruptcy proceedings. If that happens, you need not worry about coverage in the event of a release or a need for third-party compensation. Bankruptcy of the owner or operator does not relieve the issuer of its obligation to pay under the letter of credit. However, other creditors or the bankruptcy trustee may try to block payments under the letter because those payments would increase the debts of the bankrupt owner or operator. Such attempts usually fail. If you suspect that a release has occurred, you may want to direct payments to the standby trust fund, which is not treated as an asset of the debtor in bankruptcy. You can always release funds from the standby trust if the owner or operator secures alternative assurance.

The discovery of a release or appearance of a claim for compensation could, in rare cases, cause the owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>26</sup> Apart from that route, if the owner and operator are different parties, you could alert the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules,** you will receive unsolicited copies of the letter of credit and standby trust from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release that must be reported
- After the owner or operator fails to obtain alternate assurance after being notified that the issuer:
  - (a) intends to cancel or non-renew the letter of credit, or
  - (b) is no longer capable or authorized to issue a letter of credit
- Within 10 days after commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code, naming the owner or operator as debtor (see §280.114(a))

In each situation, you may want to ensure that the letter of credit is properly worded, the issuer is or was eligible, and the standby trust is effective so that, if not, the owner or operator can be instructed to remedy the problems or obtain alternate assurance. (See Sections C.5 through C.7 below for details on performing such a review.) In the second situation, see the discussion in C.1 above. In the third situation, while review of the FR documents is advisable, the owner or operator may not be willing or able to remedy any problems with the letter of credit and standby trust you identify.

---

<sup>26</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

**NOTE:** A letter of credit does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.5 through C.7 below for review of such submissions.

**C.3 Directing Payments to the Standby Trust Fund<sup>27</sup>**

When to Direct Payments. The Director does not have unlimited discretion to draw on the letter of credit. You must direct payments into the standby trust fund as shown in Exhibit 7-2 below:

<b>Exhibit 7-2 DIRECTING PAYMENTS TO THE STANDBY TRUST FUND</b>	
Situation	Direct Funds Into Standby Trust Fund
<p>(1) If the owner or operator fails to establish alternative financial assurance within 60 days of receiving notice of cancellation of its financial assurance mechanism, <u>and</u></p> <p style="padding-left: 40px;">(i) the Director of the implementing agency determines or suspects<sup>1</sup> that a release has occurred</p> <p style="text-align: center;"><u>OR</u></p> <p style="padding-left: 40px;">(ii) the owner or operator has notified the Director of a release pursuant to Subparts E or F</p>	✓
<p>(2) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, <u>and</u></p> <p style="padding-left: 40px;">the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F</p>	✓
<p>(3) The Director has received either:</p> <p style="padding-left: 40px;">(i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid</p> <p style="text-align: center;"><u>OR</u></p> <p style="padding-left: 40px;">(ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.</p>	✓
<p><sup>1</sup> The Director's suspicion that a release has occurred must be based on objective evidence, such as failure of a tank tightness test, discovery of free product in adjacent sewer and utility lines, notice by the owner or operator, or other clear but unverified evidence. Evidence of a suspected release under §280.50 includes positive monitoring results from testing, monitoring and sampling, unusual operating conditions, or the discovery of petroleum in the environment.</p>	

<sup>27</sup> Directing payments out of the standby trust fund is described in Chapter 11, Section C.2.

**How Much to Direct.** The amount of funds you direct to be paid into the standby trust cannot exceed the amount of coverage specified in the letter of credit. You may direct a smaller amount, but should do so only in limited circumstances. If the owner or operator has failed to provide alternate assurance, it is appropriate to direct the full amount into the standby trust fund. If the owner or operator has failed to perform corrective action, you may consider, when deciding how much to direct, the following: the estimated cost of the corrective action (including a contingency factor) and whether the owner or operator is responsible for other USTs. A conservative course is to direct the full amount into the standby trust fund. Similarly, if the owner or operator has failed to provide third-party compensation, you may consider, when deciding how much to direct, the following: the amount of the judgment, award, or settlement; any pending claims or litigation; and whether the owner or operator is responsible for other USTs. The conservative course is to direct the full amount into the standby trust fund.

**How to Direct Payments.** You must instruct the issuer of the letter of credit to deposit funds into the standby trust. To do so, you must present two documents:

- A **sight draft** referring to the letter of credit by its number. The sight draft should include the name of the party ordered to pay (i.e., the issuing financial institution), the precise sum of money to be paid, and the name of the party to whom payment is to be made (i.e., the name and address of the standby trustee and the name and account number of the trust). If you make a mistake, start over with a fresh document; do not alter or erase the draft. See Exhibit 7-3 for an example; you may contact the bank to request a blank draft form to use or you can fashion your own.
- A **signed statement** reading **exactly** as follows: "I certify that the amount of the draft is payable pursuant to regulations issued under the authority of Subtitle I of the Resource Conservation and Recovery Act of 1976, as amended." The Director should sign the statement.

Exhibit 7-3		
EXAMPLE SIGHT DRAFT		
\$	[sum of money]	_____ [date] <b>20</b> __
Reference Letter of Credit No.		-
Pay To The Order Of	[standby trustee name, address, and account number]	-
		-
Value received and charge the same to account of		
	___ [owner or operator]	
	___ [street address]	-
	___ [city, state]	
		[signature and title of Director of Implementing Agency]



#### **C.4 Monitoring the Replenishment of Assurance After Letter of Credit**

The owner or operator is responsible for replenishing financial assurance if the letter of credit has been used for corrective action and/or third-party compensation. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) The owner or operator must either:

- Renew the letter of credit or standby trust fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust have been reduced.

This replenishment must occur on the anniversary date of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

However, because the letter of credit is drawn upon only when the owner or operator fails to provide alternate assurance, fails to perform corrective action, or fails to satisfy a liability judgment or award, the owner or operator also may fail to take steps to replenish the letter. If that happens, you could instead determine whether the owner or operator are different parties. If they are, you can seek UST FR from the party other than the one that has failed to comply.

#### **C.5 Checking Whether the Issuer and Trustee Are Eligible**

Issuer Eligibility. The issuing institution must be an entity (e.g., a bank or other depository institution) which has the authority to issue a letter of credit in each state where used, and whose letter of credit operations are regulated and examined by a federal or state agency. You can confirm the eligibility of an issuer by seeing if it is listed on the FDIC's Institution Directory, which is described in Section E below.

Trustee Eligibility. See Chapter 11, Section C.4 which describes how to check the eligibility of a trustee for UST FR.

#### **C.6 Verifying the Wording, Scope, and Amount of Coverage of the Letter of Credit and the Standby Trust Fund**

Wording. The required wording for letters of credit is specified in the regulations. The issuer, in signing the letter of credit, certifies that the wording of the letter of credit is identical to the required wording on the date the letter of credit was executed. Additional text, omissions, and deviations in the wording of the letter of credit may compromise its effectiveness. Areas of particular concern include the following:

- ✓ Omitting quotation marks around the text of the statement that must be submitted to obtain payment under the letter of credit is a common but important flaw that must be corrected. Failure to include the quotation marks around the statement in the letter of credit can create confusion concerning the exact text that must be used to obtain payment. You should request a replacement letter that includes the quotation marks in the appropriate locations.

- ✓ The words required to draw on the letter of credit must be exactly the same as the specified wording. Changes or additions could result in delays in drawing on the instrument; for example, it may be difficult to determine if any added conditions have or have not been met.

Sometimes added language will not compromise the letter. For example, added language that specifies that no other document may revise or amend the terms of the letter of credit is not a problem. Such added language actually helps to ensure that the document under review cannot be altered or amended. Added language addressing the sale of the owner or operator should not pose a problem. It helps to ensure that if the owner or operator that obtained the letter of credit is sold, the letter of credit will continue in effect, or alternatively, that the letter of credit will have to be replaced. In either case, the language helps to clarify a situation that might otherwise be ambiguous. Nevertheless, you should ask for a replacement letter that follows the required wording exactly if you have any concerns about added language.

Scope of Coverage. The letter of credit can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the letter of credit will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the letter of credit can be used to cover the other scope area. You should ensure that the scope of coverage of the letter of credit is appropriate even when it is used in combination with other mechanisms.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a letter of credit with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the letter of credit for part of the required scope of coverage, the letter of credit also would work for the full scope because the required amount of coverage used in the letter of credit stays the same whether the letter is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A letter of credit must be in an amount that is at least equal to the required level of coverage. The exception to this rule is when a letter of credit is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

Standby Trust Fund. See Chapter 11 Section C.5 which describes how to verify the wording of the standby trust fund.

## **C.7 Checking the Authenticity of the Letter of Credit**

The authenticity of letters of credit is an issue in international trade, where signature books and test codes may be used to verify letters of credit issued in other countries. For UST FR compliance, you may confirm the authenticity of a letter of credit with the issuing institution, if you have any concerns.

## **D. FINANCIAL INSTITUTION RESPONSIBILITIES**

The following checklist summarizes the financial institution's responsibilities:

<b>CHECKLIST OF FINANCIAL INSTITUTION RESPONSIBILITIES FOR LETTERS OF CREDIT</b>
<input type="checkbox"/> Being Authorized to Issue Letters of Credit in Each Relevant State and Being Regulated and Examined by a Federal or State Agency
<input type="checkbox"/> Notifying Owner or Operator of Decision to Cancel or Not to Renew the Letter or If No Longer Eligible, Capable, or Authorized to Provide Letter of Credit
<input type="checkbox"/> Depositing Funds as Directed

### **D.1 Being Authorized to Issue Letters of Credit in Each Relevant State and Being Regulated and Examined by a Federal or State Agency**

The issuing institution must be an entity (e.g., a bank or other financial institution) which has the authority to issue a letter of credit in each state where used, and whose letter of credit operations are regulated and examined by a federal or state agency. Depository institutions that are not familiar with UST FR should review the regulations at 40 CFR Part 280 Subpart H, especially §280.99.

### **D.2 Notifying Owner or Operator of Decision to Cancel or Not to Renew the Letter or If No Longer Eligible, Capable, or Authorized to Provide Letter of Credit**

The issuer should notify the owner or operator of the following:

- If the issuer decides to cancel or not renew the letter of credit (use certified mail)
- Incapacity, suspension, or revocation of authority to issue letters of credit

The letter of credit will terminate no less than 120 days after the date the owner or operator receives the notification of cancellation or nonrenewal, as evidenced by the return receipt.

### **D.3 Depositing Funds as Directed**

By issuing the properly worded standby letter of credit, the issuer agrees to honor drafts presented to it and deposit the amount of the draft directly into the owner or operator's standby trust fund in accordance with the Director's instructions.

## E. SOURCES OF FURTHER INFORMATION

### Regulatory Authorities

#### Comptroller of the Currency

Department of the Treasury

250 E Street, S.W.

Washington, D.C. 20219

[HTTP://WWW.CCC.GOV](http://www.ccc.gov)

*regulates national banks (banks with national in the name or N.A. after the name)*

#### Federal Deposit Insurance Corporation

550 17<sup>th</sup> Street, N.W.

Washington, D.C. 20456

[HTTP://WWW.FDIC.GOV](http://www.fdic.gov)

*regulates state chartered banks that are not members of the Federal Reserve System*

#### Office of Thrift Supervision

1700 G Street, N.W.

Washington, D.C. 20552

*regulates federal savings and loans and federal savings banks*

#### National Credit Union Administration

1775 Duke Street

Alexandria, VA 22314-3428

*regulates federally chartered credit unions*

#### Board of Governors of the Federal Reserve System

20 C Street, N.W.

Washington, D.C. 20551

*regulates state chartered commercial banks that are members of the Federal Reserve System*

State Bank Supervisors. A list of state banking departments and supervisors is available on line from the Conference of State Bank Supervisors at [HTTP://WWW.CSBSDAL.ORG/INFO/INFO.HTML](http://www.csbsdal.org/info/info.html).

One way to get public information about an individual bank is to go to a Web site maintained by a federal bank regulator: the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation (insured state banks that are not members of the Federal Reserve System). These agencies maintain records about the banks they supervise. If you want to find out about a financial institution that is not a bank, you can visit the Web sites maintained by the Office of Thrift Supervision (savings and loans) or the National Credit Union Administration (credit unions).

If you don't know which federal agency is the primary regulator of the bank you're interested in, you can go the Federal Deposit Insurance Corporation (FDIC) Web site ([HTTP://WWW.FDIC.GOV](http://www.fdic.gov)) and click on the Institution Directory. Enter the name of the bank and you will get a list of likely matches (many banks have similar names) and the identity of the primary federal regulator. This site also identifies the chartering agency (state or federal) and the type of charter (commercial bank or savings institution). You also can find the primary federal regulator by going to "Search [FDIC] Institutions" ([HTTP://WWW2.FDIC.GOV/STRUCTUR/SEARCH/INDEX\\_INST.CFM](http://www2.fdic.gov/STRUCTUR/SEARCH/INDEX_INST.CFM)) the FDIC's institution search engine.

You also can use the Federal Reserve Board's National Information Center of Banking Information (NIC) to identify the type of financial institution and the federal regulator. You can access the NIC at [HTTP://WWW.FFIEC.GOV/NIC/](http://www.ffiec.gov/nic/).

*A Practical Guide to Letters of Credit*, by Charles E. Aster and Katheryn C. Patterson (eds.) (1990)

*Letter of Credit Guidebook*, by Dominick J. Policano (1983)

*Standby and Commercial Letters of Credit*, 2<sup>nd</sup> edition, by Brooke Wunnicke, Diane B. Wunnicke, and Paul S. Turner (1996)

[THIS PAGE INTENTIONALLY LEFT BLANK]

## 8. FINANCIAL RESPONSIBILITY USING STATE-REQUIRED MECHANISMS

This chapter describes the use of state-required mechanisms to demonstrate UST FR as follows:

A. BACKGROUND .....	148
A.1 Process for Approving State Mechanisms .....	148
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STATE-REQUIRED MECHANISMS .....	149
B.1 Satisfying State Requirements .....	149
C. EPA REGIONAL ADMINISTRATOR RESPONSIBILITIES AND OVERSIGHT .....	150
C.1 Evaluating Equivalency of State-Required Mechanism .....	150
C.2 Issuing Notifications About Acceptability of State-Required Mechanisms .....	151
C.3 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named a Debtor in Bankruptcy .....	151
C.4 Reviewing Financial Responsibility Submissions .....	151
D. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT .....	152
D.1 Implementing Agency Responsibilities and Oversight .....	152

## A. BACKGROUND

As of July 1, 1999, many states have federally-approved UST programs, including programs for UST FR. In these states, compliance with state requirements automatically satisfies federal FR requirements. For USTs located in a state that does not have an approved program, and where the state requires owners or operators to demonstrate UST FR, an owner or operator must comply with both federal and state rules. However, an owner or operator may use a "state-required" mechanism to satisfy the federal UST FR requirements if the EPA Regional Administrator determines that the state mechanism is at least equivalent to the federal financial mechanisms. Therefore, in states with approved programs, additional "state-required" mechanisms do not need to be approved by EPA (as described in this chapter), they simply need to meet the broad requirements in the state program approval regulations (§281.37(c)).

Although termed a "state-required" mechanism, typically a state offers a number of options for complying with UST FR requirements, most, if not all, being identical or similar to the federal options described in this *Manual*. One exception to this norm is mandatory participation in a state fund as the sole method of demonstrating compliance with all or part of UST FR; state funds are discussed in Chapter 9. Other optional state mechanisms that are not included in the federal options are discussed in Chapter 16.

### A.1 Process for Approving State Mechanisms

The state, an owner or operator, or any other interested party may submit to the Regional Administrator a written petition requesting that one or more of the state-required mechanisms be considered acceptable for meeting federal UST FR requirements. The submission must include copies of the appropriate state statutory and regulatory requirements and must show the amount of funds for corrective action and/or for third party compensation assured by the mechanism(s). The Regional Administrator may require the petitioner to submit additional information necessary to make this determination. A petition may be submitted on behalf of all of the state's underground storage tank owners and operators. The Regional Administrator must evaluate the equivalency of state-required mechanisms in terms of the certainty and amount of funds assured and the types of costs covered.

**NOTE:** An owner or operator submitting a petition to the EPA Regional Administrator should notify and/or copy the state regulatory agency also.



**B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STATE-REQUIRED MECHANISMS**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STATE-REQUIRED MECHANISMS</b>
<input type="checkbox"/> Satisfying State Requirements (see Section B.1)

**B.1 Satisfying State Requirements**

Typically, state requirements for UST FR are similar if not identical to the federal program described in this *Manual*. Regardless, owners or operators must follow specific state requirements for the state-required mechanism including:

- Establishing proper scope and amount of UST FR,
- Maintaining it,
- Keeping appropriate records, and
- Submitting necessary reports and evidence of FR.

**Owners or operators should not assume that approved state-required mechanisms are identical to the federal mechanisms described in this *Manual*.**

## C. EPA REGIONAL ADMINISTRATOR RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the EPA's responsibilities and potential oversight activities:

CHECKLIST OF EPA REGIONAL ADMINISTRATOR RESPONSIBILITIES AND OVERSIGHT FOR STATE-REQUIRED MECHANISMS	
<input type="checkbox"/>	Evaluating Equivalency of State-Required Mechanism (see Section C.1)
<input type="checkbox"/>	Issuing Notifications About Acceptability of State-Required Mechanisms (see Section C.2)
<input type="checkbox"/>	Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named a Debtor in Bankruptcy (see Section C.3)
<input type="checkbox"/>	Reviewing Financial Responsibility Submissions (see Section C.4)

### C.1 Evaluating Equivalency of State-Required Mechanism

In a state that does not have state program approval, the Regional Administrator **must** evaluate the equivalency of a state-required mechanism principally in terms of:

- Certainty of the availability of funds for taking corrective action and/or for compensating third parties
- The amount of funds that will be made available, and
- The types of costs covered.

The Regional Administrator **may** also consider other factors such as timeliness and cost of access to funds. In addition, the Regional Administrator **may** want to consider the following criteria that mechanisms must meet to be no less stringent than the federal requirements in states that have state program approval (see 40 CFR 281.37). The mechanism must:

- Be valid and enforceable;
- Be issued by a provider that is qualified or licensed in the state;
- Not permit cancellation without allowing the state to draw funds;
- Ensure that funds will only and directly be used for corrective action and third-party liability costs; and
- Require that the provider notify the owner or operator of any circumstances that would impair or suspend coverage.

The Regional Administrator **may** consider these criteria in performing a §280.100 evaluation.

## **C.2 Issuing Notifications About Acceptability of State-Required Mechanisms**

The Regional Administrator should notify the petitioner about the mechanism's acceptability in lieu of financial mechanisms specified in federal regulations. If mechanisms are not found acceptable, the Regional Administrator may want to document the reasons for the decision so that the owner or operator or state can consider possible remedies. (Pending this determination, owners and operators using such mechanisms are deemed to be in compliance with federal FR requirements for underground storage tanks located in the state for the amounts and types of costs covered by such mechanisms.)

## **C.3 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named a Debtor in Bankruptcy**

EPA Regional Administrators who receive notices that owners or operators have failed to obtain financial assurance or have been named as debtors in bankruptcy proceedings, should coordinate responses with the state agency(ies) responsible for oversight of state UST FR. Responses to such notices will likely resemble the responses described elsewhere in this *Manual*, depending on the mechanism.

## **C.4 Reviewing Financial Responsibility Submissions**

If EPA Regional Administrators receive FR submissions, they should coordinate actions with state agencies responsible for oversight of state UST FR. Reviews of such submissions will likely resemble the reviews described elsewhere in this *Manual*, depending on the mechanism.

## D. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the state's responsibilities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR STATE-REQUIRED MECHANISMS</b>
<input type="checkbox"/> Implementing Agency Responsibilities and Oversight (see Section D.1)

### D.1 Implementing Agency Responsibilities and Oversight

Typically, implementing agency responsibilities and oversight for state-required mechanisms are similar if not identical to responsibilities and oversight for the federal mechanisms described in this *Manual*, such as the following:

- Respond to notices
- Review wording and coverage of evidence of FR
- Check eligibility and qualifications of owners and operators and providers of financial assurance
- Issue notifications and request information
- Direct payments

**Implementing agencies should not assume that approved state-required mechanisms are identical to the federal mechanisms described in this *Manual*.**

## 9. FINANCIAL RESPONSIBILITY USING STATE FUNDS

This chapter describes the use of state funds to demonstrate UST FR as follows:

A. BACKGROUND	154
A.1 What Is a State Fund?	154
A.2 How Does an UST State Fund Work As a Financial Assurance Mechanism?	154
A.3 What Types of Assurance Funds Can Be Used for UST FR?	155
A.4 What Is the Future of State Funds?	156
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STATE FUNDS	157
B.1 Satisfying State Fund Requirements	157
B.2 Updating Assurance	157
B.3 Recordkeeping	157
B.4 Obtaining Alternate Assurance If the State Fund Becomes Incapable of Providing Assurance or Decides to Cancel or Terminate	158
B.5 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings	158
B.6 Submitting Financial Responsibility Documents	158
C. EPA RESPONSIBILITIES	159
C.1 Evaluating a State Fund	159
C.2 Issuing Notification About Acceptability of State Fund	160
C.3 Monitoring the Financial Soundness of Approved State Fund	160
D. STATE RESPONSIBILITIES	161
D.1 Submitting Required Information to EPA	161
D.2 Providing Each Owner or Operator for Which It Is Assuming Financial Responsibility a Letter or Certificate with Required Information as Evidence of Coverage	161
D.3 Notifying Each Owner or Operator If State Fund Has or Will Become Incapable of Paying for Assured Costs or Decides to Cancel or Terminate Coverage	161
D.4 Providing Data on Fund Soundness to EPA	161
E. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	162
E.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or That the Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings	162
E.2 Reviewing Financial Responsibility Documents	162
E.3 Directing Payments from the State Fund	163
E.4 Verifying Eligibility, Scope, and Amount of Coverage	163
F. SOURCES OF FURTHER INFORMATION	164

## A. BACKGROUND

Typically a state offers a number of options for complying with UST FR requirements, most, if not all, being identical or similar to the other federal options described in this *Manual*. One exception to this norm is participation in a state fund, which may be mandatory. State funds are discussed in this chapter. Other optional state mechanisms that are not included in the federal options are discussed in Chapter 16.

### A.1 What Is a State Fund?

An owner or operator may satisfy the UST FR requirements for underground storage tanks located in a state which assures that monies will be available from a **state fund** to cover the required amount of costs. State funds are used in some government-mandated financial responsibility programs, both environmental and non-environmental (e.g., workers compensation FR). State funds play a major role in the UST FR program. As of June 1999, most states have developed state financial assurance funds which not only provide a means of complying with FR requirements but also have expended more than \$6 billion to clean up leaking UST sites over the prior 10 years. EPA does not require any state to establish or maintain a state fund.

### A.2 How Does an UST State Fund Work As a Financial Assurance Mechanism?

Under any state fund, the state must provide reasonable assurance that it will pay full or partial coverage of cleanup and/or third-party compensation costs of an eligible owner or operator. The state can make this assurance in several ways:

- First, the state may undertake corrective action and pay for cleanup and third party costs directly. This is termed a "state-lead" cleanup.
- More frequently, state funds are designed assuming that a responsible party (RP) - lead cleanup will occur, either voluntarily or pursuant to a state administrative or judicial order. Acceptable methods of payment under this fund design include but are not limited to:
  - ~ direct payment to the RP's contractor
  - ~ direct payment to the RP based on invoices received from his contractor
  - ~ joint payment to the RP and his contractor

These payments typically take place periodically as work progresses, based on invoices received. In addition, similar methods of payment are acceptable for satisfying third party claims, settlements, and judgments. In these situations, the owner or operator takes the lead on the cleanup and/or handling third party claims, but once he has paid any **deductible**, the state fund becomes the source of further payments, thus providing financial assurance.

- Many state funds operate primarily as reimbursement funds, paying out costs only after the owner or operator has paid for the cleanup and/or any third party liability claims. The owner or operator then applies to the state for reimbursement of these costs, supported by proof that he has already paid them. Such a fund also must be structured to provide state payment of the costs it purports to assure in the event that the owner or operator is incapable of, or unwilling to, cover these costs prior to being reimbursed. Sometimes state funds have large unfunded liabilities which can result in owners and operators having to wait some period of time before their expenses can be reimbursed.

State funds might not provide complete financial responsibility for UST owners or operators. For example, funds may not cover third-party compensation or all corrective action costs. Some funds cover releases only after (or before) a certain date. Coverage may be limited based on the number, size, and types of tanks, for example. Therefore, UST owners and operators may need to use other financial assurance mechanisms in combination with these types of state fund programs to demonstrate compliance with the full scope and amount of FR.

As of 1999, EPA has approved 35 state funds and several others have submitted their funds for review.

### **A.3 What Types of Assurance Funds Can Be Used for UST FR?**

Two key features of state funds affect their use by owners and operators to demonstrate UST FR: (1) whether state funds provide either full or partial coverage, and (2) whether state funds automatically cover all owners and operators or only eligible owners or operators. Each of these features is described next.

Full Coverage. A full coverage fund means that the state fund provides an owner or operator in the state with the appropriate scope and amounts of coverage. A full coverage fund assures for eligible owners and operators in the state that money will be available to pay for corrective action and third-party compensation in the amounts required.

A state fund is a full coverage fund even if it has a deductible amount that the owner or operator is responsible for paying, as long as the fund provides for **first dollar coverage** by the state. First dollar coverage simply means that if owners and operators do not meet the deductible requirement, the state fund will still pay for corrective action and third party compensation, including the deductible amount. In this instance, the state can pursue cost recovery against the owner or operator for the deductible amount, although that would be at the state's discretion.

Partial Coverage. A state fund provides only partial coverage if the fund covers only a portion of the required dollar amounts or scope of coverage (corrective action and/or third-party liability). When a state offers a partial coverage fund, owners and operators must demonstrate FR for the amounts of corrective action and/or third-party compensation costs that are not covered by the state fund.

For example, a partial coverage fund might cover only from \$10,000 to \$1 million in corrective action costs without first dollar coverage. Owners and operators must obtain another FR mechanism to demonstrate coverage for the \$10,000 deductible for corrective action because the corrective action otherwise might not proceed. In this example, owners and operators also must demonstrate, through another assurance mechanism, coverage of third-party compensation costs.

To help owners and operators comply with deductible requirements, EPA allows states to establish their own financial tests of self-insurance for deductible amounts. The federal test of self-insurance (either \$10 million or \$20 million net worth) is inappropriate when assuring deductible amounts, which are often in the \$5,000 to \$50,000 range. In establishing their tests, states may require simply that the owner's or operator's minimum net worth be a specific multiple of the deductible amount.

Unlimited Eligibility. State funds that cover **all** owners and operators in the state have unlimited eligibility. Eligibility is considered unlimited even when state funds require that owners and operators pay a yearly tank fee in order to be eligible for fund coverage.

Limited Eligibility. A state could exclude certain categories of owners or operators or USTs from participation, or a state could set "entrance" requirements that limit the eligibility of owners and operators to use the fund. For example, a state may require that owners or operators perform a tank tightness test before being eligible for coverage by the fund. If a state limits the eligibility of owners and operators to use a state fund, non-eligible owners and operators must use other mechanisms to demonstrate financial responsibility for the full amount and scope of required coverage.

#### **A.4 What Is the Future of State Funds?**

Despite or as a result of having made substantial progress in UST cleanups, some states are concluding that the time is right for making the transition from their state funds to private insurance or other FR mechanisms. These states reason that such a transition will be especially appropriate over the next few years, as the preponderance of historic contamination is discovered and tanks are upgraded due to the 1998 deadline. On the other hand, some states may never make a transition, due in part to the support of owners and operators who are satisfied with their state funds.

Although states still have limited experience with fund transitions, it appears that solvency problems are a major impetus to moving a state along the transition route. When state officials, including legislators, face a raft of claims that exceeds their fund's balance and/or income, they may decide that part of the solution lies in setting a sunset date and phasing out of the state fund business. That has been the experience in Texas and Florida, and it may be an approach shared by other states facing an increasing number of claims associated with stepped-up 1998 compliance activity.

Thus far, states have designed somewhat different approaches to transition although, in general, some are gradually phasing out their coverage and allowing owners and operators to choose among other financial responsibility options. While some owners and operators are large enough to self-insure and some will choose one of the other financial responsibility mechanisms, most owners and operators are expected to turn to commercial insurance.



## B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STATE FUNDS

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STATE FUNDS</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Satisfying State Fund Requirements (see Section B.1)</li><li><input type="checkbox"/> Updating Assurance (see Section B.2)</li><li><input type="checkbox"/> Recordkeeping (see Section B.3)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If the State Fund Becomes Incapable of Providing Assurance or Decides to Cancel or Terminate (see Section B.4)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings (see Section B.5)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.6)</li></ul>

### B.1 Satisfying State Fund Requirements

Eligibility. To use a state fund to demonstrate compliance with FR, an owner or operator must satisfy any state fund eligibility requirements. In some states, owners or operators must notify the implementing agency if they wish to participate in the fund.

Amount of Coverage. A state fund must provide assurance of amounts at least equal to the required level of coverage. The exception to this rule is when a state fund is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required amount of coverage.

Scope of Coverage. A state fund may cover all or part of the required scope of coverage (e.g., corrective action, third party compensation, or both). Another mechanism must be used to complement a state fund that covers only part of the full scope of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), another mechanism must be used to cover the other scope area. Both mechanisms, however, must provide the total required amount of coverage (see Chapter 2).

### B.2 Updating Assurance

An owner or operator must either pay the fees or taxes required to remain covered by the state fund or arrange for a substitute FR mechanism.

If the amount of required FR coverage increases to a level above the amount assured by the state fund, the owner or operator must obtain another financial assurance mechanism to make up the difference between the new coverage level and the amount of state fund coverage.

### B.3 Recordkeeping

An owner or operator who uses the state fund to satisfy UST FR must maintain onsite or at the place of business a copy of the following documents:

- The *letter or certificate* provided by the state fund

- Updated copy of *certification of FR* (described in Chapter 2 Section D.5)

#### **B.4 Obtaining Alternate Assurance If the State Fund Becomes Incapable of Providing Assurance or Decides to Cancel or Terminate**

An owner or operator must obtain alternate assurance within 30 days of receiving notification that a state fund has become incapable of paying for assured corrective action or third-party compensation costs or within 60 days of receiving notice of cancellation or termination. See 40 CFR 280.109(b) and 280.114(f).

#### **B.5 Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings**

An owner or operator must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 60 days of receipt of notice of cancellation or termination from the state fund. The notification must include
  - ~ the name and address of the state fund
  - ~ the effective date of termination
  - ~ required records (see B.3 above)
- Failure to obtain alternate assurance within 30 days of receiving notice of the incapacity of the state fund or the suspension or revocation of its authority to provide coverage.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

#### **B.6 Submitting Financial Responsibility Documents**

**According to the federal regulations**, an owner or operator that uses the state fund must submit a copy of the state fund letter or certificate to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release. (See 40 CFR 280.110(a)(1).)
- When the owner or operator fails to obtain alternate coverage. (See 40 CFR 280.110(a)(2) and 280.109(b).)
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the owner or operator as debtor. (See 40 CFR 280.114(a).)
- At any time if requested by the implementing agency. (See 40 CFR 280.110(c).)

State regulations may require more frequent (e.g., annual) reporting.

## C. EPA RESPONSIBILITIES

The following checklist summarizes EPA responsibilities for review and oversight of state funds:

<b>CHECKLIST OF EPA RESPONSIBILITIES FOR STATE FUNDS</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Evaluating a State Fund (see Section C.1)</li><li><input type="checkbox"/> Issuing Notification About Acceptability of State Fund (see Section C.2)</li><li><input type="checkbox"/> Monitoring the Financial Soundness of Approved State Fund (see Section C.3)</li></ul>

### C.1 Evaluating a State Fund

The EPA Regional Administrator evaluates a state assurance fund either as a part of state program approval or individually as an FR mechanism:

- A state may be seeking EPA approval to operate a state UST program in lieu of the federal program. In this event the state fund will be part of the state's financial responsibility package which is examined by the EPA Regional Office to determine if it is no less stringent than the federal requirements. (See 40 CFR 281.37)
- A state without state program approval may be seeking an official decision that tank owners and operators in the state may use the fund as a mechanism for complying with the federal financial responsibility requirements. (See 40 CFR 280.101)

During a state program approval process, EPA generally reviews a state's FR regulations to ensure that they are no less stringent than the federal regulations, and a state fund is reviewed to ensure it meets §281.37(c) like any other mechanism. In the rare case where a state does not have FR regulations and is using the state fund as the sole means of providing FR for owners and operators, the fund must provide the full scope and amount of required coverage to ensure that the state's FR program is no less stringent than the federal requirements. For details, see the *State Program Approval Handbook* and other sources of information listed at the end of this chapter.

If the review falls under §280.101, the Regional Administrator will evaluate the equivalency of the state fund as an FR mechanism principally in terms of:

- Certainty of the availability of funds for taking corrective action and/or for compensating third parties;
- The amount of funds that will be made available; and
- The types of costs covered.

The Regional Administrator may also consider other factors as is necessary, such as timeliness and cost of access to funds.

EPA's regulations provide that once a state submits its fund to EPA for approval, pending the EPA Regional Administrator's determination that the fund is acceptable as a compliance mechanism, UST owners and operators are considered to be in compliance with the financial responsibility requirements for the amounts and types of costs covered by the state assurance fund.

## **C.2 Issuing Notification About Acceptability of State Fund**

The Regional Administrator will notify the state about the acceptability of the state's fund for the scope and amount of coverage it provides pursuant to 40 CFR 280.101. Notification regarding state program approval is described in 40 CFR 281 Subpart E.

## **C.3 Monitoring the Financial Soundness of Approved State Fund**

See final EPA guidance *Monitoring the Financial Soundness of Approved State Assurance Funds*, OSWER Directive 9650.14 (August 1993) for details.

## **D. STATE RESPONSIBILITIES**

The following checklist summarizes a state's FR responsibilities in its role as administrator of a state fund. The state's responsibilities in its role as the implementing agency for the UST FR program are described in Section E.

<b>CHECKLIST OF STATE RESPONSIBILITIES FOR STATE FUNDS</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Submitting Required Information to EPA (see Section D.1)</li><li><input type="checkbox"/> Providing Each Owner or Operator for Which It Is Assuming Financial Responsibility a Letter or Certificate with Required Information as Evidence of Coverage (see Section D.2)</li><li><input type="checkbox"/> Notifying Each Owner or Operator If State Fund Has or Will Become Incapable of Paying for Assured Costs or Decides to Cancel or Terminate Coverage (see Section D.3)</li><li><input type="checkbox"/> Providing Data on Fund Soundness to EPA (see Section D.4)</li></ul>

### **D.1 Submitting Required Information to EPA**

If a state is seeking state program approval, it must submit the required information about its program. For details see 40 CFR 281.

If a state is seeking a determination under 40 CFR 280.101, the state must submit to the Regional Administrator a description of the state fund to be used for financial assurance, along with a list of the classes of underground storage tanks to which the funds may be applied. The state may need to submit additional information required by the Regional Administrator to make a determination on the acceptability of the state fund. Pending the determination by the Regional Administrator, an owner or operator of a covered class of USTs is deemed to be in compliance with the UST FR requirements for the amounts and types of costs covered by the state fund.

### **D.2 Providing Each Owner or Operator for Which It Is Assuming Financial Responsibility a Letter or Certificate with Required Information as Evidence of Coverage**

The state must provide to each owner or operator for which it is assuming FR a letter or certificate describing the nature of the state's assumption of responsibility. The letter or certificate from the state must include, or have attached to it, the following information: the facility's name and address and the amount of funds for corrective action and/or for compensating third parties that is assured by the state.

### **D.3 Notifying Each Owner or Operator If State Fund Has or Will Become Incapable of Paying for Assured Costs or Decides to Cancel or Terminate Coverage**

The state must notify owners or operators by certified mail of the loss of capacity to pay for assured costs and any decision to cancel or terminate financial assurance coverage.

### **D.4 Providing Data on Fund Soundness to EPA**

See *Monitoring the Financial Soundness of Approved State Assurance Funds*, OSWER Directive 9650.14 (August 1993).

## E. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the UST program implementing agency's responsibilities and potential oversight activities:

CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR STATE FUNDS	
<b>Implementing Agency Responsibilities</b>	
<input type="checkbox"/>	1. Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or That the Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings (see Section E.1)
<input type="checkbox"/>	2. Reviewing Financial Responsibility Documents (see Section E.2)
<b>Implementing Agency Oversight</b>	
<input type="checkbox"/>	3. Directing Payments from the State Fund (see Section E.3)
<input type="checkbox"/>	4. Verifying Eligibility, Scope, and Amount of Coverage (see Section E.4)

### E.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or That the Owner or Operator Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that the owner or operator cannot obtain alternate assurance when required. However, following receipt of such a notice from the owner or operator, you may want to monitor the efforts being made by the owner or operator to secure alternate assurance. This could include alerting the owner about the need for alternate assurance if the operator had been providing the financial assurance through the state fund and vice versa. Termination of state fund coverage due to the owner or operator's failure to pay the required fee or tax indicates inability or unwillingness to comply with FR, unless failure to pay was an oversight or was due to use of a substitute FR mechanism. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

Owner or Operator Named A Debtor in Bankruptcy. Similarly, it is unlikely that an owner or operator using a state fund will be named as a debtor in bankruptcy proceedings. The discovery of a release or appearance of a claim for compensation could, in rare cases, cause the owner or operator to seek protection under the Bankruptcy Code. Regardless, bankruptcy does not represent a serious potential gap in coverage in the event of a release or a need for third-party compensation because bankruptcy of the owner or operator does not relieve the state fund of its obligations even if the owner or operator stops making required fee payments.

### E.2 Reviewing Financial Responsibility Documents

**Based on the federal reporting rules,** you will receive an unsolicited copy of the state fund letter and/or certificate from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identified a release that must be reported
- After the owner or operator fails to obtain alternate assurance after being notified that the state fund intends to cancel or terminate coverage
- After the owner or operator fails to obtain alternate assurance after being notified that the state fund is no longer capable of providing coverage
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor

In the first situation, the implementing agency may want to ensure that the owner or operator is covered by the state fund so that, if not, the owner or operator can be instructed to remedy the problem or obtain alternate assurance. In the second and third situations, there is little environmental and public health value to reviewing the state fund letter or certificate because coverage will soon be terminated and you cannot draw upon it. Finally, in the fourth situation, as discussed above, bankruptcy of the owner or operator does not affect state fund coverage.

**NOTE:** The state fund letter or certificate does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular annual reporting or may request evidence of FR for monitoring compliance. See Section E.4 below for review of such submissions.

### **E.3 Directing Payments from the State Fund**

The role of the implementing agency depends on how the state fund is designed and administered.

