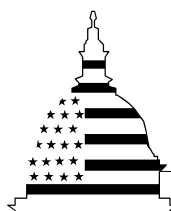


August 2005

ENVIRONMENTAL LIABILITIES

EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-05-658](#), a report to congressional requesters

Why GAO Did This Study

The burden of cleaning up Superfund and other hazardous waste sites is increasingly shifting to taxpayers, particularly since businesses handling hazardous substances are no longer taxed under Superfund and the backlog of sites needing cleanup is growing. While key environmental laws rely on the “polluter pays” principle, the extent to which liable parties cease operations or restructure—such as through bankruptcy—can directly affect the cleanup costs faced by taxpayers. GAO was asked to (1) determine how many businesses with liability under federal law for environmental cleanups have declared bankruptcy, and how many such cases the government has pursued in bankruptcy court; (2) identify challenges the Environmental Protection Agency (EPA) faces in holding bankrupt and other financially distressed businesses responsible for their cleanup obligations; and (3) identify actions EPA could take to better ensure that such businesses pay for their cleanups.

What GAO Recommends

GAO’s nine recommendations include EPA’s (1) implementing a financial assurance mandate for businesses handling hazardous substances and (2) enhancing its oversight and enforcement of existing financial assurances and authorities. EPA generally agreed with many of the recommendations, stating its intent to further evaluate some of them.

www.gao.gov/cgi-bin/getrpt?GAO-05-658.

To view the full product, including the scope and methodology, click on the link above. For more information, contact John B. Stephenson at (202) 512-3841 or stephensonj@gao.gov.

ENVIRONMENTAL LIABILITIES

EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations

What GAO Found

While more than 231,000 businesses operating in the United States filed for bankruptcy in fiscal years 1998 through 2003, the extent to which these businesses had environmental liabilities is not known because neither the federal government nor other sources collect this information. Information on bankrupt businesses with federal environmental liabilities is limited to data on the bankruptcy cases that the Justice Department has pursued in court on behalf of EPA. In that regard, the Justice Department initiated 136 such cases from 1998 through 2003.

In seeking to hold liable businesses responsible for their environmental cleanup obligations, EPA faces significant challenges that often stem from the differing goals of environmental laws that hold polluting businesses liable for cleanup costs and other laws that, in some cases, allow businesses to limit or avoid responsibility for these liabilities. For example, businesses can legally organize or restructure in ways that can limit their future expenditures for cleanups by, for example, separating their assets from their liabilities using subsidiaries. While many such actions are legal, transferring assets to limit liability may violate federal law in some cases. However, such cases are difficult for EPA to identify and for the Justice Department to prosecute successfully. In addition, bankruptcy law presents a number of challenges to EPA’s ability to hold parties responsible for their cleanup obligations, challenges that are largely related to the law’s intent to give debtors a fresh start. Moreover, by the time a business files for bankruptcy, it may have few, if any, assets remaining to distribute among creditors. The bankruptcy process also poses procedural and informational challenges for EPA. For example, EPA lacks timely, complete, and reliable information on the thousands of businesses filing for bankruptcy each year.

Notwithstanding these challenges, EPA could better ensure that bankrupt and other financially distressed businesses meet their cleanup obligations by making greater use of existing authorities. For example, EPA has not implemented a 1980 statutory mandate under Superfund to require businesses handling hazardous substances to demonstrate their ability to pay for potential environmental cleanups—that is, to provide financial assurances. EPA has cited competing priorities and lack of funds as reasons for not implementing this mandate, but its inaction has exposed the Superfund program and U.S. taxpayers to potentially enormous cleanup costs at gold, lead, and other mining sites and at other industrial operations, such as metal-plating businesses. Also, EPA has done little to ensure that businesses comply with its existing financial assurance requirements in cleanup agreements and orders. Greater oversight and enforcement of financial assurances would better guarantee that cleanup funds will be available if needed. Also, greater use of other existing authorities—such as tax offsets, which allow the government to redirect tax refunds it owes businesses to agencies with claims against them—could produce additional payments for cleanups from financially distressed businesses.

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Abbreviations

BLM	Bureau of Land Management
CERCLA	Comprehensive Environmental Response, Compensation and Liability Act
EFAB	Environmental Financial Advisory Board
EPA	Environmental Protection Agency
IG	inspector general
NPL	National Priorities List
RCRA	Resource Conservation and Recovery Act

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United States Government Accountability Office
Washington, D.C. 20548

August 17, 2005

The Honorable James M. Jeffords
Ranking Minority Member
Environment and Public Works Committee
United States Senate

The Honorable Patrick J. Leahy
Ranking Minority Member
Committee on Judiciary
United States Senate

The Honorable Barbara Boxer
The Honorable Maria Cantwell
United States Senate

Key federal environmental statutes, such as the Resource Conservation and Recovery Act (RCRA) and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA),¹ which established the Superfund program, require that parties statutorily responsible for pollution bear the cost of cleaning up contaminated sites.² In many cases, liable parties have met their cleanup responsibilities. However, parties responsible for cleaning up some Superfund sites include businesses that no longer exist, having been liquidated through bankruptcy or otherwise dissolved. In the past, most of the costs for these “orphan” Superfund sites were borne by a Superfund trust fund supported primarily by a tax on crude oil and certain chemicals and an environmental tax on corporations. However, authority to collect these taxes expired in 1995, and the fund is now mostly depleted. As a result, the government—the Environmental Protection Agency (EPA)—now largely pays for hazardous waste cleanups with appropriations from the general fund when responsible parties do not.³

¹For simplicity in this report, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 will generally be referred to as the Superfund law.

²The Superfund law generally applies to cleanups of contaminated sites that are no longer in use. RCRA generally applies to operating businesses that treat, store, or dispose of hazardous wastes.

³See GAO, *Superfund Program: Current Status and Future Fiscal Challenges*, [GAO-03-850](#) (Washington, D.C.: July 31, 2003).

In light of the substantial federal deficit, EPA's management of its financial risks associated with Superfund and RCRA is increasingly important. For example, the extent to which responsible parties with liabilities cease operations or restructure—often through bankruptcy proceedings—can directly affect the Superfund costs that will be borne by the government. According to recent studies, it will cost \$140 million, on average, to clean up each of the 142 largest Superfund sites, for a total of almost \$20 billion.⁴ Importantly, cleanups at 60 of these megasites are already being funded either wholly or partially by EPA. In addition, the cleanup burden borne by EPA and other government entities will be increased if operating businesses, including those regulated under RCRA, fail to fulfill their cleanup obligations. For example, businesses may simply close and abandon contaminated properties—or they may go through bankruptcy proceedings—leaving contaminated properties for state programs or EPA's Superfund program to clean them up.

In implementing the Superfund and RCRA programs, EPA uses some risk management approaches, such as requiring that certain responsible parties—generally businesses—provide the agency with evidence of their ability to pay their expected future cleanup costs because the cleanups often take many years and the financial position of liable businesses can change during that time. Financial assurances are meant to assure EPA that the businesses will have the money to finish the cleanups in the future. Thus, when negotiating Superfund and RCRA cleanup agreements with EPA, businesses generally agree to provide financial assurances aimed at demonstrating their ability to meet the requirements of the agreements.⁵ These financial assurances include bank letters of credit, trust funds, and, under certain conditions, guarantees that businesses or their parent corporations have the financial wherewithal to meet the obligations.

According to EPA officials, businesses file for bankruptcy protection generally for economic reasons unrelated to environmental liabilities, with some notable exceptions. When businesses file for bankruptcy in 1 of 90 U.S. bankruptcy courts, they seek either to liquidate all assets and go out of business or to reorganize—which can include a partial liquidation—and

⁴National Advisory Council for Environmental Policy and Technology Superfund Subcommittee Final Report, April 2004, and Katherine N. Probst and David M. Konisky: *Superfund's Future: What Will It Cost?* (Washington, D.C.: Resources for the Future, 2001).

⁵Permits are also a vehicle for establishing financial assurance requirements for businesses required to obtain RCRA operating permits.

remain in business. EPA has set up an informal process to identify bankruptcy cases that involve environmental liabilities and to assess whether the assets available for creditors, which include EPA, warrant referring a case to the Department of Justice, which files claims in bankruptcy court on behalf of EPA.

In this context, our objectives were to (1) determine how many businesses with liability under federal law for environmental cleanups have declared bankruptcy and how many such cases the Justice Department has pursued in bankruptcy court, (2) identify key challenges that EPA faces in holding bankrupt and other financially distressed businesses responsible for their cleanup obligations, and (3) identify any actions EPA could take to better ensure that bankrupt and other financially distressed businesses pay the costs of cleaning up their hazardous waste sites to the maximum extent practicable.

To address these objectives, we reviewed federal statutes and policies associated with hazardous waste management and cleanup, the federal bankruptcy code and procedures, and academic and professional literature addressing the intersection of environmental and bankruptcy law, corporate limited liability, forms of business organization, and asset management. In addition, we interviewed EPA headquarters and regional enforcement officials about how the agency identifies, pursues, and recovers federal environmental liabilities from financially distressed or bankrupt businesses; the challenges EPA faces in these tasks; and the extent to which the agency has used available authorities and enforcement tools in this effort. We also analyzed bankruptcy data for fiscal years 1998 through 2003 from the Administrative Office of the U.S. Courts. In addition, for the same period, we analyzed Justice Department data on bankruptcies involving environmental liabilities that the department pursued in bankruptcy court on behalf of EPA. More detail on our scope and methodology can be found in appendix I. We performed our work between September 2003 and July 2005 in accordance with generally accepted government auditing standards.

Results in Brief

While national bankruptcy data show that more than 231,000 businesses operating in the United States filed for bankruptcy in fiscal years 1998 through 2003, the extent to which these businesses had existing environmental liabilities is not known because neither the federal government nor other sources collect this information. EPA seeks to identify information on those business bankruptcies that involve

environmental liabilities owed to EPA by, among other things, reviewing bankruptcy notices. However, EPA does not maintain information on the results of its reviews of bankruptcy cases. According to EPA officials, the agency does not maintain information on the results of all of its reviews of bankruptcy cases—including whether environmental liabilities are involved—because of the large volume of bankruptcy notices it receives and the limited resources available to track such information. Thus, information on businesses in bankruptcy proceedings with federal environmental liabilities is limited to data on the bankruptcy cases that the Justice Department has pursued in court on behalf of EPA and other agencies. In that regard, the Justice Department initiated 136 such cases from 1998 through 2003, most of which were for hazardous waste liabilities under Superfund and RCRA.

In seeking to hold bankrupt and other financially distressed businesses responsible for their cleanup obligations, EPA faces significant challenges that often stem from the differing goals of environmental laws that hold polluting businesses liable for cleanup costs and other laws that, in some cases, allow businesses to limit or avoid responsibility for those liabilities. For example, businesses can legally reorganize or restructure in ways that can limit their future expenditures for environmental cleanups by separating their assets from their liabilities using subsidiaries. Importantly, the long-term nature of many environmental cleanups—particularly under Superfund—gives businesses a significant amount of time to make such corporate changes. While many such actions are legal, transferring assets to limit liability may be prohibited under certain circumstances. However, such cases are difficult both for EPA to identify and for the Justice Department to prosecute successfully. In addition, federal bankruptcy law, like corporate law, presents a number of significant challenges to EPA's efforts to hold bankrupt and other financially distressed businesses responsible for their cleanup obligations. Bankruptcy law serves both to provide insolvent debtors a measure of financial relief—including a fresh start—and to equitably distribute their funds to maximize creditors' interests in receiving payment. However, these goals can conflict with the Superfund and other environmental laws, which generally require the cleanup of environmental contamination and the imposition of costs on the parties responsible for the pollution. These challenges are partly related to the bankruptcy law's discharging of a debtor's liability for pre-bankruptcy debts. Moreover, by the time a business files for bankruptcy, it may have few, if any, assets remaining to distribute among creditors. The bankruptcy process also poses procedural and informational challenges for EPA. For example, EPA's efforts to identify bankruptcies that may warrant pursuit in

bankruptcy court are hampered by the lack of timely, complete, and reliable information on the many thousands of businesses filing for bankruptcy each year.

Notwithstanding these inherent challenges, EPA could better ensure that bankrupt and other financially distressed businesses carry out their cleanup responsibilities by making greater use of existing authorities and enforcement tools. For example, EPA has not yet implemented a 1980 statutory mandate under Superfund to require businesses handling hazardous substances to maintain financial assurances that would provide evidence of their ability to pay to clean up potential spills or other environmental contamination that could result from their operations. By its inaction on this mandate, EPA has continued to expose the Superfund program, and ultimately the U.S. taxpayers, to potentially enormous cleanup costs at facilities that currently are not required to have financial assurances for cleanup costs, such as many gold, lead, and other hardrock mining sites and metal-plating facilities. Although implementing the requirement could help avoid the creation of additional Superfund sites and could provide funds to help pay for cleanups, EPA has cited, among other things, competing priorities and lack of funds as reasons for having made no progress in this area for nearly 25 years. Additionally, although EPA's current practice is to include requirements in settlement agreements and orders under Superfund and RCRA for businesses to provide financial assurances within a specified period of time, EPA has done little to ensure that the businesses comply with the financial assurance requirements. For example, EPA has not collected data on the financial assurances businesses are required to have in place under the Superfund and RCRA corrective action programs, such as the type of assurance required, the amount of financial assurance they provide, and whether the financial assurance is still authorized or is in force. The one study on this issue, conducted by an EPA regional office, found that (1) about half of the responsible parties subject to Superfund financial assurance requirements in that region were not in compliance with them and (2) the agency could not locate relevant financial assurance documents to evaluate compliance in many cases—22 percent. Providing greater oversight and enforcement of financial assurances would better guarantee that cleanup funds will be available if needed.

In addition to financial assurances, EPA has on occasion used other enforcement authorities to obtain payments for cleanups. For example, in a few instances, EPA has used tax offsets, which allow the federal government to redirect tax refunds it owes businesses to federal agencies

with claims against these businesses. Greater emphasis on and use of such authorities could produce additional payments for cleanups from bankrupt and other financially distressed businesses. We are making nine recommendations to the Administrator, EPA, aimed at improving EPA's ability to ensure that liable parties meet their environmental cleanup obligations, including implementing the statutory mandate under Superfund to develop financial assurance regulations for businesses handling hazardous substances; enhancing its efforts to manage and enforce its existing financial assurance requirements; evaluating the financial assurances the agency accepts; and seeking opportunities to more fully use its enforcement tools, particularly tax and other offsets. In commenting on a draft of the report, EPA generally agreed with many of the recommendations and said the agency will further evaluate the others (app. III contains EPA's comments and our responses).

Background

At the federal level, the cleanup of hazardous waste sites is primarily addressed under the Superfund and RCRA corrective action programs. The Superfund program is directed primarily at addressing contamination resulting from past activities at inactive or abandoned sites or from spills that require emergency action. The RCRA corrective action program primarily addresses contamination at operating industrial facilities. In addition to these cleanup response programs, another RCRA program—the closure/post-closure program—is designed to prevent environmental contamination by ensuring that hazardous waste facilities are closed in a safe manner and monitored after closure to the extent necessary to protect human health and the environment.

CERCLA created the Superfund program, under which EPA may compel parties statutorily responsible for contaminated sites to clean them up or to reimburse EPA for its cleanup costs.⁶ In many cases, liable parties have met their cleanup responsibilities under Superfund. For example, EPA has reported that, as a result of its enforcement activities, liable parties

⁶Courts have interpreted the liability of responsible parties under CERCLA to be strict, joint and several, and retroactive. Under strict or “no fault” liability, a party may be liable for cleanup even though its actions were not considered improper when it disposed of the wastes. Under joint and several liability, when the harm done is indivisible, one party can be held responsible for the full cost of the remedy even though that party may have disposed of only a portion of the hazardous substances at the site. Under retroactive liability, parties can be held responsible for actions that took place before CERCLA was enacted.

participate in cleanup work at about 70 percent⁷ of the sites on the Superfund National Priorities List (NPL), EPA's list of seriously contaminated sites.⁸ However, in some cases, parties responsible for the contamination cannot be identified (for example, at long-abandoned landfills where many parties may have dumped hazardous substances) or the parties do not have sufficient financial resources to perform or pay for the entire cleanup. In the latter case, EPA often settles environmental claims with businesses for less than the cleanup costs if paying for the cleanup would present "undue financial hardship," such as depriving a business of ordinary and necessary assets or resulting in an inability to pay for ordinary and necessary business expenses. (EPA said it also often settles environmental claims for less than the total cleanup costs if the agency believes making the business pay the full cost would be inequitable.) Further, when parties file for bankruptcy protection, EPA's recovery of cleanup costs may be reduced or eliminated, particularly when there are few other parties with cleanup liabilities at the Superfund site.

To help EPA pay for cleanups and related program activities, the Superfund law established a trust fund. Among other things, the trust fund can be used to pay for cleaning up sites on the NPL. Cleaning up NPL sites has often been a very lengthy process—in many cases, it has taken 10 to 20 years. The cleanup process begins when EPA either conducts cleanup studies for the sites or negotiates with liable parties to conduct such studies. These studies identify the types and quantities of contamination at sites and consider alternative cleanup remedies. EPA then chooses the cleanup

⁷This percentage does not address the percentage of cleanup costs paid by liable parties versus that paid by the government. According to EPA, the agency has information on cleanup amounts liable parties commit to through enforcement instruments but does not have access to information on amounts the liable parties actually spend at the cleanup sites.

⁸To determine which sites are eligible for listing on the NPL, EPA uses its Hazard Ranking System, a numerical scoring system that assesses the hazards a site poses to human health and the environment as its principal determining factor. Once EPA has determined that the risks posed by a site make it eligible for the NPL, EPA regions then consider many other factors in selecting the sites to submit to EPA headquarters for proposal to the NPL, including the availability of alternative federal or state programs that could be used to clean up the site, the status of responsible parties associated with the site, and the cleanup's cost and complexity.

remedies it considers most appropriate and performs the cleanups itself or negotiates settlements with liable parties for them to finance and perform cleanups.⁹

Historically, a tax on crude oil and certain chemicals and an environmental tax on corporations were the primary sources of revenues for the Superfund trust fund; however, the authority for these taxes expired in 1995. The trust fund continues to receive revenues in the form of recoveries of Superfund-related costs from liable parties, interest on the fund balance, fines and penalties, and general revenue fund appropriations that supplement the trust fund balance. Since fiscal year 2000, the Superfund program has increasingly relied on revenue from general revenue fund appropriations.¹⁰ For fiscal year 2004, for example, EPA's Superfund appropriation of \$1.2 billion was from general revenue only.¹¹ In contrast, through the 1990s, Superfund trust fund revenues other than general fund appropriations provided more than \$1 billion a year in program funding.¹² Further, appropriations for the Superfund program (from both general revenue and trust fund revenues) has decreased from \$1.9 billion to \$1.2 billion, in constant 2003 dollars, from fiscal year 1993 to fiscal year 2004.

Although funding for the Superfund program has decreased, sites continue to be added to the NPL to address serious risks to health and the environment. As of September 30, 2004, there were 1,236 NPL sites.¹³ According to a recent study, the cleanup costs for a majority of these sites are under \$50 million each and will cost \$12 million on average. However,

⁹In reality, sites rarely move through the cleanup process in a linear, step-by-step manner. Most sites are divided early in the cleanup process into multiple projects, known as operable units. Cleanup activity at sites with multiple operable units is generally staggered. Operable units may move through the cleanup pipeline at different paces because of a number of factors, such as the availability of funding, the complexity of the cleanup, or the level of cooperation of responsible parties. The discovery of new information about the site can even push an operable unit backward to an earlier stage of the cleanup process.

¹⁰See GAO, *Superfund Program: Breakdown of Appropriations Data*, [GAO-04-787R](#) (Washington, D.C.: May 14, 2004).

¹¹EPA officials noted that in fiscal year 2004, the agency also received \$148 million from settlement payments from liable parties.

¹²For the first half of the 1990s, the trust fund received the Superfund taxes.

