

EXECUTIVE SUMMARY

North Carolina's Commercial and Noncommercial Underground Storage Tank (UST) Trust Funds pay most of the costs of cleaning up petroleum contamination from leaking underground storage tanks. The Commercial UST Trust Fund can also be used by commercial tank owners to meet federal financial responsibility requirements. Federal law requires that the owners and operators of commercial USTs show that they have financial assurance in the amount of \$1 million for cleanup of contamination in the event of a leak.

A small percentage of the State's motor fuels tax goes into the UST Trust Funds and forms the main source of revenue for cleanup. The Commercial UST Fund receives some additional revenue from fees paid by tank owners. The owners of noncommercial tanks pay no fees. Like many other states, North Carolina has a gap between UST Trust Fund revenues and claims against the Funds for cleanup costs. In 2003-2004, tank owners and contractors had to wait up to 11 months to receive reimbursement from the Commercial Trust Fund for cleanup activities.

Over 20,000 petroleum releases from USTs have been reported in North Carolina. Of those, around 11,000 sites have been addressed; the UST program in DENR is continuing to work with tank owners to assess and cleanup contamination at the remaining 9,000 sites. New petroleum releases continue to be reported every year.

The State has implemented most of the cost-control measures used nationally to reduce the costs of cleanup and assessment, including risk-based remediation and preapproval of cleanup activities. In 2004, the General Assembly put approximately \$32 million into the UST Trust Funds to address the backlog of unpaid claims. This one-time appropriation will be sufficient to pay the claims backlog, but does not address the ongoing gap between revenue and demand for cleanup funds. The 2004 legislation also put new limits on DENR's ability to order assessment and cleanup on a UST site in order to assure that claims would not exceed available funds. Except for emergency situations, DENR can order remediation of UST sites only to the extent that the cleanup activity can be reimbursed within 90 days. To implement the legislation, DENR ranked all of the high risk UST sites based on threat to public health and the environment. DENR is now directing that remediation work be done on 153 of the 2,680 high risk UST sites; around 40 of those sites have been identified as emergencies. No remediation work is being ordered on intermediate and low risk sites.

Some states facing similar UST trust fund deficits have made the decision to sunset their UST trust funds and require tank owners to obtain private insurance to cover cleanup of

any future petroleum leaks. Moving to private insurance does not eliminate the need to provide funding to cleanup existing contaminated sites, but it does limit the state's liability to the existing sites so that after some date in the future, the state acquires no new cleanup liability. Several things can be learned from other states' experiences in making a transition from a state UST trust fund to private environmental insurance:

1. There needs to be a transition period to allow the insurance market to develop and give tank owners time to get coverage;
2. One way to ease the burden on tank owners is to phase-in the transition to private insurance. In Florida, the state trust fund continued to provide reimbursement for cleanup for a time– but at gradually reduced levels – before ending completely.
3. A good state enforcement program and/or a risk reduction program put in place by the insurer can keep premium costs down by preventing future leaks.
4. New leaks are often discovered when UST systems are upgraded, so system upgrades (whether voluntary or as a result of new rules) can lead to changes in the cost or availability of private insurance coverage.

There are several advantages to making the transition from the UST Commercial Trust Fund to an insurance model (whether private insurance, an industry-managed insurance pool or a State managed self-insurance program). It would not eliminate the State's responsibility to address the existing contaminated UST sites, but it would put an end date on the State's cleanup liability. An insurance model would also require that revenue for cleanup (in the form of premiums) be linked to the risk of future releases – which creates an incentive for good operation and maintenance of UST systems and provides a more sustainable financial structure for funding cleanups. There would still be a need to provide either additional state funding or a financing mechanism to allow the remediation of existing sites within a reasonable time. The greatest challenge will be addressing industry concerns about the cost and availability of insurance coverage.

Financial Assurance for Underground Storage Tank Cleanups: Alternatives to the State Underground Storage Tank Trust Fund¹

Introduction

In the 2004 legislative session, the North Carolina General Assembly made a one-time special allocation of funds from the motor fuels tax to the Commercial and Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Funds (UST Funds). This allocation will result in a total of \$32 million going into the UST Funds by the end of the 2004-2005 fiscal year (in addition to the UST Funds' normal revenue stream). The additional money will allow the State to address a backlog of unpaid claims against the UST Funds, but will not address what appears to be a structural deficit in the UST Funds. This paper describes the nature of the gap between revenue and demand for cleanup funds and also evaluates potential alternatives to the UST Funds.