### **E.4 Verifying Eligibility, Scope, and Amount of Coverage**

Eligibility. If the state fund has limited eligibility, as described in Section A.2 above, you need to determine whether an owner or operator is eligible to use the fund to demonstrate full or partial UST FR. An owner or operator that is not eligible must obtain another mechanism.

Scope of Coverage. The scope of coverage provided by a state fund depends on its statutory authorization. It is possible that another mechanism must be used to complement a state fund that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation, a mechanism (e.g., insurance policy) covering third-party compensation can be used to cover the other scope area. You should ensure that the scope of coverage is appropriate whether the fund is used alone or in combination with other mechanisms.

Amount of Coverage. The state fund must provide an amount of coverage that is at least equal to the required level of coverage. The exception to this rule is when the state fund is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required coverage amount. You should ensure that the amount of coverage is appropriate whether the fund is used alone or in combination with other mechanisms.

## **F. SOURCES OF FURTHER INFORMATION**

*1999 State LUST Financial Assurance Funds Survey Results* (June 1999), available on-line from the Association of State and Territorial Solid Waste Management Officials (ASTSWMO).

*Final OUST Guidance on Reviewing State Funds for Financial Responsibility*, OSWER Directive 9650.11 (May 1992), available on-line from EPA OUST.

*Monitoring the Financial Soundness of Approved State Assurance Funds*, OSWER Directive 9650.14 (August 1993), available on-line from EPA OUST at [HTTP://WWW.EPA.GOV/SWERUST1/DIRECTIV/OD965014.HTM](http://www.epa.gov/swerust1/directiv/OD965014.htm).

*State Funds in Transition: Models for Underground Storage Tank Assurance Funds*, EPA 510-B-97-002 (January 1997).

*State Fund Success Stories Compendium* (3<sup>rd</sup> Edition), The Association of State Underground Storage Tank Cleanup Funds (June 1998).

*Status of State Fund Programs*, available at [HTTP://WWW.EPA.GOV/SWERUST1/STATES/FNDSTATUS.HTM](http://www.epa.gov/swerust1/states/fndstatus.htm).



## 10. FINANCIAL RESPONSIBILITY USING TRUST FUNDS

This chapter describes the use of trust funds to demonstrate UST FR as follows:

A. BACKGROUND	166
A.1 What Is A Trust Fund?	166
A.2 How Does An UST Trust Fund Work?	167
A.3 Types of Trust Fund Institutions and Their Regulation	167
B. OWNER OR OPERATOR RESPONSIBILITIES	171
B.1 Selecting an Eligible Trustee	171
B.2 Obtaining a Properly Worded Trust Fund Agreement and Certification of Acknowledgment	171
B.3 Providing Proper Scope and Amount of Coverage	171
B.4 Recordkeeping	172
B.5 Maintaining Assurance	172
B.6 Submitting Financial Responsibility Documents	172
B.7 Replenishing Assurance after Trust Fund Is Used for Corrective Action or Third-Party Compensation	172
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	174
C.1 Reviewing Financial Responsibility Submissions	174
C.2 Directing Payments from the Trust Fund	175
C.3 Responding to Requests for Release of Excess Funds	176
C.4 Checking Whether the Trustee Is Eligible	176
C.5 Verifying the Wording, Scope, and Amount of the Trust Fund Agreement and Certification of Acknowledgment	177
D. TRUSTEE RESPONSIBILITIES	178
D.1 Being an Entity with Authority to Act as a Trustee and Whose Trust Operations Are Regulated and Examined by a Federal Agency or an Agency of the State in Which the Trust Fund Is Established	178
D.2 Investing the Principal and Income of the Fund as Specified	178
D.3 Responding to Written Instructions to Make Payments or Release Funds as Directed	178
E. SOURCES OF FURTHER INFORMATION	179

## A. BACKGROUND

### A.1 What Is A Trust Fund?

An owner or operator may satisfy the UST FR requirements by establishing a **trust fund**. A trust fund is an option in many government-mandated financial responsibility programs, both environmental and non-environmental.

A **trust** is a three-party agreement whereby one party, called the **grantor** (sometimes also called the **trustor**), transfers some assets (often money) to a second party, called the trustee, to hold on behalf of a third party, called the **beneficiary**. A trustee is a special type of **fiduciary**. Monies in a trust fund are administered by the trustee who has a fiduciary responsibility to keep or use the property in the fund for the benefit of the beneficiary. The property in the trust fund no longer is legally owned by the grantor. In an UST trust fund, the owner or operator is the grantor, a bank or other eligible entity is the trustee, and the implementing agency is the beneficiary.

The trust has the following components:

- The *trust agreement* (along with any amendments) is the written document that specifies the terms and conditions of the trust.
- *Schedule A* identifies the names and addresses of the facilities and the number(s) of USTs covered by the trust.
- *Schedule B* lists the persons designated to issue orders, requests, and instructions on behalf of the grantor.
- The notarized *letter of acknowledgment* verifies the execution of the trust agreement by the owner or operator and certifies the signatory's authority to enter into the agreement on behalf of the owner or operator.

The trust agreement sets out the responsibilities and rights of each party. A trust can be **revocable** or **irrevocable**. The UST trust agreement is irrevocable, which means that it need not be renewed and can be terminated only at the written direction of the grantor and the trustee, and/or, if the grantor ceases to exist, the written direction of the trustee and the Director of the implementing agency.

The trustee is empowered to invest the trust funds during the existence of the trust. **The investments which the trustee may make are limited by the UST trust agreement and sometimes by state law.** A trustee can make only prudent investments and is not empowered to make speculative or other risky investments. Any investment income accrues to the trust which is responsible for paying income taxes. Of course, the return on the trustee's assets will vary depending on the investments made. The owner or operator usually pays a fee for the trust services provided.

The trust agreement must be properly "acknowledged." An acknowledgment is a formal declaration by persons entering into a trust agreement that they affirm their obligations created in the trust agreement and are acting of their own free will. The requirements for acknowledgments differ from state to state.

## A.2 How Does An UST Trust Fund Work?

An owner or operator, as grantor, pays into the trust fund the **full amount** of the annual aggregate, unless used in combination with other mechanisms, in cash or securities which is held in trust by the trustee. Based on instructions from the Director of the implementing agency, money in the fund is used to pay for corrective action and third-party compensation or to reimburse the owner or operator for making such payments. The Director can instruct the trustee to return monies not used to the owner or operator upon release from FR requirements or substitution of an alternate mechanism.

The federal regulations require that the UST trust fund trustee be an entity that has the authority to act as a trustee and whose trust operations are regulated and examined by a federal agency or an agency of the state where the fund is established. The trustee is typically either a bank that is authorized to administer trusts or a trust company, which performs only trust administration services. If a bank or trust company encounters financial difficulties, the receiver or liquidating agent will transfer the trust account to a substitute trustee. Similarly if a bank's fiduciary powers are revoked or surrendered, the trust account will be transferred. A trust never fails for lack of a trustee.

This option differs from **self-insurance** because it involves a source of UST financial responsibility other than the owner or operator.

Trust funds do not make trustees responsible for activities that are the day-to-day responsibility of the owner or operator. Trust funds may not be used to pay for response actions that are part of routine maintenance, upgrade, or enhancement of the tank site. Corrective action coverage is required only for those activities associated with cleanup of releases set forth at §§280.60 to 280.66 and §280.72(b) of the technical standards, or ordered by the implementing agency.

Certain exclusionary language in the terms of the trust fund clearly limits the type and circumstances of third-party compensation for which the funds in this mechanism can be used.

An owner or operator may need or choose to replace the current trustee with a new trustee. To be acceptable, any successor trustee must meet the same standard as the original trustee (i.e., must be an entity that has the authority to act as a trustee and whose trust operations are regulated and examined by a federal or state agency). There is no need for the owner or operator to notify the Director of the implementing agency of changes in trustees.

**NOTE:** The language of the trust fund is identical, in most parts, to the language of the **standby trust fund** used for funds paid from other mechanisms (e.g., letter of credit). Chapter 11 describes the role of standby trust funds in the UST FR program.

## A.3 Types of Trust Fund Institutions and Their Regulation

Trust funds are as secure as the ability of the depository institution to manage and honor them. Banking has traditionally been viewed as being unacceptably unstable if left unregulated. As a result, it has long been subject to regulation in order to ensure that banks and their fiduciary activities are "safe and sound." The financial strength and liquidity of banks and trust companies are assured through federal and state regulation and oversight. This section summarizes the system for authorizing, regulating, and examining relevant trust operations in the United States.

A trust company is an institution specifically authorized to exercise trust or fiduciary powers and may be organized as a commercial bank, savings bank, or a "non-bank" trust company. Trust services are offered by both large, multi-state fiduciary banking organizations and small banks that conduct fiduciary activities primarily on a local level. Many small institutions offer fiduciary services primarily as a service to their communities, with profitability being a secondary consideration. Most trust institutions are commercial banks, with a relatively small number of savings bank and savings (and loan) associations also engaged in trust services. Only 1 credit union appears to offer trust services.

Several different types of regulated financial institutions in the United States may offer trust services, including depository institutions such as commercial and savings banks, savings and loan associations, credit unions, agencies and branches of foreign banks, and "non-bank" trust companies. Each of these institutions is subject to supervision and regulation by federal as well as state agencies. Unlike any other type of financial institution or other type of business, commercial banks and thrift institutions are chartered by both the federal and state governments; this is called a "dual banking system." The federal government regulates the financial operations of both federal- and state-chartered depository institutions through federal bank regulatory agencies. There is more federal regulation of federally-chartered institutions than state-chartered institutions.

Federal Regulatory Agencies. There are two major types of depository institutions in the U.S.: **commercial banks** and **thrifts** (savings and loan associations, savings banks, and credit unions). Recent changes in the law and regulatory policy largely have eliminated differences in the nature of commercial banks and thrifts. Except for federal credit unions each type can be authorized to exercise trust powers. **Depository institutions must seek and obtain approval to conduct fiduciary activities, which include trust services.**

Exhibit 10-1 displays which federal agencies regulate which depository institutions. The **Federal Reserve System** (FRB), the **Office of the Comptroller of the Currency**, and the **Federal Deposit Insurance Corporation** (FDIC) are responsible for examining commercial banks and savings banks. The **Office of Thrift Supervision** (OTS) performs for savings and loan associations the functions the Comptroller performs for commercial banks with federal charters. OTS charters, regulates, examines, and supervises all thrifts with federal charters and regulates many state-chartered thrifts. The functions of the OTS are handled for federally-chartered credit unions by the **National Credit Union Administration** (NCUA). These five agencies all are members of the **Federal Financial Institutions Examination Council** (FFIEC), a coordinating body. Each institution which has been granted trust powers must file the FFIEC 001 form, which provides federal regulatory agencies with information about the type and amount of trust activities. Federal examiners use the Uniform Interagency Trust Rating System (UITRS) for evaluating the condition of bank fiduciary activities and uninsured trust companies to identify institutions requiring special supervisory attention.

Some commercial banks -- termed **national banks** -- are chartered by the federal government. National banks' charters are issued by the Office of the Comptroller of the Currency (OCC), an independent bureau of the Department of the Treasury. These banks have the word "national" or carry the abbreviations of "N.A." or "N.S.&T." in their names. The OCC also can charter trust companies. National banks that limit their services solely to fiduciary services sometimes are called "national trust banks" or "national trust companies." About 2,800 national banks are supervised by the OCC. National banks chartered to exercise fiduciary powers cannot exercise greater (or lesser) powers in a state than the powers that the state grants to fiduciaries that it charters. The OCC conducted a major rulemaking to overhaul the regulations in the mid-1990s. A national bank must obtain fiduciary powers from the OCC pursuant to 12 CFR Part 5. A national bank must submit an application and obtain approval to exercise fiduciary powers (see 12 CFR 5.26). 12 CFR Part 9 governs the fiduciary activities of national banks. For example, special audit requirements apply to trust operations, which must be audited on an annual or continuous cycle).

**Exhibit 10-1**  
**FEDERAL AGENCIES RESPONSIBLE FOR REGULATING FINANCIAL**  
**INSTITUTIONS THAT CAN SERVE AS UST TRUSTEES**

Type of Institution	Federal Supervisor
<u>Commercial Banks</u>  Federally Chartered National Banks  State-Chartered Commercial Banks  - member of Federal Reserve System - not member of Federal Reserve System	Office of the Controller of the Currency (OCC)   Federal Reserve Board (FRB) Federal Deposit Insurance Corporation (FDIC)
<u>Thriffs</u>  Federally Chartered Savings Banks State-Chartered Savings Banks Federally Chartered Savings (and Loan) Associations State-Chartered Savings (and Loan) Association Federally Chartered Credit Unions State-Chartered Credit Unions	Office of Thrift Supervision (OTS) FDIC or OTS OTS FDIC or OTS National Credit Union Administration (NCUA) N/A
<u>U.S. Branches of Foreign-Chartered Institutions</u>  Federal License State License Covered by Deposit Insurance	OCC FRB FDIC

About 7,000 commercial banks are chartered by states. **State banks** require state authorization to conduct trust operations. The easiest way to identify state-chartered banks is by the lack of national bank identifiers in their names. State-chartered banks that are members of the Federal Reserve System (FRS) are regulated, at the federal level, by the Board of Governors of the Federal Reserve System (FRB), an independent agency; around 5,800 state-chartered banks that are not members of the FRS are regulated by the Federal Deposit Insurance Corporation (FDIC), an independent agency that also insures the deposits of banks. State chartered banks are supervised and regulated at the state level by state banking agencies, which are members of the Conference of State Bank Supervisors (CSBS). The FDIC also regulates federally-chartered savings banks and around 600 state-chartered savings banks. The FDIC periodically examines the trust operations of banks or savings institutions that it regulates.

**Savings (and loan) associations**, also known as thrifts, have either federal or state charters. Thrifts chartered by the federal government must have the word "federal" in their names. Regardless of charter type, the Office of Thrift Supervision (OTS), an independent Treasury bureau, regulates savings and loan associations. The OTS approves applications from federal savings associations to exercise trust powers under 12 CFR 550. The OTS comprehensively updated its rules governing trust activities of federal saving associations effective in 1998. Some OTS regulated thrifts have organized solely to offer trust services. In 1999, about 75 thrifts actively offer trust services to their customers. The OTS can authorize federally-chartered savings associations to offer trust services on the same basis as national banks. While state-chartered savings associations must conduct their fiduciary operations in accordance with state law, OTS may restrict or prohibit activities that threaten a state association's safety and soundness.

**Credit unions** have either federal or state charters. Over 6,700 federal credit unions are supervised and examined by the National Credit Union Administration (NCUA), which also insures credit union deposits. Federal credit unions are not authorized to establish and offer trust services directly, but can offer those services to its members either through an independent vendor or a service organization without getting the approval of the NCUA. Over 4,000 state-chartered credit unions are supervised by state banking authorities. Only one credit union appears to offer trust services.

Agencies and branches of **foreign banks** may be licensed to conduct banking business in the United States by either the federal government or the states. Chartered U.S. branches and agencies of foreign banks are the only types of foreign bank entity that are regulated and examined by Federal or State agencies. Therefore, these branches and agencies are the only types of foreign bank entity that meet UST eligibility requirements. As of 1999, 66 agencies or branches hold federal licenses and were supervised by the OCC. About 430 agencies or branches of foreign banks hold a state license; they are supervised by the FRB. A small number of branches of foreign banks are permitted to accept insured deposits; these branches are supervised by the FDIC. A small number have been authorized to provide trust services. By statute, the FRB has overall responsibility for foreign banks operating in the United States.

State Regulation. States have regulatory power only over state-chartered institutions. States usually have specific requirements to qualify for chartering and operating trust services. Some states have extensive laws regulating the operation of the trust department of a state-chartered bank or a trust company. These laws include requirements for a deposit of securities or a pledge of assets, qualifications for directors and officers, accounting and reporting standards, bonding of trustees, and investment limitations, among others.

## B. OWNER OR OPERATOR RESPONSIBILITIES

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING TRUST FUNDS</b>	
<input type="checkbox"/>	Selecting an Eligible Trustee (see Section B.1)
<input type="checkbox"/>	Obtaining a Properly Worded Trust Fund Agreement and Certification of Acknowledgment (see Section B.2)
<input type="checkbox"/>	Providing Proper Scope and Amount of Coverage (see Section B.3)
<input type="checkbox"/>	Recordkeeping (see Section B.4)
<input type="checkbox"/>	Maintaining Assurance (see Section B.5)
<input type="checkbox"/>	Submitting Financial Responsibility Documents (see Section B.6)
<input type="checkbox"/>	Replenishing Assurance After Trust Fund is Used for Corrective Action or Third-Party Compensation (see Section B.7)

### B.1 Selecting an Eligible Trustee

The first step that an owner or operator considering using a trust fund must take is to locate an eligible entity willing to act as trustee. The trustee must satisfy two UST FR eligibility requirements: (1) it must be an entity that has the authority to act as a trustee and (2) its trust operations must be regulated and examined by a federal agency or an agency of the state in which the fund is established. If there is any doubt about whether the entity is empowered to act as a trustee, the owner or operator can ask the entity what authority regulates it and then contact the authority to determine whether the entity has the power to act as a trustee. Before accepting a fiduciary account, a bank typically will review the trust to determine whether it can administer the account properly. **Trust operations are regulated separately from other banking operations, and it is common for a regulated bank not to have the authority to act as a trustee.**

### B.2 Obtaining a Properly Worded Trust Fund Agreement and Certification of Acknowledgment

The required wording of the trust agreement is specified in the regulations at 40 CFR 280.103(b)(1). The trust fund agreement must be accompanied by a formal certification of acknowledgment worded similarly to the language specified in 40 CFR 280.103(b)(2).

### B.3 Providing Proper Scope and Amount of Coverage

**Scope of Coverage.** The trust fund can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). The trust fund can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a state fund that covers only corrective action and not third-party compensation (or vice versa), the trust fund can be used to cover the other scope area.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a trust fund with an insurance policy that covers only third-party liability but not corrective action (or vice versa). In such a situation, if the owner or operator can use the trust fund for corrective action FR, the trust fund would also work for third-party compensation FR (and vice versa) because the amount in the trust stays the same whether it covers all or part of the full scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

**Amount of Coverage.** The trust fund, when established, must be funded for the full required aggregate amount of coverage, or the trust fund can be funded for part of the required amount of coverage and used in combination with other mechanism(s) that provide the remaining required amount of coverage. Assets in the trust fund are valued at their *current market value*.

#### **B.4 Recordkeeping**

An owner or operator using the trust fund for UST FR must maintain on-site or at the place of business a copy of the following documents:

- A copy of the signed *trust fund agreement* and any amendments, and
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5).

#### **B.5 Maintaining Assurance**

If the required amount of coverage is greater than the current market value of the trust fund, the owner or operator must either (1) increase the level of assets in the trust fund to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the current market value of the trust fund. The trustee can provide information on the current market value of the trust fund.

The trust fund agreement is "irrevocable," which means that it remains valid until it is terminated; it does not need to be renewed.

#### **B.6 Submitting Financial Responsibility Documents**

**Based on the federal regulations**, owners or operators that use the trust fund must submit a copy of the signed trust fund to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- Within 10 days after the commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code naming the owner or operator as debtor;
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) submissions.

#### **B.7 Replenishing Assurance after Trust Fund Is Used for Corrective Action or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the trust fund has been drawn upon to fund corrective action or third-party compensation. The owner or operator must either:

- Reimburse the trust fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the trust have been reduced.



This replenishment must occur on the anniversary date of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR TRUST FUNDS</b>	
<b>Implementing Agency Responsibilities</b>	
<input type="checkbox"/>	Reviewing Financial Responsibility Submissions (see Section C.1)
<input type="checkbox"/>	Directing Payments from the Trust Fund (see Section C.2)
<input type="checkbox"/>	Responding to Requests for Release of Excess Funds (see Section C.3)
<b>Implementing Agency Oversight</b>	
<input type="checkbox"/>	Checking Whether the Trustee Is Eligible (see Section C.4)
<input type="checkbox"/>	Verifying the Wording, Scope, and Amount of the Trust Fund Agreement and Certification of Acknowledgment (see Section C.5)

### C.1 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, you will receive unsolicited copies of the trust fund from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identified a release that must be reported
- After the owner or operator fails to obtain alternate assurance after finding or being notified that the trustee has lost its authority
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator or as debtor

In the first situation, the implementing agency may want to ensure that the trust fund is effective and fully-funded so that, if not, the owner or operator can be instructed to remedy the problems or obtain alternate assurance. See C.4 and C.5 below for details. In the second situation, in addition to reviewing the trust fund you should monitor the owner or operator's efforts to find a successor trustee willing to accept responsibility for the trust fund. "Alternate assurance" in this context does not require a new mechanism but a new provider willing to accept and administer the existing mechanism. In the third situation, the owner or operator may be willing to remedy any problems you find with the trust fund to stay in compliance with UST FR but may not be able or willing to make further deposits.

**NOTE:** The trust fund agreement does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.4 and C.5 below for review of such submissions.

## C.2 Directing Payments from the Trust Fund

When to Direct Payments. The trust fund clearly describes when you may draw on it; the Director does not have unlimited discretion to draw on the trust fund. As shown in Exhibit 10-3, if an owner or operator does not pay for corrective action and/or third party compensation, you can direct monies in the trust fund for such payments.

<b>Exhibit 10-3 CONDITIONS FOR DRAWING ON TRUST FUND</b>	
Situation	Draw on the Trust Fund
(1) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, <u>and</u>  the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F;	✓
(2) The Director has received either:  (i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid  <u>OR</u>  (ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.	✓

How Much Payment to Direct? Payment amounts should be based on the actual costs of the corrective action or third-party compensation, based on invoices, settlement agreements, or court orders, as applicable.

Reimbursement Payments to Owner or Operator. Alternatively, if the owner or operator itself pays for corrective action and/or third-party compensation, monies in the trust fund can be used to reimburse the owner or operator for its expenditures. In general, such reimbursements should be authorized only in the following situations:

- The owner or operator is conducting corrective action and/or third-party compensation in connection with **the only UST covered by this mechanism** (e.g., if the Director determines that no additional corrective action costs or third-party liability claims will occur as a result of a release covered by the trust fund)
- The owner or operator has arranged alternate assurance in an amount that offsets reimbursement payments from the trust fund
- Upon release of the owner or operator from FR

By observing these limitations, you ensure that the full amount of required coverage is maintained.

Priority of Payments. If the Director of the implementing agency determines that the amount of corrective action costs and third-party liability claims eligible for payment may exceed the amount of available financial assurance, the first priority for payment should be corrective action costs necessary to protect human health and the environment. The Director should pay third-party liability claims in the order in which the Director receives certifications and valid court orders.

### **C.3 Responding to Requests for Release of Excess Funds**

The owner or operator may submit a written request to the Director of the implementing agency for release of excess funds in three situations:

- If the current market value of the trust fund is greater than the required amount of coverage
- If the owner or operator substitutes other financial assurance for all or part of the trust fund
- Upon release of the owner or operator from FR

Within 60 days after receiving a request from the owner or operator for release of excess funds, the Director of the implementing agency should instruct the trustee to release to the owner or operator such funds as the Director specifies in writing. The amount of funds released should be no more and no less than the excess over the required amount of coverage.

Because the current market value of securities in a trust fund can fluctuate, you should be conservative in authorizing release of excess funds, unless the owner or operator has been released from being subject to UST FR regulations or is substituting other financial assurance for all of the trust fund. Otherwise, in calculating how much to release, you should value the current balance of the trust fund as the **lower** of cost or market value.

**NOTE:** The Director of the implementing agency should not agree to release funds that would bring the trust fund balance below the required amount of coverage, even if the owner or operator can show that returns on trust fund investments have been substantial. Future returns are unpredictable and should not be the basis for release of funds. If future returns turn out to be strong, the owner or operator can again request release of monies above the required amount of coverage.

### **C.4 Checking Whether the Trustee Is Eligible**

The trustee must satisfy two UST FR eligibility requirements: (1) it must be an entity that has the authority to act as a trustee and (2) its trust operations must be regulated and examined by a federal or an agency of the state in which the fund is established.

If there is any doubt about whether the entity is empowered to act as a trustee, you can ask the trustee who authorized and regulates it and then contact the federal or state agency to confirm the information. Alternatively, you can confirm the eligibility of an institution by seeing if it is listed in the "Trust Institutions Search" database, which you can access at [HTTP://WWW2.FDIC.GOV/STRUCTUR/TRUST/INDEX.HTML](http://www2.fdic.gov/STRUCTUR/TRUST/INDEX.HTML). As of October 1999, the database contains about 3,400 institutions, both state and federally chartered, including authorized foreign banks.

## C.5 Verifying the Wording, Scope, and Amount of the Trust Fund Agreement and Certification of Acknowledgment

Wording. The required wording for trust fund agreements is specified in the regulations. Both the owner or operator and the trustee, in signing the trust fund agreement, certify that the wording of the trust is identical to the required wording on the date the trust was executed. Deviations in the wording of the trust may compromise its effectiveness. Check that the wording is for the trust fund and **not** the standby trust fund.

Because states may have different requirements for formal **certifications of acknowledgment**, their wording may differ somewhat from the acknowledgment language in the regulations.

Scope of Coverage. The trust fund can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the trust fund will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the trust fund can be used to cover the other scope area. You should ensure that the scope of coverage of the trust fund is appropriate even when it is used in combination with other mechanisms.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a trust fund with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the trust fund for part of the required scope of coverage, the trust fund also would work for the full scope because the required amount of coverage for the trust stays the same whether the trust is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A trust fund must be fully-funded in an amount that is at least equal to the required level of coverage. The exception to this rule is when a trust fund is being combined with another FR mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

If the required level of coverage is greater than the current market value of the trust fund, or if the current market value of the trust fund declines below the required amount of coverage, the owner or operator must either (1) increase the level of assets in the trust fund to assure the appropriate amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the current market value of the trust fund.

## D. TRUSTEE RESPONSIBILITIES

The following checklist summarizes the trustee's responsibilities:

<b>CHECKLIST OF TRUSTEE RESPONSIBILITIES</b>	
<input type="checkbox"/>	Being an Entity with Authority to Act as a Trustee and Whose Trust Operations Are Regulated and Examined by a Federal Agency or an Agency of the State in Which the Trust Fund Is Established (see Section D.1)
<input type="checkbox"/>	Investing the Principal and Income of the Fund as Specified (see Section D.2)
<input type="checkbox"/>	Responding to Written Instructions to Make Payments or Release Funds as Directed (see Section D.3)

### D.1 Being an Entity with Authority to Act as a Trustee and Whose Trust Operations Are Regulated and Examined by a Federal Agency or an Agency of the State in Which the Trust Fund Is Established

The trustee must be an entity which has the authority to act as a trustee and whose trust operations are regulated and examined by a federal agency or an agency of the state in which the trust fund is established. Depository institutions and trust companies that are not familiar with UST FR should review the regulations at 40 CFR Part 280 Subpart H, especially §280.102.

### D.2 Investing the Principal and Income of the Fund as Specified

The trust agreement describes the trustee's responsibilities, powers, and limitations in investing the principal and income of the trust fund.

### D.3 Responding to Written Instructions to Make Payments or Release Funds as Directed

The trustee must act in accordance with all properly signed, written orders, requests, and instructions of the owner or operator and the Director of the implementing agency. The trustee is not required to inquire into the basis of any orders, requests, and instructions.

Instructions from the Director will concern

- Payments or reimbursements from the trust fund for corrective action and/or third-party liability compensation, and
- Release of excess funds.

Instructions from the owner or operator will concern only the investment of trust funds, which is also governed by explicit powers and limitations described in the trust agreement.

## **E. SOURCES OF FURTHER INFORMATION**

*Comptroller's Handbook for Fiduciary Activities*, Office of the Controller of the Currency (1999).

*Restatement (Third) of Trusts*, American Law Institute (1992).

*The Trust Regulatory Handbook 1998-9*, PriceWaterhouseCoopers (1999).

*Trust Law: Analysis and Explanation*, Garn H. Webb and Thomas C. Bianco (1970).

**The Trust Institutions Search** is a data base of both FDIC-insured and non-insured institutions with trust powers including non-FDIC-insured trust companies which are not under the jurisdiction of the Federal Financial Institutions Examination Council (FFIEC) regulatory agencies. Search by institution name, city, state, county, and/or FDIC certificate number. Go to [HTTP://WWW2.FDIC.GOV/STRUCTUR/TRUST/INDEX.HTML](http://www2.fdic.gov/STRUCTUR/TRUST/INDEX.HTML).

[THIS PAGE INTENTIONALLY LEFT BLANK]



## 11. USING STANDBY TRUST FUNDS WITH OTHER MECHANISMS TO DEMONSTRATE FINANCIAL RESPONSIBILITY

This chapter describes the use of standby trust funds in UST FR as follows:

A. BACKGROUND .....	182
A.1 What Is A Standby Trust Fund? .....	182
A.2 How Does An UST Standby Trust Fund Work? .....	182
A.3 Regulation of Trust Fund Institutions .....	183
B. OWNER OR OPERATOR RESPONSIBILITIES .....	184
B.1 Selecting an Eligible Trustee .....	184
B.2 Obtaining a Properly Worded Standby Trust Fund and Certification of Acknowledgment .....	184
B.3 Providing Proper Scope and Amount of Coverage .....	184
B.4 Recordkeeping .....	185
B.5 Maintaining Assurance .....	185
B.6 Submitting Financial Responsibility Documents .....	185
B.7 Replenishing Assurance After Standby Trust Fund is Used to Fund Corrective Action or Third-Party Compensation .....	186
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT .....	187
C.1 Reviewing Standby Trust Fund Agreements Included in Financial Responsibility Submissions .....	187
C.2 Directing Payments from the Standby Trust Fund .....	188
C.3 Responding to Requests for Release of Excess Funds .....	189
C.4 Checking Whether the Trustee Is Eligible .....	189
C.5 Verifying the Wording, Scope, and Amount of the Standby Trust Fund Agreement and Certification of Acknowledgment .....	189
D. STANDBY TRUSTEE RESPONSIBILITIES .....	191
D.1 Being an Entity with Authority to Act as a Trustee and Whose Trust Operations Are Regulated and Examined by a Federal Agency or an Agency of the State in Which the Standby Trust Fund Is Established .....	191
D.2 Accepting and Depositing Cash and Securities into the Trust Fund .....	191
D.3 Investing the Principal and Income of the Fund as Specified .....	191
D.4 Responding to Written Instructions to Make Payments or Refunds as Directed .....	191
E. SOURCES OF FURTHER INFORMATION .....	192

## A. BACKGROUND

### A.1 What Is A Standby Trust Fund?

An owner or operator using a corporate guarantee, surety bond, or letter of credit also must establish a **standby trust fund** when the mechanism is acquired. An owner or operator using a local government or state guarantee also may need to establish a standby trust fund, as discussed in Chapter 14.

A standby trust fund is simply a **trust fund** that is not yet funded but is otherwise ready to accept monies in the event they are received from a particular source (such as a **surety bond, letter of credit, or guarantee**). Chapter 10 describes the nature of a trust fund and defines key terms in Section A. Once a standby trust is funded, the funds are available to pay the costs of corrective action and third-party compensation just as they are with an UST trust fund as described in Chapter 10. As in the case of an ordinary UST trust fund, monies in an UST standby trust fund are legally segregated and are administered by a trustee with a fiduciary responsibility to keep or use the property in the fund for the benefit of the beneficiary.

The standby trust has the following components:

- The *standby trust agreement* (along with any amendments) is the written document that specifies the terms and conditions of the standby trust.
- *Schedule A* identifies the names and addresses of the facilities and the number(s) of USTs covered by the standby trust, which should match the facilities and USTs covered by the mechanism(s) requiring a standby trust.
- *Schedule B* lists the persons designated to issue orders, requests, and instructions on behalf of the grantor.
- The notarized *letter of acknowledgment* verifies the execution of the standby trust agreement by the owner or operator and certifies the signatory's authority to enter into the agreement on behalf of the owner or operator.

### A.2 How Does An UST Standby Trust Fund Work?

Money directed into the standby trust fund is used to pay for corrective action and third-party compensation. Monies not used are returned to the guarantor, surety, or letter of credit issuer from whom the funds were originally drawn.

**NOTE: The use of a standby trust is necessary because without such a mechanism, any funds drawn under specific FR instruments that are payable to the EPA Regional Administrator would have to be paid into the U.S. Treasury and could not be used without Congressional action (see 31 U.S.C. 3302) to pay for the UST corrective action or third-party compensation for which the funds were intended. Due to similar state laws, funds payable to the state Director may have to be paid into the state treasury, unless a standby trust is used.**

An owner or operator may establish one standby trust fund as the depository mechanism for all assured funds. Owners and operators with a number of USTs in various states may, therefore, establish one

standby trust into which funds can be deposited if and when required. However, some states may require the owner or operator to establish a standby trust in their own jurisdictions.

Certain exclusionary language in the terms of the standby trust agreement clearly limit the use of the mechanism only to costs associated with releases from USTs.

The owner or operator may need or choose to replace the current trustee with a new trustee. To be acceptable, any successor trustee must meet the same standard as the original trustee (i.e., must be an entity that has the authority to act as a trustee and whose trust operations are regulated and examined by a federal or state agency). There is no need for the owner or operator to notify the Director of the implementing agency of changes in trustees.

The language of the standby trust fund agreement is identical, in most but not all parts, to the language of the fully-funded trust fund. The trust fund chapter describes the use of fully-funded trusts to comply with UST FR.

### **A.3 Regulation of Trust Fund Institutions**

The trustee of the standby trust fund must be an entity that has the authority to act as a trustee and whose trust operations are regulated and examined by a federal agency or an agency of the state in which the fund is established. See the discussion in Section A.3 of the Trust Fund chapter.

## B. OWNER OR OPERATOR RESPONSIBILITIES

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING STANDBY TRUST FUNDS</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Selecting an Eligible Trustee (see Section B.1)</li><li><input type="checkbox"/> Obtaining a Properly Worded Standby Trust Fund and Certification of Acknowledgment (see Section B.2)</li><li><input type="checkbox"/> Providing Proper Scope and Amount of Coverage (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Maintaining Assurance (see Section B.5)</li><li><input type="checkbox"/> Submitting Financial Responsibility Forms (see Section B.6)</li><li><input type="checkbox"/> Replenishing Assurance After Standby Trust is Used to Fund Corrective Action or Third-Party Compensation (see Section B.7)</li></ul>

### B.1 Selecting an Eligible Trustee

The first step that an owner or operator must take is to locate an eligible entity willing to act as trustee of the standby trust fund. The trustee must satisfy two UST FR eligibility requirements:

- It must be an entity that has the authority to act as a trustee and
- Its trust operations must be regulated and examined by a federal agency or an agency of the state in which the fund is established.

If there is any doubt about whether the entity is empowered to act as a trustee, the owner or operator can ask the entity what authority regulates it and then contact the authority to determine whether the entity has the power to act as a trustee. Before accepting a fiduciary account, a bank typically will review the trust to determine whether it can administer the account properly.

**NOTE:** Trust operations are regulated separately from other banking operations, and it is common for a regulated bank not to have the authority to act as a trustee.

### B.2 Obtaining a Properly Worded Standby Trust Fund and Certification of Acknowledgment

The required wording of the standby trust agreement is specified in the regulations at 40 CFR 280.103(b)(1). The standby trust fund agreement must be accompanied by a formal certification of acknowledgment worded similarly to the specifications in 40 CFR 280.103(b)(2).

### B.3 Providing Proper Scope and Amount of Coverage

Scope of Coverage. **The scope of the standby trust fund must match the scope(s) of the mechanism(s) that could be used to fund the standby trust fund.** It is unlikely but possible that a mechanism requiring a standby trust fund will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party

compensation (or vice versa), a standby trust fund and the corresponding mechanism(s) can be used to cover the other scope area.

Amount of Coverage. Standby trusts generally do not need to contain any money or property at the time they are established. State law in some states may require a standby trust fund to contain a token level of funding in order to be legally effective.

#### **B.4 Recordkeeping**

An owner or operator who uses the standby trust fund for UST FR must maintain on-site or at the place of business a copy of the following documents:

- A copy of the signed *standby trust fund agreement* and any amendments, and
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5).

#### **B.5 Maintaining Assurance**

**If funds representing the full amount of required aggregate coverage** are deposited from a surety bond, letter of credit, or guarantee into a standby trust fund, the trust must at all times contain sufficient assets, valued at their *current market value*, equal to the required aggregate amount of coverage. If the required amount of coverage is greater than the current market value of the standby trust fund, in this situation, the owner or operator must either (1) increase the level of assets in the standby trust fund to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the current market value of the standby trust fund. The trustee can provide information on the current market value of the standby trust fund.

The trust fund agreement is "irrevocable," which means that it remains valid until it is terminated; it does not need to be renewed.

#### **B.6 Submitting Financial Responsibility Documents**

**Based on the federal reporting requirements**, owners or operators that use the corporate guarantee, surety bond, letter of credit, or certain government guarantees must submit a copy of the signed standby trust fund and any amendments to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release
- Within 10 days after the commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code naming the owner or operator as debtor
- At any time if requested by the implementing agency

States regulations may require more frequent (e.g., annual) submissions.

## **B.7 Replenishing Assurance After Standby Trust Fund is Used to Fund Corrective Action or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the standby trust fund has been drawn upon to fund corrective action or third-party compensation. The owner or operator must either:

- Reimburse the standby trust fund or renew the guarantee, surety bond, or letter of credit (if available) to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the standby trust have been reduced.

This replenishment must occur on the anniversary date of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR STANDBY TRUST FUNDS</b>	
<b>Implementing Agency Responsibilities</b>	
<input type="checkbox"/>	1. Reviewing Standby Trust Fund Agreements Included in Financial Responsibility Submissions (see Section C.1)
<input type="checkbox"/>	2. Directing Payments from the Standby Trust Fund (see Section C.2)
<input type="checkbox"/>	3. Responding to Requests for Release of Excess Funds (see Section C.3)
<b>Implementing Agency Oversight</b>	
<input type="checkbox"/>	4. Checking Whether the Trustee Is Eligible (see Section C.4)
<input type="checkbox"/>	5. Verifying the Wording, Scope, and Amount of the Standby Trust Fund Agreement and Certification of Acknowledgment (see Section C.5)

### C.1 Reviewing Standby Trust Fund Agreements Included in Financial Responsibility Submissions

**Based on the federal reporting rules**, you will receive unsolicited copies of the standby trust fund from the owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identified a release that must be reported
- After the owner or operator fails to obtain alternate assurance when required
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator or as debtor

In the first situation, the implementing agency should ensure that the standby trust fund is properly worded and effective so that, if not, the owner or operator can be instructed to remedy the problems. You may not be able to draw on the mechanisms if the standby trust is not effective. See C.4 and C.5 below for details. In the second situation, it also is important to quickly review the standby trust fund in case you want to draw on the FR mechanism. In the third situation, review of the standby trust fund is advisable because the owner or operator may be willing to remedy any problems with the standby trust fund in order to stay in compliance with UST FR regulations.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.4 and C.5 below for review of such submissions.