¹³Of the 1,236 sites currently on the NPL, 158 are federal facilities. These properties are owned or used by a federal agency, typically either the Department of Defense or the Interior.

there are 142 Superfund megasites—NPL sites whose cleanup is estimated to cost more than \$50 million each—for which the average cost is expected to be \$140 million. According to EPA estimates, the vast majority of costs for most NPL sites will be incurred getting to the construction completion stage.¹⁴ EPA officials said that 933 NPL sites have reached the construction complete stage as of July 2005.

Despite EPA's significant progress, a backlog of NPL sites is ready to proceed to construction of a long-term cleanup remedy—which is typically the most expensive stage of a cleanup. The decrease in Superfund funding in recent years and this backlog of sites ready for additional funding may make the already lengthy NPL cleanup process even lengthier. According to EPA, many sites in this backlog are large, complex, and costly.¹⁵ Further complicating the funding situation, as we reported in 2003, the number of sites that do not have an identifiable nonfederal source to fund their cleanup is growing, and several factors indicate the potential for additional growth in the future.¹⁶ For example, officials in 8 of the 10 EPA regions noted that they expected more liable parties to declare bankruptcy in the future. Thus, the number of taxpayer-funded cleanups could increase, especially at sites where there are no (or few) other liable parties.

¹⁴According to EPA, “construction completion” means that physical construction (if needed) to address contamination at an NPL site—such as construction of a pump-and-treat system to address groundwater contamination—is complete, regardless of whether final cleanup levels have been achieved; all immediate threats from the contamination have been addressed, and all long-term threats are under control. Most of these sites then enter into the operation and maintenance phase, when the responsible party or the state ensures that the cleanup remedy continues to be protective of human health and the environment. Eventually, when EPA and the state determine that no further remedial activities at the site are appropriate, EPA deletes the site from the NPL.

¹⁵EPA, *Superfund: Building on the Past, Looking to the Future* (Washington, D.C.: Apr. 22, 2004).

¹⁶GAO-03-850. We also reported that states play a significant role in the cleanup of hazardous waste sites. However, many state cleanup programs have limited capacity to address costly and complex sites that do not have responsible parties to pay for the cleanup.

In contrast to the Superfund program, the corrective action program under the Resource Conservation and Recovery Act of 1976 (RCRA), as amended, primarily addresses contamination at operating industrial facilities.¹⁷ Among other things, RCRA regulates the management of hazardous waste from “cradle to grave”—that is, from the time hazardous waste is created and throughout its lifetime, even after it enters a landfill or is incinerated. While EPA has overall responsibility for implementing the act, and retains enforcement authority, it has authorized most states to administer all or part of RCRA’s hazardous waste program.

RCRA requires owners and operators of hazardous waste facilities—those used to treat, store, or dispose of hazardous waste and often called “TSDFs”—to obtain operating permits specifying how hazardous waste will be safely managed at the facilities. Owners and operators of hazardous waste facilities are also required to prepare closure plans and cost estimates for removing or securing wastes, decontaminating equipment, and other activities required when they eventually cease operations—such as capping a landfill when it is full. In addition, under the RCRA corrective action program, these owners or operators must clean up contamination occurring at their facilities.¹⁸ This is consistent with one of RCRA’s primary purposes, which is to ensure the proper management of hazardous waste so as to minimize present and future health and environmental threats.

¹⁷While RCRA primarily applies to operating facilities, it may also apply to facilities that are no longer operating. RCRA is an amendment to the Solid Waste Disposal Act of 1965, the first federal law regulating solid wastes—a broad category of materials including such materials as garbage from homes or businesses and waste materials resulting from industrial, commercial, or agricultural activities. Under the general statutory RCRA definition, a waste is considered hazardous if either (1) the waste has at least one of the following characteristics—it is ignitable, reactive, corrosive, or contains certain toxic constituents such as arsenic or lead (sometimes called characteristic wastes) or (2) the agency has specifically named the waste on a list of products or chemicals, such as pesticides or acids, that the agency has determined are hazardous (sometimes called listed wastes). For purposes of permitting and other RCRA Subtitle C requirements, a waste is considered hazardous if it is a solid waste, which is not exempted or excluded by the Subtitle C regulations, and if it is either specifically listed as a hazardous waste or meets the characteristics of a hazardous waste in those regulations.

¹⁸The corrective action can be specified in the facility’s operating permit or in a separate corrective action permit. Such permits must require the facility to provide financial assurance that the cleanup actions specified in the permit will be carried out. EPA may also use its enforcement authority to require facilities to clean up hazardous waste contamination by issuing to the facility an enforcement order specifying the corrective action it must take.

A 2002 EPA study on the implementation of RCRA's corrective action program reported that nearly 900 facilities had undertaken cleanup measures and/or had selected a cleanup remedy by 1997.¹⁹ EPA reported that spills were a major source of contamination at over half of the facilities. The study suggests that those industries with a high risk for contamination requiring clean up under the corrective action program include chemical manufacturing, wood preserving, petroleum refining or other manufacturing industries, and the service sector that includes dry cleaning. In addition, EPA reported that required cleanups under the RCRA corrective action program could be as costly as cleanups at many Superfund sites—EPA estimated that between 2 and 16 percent of the nearly 900 RCRA facilities would have total cleanup costs in excess of \$50 million.

RCRA's closure/post-closure and corrective action programs regulate facilities that treat, store, or dispose of hazardous wastes—but, importantly, RCRA does not regulate some facilities that make or use hazardous substances that are not considered listed or characteristic hazardous wastes under RCRA, but that nevertheless may in some circumstances present a high risk for environmental contamination. Businesses may generally store waste on site in compliance with specified requirements for up to 90 days without needing a permit or being subject to the regulations governing hazardous waste storage facilities.²⁰ Thus, for example, chemical companies that manufacture and sell highly hazardous substances, such as chlorine products, may not be required to obtain a RCRA permit if they do not store their hazardous waste—even though the products themselves may pose environmental risk.

RCRA authorizes EPA to issue regulations for the operation of hazardous waste treatment, storage, and disposal facilities, including such additional qualifications as to financial responsibility as may be necessary or

¹⁹Using a stratified random sample of 65 of these facilities, this study examined relevant information on industries at risk for environmental contamination and on costs of these cleanups.

²⁰Specifically, a generator may generally accumulate hazardous waste on site for 90 days or less provided that, among other things, the waste is placed in containers, tanks, containment buildings, or on drip pads in compliance with applicable EPA regulations. Generators of hazardous waste are also required to comply with certain RCRA requirements intended to ensure the safe management of hazardous wastes.

desirable.²¹ EPA has issued regulations under the closure/post-closure program requiring that owners and operators of certain hazardous waste facilities provide evidence to EPA, or a state regulator, that they have sufficient financial resources to clean up as required for proper closure, and, if necessary, for post-closure care.²² EPA regulations also require a facility seeking a permit to provide financial assurances to cover any corrective action responsibilities identified in the permit.²³ The principal purpose of financial assurance requirements is to ensure that the parties responsible for environmental contamination assume the costs of cleanup rather than forcing the general public to pay for or otherwise bear the consequences of businesses' environmental liabilities.²⁴ That is, financial assurances can help ensure that resources are available to fulfill the businesses' cleanup obligations as they arise. The fact that the parties responsible for the contamination are also responsible for cleaning it up encourages businesses to adopt responsible environmental practices.

Under the RCRA closure and post-closure and other EPA programs, financial assurances can include, among other things, bank letters of credit that guarantee payment by the financial institutions that issue them and, under certain conditions, guarantees that businesses or their parent corporations have the financial wherewithal to meet their obligations. While EPA has not issued financial assurance regulations under the RCRA corrective action program, EPA typically requires that owners and operators provide financial assurances for cleanups of spills or other contamination at hazardous waste facilities in administrative orders the

²¹42 U.S.C. § 6924(a)(6). Financial responsibility may be established in accordance with EPA regulations by any one or a combination of the following: insurance, guarantee, surety bond, letter of credit, or qualification as a self-insurer. 42 U.S.C. § 6924(t)(1).

²²See RCRA closure/post-closure financial assurance regulations at 40 C.F.R. Part 264, Subpart H.

²³40 C.F.R. § 264.101(b). See footnote 18.

²⁴Financial assurance requirements serve several purposes, including fairness, economic efficiency, and pollution deterrence. See James Boyd, *Financial Responsibility for Environmental Obligations: Are Bonding and Assurance Rules Fulfilling Their Promise?* (Washington, D.C.: Resources for the Future, August 2001). Courts have recognized that financial assurance regulations play a critical role in deterring environmental misconduct and ensuring the safe design and operation of hazardous waste facilities, e.g., *Safety-Kleen v. Wyche*, 274 F.3d 846, 866 (4th Cir. 2001).

agency issues under this program.²⁵ Also, as noted above, EPA regulations require a facility seeking a permit to provide financial assurances to cover any corrective action responsibilities identified in the permit. Since, as discussed above, generators of hazardous waste generally are not subject to the RCRA corrective action and closure and post-closure requirements, they are not required to provide financial assurances for any RCRA cleanups that may be needed as a result of their operations.

EPA also has not issued financial assurance regulations for the Superfund program, but in some cases does require liable businesses to obtain financial assurances demonstrating their ability to pay cleanup costs for existing contamination at Superfund sites. Specifically, when EPA reaches settlement agreements with parties regarding site cleanups, the agency generally requires the businesses to provide financial assurance demonstrating their ability to pay for the agreed-upon cleanup activities. In this regard, EPA has included financial assurance requirements in its “model agreements” for staff to use in negotiating Superfund settlements. However, if EPA and a liable party do not reach a settlement, there is no regulatory requirement under Superfund that the party provide financial assurance that it will be able to pay its cleanup liabilities. There is, however, a statutory mandate under Superfund law that EPA has not implemented requiring it to issue financial assurance regulations for facilities that handle hazardous substances. As discussed further in this report, these regulations could cover a number of facilities not currently covered by financial assurances under RCRA.

Businesses that may incur environmental liabilities under Superfund or RCRA run the gamut in terms of organization type and size—they include large U.S. and international corporations as well as small businesses, such as sole proprietorships. These entities may be publicly held—that is, their stock is traded on public stock exchanges—or they may be closely (privately) held. The different forms of organization—such as corporations and partnerships—have different legal and tax attributes. A corporation is a legal entity that exists independently of its owners or investors, called shareholders. A key attribute of corporations is that they limit the liability of their owners, the shareholders. That is, corporations are liable for the debts and obligations of their businesses, while the shareholders are liable only for what they have invested. In contrast to shareholders, the owners of

²⁵Although EPA has not issued financial assurance regulations for the corrective action program, the agency issued guidance on this topic in 2003.

unincorporated businesses, such as partnerships and sole proprietorships, are generally liable for all debts and liabilities incurred by their businesses but also have tax advantages that corporation owners do not. However, another unincorporated organizational form that is relatively new but is becoming more popular for businesses of all sizes—the limited liability company—provides owners limited liability similar to a corporation as well as tax treatment similar to partnerships and sole proprietorships.²⁶ Like many corporations, these “hybrids” can have any number of investors (owners), and the investors may include partnerships, corporations, individuals, and others.²⁷

In general, more financial and ownership information is available about publicly held corporations, which must comply with more federal reporting requirements, such as those of the U.S. Securities and Exchange Commission (SEC), than about privately held corporations. Information about limited liability companies, including those in offshore locations such as the Bahamas, may be limited or unavailable. Information may also be limited or unavailable about special purpose entities—legal entities created to carry out a specified purpose or activity, such as to consummate a specific transaction or a series of transactions with a narrowly defined purpose. Some large corporations, such as Enron, allegedly have used special purpose entities to hide the true financial condition of the companies.²⁸ Following the bankruptcy of Enron and other corporate failings, the Congress passed the Sarbanes-Oxley Act of 2002 to protect investors by improving the accuracy and reliability of corporate disclosures. Among other things, the law includes requirements governing financial disclosures and audits for publicly held corporations.

In addition, in 2003 the Financial Accounting Standards Board, the organization that establishes financial accounting and reporting standards

²⁶Limited liability companies originated in Wyoming in 1977. Today, all states allow this form of business organization.

²⁷Certain corporations, called subchapter S corporations, also provide limited liability and more favorable tax treatment but ownership is limited in terms of the number of allowable owners and type of owners. For example, all shareholders in a subchapter S corporation must be individuals.

²⁸The May 1, 2003, Justice Department indictment of former Enron officials included charges of conspiring to improve Enron’s balance sheet using special purpose entities. See also *Special Purpose Entities: Uses and Abuses*, Presentation to the International Monetary Fund by Janet Tavakoli, President, Tavakoli Structured Finance, April 2005.

for the private sector, issued revised guidance on accounting for special purpose entities and is currently working on further accounting guidance for them.

While some financially distressed businesses simply cease operations, others file for bankruptcy protection. The bankruptcy code is a uniform body of federal law that governs all bankruptcy cases and gives debtors—individuals or businesses—a fresh start or some measure of relief from burdensome debts.²⁹ Filing a bankruptcy petition gives the petitioner some immediate relief in the form of an automatic stay, which generally bars creditors from commencing or continuing any debt collection actions against the entity while it is in bankruptcy.³⁰

In bankruptcy, debt can be placed in one of three broad categories: secured, priority unsecured, and general unsecured, which are generally satisfied in that order when a debtor's assets are distributed in a bankruptcy proceeding. The actual, necessary costs and expenses of preserving the bankruptcy estate are administrative expenses, which must be paid in full before any other class of claims are paid. By definition, administrative expenses must be incurred post-petition because the bankruptcy estate is created by the filing of the bankruptcy petition. Response costs incurred by EPA under the Superfund law post-petition with respect to property of the estate may be entitled to administrative priority. However, environmental response costs at property the debtor does not own are typically considered general unsecured debts, and often are paid at pennies on the dollar—if at all—in a bankruptcy proceeding.

The two types of bankruptcy cases most relevant to EPA are chapter 7 business liquidations and chapter 11 corporate reorganizations. Businesses file for bankruptcy under chapter 7 when they are ceasing operations.³¹

²⁹The bankruptcy code was substantially revised in April 2005, primarily to address consumer bankruptcies.

³⁰Environmental enforcement actions seeking injunctive relief against companies in bankruptcy are generally excepted from the automatic stay pursuant to the "police power" exemption in the bankruptcy code. Administrative or judicial proceedings to fix the amount of a penalty or establish the amount of cost recovery owed are also exempt from the automatic stay. However, once a penalty is assessed or a judgment is obtained, the automatic stay prohibits collection activities other than through the bankruptcy process.

³¹In some cases, companies filing for bankruptcy protection under chapter 11 also cease operations and go through liquidation rather than reorganization.

While some financially distressed businesses cease operations without the formality of bankruptcy proceedings, those that file under chapter 7 use a court-supervised procedure in which a trustee collects the assets of the business (the bankruptcy estate), reduces them to cash, and makes distributions to creditors. In many chapter 7 cases, however, few or no assets are available for distribution.

Alternatively, businesses facing financial difficulties may want to continue to operate. These businesses can use the chapter 11 bankruptcy process to restructure unmanageable debt burdens. Most bankruptcy claims EPA pursues in court are chapter 11 reorganizations. EPA's goals in participating in chapter 11 cases include collecting environmental costs owed to the government, ensuring that the debtor complies with applicable environmental laws and regulations, and ensuring that cleanup obligations are satisfied. The chapter 11 debtor generally has 120 days during which it has the exclusive right to file a plan of reorganization. However, the bankruptcy court can extend or reduce this period.³² The debtor must provide creditors with a disclosure statement containing information adequate to enable creditors to evaluate the plan, including how the existing debts will be paid. The court ultimately approves (confirms) or disapproves the plan of reorganization. Confirmation of the plan generally discharges eligible debts that were incurred prior to the plan's confirmation. Certain cleanup obligations, however, such as future cleanup liabilities under RCRA, are not dischargeable under bankruptcy. The debtor normally goes through a period of consolidation and emerges with a reduced debt load and a reorganized business. However, many chapter 11 reorganizations are not successful in that many reorganized businesses subsequently fail and go through liquidation.

Bankruptcy cases are heard by U.S. bankruptcy judges in 90 federal bankruptcy courts, which are under 12 regional federal appellate circuit courts.³³ In many instances, applicable law on key questions is unsettled and interpretations may vary among the circuits. For example,

³²Bankruptcy courts routinely grant extensions of this exclusivity period, according to the chair of EPA's bankruptcy work group. For example, the exclusivity period has been repeatedly extended during the 4 years since W.R. Grace and Company filed for bankruptcy in April 2001.

³³Bankruptcy judges are judicial officers of the district courts and are appointed for 14-year terms by the court of appeals for the appellate circuit in which the bankruptcy court is located. A bankruptcy court order is appealed first to the relevant federal district court and then to the relevant court of appeals.

interpretations may vary concerning the extent to which post-petition response costs incurred by EPA under CERCLA with respect to property of the bankruptcy estate may be entitled to administrative priority. Businesses may generally file for bankruptcy protection in a bankruptcy court in a state either in which (a) their facilities are located or (b) they are incorporated. In fact, many businesses file for bankruptcy protection in the second and third circuits, which include Delaware and the Southern District of New York.

EPA has established a bankruptcy work group comprised of several EPA headquarters staff members, along with one or two staff members from each of the 10 regions, many of whom are Superfund enforcement attorneys who handle bankruptcy matters as a collateral duty. The work group helps identify bankruptcy cases in which EPA may have a claim and assists in resolving other issues that involve contaminated property or otherwise affect EPA's interests in bankruptcies, among other things. In addition, several Justice Department attorneys participate in the work group.

The Number of Business Bankruptcies Involving Environmental Liabilities Is Not Known

Information on the number of bankruptcies involving environmental liabilities is very limited. For example, while the bankruptcy courts collect data on the number of businesses that file for bankruptcy each year and the Administrative Office of the U.S. Courts maintains these data in a national database, neither the courts, EPA, nor private providers of business data collect information on how many of these businesses have environmental liabilities.³⁴ Thus, although national bankruptcy data show that 231,630 businesses operating in the United States filed for bankruptcy in fiscal years 1998 through 2003—an average of about 38,600 businesses a year—how many of these had environmental liabilities is not known. Currently, information on bankrupt businesses with federal environmental liabilities is limited to data on the bankruptcy cases that the Justice Department has pursued in court on behalf of EPA and other agencies, such as the Department of the Interior. In fiscal years 1998 through 2003, the Justice Department filed 136 such claims, 112 of which related to hazardous waste liabilities under Superfund and RCRA. The gap in data between businesses that file for bankruptcy and those with environmental liabilities that the Justice Department has pursued in court is large: what is not known is how

³⁴Private sources of data on business bankruptcies include companies such as Dun and Bradstreet and Moody's Investors Service.

many of the other 231,494 businesses that filed for bankruptcy during this time period had environmental liabilities.

EPA may learn of bankruptcy filings that involve environmental liabilities in various ways—for example, from the businesses themselves or from other federal or state agencies. However, the most systematic notification is from the bankruptcy courts. These courts mail notices of filings to EPA when the agency is listed as a creditor in the bankruptcy filing.³⁵ Although EPA reviews information about the businesses identified in the bankruptcy notices to determine whether it should request the Justice Department to pursue an environmental claim in the bankruptcy proceedings, the agency does not keep records on the bankruptcy filings it has researched, its basis for deciding whether to pursue a claim related to environmental liabilities, or the characteristics of the businesses involved, such as industry type. Among the factors EPA considers in deciding whether to pursue a claim in bankruptcy court is whether the debtor has any assets remaining to be divided among creditors. In many cases, particularly when the company is ceasing operations under chapter 7, EPA decides not to pursue a claim in bankruptcy court because it concludes that the business involved has few, if any, remaining assets. Similarly, EPA may choose not to pursue a claim when the claim is small relative to the resources needed for the government to pursue it.