Creation of State UST Trust Funds

Federal statutes and rules regulating petroleum underground storage tanks require tank owners to show financial assurance in the amount of \$1 million for the costs of cleaning up contamination from a leak or other accidental petroleum release. When Congress established the UST program over twenty years ago, private insurance for pollution liability was either unavailable or very expensive. Consequently, Congress allowed states to set up publicly-managed trust funds to assist tank owners with cleanup costs; the state trust funds also served, in place of private insurance or a bond, to meet the tank owners' financial responsibility requirements under federal law.

Almost every state chose to set up a UST trust fund to assist with the cleanup of sites contaminated by leaks from underground storage tanks. Although there are individual differences, the state UST trust funds operate in much the same way -- the trust funds reimburse the UST owners and operators for the cost of cleaning up petroleum releases in excess of a co-payment or deductible. These funds have really served two functions -- 1. To help UST owners with the cost of cleaning up existing contamination from old tanks and 2. To provide the required \$1 million in financial assurance for cleanup of future releases.

UST Trust Fund Shortfalls

Nationally, state UST trust funds have paid out over \$10 billion for cleanups of contaminated petroleum sites. Like North Carolina, many states relied on a combination of tax revenues and fees as the revenue source for state UST trust funds. In most cases, there was no direct relationship between the amount of revenue going into these trust funds and anticipated demand for cleanup. As a result, many UST trust funds, including North Carolina's, have faced large deficits. As of August 2004, twelve states had UST trust funds in which the outstanding claims exceeded the balance in the fund. In 2004,

¹ This paper was prepared by Robin W. Smith, Assistant Secretary, Department of Environment and Natural Resources and Steve Wall, Policy Analyst.

Tennessee made a one-time allocation of \$10 million to address the backlog of claims on its state UST trust fund.²

The shortfall between revenue coming into state UST trust funds and the claims for reimbursement often results in an increasing backlog of unreimbursed claims, forcing tank owners and consultants to wait lengthy periods for reimbursement. The processing time for claims in North Carolina has recently been as high as 13 months. Other states in the southeast are experiencing similar delays in providing reimbursements on submitted claims. In Georgia the estimated reimbursement time is one year and in Virginia it was recently as high as 10 months. Tennessee's situation is even worse, with a reimbursement time of 14 months.

North Carolina's UST Program

North Carolina has two UST Funds – one for commercial tanks and the other for noncommercial (primarily home heating oil) tanks.³ North Carolina's UST Trust Funds go beyond the minimum federal requirement that commercial UST owners have a means of demonstrating \$1 million in financial responsibility. The Funds also provide a source of funding for cleanup of orphan sites (petroleum-contaminated sites where there is no financially viable responsible party) and for cleanup of contamination from noncommercial USTs – primarily home heating oil tanks.

The UST Funds essentially function like a self-insurance program, except that most of the money going into the trust funds comes from tax revenues, rather than from fees or premiums paid by tank owners. In North Carolina, commercial tank owners pay fees that range from \$200-\$300 per tank; those fees represent 31% of the money going into the Commercial UST Fund. The owners of non-commercial USTs, such as home heating oil tanks, pay no tank fees to have access to the Noncommercial UST Fund to cover the costs of cleaning up a petroleum release.

The main revenue source for the UST Funds is the motor fuels tax. The Commercial UST Fund receives .297 cents per gallon on motor fuel and kerosene sales. This tax generated over \$15 million in revenue for the Commercial UST Fund in FY 2003-04. The Noncommercial UST Fund receives .047 cents per gallon on motor fuel and kerosene sales, which generated approximately \$3.5 million in revenue for FY 2003-04.

Since the creation of the UST program in 1988, over 20,000 discharges or releases from petroleum USTs have been reported in North Carolina. Approximately 11,000 of those incidents have been closed; 9,000 remain active. While recent data suggests that the number of releases is decreasing, the number of reported incidents per year remains significant. For example, in FY 2003-04 over 1600 incidents were reported statewide.

² Tennessee also generated additional revenue by assessing a special tank fee of \$400-700 per tank.

³ Federal rules do not require the owners of small, noncommercial tanks to demonstrate financial assurance for cleanup; North Carolina's Noncommercial UST Fund exists simply to assist those tank owners with the costs of cleaning up any petroleum release.