**NOTE:** A standby trust fund agreement does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

## C.2 Directing Payments from the Standby Trust Fund

When to Direct Payments. The standby trust fund clearly describes when you may draw on it; the Director does not have unlimited discretion to draw on the standby trust fund. As shown in Exhibit 11-3, if an owner or operator does not pay for corrective action and/or third-party compensation, you can direct monies in the standby trust fund for such payments.

<b>Exhibit 11-3 CONDITIONS FOR DRAWING ON STANDBY TRUST FUND</b>	
Situation	Draw on the Standby Trust Fund
(1) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, <u>and</u>  the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F;	✓
(2) The Director has received either:  (i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid  <u>OR</u>  (ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.	✓

How Much Payment to Direct. Payment amounts should be based on the actual costs of the corrective action or third-party compensation, based on invoices, settlement agreements, or court orders, as applicable.

Refunding Payments. If the owner or operator establishes alternate assurance, is released from FR, or pays for corrective action and/or third party compensation, monies in the standby trust fund can be refunded to the guarantor, surety, or issuer of the letter of credit from whom the funds were originally drawn. Only make such refunds if the Director determines that no additional corrective action costs or third-party liability claims will occur as a result of a release covered by the financial assurance mechanism for which the standby trust fund was established.

Priority of Payments. If the Director of the implementing agency determines that the amount of corrective action costs and third-party liability claims eligible for payment may exceed the amount of available financial assurance, the first priority for payment should be corrective action costs necessary to protect human health and the environment. The Director should pay third-party liability claims in the order in which the Director receives certifications and valid court orders.



### C.3 Responding to Requests for Release of Excess Funds

You may receive a written request from the owner or operator for release of excess funds in three situations:

- If the current market value of the standby trust fund is greater than the required amount of coverage
- If the owner or operator substitutes other financial assurance for all or part of the standby trust fund
- Upon release of the owner or operator from FR.

Within 60 days after receiving a request from the owner or operator for release of excess funds, the Director of the implementing agency should instruct the trustee to release to the guarantor, surety, or letter of credit issuer such funds as the Director specifies in writing. The amount of funds released should be no more and no less than the excess over the required amount of coverage.

Because the current market value of securities in a trust fund can fluctuate, you should be conservative in authorizing release of excess funds, unless the owner or operator has been released from being subject to UST FR regulations or is substituting other financial assurance for all of the standby trust fund. Otherwise, in calculating how much to release, you should value the current balance of the standby trust fund as the **lower** of cost or market value.

**NOTE:** The Director of the implementing agency must not agree to release funds that would bring the standby trust fund balance below the required amount of coverage, even if the owner or operator can show that returns on trust fund investments have been substantial. Future returns are unpredictable and should not be the basis for release of funds. If future returns turn out to be strong, the owner or operator can again request release of monies above the required amount of coverage.

### C.4 Checking Whether the Trustee Is Eligible

Eligible trustees include only financial institutions that have the authority to act as trustees and whose trust operations are regulated and examined by a Federal or State agency. Trust operations are regulated separately from other banking operations, and it is very common for a regulated bank not to have the authority to act as a trustee. Section C.4 of the Trust Fund chapter describes how you can check trustee eligibility.

### C.5 Verifying the Wording, Scope, and Amount of the Standby Trust Fund Agreement and Certification of Acknowledgment

**Wording.** The required wording for standby trust funds is specified in the regulations. Both the owner or operator and the trustee, in signing the standby trust fund agreement, certify that the wording of the standby trust is identical to the required wording on the date the trust was executed. Deviations in the wording of the standby trust may compromise its effectiveness. Check that the wording is for the standby trust fund **not** the trust fund.

Because states may have different requirements for formal **certifications of acknowledgment**, their wording may differ somewhat from the acknowledgment language in the regulations.

Scope of Coverage. **The scope of the standby trust fund must match the scope(s) of the mechanism(s) that could be used to fund the standby trust fund.** It is unlikely but possible that a mechanism requiring a standby trust will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), another mechanism requiring the standby trust fund can be used to cover the other scope area. You should ensure that the scope of coverage of the standby trust fund matches the scope of the mechanism(s) requiring a standby trust.

Amount of Coverage. Standby trusts generally do not need to contain any money or property at the time they are established. State law in some states may require a standby trust fund to contain a token level of funding in order to be legally effective.

**If funds representing the full amount of required aggregate coverage** are directed to the standby trust, you may want to monitor whether if the current market value of the standby trust fund is less than the required level of coverage. If so, the owner or operator must either (1) increase the level of assets in the standby trust fund to assure the appropriate amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the current market value of the standby trust fund.

## **D. STANDBY TRUSTEE RESPONSIBILITIES**

The following checklist summarizes the standby trustee's responsibilities:

<b>CHECKLIST OF STANDBY TRUSTEE RESPONSIBILITIES</b>	
<input type="checkbox"/>	Being an Entity with Authority to Act as a Trustee and Whose Trust Operations Are Regulated and Examined by a Federal Agency or an Agency of the State in Which the Standby Trust Fund Is Established (see Section D.1)
<input type="checkbox"/>	Accepting and Depositing Cash and Securities into the Trust Fund (see Section D.2)
<input type="checkbox"/>	Investing the Principal and Income of the Fund as Specified (see Section D.3)
<input type="checkbox"/>	Responding to Written Instructions to Make Payments as Directed (see Section D.4)

### **D.1 Being an Entity with Authority to Act as a Trustee and Whose Trust Operations Are Regulated and Examined by a Federal Agency or an Agency of the State in Which the Standby Trust Fund Is Established**

The trustee must be an entity (e.g., a bank or other depository institution) which has the authority to act as a trustee and whose trust operations are regulated and examined by a federal agency or an agency of the state in which the standby trust fund is established. Institutions that are not familiar with UST FR should review the regulations at 40 CFR Part 280 Subpart H especially §280.103.

### **D.2 Accepting and Depositing Cash and Securities into the Trust Fund**

The trustee must accept into the trust fund acceptable cash and securities tendered by a corporate or government guarantor, a surety, or an issuer of a letter of credit.

### **D.3 Investing the Principal and Income of the Fund as Specified**

The trust agreement describes the trustee's responsibilities, powers, and limitations in investing the principal and income of the trust fund.

### **D.4 Responding to Written Instructions to Make Payments or Refunds as Directed**

The trustee must act in accordance with all properly signed, written orders, requests, and instructions of the owner or operator and the Director of the implementing agency. The trustee is not required to inquire into the basis of any orders, requests, and instructions.

Instructions from the Director will concern:

- Payments from the standby trust fund for corrective action and/or third-party liability compensation, and
- Refunding remaining fund balances to financial assurance providers.

Instructions from the owner or operator will concern only the investment of trust funds, which is also governed by explicit powers and limitations described in the trust agreement.

**E. SOURCES OF FURTHER INFORMATION**

See Trust Fund chapter Section E.

## 12. FINANCIAL RESPONSIBILITY USING THE LOCAL GOVERNMENT BOND RATING TEST

This chapter describes the use of the local government bond rating test to demonstrate UST FR as follows:

A. BACKGROUND .....	194
A.1 What Is the Local Government Bond Rating Test of Self-insurance? .....	194
A.2 How Does the UST Bond Rating Test of Self-Insurance Work? .....	194
A.3 Who Can Use the Test? .....	194
A.4 What Are Municipal Bonds? .....	196
A.5 What Is Municipal Bond Insurance? .....	196
A.6 What Are Bond Ratings? .....	197
A.7 What Is the UST Bond Rating Test? .....	198
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT BOND RATING TEST .....	201
B.1 Determining Eligibility of Local Government to Use Bond Rating Test .....	201
B.2 Satisfying the Criteria for the Local Government Bond Rating Test for Proper Scope and Amount of Coverage .....	201
B.3 Preparing a Properly Worded Letter from the Chief Financial Officer .....	202
B.4 Recordkeeping .....	202
B.5 Obtaining Alternate Assurance If the Local Government Can No Longer Satisfy the Bond Rating Financial Test .....	202
B.6 Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy Proceedings .....	202
B.7 Responding to Requests for Reports of Financial Condition .....	203
B.8 Submitting Financial Responsibility Documents .....	203
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT .....	204
C.1 Responding to Notices That the Local Government Can No Longer Satisfy the Bond Rating Test and Has Failed to Obtain Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings .....	204
C.2 Reviewing Financial Responsibility Submissions .....	205
C.3 Checking Whether the Local Government Is Eligible and Qualified to Use the Bond Rating Test .....	205
C.4 Verifying Satisfaction of the Bond Rating Test for Proper Scope and Amount of Coverage .....	207
C.5 Verifying the Wording of the Chief Financial Officer Letter .....	207
C.6 Requesting Reports of Financial Condition .....	208
C.7 Notifying the Owner or Operator That It No Longer Meets the Bond Rating Test .....	208
D. SOURCES OF FURTHER INFORMATION .....	209

## A. BACKGROUND

Local government entities are, in general, more financially stable than private companies. Most local governments, unlike private entities, have the authority to levy taxes or to independently set rates, which provides a consistent, reliable source of income. In contrast to corporations, they are less likely to dissolve or merge with other entities which means that they are less likely to have abrupt changes in financial structure. They are, by definition, geographically fixed, eliminating potential concerns that they may move and abandon their USTs. They rarely go bankrupt, and even bankruptcy does not allow local government entities to void their legal obligations. Assurance that local government owners and operators will be financially responsible for their UST related obligations, therefore, can be based primarily on evidence of financial stability and prudent financial management.

### A.1 What Is the Local Government Bond Rating Test of Self-insurance?

A local government owner or operator may satisfy the UST FR requirements by passing the local government **bond rating test of self-insurance**. Self-insurance is a common option in many government-mandated financial responsibility programs, both environmental and non-environmental (e.g., FR for workers compensation). Self-insurance often will be the least expensive method of demonstrating FR. Large, creditworthy local governments can provide evidence of financial responsibility without having to pay the costs of procuring financial mechanisms from other parties. Typically, local governments that use a self-insurance option demonstrate financial strength by passing a set of pass/fail criteria, termed a financial test. **To pass the UST FR bond rating test, a local government owner or operator must meet a test based on outstanding bond issues and ratings.**

### A.2 How Does the UST Bond Rating Test of Self-Insurance Work?

This option is termed **self-insurance** because it involves no source of funding other than the owner or operator itself. **Those who pass the test are expected to be able to pay for their corrective action and third-party compensation obligations.** How these local governments arrange to pay their obligations is solely their decision. Passing the test does not limit the owner or operator's liability for corrective action and third-party compensation. The test is designed so that those who pass are very unlikely to experience financial distress that prevents their performance of corrective action and third-party compensation.

Because the owner or operator's **bond ratings** form the basis of the assurance, alternate assurance must be provided when the ratings cease to satisfy test requirements. If an owner or operator finds that it is no longer eligible to use the bond rating test, the owner or operator must obtain an alternate mechanism within 150 days of the change in status. The Director of the implementing agency may disqualify use of the bond rating test upon a finding, based on reports of financial condition or other information, that the local government owner or operator no longer meets the bond rating test requirements. The owner or operator has 30 days after notification of such a finding to obtain another financial assurance mechanism.

### A.3 Who Can Use the Test?

Only local government owners or operators can use the test. Local government entities are created under state constitutions and statutes, and consequently vary significantly from state to state. As recognized by the Bureau of the Census, local government entities generally fall into the categories shown in Exhibit 12-1. Local government entities include both general purpose local governments and special purpose local governments. **General purpose local governments** include municipalities,

**Exhibit 12-1**  
**TYPES OF LOCAL GOVERNMENTS**

General Purpose Governments

County Governments: Organized county governments are found throughout the nation except for Connecticut, Rhode Island, the District of Columbia, and parts of other states. In Louisiana, county governments are officially designated as "parish" governments, and the "borough" governments of Alaska resemble county governments in other states. In general, county governments are defined in terms of a geographical area served, rather than a specific population.

Municipal Governments: Municipal governments include active government units officially designated as cities, boroughs (except in Alaska), towns (except in the six New England states and Minnesota, New York, and Wisconsin), and villages. This concept corresponds to the "incorporated places" that are recognized in Census Bureau reporting of population and housing statistics. Municipal governments are typically organized to serve specific population concentrations, rather than specific geographic areas.

Township Governments: As distinguished from municipal governments, which are created to serve specific population concentrations, township governments exist to serve inhabitants of areas without regard to population concentrations. This category includes governments officially designated as "towns" in the six New England states, New York, and Wisconsin, some "plantations" in Maine, and "locations" in New Hampshire, as well as governments called townships in other areas. In Minnesota, the terms "town" and "township" are used interchangeably.

Indian Tribes: Indian Tribes are included in the statutory definition of local government entities in RCRA Section 1004(13).

Non-General Purpose Governments

School District Governments: Forty-five states have established public school systems with sufficient autonomy and fiscal authority that they can be classified as independent local government entities.

Special Purpose Districts: Special purpose districts are governmental entities created to perform a single or limited range of functions (e.g., park and recreation districts, libraries, fire protection districts, cemeteries). These districts may be subdivided into any of the following distinct categories: (1) local or metropolitan districts, (2) districts dependent on or independent of a municipality for their creation or operation, and (3) districts created by state enactment or by municipal resolution. They have sufficient administrative and fiscal autonomy to qualify as separate governments.

counties, townships, towns, villages, parishes, and New England towns. **Special purpose local governments** include organizations that perform a single function or a limited range of functions. Special purpose local governments generally are designated as either "special districts" or "public authorities" such as school districts, water and sewer authorities, transit authorities, redevelopment authorities, or power authorities. Special districts may be authorized by state charter or constitution or may be established by general purpose governments.

#### **A.4 What Are Municipal Bonds?**

Municipal bonds are used to finance virtually every kind of public capital project, from bridges, highways, and mass transit systems to sewage treatment plants, court houses, and electric generating plants. They also finance certain types of private projects that serve important public purposes such as low- and moderate-income housing, private hospitals and colleges, and industrial facilities.

More than half of the money used to finance public construction projects in the average American town comes from municipal bonds. In 1998, \$285 billion of municipal bonds were issued. Approximately 50,000 different state and local governments and agencies of government are authorized to issue bonds.

Municipal bonds are long-term debt instruments; they are issued with maturities greater than a year, often 10, 15, 20, or 30 years. Debt securities that mature in less than a year, such as commercial paper, bank deposits, or money market funds, do not constitute bonds. There are two major types of municipal bonds:

- **General obligation (G.O.) bonds** (also termed "**full faith and credit**" bonds) are secured by the issuer's ability to levy property (termed "ad valorem") taxes or to draw from other unrestricted revenue sources, such as sales or income taxes. These bonds are important mechanisms for financing capital improvements such as schools, streets, and municipal buildings.
- **Revenue Bonds** are issued to finance a specific public enterprise and are payable solely from enterprise earnings or from a dedicated tax.

#### **A.5 What Is Municipal Bond Insurance?**

Local governments often prefer to offer their bonds with **insurance** in order to lower borrowing costs. Half of all new-issue municipal bonds are insured. This means that scheduled interest and principal payments are guaranteed by municipal bond insurers. The guarantee covers 100% of interest and principal for the full term of the issue. By boosting the rating on a security, bond insurance enables the issuer to save on interest costs, since bonds with the highest rating - and thus with the greatest security - pay the least interest.

Municipal bond insurance companies must meet the requirements of insurance regulators in every state where they do business. They are also subject to scrutiny from the rating agencies which evaluate and assign a rating to every transaction they insure. To test the adequacy of the insurance companies' capital resources, the rating agencies apply a computer-simulated stress test which measures their ability to pay claims at a level comparable to those experienced during the Great Depression.

Bond insurers have a strong financial interest in the soundness of the local governments whose bonds they insure. If a local government defaults on a payment, the bond insurers must meet the payment. Consequently, bond insurers track the financial obligations of insured local governments closely and often have covenants that allow them to intervene in local government operations. Insurers, for example, may insist



on more conservative fiscal policies to preserve the financial strength of a community, which in turn, lowers the risk and cost associated with the bond insurance.

Local governments do not purchase insurance as a means of earning an investment grade rating, but rather to increase the rating from a lower investment grade (e.g., Baa, Baal, or A) to the very highest (e.g., Aaa). An analysis of four major bond insurers showed that virtually all of the insured debt would have earned an investment grade rating without the insurance. In exchange for the cost of the insurance, local governments obtain a lower interest rate for the life of the bond. Bond insurance is cost effective for an issuer as long as the interest cost savings exceed the premiums paid to the insurer.

There are other means of enhancing the rating of a municipal bond besides insurance. The most common alternative is to use a **standby letter of credit**.

### A.6 What Are Bond Ratings?

A bond rating is an opinion about the credit quality of a bond usually made by an independent rating service. Ratings generally indicate the probability of the timely repayment of principal and interest of municipal bonds. Rating services are not regulated by any government agency. The two largest organizations that rate municipal bonds are Moody's Investors Service and Standard & Poor's. Only ratings made by Moody's and Standard & Poor's are eligible for use in demonstrating UST financial responsibility. Exhibit 12-2 presents the raters' descriptions of their investment grade ratings.

<b>Exhibit 12-2 INVESTMENT GRADE BOND RATINGS</b>			
<b>Moody's</b>		<b>Standard &amp; Poor's</b>	
<b>Aaa</b>	Bonds that are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edge." Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.	<b>AAA</b>	An obligation rated AAA has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.
<b>Aa</b>	Bonds that are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best of bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present that make the long-term risks appear somewhat larger than in Aaa securities.	<b>AA</b>	An obligation rated AA differs from the highest-rated obligations only in small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

Exhibit 12-2 (continued)			
INVESTMENT GRADE BOND RATINGS			
Moody's		Standard & Poor's	
<b>A</b>	Bonds that are rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present that suggest a susceptibility to impairment some time in the future.	<b>A</b>	An obligation rated A is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.
<b>Baa</b>	Bonds that are rated Baa are considered as medium grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.	<b>BBB</b>	An obligation rated BBB exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

#### A.7 What Is the UST Bond Rating Test?

Exhibit 12-3 displays the elements of the UST bond rating test, which differ depending on whether the owner or operator is a general purpose local government or a local government that lacks the authority to issue general obligation bonds.

Exhibit 12-3	
LOCAL GOVERNMENT BOND RATING TEST	
General Purpose Local Governments	Non-General Purpose Local Governments
At least \$1 million of <b>general obligation bonds</b>	At least \$1 million of <b>revenue bonds</b>
~ excluding refunded issues	~ excluding refunded issues
~ excluding bonds backed by credit enhancement <b>other than</b> insurance	~ excluding bonds backed by <b>any</b> type of credit enhancement
~ excluding revenue bonds	
Investment grade rating for all outstanding general obligation bonds	Investment grade rating for all rated revenue bonds

EPA intended the bond rating test of self-insurance to be used by local governments that have shown their capability to sustain debts comparable in size to the minimum level of aggregate UST financial assurance as determined by RCRA (i.e., \$1 million). Local governments that are not able to demonstrate such capability may use another mechanism to demonstrate financial responsibility. At the time it promulgated the bond rating test, EPA estimated that approximately 87 percent of general obligation bonds were issued for aggregate amounts greater than \$1 million.

The local government must be both **eligible** and **qualified** to use the bond rating test. To be **eligible** to use the bond rating test:

- **General purpose local governments** must have \$1 million or more of total outstanding issues of general obligation bonds.
  - ~ Only G.O. bonds may be counted, not revenue bonds.
  - ~ Refunded obligations also cannot be considered in determining whether the \$1 million threshold has been met.
  - ~ General obligation bonds that are backed by credit enhancement mechanisms **other than** bond insurance may not be considered in determining whether the \$1 million threshold has been met.
- **Non-general purpose local governments** (e.g., special districts and school districts) that do not have the authority to issue general obligation bonds must have \$1 million or more of total outstanding revenue bonds.
  - ~ Revenue bonds that are backed by **any** type of credit enhancement mechanism (including insurance) may not be considered.
  - ~ Refunded obligations also may not be considered in determining whether the \$1 million threshold has been met.

As noted above, municipal bonds frequently are insured. The ratings assigned to such bonds are driven primarily by the creditworthiness of the insurer, not the issuing local government. Although the rating of insured bonds does not directly indicate a local government's financial condition, it does demonstrate both that the government has assured the insurance company of its ability to meet debts, and that the insurer has strong confidence in the financial health of the local government. The federal UST FR rule, therefore, does not distinguish between general obligation bonds that are insured and those that are not insured by a bond insurance company in determining whether a local government is eligible to use the test. On the other hand, EPA did not find evidence that other providers of other methods of credit enhancement, such as issuers of letters of credit, provide a degree of oversight equivalent to that provided by bond insurers. Consequently, bonds that are supported by other means of credit enhancement may not be used to demonstrate the \$1 million threshold for eligibility.

To be **qualified** to use the bond rating test, all outstanding issues of general obligation bonds must be rated at least "investment grade" by Moody's or Standard & Poor's. Special districts, such as school districts or airport authorities, that do not have the authority to issue general obligation bonds, may satisfy the bond rating test by showing that all rated revenue bonds are at least investment grade. **Investment grade bonds** are bonds rated Aaa, Aa, A, and Baa by Moody's Investors Service (Moody's) or AAA, AA, A, and BBB by Standard & Poor's Corporation (Standard & Poor's).<sup>28</sup>

---

<sup>28</sup> Both Standard & Poor's and Moody's recognize groupings within the major bond rating classes. Moody's signifies higher ranking bonds within a class with a "1" (e.g., Baa1), whereas Standard and Poor's uses a +/- system to designate higher and lower ranking bonds.

If a local government has multiple outstanding issues of general obligation or revenue bonds with different ratings, or if the rating assigned to a single class or issue of bonds by different rating agencies differ, the lowest rating must satisfy the test.

Because the ratings for revenue bonds issued by general purpose governments do not measure the financial health and fiscal management practices of that type of government as a whole, and because revenue bonds are not usually used to finance projects central to the operation of a general purpose government, EPA determined that **general purpose governments with the authority to issue general obligation debt may not use revenue bonds to demonstrate financial responsibility.**

While the ratings of most revenue bonds issued by general purpose governments reflect a limited set of criteria pertaining to specific projects, revenue bonds issued by special districts are generally used to finance projects central to the operations of the special districts, so that the ratings encompass a broader view of the overall financial condition of the issuing entities. Thus, **a local government that does not have the authority to issue general obligation debt may use investment-grade ratings on revenue bonds to demonstrate financial responsibility.**

**B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT BOND RATING TEST**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT BOND RATING TEST</b>
<input type="checkbox"/> Determining Eligibility of Local Government to Use the Bond Rating Test (see Section B.1)
<input type="checkbox"/> Satisfying the Criteria for the Local Government Bond Rating Test for Proper Scope and Amount of Coverage (see Section B.2)
<input type="checkbox"/> Preparing a Properly Worded Letter from the Chief Financial Officer (see Section B.3)
<input type="checkbox"/> Recordkeeping (see Section B.4)
<input type="checkbox"/> Obtaining Alternate Assurance If the Local Government Can No Longer Satisfy the Bond Rating Financial Test (see Section B.5)
<input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy Proceedings (see Section B.6)
<input type="checkbox"/> Responding to Requests for Reports of Financial Condition (see Section B.7)
<input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.8)

**B.1 Determining Eligibility of Local Government to Use Bond Rating Test**

Only a local government can use the local government bond rating test. A private firm may not use this mechanism. To be eligible:

- A general purpose local government must have \$1 million or more of total outstanding issues of general obligation bonds (excluding refunded obligations)
- Non-general purpose local governments that do not have the authority to issue general obligation bonds (e.g., special districts and school districts) must have \$1 million or more of outstanding revenue bonds (excluding refunded obligations).

**B.2 Satisfying the Criteria for the Local Government Bond Rating Test for Proper Scope and Amount of Coverage**

Scope of Coverage. The bond rating test can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). The bond rating test can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the bond rating test can be used to cover the other scope area. The bond rating test must cover the full scope of UST FR (see B.2 in Chapter 2 above) unless used in combination with another mechanism that covers the remaining part of the full scope.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a bond rating test with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the bond rating test for part of the required scope of coverage, the bond rating test would also work for the full scope because the required

amount of coverage used in the bond rating test stays the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. Unlike for many other FR options, the required amount of coverage does not affect the bond rating test. Whether a local government owner or operator can pass the test is the sole issue.

### **B.3 Preparing a Properly Worded Letter from the Chief Financial Officer**

To demonstrate satisfaction of the local government bond rating test, the chief financial officer (CFO) of the local government owner or operator must sign a letter worded exactly as specified in the regulations. The required wording for a CFO letter from a general purpose local government owner or operator appears at §280.104(d) while the required wording for a CFO letter from a local government owner or operator other than a general purpose government appears at §280.104(e).

### **B.4 Recordkeeping**

A local government owner or operator using the bond rating test of self-insurance for UST FR must maintain on-site or at the place of business the following documents:

- A letter signed by the chief financial officer (e.g., comptroller, controller, or treasurer) supporting use of the bond rating test
- A copy of its *bond rating(s)* published within the last 12 months by Moody's or Standard & Poor's
- Updated copy of *certification of FR* (described in Chapter 2 Section D.5).

### **B.5 Obtaining Alternate Assurance If the Local Government Can No Longer Satisfy the Bond Rating Financial Test**

A local government owner or operator must obtain alternate assurance in the following circumstances:

- Within 150 days of change in status, including downgrading of a bond below investment grade, withdrawal of a bond rating other than for repayment of an outstanding issue, or reduction of total amounts of bonds outstanding to below \$1 million.
- Within 30 days after receiving notice of a finding by the Director of the implementing agency that disqualifies use of the bond rating test because the owner or operator no longer satisfies the test requirements.

### **B.6 Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy Proceedings**

A local government owner or operator using the bond rating test must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 150 days after determining, or within 30 days of being informed, that it no longer passes the bond rating test. The owner or operator must notify the Director of the failure within 10 days.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

### **B.7 Responding to Requests for Reports of Financial Condition**

A local government owner or operator using the bond rating test must respond to requests for reports of financial condition by providing the requested documents to the Director of the implementing agency.

### **B.8 Submitting Financial Responsibility Documents**

**According to the federal reporting regulations**, a local government owner or operator that uses the bond rating test must submit a copy of the CFO's letter and bond rating to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- When the owner or operator fails to obtain alternate coverage;
  - ~ within 150 days after finding that the owner or operator no longer meets bond rating test requirements or
  - ~ within 30 days after notification by the Director that the owner or operator does not meet bond rating test requirements;
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the owner or operator as debtor;
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) reporting.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR LOCAL GOVERNMENT BOND RATING TEST</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Responding to Notices That the Local Government Can No Longer Satisfy the Bond Rating Test and Has Failed to Obtain Alternate Assurance or Has Been Named a Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Reviewing Financial Responsibility Submissions (see Section C.2)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Checking Whether the Local Government Is Eligible and Qualified to Use the Bond Rating Test (see Section C.3) <input type="checkbox"/> Verifying Satisfaction of the Bond Rating Test for Proper Scope and Amount of Coverage (see Section C.4) <input type="checkbox"/> Verifying the Wording of the Chief Financial Officer Letter (see Section C.5) <input type="checkbox"/> Requesting Reports of Financial Condition (see Section C.6) <input type="checkbox"/> Notifying the Owner or Operator That It No Longer Meets the Bond Rating Test (see Section C.7)

### C.1 Responding to Notices That the Local Government Can No Longer Satisfy the Bond Rating Test and Has Failed to Obtain Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that an owner or operator that has been using the bond rating test is no longer eligible or qualified and cannot obtain alternate assurance. Although owners or operators may experience deterioration in their risk of default on their bonds, most ought to be able to secure alternate assurance. However, following receipt of such a notice from the owner or operator, you should monitor the efforts being made to secure alternate assurance. This could include alerting the owner about the situation if the operator had been providing the financial assurance, and vice versa. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

Owner or Operator Named A Debtor in Bankruptcy. Similarly, it is unlikely that an owner or operator using the bond rating test will be named as a debtor in bankruptcy proceedings. If that happens, it represents a potential gap in coverage in the event of a release or a need for third-party compensation. It is very unlikely but possible that the discovery of a release or appearance of a claim for compensation would itself cause the local government owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>29</sup> Apart from that route, if the owner or operator are different

---

<sup>29</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supersedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).



parties, you could alert the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, implementing agencies will receive unsolicited copies of the CFO letter from the local government owner or operator **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release that must be reported
- Within 30 days after the owner or operator fails to obtain alternate assurance after finding that it no longer passes the bond rating test
- Within 150 days after the owner or operator fails to obtain alternate assurance after being notified that it no longer passes the bond rating test
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor

In the first situation, the implementing agency may want to ensure that the bond rating test criteria have been satisfied so that, if not, the owner or operator can be instructed to obtain alternate assurance. See C.4 below for details. In the second situation, there is no point in reviewing the CFO letter because failure to pass the test has already been established. Rather, efforts should focus on securing alternate assurance. Likewise, in the third situation, there is little benefit to review of the CFO's letter because it does not represent a claim on the owner or operator's assets.

**NOTE:** A CFO letter does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.3 through C.5 below for review of such submissions.

## C.3 Checking Whether the Local Government Is Eligible and Qualified to Use the Bond Rating Test

**Eligibility.** Only local governments can use the bond rating test. Other entities can not use this option to demonstrate FR. General purpose local government entities must have \$1 million or more of total outstanding issues of general obligation bonds, while local governments that can not issue general obligation bonds must have \$1 million or more of outstanding revenue bonds. In addition, the bond ratings used for the test must be those of the owner or operator. If the bond ratings do not apply to the owner or operator but to another local government entity, see the discussion of the local government guarantee in Chapter 14.

To check whether the local government is eligible, you will want to see a complete list of its bond issues. This information may be available directly from the entity or posted on its website. Preferably, access this information from both Moody's and Standard & Poor's sources listed on Exhibit 12-3. (Note that Moody's *Bond Record* does not provide information on the value of bond issues.)

The first step is to eliminate refunded issues from the list. For example, Moody's *Bond Record* identifies these with a # (hatchmark) symbol.

If the owner or operator is a **general purpose local government**, you should eliminate any revenue bonds on the list. You usually can identify these by their titles. Then, to determine whether the threshold of \$1 million or more of outstanding bonds has been achieved, you should eliminate any bond issues that are supported by credit enhancement **other than** bond insurance. The most common alternative to insurance is use of letters of credit. In Moody's *Bond Record*, for example, these can be identified by the letters "LOC." Verify that remaining bond issues total \$1 million or more.

If the owner or operator is not a general purpose local government and does not have the authority to issue general obligation bonds, you should eliminate from the list of outstanding revenue bonds any issued with **any** type of credit enhancement. These can be identified, for example, by the listing of a bond insurer (e.g., AMBAC, MGIA) or "LOC" notation. Verify that remaining bond issues total \$1 million or more.

Qualifications. The test requires that:

- A general purpose local government owner or operator must have a currently outstanding issue or issues of general obligation bonds with a Moody's rating of Aaa, Aa, A, or Baa, or a Standard & Poor's rating of AAA, AA, A, or BBB as the lowest rating for any rated general obligation bonds issued by the local government.
- A local government owner or operator that is not a general-purpose local government and does not have the legal authority to issue general obligation bonds must have a currently outstanding issue or issues of revenue bonds with a Moody's rating of Aaa, Aa, A, or Baa, or a Standard & Poor's rating of AAA, AA, A, or BBB as the lowest rating for any rated revenue bonds issued by the local government.

Where a local government has multiple outstanding issues, or where a local government's bonds are rated by both Moody's and Standard & Poor's, the lowest rating must be used.

**NOTE:** G.O. bonds that are backed by credit enhancement may be considered in determining the ratings of applicable bonds outstanding; similarly, revenue bonds supported by credit enhancement also may be considered. Such bonds may not be considered in determining the \$1 million threshold.

To identify all of the outstanding bond issues, consult Standard and Poor's *Municipal Ratings Handbook* or Moody's *Bond Record*. A local government's bonds may be rated by Standard & Poor's and/or Moody's. **Moody's and Standard & Poor's ratings may not be identical. It is unlikely but possible that one may issue an investment grade rating while the other does not. Thus, you should check both sources of bond ratings.** Exhibit 12-4 identifies sources of information on bond ratings.

**Exhibit 12-4**  
**SOURCES OF BOND RATING INFORMATION**

Moody's Bond Ratings	Call 1-212-553-0377 (Ratings Desk) for a verbal rating or consult <i>Moody's Bond Record</i> found in many public libraries
Standard & Poor's (S&P) Bond Ratings	Call 1-212-208-1146 (Ratings Desk) for a verbal rating or consult S&P's <i>Municipal Ratings Handbook</i> found in many public libraries.

**C.4 Verifying Satisfaction of the Bond Rating Test for Proper Scope and Amount of Coverage**

If a local government passes the bond rating test, it can provide assurance for the full scope and required amount of UST FR. Owners or operators have no need to combine this mechanism with any other in order to demonstrate compliance.

Scope of Coverage. The bond rating test can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the bond rating test will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the bond rating test can be used to cover the other scope area. Because the owner and operator are responsible for performing corrective action and satisfying compensation obligations anyway, you need not be overly concerned with the scope of coverage of the bond rating test of self-insurance even when it is used in combination with other mechanisms. Rather, it is more important that you verify that the test criteria have been met (see C.3 above).

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a bond rating test with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the bond rating test for part of the required scope of coverage, the bond rating test would also work for the full scope because the requirements of the bond rating test stay the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. The bond rating test can be used for any amount of coverage.

**C.5 Verifying the Wording of the Chief Financial Officer Letter**

Verifying the wording of the CFO letter is a straightforward activity. The CFO letter should match the required wording, without any additions, omissions, or changes. However, unlike other FR documents, minor deviations in the wording or format of the CFO letter will have little impact on the effectiveness of the bond rating test, unless the changes affect the substance of the bond rating test criteria. Look for the following in the CFO's letter:

- The letter should be signed by the person who is officially designated as the Chief Financial Officer of the owner or operator. **In the case of local government owners and operators, a CFO is the individual with the overall authority and responsibility for the collection, disbursement, and use of funds by the local government.** However, the CFO may not use that title. The letter might, instead, be labeled as the CFO's letter but be signed by the local government treasurer or some other official. The person signing the CFO letter must be the

functional equivalent of the CFO. Sometimes it will be quite clear that the CFO has not signed the letter. For example, if it is signed by the "Assistant Treasurer," that person is unlikely to be the "chief" financial officer. An "Acting Chief Financial Officer," on the other hand, probably meets the requirements of the rule because there is no superior financial officer, at least temporarily. If there is any reason for doubt, request documentation, such as a copy of local government by-laws or a local government resolution, that demonstrate the person's authority to sign the CFO letter.

#### **C.6 Requesting Reports of Financial Condition**

The Director of the implementing agency may require reports of financial condition at any time from the local government owner or operator using the bond rating test. Such requests are likely to be rare.

#### **C.7 Notifying the Owner or Operator That It No Longer Meets the Bond Rating Test**

If you find that the local government owner or operator no longer meets the requirements of the bond rating test, you should notify the owner or operator to arrange alternate assurance within 30 days.

**D. SOURCES OF FURTHER INFORMATION**

*Background Document in Support of Financial Self-Test for Local Governments Subject to the Financial Responsibility Requirements of Subtitle I of the Resource Conservation and Recovery Act, U.S. Environmental Protection Agency, Office of Underground Storage Tanks (November, 1992).*

*Response to Comments on the June 18, 1990 Proposed Rule to Provide Additional Mechanisms for Local Government Entities to Demonstrate Financial Responsibility for Underground Storage Tanks, EPA Office of Underground Storage Tanks (November, 1992).*

The Association of Financial Guaranty Insurers (AFGI) is the trade association of the insurers and reinsurers of municipal bonds.

[THIS PAGE INTENTIONALLY LEFT BLANK]

### 13. FINANCIAL RESPONSIBILITY USING THE LOCAL GOVERNMENT FINANCIAL TEST

This chapter describes the use of the local government financial test to demonstrate UST FR as follows:

A. BACKGROUND	212
A.1 What Is the UST Local Government Financial Test of Self-insurance?	212
A.2 How Does the UST Local Government Financial Test of Self-insurance Work?	212
A.3 Who Can Use the Test?	213
A.4 What Data Does the Test Require?	213
A.5 What are Independent Auditors' Opinions?	214
A.6 What Does the Local Government Financial Test Measure?	217
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING THE LOCAL GOVERNMENT FINANCIAL TEST	219
B.1 Determining Eligibility to Use the Local Government Financial Test	219
B.2 Satisfying the Criteria of the Local Government Financial Test for Proper Scope and Amount of Coverage	219
B.3 Preparing a Properly Worded Letter from the Chief Financial Officer	220
B.4 Recordkeeping	220
B.5 Updating Assurance Annually	221
B.6 Obtaining Alternate Assurance If the Local Government Can No Longer Satisfy the Local Government Financial Test	221
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named as a Debtor in Bankruptcy Proceedings	221
B.8 Responding to Requests for Reports of Financial Condition	221
B.9 Submitting Financial Responsibility Documents	222
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	223
C.1 Responding to Notices That the Local Government Can No Longer Satisfy the Financial Test and Has Not Obtained Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings	223
C.2 Reviewing Financial Responsibility Submissions	224
C.3 Checking Whether the Local Government Is Eligible to Use the Financial Test	224
C.4 Verifying That the Local Government Satisfies the Financial Test for Proper Scope and Amount of Coverage	225
C.5 Verifying the Wording of the Chief Financial Officer Letter	226
C.6 Checking the Qualifications of Accountants	226
C.7 Requesting Reports of Financial Condition	226
C.8 Notifying the Owner or Operator That the Local Government No Longer Meets the Financial Test	226
D. SOURCES OF FURTHER INFORMATION	227

## A. BACKGROUND

Local government entities are, in general, more financially stable than private companies. Most local governments, unlike private entities, have the authority to levy taxes or to independently set rates, which provides a consistent, reliable source of income. In contrast to corporations, they are less likely to dissolve or merge with other entities which means that they are less likely to have abrupt changes in financial structure. They are, by definition, geographically fixed, eliminating potential concerns that they may move and abandon their USTs. They rarely go bankrupt, and even bankruptcy does not allow local government entities to void their legal obligations. Assurance that local government owners and operators will be financially responsible for their UST related obligations, therefore, can be based primarily on evidence of financial stability and prudent financial management.

### A.1 What Is the UST Local Government Financial Test of Self-insurance?

A local government owner and operator may satisfy the UST FR requirements by using the local government **financial test of self-insurance**. A local government financial test is an option in many government-mandated financial responsibility programs, both environmental and non-environmental (e.g., FR for workers compensation). Self-insurance often will be the least expensive method of demonstrating FR. Financially viable local governments can provide evidence of financial responsibility without having to pay the costs of procuring financial mechanisms from other parties. Typically, local governments that use a self-insurance option demonstrate financial strength by passing a set of pass/fail criteria, termed a financial test. To pass the UST FR local government financial test, an owner or operator must attain an appropriate score on a worksheet based on **year-end financial statements** for the latest completed **fiscal year**.