According to EPA officials, the agency does not routinely collect or maintain information on the bankruptcy cases it reviews but decides not to pursue in bankruptcy because of the volume of bankruptcy notices it receives—including many that do not involve EPA liabilities—and the limited resources available to track such information. While EPA would incur a cost to routinely collect and maintain information about bankruptcies involving environmental liabilities—including those that EPA decides not to pursue—such information would be useful as a management tool, for example, in identifying (1) the types of businesses that have avoided or limited their environmental liabilities by filing for bankruptcy protection and (2) individual business owners who have a history of filing for such bankruptcy protection.

The 112 companies with hazardous waste liabilities that the Justice Department pursued in bankruptcy court between 1998 and 2003 represent a variety of industries, including some that could be expected to have

³⁵These notices may be sent to EPA regional offices or to EPA headquarters.

significant environmental liabilities, such as chemical companies, metal finishers, hazardous waste recyclers, and paper mills. Other companies, such as Fruit of the Loom and Kmart Corporation, represent industries not immediately associated with a great likelihood of creating environmental liabilities.³⁶ Most of the companies for which the Justice Department filed a bankruptcy claim on behalf of EPA were undergoing reorganization in bankruptcy rather than liquidating and going out of business. Further, 100 of the cases involved liabilities under the Superfund program, and 12 involved liabilities under RCRA.³⁷ As of February 2005, 35 of the 112 bankruptcy cases the Justice Department pursued had essentially been completed, and more than half—59—were still ongoing. For example, W. R. Grace and Company and many of its subsidiaries filed for bankruptcy under chapter 11 in April 2001, and this bankruptcy case is still under way as of July 2005. The remaining 18 cases were dismissed by the bankruptcy court for various reasons. In such cases, EPA and other creditors are no longer barred from pursuing claims against these businesses directly. However, EPA may have little success in recovering costs or ensuring compliance with environmental responsibilities if these businesses are, in fact, financially distressed.

Over time, the current information gap that exists between businesses filing for bankruptcy and the subset of those for which the Justice Department files an environmental claim in bankruptcy court may be reduced because of new filing requirements that became effective recently. Since 2003, bankruptcy petitions and the accompanying Statement of Financial Affairs have required companies filing for bankruptcy to provide information identifying sites they own or possess that have actual or potential environmental problems, including any sites that pose or

³⁶Fruit of the Loom, a leading international apparel company, filed for bankruptcy in 1999. The company's significant environmental obligations principally pertain to environmental management and cleanup costs at seven sites owned by a related corporation, formerly owned by Fruit of the Loom. Kmart Corporation, one of the largest discount retailers in the United States, had environmental liabilities associated with disposal of hazardous waste products from its auto repair shops when it filed for bankruptcy in 2002.

³⁷Some of the cases cover environmental liabilities under both Superfund and RCRA and some cases also include claims under other environmental laws, such as the Clean Water Act or the Clean Air Act.

allegedly pose an imminent threat to public health and safety.³⁸ However, this additional environmental information is not yet readily available electronically from the 90 bankruptcy courts in the United States. That is, the systems cannot be queried to identify filings with information on sites with environmental liabilities. However, EPA has sought assistance in this regard from the U.S. trustees who participate in all bankruptcy cases except those filed in Alabama and North Carolina.³⁹ In August 2004, the Acting General Counsel, Executive Office for U.S. Trustees, sent a memorandum to all U.S. trustees instructing them to coordinate with EPA in bankruptcy cases involving contaminated property.

The trustees are to alert the appropriate EPA contact by email when they become aware of an affirmative response to the questions asking petitioners to identify sites with actual or potential environmental liabilities, and to attach the bankruptcy petition and appropriate schedules. EPA officials told us that they have received some notifications from U. S. trustees since this August 2004 memorandum.

Because these environmental disclosure requirements are relatively new, little is known about the thoroughness and accuracy of the data on environmental liabilities that companies in bankruptcy have submitted to the courts. We note that the information businesses provide about their environmental liabilities would likely be subject to the same data quality issues as other self-reported data. For example, studies on other bankruptcy filing information from debtor companies, such as information on assets and liabilities, have found that such self-reported data tend to be flawed.⁴⁰ Consequently, it is too soon to know the extent to which this

³⁸Specifically, the Statement of Financial Affairs requires that companies filing for bankruptcy identify every site for which they have received a notice of potential environmental liability or reported a release of a hazardous substance. They must also identify all legal proceedings under any environmental law to which they have been a party. In addition, Exhibit C of the bankruptcy petition requires that debtors identify any property they own or possess that poses, or is alleged to pose, a threat of imminent harm to public health or safety. However, according to EPA officials, debtors rarely complete Schedule C.

³⁹The U.S. Trustees program, a component of the Justice Department, is responsible for overseeing the administration of bankruptcy cases in all but two states. The program has 21 regional U.S. Trustees offices and an executive office in Washington, D.C. The Administrative Office of the U.S. Courts, part of the judicial branch, oversees the administration of cases filed in bankruptcy courts in Alabama and North Carolina.

⁴⁰For example, see Jennifer Connors Frasier, "Caught in a Cycle of Neglect: The Accuracy of Bankruptcy Statistics," *Commercial Law Journal* (Winter 1996).

additional information provided to bankruptcy courts will help fill the existing data gap relating to bankrupt companies with environmental liabilities.

EPA Faces Significant Challenges When Seeking to Hold Businesses Responsible for Their Cleanup Obligations, Particularly Businesses in Bankruptcy and Other Financial Distress

In its efforts to hold businesses responsible for their cleanup obligations, particularly when they are in bankruptcy or other financial distress, EPA faces significant challenges, often stemming from the differing goals of environmental laws that hold polluting businesses liable for cleanup costs and other laws that, in some cases, allow businesses to limit or avoid responsibility for such liabilities. Further, the complexities of the federal bankruptcy code and its associated procedures, along with the complexities of the environmental cleanup process and EPA's many information needs when dealing with bankruptcies, present challenges to EPA's ability to hold businesses responsible for their environmental cleanup obligations.

Businesses Can Organize and Restructure Themselves in Ways That May Allow Them to Limit Their Expenditures for Environmental Cleanups

A key legal attribute of corporations is that the liability of their owners—the shareholders—is limited. That is, corporations are liable for the debts and obligations of their businesses, while the shareholders are liable only for what they have invested. Aimed at encouraging shareholder investment to generate capital, the limited liability principle enables corporations to engage in enterprises that might not attract sufficient funding if shareholders were not protected in this way. Shareholders generally include individuals, corporations, and unincorporated business forms, such as partnerships.

Many businesses take advantage of this limited liability principle to protect their assets by using a parent and subsidiary corporate structure in which the subsidiary is largely or wholly owned by the parent corporation—in other words, the parent is the subsidiary's shareholder. For example, using this structure, a subsidiary that is engaged in a business that is at risk of incurring substantial liability, such as mining or chemical manufacturing, can protect its assets by transferring the most valuable ones—such as equipment and patents—to a related entity, such as the parent or other subsidiary engaged in less risky endeavors. The high-risk subsidiary can continue to use the transferred assets, as appropriate, by leasing or renting

them. It has become common practice for experts in asset protection to recommend that corporations protect their assets in this way. A goal is to continually draw down on the subsidiary's remaining assets, such as cash from the sale of equipment, to pay operating expenses, including rental and lease payments and salaries. If a liability arises, under the limited liability principle, the high-risk subsidiary's remaining assets may be reached—but generally not those of the parent corporation or other subsidiaries to which assets were transferred. And if the subsidiary incurs an environmental liability and does not have sufficient resources to fund the cleanup, the burden for the cleanup may be shifted to taxpayers. For example, the subsidiary could plead financial hardship, and under its ability-to-pay process, EPA may reduce the amount of funding the subsidiary has to provide, with the balance coming from the Superfund trust fund in the absence of other liable parties. Alternatively, the subsidiary could seek reorganization under the bankruptcy act, which could result in the discharge of the liability.

While these asset protection strategies are generally legal depending on the circumstances, it is generally unlawful to transfer assets with the intent to hinder or defraud creditors. Under federal bankruptcy law, a transfer may be invalidated if it occurred within 1 year prior to the bankruptcy filing and if the transfer (1) occurred with the intent to defraud creditors or (2) in certain circumstances yielded less than reasonably equivalent value for the debtor.⁴¹ In addition, most states have enacted the Uniform Fraudulent Transfer Act, which contains prohibitions on fraudulent transfers analogous to the bankruptcy provision. Creditors generally must seek to invalidate such transfers within 4 years of their occurrence.

Perhaps for these reasons, publications by financial and legal advisors have suggested that asset transfers be implemented in stages over time to avoid

⁴¹EPA officials noted the agency's recent participation in a successful challenge to a fraudulent transfer associated with an ongoing bankruptcy case. The Department of Justice, on behalf of EPA, intervened in an action brought against Sealed Air Corporation by the official bankruptcy committees representing personal injury and property damage claimants of W.R. Grace. The committees contended that (1) the sale of one of W.R. Grace's divisions was fraudulent under New Jersey's fraudulent transfer statute because W.R. Grace was not paid a reasonably equivalent value for the Sealed Air division and (2) W.R. Grace was rendered insolvent by the transaction. In its complaint, Justice alleged a fraudulent transfer claim under the Federal Debt Collection Procedures Act against Sealed Air Corporation. The Justice Department was granted leave to intervene to specifically assist with the fair valuation of environmental liabilities at the time of the contested transaction. According to EPA, the parties have reached a settlement agreement, which includes cash and stock valued at more than \$1 billion, that has been submitted to the bankruptcy court for approval.

calling attention to them.⁴² The goal is to make them indistinguishable from ordinary business decisions and transactions and to implement them as early as possible, preferably well in advance of claims. From an asset protection standpoint, this approach makes sense because it helps protect transfers from legal challenges by the mere passage of time. However, the use of such strategies by parties liable for environmental cleanups presents a significant challenge to EPA in obtaining cleanup costs because it is hard for the agency to know about such transfers, much less obtain sufficient information to successfully challenge them within the time permitted by law or to challenge businesses' claims that paying the cleanup costs represents an undue economic hardship. Further, because businesses typically are aware of Superfund liabilities for many years before they actually have to fund the cleanups, they have ample time to reorganize and structure themselves in ways that can limit the expenditures they may be required to make in the future. For example, it is not unusual for it to take 10 or more years in total for sites to be placed on the National Priorities List, for cleanup remedies to be selected, and for the cleanups to be conducted.

In addition, to protect assets even further, businesses may be structured with multiple organizational layers—beyond the two-tier parent/subsidiary construct—as well as with different types of corporate entities, such as limited liability companies. As outlined in a recent book on asset protection, dispersing assets among as many different types of entities and jurisdictions as possible is also a useful way to protect them from creditors.⁴³ The goal of this approach is to create complex structures that, in effect, provide multiple protective trenches around assets, making it challenging and burdensome for creditors to pursue their claims. Because it is easier and less costly to set up and maintain limited liability companies than corporations, this relatively new hybrid form of business organization facilitates the establishment of complex, multi-layered businesses using corporations and limited liability companies.⁴⁴

⁴²For example, see *Asset Protection: Concepts and Strategies for Protecting Your Wealth*, Jay D. Adkisson and Christopher M. Riser, McGraw-Hill, 2004.

⁴³*Ibid.*

⁴⁴From a regulatory standpoint, limited liability businesses can be more difficult to monitor than corporations because they are required to provide only limited information to the public.

Creditors may go to court to obtain the assets of a corporation's shareholders (including, for example, a parent corporation) to satisfy the corporation's debts. This is called "piercing the corporate veil," and it is difficult to achieve.⁴⁵ EPA occasionally attempts to secure cleanup costs from a parent corporation under a veil-piercing theory. However, these cases are extremely complex and resource intensive, according to EPA officials. The strategy recommended to businesses to use multiple organizational layers to protect assets recognizes this challenge and seeks to make any challenge as difficult and costly as possible. Along these lines, an EPA enforcement official—who said that EPA is seeing more and more cases in which companies are restructuring using various layers and thereby shielding corporate assets—noted that the "transaction cost" for EPA to try to follow such cases to ensure that these companies satisfy their environmental liabilities can be prohibitively high.

Finally, some EPA officials stated that a 1998 Supreme Court case has further complicated efforts to obtain cleanup costs from parent corporations. Under the Superfund law, past and present owners and operators are among the parties generally liable for cleanup costs at a contaminated site. The Supreme Court decision in *United States v. Bestfoods* held that a corporate parent could be liable (1) indirectly (as an owner) if the corporate veil could be pierced; and (2) directly (as an operator) if the corporate parent actively participated in, and exercised control over, the operations of the contaminated facility itself.⁴⁶ The *Bestfoods* decision confirmed that the government could hold a parent corporation directly liable under the Superfund law for a subsidiary's cleanup costs under certain circumstances. However, EPA officials noted that prior to the *Bestfoods* decision, some courts had found a parent corporation liable where it exercised control over the subsidiary even if the parent did not control the contaminated facility. In addition, while the *Bestfoods* case recognized that the government could hold a parent corporation directly liable under the Superfund law, these officials stated that the case also helped establish a road map for observing corporate formalities that companies could follow to insulate themselves from this liability.

⁴⁵For example, the Supreme Court has stated that "Ordinarily a corporation which chooses to facilitate the operation of its business by the employment of another corporation as a subsidiary will not be penalized by a judicial determination of liability for the legal obligations of the subsidiary." *United States v. Bestfoods*, 524 U.S. 51, 61 (1998).

⁴⁶524 U.S. 51 (1998).

Legal and Informational Challenges Constrain EPA's Ability to Hold Businesses in Bankruptcy Responsible for Their Cleanup Obligations

Differing Statutory Goals and Program Complexities Present EPA with Challenges

An obvious challenge that EPA faces when it attempts to ensure that businesses in bankruptcy carry out their environmental cleanup obligations is that the businesses may have little or no financial resources to pay EPA or any other creditors. However, EPA faces further challenges when companies file for bankruptcy, stemming from the differing goals of the bankruptcy code and federal environmental laws, the complexities of bankruptcy procedures and environmental cleanup programs, and EPA's many information needs when dealing with bankruptcies.

Federal bankruptcy and environmental laws seek to address vastly different problems using solutions that frequently come into conflict. Specifically, while environmental laws generally impose cleanup costs on the parties responsible for pollution, one purpose of bankruptcy law is to give the debtor a fresh start by discharging existing claims against the debtor, including environmental claims in some cases. For example, when businesses with liability under the Superfund law file for bankruptcy protection, payment of cleanup costs may be nonexistent or substantially reduced in some cases, depending in part on the type of financial assurance the businesses agreed to provide under settlement agreements to meet the obligations.⁴⁷ As a result, cleanup costs may be shifted to the general public, especially when the site has no other liable parties.⁴⁸

The inherent conflict between the goals of environmental cleanup laws and the bankruptcy code represents only the first of several key challenges EPA faces in attempting to hold businesses in bankruptcy responsible for their environmental cleanup obligations. For example, conflicts relating to the

⁴⁷As discussed in the next section of this report, some financial assurances that businesses provide to EPA to show their ability to meet their financial obligations make specific funds available to EPA for cleanups in the event businesses default, while others do not. However, if the party with Superfund liabilities has not reached a settlement agreement with EPA, it is not required to provide a financial assurance. Moreover, enforcing financial assurance requirements against bankrupt parties under Superfund may be more difficult than under programs such as the RCRA closure/post-closure program that have comprehensive financial assurance regulations in place. See, e.g., *Safety-Kleen v. Wyche*, 274 F.3d 846, 864-65 (4th Cir. 2001) (upholding state enforcement of RCRA closure/post-closure financial assurance regulations against a party in bankruptcy).

⁴⁸At some Superfund NPL sites, such as large hazardous waste landfills, there may be hundreds or even thousands of liable parties from whom EPA may attempt to obtain cleanup costs. If one liable party at such a Superfund site files for bankruptcy, EPA may compel other liable parties to pay for the cleanup rather than having to turn to taxpayers for funding. However, EPA will not do so when it believes seeking such payments would be inequitable under the circumstances.

timing of events can have a significant impact on EPA's ability to recover costs in bankruptcy proceedings. One timing issue relates to the interpretations by various bankruptcy courts of when an environmental liability arises as a claim subject to discharge in bankruptcy. For example, bankruptcy courts in the Second Circuit⁴⁹—where many chapter 11 bankruptcies are filed—generally hold that a claim arises when a release of a hazardous substance into the environment (such as a spill) occurs.⁵⁰ In many bankruptcy cases involving responsible parties under Superfund, the relevant releases took place prior to the filing of the bankruptcy petition, making all claims for such releases subject to discharge even if EPA has not yet incurred cleanup or other response costs.

Another challenge EPA faces is the need to provide timely estimates of cleanup costs that will form the basis for claims. Bankruptcy courts aim to resolve cases expeditiously and set specific time frames for proceedings, but it can be difficult for EPA to estimate the dollar amount of cleanup work needed at sites within the court's time frames. In particular, Superfund sites often require long-term investigations to both identify the nature and extent of contamination and to develop cleanup requirements and cost estimates. For many Superfund NPL sites, these processes may take a number of years. Depending upon where EPA is in these processes, it may be challenging to provide an estimate of future cleanup costs. For example, the extent of contamination may still be unknown or the cleanup remedy may not yet have been determined. Nonetheless, the Justice Department must submit a "proof of claim" in the bankruptcy court in order for EPA to have a chance for any cost recovery. With incomplete information regarding future cleanup costs, EPA may underestimate these costs in its claims to bankruptcy courts. Further, if EPA provides a cost estimate that the court rejects because it considers the estimate to be speculative, or if EPA does not have the time or resources to develop an estimate to support its bankruptcy claim, the government can lose any opportunity to recover at least some of the cleanup costs for such sites.⁵¹

⁴⁹The Second Circuit includes the states of Connecticut, New York, and Vermont.

⁵⁰Other courts have considered a broader array of factors in deciding whether a claim subject to discharge has arisen, e.g., *Matter of Chicago, Milwaukee, St. Paul, and Pacific R. Co.*, 974 F.2d 775, 782-86 (7th Cir. 1992).

⁵¹When a debtor in a chapter 11 bankruptcy continues to own the site under the reorganization plan, EPA may hold the reorganized company responsible for cleanup costs incurred after the bankruptcy ends, but not for those incurred prior to the court's acceptance of the reorganization plan.

Provided that EPA is able to meet these challenges and develops a supportable claim for the Justice Department to file in the bankruptcy case, provisions of the bankruptcy code may result in the claim being assigned a low status in the distribution of the debtor's assets. Many of EPA's claims may be considered general unsecured claims—the last to be paid after claims for creditors holding secured and priority unsecured claims have been paid. Further, although EPA may submit a claim for environmental penalties and/or fines, under chapter 7, these claims may rank even lower than most other unsecured claims. In some cases, a bankruptcy judge may deem certain EPA claims to be entitled to priority as administrative expenses—for example, if the expenses were incurred to address conditions endangering public health and the environment. Often, however, insufficient funds are available from the bankruptcy estate to pay cleanup and/or closure costs, or they provide only “pennies on the dollar” of the claims amounts when a debtor's assets are distributed. In these cases, the responsibility for cleaning up a Superfund site or closing and monitoring an RCRA hazardous waste facility may fall to EPA or a state agency unless, for example, other liable parties pay the cleanup costs or sufficient financial assurances are in place to cover these costs.

Another important challenge facing EPA in bankruptcy cases results from the automatic stay provision, which preserves the status quo during bankruptcy proceedings, both giving debtors a “breathing spell” from their creditors and preventing the piecemeal distribution of a debtor's remaining assets in ways that could be preferential to some creditors and detrimental to others. However, the bankruptcy code expressly allows an exemption from the automatic stay for a governmental unit to begin or continue a proceeding to enforce its police or regulatory power, or to carry out a court judgment (other than a money judgment) to enforce its police or regulatory power. If EPA can successfully argue that the environmental proceedings fall within this exception to the stay, it can take action in federal district court while the bankruptcy proceedings continue. If EPA is unsuccessful in avoiding the automatic stay, it must pursue the claim in the bankruptcy court, along with other creditors. The key to when a court will permit an environmental action to avoid application of the automatic stay is how the court defines the phrase “money judgment.”

