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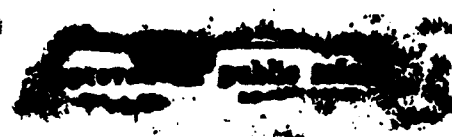
Underground Petroleum Tank Owners'
Ability to Comply With Federal Financial
Responsibility Requirements

Statement of
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Resources, Community, and Economic
Development Division

Before the
Committee on Small Business
United States Senate

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Mr. Chairman and Members of the Committee:

The Superfund Amendments and Reauthorization Act (SARA) of 1986 required that we report to the Congress on whether owners of underground petroleum storage tanks could obtain liability insurance or meet the act's financial responsibility requirements by some other method.¹ These requirements are intended to ensure that tank owners have the resources to clean up any tank leaks and compensate anyone harmed by the leaks.

Our report, issued in January 1988, concluded that insurance for underground petroleum tanks was generally unavailable and that the alternatives to insurance permitted by the law, such as self-insurance, were not practical or available for small businesses.² Because thousands of tank owners might not have been able to meet the deadline for demonstrating financial responsibility under consideration at the time, we recommended that the Environmental Protection Agency (EPA) phase in the requirements over a more realistic timetable. We thought that a gradual approach might permit the development of a more active insurance market and other financial assurance methods, such as special state funds.

In a regulation issued after our report, EPA grouped firms owning underground petroleum storage tanks into four categories and phased in its financial responsibility requirements over 2 years starting from the regulation's issuance in October 1988. On March 14, 1990, EPA announced that it will amend the regulation to extend by one year the compliance deadlines for two categories of smaller

¹These requirements can be satisfied by either the tanks' owners or operators. For convenience, we refer only to tank owners in this statement.

²Superfund: Insuring Underground Petroleum Tanks (GAO/RCED-88-39, Jan. 15, 1988).

firms.³ Category 1 firms, which are very large petroleum marketing firms, had to comply by January 1989; category 2 firms, which include large and medium-sized firms, had until October 1989. Under EPA's newly announced rule, Category 3 firms, which comprise smaller firms, will have until April 1991, and category 4 firms-- which include very small petroleum marketing firms; most tank facilities that do not produce, refine, or market petroleum; and all local governments--will have until October 1991 to comply. We are pleased to be here today to discuss our report and update its findings to the extent we could in the time available.

OVERVIEW

Because the category 1 firms generally can self-insure, they did not have problems complying with EPA regulations. Many of the estimated 500 firms in the second category appear to have satisfied the financial responsibility requirements through insurance or by coverage from special trust funds established by some states. However, it is uncertain whether a sufficient amount of affordable commercial insurance or sufficient state trust funds are available for owners in the last two categories--especially the many thousands of small businesses. Recently, one of the largest suppliers of tank insurance announced that it is suspending the sale of new policies, and another is reducing its area of operations. In addition, most states either have not submitted for EPA approval trust funds to help tank owners establish financial responsibility or have created funds that only partially satisfy the regulations' coverage requirements.

Firms that do not meet the financial responsibility requirements are potentially subject to large federal fines. Noncompliance, according to industry representatives, also violates

³GAO had suggested this action in testimony on February 20, 1990, before the Subcommittee on Environmental Protection, Senate Committee on Environment and Public Works (GAO/T-RCED-90-29).

tank owners' contracts with creditors and suppliers, which require them to operate in accordance with all laws and regulations. Additionally, noncompliance creates a risk that owners may not be able to pay for damages to the public and the environment caused by tank leaks. Therefore, the issue of when to impose the financial responsibility requirements mandated by law is important.

EPA decided not to postpone the regulations or suspend enforcement for category 2 tank owners but last week announced a decision to postpone the category 3 and 4 deadlines for one year. Currently, there does not appear to be reasonable assurance that category 3 and 4 firms can meet the financial responsibility requirements. We therefore agree with EPA's postponement decision. During the extension period, EPA needs to increase its collection of information on the cost and availability of insurance and the consequences of noncompliance on the business relationships of tank owners. EPA also needs to continue to work with the states so that more of them can use state funds to help tank owners in categories 3 and 4 satisfy federal financial responsibility rules in the future. At the same time, we think EPA needs to ensure, through a more active enforcement program, that category 1 and 2 firms comply with the federal rules.