### A.2 How Does the UST Local Government Financial Test of Self-insurance Work?

This option is **self-insurance** because it involves no source of funding other than the local government owner or operator itself. The local government owner or operator using the financial test must itself fund any corrective action and third-party compensation. **Those who pass the test are expected to be able to pay for their corrective action and third-party compensation obligations.** How these local governments arrange to pay their obligations is solely their decision. Passing the test does not limit the owner or operator's liability for corrective action and third-party compensation. The test is designed so that those who pass are very unlikely to experience financial distress that prevents their performance of corrective action and third-party compensation.

Because the owner or operator's financial statements form the basis of the assurance provided, the test must be passed anew with each year's financial statements. Within 120 days after the close of each fiscal year, the chief financial officer of the local government owner or operator must sign a letter reporting the year-end financial information supporting use of the financial test. If an owner or operator finds that it is no longer eligible to use a financial test, the owner or operator must obtain an alternate mechanism within 150 days of the end of the fiscal year. The Director of the implementing agency may disqualify use of the local government financial test upon a finding, based on reports of financial condition, that the owner or operator no longer meets the local government financial test requirements. The owner or operator has 30 days after notification of such a finding to obtain another financial assurance mechanism.



### A.3 Who Can Use the Test?

Only local government owners or operators can use the test. Local government entities are created under state constitutions and statutes, and consequently vary significantly from state to state. As recognized by the Bureau of the Census, local government entities generally fall into the categories shown in Exhibit 12-1 of chapter 12. Local government entities include both general purpose local governments and special purpose local governments:

- **General purpose local governments** include municipalities, counties, townships, towns, villages, parishes, and New England towns.
- **Special purpose local governments** include organizations that perform a single function or a limited range of functions. Special purpose local governments generally are designated as either "special districts" or "public authorities" such as school districts, water and sewer authorities, transit authorities, redevelopment authorities, or power authorities. Special districts may be authorized by state charter or constitution or may be established by general purpose governments.

EPA designed the local government financial test, also called the "worksheet test," for local governments that cannot use the bond rating test described in Chapter 12 because they have less than \$1 million in outstanding investment grade bonds. To be eligible to use the financial test, the local government owner or operator must have the ability and authority to assess and levy taxes or to freely establish fees and charges. Most local governments will satisfy this requirement, as described in Section A.3 of Chapter 12.

### A.4 What Data Does the Test Require?

The local government owner or operator must have the following information available, based on year-end financial statements for the latest completed fiscal year:

- *Total revenues*: sum of general fund operating and non-operating revenues including net local taxes, licenses and permits, fines and forfeitures, revenues from use of money and property, charges for services, investment earnings, sales (property, publications, etc.), intergovernmental revenues (restricted and unrestricted), and total revenues from all other governmental funds including enterprise, debt service, capital projects, and special revenues, but excluding revenues to funds held in a trust or agency capacity. For the local government financial test, the calculation of total revenues must exclude all transfers between funds (interfund transfers) under the direct control of the local government using the financial test, liquidation of investments, and issuance of debt.
- *Total expenditures*: sum of general fund operating and non-operating expenditures including public safety, public utilities, transportation, public works, environmental protection, cultural and recreational, community development, revenue sharing, employee benefits and compensation, office management, planning and zoning, capital projects, interest payments on debt, payments for retirement of debt principal, and total expenditures from all other governmental funds including enterprise, debt service, capital projects, and special revenues. For purposes of the local government financial test, the calculation of total expenditures must exclude all transfers between funds (interfund transfers) under the direct control of the local government using the financial test.

- *Local revenues*: total revenues (as defined above) minus the sum of all transfers from other governmental entities, including all monies received from federal, state, or local government sources.
- *Debt service*: sum of all interest and principal payments on all long-term credit obligations and all interest-bearing short-term credit obligations. Includes interest and principal payments on general obligation bonds, revenue bonds, notes, mortgages, judgments, and interest bearing warrants. Excludes payments on non-interest-bearing short-term obligations, interfund obligations, amounts owed in a trust or agency capacity, and advances and contingent loans from other governments.
- *Total funds*: sum of cash and investment securities from all funds, including general, enterprise, debt service, capital projects, and special revenue funds, but excluding employee retirement funds, at the end of the local government's financial reporting year. Includes Federal securities, Federal agency securities, state and local government securities, and other securities such as bonds, notes, and mortgages. For purposes of the local government financial test, the calculation of total funds must exclude agency funds, private trust funds, accounts receivable, value of real property, and other non-security assets.
- *Population*: the number of people in the area served by the local government.
- *Investment grade bond ratings*: local government entities can not have outstanding bonds rated as less than investment grade, even if this amount is less than \$1 million. This limitation on the use of the worksheet test applies to the general obligation debt of general purpose local governments and to outstanding revenue bonds of those local government entities that are legally restricted from issuing general obligation bonds. (See Chapter 12 Section A.6)
- *Auditor's opinion*: if financial statements are independently audited (see below).

## A.5 What are Independent Auditors' Opinions?

An independent auditor's opinion addresses whether a set of financial statements conforms with **generally accepted accounting principles (GAAP)** and **government auditing standards** issued by the Comptroller General of the United States.

Local governmental entities are audited by either private, independent certified public accountants or independent certified public accountants working for the **state auditor's office**. As an example, a State Auditor's Office may contract with independent certified public accountants to conduct the audits for all the cities and counties in the state, but use accountants from the State Auditor's Office to audit other local governmental entities such as public universities and state agencies. In order to identify who conducted the audit, contact the State Auditor's Office or the local government entity in question.

An independent auditor's opinion has a standardized format based on the *Statement of Accounting Standards* (SAS) 58. The opening paragraph is introductory in nature. It differentiates between the responsibilities of local government management and the auditor. The second paragraph describes the scope of the audit, which must be performed in accordance with generally accepted auditing standards and government auditing standards. The third paragraph presents the opinion itself. For local government entities a fourth paragraph is often included to indicate the use of government auditing standards in considering the local government's internal controls. For UST FR, the fourth paragraph can be ignored. The opinion paragraph is key.

Most financial statements receive an **unqualified** (or "clean") **opinion**, which usually consists of four short paragraphs (such as those shown in Exhibit 13-1) expressing no doubts about the financial statements. By stating that the financial statements conform to GAAP, the auditor indicates satisfaction with the accounting principles that local government management has chosen and the estimates employed.

**Exhibit 13-1**  
**EXAMPLE LANGUAGE FOR UNQUALIFIED AUDITOR OPINIONS**

"We have audited the general purpose financial statements of the County of ABC as of and for the year ended June 30, 1997, as listed in the accompanying table of contents. These general purpose financial statements are the responsibility of the County's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the County of ABC as of June 30, 1997, and the results of its operations and the cash flows of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated November 14, 1997 on our consideration of the County's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants."

*Source: Adapted from an actual audit report taken from the World Wide Web.*

**Qualified opinions** express some reservations by the accountant that the financial statements fairly or completely represent the financial condition and operating results of the local governmental entity. The major types of qualified auditors' opinions include the following:

- A **qualified opinion** given when the accountant has identified **uncertainties** (e.g., litigation, payment of liabilities) that could have a material impact on the operations of the local governmental entity, but the auditor believes that the financial statements otherwise represent fairly the economic condition of the local governmental entity. See Exhibit 13-2 for an example of a qualified opinion.
- An **adverse opinion** is given when the accountant believes that the financial statements do not present fairly the financial condition of the local governmental entity. The auditor will clearly state this in the third paragraph of the opinion. See Exhibit 13-3 for an example of an adverse opinion.
- A **disclaimer of opinion** is given when the accountant cannot express an opinion on the financial statements of the local governmental entity. A report on examination will still be given, but the third paragraph will state that the auditor has not expressed an opinion on the financial statements.

**Exhibit 13-2**  
**EXAMPLE OF A QUALIFIED OPINION**

“The general purpose financial statements referred to above do not include financial data of the [identify the component unit(s) omitted], which should be included in order to conform with generally accepted accounting principles. If the omitted component unit(s) had been included the assets and revenues of the [identify fund type(s) - for example, special revenue fund type-or component units column(s)] would have been increased by \$XXX,XXX and \$XXX,XXX, respectively, there would have been an excess of expenditures over revenues in that fund type [or component unit(s)] of \$ XXX,XXX for the year, and the [identify fund type(s) or discretely presented component unit column] fund balance would have been a deficit of \$XXX,XXX.

In our opinion, except for the effects on the financial statements of the omission described in the preceding paragraph, the general-purpose financial statements referred to above present fairly, in all material respects, the financial position of the County of ABC as of June 30, 1997, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds for each year then ended in conformity with generally accepted accounting principles.”

**Exhibit 13-3**  
**EXAMPLE OF AN ADVERSE OPINION**

“The general purpose financial statements referred to above do not include financial data of the [identify the component unit(s) omitted], which should be included in order to conform with generally accepted accounting principles.

Because of the departure from generally accepted accounting principles identified above, as of June 30, 1997, the assets and revenues of the [identify fund type(s)-for example, special revenue fund type-or component unit column(s)] would have increased by \$XXX,XXX and \$XXX,XXX, respectively, there would have been an excess of expenditures over revenues in the fund type [or component unit(s)] for the year of \$XXX,XXX and the [identify fund type(s) or components unit(s)] fund balance would have been a deficit of \$XXX,XXX.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the general-purpose financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of the County of ABC, as of June 30, 1997, or the results of its operations or the cash flows of its proprietary fund types and nonexpendable trust funds for the year ended.

*Source: Auditing and Accounting Guide - State and Local Governments, Appendix A.”*

**For an owner or operator to qualify for self-insurance, the independently audited financial statements can not carry an adverse opinion or a disclaimer of opinion by an independent certified public accountant. These types of auditor's opinions disqualify a local government from using the financial test.**

## A.6 What Does the Local Government Financial Test Measure?

The variables used in the local government financial test are listed below with a brief description of each.

- **Total Revenue to Population** is interpreted as a measure of the government's ability to raise funds, either from its citizens or from other sources, and is one of three measures of burden included in the test. EPA assumed that a higher ratio is, in general, related to ability and willingness to pay for governmental services. The variable does not include proceeds of bond issues.
- **Total Expenses to Population** is included as a measure of the demand of the population for municipal services, and is one of three measures of burden included in the test. The definition of expenditures excludes repayment of the principal on debt. As with the ratio of Total Revenue to Population, EPA assumed that higher ratios indicate greater ability to respond to emergencies.
- **Local Revenue to Total Revenue** measures the fraction of revenue obtained from local sources. Within the test, a higher fraction can be interpreted as providing a higher assurance of continued revenue, as well as a greater flexibility in allocating the funds to an UST release, if necessary.
- **Debt Service to Population** is one of three measures of burden on the population to meet fixed expenses for repaying debt. Assuming that state or federal aid will not generally provide for meeting debt payments, higher values suggest higher levels of local burden and lower flexibility in reallocating budgets to respond to emergencies.
- **Debt Service to Total Revenue** is a measure of the fraction of revenue devoted to debt service payments. Because these are fixed costs, a higher ratio reduces the likelihood of a government being able to reallocate funds to pay for an UST release.
- **Total Revenue to Total Expenditures** is the excess of revenues over expenditures (if greater than one). In this calculation, revenues and expenditures exclude transfers to and from enterprise funds, funds spent in refunding bonds, and funds obtained through new issues of long-term bonds. Higher ratios indicate a healthier financial condition.
- **Funds Balance to Total Revenue** is a measure of the cash and marketable securities maintained by the government. Larger ratios indicate that the government is more successful at raising and saving money for longer term projects, and may indicate better fiscal management.
- **Funds Balance to Total Expenses** is similar to Funds Balance to Total Revenue, and is correlated with the same factor. In its analysis, EPA used the two ratios together to represent the factor "Funds Coverage."
- **Total Funds to Population** measures the cash and marketable securities maintained by the government relative to the population served. Larger ratios indicate that the government is more successful at raising and saving reserves, and may indicate better fiscal management. This ratio is correlated with a different factor than the ratios of total funds to total revenue or total funds to total expenses, indicating that it is a different measure of solvency.

EPA designed the test to isolate the fraction of governmental entities that are in poor financial condition from those other governments that, in general, have sufficient resources and flexibility to respond to an UST release.

**B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING THE LOCAL GOVERNMENT FINANCIAL TEST**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT FINANCIAL TEST</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Determining Eligibility to Use the Local Government Financial Test (see Section B.1)</li><li><input type="checkbox"/> Satisfying the Criteria of the Local Government Financial Test for Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Preparing a Properly Worded Letter from Chief Financial Officer (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Updating Assurance Annually (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If the Local Government Can No Longer Satisfy the Local Government Financial Test (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named as a Debtor in Bankruptcy Proceedings (see Section B.7)</li><li><input type="checkbox"/> Responding to Requests for Reports of Financial Condition (see Section B.8)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.9)</li></ul>

**B.1 Determining Eligibility to Use the Local Government Financial Test**

Only a local government is eligible for the local government financial test. To be eligible to use the test, the local government owner or operator must have the ability and authority to assess and levy taxes or to freely establish fees and charges. Specific data requirements may preclude some special districts from using the worksheet test.

**B.2 Satisfying the Criteria of the Local Government Financial Test for Proper Scope and Amount of Coverage**

Scope of Coverage. The local government financial test can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). The local government financial test can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the local government financial test can be used to cover the other scope area. The local government financial test must cover the full scope of UST FR (see B.2 in Chapter 2 above) unless used in combination with another mechanism that covers the remaining part of the full scope.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a local government financial test with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the local government financial test for part of the required scope of coverage, the financial test also would work for the full scope. (Of course, apart from demonstrating compliance, the local government owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. The amount of required coverage is not an input to the local government financial test. Whether a local government owner or operator can pass the test is the issue.

Financial Test Criteria. The owner or operator must meet the following criteria:

- The local government's year-end financial statements cannot include an adverse auditor's opinion or disclaimer of opinion if independently audited.
- The local government cannot have outstanding issues of general obligation or revenue bonds that are rated at less than investment grade.
- Using the worksheet, the owner or operator must calculate a score for each of nine ratios. The individual scores are then added and adjusted to calculate a total score. Local governments must have a total score above zero in order to use the test as a mechanism for demonstrating UST FR.

### **B.3 Preparing a Properly Worded Letter from the Chief Financial Officer**

The local government owner or operator must prepare a letter signed by its chief financial officer (CFO) worded as specified in §280.105(c) within 120 days of the close of each financial reporting year. The financial reporting year is defined as the twelve-month period for which financial statements used to support the financial test are prepared. By signing the CFO letter, the owner or operator certifies that the letter is properly worded.

### **B.4 Recordkeeping**

An owner or operator using the local government financial test for UST FR must maintain on-site or at the place of business the following documents:

- A copy of the signed *CFO letter* for the most recent completed financial reporting year.
- Updated copy of the *certification of FR* (described in Chapter 2 Section D.5).

Such evidence must be on file on site or at the place of business no later than 120 days after the close of each fiscal year.

Although not required, an owner or operator using the worksheet test may also want to maintain the following information at the same location:

- A copy of the underlying data (e.g., year-end financial statements) used to compute the worksheet,
- Data from Moody's or Standard & Poor's, showing the ratings for all outstanding general obligation or revenue bonds; and
- Auditor's opinion, if financial statements are independently audited.



## **B.5 Updating Assurance Annually**

A local government owner or operator must update the CFO letter annually. From year-to-year the following data in the CFO letter may change:

- Total Revenues
- Total Expenditures
- Local Revenues
- Debt Service
- Total Funds
- Population
- Bond Ratings
- Auditors' Opinions

## **B.6 Obtaining Alternate Assurance If the Local Government Can No Longer Satisfy the Local Government Financial Test**

An owner or operator must obtain alternate assurance in the following circumstances:

- Within 150 days of the end of the fiscal year, if the owner or operator finds that it is no longer qualified to use the local government financial test.
- Within 30 days after receiving notice of a finding by the Director of the implementing agency that disqualifies use of the local government financial test because the owner or operator no longer meets the test requirements.

## **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named as a Debtor in Bankruptcy Proceedings**

A local government owner or operator using the local government financial test must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 150 days after determining, or within 30 days of being informed, that it no longer passes the local government financial test. The owner or operator must notify the Director of the failure within 10 days.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

## **B.8 Responding to Requests for Reports of Financial Condition**

An owner or operator using the local government financial test must respond to requests for reports of financial condition by providing the requested documents to the Director of the implementing agency.

## **B.9 Submitting Financial Responsibility Documents**

**According to the federal reporting regulations**, an owner or operator who uses the local government financial test must submit a copy of the CFO's letter to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release
- When the owner or operator fails to obtain alternate coverage
  - ~ within 150 days after finding that the owner or operator no longer meets local government financial test requirements or
  - ~ within 30 days after notification by the Director that the owner or operator does not meet local government financial test requirements
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding under the U.S. Bankruptcy Code naming the owner or operator as debtor
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) reporting.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR LOCAL GOVERNMENT FINANCIAL TEST</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Responding to Notices That the Local Government Can No Longer Satisfy the Financial Test and Has Not Obtained Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Reviewing Financial Responsibility Submissions (see Section C.2)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Checking That the Local Government Is Eligible to Use the Financial Test (see Section C.3) <input type="checkbox"/> Verifying That the Local Government Satisfies the Financial Test for Proper Scope and Amount of Coverage (see Section C.4) <input type="checkbox"/> Verifying the Wording of the Chief Financial Officer Letter (see Section C.5) <input type="checkbox"/> Checking the Qualifications of Accountants (see Section C.6) <input type="checkbox"/> Requesting Reports of Financial Condition (see Section C.7) <input type="checkbox"/> Notifying the Owner or Operator That the Local Government No Longer Meets the Financial Test (see Section C.8)

### C.1 Responding to Notices That the Local Government Can No Longer Satisfy the Financial Test and Has Not Obtained Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that an owner or operator that has been using the local government financial test is no longer qualified and cannot obtain alternate assurance. Although local government owners or operators may experience deterioration in their financial strength, most ought to be able to secure alternate assurance. However, following receipt of such a notice from the local government owner or operator, you should monitor the efforts being made to secure alternate assurance. This could include alerting the operator about the situation if the owner had been providing the financial assurance, and vice versa. Typically, alternate assurance is available, but its price may be more than the local government owner or operator wishes to pay.

Owner or Operator Named A Debtor in Bankruptcy. Similarly, it is unlikely that an owner or operator using the local government financial test will be named as a debtor in bankruptcy proceedings. If that happens, it represents a serious potential gap in coverage in the event of a release or a need for third-party compensation. It is very unlikely but possible that the discovery of a release or appearance of a claim for compensation would itself cause the owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>30</sup> Apart from that route, if the owner or

---

<sup>30</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous* (continued...)

operator are different parties, you could alert the operator to the need for alternate assurance if the owner has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, implementing agencies will receive unsolicited copies of the CFO letter from the local government owner or operator demonstrating financial responsibility **only** in the following circumstances:

- Within 30 days after the owner or operator identifies a release that must be reported
- After the owner or operator fails to obtain alternate assurance after finding or being notified that it no longer passes the local government financial test
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor

In the first situation, the implementing agency may want to ensure that the local government financial test criteria have been satisfied so that, if not, the owner or operator can be instructed to obtain alternate assurance. See C.4 below for details. In the second situation, there is no point in reviewing the CFO letter because failure to pass the test has already been established. Rather, efforts should focus on securing alternate assurance. Likewise, in the third situation, there is little benefit to review of the CFO's letter because it does not represent a claim on the owner or operator's assets. Again, explore opportunities for securing alternate assurance.

**NOTE:** A CFO letter does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Section C.4 below for review of such submissions.

## C.3 Checking Whether the Local Government Is Eligible to Use the Financial Test

Only local governments can use the local government financial test. Other entities can not use this option to demonstrate FR. In addition, the financial statements used for the test must be those of the owner or operator. If the financial statements are those of another local government entity, the owner or operator may be able to demonstrate UST FR by using a local government guarantee, as described in Chapter 14.

To be eligible to use the financial test, the local government owner or operator must have the ability and authority to assess and levy taxes or to freely establish fees and charges. If you have any questions about local government authority, you can consult with the local government itself, the chartering local government (e.g., for non-general purpose entities chartered by general purpose entities), or the state government.

---

<sup>30</sup> (...continued)

*Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

#### C.4 Verifying That the Local Government Satisfies the Financial Test for Proper Scope and Amount of Coverage

If a local government passes the local government financial test, it can provide assurance for the full scope and required amount of UST FR. Owners or operators have no need to combine this mechanism with any other in order to demonstrate compliance.

Scope of Coverage. The local government financial test can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the local government financial test will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the local government financial test can be used to cover the other scope area. Because the owner and operator are responsible for performing corrective action and satisfying compensation obligations anyway, you need not be overly concerned with the scope of coverage of the financial test of self-insurance even when it is used in combination with other mechanisms. Rather, it is more important that you verify that the test criteria have been met.

To demonstrate compliance with UST FR, an owner or operator need not combine a local government financial test with an insurance policy that covers only part of the scope (e.g., third-party liability but not corrective action). In such a situation, if the owner or operator can use the local government financial test for part of the required scope of coverage, the financial test would also work for the full scope. (Of course, apart from demonstrating compliance using the local government financial test, the owner or operator might want to purchase insurance to manage its financial risks.)

Financial Test Criteria. Checking the qualifications of the owner or operator against the requirements of the local government financial test can be laborious. Verifying the mathematics is important given the large number of calculations involved. However, before verifying the details of the test, you may first want to check that the CFO letter is based on the financial statements of the owner or operator and not on the financial statements of another government entity. If the CFO letter is based on the financial statements of another government entity (e.g., the chartering entity of a special district), you can direct the owner or operator to resubmit the letter based on its own financial statements or switch to the government guarantee mechanism (described in Chapter 14).

If the local government owner or operator has independently audited financial statements, you should review the auditor's opinion to ensure it is not adverse or a disclaimer of opinion. See discussion in A.4 above. If it is, you need not proceed any further in the review because the owner or operator must obtain alternate assurance.

To verify that the local government's bond ratings are **investment grade**, see the discussion in Section C.4 of Chapter 12.

The last step is to verify that the data used in the local government financial test are correct. This will involve comparing the local government's financial statements with the data in the CFO letter. This may be very difficult, depending on the complexity of the local government's finances and the clarity and level of detail of its financial statements. At a minimum, you can ask the local government owner or operator to explain how the numbers in the CFO letter were derived from the financial statements and whether the local government deviated from any of the definitions contained in the regulations. Going any further beyond this level will require the assistance of professionals with training in accounting and/or finance.

## C.5 Verifying the Wording of the Chief Financial Officer Letter

Verifying the wording of the CFO letter is a straightforward activity. The CFO letter must match the required wording, without any additions, omissions, or changes. However, unlike other FR documents, minor deviations in the wording or format of the CFO letter will have little impact on the effectiveness of the financial test, unless the changes affect the substance of the financial test criteria. Look for the following in the CFO's letter:

- The letter should be signed by the person who is officially designated as the Chief Financial Officer of the owner or operator. **In the case of local government owners and operators, a CFO is the individual with the overall authority and responsibility for the collection, disbursement, and use of funds by the local government.** However, the CFO may not use that title. The letter might, instead, be labeled as the CFO's letter but be signed by the local government treasurer or some other official. The person signing the CFO letter must be the functional equivalent of the CFO. Sometimes it will be quite clear that the CFO has not signed the letter. For example, if it is signed by the "Assistant Treasurer," that person is unlikely to be the "chief" financial officer. An "Acting Chief Financial Officer," on the other hand, probably meets the requirements of the rule because there is no superior financial officer, at least temporarily. If there is any reason for doubt, request documentation, such as a copy of local government by-laws or a local government resolution, that demonstrate the person's authority to sign the CFO letter.

## C.6 Checking the Qualifications of Accountants

Although falsification of credentials is rare, to confirm that the independent auditor responsible for preparing the opinion is certified by an officially recognized accreditation organization, you can contact the State Board of Accountancy in the state where the auditor resides, if there is any doubt about the accountant's qualifications. To verify that the auditor is independent, you can contact the state auditor's office.

## C.7 Requesting Reports of Financial Condition

The Director of the implementing agency may require reports of financial condition at any time from the local government owner or operator using the local government financial test.

## C.8 Notifying the Owner or Operator That the Local Government No Longer Meets the Financial Test

If you find that the local government owner or operator no longer meets the requirements of the local government financial test, you should notify the owner or operator to arrange alternate assurance within 30 days.

**D. SOURCES OF FURTHER INFORMATION**

*Background Document in Support of Financial Self-Test for Local Governments Subject the Financial Responsibility Requirements of Subtitle I of the Resource Conservation and to Recovery Act, U.S. Environmental Protection Agency, Office of Underground Storage Tanks (November, 1992).*

*Response to Comments on the June 18, 1990 Proposed Rule to Provide Additional Mechanisms for Local Government Entities to Demonstrate Financial Responsibility for Underground Storage Tanks, EPA Office of Underground Storage Tanks (November, 1992).*

[THIS PAGE INTENTIONALLY LEFT BLANK]



## 14. FINANCIAL RESPONSIBILITY USING A LOCAL GOVERNMENT OR STATE GUARANTEE

This chapter describes the use of the government guarantee to demonstrate UST FR as follows:

A. BACKGROUND	231
A.1 What Is the UST Local Government or State Guarantee?	231
A.2 How Does the UST Government Guarantee Work?	231
A.3 Who Can Provide A Guarantee?	232
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT OR STATE GUARANTEES	234
B.1 Selecting an Eligible Guarantor	234
B.2 Determining That Guarantor Satisfies the Qualifications for the Bond Rating Test, Financial Test, or Local Government Fund for the Proper Scope and Amount of Coverage	234
B.3 Obtaining a Properly Worded Government Guarantee and Letter from the Chief Financial Officer of the Government Guarantor	235
B.4 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust (If Applicable)	236
B.5 Recordkeeping	236
B.6 Obtaining Alternate Assurance If the Local Government Guarantor Is No Longer Eligible or Qualified to Satisfy the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements; If the Guarantor Decides to Cancel or Not to Renew the Guarantee; or If Guarantor Has Been Named as a Debtor in Bankruptcy Proceedings	236
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy Proceedings	237
B.8 Submitting Financial Responsibility Documents	237
B.9 Replenishing Assurance after Guarantee Is Used for Corrective Action and/or Third-Party Compensation	238
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	239
C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings	239
C.2 Reviewing Financial Responsibility Submissions	240
C.3 Making Funds Available for Corrective Action and Third-Party Compensation	241
C.4 Monitoring Replenishment of Assurance after Guarantee Is Used for Corrective Action and/or Third-Party Compensation	244
C.5 Checking Whether the Local Government Is Eligible to Use and Provide A Guarantee	244
C.6 Checking Whether the Standby Trustee is Eligible (If Applicable)	245
C.7 Verifying That the Local Government Guarantor Can Satisfy the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements for the Proper Scope and Amount of Coverage	245

C.8	Verifying the Wording of the Guarantee, the Chief Financial Officer Letter, and Standby Trust Fund .....	245
C.9	Requesting Reports of the Guarantor's Financial Condition .....	246
C.10	Notifying the Owner or Operator That the Local Government Guarantor No Longer Meets the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements .....	246
D.	STATE OR LOCAL GOVERNMENT GUARANTOR RESPONSIBILITIES .....	247
D.1	Being Either the State in Which the Owner or Operator Is Located or a Local Government Having a "Substantial Governmental Relationship" with the Owner or Operator .....	247
D.2	Satisfying Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements for the Proper Scope and Amount of Coverage (Local Government Guarantor Only) .....	247
D.3	Delivering CFO Letter and Signed Guarantee to Owner or Operator .....	248
D.4	Notifying Owner or Operator of Decision to Cancel or Non-Renew the Guarantee, If No Longer Eligible or Qualified to Provide Guarantee, or If Named as a Debtor in Bankruptcy Proceedings .....	248
D.5	Fund a Standby Trust or Make Funds Available as Instructed .....	248
E.	SOURCES OF FURTHER INFORMATION .....	250

## A. BACKGROUND

Local government entities are, in general, more financially stable than private companies. Most local governments, unlike private entities, have the authority to levy taxes or to independently set rates, which provides a consistent, reliable source of income. In contrast to corporations, they are less likely to dissolve or merge with other entities which means that they are less likely to have abrupt changes in financial structure. They are, by definition, geographically fixed, eliminating potential concerns that they may move and abandon their USTs. They rarely go bankrupt, and even bankruptcy does not allow local government entities to void their legal obligations. Assurance that local government owners and operators will be financially responsible for their UST related obligations, therefore, can be based primarily on evidence of financial stability and prudent financial management.

### A.1 What Is the UST Local Government or State Guarantee?

A local government owner or operator may satisfy the UST FR requirements by obtaining a **local or state government guarantee**. A **guarantee** is a promise by one party (the **guarantor**) to pay specified debts or satisfy the specified obligations of another party (the **principal**) in the event that the principal fails to satisfy its debts or obligations. In the UST government guarantee, if the local government owner or operator fails to perform corrective action or third-party compensation or provide alternate FR when required, the guarantor agrees either to pay the costs or fund a standby trust from which the implementing agency will direct the payment of corrective action and/or third-party compensation costs.

This mechanism provides local government owners and operators with a financial assurance mechanism comparable to the corporate guarantee allowed for private owners and operators of USTs. The governmental guarantee differs from the corporate guarantee in two key respects.

- Unlike the corporate guarantee, local governments can choose between a guarantee with or without a standby trust requirement.
- Certification by the state Attorney General is not required for the government guarantee.

### A.2 How Does the UST Government Guarantee Work?

The government guarantee works differently depending on whether or not a **standby trust** is involved:

- In a government guarantee **with** a standby trust, the guarantor agrees to fund a standby trust in the event that owner or operator fails to pay corrective action or third-party compensation costs or to provide alternate assurance when required.
- In a government guarantee **without** a standby trust, the guarantor agrees to provide funds for corrective action and third-party compensation as directed by the implementing agency on an ongoing basis, up to the limits of the guarantee. Rather than fully funding a standby trust, the guarantor makes the payments directly as funds are required.

**NOTE:** The use of a standby trust is necessary because without such a mechanism, any funds drawn under the corporate guarantee that are payable to the EPA Regional Administrator would have to be paid into the U.S. Treasury and could not be used without Congressional action (see 31 U.S.C. 3302) to pay for

the UST corrective action or third-party compensation for which the funds were intended. Due to similar state laws, funds payable to the state Director may have to be paid into the state treasury, unless a standby trust is used.

The guarantee is likely to be used primarily by governments with close and long-standing ties. Using this mechanism, a municipality, for example, might obtain a guarantee from its state, a town might obtain a guarantee from the surrounding county or parish, or a special district might obtain a guarantee from the sponsoring local government entity. **The guarantee mechanism was developed to allow governments with common interests to cooperate to keep necessary USTs in operation.** However, no government is required to act as a guarantor.

This option differs from self-insurance because it involves a source of UST financial responsibility other than the owner or operator.

Within 120 days after the close of each financial reporting year, if the guarantor finds that it is no longer eligible or qualified to provide a guarantee, the guarantor must notify the owner or operator. The guarantee will terminate no less than 120 days after the date that the owner or operator receives the notification. The owner or operator has 30 days after receipt of the notification to obtain another financial assurance mechanism.

When a guarantee without a standby trust fund is used, there is a limitation on the ability of the guarantor to cancel the guarantee. If notified of a probable release, the guarantor remains bound for all corrective action and third-party compensation costs arising from the release, up to the coverage limits specified in the guarantee, notwithstanding cancellation of the guarantee with respect to other releases.

The contractual language specified for the guarantee explicitly limits the guarantor's obligation to the per-occurrence and aggregate amounts for UST corrective action and third-party liability compensation as stated on the face of the instrument. Exclusionary language in the terms of the guarantee clearly limit the type and circumstances of third-party liability compensation for which the guarantee can be used. A guarantor may, however, have incurred obligations outside those of the UST FR guarantee contract, under state law or other contractual agreements with the owner or operator. Such legal obligations (e.g., guarantee of workers compensation FR) are not changed by the limitations in the UST FR guarantee.

### **A.3 Who Can Provide A Guarantee?**

To be **eligible** to provide a guarantee, a local government must have a "**substantial governmental relationship**" with the owner and operator and issue the guarantee as an act incident to that relationship. This parallels the requirement in the corporate guarantee for a "substantial business relationship," while recognizing that the types of relationships between governments are fundamentally different than business relationships and that they are primarily based on common or overlapping constituencies.

Most guarantees will be based on clear and significant governmental relationship such as overlapping geographical boundaries, common taxing or service constituencies, or shared impact from an UST release. Examples include: (1) a guarantee offered by a county to an incorporated city located partially or entirely within the limits of the county; (2) a guarantee offered by one county to another if both counties cover a common aquifer subject to contamination by UST releases; (3) a guarantee offered by the state to a local government within the state; or (4) a guarantee offered by a general purpose local government to independent school district, water district, utility district, or other special district serving the guarantor in whole or in part. The requirement of a "substantial governmental relationship" is intended to ensure that the guarantee contract

is founded on a sufficient basis to be held valid and enforceable and not in conflict with state insurance laws and regulations. EPA concluded that the existence of a "substantial governmental relationship" should address these concerns.

Certain types of organizations can not serve as government guarantors. In promulgating its final regulations, EPA determined that an intergovernmental risk pool, based on a contractual relationship to provide safety and risk management services, should not be allowed to operate as a guarantor because the nature of the relationship is strictly monetary and does not necessarily involve a substantial governmental relationship. EPA also determined that a "joint action agency," a not-for-profit entity created by state law to allow publicly-owned utilities to combine resources for various purposes, is not eligible to act as a government guarantor because joint action agencies are nonprofit organizations and not government entities.

Local governments wishing to provide a guarantee should seek clarification of their authority if they are unsure whether they may issue guarantees.

Guarantors must demonstrate that they are **qualified** to provide financial assurance by satisfying either the bond rating test, the financial test, or the local government fund requirements for the required amount of coverage. These options are described in Chapters 12, 13, and 15, respectively. Guarantors who qualify are expected to be able to pay for corrective action and third-party compensation obligations if the owner or operator does not. Guarantors who meet those requirements are very unlikely to experience financial distress that prevents their funding corrective action and third-party compensation. Because the guarantor's financial qualifications form the basis of the assurance provided, the guarantor must review its qualifications every year.

**NOTE:** Although guarantors may cease to be eligible or qualified, the guarantee itself remains effective until it is cancelled or terminated.

**B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT OR STATE GUARANTEES**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT OR STATE GUARANTEES</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Selecting an Eligible Guarantor (see Section B.1)</li><li><input type="checkbox"/> Determining That Guarantor Satisfies the Qualifications for the Bond Rating Test, Financial Test, or Local Government Fund for the Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Obtaining a Properly Worded Guarantee and Letter from the Chief Financial Officer of the Government Guarantor (see Section B.3)</li><li><input type="checkbox"/> Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust (If Applicable) (see Section B.4)</li><li><input type="checkbox"/> Recordkeeping (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If the Local Government Guarantor Is No Longer Eligible or Qualified to Satisfy the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements; If the Guarantor Decides to Cancel or Not to Renew the Guarantee; or If Guarantor Has Been Named as a Debtor in Bankruptcy Proceedings (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named a Debtor in Bankruptcy Proceedings (see Section B.7)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.8)</li><li><input type="checkbox"/> Replenishing Assurance after Guarantee Is Used for Corrective Action and/or Third-Party Compensation (see Section B.9)</li></ul>

**B.1 Selecting an Eligible Guarantor**

A local government owner or operator must select as a guarantor either the state in which the local government owner or operator is located or another local government having a substantial government relationship with the owner or operator and issuing the guarantee as an act incident to that relationship.

**B.2 Determining That Guarantor Satisfies the Qualifications for the Bond Rating Test, Financial Test, or Local Government Fund for the Proper Scope and Amount of Coverage**

A local government owner or operator must ensure that its local government guarantor:

- Passes the bond rating test (see Chapter 12), or
- Passes the worksheet test (see Chapter 13), or
- Meets the local government fund requirements (see Chapter 15).

These qualifications need not be met by a state acting as guarantor.

Scope of Coverage. The government guarantee can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). The government guarantee can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the government guarantee can be used to cover the other

scope area. The government guarantee must cover the full scope of UST FR (see B.2 in Chapter 2 above) unless used in combination with another mechanism that covers the remaining part of the full scope.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a government guarantee with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the government guarantee for part of the required scope of coverage, the government guarantee would also work for the full scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A government guarantee must be in an amount that is at least equal to the required amount of coverage. The exception to this rule is when a government guarantee is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the **sum** of the coverage provided by the mechanisms that must be at least equal to the required amount of coverage.

**NOTE:** The government guarantee may be combined with a local government financial test of self-insurance only if the financial statements of the local government owner or operator are not consolidated (i.e., combined) with the financial statements of the local government guarantor.

**B.3 Obtaining a Properly Worded Government Guarantee and Letter from the Chief Financial Officer of the Government Guarantor**

Guarantee. The guarantee agreement must be worded as specified in §280.106(d) or §280.106(e), depending on whether the guarantor is a state or local government and whether or not a standby trust is involved. If, in the default or incapacity of the owner or operator, the guarantor is to fund a standby trust, the guarantee must be worded as specified in 280.106(d). If, in the default or incapacity of the owner or operator, the guarantor is to make payments for taking corrective action or compensating third parties for bodily injury and property damage, the guarantee must be worded as specified in paragraph 208.106(e). The four options for the guarantee are shown in Exhibit 14-1:

<b>Exhibit 14-1</b>		
<b>FOUR OPTIONS FOR GOVERNMENT GUARANTEES</b>		
	Guarantor	
	Local Government	State Government
With Standby Trust	280.106(d)	280.106(d)
Without Standby Trust	280.106(e)	280.106(e)

CFO Letter. The owner or operator must obtain a properly worded letter from the chief financial officer (CFO) of the local government guarantor, as described in Chapters 12, 13, and 15.

#### **B.4 Finding an Eligible Trustee and Obtaining a Properly Worded Standby Trust (If Applicable)**

Trustee. An eligible trustee must satisfy two requirements: (1) it must be an entity that has the authority to act as a trustee and (2) its trust operations must be regulated and examined by a federal or state agency. If there is any doubt about whether the entity is empowered to act as a trustee, the owner or operator can ask the entity what authority regulates it and then contact the authority to determine whether the entity has the power to act as trustee. See Chapter 11 for further details.

Standby Trust. The wording of the standby trust agreement must be identical to the wording specified in §280.103(b)(1), and must be accompanied by a formal certification of acknowledgment as specified in §280.103(b)(2). See Chapter 11 for details.