As we reported in 1986, the stay can interfere with efforts of federal and state agencies to ensure that owners carry out their environmental responsibilities, such as cleaning up and properly closing hazardous waste

facilities according to RCRA requirements.⁵² For example, although companies undergoing liquidation under chapter 7 are required to comply with federal and state environmental laws to the same extent as any other party, they may argue that the automatic stay allows them to avoid expending funds to carry out compliance actions. Companies reorganizing under chapter 11 are also obliged to comply with environmental laws while they are in bankruptcy proceedings even if it requires the debtor to incur additional expenses. Moreover, EPA enforcement officials noted, during a company's period of reorganization under chapter 11, EPA can pursue administrative expense penalties if the company continues to operate in violation of environmental laws, and has in some cases been successful in this regard. However, an EPA enforcement official also noted that the agency has limited leverage to ensure that such companies continue facility closures, site cleanups, and other environmental responsibilities during the bankruptcy proceedings—that can take years to complete—unless EPA can convince a bankruptcy judge that a company must carry out these activities to address an imminent threat to human health or the environment.⁵³

The automatic stay also prevents creditors, such as federal and state agencies, from immediately collecting on certain court judgments. Thus, while courts may order businesses to pay environmental fines and/or cleanup costs to EPA, the government's ability to collect these payments may be reduced or negated by bankruptcy filings. For example, in August 2003, W.R. Grace and Company, the primary liable party at the Libby Asbestos Superfund site in Libby, Montana, was ordered by a U. S. district court to reimburse EPA \$54.5 million for costs the agency had incurred in investigating and conducting certain emergency cleanup actions at the site.⁵⁴ (Total long-term cleanup costs at this site are expected to rise to at least \$179 million.) However, because W.R. Grace filed for bankruptcy protection in 2001 and is protected by the automatic stay, the company does not have to pay this judgment until the reorganized company emerges

⁵²GAO, *Hazardous Waste: Environmental Safeguards Jeopardized When Facilities Cease Operating*, [GAO/RCED-86-77](#) (Washington, D.C.: Feb. 11, 1986).

⁵³As noted above, the bankruptcy code includes an exception to the automatic stay, known as the police and regulatory powers exception, which can permit certain environmental enforcement actions to proceed during bankruptcy despite the automatic stay. Thus, EPA can continue compliance enforcement efforts outside the bankruptcy proceedings.

⁵⁴W.R. Grace appealed this ruling in November 2003. The case was still pending before the U.S. Circuit Court of Appeals for the Ninth Circuit as of June 2005.

from bankruptcy.⁵⁵ Moreover, EPA officials noted that because any reimbursement of the \$54.5 million will be subject to the repayment terms agreed to in the company's reorganization plan, it has not yet been determined how much the federal government will be reimbursed for these cleanup costs. However, according to the lead EPA attorney working on this case, it is likely that creditors, including EPA, will receive a substantial return in this bankruptcy case once the company's reorganization plan has been confirmed by the court.⁵⁶ In the meantime, according to EPA, the agency continues to pay for and oversee the cleanup work to address the most hazardous conditions at the site, at an estimated cost to taxpayers of \$18 million per year over the past several years.

Information Gaps Regarding Bankruptcies Also Present EPA with Challenges

In evaluating bankruptcy filings to determine whether EPA should request that the Justice Department pursue cases in bankruptcy court, EPA faces further challenges because it does not consistently have accurate and readily available information on which to base these evaluations. As a result, EPA cannot be assured that it is aware of all relevant bankruptcy filings.

EPA officials have acknowledged that the agency could miss identifying some relevant bankruptcy cases. According to the chair of EPA's bankruptcy work group, one of the more common reasons EPA is likely to miss identifying some relevant bankruptcies is that the debtor fails to include EPA on its list of creditors in bankruptcy filings, which means that bankruptcy courts will not send the notices of bankruptcy filing that are routinely sent to creditors to inform them of the filings. In addition, EPA could also miss relevant bankruptcy cases for other reasons, including the following:

- Because businesses may change their names over time for various reasons—including reorganizations and mergers—and because a business filing for bankruptcy may be affiliated with a number of different company names, EPA staff may not recognize the business

⁵⁵W.R. Grace and Company filed for protection under chapter 11 of the bankruptcy code in April 2001 and remains in bankruptcy as of June 2005.

⁵⁶According to this EPA attorney, W. R. Grace has proposed a plan of reorganization, which is moving through the confirmation process by the bankruptcy court, that would pay all creditors, including EPA, 100 percent of claims allowed by the court. However, the plan may not be approved as proposed, this official noted; thus, EPA and other creditors may not receive the full amount of their allowed claims.

name or names cited in bankruptcy filings. In addition, owners of businesses sometimes file for bankruptcy in their own names, rather than in the business names, which EPA may be more likely to recognize.

- Data quality problems in EPA's Superfund database limit the usefulness of automated searches to match the businesses associated with the bankruptcy notices sent to EPA with businesses with environmental liabilities nationwide.⁵⁷ Further, even if EPA staff search program and enforcement databases to identify contaminated sites associated with a company, the searches may not be reliable because the current name or names associated with the bankruptcy filing may not be reflected in EPA's databases. For this reason, some EPA staff do not routinely search these databases for such matches because the information is likely to be incomplete or outdated. However, EPA's most recent bankruptcy guidance, discussed later, recommends that staff search the Superfund and other relevant databases to help them determine whether an environmental claim or issue of interest is involved.
- EPA officials said that the agency has some difficulty identifying from its program and enforcement databases which companies have large liabilities, particularly when those liabilities are dispersed across states in several regions. As a result, certain companies in bankruptcy may not capture EPA's attention as being worthwhile cases for the government to pursue.

Overall, EPA's current system of identifying bankruptcies of concern to the agency relies heavily on the availability of staff with knowledge of the companies and their related environmental liabilities to identify cases that the agency should pursue in bankruptcy court in time to meet the court's deadlines. Although the chair of EPA's bankruptcy work group believes that their current approach to timely identification of relevant bankruptcies has worked well under these limitations, she acknowledged that EPA has no assurance that it has not missed some relevant bankruptcies. As discussed above, EPA does not maintain records on all bankruptcy cases that the agency has identified and researched, and the reason the cases were either pursued in bankruptcy court or not. Consequently, information to evaluate EPA's efforts in identifying and researching relevant bankruptcies is not

⁵⁷EPA, Office of Inspector General, *Information Technology: Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS) Data Quality*, 2002-P-00016 (Washington, D.C.: Sept. 30, 2002).

available. Further, because the bankruptcies of small and medium-sized businesses are not as widely reported in the business press, EPA is more at risk of not identifying relevant bankruptcies of such companies.

Some members of EPA's bankruptcy work group noted that, in their view, developing a fail-safe system for identifying relevant bankruptcies could require significant additional resources and might not be a cost-effective endeavor. For example, in many bankruptcy cases there may be few, if any, assets available for distribution to creditors. Nonetheless, on May 10, 2005, EPA issued an interim protocol for coordination of bankruptcy matters under the Superfund program that, among other things, (1) recommends actions to better ensure that EPA receives relevant bankruptcy notices and (2) identifies additional actions that may be relevant in bankruptcy cases other than filing claims, such as opposing abandonment of contaminated properties and objecting to terms of plans of reorganization or sales of property. Further, available technologies, such as an EPA Intranet site, could be an efficient and effective tool for the agency to track bankruptcy cases it identifies and reviews. For example, such a site could contain an EPA data sheet on each bankruptcy case identified, as well as key court documents as appropriate and available, that would be readily accessible to EPA staff across the agency to review and update.

Even when EPA identifies relevant bankruptcy filings to assess, the agency is hampered by other information limitations. For example, as previously discussed, in many cases, EPA does not yet have adequate information on the extent of contamination at relevant sites and has difficulty in developing supportable cleanup cost estimates for the claim in the bankruptcy case. In other cases, the bankruptcy filings include lengthy lists of sites, some of which EPA may have no information about, including whether there is any liability under federal environmental law. Lack of information about sites can present challenges to EPA in negotiating bankruptcy settlement agreements with large companies, such as Exide Technologies and Kaiser Aluminum, which cover numerous contaminated sites. An EPA attorney who worked on the Kaiser Aluminum case said that the tight time frames under which they had to obtain information about the relevant contaminated sites and the significantly larger resources the company had to support its negotiations made this effort challenging.

Another challenge EPA faces is that companies may send EPA notice of their bankruptcy filings identifying sites with no related enforcement actions. According to an EPA official, if a company provides EPA with notice of its bankruptcy filing and EPA does not submit a proof of claim in

the bankruptcy court—likely in this situation since EPA would not be aware of any environmental hazard—the claim could be discharged in the bankruptcy process.⁵⁸ Consequently, reviews of the environmental disclosures in Exhibit C of the debtor’s bankruptcy petition and the Statement of Financial Affairs are important to identify those sites for which EPA may file a claim as well as those sites about which the agency has no knowledge and can potentially challenge discharge requests to the bankruptcy court.⁵⁹ We note that EPA’s May 10, 2005, interim bankruptcy protocol recommends that the agency’s bankruptcy coordinators review these documents in determining whether an environmental claim or issue of interest is involved.

Finally, it is a challenge for EPA to have timely and accurate information to identify those instances in which fraudulent transfers of assets may have occurred and which a bankruptcy court would nullify if such transfers were brought to its attention. Generally, EPA has limited, if any, information on the complex organizational structures businesses may be using and on any transfers among entities that may have taken place. Similarly, information is not readily available about privately held corporations or limited liability companies—an organizational form being used by many businesses. For instance, limited liability companies registered in Nevada do not have to provide information about all of the owners, making it difficult for EPA or others to identify transactions among related companies that may be illegal. Because the liable parties often are aware of environmental liabilities for years before they must pay for the cleanups, they have time to reduce their net worth by making business decisions that result in the redistribution of assets—and thus make these resources unavailable for payment of environmental liabilities. According to an EPA enforcement official, it is extremely difficult for the agency to look back on the business decisions a company has made over three or more years to determine whether its actions may have been fraudulent.

⁵⁸According to EPA, this occurs because some courts have held that a claim for cleanup costs arises under the Superfund law when a hazardous substance release (e.g., leakage from buried drums) occurs, regardless of whether the release was detected before the bankruptcy filing and whether EPA has actually incurred any costs; other courts have not adopted this view of when a claim arises.

⁵⁹Along these lines, an August 1999 United States Attorneys publication noted that if some companies succeed in using bankruptcy to shed environmental liabilities of which EPA is not yet aware, their competitors may also file for bankruptcy reorganization to obtain the same business advantage. See United States Attorneys’ Bulletin, *Environmental Issues in Bankruptcy Cases: Protecting the Public Interest from Overzealous Debtors*, August 1999.

EPA Could Make Greater Use of Available Authorities and Enforcement Tools to Pursue Hazardous Waste Cleanup Costs from Bankrupt and Other Financially Distressed Businesses

EPA has authorities and enforcement tools that it could use more fully to obtain cleanup costs from liable businesses, especially those in bankruptcy or other financial distress. Specifically, EPA has not implemented a 1980 statutory mandate under the Superfund law to require that businesses handling hazardous substances maintain financial assurances that would provide evidence of their ability to pay to clean up potential spills or other environmental contamination that could result from their operations. As a result of EPA's inaction, the federal treasury continues to be exposed to potentially enormous cleanup costs associated with businesses not currently required to provide financial assurances. Also, although EPA requires financial assurances from businesses entering into settlement agreements and orders under Superfund and, as a matter of policy, includes them in settlement agreements and orders under RCRA, the agency has done little to ensure compliance with these requirements. EPA has on occasion used other enforcement authorities, including (1) obtaining offsets, which allow the government to redirect payments or tax refunds it owes businesses to federal agencies with claims against these businesses and (2) filing liens on property for which the government has incurred expenses under Superfund.⁶⁰ Greater use of these authorities could produce additional payments for cleanups from liable businesses, even in bankruptcies.

EPA Has Not Implemented a Statutory Mandate under Superfund to Establish Financial Assurance Requirements for Certain Businesses Handling Hazardous Substances

Despite a requirement to do so in the 1980 statute creating the Superfund program, EPA has not issued regulations requiring certain businesses that handle hazardous substances to demonstrate their ability to pay for environmental cleanup costs.⁶¹ Specifically, the statute required EPA to issue requirements "that classes of facilities establish and maintain evidence of financial responsibility consistent with the degree and duration of the risk associated with the production, transportation, treatment, storage or disposal of hazardous substances."

Such regulations could help to fill several significant gaps in EPA's environmental financial assurance coverage, thereby reducing the risk that the general public (i.e., taxpayers) will eventually have to assume financial responsibility for cleanup costs. One gap involves types of waste that are

⁶⁰A lien is a claim against property for the payment of a debt or obligation.

⁶¹Section 108(b)(1) of CERCLA.

excluded from RCRA coverage. Some wastes associated with mining activities can result in substantial cleanup costs but are excluded from the definition of hazardous wastes and, therefore, are not regulated under RCRA's hazardous waste provisions. A second gap in EPA's financial assurance coverage is that hazardous waste generators (such as metal-plating facilities and dry cleaners) are generally not required to maintain any financial assurances. Specifically, businesses may generally store waste in compliance with specified requirements for up to 90 days without needing a permit or being subject to the regulations governing hazardous waste storage facilities. Finally, a third gap is that none of EPA's current financial assurance regulations require companies or industries that pose a significant risk of environmental contamination to provide assurance that they could meet cleanup obligations associated with future accidents or spills of hazardous substances or wastes.⁶² These gaps may be more significant since the authority for an environmental tax on corporations, crude oil, and certain chemicals, which had largely funded the Superfund program, expired in 1995. As a result, the federal government's general appropriations fund is increasingly funding the cleanups paid for by the Superfund trust fund when responsible parties do not. For example, for fiscal year 2004, EPA's appropriation for the Superfund program was from general revenues only.⁶³

Regarding the financial assurance requirements in the Superfund statute, which could help to address these gaps, the statute requires EPA to develop financial assurance regulations for businesses handling hazardous substances. As previously noted, EPA was to use a risk-based approach for both (1) identifying the entities that would be covered and (2) specifying the financial assurance coverage they would be required to have.⁶⁴ The law requires EPA to give priority in developing these requirements to those

⁶²RCRA's closure and post-closure financial assurances cover normal costs of closing and conducting post-closure care, and do not cover cleanups stemming from accidental releases. The financial assurance regulations also require regulated facilities to carry third-party liability insurance, but these policies only cover third-party bodily injury and property damage from hazardous releases, not the actual cleanup costs.

⁶³In addition to the appropriated funds in fiscal year 2004, EPA officials noted that \$148 million was deposited into Superfund special accounts, which receive payments from liable parties for past and future cleanup costs.

⁶⁴The provision calls for the use of essentially the same financial assurance mechanisms allowed under the RCRA regulations for financial assurance for the costs of closure and post-closure care of hazardous waste facilities. See table 1 for a description of these mechanisms.

classes of facilities, owners, and operators that the agency determined present the highest level of risk of injury. Once identified, the different classes of facilities that handle hazardous substances—which could, for example, include all businesses in a given industry or all those handling a specific hazardous substance—would be required to maintain evidence of financial ability to cover actual and potential cleanup costs consistent with the degree and duration of risk associated with the production, transportation, treatment, storage, or disposal of hazardous substances.⁶⁵

Implementation of this requirement could help to close the financial assurance gaps discussed above because under the Superfund law EPA could require financial assurances for cleaning up existing and future contamination at facilities that handle hazardous substances but are not subject to RCRA's closure/post-closure or corrective action programs, including many mining sites and facilities that generate, but do not treat, store, or dispose of hazardous waste. EPA may also wish to give priority in developing these requirements to facility owners whose prior actions indicate they may pose a high risk of default on their environmental obligations. Factors EPA may wish to consider in evaluating owner risk include compliance history—such as a history of noncompliance with environmental laws, including cleanup obligations, and magnitude of past, current, and potential environmental liabilities.

In applying the Superfund law's risk-based criterion for developing financial assurance requirements, EPA may want to consider hardrock mining a high priority—for example, gold, copper, and iron ore mining—because it presents taxpayers with an especially serious risk of having to pay cleanup costs associated with wastes from thousands of abandoned, inactive, and operating mines on private lands in the United States. Using a statutory provision that allows solid waste from certain mining activities to be excluded from regulation as hazardous waste under RCRA, EPA has excluded several types of mining wastes from the definition of hazardous waste under RCRA, characterizing them as “low toxicity, high volume

⁶⁵The law requires EPA to establish a minimum level of financial responsibility the agency believes is appropriate, to be based on the payment experiences for site cleanups by the Superfund, commercial insurers, and court settlements and judgments. Further, the law specifies that if the owner or operator of a facility required to have financial assurance is in bankruptcy, any guarantor providing evidence of financial responsibility for the owner can be directly liable for releases of hazardous substances from the facility. The law also directs EPA to cooperate with the commercial insurance industry to the maximum extent practicable in developing these financial assurance requirements.

wastes.”⁶⁶ This exclusion has resulted in a significant gap in financial assurance, as discussed above. In addition, mining activities on private lands are not covered by the financial assurance requirements the Department of the Interior’s Bureau of Land Management (BLM) requires for mines on federal land it manages.⁶⁷ However, some mining facilities handle hazardous substances as defined under the Superfund law, and therefore financial assurance regulations issued under the Superfund law could apply to these facilities.⁶⁸

According to the EPA Inspector General, mining sites can cause significant environmental problems, and these sites are typically large, complex, and costly to clean up. A March 2004 report by EPA’s Office of Inspector General identified 63 hardrock mining sites on the Superfund’s National Priority List (NPL) and another 93 sites with the potential of being added to the list.⁶⁹ At least 19 of the 63 existing NPL mining sites had estimated cleanup costs of \$50 million or more. In total, the 63 sites were estimated to cost up to \$7.8 billion to clean up, \$2.4 billion of which is expected to be borne by taxpayers rather than the parties responsible for the

⁶⁶In October 1980, RCRA was amended by adding section 3001(b)(3)(A)(ii), known as the Beville amendment, to exclude, among other things, "solid waste from the extraction, beneficiation, and processing of ores and minerals" from regulation as hazardous waste under Subtitle C of RCRA. This exclusion applied pending completion of a study and a report to Congress, and pending a determination by the EPA Administrator either to promulgate regulations under Subtitle C or to declare such regulations unwarranted. Since completing the required report, EPA has concluded that twenty mineral processing wastes qualify for the Beville exclusion as "low toxicity, high volume wastes." Other mineral processing wastes are regulated under Subtitle C of RCRA, provided they meet the definition of hazardous waste.

⁶⁷Our report *Hardrock Mining: BLM Needs to Better Manage Financial Assurances to Guarantee Coverage of Reclamation Costs*, [GAO-05-377](#) (Washington, D.C.: June 20, 2005) recommends ways for BLM to better manage financial assurances it requires of operators to guarantee reclamation costs if they fail to reclaim BLM-managed lands after operations cease.

⁶⁸Most states with significant hardrock mining have established their own statutory programs and regulate mine activities through mine permits. However, EPA’s Inspector General has reported that some state statutes and regulations do not provide for adequate financial assurances for hardrock mines. EPA, Office of Inspector General, *EPA Can Do More to Minimize Hardrock Mining Liabilities*, E1DMF6-08-0016-7100223 (1997).