BACKGROUND

EPA estimates that nationwide there are up to 2 million petroleum underground storage tanks at three-quarters of a million facilities, such as gas stations, utility companies, or car dealerships.⁴ EPA believes that hundreds of thousands of these tanks have corroded and are leaking. About 8,000 cleanups have been completed since EPA began making cleanup grants to states in mid-1987, and another 24,800 cleanups are underway. Leaking tanks

⁴According to EPA, owners have reported 1.7 million underground petroleum storage tanks to state regulatory officials, but EPA estimates that there are hundreds of thousands of unreported tanks.

can contaminate groundwater--a drinking water source for half of our nation--and cause fires or explosions. To protect against such risks, the Hazardous and Solid Waste Amendments of 1984 required EPA to develop regulations to prevent, detect, and correct tank leaks. Issued in September 1988, these regulations set forth spill cleanup procedures and standards for tank construction and operation, to become effective over a 10-year period.

SARA subsequently directed EPA to issue regulations stipulating a minimum financial responsibility requirement of \$1 million per occurrence for owners of underground petroleum tanks.⁵ Noncompliance could subject tank owners to fines of up to \$10,000 a day. However, SARA allows EPA to suspend enforcement of financial responsibility requirements for 6-month periods for individual classes of owners if EPA determines that insurance and other financial assurance methods are generally unavailable and progress is being made toward meeting financial responsibility. Additionally, the law states that in developing regulations, EPA may consider the impact of any rules on small businesses.

In October 1988, EPA published final regulations requiring all petroleum tank owners to maintain evidence of financial responsibility of \$1 million or \$2 million, depending on the number of tanks they own.⁶ These regulations were to be phased in over 2 years by size category of tank owner; however, EPA has recently decided to extend the phase-in period to 3 years.

Under the law, states can with EPA approval operate and enforce underground storage tank programs "in lieu of" the federal

⁵SARA also gave EPA discretion to set lower limits for low-volume tank facilities, referred to as nonmarketers, that do not produce, refine, or market petroleum.

⁶EPA originally published proposed financial responsibility regulations in April 1987, with implementation to have taken effect about June 1988.

program. To obtain approval for these programs, states must (1) establish technical and financial responsibility requirements at least as strict as the federal government's and (2) provide for the enforcement of these requirements. EPA has one state program under consideration (Mississippi's) and expects to approve about 13 others over the next 12 months.

GAO'S REPORT TO THE CONGRESS

In January 1988 we reported that uncertainty about potential losses had kept insurance companies out of the underground tank market. Two sources provided virtually all of the tank insurance sold in the United States in the 3 years prior to our report, and one of them had withdrawn from the market midway through 1987. The two firms had insured about 14 percent of U.S. tanks, mostly those owned by bulk sellers of petroleum products, known as jobbers. We also found that the alternatives to insurance permitted by the law, such as self-insurance, letters of credit, and surety bonds, were not feasible for most tank owners. Only the largest firms, such as the major oil companies and national bus companies, could use these alternatives because these methods were (1) expensive for smaller firms, (2) did not transfer risk, or (3) required more assets to be pledged than the average tank owner could afford. At the time of our review, relatively few states had established funds to clean up tank leaks, although we said that these funds might be the only hope for small firms to establish financial responsibility.

We related the insurance experience of eight tank owners of various sizes from around the country. Six of these firms had insurance expiring in 1988, and they were having extreme difficulty in replacing it; the other two had no insurance. Some companies with insurance reported increasing rates and declining coverage on their policies.

Our report recommended that EPA phase in the financial responsibility requirements to allow time for insurers to develop tank programs and tank owners to pursue insurance alternatives. We also recommended that EPA speed up implementation of the tank construction and operation requirements, which we stated were most important for protecting the public and the environment.

THE INSURANCE MARKET AND
DEVELOPMENT OF STATE FUNDS

Since our January 1988 report, two developments have made it possible for more tank owners to comply with the financial responsibility requirements. First, more insurance companies have started offering tank coverage. Second, more states have created funds to pay for damages caused by leaks from tanks and are using these funds to help owners meet EPA's financial responsibility regulations. Nevertheless, many small businesses may not be able to obtain insurance or state trust fund coverage.