#### **B.5 Recordkeeping**

A local government owner or operator using the government guarantee must maintain on-site or at the place of work the following documents:

- An originally signed and dated *guarantee contract*,
- *Letter* signed by the local government guarantor's chief financial officer demonstrating satisfaction of the bond rating test, financial test, or local government fund requirements,
- Records required by the mechanism -- bond rating test, financial test, or local government fund -- being used by the local government guarantor to demonstrate its qualifications:
  - ~ Copy of the guarantor's *bond rating* published within the last 12 months by Moody's or Standard & Poor's, if the guarantor is using the bond rating test
  - ~ Copy of the guarantor's *year-end financial statements* for the most recent completed financial reporting year, if the guarantee is based on the local government financial test
  - ~ Copy of the guarantor's *year-end financial statements* for the most recent completed financial reporting year, showing the amount of the fund, if the guarantee is based on the local government fund
- Updated copy of a *certification of FR* (described in Chapter 2 Section D.5),
- Copy of the signed *standby trust fund agreement* and copies of any amendments to the agreement, if applicable,

#### **B.6 Obtaining Alternate Assurance If the Local Government Guarantor Is No Longer Eligible or Qualified to Satisfy the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements; If the Guarantor Decides to Cancel or Not to Renew the Guarantee; or If Guarantor Has Been Named as a Debtor in Bankruptcy Proceedings**

A local government owner or operator must obtain alternate assurance in the following circumstances:

- Within 30 days after receiving notice from the local government guarantor that it is unable to satisfy the bond rating test, financial test, or local government fund requirements



- Within 60 days of receiving a notice that the guarantor intends to cancel or not renew the guarantee
- Within 30 days after receiving notice that the local government guarantor has been named as a debtor in bankruptcy proceedings

**NOTE:** When a guarantee without a standby trust fund is used, there is a limitation on the ability of the guarantor to cancel the guarantee. If notified of a probable release, the guarantor remains bound for all corrective action and third-party compensation costs arising from the release, up to the coverage limits specified in the guarantee, notwithstanding cancellation of the guarantee with respect to future releases.

### **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named A Debtor in Bankruptcy Proceedings**

A local government owner or operator must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 60 days after receiving notification that the guarantor intends to cancel or not renew the guarantee. The owner or operator must notify the Director of the failure within 10 days. The notification must include
  - ~ the name and address of the guarantor
  - ~ the effective date of termination
  - ~ required records (see B.5 above)
- Failure to obtain alternate assurance within 30 days after receiving notification that the local government guarantor is unable to satisfy the bond rating test, financial test, or local government fund requirements or has been named as a debtor in bankruptcy proceedings
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The owner or operator must notify the Director within 10 days by certified mail.

### **B.8 Submitting Financial Responsibility Documents**

**According to the federal reporting regulations,** the local government owner or operator that uses a government guarantee must submit FR documents to the implementing agency **only** in the following circumstances:

- Within 30 days after identifying a reportable release;
- When the owner or operator fails to obtain alternate coverage;
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the local government owner or operator as debtor;
- At any time if requested by the implementing agency.

State regulations may require more frequent (e.g., annual) reporting.

### **B.9 Replenishing Assurance after Guarantee Is Used for Corrective Action and/or Third-Party Compensation**

If funds **are paid** for corrective action and/or third-party compensation from a guarantee or from a standby trust supporting a guarantee, the local government owner or operator must either:

- Replenish the value of the guarantee or standby trust to equal the full amount of coverage required, or
- Acquire another financial assurance mechanism for the amount by which funds have been spent.

(Because funding the standby trust fund alone does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) This replenishment must occur on the anniversary date of the government guarantee. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT FOR LOCAL GOVERNMENT OR STATE GUARANTEES</b>
<b>Implementing Agency Responsibilities</b>
<input type="checkbox"/> Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings (see Section C.1) <input type="checkbox"/> Reviewing Financial Responsibility Submissions (see Section C.2) <input type="checkbox"/> Making Funds Available for Corrective Action and Third-Party Compensation (see Section C.3) <input type="checkbox"/> Monitoring Replenishment of Assurance after Guarantee Is Used for Corrective Action and/or Third-Party Compensation (see Section C.4)
<b>Implementing Agency Oversight</b>
<input type="checkbox"/> Checking Whether the Local Government Is Eligible to Use and Provide a Guarantee (see Section C.5) <input type="checkbox"/> Checking Whether the Standby Trustee is Eligible (If Applicable) (see Section C.6) <input type="checkbox"/> Verifying That the Local Government Guarantor Can Satisfy the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements for the Proper Scope and Amount of Coverage (see Section C.7) <input type="checkbox"/> Verifying the Wording of the Guarantee, the Chief Financial Officer Letter, and Standby Trust Fund (see Section C.8) <input type="checkbox"/> Requesting Reports of the Guarantor's Financial Condition (see Section C.9) <input type="checkbox"/> Notifying the Owner or Operator That the Local Government Guarantor No Longer Meets the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements (see Section C.10)

### C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that a guarantor is no longer qualified or has decided to cancel the guarantee and the owner or operator cannot obtain alternate assurance. Most owners or operators ought to be able to secure alternate assurance. However, following receipt of such a notice, you may want to monitor the efforts being made by the owner or operator to secure alternate assurance. This could include alerting the operator about the situation if the owner had been providing the financial assurance through a guarantee, and vice versa. Typically, alternate assurance is available, but its price may be more than the owner or operator wishes to pay.

If it does not appear that alternate assurance is immediately forthcoming, you may want to draw upon the guarantee. In order to draw upon the guarantee, the Director must

- Ascertain the date the guarantee will be cancelled by the guarantor
- Investigate whether a release has occurred or may have occurred

- Determine whether there is supposed to be an effective standby trust in place, and, if it is not, instruct the owner or operator to establish one quickly, and
- If the Director determines or suspects that a release has occurred, notify the guarantor and direct payment into the standby trust fund unless the guarantee does not involve a standby trust.

These activities must be completed before the guarantee is cancelled. **If you suspect, have determined, or have been notified that a release has occurred, you may not want to miss your opportunity to direct payments to the standby trust fund in hope that the owner or operator will secure alternate assurance. You can always release funds from the standby trust if the owner or operator does secure alternative assurance.**

**NOTE:** Termination of the guarantee is almost as worrisome as bankruptcy of the guarantor. After previously committing to provide a guarantee, a state or local government decision to terminate or cancel the guarantee may be evidence of a reduced level of support to the local government owner or operator.

**NOTE:** When a guarantee without a standby trust fund is used, there is a limitation on the ability of the guarantor to cancel the guarantee. If notified of a probable release, the guarantor remains bound for all corrective action and third-party compensation costs arising from the release, up to the coverage limits specified in the guarantee, notwithstanding cancellation of the guarantee with respect to future releases.

Owner or Operator Named A Debtor in Bankruptcy. Similarly, it is unlikely that a guarantor will be named as a debtor in bankruptcy proceedings. If that happens, it represents a potential gap in coverage in the event of a release or a need for third-party compensation. The guarantee itself is not affected by the owner or operator's entry into bankruptcy proceedings. However, if the guarantee is being provided by a special purpose local government chartered by the owner or operator, the owner or operator's bankruptcy filing may have implications for the financial capability of the guarantor, with which it has a relationship.

It is very unlikely but possible that the discovery of a release or appearance of a claim for compensation would itself cause the owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>31</sup> Apart from that route, if the owner and operator are different parties, you could alert the owner to the need for alternate assurance if the operator has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules,** you will receive unsolicited copies of the guarantee, the guarantor's CFO letter, and the standby trust fund (if applicable) from the owner or operator **only** in the following circumstances:

- Within 30 days after the owner or operator identified a release that must be reported

---

<sup>31</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

- Within 30 days after the owner or operator fails to obtain alternate assurance after being notified that the guarantor
  - ~ no longer is eligible or qualified to pass the bond rating test, the financial test, or the local government fund requirements
  - ~ intends to cancel or non-renew the guarantee, or
  - ~ has been named as a debtor in a voluntary or involuntary bankruptcy proceeding
- Within 10 days after commencement of a voluntary or involuntary proceeding under Title 11 (Bankruptcy), U.S. Code, naming the owner or operator as debtor.

In the first situation, you may want to ensure that the guarantee is properly worded, the local government guarantor is eligible and qualified, and the standby trust (if applicable) is effective so that, if not, the owner or operator can be instructed to remedy the problem(s) or obtain alternate assurance. See C.4 through C.6 below for details. In the second situation, there is no point in reviewing the CFO letter because the incapacity of the local government guarantor has already been established. **The key document is the guarantee, which remains effective even if the guarantor is no longer eligible or qualified.** You should ensure that the guarantee is properly worded and the standby trust (if applicable) is effective so you may call upon the guarantee as needed. In the third situation, you also may want to ensure that the guarantee is properly worded, the local government guarantor is eligible and qualified, and the standby trust (if applicable) is effective so that you may call upon the guarantee as needed.

**NOTE:** A CFO letter and guarantee do not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.4 through C.6 below for review of such submissions.

### **C.3 Making Funds Available for Corrective Action and Third-Party Compensation**

If the guarantee involves a standby trust fund the Director must instruct the guarantor to deposit funds into the standby trust.<sup>32</sup> If the guarantee does not involve a standby trust fund, the Director must direct the guarantor to make payments for corrective action and third-party compensation.

When to Direct Payments. The guarantee clearly describes the situations in which you may draw or direct funds; the Director does not have unlimited discretion to draw on the guarantee. You may instruct the guarantor to make funds available or may direct payments into the standby trust fund as shown in Exhibit 14-2.

---

<sup>32</sup> Directing payments out of the standby trust fund is described in Chapter 11, Section C.2.

**Exhibit 14-2**  
**CONDITIONS FOR MAKING FUNDS AVAILABLE FROM**  
**GOVERNMENT GUARANTEE**

Situation

(1) If the owner or operator fails to establish alternative financial assurance within 60 days of receiving notice of cancellation of its financial assurance mechanism, and

(i) the Director of the implementing agency determines or suspects<sup>1</sup> that a release has occurred

OR

(ii) the owner or operator has notified the Director of a release pursuant to Subparts E or F

(2) The Director makes a final determination that a release has occurred and immediate or long-term corrective action for the release is needed, and

the owner or operator, after appropriate notice and opportunity to comply, has not conducted corrective action as required under 40 CFR Part 280, Subpart F

(3) The Director has received either:

(i) Certification from the owner or operator, the third-party liability claimant(s), and attorneys representing the owner or operator and the third-party liability claimant(s) that a third-party liability claim should be paid

OR

(ii) A valid final court order establishing a judgment against the owner or operator for bodily injury or property damage caused by an accidental release from an underground storage tank covered by financial assurance and the Director determines that the owner or operator has not satisfied the judgment.

<sup>1</sup> The Director's suspicion that a release has occurred must be based on objective evidence, such as failure of a tank tightness test, discovery of free product in adjacent sewer and utility lines, notice by the owner or operator, or other clear but unverified evidence. Evidence of a suspected release under §280.50 includes positive monitoring results from testing, monitoring and sampling, unusual operating conditions, or the discovery of petroleum in the environment.

How Much Payment to Direct. The amount of directed payment may differ depending on whether or not a standby trust is involved. If a standby trust is not involved, payment amounts should be based on the actual costs of the corrective action or third-party compensation, based on invoices, settlement agreements, or court orders, as applicable. The guarantor can be directed to make payments on an as needed basis, even if the guarantee has been cancelled, much as an insurer will continue to process an active claim even if the policy is no longer in effect for new claims.

If there is a standby trust **and** the guarantee is to be terminated, you cannot rely on an "as needed" payment approach but must consider how much to fund the standby trust before the guarantee terminates. The amount of funds directed to be paid into the standby trust cannot exceed the amount of coverage specified in the guarantee. You may direct a smaller amount, but should do so only in limited circumstances. If the owner or operator has failed to provide alternate assurance, it is appropriate to direct the full amount into the standby trust fund. If the owner or operator has failed to perform corrective action, you may consider, when deciding how much to direct, the following: the estimated cost of the corrective action (including a contingency factor) and whether the owner or operator is responsible for other USTs. The conservative course is to direct the full amount into the standby trust fund. Similarly, if the owner or operator has failed to provide third-party compensation, you may consider, when deciding how much to direct, the following: the amount of the judgment, award, or settlement; any pending claims or litigation; and whether the owner or operator is responsible for other USTs. The conservative course is to direct the full amount into the standby trust fund.

How to Direct Payments. In directing payments, include appropriate language drawn from the guarantee in your instructions as follows:

- "Because the owner or operator has failed to provide alternate coverage within 60 days after receipt of a notice of cancellation of this guarantee and the Director of the implementing agency has determined or suspects that a release has occurred at an underground storage tank covered by this guarantee, you are instructed in accordance with the provisions of 40 CFR 280.112 to deposit funds in *name and address of standby trustee and name and account number of standby trust.*"
  
- "Because the owner or operator has failed to perform corrective action for releases arising out of the operation of the above-identified tank(s) covered by this guarantee, you are instructed in accordance with the provisions of 40 CFR 280.112 to
  - ~ deposit funds in *name and address of trustee and name and account number of standby trust*"
  - OR**
  - ~ pay *name and address of owner or operator, or the contractor performing the corrective action*"
  
- "Because the owner or operator has failed to satisfy a judgment or award based on a determination of liability for bodily injury or property damage to third parties caused by accidental releases arising from the operation of the above-identified tank(s), or has failed to pay an amount agreed to in settlement of a claim arising from or alleged to arise from such injury or damage covered by this guarantee, you are instructed in accordance with the provisions of 40 CFR 280.112 to
  - ~ deposit funds in *name and address of trustee and name and account number of standby trust*"
  - OR**
  - ~ pay *name and address of the attorney representing the third-party claimants*"

For the owner or operator's failure to obtain alternative coverage, the instructions need not be in writing, though written instructions are recommended to avoid misunderstandings. For the owner or operator's failure to perform corrective action and failure to provide third-party compensation, the instructions must be in writing.<sup>33</sup> Send your instructions by certified mail (after verifying the proper office to be addressed) and specify the latest date when funds are to be deposited in the standby trust or paid. You will need to provide the guarantor with the name and address of the trustee and the name and account number of the standby trust to facilitate deposit of funds.

Priority of Payments. The UST FR mechanisms and procedures for distributing funds do not require the implementing Agency or the provider of the mechanism to decide on the validity and priority of claims. If the Director of the implementing agency determines that the amount of corrective action costs and third-party liability claims eligible for payment may exceed the amount of available financial assurance, the first priority for payment should be corrective action costs necessary to protect human health and the environment. The Director should pay third-party liability claims in the order in which the Director receives certifications and valid court orders.

---

<sup>33</sup> When a standby trust is not involved, all instructions must be in writing.

#### **C.4 Monitoring Replenishment of Assurance after Guarantee Is Used for Corrective Action and/or Third-Party Compensation**

The owner or operator is responsible for replenishing financial assurance if the guarantee has been drawn upon to pay corrective action and/or third-party compensation costs. (Because funding the standby trust fund does not reduce the total amount of assurance provided, there is no need to replenish assurance until after payments are made from the standby trust fund.) The owner or operator must either:

- Renew the guarantee to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds have been expended.

This replenishment must occur on the anniversary date of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. You may need to remind the owner or operator of this responsibility. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

However, because the guarantee is drawn upon only when the owner or operator fails to provide alternate assurance, fails to perform corrective action, or fails to satisfy a liability judgment or award, the owner or operator also may fail to replenish the guarantee. If that happens, you could instead determine whether the owner or operator are different parties. If they are, you can seek needed UST FR from the party other than the one that has failed to comply.

#### **C.5 Checking Whether the Local Government Is Eligible to Use and Provide A Guarantee**

Only local governments are eligible to **use** the government guarantee to demonstrate UST FR. Other entities can not use this option to demonstrate FR. Only a state or local government is eligible to **provide** a government guarantee. In promulgating the final regulations for local governments, EPA concluded that because joint action agencies that allow publicly-owned utilities to combine resources for various purposes are nonprofit organizations and not governmental entities, they are not eligible to act as government guarantors. If you are uncertain whether the owner or operator is a local government or a non-profit entity, you can directly question the owner or operator about its status.

In promulgating the final regulations, EPA also concluded that an intergovernmental risk pool based on a contractual relationship to provide safety and risk management services should not be allowed to operate as a guarantor, because the nature of the relationship is strictly monetary and does not necessarily involve a substantial governmental relationship.

The only state eligible to issue a state guarantee is the state in which the local government owner or operator is located. No out-of-state UST facilities should be listed on a state guarantee.

See Chapters 12, 13, and 15 for other eligibility requirements for local government guarantors, depending on whether they are using the bond rating test, financial test, or local government fund.

#### **C.6 Checking Whether the Standby Trustee is Eligible (If Applicable)**

See Chapter 11, Section C, which describes how to check the eligibility of a standby trustee for UST FR.



## C.7 Verifying That the Local Government Guarantor Can Satisfy the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements for the Proper Scope and Amount of Coverage

To act as guarantor, a local government must:

- Pass the bond rating test (see Chapter 12), or
- Pass the worksheet test (see Chapter 13), or
- Meet the local government fund requirements (see Chapter 15).

To act as an UST guarantor, a state is not required to meet any of these requirements. You will need other documents beyond the CFO letter to conduct a complete review of the local government guarantor's qualifications. See Chapters 12, 13, and 15 for details.

Scope of Coverage. The government guarantee can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the government guarantee will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a fund that covers only corrective action and not third-party compensation (or vice versa), the government guarantee can be used to cover the other scope area. You should ensure that the scope of coverage of the guarantee is appropriate even when it is used in combination with other mechanisms.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a government guarantee with an insurance policy that covers only part of the scope (e.g., third-party liability but not corrective action). In such a situation, if the owner or operator can use the guarantee for third-party compensation FR, the guarantee would also work for corrective action FR. (Of course, apart from demonstrating compliance using the guarantee, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. The proper amount of coverage is the aggregate amount, which is either \$1 million or \$2 million depending on the number of tanks being covered unless the government guarantee is being used in combination with another mechanism. Combining the guarantee with another FR mechanism is an unlikely scenario with one exception: an owner or operator may choose to use the guarantee to cover amounts not assured by a state fund. For example, if a state fund provides aggregate coverage up to \$500,000, then the government guarantee could be used to cover an additional \$500,000 if the owner or operator has 100 or fewer USTs.

## C.8 Verifying the Wording of the Guarantee, the Chief Financial Officer Letter, and Standby Trust Fund

CFO Letter. Verifying the wording of the guarantor's CFO letter is a straightforward activity. Unlike the other FR mechanisms, deviations in wording or format of the CFO letter may have little impact on the effectiveness of the guarantee, unless the changes affect the substance of the bond rating test, worksheet test, or government fund criteria. The CFO's letter is intended to provide information in support of the guarantee, but does not create the guarantee. See discussion in Chapters 12, 13, and 15.

- The letter should be signed by the person who is officially designated as the Chief Financial Officer of the guarantor. **In the case of local government guarantors, a CFO is the individual with the overall authority and responsibility for the collection, disbursement, and use of**

**funds by the local government.** However, the CFO may not use that title. The letter might, instead, be labeled as the CFO's letter but be signed by the local government treasurer or some other official. The person signing the CFO letter must be the functional equivalent of the CFO. Sometimes it will be quite clear that the CFO has not signed the letter. For example, if it is signed by the "Assistant Treasurer," that person is unlikely to be the "chief" financial officer. An "Acting Chief Financial Officer," on the other hand, probably meets the requirements of the rule because there is no superior financial officer, at least temporarily. If there is any reason for doubt, request documentation, such as a copy of local government by-laws or a local government resolution, that demonstrate the person's authority to sign the CFO letter.

Guarantee. Deviations, omissions, or additions in the wording of the guarantee may compromise its effectiveness. The guarantee agreement establishes the terms and conditions of the guarantee. Without certain key phrases, the financial assurance mechanism has not been established. Therefore, the wording of the guarantee should be as identical as possible to that found in the rule.

Standby Trust (If Applicable). See Chapter 11, Section C, with respect to verifying the wording of the standby trust agreement.

### **C.9 Requesting Reports of the Guarantor's Financial Condition**

The Director of the implementing agency may require reports of financial condition at any time from the guarantor and may disallow use of the government guarantee if these reports demonstrate the bond rating, financial test, or local government fund criteria are no longer being met. See discussion in Chapters 12, 13, and 15, respectively. Any information (e.g., capital spending plans) not bearing on the requirements specified in the bond rating test, worksheet test, or government fund should not be requested and can not be used to disqualify a guarantor.

### **C.10 Notifying the Owner or Operator That the Local Government Guarantor No Longer Meets the Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements**

If you find that the guarantor no longer meets the necessary requirements, you should notify the owner or operator to arrange alternate assurance.

**D. STATE OR LOCAL GOVERNMENT GUARANTOR RESPONSIBILITIES**

The following checklist summarizes the state or local government guarantor's responsibilities:

<b>CHECKLIST OF STATE OR LOCAL GOVERNMENT GUARANTOR RESPONSIBILITIES</b>	
<input type="checkbox"/>	Being Either the State in Which the Owner or Operator Is Located or a Local Government Having a "Substantial Governmental Relationship" with the Owner or Operator (see Section D.1)
<input type="checkbox"/>	Satisfying Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements for the Proper Scope and Amount of Coverage (Local Government Guarantor Only) (see Section D.2)
<input type="checkbox"/>	Delivering CFO Letter and Signed Guarantee to Owner or Operator (see Section D.3)
<input type="checkbox"/>	Notifying Owner or Operator of Decision to Cancel or Non-Renew the Guarantee, If No Longer Eligible or Qualified to Provide Guarantee, or If Named as a Debtor in Bankruptcy Proceedings (see Section D.4)
<input type="checkbox"/>	Fund a Standby Trust or Make Funds Available as Instructed (see Section D.5)

**D.1 Being Either the State in Which the Owner or Operator Is Located or a Local Government Having a "Substantial Governmental Relationship" with the Owner or Operator**

The guarantor must be either

- The state in which the local government owner or operator is located or
- A local government having a "substantial governmental relationship" with the owner and operator and issuing the guarantee as an act incident to that relationship. EPA intended the requirement of a "substantial governmental relationship" to ensure that the guarantee contract is founded on a sufficient basis to be held valid and enforceable and not in conflict with State insurance laws and regulations.

A state can serve as a guarantor only for local governments located in its jurisdiction.

**D.2 Satisfying Bond Rating Test, Local Government Financial Test, or Local Government Fund Requirements for the Proper Scope and Amount of Coverage (Local Government Guarantor Only)**

Based on information from the owner or operator regarding the scope and amount (i.e., the number of tanks to be assured) of required coverage, the guarantor must demonstrate that it meets the bond rating, financial test, or local government fund criteria. See Chapters 12, 13, and 15, respectively, for specific requirements. A guarantor need satisfy only one of the three options.

At the end of the financial reporting year, the local government guarantor must determine whether it still meets the criteria. If not, the guarantor must notify the owner or operator.

A state can serve as a guarantor without meeting any of these requirements.

**D.3 Delivering CFO Letter and Signed Guarantee to Owner or Operator**

The guarantor must deliver a copy of the applicable CFO letter (depending on whether the guarantor uses the bond rating test, financial test, or local government fund) to the owner or operator, and sign the properly worded guarantee. By signing the guarantee, the guarantor certifies that the wording is identical to the wording specified in the regulations. The guarantor must sign the guarantee before a witness or notary.

The guarantee need be provided only one time to the owner or operator.

**D.4 Notifying Owner or Operator of Decision to Cancel or Non-Renew the Guarantee, If No Longer Eligible or Qualified to Provide Guarantee, or If Named as a Debtor in Bankruptcy Proceedings**

There are four circumstances that require the guarantor to notify the owner or operator:

Trigger	Requirement
(1) If the guarantor decides to cancel the guarantee	Notify owner or operator by certified mail at any time, but cancellation is not effective until 120 days after receipt
(2) If the guarantor is named as a debtor in bankruptcy proceedings	Notify owner or operator by certified mail within 10 days after commencement of the proceedings
(3) If the guarantor fails to meet the requirements of the bond rating test, financial test, or local government fund requirements at the end of any financial reporting year	Notify owner or operator within 120 days of the end of that financial reporting year by certified mail,
(4) If the guarantor receives a notification from the Director of the implementing agency that the guarantor no longer meets the requirements of the financial test	Notify owner or operator within 10 days of receiving notice from the Director

In Cases 1 and 3, the guarantee will terminate no less than 120 days after the date the owner or operator receives the notification, as evidenced by the return receipt.

When a guarantee without a standby trust fund is used, there is a limitation on the ability of the guarantor to cancel the guarantee. If notified of a probable release, the guarantor remains bound for all corrective action and third-party compensation costs arising from the release, up to the coverage limits specified in the guarantee, notwithstanding cancellation of the guarantee with respect to other releases.

**D.5 Fund a Standby Trust or Make Funds Available as Instructed**

Based on instructions from the Director of the implementing agency, the guarantor must fund a standby trust or make funds available to pay for corrective action or third-party compensation in the following circumstances:

- If the owner or operator fails to provide alternate coverage within 60 days after receipt of a notice of cancellation of the guarantee and the Director has determined or suspects that a release has occurred at an underground storage tank covered under the guarantee; or
- If the Director determines that the local government owner or operator has failed to perform corrective action for releases arising out of the operation of the guaranteed tanks.
- If the owner or operator has failed to satisfy a judgment or award based on a determination of liability for bodily injury or property damage to third parties caused by accidental releases arising from the operation of the guaranteed tanks, or has failed to pay an amount agreed to in settlement of a claim arising from or alleged to arise from such injury or damage covered by the guarantee

The guarantor must follow the instructions of the Director of the implementing agency and either deposit funds into the standby trust fund or make payments for corrective action and/or third-party compensation.

**E. SOURCES OF FURTHER INFORMATION**

*Background Document in Support of Financial Self-Test for Local Governments Subject the Financial Responsibility Requirements of Subtitle I of the Resource Conservation and to Recovery Act, U.S. Environmental Protection Agency, Office of Underground Storage Tanks (November, 1992).*

*Response to Comments on the June 18, 1990 Proposed Rule to Provide Additional Mechanisms for Local Government Entities to Demonstrate Financial Responsibility for Underground Storage Tanks, EPA Office of Underground Storage Tanks (November, 1992).*

## 15. FINANCIAL RESPONSIBILITY USING A LOCAL GOVERNMENT FUND

This chapter describes the use of a local government fund to demonstrate UST FR as follows:

A. BACKGROUND	252
A.1 What Is A Local Government Fund?	252
A.2 How Does the UST Local Government Fund Work?	252
A.3 Who Can Use It?	253
A.4 What Are the Three Options?	253
B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT FUND	255
B.1 Determining Eligibility of Local Government to Use the Local Government Fund	255
B.2 Satisfying the Criteria for the Local Government Fund for the Proper Scope and Amount of Coverage	255
B.3 Preparing a Properly Worded Letter from Chief Financial Officer	257
B.4 Recordkeeping	257
B.5 Checking Fund Balance Annually and Updating Assurance as Needed	257
B.6 Obtaining Alternate Assurance If No Longer Eligible or Qualified to Use Local Government Fund	258
B.7 Reporting Failure to Obtain Alternate Assurance or Being Named as a Debtor in Bankruptcy Proceedings	258
B.8 Responding to Requests for Reports of Financial Condition	258
B.9 Submitting Financial Responsibility Documents	258
B.10 Replenishing Assurance After Payments Are Made from the Local Government Fund	259
C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT	260
C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings	260
C.2 Reviewing Financial Responsibility Submissions	261
C.3 Monitor Replenishment of Assurance	261
C.4 Checking Whether the Local Government Is Eligible	262
C.5 Verifying That the Local Government Fund Satisfies the Qualifications for the Proper Scope and Amount of Coverage	262
C.6 Verifying the Wording of the Letter from the Chief Financial Officer	264
C.7 Requesting Reports of Financial Information	264
C.8 Notifying the Owner or Operator That the Local Government Fund Does Not Meet Necessary Criteria	264
D. SOURCES OF FURTHER INFORMATION	265

## **A. BACKGROUND**

Local government entities are, in general, more financially stable than private companies. Most local governments, unlike private entities, have the authority to levy taxes or to independently set rates, which provides a consistent, reliable source of income. In contrast to corporations, they are less likely to dissolve or merge with other entities which means that they are less likely to have abrupt changes in financial structure. They are, by definition, geographically fixed, eliminating potential concerns that they may move and abandon their USTs. They rarely go bankrupt, and even bankruptcy does not allow local government entities to void their legal obligations. However, some local governments may not be eligible or qualify to use the bond rating test or local government financial test. They may want to use a local government fund as their UST FR mechanism.

### **A.1 What Is A Local Government Fund?**

A local government owner or operator may satisfy the UST FR requirements by establishing or using a **local government fund** account. A local government fund is an option in some government mandated financial responsibility programs, both environmental and non-environmental (e.g., FR for workers compensation). An UST FR government fund must be more than an unfunded accounting entity or a carryover balance in a general fund. It must be funded and established as an **irrevocable fiduciary or trust** account, with proceeds invested in cash or readily marketable securities. This mechanism is similar to, but less formal than, the trust fund option described in Chapter 10.

A dedicated UST fund may be established through an order by any local government whose state charter grants the authority to issue an order establishing such a fund. In their state charters, local governments are granted express powers to conduct their primary business and implied powers to carry out those actions that are incidental and essential to the conduct of their business. Because meeting statutory and regulatory requirements is both incidental and essential to the operation of a local government, it would appear that, in general, such entities would have the legal authority to establish an UST fund. Because the specific authorities of local governments vary from state to state, however, and because within a state, each charter may be unique, a local government may want to obtain the advice of legal counsel before establishing a fund for UST corrective action and third-party compensation.

### **A.2 How Does the UST Local Government Fund Work?**

Under this option, the UST owner or operator pays for corrective action and third-party compensation from a fund dedicated specifically for UST releases or for general emergencies. A dedicated fund may not be combined with other local government funds or otherwise used in normal operations. Control of the local government fund rests with the local government. The fund may be administered by the treasurer or chief financial officer of the local government. States often permit local governments to administer fiduciary and trust accounts, such as pension funds and workers' compensation funds, while requiring private companies to use third-party trustees or to subscribe to state-maintained funds. EPA anticipated that local government UST funds would be administered following the standards used for other trust funds already maintained by local government entities, including pension trusts and worker's compensation funds.

The fund balances must be held as cash or investment securities that will be available in the event of an UST release and must be irrevocably dedicated to use for UST response or for responding to emergencies, including UST releases. As discussed below, EPA provided three alternatives that may be used for demonstrating FR.



### A.3 Who Can Use It?

Any local government can use this mechanism. Section A.4 of Chapter 12 describes the different types of local governments. At the time of promulgation of the mechanism, EPA expected that the local government fund was unlikely to be used widely by general purpose governments, because few who require an alternative mechanism to the bond rating and worksheet tests were expected to have adequate funds available. EPA expected that the local government fund mechanism would prove useful for special districts and school districts that may not be able to use the bond rating or worksheet tests.

### A.4 What Are the Three Options?

Any one of the following three options may be used to demonstrate UST financial responsibility.

Fully-Funded Dedicated Fund. Under this alternative, a local government establishes a separate fund dedicated to payment of UST corrective actions and third-party compensation, in the amount of its aggregate financial responsibility requirement. The fully-funded dedicated fund option does not require a local government to establish a third-party trustee for the fund. Instead, the fund can be administered by the treasurer or chief financial officer of the local government entity as a separate trust account.

General Emergencies Contingency Fund. Under this option, a local government uses a fund dedicated for general emergencies including response and third-party compensation (e.g., flood relief, hurricane relief, or other environmental cleanups) as evidence of UST financial responsibility. A fund used to cover both UST costs and other emergency costs incurred by local governments must be funded at **five times** the required amount of coverage to qualify as a mechanism for demonstrating financial responsibility. EPA developed this alternative as an administrative convenience for those local governments that already maintain large contingency funds.

**NOTE:** Local governments may prefer to establish a dedicated fund equal to their aggregate annual UST liability if doing so requires sequestering less money.

A fund balance of \$5 million will equal or exceed five times the aggregate financial assurance level for most local government entities, based on the number of USTs they own and operate. EPA expected the \$5 million requirement to assure the availability of funds for any number of UST releases should other emergency events occur in the same year. Thus, although the fund may not be solely dedicated to responding to UST releases, the required fund balance of five times the required amount of UST coverage was expected to assure adequate resources to respond to an UST emergency. This requirement is analogous to the requirement in the corporate financial test and guarantee that firms must have tangible net worth equal to at least ten times the aggregate required amount of coverage (see Section A.4 of Chapter 3).

Dedicated Pay-In Fund Combined With Unused Bonding Authority. Under this option, a local government must fund incrementally a fund dedicated for UST releases, making payments each year into the fund in an amount equal to at least one-seventh of the aggregate required amount of coverage. A local government using this alternative must fully fund the fund by the beginning of the seventh year. In addition, until the dedicated fund is fully funded, the local government must demonstrate its **bonding authority** in an amount at least equal to the difference between the required amount of coverage and the amount held in the dedicated fund. Bonding authority may consist of either:

- A voter-approved bond referendum specifically targeted for payment of the costs associated with an UST release, or

- Certification from the State Attorney General that the local government has the authority to issue the bonds without voter approval and that the proceeds of these bonds can be used to respond to an UST release.

EPA decided to require a demonstration of unused bonding authority in order to ensure that local governments have the capacity to respond to UST releases while allowing them to build a dedicated fund over time. In developing this option, EPA learned that local governments will frequently obtain a bond referendum **before** incurring costs related to specific projects, such as construction projects, and will **delay the issuance of the bonds until the funds are needed**. EPA concluded that there is both a precedent for having unused bonding authority and an incentive not to issue bonds unless necessary for actual payment of obligation.

**NOTE:** EPA offered this mechanism to local governments, but not private companies, for several reasons. First, local governments operate under statutory and constitutional limitations on debt issuance. By requiring prior voter approval or certification that such approval is not necessary, EPA relied on safeguards that do not exist for private companies. Second, local governments exist to provide public services, whereas private companies do not. Third, local governments have historically been much more stable than private companies. Fourth, local governments have the authority to levy taxes or raise fees and charges, a power which is not available to private companies.

## **B. OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT FUND**

The following checklist summarizes owner or operator responsibilities:

<b>CHECKLIST OF OWNER OR OPERATOR RESPONSIBILITIES WHEN USING LOCAL GOVERNMENT FUND</b>
<ul style="list-style-type: none"><li><input type="checkbox"/> Determining Eligibility of Local Government to Use the Local Government Fund (see Section B.1)</li><li><input type="checkbox"/> Satisfying the Criteria for the Local Government Fund for the Proper Scope and Amount of Coverage (see Section B.2)</li><li><input type="checkbox"/> Preparing a Properly Worded Letter from Chief Financial Officer (see Section B.3)</li><li><input type="checkbox"/> Recordkeeping (see Section B.4)</li><li><input type="checkbox"/> Checking Fund Balance Annually and Updating Assurance as Needed (see Section B.5)</li><li><input type="checkbox"/> Obtaining Alternate Assurance If No Longer Eligible or Qualified to Use Local Government Fund (see Section B.6)</li><li><input type="checkbox"/> Reporting Failure to Obtain Alternate Assurance or Being Named as a Debtor in Bankruptcy Proceedings (see Section B.7)</li><li><input type="checkbox"/> Responding to Requests for Reports of Financial Condition (see Section B.8)</li><li><input type="checkbox"/> Submitting Financial Responsibility Documents (see Section B.9)</li><li><input type="checkbox"/> Replenishing Assurance After Payments are Made from the Local Government Fund (see Section B.10)</li></ul>

### **B.1 Determining Eligibility of Local Government to Use the Local Government Fund**

Only a local government can use the local government fund. A private firm may not use this mechanism.

### **B.2 Satisfying the Criteria for the Local Government Fund for the Proper Scope and Amount of Coverage**

Scope of Coverage. The local government fund can be used for any scope of coverage (e.g., corrective action, third-party compensation, or both). The local government fund can be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a state fund that covers only corrective action and not third-party compensation (or vice versa), the local government fund can be used to cover the other scope area. The local government fund must cover the full scope of UST FR (see B.2 in Chapter 2 above) unless used in combination with another mechanism that covers the remaining part of the full scope.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a local government fund with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the local government fund for part of the required scope of coverage, the local government fund would also work for the full scope because the required amount of coverage used in the local government fund stays the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. Assets in the local government fund must be valued at their *current market value*. The proper amount of coverage depends on the fund option being used:

- The **fully-funded dedicated fund** must be funded for the total amount of required coverage, or funded for part of the required amount of coverage and used in combination with other mechanism(s) that provide the remaining coverage.
- The **emergency fund** must be funded for five times the full amount of required UST coverage, or funded for part of the required amount of UST coverage and used in combination with other mechanism(s) that provide the remaining coverage. If the emergency fund is funded for less than five times the required amount of coverage, the amount of financial responsibility demonstrated by the fund may not exceed one-fifth the amount in the fund.
- The amount of coverage in the **dedicated pay-in fund** depends on the number of years it has been in existence. A payment must be made to the pay-in fund once every year for seven years until the fund is fully-funded. The amount of each payment must be determined by this formula:

$$(TF-CF)/Y$$

TF: the total required amount of coverage

CF: the current amount in the fund

Y: the number of years remaining in the pay-in-period

Fund Criteria. A local government fund must meet one of the following requirements:

- The fund must be dedicated by state constitutional provision, or local government statute, charter, ordinance, or order, either:
  - ~ to pay for taking corrective action and for compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks, **OR**
  - ~ as a **contingency fund for general emergencies**, including taking corrective action and compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks.
- Under the pay-in fund, the local government owner or operator must have:
  - ~ the available bonding authority, approved through voter referendum (if such approval is necessary prior to the issuance of bonds), for an amount equal to the difference between the required amount of coverage and the amount held in the dedicated fund. This bonding authority must be available for taking corrective action and for compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks, **OR**
  - ~ a letter signed by the appropriate state attorney general stating that the use of the bonding authority will not increase the local government's debt beyond legal debt ceilings established by relevant state laws. The letter must also state that prior voter approval is not necessary before use of the bonding authority.

### **B.3 Preparing a Properly Worded Letter from Chief Financial Officer**

The local government owner or operator must prepare a letter signed by its chief financial officer (CFO) worded as specified in §280.105(c) within 120 days of the close of each financial reporting year. The financial reporting year is defined as the twelve-month period for which financial statements used to support the financial test are prepared. By signing the CFO letter, the owner or operator certifies that the letter is properly worded.