⁶⁹EPA, Office of Inspector General, *Nationwide Identification of Hardrock Mining Sites*, 2004-P-00005 (Washington, D.C.: Mar. 31, 2004). The report noted that its inventory may be understated because, among other things, it did not include sites where it was too early in the evaluation process to determine whether the sites had the potential to cost the Superfund trust fund \$1 million or more.

contamination. The EPA Inspector General reported that at least one “clearly viable” party has been identified for 70 percent of the 63 NPL mining sites (including 11 percent where the viable party was a federal agency, such as the Department of the Interior). However, the report also emphasized that EPA should be concerned about the viability of these parties over time because of the long-term nature of the cleanup liabilities at mines. For example, the report states that the projected operation and maintenance period for the cleanup remedy ranges from 40 years to “in perpetuity.” The costs to taxpayers would increase if the liable parties expected to pay for the cleanup remedies proved to be unable to do so.⁷⁰

Some mine owners have defaulted on environmental liabilities associated with their mines on multiple occasions, and the cleanup costs for these sites are being or are expected to be borne largely by taxpayers. These owners may reasonably be viewed as at high risk for defaulting on environmental obligations associated with mines or businesses that they currently own. For example, one individual is associated with several businesses that have filed for bankruptcy protection.⁷¹ Like other mine owners with serial bankruptcies involving contaminated mining sites, this owner continues to operate businesses with significant contamination that need to be cleaned up, potentially via the Superfund. If EPA developed and implemented the financial assurance regulations that the Superfund law requires, EPA could require such owners to provide financial assurances now for existing and future cleanups, thereby reducing the amount that taxpayers would otherwise likely be required to pay.

A Superfund site in Delaware provides an example of the exposure of the federal treasury to enormous cleanup costs associated with industries not currently required to provide EPA with financial assurances because, as generators of hazardous waste, they were not covered by RCRA’s financial assurance requirements. In the 1980s, when this facility was owned by

⁷⁰In addition, taxpayers may also pay for the cleanups to the extent that EPA settles with liable parties for less than the full cost of the cleanups. According to EPA, the agency often settles for less than the full cleanup cost as a result of equitable factors.

⁷¹In one case, the company (MagCorp) filed for Chapter 11 bankruptcy protection 7 months after the Justice Department initiated a lawsuit on behalf of EPA for fines of approximately \$900 million for toxic waste violations. The bankruptcy court permitted the owner to sell MagCorp’s assets to a new company (US Magnesium) controlled by the same owner, and the bankruptcy case was subsequently converted to a Chapter 7 liquidation with essentially no assets available to pay creditors. This sale may substantially impede government efforts to collect the penalties.

Standard Chlorine Corporation, it experienced two major chemical releases—including a 569,000-gallon release of hazardous chemicals that contaminated soil, sediment, a groundwater aquifer, and nearby surface water. Because the facility did not treat or dispose of hazardous waste, and did not store waste for more than 90 days, however, Standard Chlorine did not have to provide financial assurance under RCRA for the cleanups.⁷² In 1987, EPA added the site to the Superfund NPL because of the extensive contamination. Subsequently a limited liability business, Charter Oak Capital Partners LP, established a subsidiary corporation called Metachem Products, which acquired substantially all of Standard Chlorine’s assets including the facility in 1998, and Metachem accordingly became liable for the Superfund cleanup. However, in May 2002, Metachem declared bankruptcy and abandoned the chlorinated benzene manufacturing facility. EPA estimates that it has incurred about \$28 million in cleanup costs to date at this site and that the total cleanup cost will eventually rise to \$100 million.

Despite the clear benefits that EPA could derive from implementing financial assurance requirements under the Superfund statute, over the past 25 years, EPA has made only sporadic efforts to do so. For example, EPA took some steps early on to identify high-priority classes of facilities but did not complete this effort, although the statute included a December 1983 deadline for this task (see app. II for more detail). In 1983, the Director of EPA’s Office of Solid Waste stated that resources were insufficient to develop and implement the Superfund financial assurance requirements. But EPA never asked the Congress to provide additional funds for this purpose.

In 1987, we recommended that EPA set milestones leading to the timely implementation of Superfund financial assurance regulations, but EPA did not implement this recommendation.⁷³ More recently, an April 2004 internal review of EPA’s Superfund program recommended that the Office of Solid Waste and Emergency Response study whether promulgating new

⁷²As noted above, a generator may generally accumulate hazardous waste on site for 90 days or less provided that, among other things, the waste is placed in containers, tanks, containment buildings, or on drip pads in compliance with applicable EPA regulations. Generators of hazardous waste are also required to comply with certain RCRA requirements intended to ensure the safe management of hazardous wastes.

⁷³GAO, *Hazardous Waste: Issues Surrounding Insurance Availability*, [GAO/RCED-88-2](#) (Washington, D.C.: Oct. 16, 1987).

regulations under the broad financial assurance authorities contained in the Superfund law could reduce future Superfund liabilities with respect to facilities not covered under RCRA financial assurance requirements. In response to this recommendation, EPA created a work group that is collecting and evaluating information on the industries and types of facilities that have been listed on the Superfund program's National Priorities List (NPL).⁷⁴

While this study should provide useful and relevant information to EPA—in particular on gaps in the coverage of RCRA's corrective action program—we believe that the issue for implementing the financial assurance requirement under the Superfund law is broader than the question of which industries have sites that have been listed on the NPL. That is, the key issue is identifying industries at high risk for environmental contamination. EPA and the states have a wealth of information from both existing studies and from the knowledge base of EPA's and states' enforcement staff across the country. For example, EPA's 2002 study on the almost 900 RCRA facilities undergoing cleanup measures under the corrective action program provides relevant information on industries at risk for environmental contamination and on the costs of those cleanups.

EPA Does Not Effectively Manage Its Existing Portfolio of Financial Assurances for Cleanups

In addition to not establishing the financial assurance requirements called for in the Superfund law, EPA is not ensuring that the benefits that could be derived from its existing financial assurance requirements for Superfund and RCRA corrective action cleanups are realized. Specifically, in negotiating compliance orders and settlements for these cleanups, EPA generally accedes to the financial assurance mechanism the liable party suggests without routinely determining the risk of the proposed mechanism in light of such factors as the strengths and limitations of the various mechanisms, the financial histories of liable parties, any existing agreements that have reduced the amounts businesses are required to pay for cleanups on the basis of ability-to-pay analyses, and the estimated total environmental liability of individual parties. In addition, EPA has increased the financial risk to the government by not providing adequate oversight and enforcement to ensure that the parties responsible for Superfund and RCRA cleanups obtain and maintain the required financial assurances. EPA

⁷⁴The NPL is EPA's list of seriously contaminated sites, and placement on this list is limited, in part, by funding for the program. Thousands of contaminated sites exist that are not on the list or subject to RCRA's corrective action program.

has acknowledged that its enforcement of financial assurances has been inadequate and has initiated some actions to address this problem.

EPA Allows Companies to Choose among Financial Assurance Mechanisms That Carry Varying Degrees of Financial Risk to the Government, Rather Than Taking into Account Information on the Extent of Default Risk That Companies May Pose

EPA has generally given companies significant flexibility to choose the type of financial assurance mechanism they will use to demonstrate their ability to meet their obligations under the RCRA corrective action and Superfund programs. While the closure/post-closure program has regulations governing financial assurances, the corrective action and Superfund programs do not. EPA generally accepts the same financial assurance mechanisms in the Superfund and RCRA corrective action programs as are outlined in the RCRA closure/post-closure regulations. Under the closure/post-closure regulations EPA must generally accept the financial assurance mechanism chosen by the party, so long as the party meets the relevant regulatory requirements for that mechanism. The financial assurance mechanisms EPA generally accepts in all three programs are outlined in table 1.

Table 1: Financial Assurance Mechanisms Generally Accepted by EPA

Mechanism	Description
Corporate financial test	A company may demonstrate its ability to meet its obligations by passing one of two financial tests, one of which evaluates certain financial ratios, and one of which requires a minimum bond rating. Both tests require that the company have at least \$10 million in tangible net worth and demonstrate that this tangible net worth is equal to at least 6 times the sum of the current estimates of the cleanup, closure/post-closure, or other costs for which the company is using the financial test as its financial assurance. Use of the corporate financial test is also called self-insurance.
Corporate guarantee	A company may demonstrate its ability to meet its obligations by obtaining a written guarantee from an affiliated entity, such as a parent corporation. For EPA to accept this guarantee, the affiliated entity must meet one of the two corporate financial tests described above.
Insurance	Ability to meet obligations may be demonstrated by an insurance policy covering the estimated cost of these obligations.
Letter of credit	To demonstrate its ability to meet its obligations, a company may provide an irrevocable standby letter of credit issued by a financial institution guaranteeing payment of the obligations up to a specified amount.
Surety bond	A company may obtain a bond from an approved surety company ^a guaranteeing that its obligations will be met.
Trust fund	A company may establish a trust fund with a financial institution to demonstrate its ability to meet its obligations. The release of funds from the trust fund may be directed only by EPA or other regulator.

Source: EPA closure and post-closure regulations.

^aTo be approved, a surety company must be listed on U.S. Department of the Treasury's Circular 570.

Financial assurance mechanisms vary in

- the financial risks they pose to the government—and thus to taxpayers who may ultimately have to pay for environmental cleanups if the responsible parties default on their obligations;
- the oversight and enforcement challenges they pose to the regulators, such as EPA, who are responsible for enforcing them; and
- the costs companies may incur to obtain them.

For example, as shown in table 2, while the costs to companies of the corporate financial test and the corporate guarantee mechanisms are low compared with other forms of financial assurance, the relative financial risk to the government and the amount of oversight needed are relatively high. In contrast, letters of credit present comparatively low financial risk to the government and need less oversight but impose relatively high costs on companies. In essence, as the table shows, those financial assurance mechanisms that impose the lowest costs on the companies using them also typically pose the highest financial risks to the government entity accepting them. We note that EPA continues to allow financial assurances that are simply promises to pay—the corporate financial test and the corporate guarantee—even though its 2003 guidance on financial assurance for the RCRA corrective action program underscores the importance of having resources set aside “in the event a company hits a financial decline.”

Table 2: Relative Financial Risk, Necessary Oversight and Enforcement Effort, and Costs of Financial Assurance Mechanisms

Mechanism	Relative financial risk to the government	Oversight and enforcement effort needed	Cost to the company
Corporate financial test	High If a company that passed the test later files for bankruptcy or becomes insolvent, the company in essence is no longer providing financial assurance because it may no longer have the financial capacity to meet its obligations. Such financial deterioration can occur quickly. While companies no longer meeting the financial test are to obtain other financial assurance, they may not be able to obtain or afford to purchase it.	High The test requires regulators to have expertise in financial analysis and monitor companies' financial condition. For example, the regulator is expected to review companies' annual financial submissions showing that they continue to pass the test. Regulators should also monitor the business press for adverse news about the company, indicating that it may no longer pass the test.	Low The corporate financial test and the corporate guarantee (discussed below) are the lowest-cost options for companies because they do not have to set aside funds for future payments or pay fees or premiums to third parties, such as banks.
Corporate guarantee	High Same issues as with the corporate financial test.	High Same issues as with the corporate financial test.	Low See discussion concerning the corporate financial test.
Insurance	Varies Several factors affect financial risk. For example, "captive" insurance companies—those not independent of the liable business—can pose greater risk than independent insurance providers. Also, if there is conflicting language between an insurance policy and EPA's regulatory requirements, recovery on the policy may be delayed.	Moderate However, extent of oversight needed can vary based on the type of insurance. Captive insurance, in particular, poses many of the same challenges as the corporate financial test and corporate guarantee (see above) because the captive insurer is not a true third-party provider of assurance. Even with an independent insurance provider, however, significant oversight is needed.	Moderate However, cost can vary based on the type of insurance. For example, captive insurance can pose lower costs than insurance from an independent provider. Also, many independent providers are underwriting environmental insurance using finite or fully funded policies—which limit their risk. Such policies resemble trust funds and, like trusts, present higher costs to the company than do conventional insurance policies.
Letter of credit	Low Financial institutions issuing letters of credit are required to pay the amounts specified if EPA requests such payments within the periods of time specified in the letters.	Low Requires periodic monitoring to verify that the letter of credit remains in force and is maintained in a secure place and that the financial institution issuing the letter of credit is still viable.	High Companies typically pay fees to obtain letters of credit and may be required to set aside substantial collateral. Fees may be up to 1 percent of the amount guaranteed, depending on the company's creditworthiness, according to EPA.

(Continued From Previous Page)

Mechanism	Relative financial risk to the government	Oversight and enforcement effort needed	Cost to the company
Surety Bond	Low to moderate Surety companies are required to pay the amounts specified in the bonds upon receipt of demand letters by the regulator. ^a	Low to moderate Periodic monitoring is required to verify that the bond remains in force and that the surety company is still approved.	Moderate to high Companies pay annual premiums to surety companies and generally are required to provide substantial cash collateral.
Trust fund	Low There is a risk that the trust may not be fully funded if the company is allowed the flexibility of paying over time.	Low to moderate Periodic monitoring is required to ensure, among other things, that the financial institution has the authority to act as trustee.	High The company must set aside funds into the trust to cover its anticipated obligations. In addition, the company usually pays a fee for the administrative services provided by the trustee.

Source: GAO analysis.

^aIn some cases, EPA allows performance bonds to be used; the surety guarantees that it will either perform the required work or will pay out the amount specified in the bond upon receiving notification from the regulator that the company for which the surety has provided a performance bond has failed to carry out its obligations.

The mechanisms that pose the greatest financial risk to the government—the corporate financial test, the corporate guarantee, and some insurance products—also require specialized expertise to oversee. Concerns have been raised, both within EPA and by others, that the corporate financial test and the corporate guarantee offer EPA minimal long-term assurance that the company with environmental liability will be able to fulfill its financial obligations. In 2000, the Department of the Interior’s Bureau of Land Management (BLM) identified similar concerns when it decided to prohibit new corporate guarantees for future reclamation work to restore lands when mining operations cease. In making this decision, BLM cited both the agency’s lack of expertise to perform the periodic reviews of companies’ assets, liabilities, and net worth that would be necessary to oversee guarantees and the fact that even with annual reviews by skilled staff, a default risk would remain.⁷⁵

Further, some concerns about the financial test, such as the following, stem from limitations inherent in relying on financial indicators rather than secured guarantees:

⁷⁵See GAO, *Hardrock Mining: BLM Needs to Better Manage Financial Assurances to Guarantee Coverage of Reclamation Costs*, GAO-05-377 (Washington, D.C.: June 20, 2005) for examples of BLM’s inability to collect funds for reclamation when operators of hardrock mines using corporate guarantees filed for bankruptcy.

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- The corporate financial test rests on the assumption that a company's recent financial performance is a reasonable predictor of its financial future. However, the financial test cannot anticipate sudden changes in market conditions or other factors that can dramatically change a company's financial picture—and a company's ability to meet its environmental obligations.
 - Once a company's financial condition declines to the point that the company can no longer pass the financial test, it can be very difficult for the company to meet the requirements, or pay the costs, of obtaining an alternative form of financial assurance from a third-party provider.
 - The financial test is only as sound as the data used to calculate the financial ratios underpinning the test—if a company's accounting of its net assets or liabilities is questionable, or the quality of its assets is weak, one or more of the ratios may not represent the company's true financial condition. EPA officials noted that the passage of the Sarbanes-Oxley Act of 2002, with its requirements aimed at improving the accuracy and reliability of corporate disclosures, may have reduced some of these data-related concerns about the financial test, at least for publicly held companies.

In addition to these limitations, weaknesses in the financial test itself are actively under discussion. For example, EPA's Environmental Financial Advisory Board, a federal advisory committee that provides advice and recommendations to EPA on environmental finance issues, has been charged by EPA with reviewing financial assurance mechanisms. In March 2005, the project work group leading this review submitted to the full board for consideration the first draft of a proposed letter to the EPA Administrator commenting on the financial test. In this draft letter, the work group stated that the current test is "an inadequate mechanism for determining financial capacity." The draft letter also stated that while the EPA financial test is transparent and objective, the test is not sufficiently comprehensive in what it assesses, does not examine and incorporate historical trends, and is not sufficiently rigorous to protect against manipulation. The membership of the full board is reviewing the draft letter, and the board has received substantive comments on the draft letter from outside parties. The work group is reviewing comments on the draft letter and expects to develop a revised draft letter for full board review and approval outlining the board's findings and recommendations concerning the financial test.

Another concern about the financial test relates to the threshold a company must meet to qualify for the test—a company must have at least \$10 million in tangible net worth. EPA has not adjusted the standard since 1982 when the RCRA financial assurance regulations were implemented.⁷⁶ The Environmental Financial Advisory Board subcommittee noted that the \$10 million threshold may be inadequate and should either be recalibrated or have standards of proportionality. We believe that the \$10 million standard is likely to no longer be appropriate given, for example, the rate of inflation since 1982.

In addition, the financial test requires that EPA and state regulators have the financial skills to assess whether a company's representation of its financial condition is reasonable. An EPA regional enforcement official said that the assessment of whether a company meets the financial test can be particularly difficult given that companies have an incentive to pass the test—therefore, companies may try to paint their financial position as “rosier” than it actually is to avoid having to pay for higher-cost financial assurance. (As recent court cases, such as those involving Enron and Worldcom, have shown, serious misstatements of financial position aimed at demonstrating strong financial position may occur for a number of other reasons as well—for example, to protect or improve the value of the corporate stock.) Because EPA and state staff who oversee the implementation of these mechanisms may not have sufficient expertise to provide the desired level of financial analysis, the Environmental Financial Advisory Board's March 2005 draft letter to the EPA Administrator noted that the financial test may be better served if companies retained credit services to provide independent financial analysis.

Moreover, in a March 2001 report, EPA's Inspector General identified other factors that complicate overseeing the financial test.⁷⁷ In this report, officials cited difficulties in predicting companies' long-term financial viability. For example, in reviewing the financial assurances of a sample of hazardous waste facilities required to have financial assurances, the Inspector General found that some facilities that had established financial assurance through the corporate financial test no longer met the requirements of the test a year later. Other difficulties officials cited in

⁷⁶EPA last evaluated the net worth requirement in 1991. 56 *Fed. Reg.* 30201.

⁷⁷EPA, Office of Inspector General, *RCRA Financial Assurance for Closure and Post-Closure*, 2001-P-007 (Washington, D.C.: Mar. 30, 2001).

overseeing the financial test included evaluating data from companies that have hazardous waste facilities in many states and factoring in the impact of mergers and acquisitions, among other things.

In a 2003 paper summarizing its review of RCRA financial assurances, the Association of State and Territorial Solid Waste Management Officials⁷⁸ reported that waste and remediation managers from various states believe that EPA should reconsider the financial test and corporate guarantee as financial assurance mechanisms due to the financial meltdown of Enron and many other publicized financial scandals of Fortune 500 companies with audited financial statements.⁷⁹ The paper states that EPA's position is that eliminating these financial assurances could add substantially to the cost of the financial assurance regulations.⁸⁰

As table 2 shows, the corporate financial test and the corporate guarantee are the least costly financial assurances for companies to use, so eliminating them would increase compliance costs. At the same time, these two financial assurance mechanisms are the most costly for the government because of the high oversight costs associated with them, as discussed above, and because the government, rather than the companies, is carrying the default risk.

In addition to the risks posed by the use of the corporate financial test and the corporate guarantee, the use of insurance policies as financial assurance has typically presented higher financial risk to the government than letters of credit, surety bonds, and trust funds. For example, concerns have been raised about the increased use of policies written by “captive” insurance companies—that is, by wholly-owned subsidiaries controlled by parent companies and established to insure the parent companies or other subsidiaries.

⁷⁸The Association of State and Territorial Solid Waste Management Officials is an organization that supports state environmental agencies and trust territories by focusing on their solid and hazardous waste programs, Superfund and state cleanup programs, underground storage tank programs, and other programs.

⁷⁹Association of State and Territorial Solid Waste Management Officials (ASTSWMO), *Financial Assurance Review Paper* (Washington, D.C.: April 21, 2003).

⁸⁰CERCLA and RCRA both specifically authorize self-insurance as a form of financial assurance. 42 U.S.C. § 9608(b)(1); 42 U.S.C. § 6924(t)(1). However, both statutory provisions give EPA broad discretion in determining the circumstances under which the agency accepts self-insurance. Moreover, neither provision specifically applies to financial assurances included in corrective action orders issued under RCRA.