According to EPA, about 15 sources are now offering liability insurance for underground petroleum tanks, including 1 company that specializes in insuring owners with 25 or fewer tanks. However, one of the most active insurers (Petromark) recently announced that it is suspending new sales pending a review of its reserves, and another insurer (Federated) is suspending new sales in some states with tank funds.

Within the last 6 months, we discussed tank owners' insurance prospects with representatives of EPA, the Small Business Administration, insurance companies, state agencies, and industry. These officials generally said that tank insurance was available on some terms to many businesses. According to EPA and industry representatives, the very large firms already required to meet the regulations have complied through self-insurance. In addition, an official of an association representing small gasoline dealers said

that insurance was available to these dealers, although he did not know how many actually had it. However, industry representatives said that available insurance was expensive, did not always meet regulatory requirements, or was sometimes offered by companies with unproven track records. Of the 10 insurance companies we contacted, only two company representatives said that private tank insurance is currently available and affordable for both category 3 and 4 firms. When we spoke with representatives of the largest insurers before EPA's announcement of postponement, they told us they favored postponing the category 4 October 1990 deadline.

Representatives of the groups we interviewed said that many small firms, including those not in the business of selling petroleum, such as farmers or operators of delivery vehicles, were not likely to qualify for insurance. A Small Business Administration official told us that these small firms are not insurable at present because the firms know little about tank technology or risk management, and there was no actuarial history for their tanks. According to an EPA official, these firms, many of which have older, less safe tanks, will need to rely on the state trust funds for financial responsibility.

In January 1988 we reported that 12 states had established funds as of August 1987. The situation has improved. According to EPA, at this time, 34 states have created trust funds to pay for cleanups and in many cases compensate victims of leaks. EPA has given final or conditional approval to about 23 state trust funds so that tank owners can use them to satisfy, at least in part, the financial responsibility requirements. EPA expects that it will approve additional state funds in time for the deferred financial responsibility deadlines. EPA plans to use the additional time made available by the extension to work with the states in developing trust funds. It should be noted that even with state trust funds, some tanks are in such poor condition that they will not qualify for coverage under the funds.

Many states place conditions on the eligibility of tank owners to use the fund to meet financial responsibility requirements, such as requiring owners to be in compliance with technical tank standards. In addition, most state funds will pay costs only above a specified deductible, and some limit or exclude third-party coverage. Therefore, tank owners will have to supplement the state fund coverage with insurance or other financial responsibility methods.

Within the last few weeks, prior to EPA's extension of the compliance dates, we asked underground storage tank program officials from 44 state governments plus the District of Columbia whether they thought that category 3 and 4 firms would be able to comply with the 1990 deadlines. The majority of the officials said that half or more of the category 3 and 4 firms would not be able to comply. Even in states with EPA approved trust funds, officials were not optimistic about owners' compliance. Officials in 9 of 21 states with trust funds we spoke with thought half or more of the category 3 owners would not be able to comply, and officials in 13 states said the same thing about category 4 firms.

In view of the status of state trust funds and the condition of the insurance market, we believe that EPA's decision on the financial responsibility deadlines was appropriate.

NEED TO MONITOR

FUTURE DEVELOPMENTS

During the next 12 to 18 months, EPA will need to monitor closely conditions in the insurance market and the development of state funds so that it can act appropriately as the extended deadlines approach. Several factors indicate that uncertainty over the ability of small tank owners to comply with the financial responsibility requirements may persist. First, most states still

do not have EPA-approved trust funds. It is uncertain how many will obtain approval by the new 1991 deadlines. Second, a very small percentage of category 3 and 4 firms are now insured. The 10 insurers we contacted reported having issued about 3,600 policies to category 3 and 4 firms, while EPA estimates that these two categories include 225,000 owners. Third, because many of the insurers offering pollution liability insurance to underground petroleum storage tank owners are new to this market, the extent to which they will service the tank owner population remains to be seen. Most of the insurers we talked with thought that smaller firms could not comply with the financial responsibility regulations for 1 or more years or could make no estimate at all. In addition, some insurers require that owners upgrade their tanks to qualify for coverage. This will pose financial hardships for some smaller tank owners. State and federal programs to help tank owners upgrade tanks are limited or non-existent. Thirty of 45 states we contacted had no plans to offer such assistance.