### **B.4 Recordkeeping**

A local government owner or operator using a local government fund for UST FR must maintain on-site or at the place of work the following documents:

- *Letter signed by the chief financial officer* (e.g., comptroller, controller, or treasurer) certifying the use of the local government fund mechanism
- *Copy of the state constitutional provision or local government statute, charter, ordinance, or order* authorizing the fund
- *Year-end financial statements* for the most recent completed financial reporting year showing the amount in the fund
- If the fund was established using incremental funding backed by bond authority
  - ~ *financial statements showing the previous year's balance, the amount of funding during the year, and the closing balance* in the fund
  - ~ *documentation of the required bonding authority, including either the results of a voter referendum or attestation by the State Attorney General*
- Updated copy of the *certification of FR*, described in Chapter 2, Section D.5

### **B.5 Checking Fund Balance Annually and Updating Assurance as Needed**

A local government fund must at all times contain sufficient assets, valued at their *current market value*, to satisfy UST FR requirements. The exception to this rule is when a local government fund is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

If the required amount of coverage is greater than the amount assured by the local government fund, the owner or operator must either (1) revise the local government fund to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the current market value of the local government fund.

Each fiscal year the local government must prepare an updated CFO letter. The following may change from year to year:

- Market value of local government fund at close of fiscal year
- Amount added to pay-in fund
- Number of years remaining in the pay-in period

#### **B.6 Obtaining Alternate Assurance If No Longer Eligible or Qualified to Use Local Government Fund**

A local government owner or operator must obtain alternate assurance in the following circumstances:

- Within 30 days after receiving notification of a finding by the Director of the implementing agency that the local government fund requirements are no longer being met

#### **B.7 Reporting Failure to Obtain Alternate Assurance or Being Named as a Debtor in Bankruptcy Proceedings**

A local government owner or operator using a local government fund must notify the Director of the implementing agency of the following:

- Failure to obtain alternate assurance within 30 days after being informed that the government fund no longer meets UST local government fund requirements.
- Being named a debtor following commencement of a voluntary or involuntary proceeding under the U.S. Bankruptcy Code. The local government owner or operator must notify the Director within 10 days by certified mail (see 40 CFR 280.114(a)).

#### **B.8 Responding to Requests for Reports of Financial Condition**

A local government owner or operator should respond to requests for reports of financial condition by providing the requested documents to the Director of the implementing agency.

#### **B.9 Submitting Financial Responsibility Documents**

**According to the federal regulations**, an owner or operator that uses the local government fund must submit a copy of the CFO letter and a copy of the state constitutional provision or local government statute, charter, ordinance, or order dedicating the fund **only** in the following circumstances:

- Within 30 days after identifying a reportable release. (See 40 CFR 280.110(a)(1).)
- When the owner or operator fails to obtain alternate coverage when required. (See 40 CFR 280.110(a)(2).)
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the local government owner or operator as debtor. (See 40 CFR 280.114(a).)
- At any time if requested by the implementing agency. (See 40 CFR 280.110(c).)

State regulations may require more frequent (e.g., annual) reporting.

## **B.10 Replenishing Assurance After Payments Are Made from the Local Government Fund**

The owner or operator is responsible for replenishing financial assurance if the local government fund has been drawn upon such that the remaining balance is less than the required amount of coverage. The owner or operator must either:

- Reimburse the local government fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which local government funds have been reduced.

This replenishment must occur on the anniversary date of the financial mechanism. If a combination of mechanisms is used, replenishment must occur at the earliest anniversary date among them. Replenishment assures that the FR mechanism complies with the annual aggregate component of required coverage, which ensures that funds are available for additional releases.

## C. IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT

The following checklist summarizes the implementing agency's responsibilities and potential oversight activities:

<b>CHECKLIST OF IMPLEMENTING AGENCY RESPONSIBILITIES AND OVERSIGHT OF LOCAL GOVERNMENT FUND</b>	
<b>Implementing Agency Responsibilities</b>	
<input type="checkbox"/>	Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings (see Section C.1)
<input type="checkbox"/>	Reviewing Financial Responsibility Submissions (see Section C.2)
<input type="checkbox"/>	Monitor Replenishment of Assurance (see Section C.3)
<b>Implementing Agency Oversight</b>	
<input type="checkbox"/>	Checking Whether the Local Government Is Eligible (see Section C.4)
<input type="checkbox"/>	Verifying That the Local Government Fund Satisfies the Qualifications for the Proper Scope and Amount of Coverage (see Section C.5)
<input type="checkbox"/>	Verifying the Wording of the Letter from the Chief Financial Officer (see Section C.6)
<input type="checkbox"/>	Requesting Reports of Financial Information (see Section C.7)
<input type="checkbox"/>	Notifying the Owner or Operator That the Local Government Fund Does Not Meet Necessary Criteria (see Section C.8)

### C.1 Responding to Notices That the Owner or Operator Has Failed to Secure Alternate Assurance or Has Been Named as a Debtor in Bankruptcy Proceedings

Failure to Obtain Alternate Assurance. It is unlikely that implementing agencies will receive notices that an owner or operator that has been using the local government fund is no longer qualified and cannot obtain alternate assurance. Although local government owners or operators may experience deterioration in their financial strength, most ought to be able to secure alternate assurance. However, following receipt of such a notice from the local government owner or operator, you should monitor the efforts being made to secure alternate assurance. This could include alerting the operator about the situation if the owner had been providing the financial assurance, and vice versa. Typically, alternate assurance is available, but its price may be more than the local government owner or operator wishes to pay.

Owner or Operator Named A Debtor in Bankruptcy. Similarly, it is unlikely that an owner or operator using the local government fund will be named as a debtor in bankruptcy proceedings. If that happens, it represents a potential gap in coverage in the event of a release or a need for third-party compensation **only to the extent that the local government fund is not fully-funded**. It is very unlikely but possible that the discovery of a release or appearance of a claim for compensation would itself cause the local government owner or operator to seek protection under the Bankruptcy Code. If the owner or operator has been named a debtor, you may want to consult EPA guidance on protecting financial responsibility and other environmental interests in bankruptcy.<sup>34</sup> Apart from that route, if funding is not complete and the owner or operator are

---

<sup>34</sup> See *EPA Participation in Bankruptcy Cases* (September 30, 1997), which supercedes *Guidance Regarding CERCLA Enforcement Against Bankrupt Parties*, OSWER Directive #9832.7 (May 24, 1984) and *Revised Hazardous* (continued...)



different parties, you could alert the operator to the need for alternate assurance if the owner has been named a debtor in bankruptcy, or vice versa.

## C.2 Reviewing Financial Responsibility Submissions

**Based on the federal reporting rules**, you will receive unsolicited copies of the CFO letter, the state constitutional provision or local government statute, charter, ordinance, or order dedicating the fund, and other evidence of FR described in Section B.4 above **only** in the following circumstances:

- Within 30 days after identifying a reportable release. (See 40 CFR 280.110(a)(1).)
- When the owner or operator fails to obtain alternate coverage when required. (See 40 CFR 280.110(a)(2).)
- Within 10 days after the commencement of a voluntary or involuntary bankruptcy proceeding naming the local government owner or operator as debtor. (See 40 CFR 280.114(a).)

In the first situation, the implementing agency may want to ensure that the fund satisfies the local government fund criteria, so that, if not, you can instruct the owner or operator to remedy the problem(s) or obtain alternate assurance. See C.4 and C.6 below for details on performing such a review. In the second situation, there is little point in reviewing the FR documents because failure to meet local government fund requirements has been established. Likewise, in the third situation, there is little benefit to review of the FR documents because they do not represent a claim on the owner or operator's assets.

**NOTE:** A CFO letter does not require extraordinary physical safeguards or care, as discussed in Section E.10 of chapter 2.

**NOTE:** Some states may require regular, annual reporting or may request evidence of FR for monitoring compliance. See Sections C.4 through C.6 below for review of such submissions.

## C.3 Monitor Replenishment of Assurance

The owner or operator is responsible for replenishing financial assurance whenever monies are withdrawn from a local government fund used for UST FR that leaves the current market value of the fund beneath UST FR requirements. The owner or operator must either:

- Replenish the value of the local government fund to equal the full amount of required coverage, or
- Acquire another mechanism for the amount by which funds in the local government fund fall short of the required amount of coverage.

This replenishment must occur on the anniversary date of the financial mechanism. You may need to remind the owner or operator of this responsibility.

---

<sup>34</sup> (...continued)

*Waste Bankruptcy Guidance*, OSWER Directive #9832.8 (May 23, 1986).

#### C.4 Checking Whether the Local Government Is Eligible

Only local governments can use the local government fund. Other entities can not use this option to demonstrate FR. In addition, the government fund used must be that of the owner or operator. If the fund is owned by another local government entity, the owner or operator may be able to demonstrate UST FR through a local government guarantee, as described in Chapter 14.

#### C.5 Verifying That the Local Government Fund Satisfies the Qualifications for the Proper Scope and Amount of Coverage

Scope of Coverage. The local government fund can be used for any scope of coverage (e.g., corrective action, third party compensation, or both). It is unlikely but possible that the local government fund will be used to complement another mechanism that covers only part of the scope (e.g., only corrective action, only third-party compensation) of required coverage. For example, if tanks are located in a state with a state fund that covers only corrective action and not third-party compensation (or vice versa), the local government fund can be used to cover the other scope area.

To demonstrate compliance with the full scope of UST FR, an owner or operator need not combine a local government fund with an insurance policy that covers only part of the scope (e.g., third-party liability but not on-site corrective action). In such a situation, if the owner or operator can use the local government fund for part of the required scope of coverage, the local government fund would also work for the full scope because the requirements of the local government fund stay the same whether the test is used for all or part of the scope. (Of course, apart from demonstrating compliance, the owner or operator might want to purchase insurance to manage its financial risks.)

Amount of Coverage. A local government fund must meet the UST FR funding requirements even when it is being combined with another FR mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

If the required level of coverage is greater than the current market value of the local government fund, or if the current market value of the local government fund declines below the required amount of coverage, the owner or operator must either (1) increase the level of assets in the local government fund to assure the appropriate amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the current market value of the local government fund. There are three reasons why the required amount of coverage can be greater than the current market value of the local government fund:

- The required amount of coverage increased because more than 100 USTs are being covered;
- The current market value of local government fund assets declined below the required amount of coverage due to market events; and
- Payments have been made out of the local government fund.

Your ability to independently verify the amount in the local government fund from the owner or operator's financial statements will depend on their level of detail and clarity. In most instances, you should find fund balances reported with other **fiduciary funds**. But local government financial statements may not report fiduciary fund balances individually. If the local government fund is not reported as a fiduciary or trust fund on the financial statements, you may want to inquire whether the funds actually exist or are merely accounting entities. In addition, local governments are generally free to move money into and out of their

various funds other than trust or fiduciary accounts, which is why you should be concerned if the local government fund is not designated as a trust or fiduciary fund.

Other Local Government Fund Criteria. To verify legal authority, check the state constitutional provision, or local government statute, charter, ordinance, or order that authorized the fund. This information must be attached to the CFO letter. Verify that the local government fund can pay for taking corrective action and compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks.

Verify that the contingency fund for general emergencies, can pay for taking corrective action and compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks. This may require some interpretation of the fund's charter, which cannot be either too narrow nor too broad. A local government "rainy day" fund may have too broad a charter and lack protections against transfers of funds to qualify as an "emergency" or "catastrophe" fund. A "general fund" balance would definitely not meet EPA's intent for this mechanism, even though money in the general fund likely could be used for UST corrective action and third-party compensation.

Check whether the emergency fund is funded for five times the full amount of required coverage. If the fund is funded for less than five times the amount of required coverage, the amount of financial responsibility demonstrated by the emergency fund may not exceed one-fifth the amount in the fund

For the pay-in fund, verify that a payment has been made to the fund once every year for seven years or that the fund is now fully-funded. The amount of each payment must be determined by this formula:

$$\frac{TF - CF}{Y}$$

Where TF is the total required financial assurance for the owner or operator, CF is the current amount in the fund, and Y is the number of years remaining in the pay-in-period.

For the pay-in fund, also verify that the local government owner or operator has available bonding authority, approved through voter referendum (if such approval is necessary prior to the issuance of bonds), for an amount equal to the difference between the required amount of coverage and the amount in the pay-in fund. Confirm that this bonding authority is available for taking corrective action and for compensating third parties for bodily injury and property damage caused by accidental releases arising from the operation of petroleum underground storage tanks. Alternatively, confirm that the local government owner or operator has a letter signed by the appropriate state attorney general stating that the use of the bonding authority will not increase the local government's debt beyond the legal debt ceilings established by the relevant state laws. The letter must also state that prior voter approval is not necessary before use of the bonding authority. **You may want the assistance of a professional with legal training in reviewing these documents, particularly if you have any concerns about their contents.**

## **C.6 Verifying the Wording of the Letter from the Chief Financial Officer**

Verifying the wording of the CFO letter is a straightforward activity. The CFO letter should match the required wording specified in 280.107(d). The CFO's letter provides important information about the local government fund. The following are key items to look for in the CFO's letter:

- The letter should be signed by the person who is officially designated as the Chief Financial Officer of the local government. **In the case of local government owners and operators, a CFO is the individual with the overall authority and responsibility for the collection, disbursement, and use of funds by the local government.** However, the CFO may not use that title. The letter might, instead, be labeled as the CFO's letter but be signed by the government treasurer or some other official. The person signing the letter must be the functional equivalent of the CFO. Sometimes it will be quite clear that the CFO has not signed the letter. For example, if it is signed by the "Assistant Treasurer," that person is unlikely to be the "chief" financial officer. An "Acting Chief Financial Officer" probably, on the other hand, meets the requirements of the rule because there is no superior financial officer, at least temporarily.
- The letter should show the fund balance and specify which of the three options is being used.
- If a pay-in fund is being used, the CFO letter should address which bonding authority option is being used, and include an attached letter signed by the State Attorney General, if applicable, stating that (1) the use of the bonding authority will not increase the local government's debt beyond the legal debt ceilings established by the relevant state laws and (2) that prior voter approval is not necessary before use of the bonding authority.
- A copy of the state constitutional provision, or local government statute, charter, ordinance, or order authorizing the fund should be attached.

## **C.7 Requesting Reports of Financial Information**

The Director of the implementing agency may require reports of financial condition at any time from the local government owner or operator using the local government fund.

## **C.8 Notifying the Owner or Operator That the Local Government Fund Does Not Meet Necessary Criteria**

If you find that the local government no longer meets the requirements of the local government fund, you should notify the owner or operator to obtain alternate assurance.

**D. SOURCES OF FURTHER INFORMATION**

*Background Document in Support of Financial Self-Test for Local Governments Subject the Financial Responsibility Requirements of Subtitle I of the Resource Conservation and to Recovery Act, U.S. Environmental Protection Agency, Office of Underground Storage Tanks (November, 1992).*

*Response to Comments on the June 18, 1990 Proposed Rule to Provide Additional Mechanisms for Local Government Entities to Demonstrate Financial Responsibility for Underground Storage Tanks, EPA Office of Underground Storage Tanks (November, 1992).*

[THIS PAGE INTENTIONALLY LEFT BLANK]

## 16. OTHER FINANCIAL RESPONSIBILITY MECHANISMS

This chapter describes the use of other financial responsibility mechanisms for demonstrating UST FR as follows:

A. BACKGROUND	268
A.1 What Criteria Can Be Used for Evaluating Potential Financial Assurance Mechanisms?	268
A.2 Which Mechanisms Were Found Not Acceptable for the Federal Rules?	270
B. ESCROW ACCOUNTS	272
B.1 What Is An Escrow Account?	272
B.2 How Would An UST Escrow Agreement Work?	273
B.3 What Should Be the Qualifications of the Escrow Agent?	273
B.4 Scope and Amount of Coverage	274
B.5 Wording of UST Escrow	274
B.6 Recommended Documentation and Recordkeeping	274
C. CERTIFICATES OF DEPOSIT	276
C.1 What Is A Certificate of Deposit?	276
C.2 How Does A CD Work for UST FR?	276
C.3 Qualifications of the Issuer	277
C.4 Scope and Amount of Coverage	278
C.5 Wording of UST CD	278
C.6 Recommended Documentation and Recordkeeping	279
D. DEPOSITS OF GOVERNMENT SECURITIES	281
D.1 What Is A Deposit of Government Securities?	281
D.2 How Would A Deposit of Government Securities Work?	281
D.3 Qualifications of the Issuer	282
D.4 Scope and Amount of Coverage	282
D.5 Recommended Documentation and Recordkeeping	282
E. GOVERNMENT FUNDS	284
E.1 Qualifications of the Issuer: The State or State Agency	284
E.2 Level of Coverage	284
E.3 Recommended Documentation	285
Attachment 16-1: EXAMPLE UST FR ESCROW AGREEMENT	286

## A. BACKGROUND

States may allow owners and operators to use FR mechanisms not included in the federal regulations. In non-approved states, any additional mechanisms need to be approved by EPA, as described in Chapter 8. In approved states, any additional mechanisms simply need to meet the broad requirements in the state program approval regulations (40 CFR 281.37(c)). This chapter presents criteria for evaluating alternative FR mechanisms. The chapter also summarizes EPA's rationales for excluding certain mechanisms from the federal rules. This chapter then describes the strengths and weaknesses of several specific mechanisms such as escrows, certificates of deposit, deposits of government securities, and state government funds.

### A.1 What Criteria Can Be Used for Evaluating Potential Financial Assurance Mechanisms?

You can evaluate FR mechanisms using several sets of criteria. Most generally, FR mechanisms should be evaluated in terms of the following criteria:

- Amount of funds assured and types of costs covered
- Certainty that assured funds will be available
- Availability of mechanisms to owners and operators
- Cost of mechanisms to owners and operators
- Implementing agency administrative burden

Good mechanisms will assure the required types and amounts of coverage with certainty. Good mechanisms will be broadly available to owners and operators at a reasonable cost. And good mechanisms will not impose excessive administrative burdens on implementing agencies. The federal UST rules offer a wide variety of mechanisms that satisfy these criteria. EPA developed several innovative mechanisms for use by local governments. As discussed below, EPA declined to include some mechanisms in the federal regulations, primarily on the grounds of concerns about certainty of coverage and administrative burden.

The general criteria noted above are consistent with the EPA's criteria for evaluating state-required mechanisms (discussed in Chapter 8). In 40 CFR 280.100, EPA articulated criteria that a Regional Administrator should use to evaluate the equivalency of a state-required FR mechanism, as follows:

- Certainty of the availability of funds
- Amount of funds that will be made available, and
- Types of costs covered

The most difficult criterion to evaluate is **certainty**. Amounts and types of costs covered can be evaluated relatively easily against the requirements described in Chapter 2. In terms of amount of funds, both the total amount assured and the amount assured at different points in time should be considered because accidental releases from USTs can occur at any time. EPA's regulations for reviewing state programs for approval elaborate on the certainty criterion by stating that to be no less stringent than the federal requirements, an FR mechanism must:

- Be valid and enforceable
- Be issued by a provider that is qualified or licensed in the state where the USTs are located
- Not permit cancellation without allowing the implementing agency to draw funds



- Ensure that funds will only and directly be used for corrective action and third-party compensation costs, and
- Require that the provider notify the owner or operator of any circumstances that would impair or suspend coverage

With the exception of the first criterion above, these criteria can easily be applied to any type of FR mechanism. Additional aspects of certainty you might want to consider include the protection of assured funds against claims of creditors and provisions for contingencies such as bankruptcy of the owner or operator or substitution of mechanisms. Unfortunately, legal analysis is required in determining whether a mechanism that differs from the federal models is **valid and enforceable**.

Financial responsibility mechanisms that satisfy general legal rules concerning commercial instruments will typically be adequate to meet the valid and enforceable criterion. The financial instruments used to provide evidence of financial responsibility, and in some cases the associated regulatory requirements, should be designed to anticipate and avoid typical problems in contracts and commercial transactions, which can come from several directions:

- First, the validity of the contract might be challenged. To address this problem, a mechanism should be designed to include information that helps to ensure and to demonstrate its validity. This information includes the names and signatures of the parties entering into the agreement, their titles, the date(s) of signing (and the effective date of the agreement, if different), and a description of the basic agreement being entered into.
- Second, unanticipated events could lead to a need to change the mechanism. To address this potential problem, instruments should contain provisions describing how they can be amended. Associated regulations, and in most cases the instruments themselves, should contain procedures under which an instrument can be terminated and replaced by a new mechanism.
- Third, disagreements may arise over interpretation of the mechanism. Some instruments should contain rules of interpretation, or references to rules of interpretation like the *Uniform Commercial Code* or the *Uniform Customs and Practice for Documentary Credits*, that specify how disagreements over the meaning of the mechanism should be resolved. Financial mechanisms used for financial responsibility should make it difficult for a third-party provider to avoid providing funds when necessary, even if differences of opinion about the scope or details of the mechanism have not been resolved.
- Fourth, to be considered valid and enforceable, financial assurance mechanisms should also be able to respond to contingencies which, unless anticipated and planned for, could fundamentally affect the ability of a financial assurance mechanism to provide funding when necessary. Specifically, it is important to ensure that an enforceable financial assurance mechanism continues to provide coverage until replaced by another valid and enforceable mechanism. Even if the facilities or USTs are transferred to a new owner or operator, the financial assurance provided by the previous owner or operator should remain in effect until the transfer of responsibility for providing financial assurance has taken place and the new owner or operator has obtained a new financial assurance mechanism.
- Finally, mechanisms should be selected because they can usually provide funds despite the bankruptcy of the party that procured the mechanism. Some financial mechanisms, such as trusts,

corporate guarantees, and insurance, are supplied by separate legal entities, and the funds that they provide are not affected by bankruptcy action.

A related bankruptcy issue is the potential bankruptcy of the third-party provider of the financial assurance. The mechanism should anticipate the possibility that a provider may be unable to meet its obligations, and FR rules should include criteria for the qualifications of providers to ensure that financially weak firms are not allowed to supply assurance mechanisms for owners or operators. In order to help ensure that the provider will be able to meet its obligations, regulations can specify eligibility requirements that providers be examined and supervised for continuing solvency by state or federal agencies.

The events profiled above can be planned for. Provisions should be incorporated into financial assurance instruments to ensure that if such contingencies do arise, the mechanisms can respond to them and/or replacements can be established in a timely manner, preventing any gaps in coverage.

## A.2 Which Mechanisms Were Found Not Acceptable for the Federal Rules?

After reviewing the public's comments on the FR rulemaking, EPA decided in 1988 not to include the following mechanisms in the federal UST FR program:

- Security agreements;
- Lines of credit;
- Risk pools;
- Trust fund with pay-in period; and
- Indemnities.

EPA rejected **security agreements** because of three concerns about the adequacy of the assurance such agreements provide: (1) the limited liquidity and uncertain value of the collateral subject to the agreement; (2) the complex and demanding procedural requirements to establish, maintain and oversee a security agreement; and (3) the ability of the implementing agency to seize and sell the collateral. These three concerns raised questions about the amount and timeliness of coverage as well as high costs both to the owner or operator and to the implementing agency.

EPA also prohibited **lines of credit** because they are conditional on the current financial standing of the borrower and therefore do not represent a substitution of the issuer's credit for the borrower's. Moreover, because lines of credit can be used for other business purposes as well as for UST purposes, the amount of available credit may not be adequate when needed for UST corrective action and/or third-party compensation. This mechanism raises concerns about both the amount and certainty of coverage.

Although **participation in a risk pool** provides a means for local governments to manage their financial liabilities for large unforeseen events, EPA did not approve risk pools as a federal financial responsibility mechanism because it concluded that no comprehensive yet manageable set of federal guidelines could be developed to ensure that all risk pools would have adequate oversight to make them comparable to the other financial responsibility mechanisms allowed, in terms of certainty and amount of coverage. This is in contrast to a **risk retention group** which is a regulated entity that can provide insurance acceptable for demonstrating UST FR.

EPA did not include in the federal rules the option of a **trust fund with a pay-in period**. This mechanism allows gradual funding over a period of years until the value of the trust fund equals the required amount of coverage. However, this mechanism is the most expensive for owners or operators. And, until the trust is fully funded, it does not assure the appropriate amount of funds. In contrast, EPA allows local

governments, which present lower risks than firms, to use a trust fund with a pay-in period as long as the pay-in trust fund is combined with assurance of available bond authority.

Since **indemnities** are generally provided by the same firms that can provide guarantees, EPA decided that their inclusion would not increase the number (i.e., availability) of potential providers of assurance. Additionally, indemnities so closely duplicate the structure and operation of a guarantee that there was little to be gained by including them, and including an indemnity as a separate mechanism might create unnecessary confusion.

## B. ESCROW ACCOUNTS

### B.1 What Is An Escrow Account?

An **escrow** (or **escrow account**) is a written agreement whereby the owner or operator transfers assets to an **escrow agent**, such as a bank. The escrow agent manages the account according to the terms of the written **escrow agreement** for the benefit of the **beneficiary**. An escrow account functions much like a savings account except that (1) monies are legally segregated for a specific purpose, and (2) the account is administered by someone with a **fiduciary responsibility** to keep or use the property in the account. The escrow itself is a written instrument that creates the fiduciary obligation and gives instructions to the escrow agent concerning the deposit. Money deposited to be held until the performance of a condition is treated as "deposited in escrow."

There can be no escrow without the delivery of the subject matter (e.g., the cash) to a third person as depository. In order to constitute a deposit in escrow, the deposit must be **irrevocable** -- that is, when the deposit is placed in the hands of the depository, it passes from the control of the parties, and the parties part with all present and temporary right of possession and control over it.

Until the delivery of the escrow deposit to the depository, the escrow arrangement may be revoked at any time by the parties; but when the cash deposit is delivered, accompanied by an underlying contract with conditions in which each party has an interest, the escrow arrangement then becomes irrevocable during the period stated in the escrow agreement. This is the point in time when the mechanism actually provides financial assurance.

This irrevocability makes it especially important to draft an escrow agreement carefully, so that the conditions for use of the cash deposit are clear and unequivocal. Although neither party can revoke the escrow during the escrow period without the consent of the other, the escrow agreement may include terms upon which it can be amended by mutual consent, much like the UST trust fund.

In an escrow arrangement, the **escrow agent** serves both as depository institution and as a fiduciary, whose actions are governed by an escrow agreement. The escrow agent is responsible for the protection of the deposit and usually is chosen for its particular skills in handling the deposited assets. As a fiduciary, an escrow agent is required to exercise reasonable skill and ordinary diligence in the protection of the funds in its care. In its fiduciary capacity, the escrow agent must conduct the affairs with which it is entrusted with scrupulous honesty, skill, and diligence and may be guilty of negligence with respect to losses occasioned by its breach of duty; or it may incur criminal liability for embezzlement with respect to conversions and misappropriations of the deposit.

In order for an instrument to operate as an escrow agreement, there must be a valid contract between the parties with respect to the subject matter. The underlying contract between the parties must be so complete that it only remains for a specified condition to be performed or an event to happen, to give the escrow agreement effect. For purposes of UST financial responsibility, the underlying contract is the regulation for corrective action and third-party compensation FR.

An escrow is the agent of both parties. It is empowered to aid neither, being merely the conduit used in the transaction. As a special agent of both parties, with powers limited only to those stipulated in the escrow agreement, its authority is strictly construed and does not extend beyond what is given by the terms of the instrument, or what is necessary and proper to carry out and give full effect to the authority granted in the escrow agreement. In addition, although anyone can serve as an escrow agent, to enhance the security of the mechanism, escrow agents should be limited to institutions whose operations are regulated and supervised by

a state or federal agency. Detailed investment instructions and limitations must be included in the escrow agreement.

An escrow is an infrequent option in government-mandated financial responsibility programs, both environmental and non-environmental. The main reason is because it offers less security than other mechanisms. The strengths and weaknesses of the mechanism are as follows:

#### Strengths

- Easier and cheaper for owner or operator than trusts

#### Weaknesses

- Funds remain legal property of the owner or operator and are vulnerable to the bankruptcy of the owner or operator
- Escrow agent must look out for the interests of the owner or operator and thus is not as independent as the trustee

**NOTE:** A trust differs from an escrow account in that although a bank takes possession of property in an escrow account, it does not hold legal ownership of escrow property.

### **B.2 How Would An UST Escrow Agreement Work?**

The UST escrow should operate much like the UST trust fund (described in Chapter 10). An owner or operator conveys to the escrow agent the full amount of the annual aggregate in cash or securities, unless the escrow is being used in combination with other mechanisms. Money in the escrow is used to pay for corrective action and third-party compensation or to reimburse the owner or operator for making such payments. Monies not used are returned to the owner or operator upon release from FR requirements. The deposit (preferably cash) is delivered to the escrow agent to hold until the happening of a specific condition, such as the failure to perform corrective action or third-party compensation, or failure to obtain alternate assurance when required.

The remainder of this section discusses the primary criteria that should determine whether particular escrow account submissions could be acceptable for UST FR.

- Section B.3 describes desirable qualifications of the issuer (the escrow agent).
- Section B.4 addresses scope and amount of coverage.
- Section B.5 presents recommended terms and conditions for an escrow agreement.
- Section B.6 discusses the documentation that should support an escrow account.

### **B.3 What Should Be the Qualifications of the Escrow Agent?**

Escrows are as secure as the ability of the depository institution to manage and honor them. Therefore, the escrow agent should be a financial institution whose operations are regulated and examined by a federal or state agency. This criterion is not usually met by individuals unless they are acting as representatives of financial institutions. Section A.3 of Chapter 10 (Trust Funds) summarizes the U.S. system for authorizing, regulating, and examining relevant banking and trust operations.

The owner or operator may need or choose to replace the current escrow agent with a new escrow agent. Any successor escrow agent should meet the same qualifications as the original escrow agent (i.e.,

must be a financial institution whose operations are regulated and examined by a federal or state agency). To be consistent with the federal UST regulations for other mechanisms, the owner or operator need not notify the implementing agency of changes in escrow agents.

#### **B.4 Scope and Amount of Coverage**

Scope of Coverage. Same as for other UST FR mechanisms.

Amount of Coverage. An escrow should at all times contain sufficient assets, valued at their *current market value*, to meet the required amount of coverage. Therefore, at the time the escrow is established, the escrow should be fully funded, with a market value at least as great as the required amount of coverage. The exception to this rule is when an escrow account is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

When submitting an escrow, an owner or operator also should submit documentation verifying the amount in the escrow (e.g., a receipt from the escrow agent or a fund balance statement). If the required amount of coverage is greater than the amount assured by the escrow account, the owner or operator must either (1) revise the escrow to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the new required coverage level and the amount of the escrow.

#### **B.5 Wording of UST Escrow**

The wording of the UST trust fund can be used as the basis for developing an acceptable escrow agreement. Exhibit 16-1 suggests recommended terms and conditions for UST escrows.

#### **B.6 Recommended Documentation and Recordkeeping**

The terms and conditions of an escrow should be governed by a written escrow agreement. Although the wording of an escrow agreement may vary, this *Manual* includes a recommended "model" as Attachment 16-1. In addition to the escrow agreement, other documentation should be used with an escrow. Recommended documentation should include the following:

- A written *escrow agreement* (along with any amendments) which specifies the terms and conditions of the escrow.
- A *certified resolution authorizing the making and performance of the escrow agreement*, which officially certifies that the owner or operator's Board of Directors has authorized entering into the escrow agreement (optional).
- A *certificate of names and specimen signatures*, which presents the names and signatures of the owner or operator's officers or representatives who are authorized to sign the escrow agreement and notices, instructions, and other communications under the agreement (optional).
- A *receipt or statement* from the escrow agent.

### Exhibit 16-1

#### RECOMMENDED TERMS AND CONDITIONS FOR UST FR ESCROW AGREEMENTS

- Introduction explaining the nature of the agreement between the parties and referring to the implementing agency's regulations concerning the regulatory obligations of the owner or operator (Paragraph 1).
- Identification of the escrow agent (Paragraph 1):
  - 1. Name and address of escrow agent;
  - 2. Position of escrow agent; and
  - 3. Duties and liabilities of escrow agent.
- Identification of the name and address of the facility, number of covered USTs, and the amount of financial assurance provided by the escrow account (Paragraph 1).
- Recital of delivery of items placed in escrow (Paragraph 2):
  - 1. Cash;
  - 2. Securities; and/or
  - 3. Other liquid assets.
- Recital of conditions and terms of the escrow account (Paragraph 3).
- Terms and conditions upon which items in escrow will be disbursed (Paragraph 4):
  - 1. Disbursements to owner or operator;
  - 2. Conditions that constitute default;
  - 3. Rights of parties upon default;
  - 4. Rights and duties of escrow agent upon default; and
  - 5. Persons or names or positions to which funds may be released.
- Recital of irrevocability of escrow arrangement (Paragraph 5).
- Escrow agent's rights and duties (Paragraph 6).
- Annual valuation requirement (Paragraph 7).
- Successor escrow agent (Paragraph 8).
- Recital of instructions to the escrow agent (Paragraph 9).
- Compensation and expenses of escrow agent (Paragraph 10).
- Amendment of the escrow agreement (Paragraph 11).
- Termination of escrow (Paragraph 12).
- The financial institution issuing the mechanism must notify the owner or operator at least 120 days prior to cancellation or non-renewal.
- Interpretation of escrow agreement (Paragraph 13).
- Acceptance of appointment by escrow agent (Paragraph 14).
- Severability provision (Paragraph 15).
- Signatures of owner or operator and escrow agent.

## C. CERTIFICATES OF DEPOSIT

### C.1 What Is A Certificate of Deposit?

The **certificate of deposit** (CD) is a written acknowledgment of the receipt of a sum of money on deposit for a pre-specified period of time, which the depository institution promises to pay to the depositor, to the order of the depositor, or to some other person or to his order. An **order** is a designation of the person to whom the money is to be paid. The order is a direction to pay and must identify the person to pay with reasonable certainty. A CD is in effect a loan to a bank by the depositor for period of time at a stated rate of interest, and creates the relationship of **debtor** and **creditor** between the bank and the depositor. A CD need not be in a particular form to be effective, provided it has the essential characteristics of such an instrument. The essential characteristics are that the CD should acknowledge the receipt of a deposit and contain a promise of repayment. The promise of repayment is essential to distinguish a CD from a mere deposit slip.

### C.2 How Does A CD Work for UST FR?

An owner or operator deposits funds sufficient for the full required amount of coverage (unless the mechanism is being used in combination with other FR mechanisms) and receives a CD. If the owner or operator defaults on its obligations, the implementing agency will draw on CDs used as financial assurance instruments. In addition, the owner or operator should establish a standby trust fund, escrow account, or government fund into which funds may be received if drawn from the CD in the event of default.

Banks have an inherent power to issue CDs, payable either on demand or at a specified time. CDs are usually signed by a duly authorized officer of the issuing bank. A certificate of deposit has the entire responsibility of the bank behind it and has been said to be the equivalent of money, although technically it is not money but an obligation to pay money.

Both non-negotiable and negotiable CDs may be used to fulfill financial assurance requirements.

- If a CD is **non-negotiable**, only the designated payee identified on the certificate may receive the funds from the bank when the CD reaches maturity. Consequently, the trustee of the trust, escrow agent of the escrow account, or state or state agency administering the government fund (if the state or state agency can hold funds without depositing them into general state revenues) must be named as payee, and should be in possession of the CD.
- If a CD is **negotiable**, however, anyone holding the CD may receive the funds. Consequently, the trustee, the escrow agent, or the state or state agency must be in possession of the CD.

The maturity of a certificate of deposit used to demonstrate UST financial responsibility should be for a limited time period. Either time or demand CDs may be used for FR requirements.

- **Time deposits** are payable only at a certain time.
- **Demand CDs** are payable on demand after a specified period of time (usually 30 to 90 days) has elapsed. Because demand CDs allow the holder to withdraw funds at will at any time after the specified period has elapsed, they are better suited to the contingency requirements of UST financial assurance mechanisms.

**If time CDs are used, their value should be sufficient to cover the required amount of coverage even if a penalty is incurred for withdrawal prior to the date specified on the certificate(s).**



States may require that all CDs obtained to provide UST financial assurance should be fully insured by the Federal Deposit Insurance Corporation (FDIC). Deposits by a given entity in federally-insured banks and savings and loan associations are insured only up to the basic total amount of \$100,000. These limitations also apply to the interest earned on deposits. Thus, if an owner or operator is providing UST financial assurance of more than \$100,000 using CDs, deposits should be split among several institutions so that all funds are fully insured by the FDIC. For example, if \$1 million in financial assurance coverage is provided, the owner or operator should purchase at least 10 CDs issued by 10 different financial institutions whose total value equals \$1,000,000.

In general, a bank issuing a certificate of deposit may have a “set-off right” to the deposited funds. This refers to the ability of the bank to look to deposits it holds for the repayment of any indebtedness to the bank on the part of the depositor and to apply the debtor’s deposit to these debts as they become due. To reduce the likelihood that the bank’s set-off right might apply to CDs used for UST FR, owners or operators should inform the issuing bank that the certificate is being used to demonstrate financial assurance in compliance with UST regulatory requirements.

The strengths and weaknesses of this mechanism are as follows:

#### Strengths

- Because there is typically no transaction fee, may be cheaper than other mechanisms for owner or operator
- May provide a higher rate of return than trust fund

#### Weaknesses

- Less liquid; usually there is a penalty for early withdrawal
- Funds remain legal property of the owner or operator (unless deposited in trust fund) and are part of the debtor's estate in bankruptcy
- Funds vulnerable to bank's set-off rights
- If negotiable, requires special custodial care

The remainder of this section discusses the primary criteria that should determine whether particular certificate of deposit submissions should be acceptable.

- Section C.3 describes desirable qualifications of the issuer.
- Section C.4 addresses funding and the adequacy of coverage.
- Section C.5 discusses the documentation that supports a certificate of deposit.
- Section C.6 presents a model certificate of deposit that should be acceptable.

### **C.3 Qualifications of the Issuer**

Depository institutions issuing CDs for financial assurance purposes should be subject to federal or state regulation and insured by the Federal Deposit Insurance Corporation (FDIC).

Also, as noted above, an owner or operator should deposit CDs into a trust fund, escrow account, or government fund. Information on the qualifications of the issuers of these types of mechanisms is provided in Chapter 10, in Section A above, and in Chapter 15.

#### C.4 Scope and Amount of Coverage

Scope of Coverage. Same as for other FR mechanisms.

Amount of Coverage. A certificate of deposit should at all times have a *current market value less any potential penalty for early withdrawal* (i.e., "net value") that is sufficient for the required amount of coverage. The exception to this rule is when a CD is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

If the required amount of coverage is greater than the amount assured by the CD, the owner or operator must either (1) revise the CD to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the amount of required coverage and the net value of the CD.

#### C.5 Wording of UST CD

Financial institutions typically use their own forms for CDs. Exhibit 16-2 presents recommended terms and conditions for UST CDs. Although the wording of a certificate of deposit may vary, Exhibit 16-3 presents an example UST FR certificate of deposit.