In 2001, for example, EPA's Office of Inspector General found that financial assurance provided by a "captive" company did not provide adequate assurance of funding for closure and post-closure activities at hazardous waste facilities.⁸¹ EPA acknowledges that the financial health and solvency of a captive insurance company may be closely connected to the financial condition of the company with environmental liabilities, and therefore, if the company faces financial difficulties, the insurer may also be in financial distress and not be able to cover claims made on its policies.

The Congress has also raised questions about the use of insurance as financial assurance at solid waste landfills, which have a separate set of financial assurance regulations.⁸² A June 2000 House committee report directed EPA to conduct a study of financial assurance agreements at solid waste landfills to determine if sufficient safeguards have been properly maintained and future liabilities minimized. According to the EPA official responsible for preparing this report, the concerns that led to this mandate dealt largely with captive insurance. EPA's draft report in response to the mandate was being reviewed within the agency as of June 2005; no expected issuance date has been announced yet. Because the report is still in draft form, EPA officials were not willing to discuss its findings or potential recommendations.

Moreover, independent of issues associated with captive insurance policies, insurance policies covering corrective action or Superfund cleanups can require significant oversight on the part of regulators. For example, since insurance policies may contain exclusions that limit their coverage, the regulator must carefully review a policy being used as financial assurance to verify that it fully covers the anticipated environmental claims. Also, the regulator must remain aware of the insurer's status—under current EPA requirements, the insurer is not required to inform the regulator if its license to operate is revoked or it becomes insolvent. In addition, EPA officials noted that insurers will sometimes include language in the policy that conflicts with EPA's

⁸¹See footnote 77.

⁸²40 C.F.R. Part 258, Subpart G.

regulatory requirements, which may delay recovery on the policy.⁸³ The Association of State and Territorial Solid Waste Management Officials has voiced concerns about the level of oversight required of insurance as financial assurance, and in 2003, recommended that EPA update its guidance on financial assurances, particularly its guidance on insurance issues, such as how to make claims on policies.⁸⁴

In addition to the financial risks to the government resulting from the use of certain financial assurance mechanisms, as discussed above, several other financial risk factors affecting liable parties' ability to fulfill their cleanup obligations make it all the more important that EPA or state regulators, if applicable, ensure that liable parties provide solid financial assurances that will be available when needed. These risk factors include (1) the financial histories of liable parties, (2) any existing agreements that have reduced the amounts businesses are required to pay on the basis of ability-to-pay analyses, and (3) the estimated total environmental liability of individual parties. When EPA or a state regulator agrees to a liable party's use of a financial assurance mechanism, it would be prudent for the agency to consider these factors as well as the risk to the government associated with the mechanism itself.

In some cases, EPA or state regulators have encountered individuals or companies with track records that indicate that they are unlikely to have the financial resources or the willingness to carry out their environmental cleanup responsibilities. The histories of these parties may indicate that they are at high risk of failing to comply with future requirements, such as

⁸³Under the financial assurance regulations for closure/post-closure, an insurer must submit a certificate to EPA providing, among other things, that any provision of the policy that is inconsistent with EPA regulations is automatically amended to eliminate any inconsistency. 40 C.F.R. § 264.151(e). While EPA officials believe this certificate resolves any conflict between the regulations and the policy, they acknowledge it may be necessary to litigate the issue, leading to a delay in recovery. A recent federal appellate court analyzing an analogous issue held that in a conflict between EPA's financial assurance regulations for underground storage tanks and a state statute, EPA's regulations governed the dispute. In *Zurich American Insurance v. Whittier Properties*, 356 F.3d 1132 (9th Cir. 2004), the court held that EPA's financial assurance regulations governing underground storage tank (UST) operators provided for the exclusive remedy of prospective cancellation of a UST insurance policy where the operator had obtained the policy fraudulently. The court held that because EPA's regulations provided the exclusive remedy, the insurer could not benefit from a state statute authorizing rescission of the policy in the event of fraud, and therefore could not avoid paying on the policy.

⁸⁴See footnote 79.

cleanup requirements under the corrective action program. Parties that present such high risks to EPA and state regulators could be required to obtain strong financial assurances to ensure that their environmental responsibilities are fulfilled.

Also, large liabilities—which may stem from one or more megasites either under Superfund and/or RCRA or from a series of smaller sites—expose EPA and taxpayers to significant financial risk, especially if there is only one or a few parties liable for the cleanups. In such cases, choosing financial assurance mechanisms that provide relatively low financial risk to the government—that is, that provide at least some actual funding—is particularly important. However, EPA and state staff overseeing financial assurances generally do not have information readily available about a company's total environmental liabilities across the United States, nor would they typically have access to information about (1) environmental obligations a company may have in other countries or (2) the extent to which the company may be using the same financial assurance mechanism to back up numerous environmental obligations.⁸⁵ As a result, these regulators may, for example, approve the financial test for financial assurance at a RCRA site or sites without considering a company's liability for a large Superfund site in another state.

Finally, for RCRA sites, typically an owner or operator is responsible for the cleanup. Similarly, at some Superfund sites, there may be few, even only one, liable parties. Along these lines, EPA enforcement officials said that strong financial assurances are particularly critical when a site's cleanup costs are large, but the number of liable parties is small. At such sites, strong financial assurances are likely to be the only way to avoid having taxpayers pay for these cleanups should the liable party experience financial reverses, file for bankruptcy, or restructure in a way that leaves the party with insufficient assets to pay for the cleanup.

⁸⁵EPA officials noted that under the RCRA closure/post-closure program, an owner or operator of a RCRA treatment, storage, or disposal facility who uses the financial test or corporate guarantee is required to (1) disclose other sites for which it is using the financial test and the current closure or post-closure cost estimates for each of these sites and (2) provide a list of facilities that are not covered by the financial test submission and the current estimated costs of closure and post-closure care for these other facilities.

EPA Has Further Increased the Financial Risk to the Government by Not Providing Adequate Oversight and Enforcement of Financial Assurance Requirements for Cleanups

EPA has conducted limited enforcement of its existing financial assurance requirements. As a result, the agency has not ensured that the parties responsible for Superfund and RCRA corrective action cleanups obtain and maintain the financial assurances they are required to provide to demonstrate their ability to meet these environmental obligations. In fact, the agency lacks basic information about its portfolio of financial assurances. That is, EPA does not have data on the financial assurances that businesses are required to have in place for Superfund and RCRA cleanups, such as the type of assurance required, the amount of financial assurance provided, and whether the financial assurance is still authorized or is in force.⁸⁶

Further, in late 2003, one EPA regional office conducted an assessment of financial assurances for Superfund cleanup settlements negotiated in that region and found significant noncompliance with financial assurance requirements. Specifically, EPA officials found that only 30 percent of the liable parties subject to financial assurance requirements in Superfund settlements, consent decrees, and EPA cleanup orders were in compliance with these requirements. Overall, the responsible parties at 48 percent of these sites appeared to be out of compliance with relevant financial assurance requirements. In addition, the regional staff reported that 22 percent of the cases needed additional follow up and review because, among other things, EPA could not locate the financial assurance documents and thus could not determine whether the liable parties were in compliance with the financial assurance requirements. (In some cases, EPA had the responsibility for maintaining the financial assurance documents, and in others that responsibility had been delegated to state regulators.) The staff member leading the assessment reported that locating the original financial assurance documents within the region's records was "painfully slow."

Moreover, EPA's key databases for Superfund and RCRA do not contain data elements related to financial assurances. In addition, although EPA's regional offices are responsible for ensuring compliance with Superfund settlement agreements, including financial assurance requirements, the regional offices have generally not tracked information on their portfolios of financial assurances supporting settlements for cleanups in their

⁸⁶For example, the use of the corporate guarantee is no longer authorized if the company providing the guarantee no longer meets EPA's financial test. Other forms of financial assurance, such as bonds and insurance, may lapse for various reasons.

regions. For example, we asked several EPA regional offices to provide information on the Superfund settlements negotiated in their offices such as (1) the number of settlements backed by financial assurances and (2) the number, if any, not in compliance with this requirement. Regional EPA officials told us that information was not readily available, and that obtaining it would entail going back to each individual settlement agreement to identify the financial assurance mechanism, if any, and then determining the current status of the financial assurance. The situation with financial assurances under the RCRA corrective action program is more complex. While EPA has overall responsibility for implementing the act, and retains enforcement authority, it has authorized most states to administer the corrective action program. As a result, to obtain information on these financial assurances, EPA would have to request that the states gather this information and provide it to EPA.

Lacking data on the financial assurances that are required, EPA cannot be assured that all appropriate financial assurances are in place and available, as needed. In addition, the data limitations preclude EPA and state officials from conducting other analyses and enforcement-related tasks, such as determining whether the financial assurances that a company provides will be adequate given the company's cleanup liability across the nation and analyzing the effectiveness of the various types of financial assurance in providing funding for cleanups.

Enforcement officials both at EPA headquarters and several regional offices acknowledged that the agency has often paid scant attention to oversight and enforcement of financial assurance requirements in cleanup settlements and cleanup orders. According to EPA officials, the agency's focus in the Superfund program has been on the environmental issues associated with cleanups, such as ensuring that appropriate cleanup remedies are chosen and that the liable parties begin the agreed-upon cleanup work. Consequently, when EPA negotiates and enforces cleanup settlements, enforcing financial assurance requirements, including reviewing complex financial data about responsible parties, typically takes a back seat to environmental concerns. According to one regional attorney, there are a number of important issues to resolve in negotiating settlements, and ensuring that a strong financial assurance mechanism is in place often becomes a "B list" issue during negotiations. Moreover, one official noted that EPA tracks whether its regional enforcement officials reach a settlement with liable parties as a key measure of enforcement activity—but there is no such results-oriented measure concerning enforcement of financial assurances. In addition, the existing model

language for Superfund settlements does not require that the financial assurance be obtained by the time the settlement is signed. Rather, the party agreeing to the settlement has 30 days after signing it to obtain financial assurance and notify EPA. This arrangement has precluded an assessment of the assurance before the settlement is signed.

Once a Superfund settlement has been signed, enforcement of financial assurances—to ensure that they were actually obtained, are sufficient to cover anticipated cleanup costs, and remain in force—is likely to remain a low priority, according to some EPA enforcement officials. An EPA official explained that this enforcement responsibility typically falls to the remedial project manager, who has overall responsibility for the site cleanup. This remedial project manager’s expertise is typically in engineering and environmental cleanup issues, not financial matters such as determining whether a liable party’s corporate guarantee provides adequate protection against default on the party’s cleanup obligations. Moreover, if EPA discovers at some point that the liable party’s financial assurance is no longer adequate, EPA is often reluctant to insist that the company incur the additional cost of obtaining further financial assurance as long as the company is carrying out at least some of the cleanup work, according to some enforcement officials. In fact, EPA and Justice Department officials have noted that at times they are faced with this dilemma: whether to require companies to use some of their limited resources to obtain secure financial assurances versus applying those funds directly to the cleanups.

EPA has begun to recognize that its limited enforcement of its financial assurance requirements for Superfund and RCRA cleanups, as well as these requirements for closure and post-closure activities at hazardous waste facilities, is exposing taxpayers to significant risk of having to pay cleanup costs at many current and future Superfund sites. As a result, EPA’s enforcement office has begun several initiatives concerning financial assurances:

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- EPA has added financial assurances to its national enforcement priorities beginning in fiscal year 2006.⁸⁷
 - EPA has taken steps to evaluate the addition of data elements, such as the type of financial assurance provided and the name of the company providing it, to its key databases for Superfund and RCRA programs. EPA estimates that the Superfund database's revisions will be in place by the end of fiscal year 2005. The data elements are expected to be added prospectively, that is, EPA would add information about financial assurances in new Superfund settlements and consent decrees to the database as they are reached, but information about existing financial assurances would not likely be added. Because the RCRA database additions involve coordinating with states and tribes authorized to implement RCRA, they are expected to take longer, and no estimate of implementation date has been made.
 - EPA has begun efforts to increase the expertise of officials who enforce its financial assurance requirements. For example, the agency has developed a course on financial assurance mechanisms for officials who enforce RCRA financial assurance requirements.
 - In late 2004, EPA made available three cost-estimating tools to help regulators estimate the appropriate level of financial assurances needed in the RCRA corrective action program. EPA has also begun to fund training in the use of cost-estimating software for its staff and state agency personnel.
 - In response to a recommendation in EPA's April 2004 internal Superfund review, as discussed earlier, EPA has begun a study that, among other things, will assess the extent to which facilities that had been required to have financial assurances under RCRA's hazardous waste program have become taxpayer-funded Superfund cleanups. Also, EPA's Office of Inspector General initiated a review in late 2004 on the effectiveness of RCRA's financial assurance requirements.

⁸⁷EPA has financial assurance requirements not only for the programs discussed in this report, but also for other areas, such as the Underground Storage Tank Program and the Underground Injection Control Program for deep injection wells. In 2003, we reported on financial assurances for Class 1 deep injection wells, which are built to contain hazardous liquid waste below the lowest underground source of drinking water. See GAO, *Deep Injection Wells: EPA Needs to Involve Communities Earlier and Ensure That Financial Assurance Requirements Are Adequate*, [GAO-03-761](#) (Washington, D.C.: June 13, 2003).

EPA Could More Fully Utilize Other Enforcement Authorities, Such as Claiming Payments the Government Owes to Liable Businesses and Filing Liens on Superfund Properties

In addition to financial assurances, EPA has other enforcement authorities available under certain circumstances to help obtain payments for cleanups. For example, EPA may in appropriate circumstances (1) seek, in cooperation with the appropriate federal agency, tax refund or other administrative offsets, which allow the federal government to redirect payments or tax refunds it owes businesses to federal agencies with claims against these businesses and (2) file liens on property for which the federal government has incurred expenses under the Superfund law. These authorities may be used regardless of whether a liable party is in bankruptcy. Under the bankruptcy code, offsets and these liens may be considered secured claims—that is, those the debtor must pay first—which can greatly increase the likelihood that EPA will recover at least some of its cleanup costs in bankruptcies.

EPA May Obtain Tax Refund and Other Administrative Offsets to Help Pay for Costs of Environmental Cleanups

An administrative offset is a procedure allowing a federal agency to obtain monies owed to it by a party from payments that the federal government owes the same party, such as tax refunds or payments under government contracts. EPA officials noted an important advantage of offsets as opposed to claims in bankruptcy court: to the extent that the offsetting amount will cover the dollar amount of EPA's claim, the claim will be paid in "full dollars." In contrast, claims in bankruptcy court, as previously discussed, may result in a payment of only pennies on the dollar amount of the claim. According to EPA and Justice Department enforcement officials, the agency has obtained tax refund offsets in several bankruptcy cases and other administrative offsets in two cases in the past few years. EPA officials noted one such example: in July 2004, after United Airlines filed for bankruptcy protection, EPA reached a settlement with the company on its environmental liabilities that included a provision to recover \$550,000 through an offset of a federal tax refund.

EPA officials also described an instance in which they had not been successful in obtaining an offset. Officials in EPA's Philadelphia office told us of their failed attempt to obtain an offset from Exide Technologies when it filed for bankruptcy reorganization in 2002. One of these officials estimated that the company had an environmental liability of about \$80 million from more than 100 contaminated sites. EPA officials believed the company had significant government contracts and tried to identify those contracts and the amount the government owed the company at that time. However, these officials said they were unable to obtain this information in time—that is, before the government paid Exide. (Under the Prompt Payment Act, an agency acquiring property or services from a business

concern must make payments by the required payment dates or pay an interest penalty to the business on the amount due, and thus information on pending government payments must be gathered quickly.) To gain the benefit of administrative offsets to help recover some cleanup costs, EPA would need to quickly identify government payments owed to bankrupt or financially distressed companies with environmental liabilities and process its offset claim before the government paid the contractor or vendor.⁸⁸

To date, EPA has provided little guidance to its enforcement staff on how to use its offset authority in recovering cleanup costs. For example, EPA's guidance for participating in bankruptcy cases mentions offsets but does not provide any instruction on the necessary steps in obtaining an offset, such as coordination that may be needed with the Internal Revenue Service for a tax refund offset. Similarly, in training sessions on bankruptcy issues for EPA attorneys that we observed in 2004, EPA and Justice Department bankruptcy experts encouraged the use of offsets, but did not include any specific information on how to obtain offsets or refer participants to any guidance on doing so. Particularly given the time-critical nature of any attempt to obtain offsets, procedures and guidance to staff to facilitate the use of offsets would both encourage staff to use these tools, when appropriate, and support their efforts to do so. For example, guidance to EPA staff on how to quickly obtain information on government contracts or grants may have helped them identify potential offsets for some environmental liabilities associated with bankruptcies. In addition, an agencywide process for identifying tax payments due to businesses would enable the agency to routinely identify whether businesses filing for bankruptcy that have environmental liabilities are owed any tax refunds.

⁸⁸Although in some cases, EPA could miss out on opportunities for recoveries because certain payments had already been made, for ongoing relationships with contractors, grantees, or vendors, the offset authority could be used against future payments to these entities.

EPA's Authority to File Liens on Superfund Properties Can Help the Agency Recover Costs Associated with Environmental Cleanups

Under the Superfund law, EPA has a lien, or legal claim, on property if the government has incurred costs associated with cleanup at the property.⁸⁹ According to a relevant House committee report, one purpose of the lien was to prevent the unjust enrichment of the responsible party, who might otherwise benefit from the rise in property value resulting from the property's cleanup. According to EPA, liens can provide the agency with leverage in obtaining cleanup costs generally, and can also assist the agency in obtaining cleanup funds under bankruptcy proceedings because liens are classified as secured claims—the highest priority category for receiving payments from a debtor in a bankruptcy. Thus, a lien can greatly increase the likelihood that EPA will recover at least some of its cleanup costs in bankruptcy cases.

However, to establish the priority of a property lien under the Superfund program among other secured parties and creditors, EPA must file notice of the lien (sometimes called “perfecting a lien”) in the appropriate governmental office in the state where the property is located.⁹⁰ Importantly, the automatic stay provision under bankruptcy law generally prohibits filing or enforcing a lien after a debtor has filed for bankruptcy. In addition, the priority of property liens is typically based on their filing dates. Thus, it is to EPA's advantage to file Superfund liens as soon as possible to secure EPA's financial interest in them and to receive as high priority for that interest as possible. An example of the benefit liens can provide is a bankruptcy case cited by EPA in which the agency recovered \$10 million in satisfaction of its property lien. (The property was sold for \$24 million at an auction conducted by the bankruptcy court.) If, however, EPA does not routinely consider and analyze the use of liens at Superfund sites to protect the government's financial interest where cost

⁸⁹Section 107(l) of the Superfund law establishes a federal lien in favor of the United States upon property which is subject to or affected by a removal or remedial action. The lien applies to all property upon which the response action has been taken, not just the portion affected by the cleanup activities, and applies to all future costs incurred at the site.

⁹⁰EPA's lien guidance advises regional officials, who are responsible for filing such notices, to consider filing notice of a lien whenever applicable, and, in making such decisions, to take into account such considerations as whether the property's value will significantly increase as a result of the cleanup work and whether there is a likelihood that the owner will file for bankruptcy. EPA Memorandum: Guidance on Federal Superfund Liens, September 22, 1987.

reimbursement may otherwise be difficult or impossible, the agency can miss opportunities to have status as a secured creditor in bankruptcy cases.⁹¹

In addition, having Superfund liens can also help EPA negotiate settlements with liable parties at Superfund sites, according to EPA. For example, according to EPA, the liens cover the entire property for which Superfund-related costs have been incurred, not just contaminated areas—and owners of some properties may wish to sell “clean” portions of their properties. Such owners would have an incentive to have the lien released, which would happen only if they conducted the cleanup or reimbursed EPA for cleanup costs. In fact, EPA has identified instances in which even the threat of filing a lien has produced agreements for payments with uncooperative parties. With filed liens, the agency may also become aware of assets businesses may wish to sell to affiliated parties, and which EPA could challenge under fraudulent transfer laws, because such transactions would need to be approved by the agency.