The need for close monitoring is also indicated by the differences between the abilities of category 3 and category 4 firms to meet requirements. The state officials we contacted were more optimistic about the compliance prospects of category 3 firms than category 4 firms.

In addition to monitoring the availability of insurance and the development of state financial assistance programs for small businesses, EPA needs to address another issue in advance of the 1991 deadlines. Representatives of petroleum marketers raised a possible problem with the financial responsibility regulations that could not be resolved by flexible enforcement policies or a suspension of enforcement. According to the representatives, tank owners who cannot establish financial responsibility will violate contracts with their creditors and suppliers because such agreements commonly require that the owners comply with all laws and regulations to qualify for further credit or supplies. A

suspension of enforcement would remove the threat of government penalties but not cure the contractual problem. EPA officials said that this situation may represent a real threat to tank owners but that EPA did not consider this issue when it developed the regulations.

Recently, following a recommendation we made to the EPA Administrator, the agency has begun to collect information on insurance availability. But this data collection effort is limited. For example, it covers only about half of the insurance companies now writing tank insurance and does not provide much information on the insurance market in individual states. In addition, EPA has little information on the risks of noncompliance to owners' credit and supply arrangements. We think that EPA needs to actively collect more information so that it can determine whether financial responsibility requirements should be imposed in 1 year.

MORE ACTIVE ENFORCEMENT OF THE FINANCIAL
RESPONSIBILITY REQUIREMENTS NEEDED

EPA has assigned a low priority to enforcement of the financial responsibility requirements. EPA's regions are working with 13 states to check on the compliance of category 1 and 2 firms in these states. But at this time EPA does not intend to actively check tank owners' compliance nationwide and has no tank inspectors in its regional offices. It plans to rely mainly on state referrals of violations, although, according to an EPA official, the states have also assigned enforcement a low priority. Even if financial responsibility violations are uncovered, EPA does not plan to penalize a firm unless, for example, its tanks are leaking and the firm cannot or will not clean up the leaks.

We believe EPA should adopt a more active enforcement strategy. While it is reasonable to be flexible in penalizing

firms that cannot comply with the regulations despite their best efforts, the law should be enforced when it is willfully disregarded by firms for which deadlines become effective. Tank owners who incur the expense of compliance should not be placed at a disadvantage with competitors who can comply but do not. EPA should monitor and enforce compliance in states where it is possible for owners to obtain insurance or qualify for state trust fund coverage, and the agency should encourage states to do the same. In light of the extended deadlines, it will be especially important for EPA to stress the enforcement of its standards for safe tank management.

CONCLUSIONS

In closing, Mr. Chairman, too much uncertainty exists about the insurance market for smaller firms with underground tanks and too few states have approved trust funds to reasonably ensure that category 3 and 4 firms can generally comply with the financial responsibility requirements at this time. We support EPA's decision to postpone the effective date for deadlines on category 3 and 4 firms until 1991. This will give states more time to establish trust funds and EPA more time to assist states in developing these funds and to better assess the entire financial responsibility situation. In preparation for the 1991 deadline, EPA will need considerably more information on the availability and cost of insurance, on state financial assistance programs, and on the effects of regulatory violations on the relations of tank owners with creditors and suppliers.

In addition, to promote compliance with the law and more balanced competition among tank owners in categories 1 and 2, there should be reasonable enforcement of these financial responsibility requirements. The low priority EPA has assigned to enforcement could lead tank owners to believe that compliance with the requirements is unimportant.

In October 1989 we testified on underground storage tanks before a subcommittee of the House Small Business Committee.⁷ In that testimony, we recommended that the Administrator, EPA,

- determine what regulatory course to follow by (1) actively monitoring the cost and availability of tank insurance and other financial responsibility mechanisms and (2) evaluating how noncompliance will affect tank owners' credit and supplies and

- plan and implement a strategy to more actively enforce the financial responsibility requirements.

Although EPA has taken some actions to address our recommendations, it has not fully implemented them.

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Mr. Chairman, this concludes my prepared statement. I will be happy to respond to questions that you or members of the Committee may have.

⁷Ability of Underground Petroleum Storage Tank Owners to Comply With Federal Financial Responsibility Requirements (GAO/T-RCED-90-9, Oct. 31, 1989).