**Exhibit 16-2**  
**RECOMMENDED TERMS AND CONDITIONS FOR**  
**UST FR CERTIFICATES OF DEPOSIT**

- Time or demand deposit.
- Non-negotiable or negotiable instrument:
  - If non-negotiable, the certificate of deposit names the trustee, escrow agent, or state or state agency as payee and is in the possession of the trustee, escrow agent, or state or state agency.
  - If negotiable, the certificate of deposit is in the possession of the trustee, escrow agent, or state or state agency.
- Name and address of issuing bank.
- Number of certificate.
- Name of owner or operator depositor.
- Amount of funds deposited.
- Name or position of payee or holder.
- Date of maturity.
- Rate of interest.
- Statement of owner or operator's regulatory obligations as reason for the CD.
- Names and addresses of facilities and numbers of assured USTs.
- Provision for automatic renewal.
- Limitation on withdrawal.
- Notice requirements.
- Provision governing penalty for early withdrawal in the event of default.
- Power of bank not to renew.
- The financial institution issuing the mechanism must notify the owner or operator at least 90 days prior to cancellation or non-renewal.
- Deposit insurance covering all CDs obtained by the owner or operator.
- Signature and date.

**Exhibit 16-3**  
**EXAMPLE CERTIFICATE OF DEPOSIT FOR UST FR**

[Name and address of issuing bank]

**CERTIFICATE OF DEPOSIT NO. [INSERT NUMBER]**

[Insert name of owner or operator] has deposited not subject to check \_\_\_\_\_ Dollars (\$\_\_\_\_\_) payable to the order of the [if the CD is non-negotiable, insert the name of the trustee of the trust, the escrow agent of the escrow account, or the state or state agency administering the government fund; if the CD is negotiable, insert "holder"] in current funds [insert number not less than 30] days after the date written above, upon surrender of this certificate properly endorsed, with interest at the rate of \_\_\_\_\_ percent per annum from date to maturity only. The rate of interest payable hereunder is subject to change by the bank to such extent as may be necessary to comply with requirements of the Federal Reserve Board made from time to time pursuant to the Federal Reserve Act.

These funds are deposited for the purpose of providing financial assurance for the payment of the costs of [insert: "taking corrective action" and/or "compensating third parties for bodily injury and property damage caused by" either "sudden accidental releases" or "nonsudden accidental releases" or "accidental releases"] arising from operating the tanks at [insert facility name(s), address(es), and number(s) of tanks], as required under Title 40 of the Code of Federal Regulations, Part 280. Accordingly, this certificate will be renewed automatically unless written notice of one of the following events is received from the implementing agency: (1) the default of the [insert name of owner or operator] on these obligations; (2) release from these requirements; or (3) the substitution of another financial assurance mechanism. In the event the implementing agency notifies the bank of the owner or operator's default, the bank shall pay the [if the CD is non-negotiable, insert "payee"; if the CD is negotiable, insert "holder"] the full amount of this certificate plus any interest accrued thereon, for deposit into the [insert "trust fund," "escrow account," or "government fund"] established for corrective action and third-party compensation.

The bank will notify [insert name of owner or operator] by certified mail at least 120 days prior to cancellation or non-renewal of this certificate.

The deposit documented in this certificate is insured by the Federal Deposit Insurance Corporation.

[Signature of authorized representative of the issuer]

[Date]

### **C.6 Recommended Documentation and Recordkeeping**

The terms and conditions of a CD are governed by a written certificate. In addition to the certificate, other documentation should be used with a CD. Recommended documentation should include the following:

- The *certificate of deposit* which constitutes the bank's written acknowledgment of the receipt and deposit of a sum of money, its promise of repayment, and other applicable terms and conditions. The wording contained in the example CD presented in Exhibit 16-3 should be acceptable.
- A *trust fund agreement, escrow agreement, or government fund* which should be established to hold the CD. The trust, escrow, or government fund should satisfy the criteria described in this *Manual*.

- Documentation specifying (1) the current market value of the CD and (2) the date on which the CD was transferred to the trust fund, escrow account, or government fund.
- Verification (e.g., a letter or receipt) from the trustee, escrow agent, or state or state agency that the CD has been placed into the trust fund, escrow account, or government fund.
- A letter from the state or state agency stating that use of funds will be restricted to covering the costs of corrective action and/or third-party compensation upon the owner or operator's default (needed only if the CD is held in a government fund).

## D. DEPOSITS OF GOVERNMENT SECURITIES

### D.1 What Is A Deposit of Government Securities?

A **deposit of government securities** is the deposit by an owner or operator into either a trust fund, an escrow account, or a government fund of securities backed by the federal government or a state or local government.

Procedures for receipt and possible reinvestment of interest from the securities should be established in the trust agreement (see Chapter 10), escrow agreement (see Section B above), or government fund governing the deposit of the securities. The proper **registrant** for U.S. Treasury securities should be either the trustee of the trust, the escrow agent of the escrow account, or the state or state agency administering the government fund.

The deposit of government securities into a trust fund, escrow account, or government fund requires the careful attention of the trustee, escrow agent, or state or state agency with respect to the following matters:

- Proper registration and endorsements;
- Reinvesting interest payments;
- Handling instruments with varying maturity dates;
- Reinvesting funds from matured and redeemed instruments; and
- Filing proper forms in a timely fashion with the appropriate government agencies.

The strengths and weaknesses of this mechanism are as follows:

#### Strengths

- Government securities have low risk of default

#### Weaknesses

- Market risk can impair current value of securities
- Negotiable instruments require special safekeeping
- If not placed in a trust, funds remain legal property of the owner or operator and vulnerable to the bankruptcy of the owner or operator
- Local government securities may have less liquidity

### D.2 How Would A Deposit of Government Securities Work?

This mechanism would operate much like the UST trust fund (described in Chapter 10). The remainder of this section discusses the primary criteria that determine whether a particular deposit of government securities submissions should be acceptable.

- Section D.3 describes desirable qualifications of the issuer.
- Section D.4 addresses scope and amount of coverage.
- Section D.5 discusses the documentation that should support a deposit of government securities.

### **D.3 Qualifications of the Issuer**

Securities used in a deposit of government securities should be backed by the federal government or a state or local government. Acceptable government securities include the following:

- U.S. Treasury bills, notes, and bonds;
- Government National Mortgage Association (GNMA) pass-through certificates;
- Mortgage-backed bonds issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLM); and
- State or municipal bonds rated BBB or higher by Standard & Poor's, or Baa or higher by Moody's Investment Services.

Also, an owner or operator should deposit government securities into a trust fund, escrow account, or government fund. Requirements for trustees and escrow agents are provided elsewhere in this *Manual*.

### **D.4 Scope and Amount of Coverage**

Scope of Coverage. Same as for other UST FR mechanisms.

Amount of Coverage. A deposit of government securities must at all times contain sufficient securities, valued at their *current market value*, for the required amount of coverage. Therefore, at the time the trust fund, escrow account, or government fund is established, it must contain government securities with a market value at least as great as the required amount of coverage. The exception to this rule is when a deposit of government securities is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required coverage level.

When submitting a deposit of government securities as evidence of FR, an owner or operator should also submit documentation verifying the amount of government securities in the trust fund, escrow account, or government fund (e.g., a receipt from the trustee, escrow agent, or state or state agency, or a fund/account balance statement). If the required amount of coverage is greater than the current market value of the deposit of government securities, the owner or operator must either (1) deposit additional government securities to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between required amount of coverage and the current market value of the deposit of government securities.

### **D.5 Recommended Documentation and Recordkeeping**

The terms and conditions of a deposit of government securities should be governed by a written trust agreement or escrow agreement, which should correspond to the requirements and recommendations of Chapter 10 or Section B of this chapter of the *Manual*, respectively. In addition to the trust or escrow agreement, other documentation should be used with a deposit of government securities. Recommended documentation should include the following:

- A *list* of securities deposited with the trustee, escrow agent, or state or state agency (which should state their current market value and the date on which the securities were transferred to the fund or account).

- The *trust agreement* or *escrow agreement* (along with all supporting documentation and any amendments) which is the written document that specifies the terms and conditions of the deposit of government securities. The wording contained in the trust and model escrow agreements presented in Chapter 10 and Section B above, respectively, should be acceptable.
- A *letter* from the State or State agency stating that use of funds will be restricted to covering the costs of corrective action and third-party compensation upon the owner or operator's default (needed only if the securities are held in a government fund).

## E. GOVERNMENT FUNDS

A **government fund** is a trust fund or escrow account for which a **state** is acting as trustee or escrow agent. To use this mechanism, an owner or operator and a state or state agency must agree that funds in an amount at least equal to the required amount of coverage will be held in a special state fund or account and will be used solely to carry out corrective action or third-party compensation activities. The owner or operator must deposit the required amount of cash, securities, or other liquid assets in the special fund or account. If the owner or operator defaults, the state or state agency must arrange for the necessary corrective action or third-party compensation work to be completed by (1) ordering the owner or operator to perform corrective action or third-party compensation, (2) ordering the owner or operator to select a contractor, or (3) choosing a contractor itself. The special fund or account terminates when the owner or operator is released from FR requirements.

**NOTE:** This mechanism differs from the **local government fund**, for which a **local government** entity acts as the trustee or agent.

The strengths and weaknesses of this mechanism are as follows:

### Strengths

- Cheaper for owner or operator than commercial trusts or escrows
- No risk of state bankruptcy or insolvency
- No divided loyalty as with escrows

### Weaknesses

- Availability may be limited
- Funds in escrow remain legal property of the owner or operator and are vulnerable to the bankruptcy of the owner or operator

The remainder of this section discusses the primary criteria that determine whether particular government fund submissions should be acceptable.

- Section E.1 describes required qualifications of the issuer (the state or state agency).
- Section E.2 addresses funding and the adequacy of coverage.
- Section E.3 discusses the documentation that should support a government fund.

### E.1 Qualifications of the Issuer: The State or State Agency

Any state or state agency holding the assets in the government fund would automatically be eligible as an acceptable trustee or escrow agent. However, a state or state agency must have the authority to establish special segregated funds or accounts to receive and hold funds for specified purposes.

### E.2 Level of Coverage

A government fund must at all times contain sufficient assets, valued at their *current market value*, to satisfy the required amount of coverage. The exception to this rule is when a government fund is being combined with another financial mechanism. In the case of a combination of mechanisms, it is the *sum* of the coverage provided by the mechanisms that must be at least equal to the required amount of coverage. Therefore, at the time the fund or account is established, it must be fully funded, with a market value at least as great as the required amount of coverage.



When submitting a government fund to the implementing agency, an owner or operator should also submit documentation verifying the amount in the fund or account (e.g., a receipt from the state or state agency, or a fund/account balance statement). If the required amount of coverage is greater than the amount assured by the government fund, the owner or operator must either (1) revise the government fund to assure the higher amount, or (2) obtain another financial assurance mechanism to make up the difference between the required amount of coverage and the amount of the government fund.

### **E.3 Recommended Documentation**

The terms and conditions of a government fund are governed by a written trust agreement or escrow agreement. Although the wording of a government fund may vary, it should be similar to the wording of the trust agreement and “model” escrow agreement described in this *Manual*. Recommended documentation should include the following:

- The *trust agreement, escrow agreement*, or other state law or regulation (along with all supporting documentation and any amendments) is the written document that specifies the terms and conditions of the government fund. The wording contained in the trust and model escrow agreements discussed in Chapter 10 and Section B, respectively, should be acceptable. Alternative wording should contain all the necessary terms and conditions.
- A *list of assets* deposited with the state or state agency which should state the assets’ current market value and the date on which the assets were transferred to the government fund.
- A *letter* from the state or state agency stating that use of funds will be restricted to covering the costs of corrective action and third-party compensation upon the owner or operator's default.

**Attachment 16-1**  
**EXAMPLE UST FR ESCROW AGREEMENT**

Escrow Account Number \_\_\_\_\_

Paragraph 1. Establishment of Escrow Account.

It is agreed between the parties that [insert name of owner or operator] has elected to establish an escrow account with [insert name, address, and position (if applicable) of escrow agent] to provide financial assurance for corrective action and third-party compensation of the facility(ies) in the amounts shown below:

[For each facility for which financial assurance is provided by the escrow agreement, list facility name(s), address(es), and number(s) of tanks, and indicate amount of financial assurance provided by the escrow account.]

Paragraph 2. Description of Property in Escrow Account.

It is hereby acknowledged by the parties that [list the assets that have been delivered to the escrow agent and indicate the market value of each item] has (have) been delivered to escrow. These assets are deposited for the purpose of providing financial assurance for the cost of corrective action and third-party compensation activities, as required under Title 40 of the Code of Federal Regulations, Part 280.

[Insert name of owner or operator] warrants to and agrees with [insert name of escrow agent] that, unless otherwise expressly set forth in this Agreement: there is no security interest in the property in the escrow account or any part thereof; no financing statement under the Uniform Commercial Code is on file in any jurisdiction claiming a security interest in or describing (whether specifically or generally) the escrow account or any part thereof; and the escrow agent shall have no responsibility at any time to ascertain whether or not any security interest exists or to file any financing statement under the Uniform Commercial Code with respect to the escrow account or any part thereof.

Paragraph 3. Conditions of Escrow Agreement.

The property described in Paragraph 2 above will remain in the escrow account created by this Agreement until one of the following two conditions has been satisfied:

- (1) The conditions specified in Paragraph 4 of this Agreement have been met; or
- (2) The activities required by 40 CFR Part 280 have been completed, the owner or operator has been released from FR compliance, or the escrow account has been terminated by notice, in writing, from [insert name of owner or operator], or by the implementing agency if the owner or operator ceases to exist.

Paragraph 4. Disbursement of Property in Escrow Account.

[Insert name of escrow agent] shall make payments from the escrow account upon receiving written notification of owner or operator's default from the implementing agency. [Insert name of escrow agent] shall make payments from the escrow account as the Director shall direct, in writing, to provide for the payment of the costs of the required corrective action and/or third-party compensation activities covered by this Agreement. As specified by the Director, the escrow agent shall reimburse the owner or operator or other persons from the escrow account for expenses for required activities in such amounts as the Director shall

direct in writing. In addition, the escrow agent shall refund to [insert name of owner or operator] such amounts as the Director specifies, in writing. Upon refund, such funds shall no longer constitute part of the escrow account as described in Paragraph 2 above.

Paragraph 5. Irrevocability.

It is also agreed between the parties that this escrow became irrevocable upon delivery to [insert name of escrow agent], the escrow agent, and will remain irrevocable and in full force and effect until the occurrence of one of the conditions described in Paragraph 3 above.

Paragraph 6. Powers of the Escrow Agent.

The only power and duties of the escrow agent shall be to hold the escrow property and to invest and dispose of it in accordance with the terms of this Agreement.

Escrow Account Management

The escrow agent shall invest and reinvest the principal and income of the escrow account and keep the escrow account invested as a single fund, without distinction between principal and income, in accordance with general investment policies and guidelines which the [insert name of owner or operator] may communicate in writing to the escrow agent from time to time, subject, however, to the provisions of the escrow account; the escrow agent shall discharge its duties with respect to the escrow account solely in the interest of the implementing agency and with the care, skill, prudence, and diligence, under the circumstances then prevailing, that persons of prudence, acting in like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims; except that:

- (a) Securities or other obligations of the owner or operator, or any of their affiliates as defined in the Investment Company Act of 1940, as amended (15 U.S.C. 80a-2(a)), shall not be acquired or held;
- (b) The escrow agent is authorized to invest the escrow account in time or demand deposits to the extent insured by an agency of the Federal government, and in obligations of the federal government such as GNMA, FNMA, and FHLM bonds and certificates or state and municipal bonds rated BBB or higher by Standard & Poor's or Baa or higher by Moody's Investment Services; and
- (c) The escrow agent is authorized to hold cash, awaiting investment or distribution uninvested, for a reasonable time and without liability for the payment of interest thereon.

Express Power of the Escrow Agent

Without in any way limiting the powers and discretion conferred upon the escrow agent by other provisions of this Agreement or by law, the escrow agent is expressly authorized and empowered:

- (a) To register any securities held in the escrow account in its own name and to hold any security in bearer form or in book entry or to deposit or arrange for the deposit of any securities issued by the U.S. Government, or any agency or instrumentality thereof, with a Federal Reserve bank, but the books and records of the escrow agent shall at all times show that all such securities are part of the escrow account;

- (b) To deposit any cash in the escrow account in interest-bearing accounts or savings certificates to the extent insured by an agency of the federal government; and
- (c) To pay taxes, from the account, of any kind that may be assessed or levied against the escrow account and all brokerage commissions incurred by the escrow account.

Paragraph 7. Annual Valuation.

After delivery has been made into this escrow account, the escrow agent shall annually, at least 30 days before the anniversary date of receipt of the property into the escrow account, furnish to the owner or operator a statement confirming the value of the escrow account. Any securities in the account shall be valued at market value as of no more than 60 days before the anniversary date of the establishment of the escrow account. The failure of the owner or operator to object in writing to the escrow agent within 90 days after the statement has been furnished to the owner or operator shall constitute a conclusively binding assent by the owner or operator, barring the owner or operator from asserting any claim or liability against the escrow agent with respect to the matters disclosed in the statement.

Paragraph 8. Successor Escrow Agent.

Upon 90 days prior notice to [insert name of owner or operator ], the escrow agent may resign; upon 90 days notice to the escrow agent, [insert name of owner or operator ] may replace the escrow agent; provided that such resignation or replacement is not effective until the escrow agent has appointed a successor escrow agent, the successor accepts the appointment, and the successor is ready to assume its duties as escrow agent. The successor escrow agent shall have the same powers and duties as those conferred upon the escrow agent under this Agreement. When the resignation or replacement is effective, the escrow agent shall assign, transfer, and pay over to the successor the funds and properties then constituting the escrow account. If for any reason the owner or operator cannot or does not act in the event of the resignation of the escrow agent, the escrow agent may apply to a court of competent jurisdiction for the appointment of a successor, or for instructions. The successor escrow agent shall specify the date on which it assumes administration of the escrow account in a writing sent to the owner or operator, the Director of the implementing agency, and the current escrow agent by certified mail 10 days before the change becomes effective. Any expenses incurred by the escrow agent as a result of any of the acts contemplated by this paragraph shall be paid as provided in Paragraph 10 of this Agreement.

Paragraph 9. Instructions to the Escrow Agent.

All orders, requests, and instructions from the owner or operator to the escrow agent shall be in writing, signed by such persons as are signatories to this Agreement, or such other designees as the owner or operator or the Director may designate in writing. All orders, requests, and instructions from the Director shall be in writing, signed by the designees of the Director. The escrow agent shall be fully protected in acting in accordance with such orders, requests, and instructions. The escrow agent shall have the right to assume, in the absence of written notice to the contrary, that no event constituting a change or a termination of the authority of any person to act on behalf of the owner or operator or the Director under this Agreement has occurred. The escrow agent shall have no duty to act in the absence of such orders, requests, and instructions from the owner or operator and/or the Director, except as provided in this Agreement.

Paragraph 10. Compensation and Expenses of the Escrow Agent.

The fee of the escrow agent for its services in establishing the escrow account shall be \$\_\_\_\_\_, payable at the time of the execution of this Agreement, to be borne by [insert name of owner or operator].

Expenses of the escrow agent for the administration of the escrow account, the compensation of the escrow agent for services subsequent to the establishing of the escrow account to the extent not paid directly by the owner or operator, and all other proper charges and disbursements shall be paid from the escrow account.

Paragraph 11. Amendment of Agreement.

This Agreement may be amended by an instrument in writing executed by the owner or operator and the escrow agent, or by the escrow agent and the Director if the owner or operator ceases to exist. All amendments shall meet the relevant regulatory requirements of the implementing agency.

Paragraph 12. Termination.

This Agreement can be terminated by written notice of termination to the escrow agent signed by [insert name of owner or operator] or by the implementing agency if the owner or operator ceases to exist.

Paragraph 13. Interpretation.

This escrow agreement constitutes the entire agreement between [insert name of owner or operator] and [insert name of escrow agent]. The escrow agent shall not be bound by any other agreement or contract entered into by [insert name of owner or operator].

Paragraph 14. Acceptance of Appointment by Escrow Agent.

[Insert name, address, and position (if applicable) of escrow agent] does hereby acknowledge its appointment by [insert name of owner or operator] to serve as escrow agent for the escrow account created under this Agreement and agrees to carry out its obligations and duties as stated in this escrow agreement.

Paragraph 15. Severability.

If any part of this Agreement is invalid, it shall not affect the remaining provisions that will remain valid and enforceable.

Paragraph 16.

This Agreement shall not become effective (and the escrow agent shall have no responsibility hereunder except to return the escrow property to the [insert name of owner or operator]) until the escrow agent shall have received the following and shall have advised [insert name of owner or operator] in writing that the same are in form and substance satisfactory to the escrow agent:

- (1) A certified resolution of its Board of Directors authorizing the making and performance of this Agreement; and

- (2) A certificate as to the names and specimen signatures of its officers or representatives authorized to sign this Agreement and notices, instructions and other communications hereunder.

[Signatures and positions of the designees of the owner or operator and the escrow agent]

[Insert name of escrow agent]

[Insert name of owner or operator]

By \_\_\_\_\_

By \_\_\_\_\_

Name \_\_\_\_\_

Name \_\_\_\_\_

Title \_\_\_\_\_

Title \_\_\_\_\_

[Date]

[Witness by Notary Public]

**CERTIFIED RESOLUTION AUTHORIZING THE MAKING  
AND PERFORMANCE OF THE ESCROW AGREEMENT**

I, \_\_\_\_\_, do hereby certify that I am Secretary of [insert name of owner or operator], a [insert state of incorporation] corporation, and that the resolution listed below was duly adopted at a meeting of this Corporation's Board of Directors on \_\_\_\_\_, 20\_\_.

IN WITNESS WHEREOF, I have hereunto signed my name and affixed the seal of this Corporation this \_\_\_ day of \_\_\_\_\_, 20\_\_.

\_\_\_\_\_  
Secretary

RESOLVED, that this Board of Directors hereby authorizes the President, or such other employee of the Company as he may designate, to enter into an escrow agreement with the [insert name of escrow agent] in accordance with the terms and conditions described to this Board of Directors at this meeting and with such other terms and conditions as the President shall approve with and upon the advice of Counsel.

**CERTIFICATE OF NAMES AND SPECIMEN SIGNATURES**

The individuals listed below are authorized to sign this Escrow Agreement on behalf of [insert name of owner or operator], and are authorized to sign any notices, instructions, and other communications made pursuant to the Agreement.

Name \_\_\_\_\_  
Title \_\_\_\_\_  
Signature \_\_\_\_\_

Name \_\_\_\_\_  
Title \_\_\_\_\_  
Signature \_\_\_\_\_

Name \_\_\_\_\_  
Title \_\_\_\_\_  
Signature \_\_\_\_\_

Name \_\_\_\_\_  
Title \_\_\_\_\_  
Signature \_\_\_\_\_



## **GLOSSARY OF TERMS RELATED TO UST FINANCIAL ASSURANCE**

The following glossary defines commonly used financial responsibility terms. It includes terms relating to financial analysis, relying on generally accepted accounting principles wherever possible; insurance; other financial assurance mechanisms, including some mechanisms not authorized under the federal regulations; and bankruptcy. A sample balance sheet is attached at the end of the glossary.

### **ACCIDENTAL OCCURRENCE:**

An accidental occurrence is an accident, including continuous or repeated exposure to conditions resulting in bodily injury or property damage neither expected nor intended from the standpoint of the insured.

### **ACCIDENTAL RELEASE:**

Accidental release means any sudden or nonsudden release of petroleum from an underground storage tank that results in a need for corrective action and/or compensation for bodily injury or property damage neither expected nor intended by the tank owner or operator.

### **ACCOUNT PARTY:**

An account party is one who purchases or arranges for a letter of credit from a financial institution. For purposes of financial assurance, the owner or operator is usually the account party; the letter of credit is extended to the implementing agency (beneficiary) by a bank on the owner's or operator's (account party) behalf.

### **ACCRUAL BASIS OF ACCOUNTING:**

Generally Accepted Accounting Principles (GAAP) require that companies use the accrual basis of accounting which recognizes revenues when they are earned and expenses when they make their contribution to income rather than when the cash is received or paid out. Some small enterprises and many local governments, however, use the cash basis; that is, they recognize revenue and expenses only when cash changes hands.

### **ACKNOWLEDGMENT (OF AN INSTRUMENT):**

Acknowledgment (of an instrument) is the formal declaration before an authorized official, such as a notary public, by the person who executed the instrument, that certifies that this action is of his or her own free act and deed. For example, under the RCRA UST financial assurance program, owners or operators using the trust fund must have the trust agreement properly "acknowledged."

### **ADMITTED CARRIER:**

An admitted carrier is an insurance company licensed to do business in the state where the insured exposure is located.

### **ADVERSE OPINION:**

Statement by an accountant that the financial statements of the firm or local government do not present fairly its financial condition in conformity with generally accepted accounting principles. This type of opinion will cause the implementing agency to disallow the use of the financial test.

### **ALIEN INSURER:**

An alien insurer is an insurance company domiciled outside the United States.

**AMORTIZATION:**

Amortization is the process used to gradually decrease the value of intangible assets such as goodwill, patents, or leases. The value of intangible assets, recorded at their initial purchase price on the balance sheet is amortized to reflect the decrease in value of the asset over time. This process is repeated year after year, until the value of the asset recorded on the balance sheet is reduced to zero. Following Generally Accepted Accounting Principles (GAAP), at the end of each year, the company reports amortization on its balance sheet as a reduction of the value of the intangible asset (accumulated amortization). (See the sample Balance Sheet, located at the end of this Glossary.)

**ANNUAL AGGREGATE:**

Annual aggregate is the maximum amount of financial assurance provided in any given year. For example, RCRA regulations require certain owners or operators of USTs to have coverage of at least \$1 million per occurrence, with an annual aggregate of at least \$2 million.

**ANNUAL REPORT TO SHAREHOLDERS:**

The Annual Report to Shareholders is the principal document used by most public companies to disclose corporate information, and it is therefore one of the most useful sources of data for public companies. The annual report is not a required Securities and Exchange Commission (SEC) filing. It includes, (1) an opening letter from the Chief Executive Officer, (2) results of continuing operations including the company's audited fiscal year-end financial statements, (3) market segment information, (4) new product plans, (5) subsidiary activities, and (6) research and development activities on future programs. The report is similar to the SEC-required Form 10-K in that it is a state-of-the-company report.

**AUTOMATIC EXTENSION, AUTOMATIC RENEWAL:**

Automatic extension and automatic renewal under a financial mechanism is the continuation of the mechanism without the need for re-negotiation.

**AUTOMATIC STAY:**

An automatic stay in bankruptcy is a judicial order that stops almost all collection efforts and foreclosure actions as soon as a bankruptcy petition is filed. The stay permits the debtor to attempt to develop and implement a repayment plan or reorganization plan or otherwise be relieved of the financial pressure that drove him or her to bankruptcy. In a number of situations, however, the filing of a petition does not operate as a stay. Actions taken against the debtor by governmental units to enforce police or regulatory powers (e.g. actions by EPA to enforce corrective action rules) may be excepted from the stay. The purpose of these exceptions is to permit governmental authorities to pursue actions to protect human health and safety and to abate violations of environmental protection laws.

**BALANCE SHEET:**

The balance sheet is one of the three financial statements which, according to Generally Accepted Accounting Principles (GAAP), must be prepared by a company. The balance sheet provides information about the composition and amounts of assets, liabilities, and net worth at a particular date in time. Unlike the income statement, which indicates a period of time (such as a year) rather than a particular date, the balance sheet shows the financial condition of a company at a specific point in time. An important aspect of the balance sheet is that it "balances." In other words, the left side of the balance sheet, total assets, equals the right side of the balance sheet, total liabilities plus stockholder's equity. This equation: total assets equals total liabilities plus stockholder's equity is called the "fundamental accounting equation."

**BANKRUPTCY PROCEEDINGS:**

A proceeding under the U.S. Bankruptcy Code may be either voluntary, in which a debtor files a petition to seek protection from creditors, or involuntary, in which creditors file a petition to force the debtor to pay debts owed to them. Bankruptcy proceedings are governed only by the U.S. Bankruptcy Code (U.S. Code Title 11) and Official Rules and Forms. Bankruptcy proceedings take place in bankruptcy courts, which are federal courts established in each federal judicial district as adjuncts to the U.S. District Courts. These bankruptcy courts are concerned exclusively with the administration of the Bankruptcy Code and are presided over by bankruptcy judges.

"Straight bankruptcy" means a liquidation proceeding (Chapter 7) and involves the collection and distribution to creditors of all the bankrupt's non-exempt property. The debtor rehabilitation provisions of the Act (Chapter 11) differ from straight bankruptcy in that the debtor looks to rehabilitation and reorganization, rather than liquidation, and the creditor looks to future earnings of the bankrupt, rather than property held by the bankrupt, to satisfy its claims. Chapter 9 addresses municipal debts. (See Chapter 7, Chapter 9, Chapter 11, Claim in Bankruptcy, Debtor in Bankruptcy, and Trustee in Bankruptcy.)

**BENEFICIARY:**

A beneficiary is the party who receives the benefits of an agreement. For example, a person may be a beneficiary of a trust fund or letter of credit.

**BINDER:**

A binder is a record of an insurance transaction or arrangement issued by a carrier pending delivery of the formal insurance contract or policy.

**BLACK LIST:**

A state-published list of non-admitted insurers that a broker or agent cannot take on as an excess or surplus lines provider. (See Non-Admitted Insurer, and White List.)

**BODILY INJURY:**

Bodily injury is a physical injury that is recoverable as a liability under applicable state law. Under RCRA regulations, however, the term does not include those liabilities that, consistent with standard industry practice, are excluded from coverage in liability insurance policies for bodily injury. For example, the insurance policy need not cover injuries caused by war, injuries covered by worker's compensation or disability benefits, or intentional injuries.

**BOND INSURANCE:**

Insurance issued by a private insurance company for either an entire issue or specific maturities that guarantees to pay principal and interest when due.

**BOND RATING:**

An assessment of the creditworthiness of an obligor with respect to a specific debt obligation (bond). Ratings take the form of letters -- e.g., AA, A, B, etc. For purposes of UST FR regulations, Moody's and Standard & Poor's are the only two acceptable bond-rating corporations. (See also Investment Grade.)

**BROKER OF INSURANCE:**

A broker of insurance is an independent businessperson whose principal function is to represent an insured (client) in obtaining optimum insurance protection at the most advantageous price. A broker is

not a licensed representative of any particular insurer and is thus free to arrange insurance from virtually any commercial insurer. (See Insurance Agent.)

**BUY-BACK COVERAGE:**

Buy-back coverage is a type of insurance coverage excluded under the basic terms of a policy--such as pollution liability--that can be included for the payment of an additional premium. The term also is frequently used to refer to reinstating policy limits used up by claims payments.

**CAPTIVE INSURER:**

A captive insurer is an insurance company set up by a single company or group of companies to insure its own risks or risks common to the group. Captive insurers may qualify under the RCRA UST regulations by obtaining a license in one of the states that currently license captive insurers or by becoming eligible or authorized to transact the business of insurance as a surplus lines or excess insurer in a state.

**CARRIER (OF INSURANCE):**

A carrier is an insurance company.

**CASH:**

The cash account in the current assets section of the balance sheet consists of cash and any instrument that banks normally will accept for deposit and immediately credit to the depositor's account, such as a check, money order, or bank draft at a particular date. Cash is the most liquid item on the balance sheet. (Exhibit A at the end of the glossary presents a sample Balance Sheet showing Cash in the Current Assets portion of the Balance Sheet.)

**CERTIFICATE OF DEPOSIT:**

A certificate of deposit (CD) is a deposit of cash by the owner or operator into a bank for a pre-specified period of time.

**CERTIFICATE OF INSURANCE:**

A certificate of insurance is a statement obtained from the insurer certifying that it has issued insurance as represented in the certificate. It is not part of the insurance policy itself. Under the RCRA UST rules, financial responsibility can be demonstrated by submitting a properly worded certificate of insurance, rather than by submitting a copy of the insurance policy.

**CERTIFIED PUBLIC ACCOUNTANT (CPA):**

A certified public accountant (CPA) is an accountant with a special state license indicating that he or she meets certain requirements for the public practice of accounting. Although requirements vary from state to state, all must pass a rigorous examination administered by the American Institute of Certified Public Accountants.

**CHAPTER 7:**

Chapter 7 of the Bankruptcy Code governs liquidation proceedings. Most bankruptcy cases fall into this category. In a Chapter 7 proceeding, a trustee in bankruptcy is appointed to gather the property of the debtor that is not exempt from the proceedings, convert the property to cash, and distribute the available proceeds to the creditors. The debtor is allowed to keep certain exempt property. What he gets in exchange for filing is possible relief, or discharge, from the amount of his debts that exceed the cash the trustee is able to obtain from his nonexempt property. Not all debtors are able to obtain discharge and not all debts are discharged. (See Debtor in Bankruptcy, Discharge of Debts, and Trustee in Bankruptcy.)

**CHAPTER 9:**

Chapter 9 of the Bankruptcy Code addresses the adjustment of the debts of a municipality. (See Bankruptcy Proceedings.)

**CHAPTER 11:**

Chapter 11 of the Bankruptcy Code governs the reorganization of financial obligations by debtors. In a Chapter 11 proceeding, the debtor generally remains in business during the bankruptcy action, retains property, and pays creditors from future earnings, in accordance with a plan of rehabilitation approved by the court. A plan confirmed by the court binds both the debtor and creditors, even those that did not accept it. (See Claim in Bankruptcy, Debtor in Bankruptcy, and Trustee in Bankruptcy.)

**CHIEF FINANCIAL OFFICER:**

The corporate officer officially designated as the Chief Financial Officer or functionally equivalent most senior financial officer. The person who signs SEC submissions or the equivalent. The most senior local government official with authority and responsibility for the collection, disbursement, and use of funds by the local government.

**CIRCULAR 570:**

Circular 570 is a list of qualified surety companies put together by the U.S. Department of Treasury. The list is published annually on approximately July 1, and updated periodically in the *Federal Register*. Circular 570 lists the states in which each qualified surety is licensed to enter into a surety bond. Circular 570 also lists the maximum amount that each surety can guarantee in one bond, called the underwriting limitation. A surety may issue a surety bond exceeding this amount only when it brings another company into the surety agreement to help share the risk. However, even several sureties acting together may not exceed the total of their individual underwriting limitations.

**CLAIM IN BANKRUPTCY:**

A claim in bankruptcy is (1) a right to payment from a debtor or (2) a right to an equitable remedy for breach of performance by a debtor if such breach provides a right to payment. Creditors with claims are eligible to participate in any distribution of the debtor's property which may be made. (See Debtor in Bankruptcy.)

**CLAIMS-MADE COVERAGE:**

Claims-made coverage is an insurance policy form under which coverage is triggered only when claims are made during the policy period. Insurers use the claims-made form with the intent of relieving themselves of the financial burden of claims brought long after the original occurrence and to reduce the difficulty of predicting the number and magnitude of claims that will be made.

An occurrence-based policy, in contrast, covers claims based on whether the event that caused the harm occurred while the policy was in force, regardless of when claims are made. (See Occurrence-Based Coverage.)

The period of coverage under a claims-made policy may be further expanded or restricted by incorporating a "retroactive period" provision. (See Extended Reporting Period and Occurrence-Based Coverage.)

**CLOSURE OR POST-CLOSURE CARE INSURANCE:**

Closure or post-closure care insurance is a type of insurance coverage that provides funds for final closure or post-closure care of RCRA Subtitle C hazardous waste facilities and thereby satisfies the financial assurance requirements for closure and post-closure care. This type of insurance should not be confused with liability insurance. (See Liability Insurance.)

**COLLATERAL:**

Collateral is tangible security or property, often readily convertible into cash, that is deposited to guarantee payment of an obligation. Either the property itself or a document of title to it is held by the creditor.

**COMMON STOCK:**

Common stock is the basic ownership interest in a corporation. Common stockholders in effect "own" the corporation; they bear the ultimate risks of loss and receive the benefit of success. To a limited extent, common stockholders can control the management of the corporation, since they have contributed either property or services to the enterprise in return for ownership shares. However, unlike partnerships, their liability is limited to the value of their shares: there is little recourse to the property of the individual stockholders.

**COMMON TRUST FUND:**

In common trust fund, a number of trust accounts are pooled and jointly invested for potentially higher yields. Sometimes trust fund management fees and costs are less because of economies of scale. Since smaller trusts can often benefit from a common trust fund arrangement, common trusts may make the trust fund mechanism a more attractive financial assurance option to owners or operators with small financial assurance needs. Not all financial institutions offer common trust funds due to the requirements of state and federal agencies such as the Securities and Exchange Commission. Under the RCRA UST financial responsibility program, a trustee may use a special common trust if it fulfills all the requirements of the specified trust agreement.

**COMMERCIAL GENERAL LIABILITY (CGL) POLICY:**

A Commercial General Liability (CGL) policy is an insurance policy form designed to cover all types of third-party damages (i.e., an "all hazards" scope of protection), subject to certain exclusions and conditions specified in the policy form. Most standard CGL policies issued since the early 1970s have excluded coverage for damages caused by release of a pollutant that is not "sudden and accidental." However, as a result of court decisions which, insurers claim, expanded coverage to include damages caused by nonsudden accidental occurrences, and for other reasons, the insurance industry rewrote CGL forms to exclude virtually all damages caused by pollution, whether sudden or gradual. (See Claims-Made Coverage, Nonsudden Accidental Occurrence, Occurrence-Based Coverage, and Sudden Accidental Occurrence.)

**CORRECTIVE ACTION COSTS:**

Corrective action costs are costs incurred while cleaning up a petroleum release from an underground storage tank.

**COST ESTIMATE:**

Under the RCRA and SDWA hazardous waste financial assurance regulations, the owner or operator prepares an estimate of the cost in current dollars of conducting closure, post-closure care, corrective action, and plugging and abandonment. The owner or operator is required to demonstrate financial responsibility in the amount of the applicable cost estimates.

**COSURETY:**

A cosurety is one of two or more sureties who share the obligation under a surety bond obligation. The purpose of this arrangement is to spread the risk among sureties. A surety may issue a surety bond exceeding the underwriting limitation established in Circular 570 only when it brings another company into the surety agreement to help share the risk. However, even several sureties acting together may not exceed the total of their individual underwriting limitations. (See Circular 570.)

**CREDITOR:**

In general, a creditor is one who has the right to require the fulfillment of an obligation or contract. A creditor is normally someone from whom a person, the debtor, has acquired assets or services for which the debtor is legally required to make payment or provide services in the future. (See Debtor.)

**CURRENT ASSETS:**

Current assets are defined by Generally Accepted Accounting Principles as "cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business." (Operating cycle is in turn defined as the average time intervening between the acquisition of materials or services and their final cash realization.) Thus, current assets comprehends such resources as: (1) cash available for current operations and items that are the equivalent of cash, (2) inventories of merchandise, raw materials, goods in process, finished goods, operating supplies, and ordinary maintenance material and parts, (3) trade accounts, notes, and acceptances receivable, (4) receivables from officers, employees, affiliates, and others, if collectible in the ordinary course of business within a year, (5) installment or deferred accounts and notes receivable if they conform generally to normal trade practices and terms within the business, (6) marketable securities representing the investment of cash available for current operations, and (7) prepaid expenses such as insurance, interest, rents, taxes, unused royalties, current paid advertising service not yet received, and operating supplies. (See Exhibit A for a sample Balance Sheet showing Current Assets.)