Since the lien provision was added to the Superfund law in 1986, EPA has issued guidance to its staff on filing liens and has encouraged staff to do so. For example, in 2002, EPA’s Director of the Office of Site Remediation Enforcement issued a memorandum encouraging the filing of liens to secure response costs in Superfund cases. Also, in training sessions on bankruptcy issues for EPA enforcement attorneys, such as those we observed in 2004, EPA and Justice Department experts in bankruptcy encouraged these attorneys to file Superfund liens whenever possible. However, we found that EPA headquarters does not require that its regions report information to them on liens they have filed, and that overall the agency has little centralized information on such liens. For example, although the principal database used to manage the Superfund program contains data fields for such liens, an EPA official with expertise in this database said that the agency has little confidence in the completeness or accuracy of these fields. Also, the lien-related fields were added in the late 1990s, so liens filed before that time are not likely to be included in the national database. Thus, it is not clear whether EPA has made good use of its authority to file Superfund liens.

⁹¹We recognize that there is a transaction cost in filing Superfund liens and that this cost should be balanced against the prospect of more certain cost recovery for the government. In some cases, a lien may provide no potential cost recovery to EPA because the land has little or no value.

In addition, it is not clear that the agency is consistently and timely aware of EPA property liens that it should pursue in bankruptcy cases. For example, EPA officials indicated that the agency generally relies on its enforcement attorneys to have knowledge of its Superfund liens at sites for which the attorneys have enforcement responsibility. However, the reliability of this informal system is questionable in light of such things as the often voluminous Superfund files we have observed—a wall of floor-to-ceiling shelves can be filled with files from just one case—staff changes over time, and the need for the relevant staff to be available when the notice of bankruptcy is circulated via email. In addition, agency guidance on bankruptcy cases does not specifically require staff to routinely determine, when reviewing notices of bankruptcy filings, whether EPA has filed a lien that could become a secured claim in the bankruptcy proceedings. Finally, we note that EPA officials highlighted the fact that lien filings are not included in the agency’s performance measures, and that greater attention can be expected to be given to those activities that are counted, such as reaching Superfund settlements.

Conclusions

The need for EPA to fully use its existing authorities to execute the “polluter pays” principle underlying the Superfund and RCRA laws is even more compelling today than it was during the 1980s and 1990s when corporate taxes—largely assessed on businesses at risk for environmental pollution—provided about \$1 billion a year for Superfund cleanups. Now, without revenue from Superfund taxes, the cleanup burden has increasingly shifted to the general public—and at a time when large federal deficits are likely to constrain EPA’s ability to obtain such funding for these cleanups. In addition, over time, businesses have become more sophisticated in using the limited liability principle to protect their assets by separating them from their liabilities. They use the traditional corporate parent/subsidiary structure as well as relatively new business forms—limited liability companies and partnerships—often in complex, multilayered organizational structures. The result is that businesses of all sizes can easily limit the amounts they may be required to pay for environmental cleanups under Superfund and RCRA. Compounding the problem, from EPA’s perspective, is the long-term nature of many of the cleanups, which provides businesses with ample time to implement complex asset protection plans. Finally, it has become more common and acceptable for businesses to use the bankruptcy courts as a reorganization tool that enables businesses to emerge with discharged or reduced environmental liabilities.

Collectively, these factors present serious challenges to EPA in attempting to enforce environmental laws and to ensure that polluters pay for cleanups. For example, the ease with which companies can protect their assets can actually encourage businesses to take more risks in their operations, thereby increasing the risks of environmental contamination. Importantly, this situation also presents a significant management challenge for EPA in determining whether businesses have resources available to meet their environmental obligations. These challenges can seriously hamper EPA's ability to achieve its primary mission of protecting human health and the environment because they present formidable obstacles to obtaining the funding needed for cleanups. That is, it is increasingly difficult for EPA to obtain funding to clean up not only existing Superfund sites but also those still in the Superfund pipeline. Thus, we believe it is imperative for EPA to increase its focus on financial management and to fully use its existing authorities to better ensure that those businesses that cause pollution also pay to have their contaminated sites cleaned up.

In this regard, EPA has not used its authority under the Superfund law to require businesses that handle hazardous substances to provide financial assurances covering existing and potential cleanups. This statutory mandate recognizes that businesses likely to cause environmental contamination and endanger public health can reasonably be expected to incur a business cost in order to ensure that they will have the financial wherewithal to pay for spills and other contamination, whenever they may occur, consistent with the degree of risk their operations pose to public health and the environment. Under this statutory mandate, EPA is to require, as appropriate, financial assurances from businesses to protect public health and the environment prospectively. This requirement may be viewed as akin to mortgage companies' requirements that borrowers provide homeowners insurance to protect the value of the assets against possible damage, except that this requirement is not directed at all businesses—it is directed at those at risk for contaminating the environment.

Importantly, using this authority would help to close gaps in EPA's existing financial assurance requirements: it would require some businesses not subject to RCRA's financial assurance coverage, such as producers of certain mining wastes that have caused enormous environmental harm, to obtain financial assurance because of the environmental problems their operations are likely to continue to cause. It would also close the gap that exists under RCRA's financial assurance requirements, which generally

extend to businesses that treat, store, or dispose of hazardous waste, but not to businesses that generate hazardous waste, even though they may be at high risk for environmental problems, such as chemical spills.

In 1980, when the Superfund financial assurance requirement was enacted by the Congress, it required EPA to first identify the classes of facilities with the highest risk of harm. This task is much easier today because EPA and the states now have 25 years of experience with Superfund and 29 years with RCRA. We believe EPA can expeditiously implement the requirement to identify those industries with the highest risk of environmental harm and establish appropriate risk-based financial assurance requirements for them. For example, EPA should be able to gather relevant information from Superfund and RCRA program data, studies, and the many officials involved with these programs over the years, among other sources, to identify those industries that pose high levels of environmental risk.

Further, to ensure that financial assurances the agency requires under the Superfund and RCRA corrective action programs actually provide funding for cleanups in the event the liable parties default on their environmental obligations, it is critically important that EPA effectively oversee and enforce the financial assurances that businesses provide to the agency. The fact that EPA currently cannot even readily identify the financial assurances that should be in force is a clear indication of inadequate oversight and enforcement. As a result, there is an increased risk that taxpayers, rather than the parties responsible for the contamination, will ultimately have to pay for the cleanups of contaminated sites under Superfund and RCRA. Although EPA has begun some efforts to increase its oversight and enforcement of financial assurances, the agency will need to sustain and increase such efforts if financial assurances are to achieve their intended goal of ensuring that responsible parties, not U.S. taxpayers, pay to clean up hazardous waste sites.

Also, we believe that EPA should evaluate the degree of financial risk and the oversight costs it is appropriate for the agency to bear. Fundamentally, it is a question of whether the industries that pose environmental risk or the government charged with protecting the environment should carry the financial risk for the contamination that the industries may cause. Considering the often very long-term nature of the cleanups—during which time it would be reasonable to expect businesses to set aside increased resources—as well as the resources and skills necessary to oversee the unsecured financial assurances, continuing to, in effect, subsidize

businesses by accepting unsecured assurances may be a luxury the government can no longer afford.

More specifically, in its evaluation, EPA should consider the different financial risks that the various financial assurances pose to the government. This is especially important in light of the problems that we, the EPA Inspector General, state regulators, and others have identified, particularly with respect to the corporate financial test, corporate guarantee, and captive insurance. For example, to effectively oversee some of the financial assurances, EPA staff—and state staff handling RCRA financial assurances for EPA—must have a high level of expertise in financial management and insurance, among other fields. However, EPA has not taken into account either the variations in number of staff or levels of expertise needed that are associated with overseeing and enforcing the various financial assurances. Doing so, however, could provide EPA with the opportunity to both minimize the costs the government needs to bear to effectively oversee and enforce its financial assurance portfolio and reduce the government's financial risk for environmental cleanups. For example, when faced with the trade-off between allocating staffing resources to oversee unsecured financial assurances and meeting other agency responsibilities, BLM decided to no longer accept corporate guarantees, in part because of the oversight challenges they present. In so doing, BLM shifted more of the financial risk to the businesses they regulate who have to purchase financial assurances from independent third parties, such as banks.

In addition to financial assurances, greater use of other enforcement authorities, such as offsets and Superfund liens, could help EPA recover more costs from parties liable for environmental cleanups in some cases. Although offset authorities are limited to situations in which the government owes the company a tax refund or some other payment, a greater willingness by EPA to use these authorities—and to establish procedures and provide direction to staff in how to use these authorities—could help the government better ensure that parties responsible for pollution pay the associated cleanup costs to the maximum extent practicable. For example, when liable parties are unwilling to fulfill their financial obligations for cleanups, EPA officials should routinely explore whether tax offsets may be available. Staff should be provided with policies and procedures detailing the steps that need to be taken to use these enforcement tools effectively.

Finally, companies with environmental liabilities that file for bankruptcy present another set of management challenges to EPA. Under its current process for identifying and reviewing bankruptcies, the agency cannot be confident that companies with EPA liabilities are held responsible for their cleanup obligations to the maximum extent practicable because the agency cannot ensure that it has identified (1) those bankruptcies for which it should request the Justice Department to file claims with the bankruptcy courts for cleanup funds and (2) any existing rights the agency has that can give its bankruptcy claims a priority status, such as liens on Superfund properties, which significantly improves the agency's chances of recovering funds under bankruptcy proceedings. Importantly, EPA also needs to review the specific sites identified in bankruptcy proceedings for purposes other than filing claims. One such purpose is to help ensure that discharges for businesses reorganizing under bankruptcy proceedings are not approved for contaminated sites that EPA has not been previously aware of.

To its credit, EPA has established a bankruptcy work group that seeks to identify relevant bankruptcy filings to pursue and bankruptcy actions to monitor, such as notices to abandon property. However, the process the agency uses to identify relevant bankruptcy cases and actions is informal and essentially undocumented. As a result, it is not clear whether EPA is devoting sufficient time and resources to maximize the cleanup funds it can obtain under bankruptcy proceedings and to ensure that businesses are not receiving discharges of environmental liabilities inappropriately. We believe that EPA should build on the existing informal processes the agency is using and formalize and document its process for identifying relevant bankruptcy proceedings. In addition, we believe that EPA guidance on bankruptcy cases should be revised to emphasize some important actions that are not sufficiently addressed in existing guidance, such as routinely identifying contaminated sites identified in bankruptcy filings about which EPA is not familiar so that the agency can take appropriate steps to ensure that courts do not inappropriately discharge such environmental liabilities.

Recommendations for Executive Action

To close gaps in financial assurance coverage that expose the government to significant financial risk for costly environmental cleanups, the EPA Administrator should expeditiously implement the statutory mandate under Superfund to develop financial assurance regulations for businesses handling hazardous substances, first addressing those businesses EPA

believes pose the highest level of risk of environmental contamination, as the statute requires.

In addition, to better ensure that the financial assurances EPA does require under the Superfund and RCRA corrective action programs provide sufficient funds for cleanups in the event liable parties do not fulfill their environmental obligations, EPA should enhance its efforts to manage and enforce the financial assurance requirements for Superfund and RCRA corrective action cleanups by taking the following actions:

- Evaluate the financial assurances the agency accepts in light of such factors as the financial risks EPA faces if liable parties do not meet their cleanup obligations; the varying financial risks posed by the individual financial assurance mechanisms; the agency's capacity to effectively oversee the various financial assurance mechanisms—in particular, the expertise of staff (federal and state) and the number of staff; the information gaps the agency faces in overseeing the various financial assurances; and the concerns about certain financial assurances, such as the corporate financial tests, corporate guarantees, and captive insurance, that have been brought to the agency's attention by state regulators, the EPA Inspector General, and others.
- If EPA continues to accept the corporate financial tests and corporate guarantees as financial assurance in these programs, it should revise and update its financial tests to address the deficiencies identified by the EPA Inspector General and others.
- Implement changes to Superfund and RCRA databases to support the efficient identification of EPA's portfolio of financial assurances and populate these databases with information on all financial assurances that liable parties should have in force, developing quality controls to ensure data reliability.
- Develop a strategy to effectively oversee the agency and state portfolios of financial assurances to ensure that all required financial assurances are in place and sufficient in the event the related businesses encounter financial difficulties, including bankruptcy. Such a strategy should include ensuring that adequate staffing resources with relevant expertise are available.
- Require that financial assurances be in place before EPA and liable parties finalize Superfund settlement agreements.

In addition, to better ensure that EPA holds liable parties responsible for their cleanup obligations to the maximum extent practicable, the agency should seek opportunities to more fully use its enforcement tools, particularly tax and other offsets, and provide specific guidance to their staff on how and when to use these tools. For example, EPA should routinely take advantage of tax offsets when liable parties are not meeting their obligations—not just when parties file for bankruptcy.

To better ensure that EPA identifies relevant bankruptcy filings to pursue and bankruptcy actions to monitor, EPA should develop a formal process for monitoring bankruptcy proceedings and maintain data on bankruptcy filings reviewed, for example using an EPA Intranet site that would be readily available to all relevant staff.

Finally, we recommend that EPA revise and update its guidance on participation in bankruptcy cases to more clearly identify some actions needed to better protect the government's interest, such as steps to take to better ensure that the courts do not inappropriately discharge environmental liabilities and to specify that staff evaluating new bankruptcy filings should routinely determine whether EPA has any existing liens related to the filings.

Agency Comments and Our Evaluation

We provided EPA with a draft of this report for review and comment. In commenting on the draft, EPA generally agreed with many of the recommendations and said the agency will further evaluate its response to others. Appendix III contains the full text of the agency's comments and our responses.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the report date. At that time, we will send copies to the Administrator, EPA; the Attorney General, Department of Justice; the Director, Office of Management and Budget; appropriate congressional committees; and other interested parties. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-3841 or stephensonj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink, reading "John B. Stephenson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

John B. Stephenson
Director, Natural Resources
and Environment

Objectives, Scope, and Methodology

GAO was asked to (1) determine how many businesses with liability under federal law for environmental cleanups have declared bankruptcy and how many such cases the Justice Department has pursued in bankruptcy court; (2) identify key challenges that EPA faces in holding bankrupt and other financially distressed businesses responsible for their cleanup obligations; and (3) identify actions EPA could take, if any, to better ensure that bankrupt and other financially distressed businesses pay the costs of cleaning up their contaminated sites to the maximum extent practicable.

To determine how many businesses with liability under federal law for hazardous waste cleanup costs have declared bankruptcy, we obtained bankruptcy case filing information from the Administrative Office of the U.S. Courts, which compiles data on the number of bankruptcy filings. Specifically, we obtained bankruptcy case filing information on the number of business bankruptcy filings under Chapters 7, 11, and 13 of the bankruptcy code for fiscal years 1998 through 2003. While the bankruptcy courts collect data on the number of businesses that file for bankruptcy each year and the Administrative Office of the U.S. Courts maintains these data in a national database, neither the courts, EPA, nor private providers of business data collect information on how many of these businesses have environmental liabilities. As a result, we were not able to report on the number of business bankruptcies with hazardous waste liabilities. To determine how many bankruptcy cases with liability under federal law the Justice Department has pursued in bankruptcy court on behalf of EPA, we spoke with officials from the Justice Department about the cases it received from EPA to determine which cases the department had pursued. We obtained data on the cases the Justice Department pursued on behalf of EPA where a proof of claim was filed for fiscal years 1998 through 2003.

To identify key challenges that EPA faces in holding bankrupt and other financially distressed businesses responsible for their cleanup obligations and to identify actions EPA could take to better ensure that bankrupt and other financially distressed businesses pay the costs of cleaning up their hazardous waste sites to the maximum extent practicable, we reviewed federal statutes and policies associated with hazardous waste management and cleanup, the federal bankruptcy code and procedures, and academic and professional literature addressing the intersection of environmental and bankruptcy law, corporate limited liability, forms of business organization, and asset management. We also interviewed enforcement officials from EPA headquarters and its 10 regional offices about how the agency identifies, pursues, and recovers federal environmental liabilities from financially distressed or bankrupt businesses; the challenges EPA

faces in these tasks; and the extent to which the agency has used available enforcement tools in this effort. Finally, we attended EPA-sponsored training sessions on RCRA closure and post-closure financial assurances and on bankruptcy-related issues for EPA attorneys in order to learn more about these challenges as well as the financial assurances and other enforcement tools and procedures available to EPA to address these challenges.

We performed our work between September 2003 and July 2005 in accordance with generally accepted government auditing standards.

Chronology of EPA's Efforts to Develop Financial Assurance Requirements for Businesses Handling Hazardous Substances

December 1980

Congress enacted the Comprehensive Environmental Compensation, Response, and Liability Act of 1980 (CERCLA, or the Superfund law), calling for, among other things, EPA to develop financial assurance requirements for businesses handling hazardous substances to demonstrate their ability to pay for environmental cleanup costs (CERCLA Section 108(b)(1)).

Early 1980s

EPA and its contractors produced issue papers on such topics as gaps in existing financial assurance requirements, the definition of "facility," and data sources for classifying facilities.

1983

In May, EPA published a Federal Register notice announcing the beginning of a process of identifying facility classes and seeking public comment on several issues related to identifying risk-based classes of industries and facilities handling hazardous substances. In November, the Director of EPA's Office of Solid Waste informed the Assistant Administrator for the Office of Solid Waste and Emergency Response that work on the facility classification effort was being halted because of a lack of contract funding and staff availability. In December, the statutory deadline passed for EPA to identify classes of facilities for which regulations would first be developed.

1987

EPA revisited the Superfund financial assurance requirements as part of a broader review of the Superfund program spurred by the 1986 amendments to the Superfund law. According to EPA officials, the agency developed recommendations to the Assistant Administrator for the Office of Solid Waste and Emergency Response for developing the regulations. However, EPA never acted upon these recommendations.

2004

An EPA internal review of the Superfund program recommended that the Office of Solid Waste and Emergency Response study whether promulgating financial assurance regulations under CERCLA could reduce Superfund liabilities for facilities not covered under RCRA financial assurance requirements. In response, EPA created a work group that is collecting and evaluating information on the types of facilities that have become Superfund National Priorities List sites as well as the industries represented among these sites.

Comments from the Environmental Protection Agency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUL 14 2005

Mr. John B. Stephenson
Director
Natural Resources and Environment
Government Accountability Office
Washington, D.C. 20548

Dear Mr. Stephenson:

This letter is in response to the Government Accountability Office (GAO) final draft report titled "Environmental Liabilities: EPA Should Do More to Ensure that Liable Parties Meet Their Cleanup Obligations (GAO-05-658, July 2005)." We appreciate GAO's recognition of the challenges that EPA faces when holding bankrupt and other financially distressed businesses responsible for their cleanup obligations.

Generally, EPA agrees with many of the recommendations, or is in the process of evaluating information to determine whether such recommendations should be pursued. In fact, EPA has already undertaken a number of activities to address bankruptcy and financial assurance requirements for parties responsible for environmental contamination. These activities include designating financial assurance as an enforcement priority; soliciting advice from EPA's Environmental Financial Advisory Board on insurance, financial tests and whether to extend financial assurance to activities not currently covered; assessing the fiscal impact of various categories of facilities in the Superfund program and the utility of using authorities under CERCLA for financial assurance in response to recommendations from an internal EPA study; and providing training to states and regions on cost estimation and other financial assurance mechanisms. Our responses to the recommendations are provided in an enclosure to this letter.

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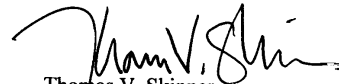
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Protection Agency**

We are confident that the efforts described in informal comments submitted to your office previously and in the enclosure here will result in improvements to the way EPA addresses bankruptcy and financial assurance issues for responsible parties. Further, we appreciate GAO's examination of EPA's past and current activities in this area.

Sincerely,



Thomas P. Dunne
Deputy Assistant Administrator
Office of Solid Waste
and Emergency Response



Thomas V. Skinner
Acting Assistant Administrator
Office of Enforcement and
Compliance Assurance

Enclosure: EPA General Comments on GAO Draft Report: Environmental Liabilities

**Enclosure: EPA General Comments on GAO Draft Report: Environmental Liabilities
July 2005**

Financial Assurance

See comment 1.

While the GAO report recognizes that OECA has focused on financial assurance compliance and enforcement as an issue, EPA is concerned that the report does not capture the significance of those efforts. First, EPA has already recognized that this area needs added attention and has identified financial assurance as an OECA national priority in FY06/07. Second, in advance of FY06/07, EPA has undertaken significant efforts to enhance the capabilities of EPA and the States by providing multiple training sessions over the past two years on the RCRA financial assurance mechanisms. Participants from 34 states have attended these financial assurance training sessions. Third, OECA has already devoted significant levels of FTE and contractor dollars to assist EPA and State personnel in enhancing the compliance with, and enforcement of, financial assurance requirements. In short, OECA is already focusing on financial assurance compliance and enforcement and will continue to do so. While EPA recognizes issues with various financial assurance mechanisms, we think in the short run the largest gains will accrue from effective enforcement, compliance assistance, training and guidance.

As with virtually all enforcement priorities, OECA's implementation will include specific goals, targeting of enforcement resources, a communication strategy, and a capacity building component. The Report offers a number of suggestions with respect to financial assurance compliance and enforcement. EPA appreciates the suggestions offered and will consider those suggestions as it moves forward in its enforcement priority implementation. As part of its implementation, OECA will need to focus its resources to obtain the largest return on its compliance and enforcement efforts. The Report's identification of the greater risk where there are fewer entities available for funding a cleanup obligation recognizes an important component of financial assurance compliance and enforcement resource allocation.

EPA has also undertaken efforts to provide additional guidance and training on other important components of financial assurance. For example, OECA and OSWER are funding, and will continue to fund, training to EPA and State personnel on cost estimation software that can be used in reviewing cost estimates submitted by owners/operators for RCRA corrective action (RACER) and closure/post-closure care (CostPro). In addition to the training, EPA is purchasing licensed copies of the software for each individual that attends the training. Both RCRA Regional and State personnel have identified cost estimating as a necessary component of having adequate financial assurances at RCRA facilities and EPA has stepped forward to provide an important tool in helping to characterize expected cleanup costs, and attendant financial assurance obligations, at RCRA facilities. EPA anticipates that the cost estimation training (and software) will have been provided in each Region, for State and Regional personnel, by the end of 2006. We also want to note State efforts to improve cost estimation. For example, California has reported reviewing its cost estimates and in many cases has increased them substantially.

Moreover, as the Report recognizes, OSWER and OECA issued corrective action policy

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guidance in late 2003 explaining that requiring financial assurance earlier than remedy selection for corrective action can be appropriate and is one available mechanism for reducing the likelihood of taxpayers bearing the burdens of corrective action costs. The cost estimation training and software should enhance the ability of EPA and States to seek financial assurance prior to remedy selection in appropriate circumstances. EPA will continue to urge Regions and States to examine whether financial assurances can be provided earlier than remedy selection on a case by case basis. Additionally, EPA is in the process of modifying the RCRAInfo and CERCLIS information systems to capture financial assurance information. This important effort should help close many of the data gaps identified in the Report and increase EPA and the States implementation of financial assurance requirements.

See comment 2.

Now on p. 50.

On page 52, the Draft Report asserts that only one Region has performed a review of its financial assurance documentation. It does not mention the financial assurance review that was performed in Region III. In this review, Region III examined all issued RD/RA UAOs and CDs to determine if the bankruptcy or insolvency of any responsible party resulted in the incomplete work becoming the responsibility of EPA. Under this review, Region III identified 119 enforceable documents that related to 93 different sites. The total value of work to be performed under those documents exceeded \$1,400,000,000. As of the date of the completion of the first phase of this review, less than \$9,000,000 of this work was defaulted upon requiring intervention by the Superfund. This review indicates that Region III was taking pro-active steps to evaluate the viability of its financial assurance agreements before it knew of the GAO study. This review concluded that, to date, more than 99.4% of the work has been completed without a negative impact on the Superfund or the taxpayers.

See comment 3.

As the report points out, RCRA Subtitle C financial assurance is required to ensure funds are available for closure and post-closure care. However, a critical component of financial assurance that the report should emphasize is the preventative aspect under RCRA Subtitle C associated with the financial assurance requirements. By requiring financial assurance for closure or post-closure care in the event the owner or operator is unable or unwilling to perform cleanup, the owner or operator has an incentive to operate in a way that will minimize the costs required for closure, meaning that by running an efficient, clean operation, it should be easier in the future to perform closure. By requiring the owner or operator to post financial assurance there is a deterrent effect because the owner or operator is obligated to perform closure and has secured the financing for that closure in advance.

See comment 4.

The report should specify, in each instance, which type of financial assurance is the subject of the report's analysis. This is critical to clarify in each instance because RCRA Subtitle C (closure, post-closure and liability) is a preventative program and has specific financial assurance regulations. In contrast, the RCRA corrective action and Superfund programs deal with existing releases and do not have a financial assurance regulatory framework. The difference in these programs must be clear in the report to provide a better understanding of the enforcement actions available and limitations of these programs. A list of clarified references to RCRA Subtitle C, RCRA corrective action, or CERCLA financial assurance is included in the technical comments.

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See comment 5.

Further points of clarification that are crucial to understanding EPA's actions are that, the current RCRA Subtitle C regulations, facility owners and operators can choose any of the permissible financial mechanisms, as long as the mechanisms meet the regulatory standards. Additionally, EPA does not "approve" insurance instruments. Instead the RCRA Subtitle C regulations require that an insurance policy contain the language in the regulations and that if there are any inconsistencies between the policy language and the regulations, inconsistent policy terms are automatically amended to conform with the regulations. This provision protects EPA from having to approve each insurance submission.

CERCLA 108(b)

See comment 6.

GAO recommends that the EPA Administrator should expeditiously implement the statutory mandate under Superfund to develop financial assurance regulations for those businesses EPA believes pose the highest level of risk for financial assurance failure. EPA has underway several analyses of the cost of unfunded sites in response to the 120 Day Study, an internal self-assessment of the Superfund program. These analyses may also have implications for EPA's financial assurance programs and whether to extend financial assurance to operations that do not currently have requirements to provide financial assurance. The results of this analysis for any category of sites could lead to regulatory action under §108(b), revisions to existing financial assurance regulators, or other actions to address financial assurance shortfalls. Given these activities and the need to evaluate the most effective means by which to address financial assurance vulnerabilities, we believe that a conclusion that EPA should pursue 108(b) rulemaking to the exclusion of other options is premature.

See comment 7.

In the Agency's charge to the Environmental Financial Advisory Board (EFAB) regarding financial assurance, the Agency has included a number of issues, including "Should Financial Assurance Requirements Be Extended to Operations That Are Not Currently Required to Meet Them?" While the EFAB may wait until analysis of the 120 Day Study has been completed to determine if they will evaluate this question, the EFAB's advice would help guide the Agency in decisions on targeting specific categories of sites for CERCLA §108 rulemaking, revising RCRA financial assurance regulations, or undertaking other actions that would reduce the impact of unfunded cleanups on Superfund and states.

Consultation with the Environmental Financial Advisory Board

EPA has already begun investigations that anticipate some of the recommendations of the GAO's report. The Agency sought the advice of the Environmental Financial Advisory Board (EFAB) on several financial assurance matters and is currently awaiting recommendations from them. Among the questions we asked the Board are:

- 1) "Whether financial assurance requirements or similar mechanisms are appropriate for categories of facilities not currently covered by such requirements." This question preceded your recommendation that EPA develop financial assurance requirements for operations which are not currently covered. We understand that the Board has first undertaken work on the financial test and insurance because they believe that they should

first understand how well the mechanisms work before recommending any extension of financial assurance.

- 2) "What are the strengths and pitfalls of the financial test and corporate guarantee?" The EFAB held a meeting in New York City in June 2004 on the financial test and corporate guarantee and has received comments on the draft letter that was produced as a result of that meeting. EPA believes it would be inappropriate to accept the draft findings based upon a draft letter from the EFAB since the final letter may differ with the draft.
- 3) "Should EPA continue to allow corporate siblings to guarantee the obligations of another subsidiary or should guarantees only be allowed for parents or higher level companies?" The draft report cites issues with corporate structures and the movement of assets among subsidiaries. EPA recognized this possibility when it raised this question to the EFAB.
- 4) "What are the strengths and pitfalls of insurance?" "Should there be minimum ratings of insurers that provide financial assurance?" "Should there be minimum capitalization requirements for captive or other insurers who provide policies for financial assurance and, if so, what requirements would best assure funds are available for protection of the environment, including closure, post-closure, corrective action and other environmental clean-up?" "Should policies written by captives and commercial insurers be treated as equally acceptable mechanisms?" "What are appropriate safeguards (such as capitalization, rating, coverage, etc.), if any, for insurance for a Brownfields cleanup?" All of the above are insurance questions EPA asked the EFAB and the EFAB held a day of hearings to solicit answers. As with the financial test questions, EPA is awaiting recommendations from the EFAB, particularly on captive insurance.

EPA appreciates the fact that GAO's identification of issues surrounding the financial test, corporate guarantee and captive insurance confirm the Agency's judgment that these are key issues. However, pending a review of the findings of the EFAB, internal investigations of the number of RCRA facilities going to Superfund, and its own Inspector General's upcoming report, EPA believes it would be premature to commit to revisions to the financial test or its insurance requirements for financial assurance in response to the GAO recommendations based upon the draft comments of the EFAB.

Insurance

Beginning on page 48, the Draft Report discusses the use of insurance as a form of financial assurance. The Draft Report focuses on the relative "riskiness" of insurance in comparison to letters of credit, bonds or trusts. The Draft Report also discusses the risk inherent in accepting insurance from captive insurers. The Draft Report, however, ignores the growing market in insurance products offered by third party independent insurers that are specifically designed to meet financial assurance requirements. Depending on the program (RCRA Subtitle C, corrective action, or Superfund), there may be a variety of insurance products designed to address several types of risks. For example, there are insurance products associated with CERCLA or corrective action to address cleanup risks (e.g. cost overrun insurance, which provides reimbursement if cleanup costs exceed a certain amount, remediation completion insurance, which – like a surety bond – provides for completion of the cleanup if the PRP becomes insolvent, etc.). While not all of these insurance products are appropriate for every site,

See comment 8.

Now on p. 42.

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many of them, used independently or in conjunction with other forms of financial assurance, may provide effective, cost efficient financial assurance. This is especially true in the context of short term response actions (e.g., one to two year durations). The Draft Report failed to mention that EPA, at both the HQ and Regional levels, is actively reviewing the viability of such insurance for financial assurance and providing training for its staff on this issue.

Bankruptcy

Our initial concern with the Draft Report is the first paragraph of the summary/highlights page. This sentence states: "*While more than 231,000 businesses operating in the United States filed for bankruptcy in fiscal years 1998 through 2003, the extent to which these businesses had environmental liabilities is not known because neither the federal government nor other sources collect this information. Information on bankrupt businesses with federal environmental liabilities is limited to data on the bankruptcy cases that the Justice Department has pursued in court on behalf of EPA. In that regard, the Justice Department initiated 136 such cases from 1998 through 2003.*" We believe this paragraph is misleading and implies a lack of will or ability on the part of EPA to pursue environmental bankruptcy cases. It is not appropriate to begin this Draft Report with such a statement that leads a reader to believe that EPA is not willing to pursue more environmental bankruptcy cases. Also, the statement does not acknowledge that it is unknown how many of the 231,000 bankruptcy filings had either environmental liability or any assets remaining to warrant our intervention. What can be said is that there were 136 cases that involved potential federal environmental claims. Since this is the leading paragraph and sets the tone of the Draft Report, we suggest the introduction be re-written so that the reader is not focused on the 136 cases out of 231,000 filings ratio.

The Draft Report states on pages 18 and 31 that EPA does not maintain information on bankruptcies that it does not pursue. This is not completely accurate. The EPA Bankruptcy Workgroup is currently exploring the possibility of using – on a Nationwide basis – the comprehensive database developed in Region III. During some of its monthly conference calls, the Bankruptcy Workgroup has discussed the steps that would be necessary to extend the database Agency-wide. In its current form, the database tracks all bankruptcies that come into the Region, even those in which the Agency does not file a claim. To capture this information, the database has a data field to indicate if the bankruptcy were "closed out" (i.e. the Region choose not to file a claim).

In addition to the database, since May 5, 2003, Region III has had a bankruptcy protocol which provides for a formal decision not to pursue a bankruptcy case. The "close out" memo documents the efforts to discover potential claims and the result. The memo then provides the basis for not pursuing a claim (e.g. no claims discovered, debtor assets too insignificant to pursue, transaction costs would exceed expected recovery, etc.). This close out process is a natural outgrowth of the recent EPA Bankruptcy Protocols (May 2005). The information collected pursuant to the Bankruptcy Protocols provides sufficient documentation to justify and explain the Agency's decision to pursue or not pursue a claim in a particular bankruptcy. The only additional step that EPA would need to take in order to meet the GAO critique regarding this issue is to make a formal documentation of its decision. Therefore, the foregoing

See comment 9.

See comment 10.

Now on pp. 18 and 30.

See comment 11.

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demonstrates that EPA is actively taking steps to better track and document all bankruptcies of which it receives notice.

The following are GAO's comments on the Environmental Protection Agency's letter dated July 14, 2005.

GAO Comments

1. We acknowledge and commend EPA for the actions the agency has initiated and for its plan to develop and implement other actions to improve compliance with the enforcement of financial assurance requirements, as EPA highlights in this and the next three paragraphs. The management challenges EPA faces in this regard are complex, but the potential benefits the agency can receive from effective financial assurances are substantial. We believe that if EPA implements our recommendations as part of its compliance and enforcement efforts focusing on financial assurance, EPA's ability to hold liable parties responsible for their environmental cleanup obligations will be substantially improved.
2. Although we obtained information about region III's review of financial assurances, we did not cite it in our report for several reasons. For example, unlike the other regional review, the region III review is not a compliance audit of financial assurances in Superfund settlements. As such, this review does not identify either Superfund settlement agreements that do not include financial assurances or the number of sites that do not have settlements in place. In addition, the reported financial impact on the government for the sites in region III's review is preliminary and will remain so until the cleanups at the sites reviewed are completed because the financial assurances may not reflect the actual cleanup costs. For example, as discussed earlier, EPA often settles for less than the full cleanup cost as a result of equitable factors or ability-to-pay issues. In addition, the financial assurances may relate to work to identify the potential cleanup remedies and not to the cost of the cleanup, which may not yet be known. An example of a case included in the study that substantially understates the negative impact on the Superfund and the taxpayers is the Metachem/Standard Chlorine case discussed in our report. According to the official who conducted this review, while the review identifies a loss of \$3.75 million associated with the Metachem site, EPA expects the government will have to spend about \$100 million to clean up the site.
3. We disagree with EPA's view that the report does not highlight the preventive aspect of financial assurance. In discussing the purpose of financial assurance, the draft and final reports point out that the fact that the parties responsible for the contamination are also responsible

for cleaning it up encourages businesses to adopt responsible environmental practices. While EPA's comments acknowledging the benefits of prospective financial assurance are limited to the RCRA closure and post-closure programs, we hope that the agency recognizes that these same preventive benefits can be more broadly attained by implementing the financial assurance requirements mandated by the Superfund law under section 108(b), which also provide for prospective financial assurances from businesses at risk for environmental contamination.

4. EPA's comment suggests that the agency's enforcement options are limited under its RCRA corrective action and Superfund programs because the agency has not developed financial assurance regulations for these programs. If this is the case, EPA should seek to correct this situation as it develops specific goals to address financial assurance as a national enforcement priority.
5. We have revised the final report to reflect that under EPA's current regulations for financial assurance for closure and post-closure, facility owners and operators may choose any of the permissible mechanisms, as long as the mechanism meets the regulatory standards. However, these regulations do not apply to the Superfund and RCRA corrective action programs, and therefore do not constrain EPA's authority to accept or decline a proffered financial assurance mechanism related to a cleanup under these programs. Similarly, with respect to insurance, the RCRA regulations EPA cites apply only to the closure and post-closure programs. Thus, for Superfund and RCRA corrective action, regulatory vigilance over the terms of the policies is still necessary.
6. The Superfund law requires EPA to develop financial assurance regulations for classes of facilities that pose a risk for environmental contamination, starting with those that pose the "highest level of risk of injury." This requirement is not, as EPA's comments suggest, limited to those that pose the highest risk for financial assurance failure. Our recommendation is for EPA to comply with the requirements in the Superfund statute. In its comments, EPA misstates the GAO recommendation by focusing on classes of facilities at risk for financial assurance failure. We are concerned that the agency is narrowly construing a broad statutory mandate that requires the agency to establish, as appropriate, prospective financial assurance requirements for entities at risk for environmental pollution. Further, EPA may miss the forest for the trees by focusing too narrowly on its ongoing study of

NPL Superfund sites as a basis or rationale for implementing the section 108(b) mandate. The universe of businesses at risk for environmental contamination is much broader than Superfund NPL sites—for example, NPL sites represent about 10 percent of contaminated sites identified in the Superfund database. Finally, we did not conclude, as EPA asserts, that EPA should pursue section 108(b) rule makings to the exclusion of other options. Nonetheless, we reject any assertion by EPA that implementing section 108(b) is optional. EPA is required to carry out the terms of the statute, and nothing in section 108(b) authorizes EPA to determine that such actions are unnecessary. By passing section 108(b), the Congress has determined that its provisions are necessary; should EPA believe otherwise, it must seek legislative relief. During the 25 years section 108(b) has been in effect, EPA has not sought amendment or repeal of the requirement.

7. EPA's comment that it will not consider whether to implement section 108(b) until certain evaluations are complete indicates that it views implementation of the statutory mandate under the Superfund law to establish financial assurance for classes of facilities at high risk for environmental contamination as optional. However, as noted above, it is not. We believe the efforts of the Environmental Financial Advisory Board (EFAB) and EPA under the 120-day study may provide important and useful information to aid EPA's implementation of section 108(b) and the agency's other financial assurance responsibilities. However, these efforts cannot provide a basis for the agency to simply decline to carry out the actions required under section 108(b).
8. Our report provides some general information and issues about insurance as one of the approved financial assurance mechanisms. However, the scope of our work did not include an analysis of the types of insurance products currently available or of all of EPA's actions regarding insurance products. Instead, our work focused on issues and concerns about some insurance products identified by the EPA Inspector General and others.
9. In response to the questions posed by our requesters, we report the number of business bankruptcies and inform readers that information to identify how many of these bankruptcies involved environmental liabilities does not exist. We also report, as requested, on the number of bankruptcy cases that EPA and the Justice Department have pursued in bankruptcy court. EPA believes that this information in the first section of the report will lead readers to conclude that the agency is not willing

to pursue more environmental bankruptcy cases. We disagree. For example, we report that without information on the number of bankruptcy cases involving environmental liabilities, EPA's efforts in identifying and pursuing relevant bankruptcies cannot be evaluated. Further, our report provides information on some of the reasons EPA may choose not to pursue bankruptcy cases in court—for example, many chapter 7 bankruptcies involve businesses with few or no assets.

10. Our report accurately reflects that EPA does not maintain information on bankruptcies it does not pursue. EPA's comments show that only one region maintains such data. Further, while EPA states that there have been discussions concerning collecting these data agencywide, the agency does not report a decision or plan to do so.
11. The fact that one region is documenting its decisions regarding bankruptcy cases does not demonstrate that the agency as a whole is taking steps to better track and document all bankruptcies of which it receives notice. We note that expanding the use agencywide of the close-out memo used by region III is the type of action/documentation we had in mind in recommending that EPA develop a formal process for monitoring bankruptcy proceedings and maintaining data on bankruptcy filings reviewed.

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