**CURRENT LIABILITIES:**

Generally Accepted Accounting Principles define current liabilities as "obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of current liabilities." As a balance sheet category, the classification is intended to include obligations for items that have entered the operating cycle, such as: (1) payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale, (2) collections received in advance of the delivery of goods or performance of services, and (3) debts that arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually 12 months, are also included, such as short-term debts arising from the collection or acceptance of cash or other assets for the account of third persons. (See the sample Balance Sheet in Exhibit A which presents Current Liabilities on the Liabilities side of the Balance Sheet, opposite Current Assets.)

**DEBTOR:**

A debtor is a person who owes assets or services to someone (i.e., a creditor). (See Creditor.)

**DEBTOR IN BANKRUPTCY:**

A debtor is a person who owes a debt or who may be compelled to pay a claim to someone (i.e., a creditor). Under bankruptcy law, a debtor is a person (individual, partnership, or corporation) or local government concerning which a case has been commenced. Insurance companies and bank institutions are not eligible to be debtors in bankruptcy. Governmental units, which are defined broadly to include federal agencies, are not eligible to be debtors under Chapters 7 or 11; however, local governments can be debtors under Chapter 9.

**DEDUCTIBLE:**

A deductible is the amount of a loss that the insured is obligated to pay and is not covered by the insurer. For example, an UST owner or operator may purchase insurance coverage with a \$50,000 deductible. For any claims made on this insurance policy, the facility owner or operator will have to pay the first \$50,000. Under RCRA UST regulations, deductibles are permitted; however, the regulations require the insurer to pay the deductible and then seek reimbursement from the insured. (See First Dollar Coverage.)

**DISCHARGE OF DEBTS:**

A discharge of debts is a step in the bankruptcy process whereby the debtor is released from his obligation to satisfy creditors' claims. As might be expected, creditors generally seek to avoid discharge of their claims so that they can pursue the debtor after bankruptcy.

**DISCLAIMER OF OPINION:**

Statement that the auditor can not express an opinion on financial statements. This opinion will cause the implementing agency to disallow the use of the financial test.

**DISCOVERY PERIOD:**

The discovery period is the time under a claims-made policy during which claims made against the insured may be covered by the insurer. Under an extended reporting period, the discovery period is extended beyond the expiration date of the policy. (See Claims-Made Coverage, Policy Period, and Exhibit 1.)

**DOMICILE:**

State or country in which an insurance company has its principal legal residence.

**DUN & BRADSTREET:**

Dun & Bradstreet is a leading provider of business information. One service it offers is a rating of a company's worth based on its interim or year-end balance sheet.

**DUTY TO DEFEND:**

The duty to defend is an obligation of an insurance company to defend the insured (i.e., pay legal defense costs or provide legal assistance to defend) against damage claims brought by third parties against the insured. An insurer's duty to defend is broader than its duty to indemnify. The obligation to defend applies to any claims that may fall within the insurer's obligation to indemnify the insured. (See Duty to Indemnify.)

**DUTY TO INDEMNIFY:**

The duty to indemnify is an obligation of an insurer to compensate or reimburse an insured for liabilities incurred in accordance with the terms of the insurance policy. (See Duty to Defend.)



**ENDORSEMENT:**

In the insurance context, an endorsement is a form attached to an insurance policy that describes the original terms of the policy and any alterations to those terms. Unlike a certificate of insurance, an endorsement is part of the insurance contract and may be used to clarify, extend, or restrict coverage. (See Certificate of Insurance and Rider.)

**ENVIRONMENTAL IMPAIRMENT LIABILITY (EIL) INSURANCE:**

EIL insurance is a type of insurance first developed in the 1970's specifically to cover third party damages caused by pollution. Virtually all EIL insurance policies are issued on a claims-made basis. EIL can be purchased to cover third party damages caused by sudden accidental occurrences and/or nonsudden accidental occurrences. (See Commercial General Liability and Claims-Made Coverage.)

**ESCROW:**

An escrow agreement is an agreement by which property (usually a deed, other legal document, or money) is deposited in the hands of a third party, usually a bank or a trust company, pending the performance of a condition or the occurrence of a specified event, and then delivered to the beneficiary. A valid escrow agreement requires three parties: the grantor (principal placing the property in escrow), the grantee (principal who is to receive the property upon the occurrence or performance of the condition agreed upon), and a neutral third party, known as the depository. After the escrow property has been properly delivered to the depository, neither principal can obtain it without mutual agreement or without complying with the terms of the escrow agreement.

**EXCESS OR SURPLUS LINES INSURERS:**

Excess or surplus lines insurers are the designation that a state may give to insurance companies that are not licensed or "admitted" to transact business in that state. Because such companies are not regulated, states often control their ability to transact business through the regulation of brokers and agents. In addition, some states maintain lists of eligible excess or surplus lines insurers that brokers may place business with. For an Excess or Surplus Line carrier's policy to comply with the RCRA UST regulations, the carrier must be eligible to provide coverage in one or more states. Captive or alien insurers not meeting either the licensing or eligibility requirements cannot issue liability policies which will comply with the RCRA UST regulations. (See Admitted Carrier, Alien Insurer, and Captive Insurer.)

**EXCLUSION:**

An exclusion is a provision in an insurance policy that certain causes of loss or certain results are not covered by the policy under any circumstances. For example, the pollution exclusion in many Commercial General Liability policies excludes coverage for pollution that is not "sudden and accidental." (See Pollution Exclusion.)

**EXTENDED REPORTING PERIOD:**

An extended reporting period is a claims-made policy provision whereby an insured, for the payment of an additional premium, may obtain an extension of coverage following the expiration of the policy for losses caused by events occurring during the policy period, but for which claims are not made until after the policy's expiration. Extended reporting periods allow the insured to report after the termination date of the policy and get coverage for a release that occurred during the policy period. Otherwise, gaps in coverage that could arise if the replacement policy does not cover releases that occur prior to the effective date of the new policy. (See Claims-Made Coverage and Tail Coverage.)

**FACE AMOUNT:**

The face amount is the total amount the insurer, surety, or other guarantor is obligated to pay; the insurer's, surety's, or other guarantor's limit of liability or policy limit. (See Policy Limit.)

**FACE VALUE:**

The face value of an instrument is the value of a surety bond, insurance policy, or letter of credit, expressed as a specific sum of money, which is printed, stamped or otherwise marked on its face.

**FIDUCIARY:**

A fiduciary is a person who has the duty to act on behalf of another or to protect the interests of another (i.e., has a fiduciary duty). For example, a trustee is a fiduciary. So is an agent.

**FINANCIAL ACCOUNTING STANDARDS BOARD (FASB):**

The Financial Accounting Standards Board (FASB) is a private, independent board that is charged with the task of establishing Generally Accepted Accounting Principles (GAAP). The board consists of seven full-time remunerated members. It is not an organ of any single professional organization; it is appointed by, and is answerable only to, the Financial Accounting Foundation whose members are representatives of different professional associations.

**FINANCIAL ASSURANCE MECHANISM:**

A financial assurance mechanism is a financial instrument, such as a state fund program, guarantee, letter of credit, surety bond, or insurance, that is available to an UST owner or operator to demonstrate financial responsibility.

**FINANCIAL GUARANTEE OR PAYMENT BOND:**

A financial guarantee or payment bond is a type of surety bond under which the surety agrees to pay the penal sum of the bond if the owner or operator fails to fulfill its obligations. (See Performance Bond, Surety, and Surety Bond.)

**FINANCIAL RESPONSIBILITY:**

Financial responsibility is the demonstrated capability to pay for remediating potential damage to the environment or compensating third parties. Also termed financial assurance.

**FINANCIAL STATEMENTS:**

Financial statements reflect the collection, tabulation, and final summarization of accounting data. They are used by the public to determine a company's financial condition. Three financial statements are required by Generally Accepted Accounting Principles (GAAP), they are: (1) the balance sheet, (2) the income statement and, (3) the statement of changes in financial position.

**FINANCIAL TEST:**

A financial test is a prescribed set of financial ratios and/or multiples which a company must pass to provide financial assurance. Companies and local governments are not required to use the financial test, but most that are able to meet the criteria tend to use the test because it is the most cost-effective mechanism.

**FIRST DOLLAR COVERAGE:**

First Dollar Coverage is an insurance policy that, in the event of a covered loss, will pay the entire loss up to the policy limit. RCRA regulations require that if a policy incorporates a deductible, the insurer must settle the claim and seek reimbursement of the deductible amount from the insured, unless the

financial test (or some other mechanism) is being used by the owner or operator to assure the deductible amount. (See Deductible.)

**FIXED ASSETS:**

Fixed assets is a term used to describe all types of plant and equipment. This term, however, is seldom used anymore in published financial statements by large corporations. The term "plant and equipment" is more commonly used. Plant and equipment items are classified into the following groups:

- **Tangible plant assets:** The term tangible denotes physical substance, as exemplified by land, a building, or a machine. This category can be subdivided into two distinct classifications: (1) plant property subject to depreciation, included are plant assets of limited useful life such as buildings and office equipment, (2) land which is not subject to depreciation since it has an unlimited term of existence.
- **Intangible assets:** The term intangible assets is used to describe assets which are used in the operation of the business but have no physical substance, and are noncurrent assets. Examples include patents, copyrights, trademarks, franchises, and goodwill. Intangible assets are only accounted for on the balance sheet if they have been acquired from another enterprise. (Current assets such as accounts receivable or prepaid rent are not included in the intangible classification, even though they are lacking in physical substance. See Current Assets.)

**FORM 10-K:**

Form 10-K is a document required by the Securities and Exchange Commission (SEC). The form must be filed annually by most domestic publicly-owned companies within 90 days of the end of their fiscal year. Form 10-K provides a comprehensive overview of the company's state of business. The Form 10-K contains: (1) the company's audited year-end financial statements, (2) the stock ownership of certain owners and of management, (3) management's discussion and analysis of the company's financial condition, (4) the names of the Directors and Executive Officers and their compensation, (5) certain company relationships and related transactions, (6) legal proceedings, (7) company relationships and related transactions, (8) the recent market price of common stock and dividend information, and (9) disagreements with the auditors on accounting and financial disclosure.

**FORM 10-Q:**

Form 10-Q is a document required by the Securities and Exchange Commission. Form 10-Q must be filed on a quarterly basis by most domestic publicly-owned corporations. It includes unaudited financial statements and provides a continuing view of the company's financial position during the year. The report must be filed three times a year (the Form 10-K constitutes the fourth quarter report) and is due within 45 days of the close of each fiscal quarter. The report contains: (1) financial statements, (2) management's discussion and analysis of the financial condition and results of operations, (3) legal proceedings, (4) changes in securities, (5) defaults upon senior securities, and (6) matters submitted to a shareholders vote.

**FRONTING (FRONT):**

An onshore carrier serving as the front for an offshore captive will issue a policy written on its paper to cover a risk, sometimes only insuring a small percentage of it and reinsuring the majority or all of the risk to the captive. Used, for example, where captive insureds need evidence of insurance from an admitted insurer.

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP):**

Generally Accepted Accounting Principles (GAAP) are principles that are deemed generally accepted as authoritative by the accounting profession and the business community. These principles are established by the Financial Accounting Standards Board and similar, now defunct, organizations which preceded it, by means of a "due process" system in which the public has the right to comment and propose ideas. (See Financial Accounting Standards Board.)

**GENERAL OBLIGATION BONDS:**

General obligation (G.O.) Bonds, also known as "full faith and credit" bonds, are secured by their issuers' ability to levy ad valorem (i.e., property) taxes or to draw from other unrestricted revenue sources, such as sales or income taxes.

**GOODWILL:**

Goodwill is an intangible asset that measures benefits derived from a favorable reputation among customers. To accountants, however, goodwill like other intangible assets, occurs only when the asset is purchased, i.e., when a company purchases another company. According to Generally Accepted Accounting Principles (GAAP) goodwill is "the excess of the cost of the acquired enterprise over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed." For example, if Diamond Company pays \$1 million for Astor Company, and the fair market value of Astor's total assets minus its total liabilities is \$800,000, Diamond will have paid \$200,000 in goodwill. This amount reflects Diamond's belief that the stream of earnings that can be derived from Astor justifies its paying \$200,000 over the fair market value of Astor's residual assets.

**GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB):**

The Government Accounting Standards Board (GASB) is a private, independent board that is charged with the task of establishing standards of financial accounting and reporting for state and local government entities. The board consists of seven members, who are appointed by, and answerable only to, the Financial Accounting Foundation whose members are representatives of different professional associations.

**GOVERNMENT FUND:**

A government fund is a trust fund or escrow account for which a State is acting as trustee or escrow agent.

**GRADUAL POLLUTION COVERAGE:**

Gradual Pollution Coverage is a policy designed to provide insurance protection for pollution incidents that take place over time and result in bodily injury or property damage neither expected nor intended by the insured. Also referred to as nonsudden pollution coverage. (See Nonsudden Accidental Occurrence and Pollution Liability Insurance.)

**GUARANTEE:**

A guarantee is a contract in which the guarantor undertakes to answer for the payment of another's debt or the performance of another's duty, liability or obligation. For example, a corporate or government guarantee is a document which states that the guarantor guarantees it will meet all financial assurance obligations specified in the guarantee.

**GUARANTOR:**

A guarantor is the company or government that provides the guarantee.

**INCOME STATEMENT:**

The income statement is one of the three financial statements required by Generally Accepted Accounting Principles (GAAP). Unlike the balance sheet, the income statement is designed to report the performance of a business over a specific period of time, such as a year, a quarter or a month, not at a specific date.

**INDEMNIFY:**

To indemnify is to agree to reimburse a person in case of a contemplated loss or liability, usually for a specific activity during a specific period. Strictly interpreted, an insurance policy that indemnifies the insured would require the insured to pay damages and other costs out of his or her own funds and then to seek reimbursement from the insurer. In contrast, a policy that "pays on behalf of" the insured would require the insurer to pay all costs directly. In practice, the insurance industry does not adhere to the strict interpretation of indemnify.

**INDEMNITY AGREEMENT:**

An indemnity agreement is a contract in which a party agrees to secure another party against an anticipated loss or damage, or to reimburse the former for the costs resulting from the loss. Many insurance policies are written as indemnity agreements.

**INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S OPINION (AUDITOR'S OPINION):**

The independent certified public accountant's opinion usually accompanies an organization's financial statements. It contains the auditor's opinion on the quality of the financial data reported in the financial statements. The independent certified public accountant's opinion letter may express several types of opinion.

**INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S SPECIAL REPORT:**

As a requirement of the hazardous waste financial test and corporate guarantee, the owner or operator of a RCRA or SDWA hazardous waste treatment, storage, or disposal facility must submit a special report from the owner or operator's independent certified public accountant. There is no prescribed EPA wording, but the report must state that:

- the certified public accountant has compared the amounts stated in the Chief Financial Officer's letter and certifies that the data came from the latest fiscal year-end audited financial statements, and
- that no matters have come to his or her attention which caused him or her to believe that the data should be adjusted.

A similar report is required by Alternative II of the UST financial test if the owner or operator or guarantor does not file financial statements annually with the Securities & Exchange Commission, Energy Information Administration, or the Rural Utilities Service. This special report is a separate document from the independent certified public accountant's opinion. (See Independent Certified Public Accountant's Opinion.)

**INSURANCE:**

Insurance is a contract whereby, for a stipulated consideration or premium, one party undertakes to compensate the other for losses on a specified subject by specified perils. (See Premium Payments.)

**INSURANCE AGENT:**

An insurance agent is a person authorized to sell insurance coverage as a representative of an insurer or underwriter. An agent may need to be licensed. (See also Broker.)

**INSURANCE POLICY:**

In broad terms, the entire written contract of insurance. More specifically, it is the basic written or printed document, as well as the coverage forms and endorsements (including binders and slips) added to it.

**INTERIM FINANCIAL STATEMENTS:**

Interim financial statements are statements prepared monthly or quarterly in addition to those statements prepared annually so that the public (and management) may monitor the firm's financial condition more frequently than annually. The annual or year-end statements are usually audited by a firm of certified public accountants; interim statements are usually unaudited. (See Financial Statements.)

**INVESTMENT GRADE:**

A bond or other debt instrument with a rating from Moody's of Aaa, Aa, A, or, Baa, or a rating from Standard & Poor's of AAA, AA, A, or BBB.

**INVOLUNTARY CASE:**

An involuntary case may be commenced only under Chapter 7 or 11 of the Bankruptcy Code against a person that may be a debtor. An involuntary case is commenced by the filing with the bankruptcy court of a petition by at least three creditors who have claims that meet certain requirements. (See Chapter 7, Chapter 11, Debtor in Bankruptcy, and Voluntary Case)

**IRREVOCABLE:**

Under RCRA UST regulations, certain financial assurance mechanisms (e.g., letters of credit) must be "irrevocable" meaning either automatically renewed or with conditions or limitations on the cancellation or termination of the mechanism.

**ISSUER:**

The party who issues an insurance policy, letter of credit, or surety bond.

**JOINT AND SEVERAL LIABILITY:**

Joint and several liability is a legal concept that makes each contributor to an injury fully responsible for the total amount of damages associated with that injury. It generally applies where liability for damages is indivisible among the persons or firms that contributed to the damage.

**LEGAL DEFENSE COST:**

Any expense that an owner or operator incurs in defending against claims or actions brought (1) by EPA or a state to require corrective action or to recover costs of corrective action, or (2) by or on behalf of a third party for bodily injury or property damage caused by an accidental release.

**LETTER OF CREDIT:**

A letter of credit is a mechanism by which the credit of one party, such as a bank, is extended on behalf of a second party, called the account party, to a third party, the beneficiary. The issuer allows the beneficiary to draw funds upon the presentation of the letter of credit in accordance with its terms. In a RCRA letter of credit, the owner or operator is the account party, the financial institution is the issuer, and the EPA is the beneficiary.

**LIABILITY INSURANCE:**

A form of insurance that indemnifies against legal liability on account of injuries to the person or property of another (i.e., a third party). (See Closure or Post-Closure Care Insurance, and Third Party.)

**LIQUIDATION PROCEEDING:**

See "Chapter 7."

**LONG-TERM DEBT:**

Generally Accepted Accounting Principles define long-term debt as obligations "which are expected to mature beyond one year (or the operating cycle, if applicable) from the date of an enterprise's balance sheet." Mortgages payable, bonds payable, and long-term notes payable are examples of long-term debt. (See Total Liabilities.) (Refer to Exhibit A for a sample Balance Sheet showing Long-Term Debt.)

**MOODY'S:**

Moody's Investors Service is one of the two bond-rating agencies acceptable for purposes of the corporate financial test and local government bond rating test. The other agency is Standard & Poor's. (See Standard & Poor's.)

**NET WORKING CAPITAL:**

Generally Accepted Accounting Principles (GAAP) define net working capital as the "excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business." Net working capital can be expressed as a dollar amount as follows:

Computation:	Total current Assets	- Total current liabilities	=	Net Working Capital
Example:	\$2,000,000	\$350,000	=	\$1,650,000

**NET WORTH OR STOCKHOLDER'S (OWNER'S) EQUITY:**

Net worth is defined as total assets minus total liabilities. It is equal to stockholder's or owner's equity. This relationship can be expressed in the following equation: Net Worth = Total Assets - Total Liabilities. The equation represents the fundamental characteristic of every balance sheet: the total figure for assets always equals the total figure for liabilities and stockholder's equity (net worth). (See Balance Sheet.) The dollar totals on both sides of the balance sheet are always equal because these two sides are two views of the same business resources. The listing of assets shows us what resources the business owns; the listing of liabilities and stockholder's equity (net worth) tells us who supplied those resources to the business and how much each group supplied. Everything that a business owns has been supplied to it by creditors or by the owners or stockholders. Thus, the total claims of the creditors and stockholders or owners equal the total assets of the firm. This means that companies with high net worth relative to, for example, the industry average are companies that are financing a higher proportion of their total assets from resources contributed by owners or stockholder's equity rather than through debt.

**NON-ADMITTED INSURER:**

Non-admitted insurer is the designation that a state gives to insurance companies that are not licensed to transact business in that state. Because such companies are not regulated, states include specific regulations for agents and brokers of excess or surplus lines in the broker's or agent's license. A state

may require a broker or agent to submit declarations from a number of licensed (or admitted) insurers stating that the service(s) provided by a particular excess or surplus line cannot be obtained from their firms. Some states maintain "black lists" of non-admitted insurers that a broker or agent cannot take on as an excess or surplus line provider. Most states, on the other hand, keep "white lists" of eligible providers. (See Excess or Surplus Lines.)

**NONSUDDEN ACCIDENTAL OCCURRENCE:**

A nonsudden accidental occurrence is an accidental occurrence that takes place over time and involves continuous or repeated exposure. Nonsudden accidental pollution, such as petroleum product gradually leaching into groundwater, also is often referred to as gradual pollution. (See Accidental Occurrence.)

**OBLIGEE:**

One in favor of whom the surety is obliged in a surety bond. In RCRA surety bonds, the implementing agency is the obligee.

**OCCURRENCE:**

Occurrence is an accident, including continuous or repeated exposure to conditions, which results in a release from an underground storage tank.

**OCCURRENCE- BASED COVERAGE:**

Occurrence-based coverage is a form of insurance that covers claims based on whether the occurrence causing damages occurred during the policy period, not whether the claim was filed during the policy period. For pollution liability coverage, insurers have moved away from occurrence-based coverage in favor of claims-made coverage. (See Claims-Made Coverage, Comprehensive General Liability, Environmental Impairment Liability, and Pollution Liability Coverage.)

**OPINION PARAGRAPH:**

The paragraph in the audit report that expresses the auditor's conclusions.

**PARENT CORPORATION:**

A parent corporation is one who directly owns at least fifty percent of the voting stock of the corporation which is the owner or operator. Stock ownership information for public companies is usually disclosed in the Form 10-K report. The Securities and Exchange Commission requires most companies to disclose ownership of subsidiaries. An ownership interest in excess of fifty percent would probably be disclosed under those requirements.

**PAY-IN-PERIOD:**

Under RCRA UST regulations, the pay-in-period is the period of time during which the local government owner or operator must make payments into the local government fund until it is fully funded (i.e., until the current market value of the trust fund equals the required amount of coverage). Payments into the local government fund must be made annually by the local government owner or operator over a seven-year term.

**PENAL SUM:**

A penal sum is the face value of a surety bond. The liability of the surety is limited to this amount. (See Face Value, Surety Bond, and Surety.)



**PERFORMANCE BOND:**

A performance bond is a type of surety bond under which the surety agrees either to pay the penal sum of the bond or to perform the required actions if the owner or operator fails to fulfill its obligation. (See Financial Guarantee or Payment Bond, Surety, and Surety Bond.)

**POLICY LIMIT:**

The policy limit for an insurance policy is the maximum amount that an insurance company agrees to pay for losses covered under the policy, often expressed in annual aggregate and per occurrence terms. (See Face Amount.)

**POLICY RETROACTIVE DATES:**

Claims-made policies typically provide coverage only for releases that begin subsequent to the policy's retroactive date and that are reported during the policy period and any extended reporting period. The retroactive date is generally the same as the effective date of the policy. In the case of policy renewal, the retroactive date of the renewal policy is generally the original issue date and not subsequent renewal dates.

**POLLUTION EXCLUSION:**

A pollution exclusion is a standard provision in Commercial General Liability (CGL) insurance policies that excludes coverage of damages caused by "sudden and accidental" and/or "nonsudden accidental" release of pollutants. Insurance companies developed the pollution exclusion in the early 1970's to exclude coverage for intentional pollution. (See Commercial General Liability and Exclusion.)

**POLLUTION LIABILITY INSURANCE:**

Pollution liability insurance is insurance designed to provide protection for bodily injury, property damage, and environmental impairment resulting from the sudden and/or gradual discharge, dispersal, release, escape or seepage of toxic substances into the environment. (See Gradual Pollution Coverage.)

**POWER OF ATTORNEY:**

Power of attorney is a written instrument authorizing another to act as one's agent or attorney.

**PREMIUM PAYMENTS:**

Premium payments are the periodic payments of money that the policyholder agrees to pay the insurer for insurance coverage.

**PRINCIPAL:**

A principal is a party bound to a contract. For example, a valid escrow agreement requires three parties: the two principals, the grantor (principal placing the property in escrow) and the grantee (principal who is to receive the property upon the occurrence or performance of the condition agreed upon) and a neutral third party, known as the depositary.

**PROPERTY DAMAGE:**

Property damage is damage to property that is recoverable as a liability under applicable state law. However, under RCRA liability coverage regulations the term does not include those liabilities that, consistent with standard industry practice, are excluded from coverage in liability insurance policies for property damage. For example, under RCRA regulations, an insurance policy need not cover property damage caused by war, covered by automobile insurance policies, or intentionally caused.

**PRUDENT-MAN STANDARD:**

The prudent-man standard is an investment rule according to which a trustee may make an investment only if it is one that a "prudent man" of discretion and intelligence, seeking reasonable income and preservation of capital, would buy. Under the RCRA financial assurance program, a trustee must follow the prudent-man standard when investing trust funds. For example, the trustee should invest in relatively low-risk investments such as U.S. government bonds, and the stocks and bonds of large "blue-chip" corporations, rather than in speculative investments such as the stocks of small, untried companies. (See Trustee.)

**QUALIFIED OPINION:**

A qualified opinion may state that (1) the financial statements do not present fairly the financial position of the company or local government, (2) the auditor does not express an opinion on the financial statements, or (3) that the company may not be able to continue as a going concern.

**REFUNDED BOND:**

When interest rates fall, an issuer may choose to sell a new issue called a refunding issue and use the proceeds of the second issue to pay off the original issue, much the same as a homeowner refinancing a mortgage in an effort to save interest costs. The proceeds of the refunding issue are used to structure a portfolio of U.S. government securities, the principal and interest payments of which exactly match the principal and interest payments of the refunded bonds. The portfolio is placed in escrow at the paying agent and the bond issue is said to be fully defeased and escrowed to maturity. Because of the U.S. Treasury backing, refunded bonds are considered the safest municipal bonds available and have the highest bond rating.

**REFUNDING BOND:**

The issuance of a new bond for the purpose of retiring an already outstanding bond.

**REHABILITATION PROCEEDING:**

See "Chapter 11" and "Chapter 13."

**REINSURANCE:**

A contract between an insurer or surety and another party, called the reinsurer, in which the reinsurer agrees to protect (reinsure) the insurer or surety against loss on some of its insurance. Reinsurance allows an insurer or surety to share the risk among more parties and issue more policies or bonds within its allowable limits.

**REPORT ON EXAMINATION:**

The independent certified public accountant's report on the financial statements, support schedules, and footnotes. Often referred to as the accountant's report or the auditor's opinion.

**RETROACTIVE DATE:**

Retroactive date is a provision in a claims-made policy that limits coverage to damages caused by events that occur subsequent to a certain (retroactive) date. The retroactive date is normally the date a policy is first issued. (See Extended Reporting Period and Tail Coverage.)

**RETROACTIVE PERIOD:**

Under a claims-made policy, insureds sometimes purchase coverage for damages caused by events that occurred before the policy was written. That period of coverage is called the retroactive period: the period between the retroactive date and the issue date of the policy. Insurance for the retroactive

period is often used to fill gaps in coverage that may occur between the end of one claims-made policy and the issue date of another. (See Retroactive Date and Discovery Period.)

**REVENUE BONDS:**

A revenue bond is a long-term debt instrument that is issued to finance a specific public enterprise and that is payable solely from enterprise earnings or from a dedicated tax.

**RIDER:**

In insurance, a rider is a form adding special provisions to a policy. (See Endorsement.)

**RISK RETENTION GROUPS:**

The Liability Risk Retention Act of 1986 is a law that allows firms to jointly establish a group captive insurance company that, in turn, offers owner-members liability insurance at favorable rates. A major advantage of risk retention groups is that, unlike other insurance companies, they need to be chartered in only one state. This eliminates a lot of expensive red tape. (See Captive Insurer.)

**SECURITIES:**

A security is evidence of debt or property such as a U.S. government bond, the bonds and stocks of corporations, collaterals, deposit funds, or certificates of deposit.

**SELF-INSURANCE, SELF RETENTION:**

Self-insurance and self-retention mean financing losses from within the financial structure of an entity, rather than transferring losses to an insurance company by purchase of liability insurance. Self-insurance may be a formal program in which funds are set aside to pay for losses that may occur at a later date. Self-insurance in this respect is different from "going bare," in that only the former involves setting aside reserves to cover claims. One major disadvantage of self-insurance is that, unlike premiums paid to insurance companies, the reserves (if any) established by the self-insurer are not tax deductible.

Under RCRA UST regulations, owners or operators may comply with the financial responsibility requirements by passing a specified financial test of self-insurance; the financial test mechanism, however, does not require the establishment of reserves.

**SPECIAL REPORT:**

The independent certified public accountant's confirmation that the financial data in the letter from the Chief Financial Officer were derived from the year-end financial statements and need no adjustment.

**STANDARD AND POOR'S:**

One of two bond-rating agencies acceptable for purposes of the corporate financial test and local government bond rating test. (See Moody's.)

**STANDBY TRUST FUND:**

Under RCRA regulations, a standby trust fund is established to receive funds from a surety bond, letter of credit, or guarantee in the event that the Regional Administrator draws on those mechanisms. A standby trust fund must accompany each RCRA surety bond, letter of credit, or guarantee because EPA lacks the authority to receive funds directly from a surety, bank, or guarantor. Instead, the funds are deposited in the standby trust fund and used at the direction of the Regional Administrator.

**STATEMENT OF CHANGES IN FINANCIAL POSITION:**

The Statement of Changes in Financial Position is one of the three financial statements required by Generally Accepted Accounting Principles (GAAP). The statement provides a link between the balance sheets of two consecutive periods by furnishing information on the financing and investing activities of the company. The statement helps analysts understand how and why the financial position has changed during the period.

**STOCKHOLDERS:**

Stockholders are owners of a corporation. Ownership is evidenced by shares of capital stock that are freely transferable to others at any time and at any price without obtaining the consent of the company or other stockholders. Each share of stock has certain rights and privileges that can be restricted only by special contract at the time the shares are issued. In the absence of restrictive provisions, each share carries the following rights: (1) to share proportionately in profits and losses, (2) to share proportionately in management and to vote for directors, (3) to share proportionately in corporate assets upon liquidation, and (4) to share proportionately in new issues of stock.

**STRICT LIABILITY:**

Strict liability is a form of tort liability where a person who causes an injury is responsible for damages associated with that injury, regardless of fault or negligence. Strict liability is often applied in product liability cases; it also applies under the common law and many statutes to "abnormally dangerous" or "ultra-hazardous" activities. Courts in some states have ruled that activities associated with petroleum storage are "abnormally dangerous" and have imposed strict liability for damages. (See Tort.)

**SUBSIDIARY CORPORATION:**

A subsidiary is an enterprise that is controlled, directly or indirectly, by another enterprise. The usual condition for control is ownership of a majority (over 50 percent) of the outstanding voting stock. The power to control also may exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or by court decree. (See Parent Corporation.)

**SUBSTANTIAL BUSINESS RELATIONSHIP:**

The extent of a business relationship necessary under applicable state law to make a guarantee contract issued incident to that relationship valid and enforceable. A guarantee contract is issued "incident to that relationship" if it arises from and depends on existing economic transactions between the guarantor and the owner or operator.

**SUDDEN ACCIDENTAL OCCURRENCE:**

A sudden accidental occurrence is an accidental occurrence that is not continuous or repeated in nature. (See Accidental Occurrence.)

**SURETY:**

A surety is a person who undertakes to pay money or do any other act in the event that another party, the principal, fails therein. A surety is entitled to reimbursement from the principal if the surety is required to pay or perform under a bond. (See Principal and Surety Bond.)

**SURETY BOND:**

A surety bond is a contract providing for monetary compensation or performance should there be a failure to perform any specific act within a specific period. Under the RCRA regulations, a surety bond is a contract in which a surety company is liable for the default of an UST owner or operator. The surety agrees to satisfy these responsibilities if the owner or operator does not. The liability of

the surety is limited to the face amount of the bond, called the penal sum. (See Financial Guarantee or Payment Bond, Performance Bond, Surety, and Penal Sum.)

**TAIL COVERAGE:**

On a claims-made policy, tail coverage is coverage of claims that stem from an incident that occurred during the policy period for which claims are made during an extended reporting period. (See Claims-Made and Extended Reporting Period.)

**TANGIBLE NET WORTH:**

Tangible net worth is net worth (i.e., total assets minus total liabilities) minus intangible assets such as goodwill and rights to patents or royalties. The formula for tangible net worth is:

$$\text{Tangible Net Worth} = (\text{Total Assets} - \text{Intangible Assets}) - \text{Total Liabilities}$$

(See Net Worth)

**THIRD PARTY:**

Third party is a person not party to financial assurance contract between the provider, but who may make claims covered by the mechanism. For example, a person whose well was contaminated by releases from an UST may bring an action against the owner or operator of the facility. This person, or third party, may be compensated for damages by the facility's insurer or other provider of assurance.

**TORT:**

A tort is a violation of a private legal right, other than a breach of contract, for which a civil action can be brought. The three fundamental elements of every tort are: (1) existence of a legal duty from defendant to plaintiff, (2) a breach of the duty, and (3) damage as a proximate result of the breach of duty.

**TOTAL ASSETS:**

Generally Accepted Accounting Principles (GAAP) define total assets as all of the "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Total assets may be tangible (physical in character) such as land, buildings or machinery, or intangible (legal claims or rights) such as income due from customers or patents. In a company's balance sheet, total assets are usually divided into current assets, fixed assets, and other assets. (Refer to Exhibit A which shows a sample Balance Sheet. Total Assets is shown on the left side of the balance sheet as the sum of all assets owned by the company.)

**TOTAL LIABILITIES:**

Total liabilities are all the company's liabilities. According to Generally Accepted Accounting Principles (GAAP), liabilities are "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." According to GAAP, for an obligation to be a liability, it must fulfill the following three characteristics:

- It must involve a present duty or responsibility to transfer or use assets at a determinable date;
- It must be unavoidable; and
- The event obligating the transfer or use of assets must have already occurred.

Total liabilities are classified in the balance sheet in two categories: current liabilities and long-term liabilities. Current liabilities are obligations which mature within a year of the date of the financial statement. Long-term liabilities mature more than a year from the date of the financial statements. (Refer to Exhibit A for a sample Balance Sheet showing Current and Long-Term Liabilities.)

**TRUST AGREEMENT:**

The document which establishes a trust.

**TRUSTEE:**

A trustee is the person appointed, or required by law, to hold and protect trust assets and invest them according to the "prudent-man standard" for the benefit of the specified beneficiary. The trustee has control over the trust and is responsible for errors in administering the trust resulting from not acting in good faith (e.g., willful negligence, gross misconduct, and violation of the prudent-man standard). Under the RCRA UST regulations, a trustee is responsible for making payments out of the trust fund at the written direction of the Regional Administrator. (See Prudent Man Standard, and Trust Fund.)

**TRUSTEE IN BANKRUPTCY:**

A trustee in bankruptcy is the person charged with the duty of administering the estate of the debtor. The trustee acts in two capacities. First, he is the statutory successor to the debtor (i.e., he takes title to the debtor's property). (During the course of Chapter 7 proceeding, for example, it is the trustee's obligation to liquidate the property of the debtor, converting it to cash with the eventual goal of distributing cash to creditors.) Secondly, the trustee asserts various powers of avoidance. Therefore, the trustee can avoid transferring certain property of the debtor to creditors and can attempt to ensure equality in the distribution of the debtor's assets.

**TRUST FUND:**

A trust is a three-party agreement whereby one party, called the grantor (sometimes also called the trustor), transfers assets (often money) to a second party, called the trustee, to hold on behalf of a third party, called the beneficiary. In a RCRA trust fund, the owner or operator is the grantor, a bank or other entity that fulfills the RCRA requirements is the trustee, and EPA or a state counterpart agency is the beneficiary. The owner or operator, as grantor, pays into the trust fund resources (such as cash or securities acceptable to the trustee) that are managed by the trustee and will be used to pay for corrective action and/or third-party compensation. The owner or operator usually pays a fee for the trust services provided by the trustee. The arrangement is governed by a trust agreement that sets out the responsibilities and rights of each party.

**TRUSTOR:**

One who creates a trust by depositing assets into it. Also called a grantor.

**UNDERWRITE (A RISK):**

To underwrite is to insure or assume a risk. In insurance, a person or company underwrites all or part of the risk against theft, fire, death, or whatever the policy stipulates, in exchange for a payment called a premium. Underwriting also is the process of rating the acceptability of risks for insurers. (See Premium.)

**UNDERWRITING LIMITATION:**

The maximum amount allowed by law for which a surety can issue a surety bond. The limit may be exceeded if the surety "shares the risk" of the obligation, but still may not exceed the combined underwriting limitation of those companies.

**UNQUALIFIED OPINION:**

Statement by an accountant that the financial statements of a firm present fairly the financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles consistently applied. The auditor does not significantly disagree with the accounting principles and estimates used in developing the financial statements, the consistency of their application, and the adequacy of the information disclosed in them.

**VOLUNTARY CASE:**

A debtor commences a voluntary case under the Bankruptcy Code by filing a petition with the Bankruptcy Court.

**WHITE LIST:**

A state-published list of eligible excess or surplus lines insurers with whom brokers may place business. (See Black List and Non-Admitted Carrier.)

**EXHIBIT A**  
**SAMPLE BALANCE SHEET**

X Company Inc.  
At December 31, 199X  
(in Thousands)

<u>ASSETS:</u>		<u>LIABILITIES:</u>	
Current Assets:		Current Liabilities:	
Cash	\$3,126.20	Accounts Payable	\$3,600.70
Accounts Receivable	2,864.50	Loans Payable	1,182.50
Inventories	6,184.20	Taxes	7,601.80
Prepaid Expenses	1,868.20		
 Total Current Assets:	 14,043.10	 Total Current Liabilities:	 12,385.00
 Long Term Assets:		 Long term Debt:	 4,452.00
Property, Plants and Equipment – at cost	37,687.20	Other Liabilities	6,273.70
(-) Less Accumulated Depreciation	<u>(18,148.90)</u>		
Net (Property, Plant, and Equipment)	19,538.30	<u>Stockholder's Equity:</u>	
Special Tools	5,000.00	Preferred Stocks	283.60
(-) Less Accumulated Depletion and Amortization	<u>(2,999.90)</u>	Common Stock	2,451.00
Net Special Tools	2,000.10	Retained Earnings	<u>15,552.50</u>
Other Assets	<u>5,816.30</u>	Total Stockholder's Equity	18,287.10
 <b>TOTAL ASSETS</b>	 \$41,397.80	 <b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b>	        \$41,397.80