Over the life of the program, the Commercial UST Fund has paid out over \$370 million and the Noncommercial UST Fund has paid out close to \$80 million for the cleanup of contaminated soil and groundwater.

Responses to UST Fund Shortfalls

States have generally approached the growing gap between trust fund revenue and requests for reimbursement in two ways – by allocating additional money to the UST trust funds (usually to address a backlog of reimbursement claims) and by implementing cost-containment measures.

North Carolina has adopted all of the primary cost-saving measures being used nationally in an effort to reduce the costs of cleanups and the burdens on the UST Funds.⁴ North Carolina, like many other states, established a “risk-based” clean up program that prioritizes cleanups based on the degree of risk to human health. Sites classified as low risk are not required to cleanup to the State’s groundwater standards. Another approach to cost control is to use “pay for performance” contracts. Under these contracts, the UST Funds reimburse for remediation activities only after specified cleanup levels have been reached on a site. In the last two years, North Carolina’s UST program has instituted “pay for performance” on a limited basis through state contracts for cleanup of orphan UST sites. UST owners may use “pay for performance” contracts in private cleanups that are later reimbursed by the North Carolina’s UST Trust Funds, but they are not required to do so. North Carolina’s UST program also requires pre-approval of all cleanup activities as a way to contain costs. North Carolina’s UST program has long required pre-approval for remediation activities and recently began to require pre-approval for some site assessments as well. DENR has also proposed rule changes that would reduce the amount of assessment required on certain contaminated sites.

In 2004, the North Carolina General Assembly authorized the transfer of \$32 million from the Highway Fund to address the backlog of unpaid claims against the State’s UST Trust Funds. The legislature also directed DENR to prioritize cleanups based on risk to public health and the environment and control the amount of remediation work done on petroleum-contaminated sites to insure that claims for reimbursement would not exceed UST Trust Fund revenue. Under the legislation, DENR has been authorized to order remediation of UST sites only to the extent that the cleanup activity can be reimbursed within 90 days. The legislation made an exception for emergency situations. UST owners may also proceed with cleanups voluntarily in the understanding that their costs will not be reimbursed by the Trust Funds until after all work ordered by the DENR has been reimbursed.

⁴ In addition to these primary cost control measures some states charge a co-payment of tank owners for reimbursements paid out by the state trust fund. North Carolina’s UST program staff has recommended establishing a co-pay for the North Carolina UST Funds.

The effect of the 2004 legislation has been to eliminate the backlog of unpaid claims, but dramatically reduce the amount of remediation work currently underway on UST sites. Prior to the 2004 legislation, assessment and remediation work was underway on nearly all of the 9,000 remaining UST sites. At present, initial site assessment work is still being done but comprehensive site assessment and remediation activities are underway on only 153 sites. Those sites represent a fraction of the 2,680 sites categorized as high priority under the State's risk assessment rules. No sites characterized as intermediate or low risk sites are being ordered to begin remediation, even though some of those sites have free petroleum product in the groundwater.

Private Insurance States

A handful of states never created a UST trust fund and relied from the beginning on other financial mechanisms, such as private insurance, to provide the necessary coverage.⁵ States with UST trust funds still outnumber those relying on private insurance for the financing of cleanups, but in recent years, a number of states have either made or begun the transition from a state UST trust fund to private insurance. A look at their experiences may be helpful in assessing the feasibility of moving toward private insurance in North Carolina. This paper examines the experiences of states that have made the transition from a UST trust fund to private insurance and evaluates the public policy decisions that led to such a transition. In addition it examines the current status of the private insurance market in North Carolina. Finally, it outlines some of the decisions that North Carolina would face in making a transition to private insurance.

Texas

Texas set up its Petroleum Storage Tank Remediation Fund (PSTRF) in 1989. The Fund received revenue from fees collected at bulk petroleum facility operations (rail, pipeline, barge, or refinery terminals). Fees were levied on petroleum products imported into Texas and on the transfer of petroleum products into cargo tanks. The Texas Fund soon faced a backlog of \$170 million in claims. After loaning the fund \$120 million to address the backlog, the Texas legislature created a special committee to evaluate the program. In 1995, the legislature approved a second \$120 million loan to the Fund, but also set a sunset date of December 23, 1998 for accepting claims against the Fund. When this deadline passed, the Texas fund faced liability for approximately 23,000 sites. Along with the sunset on claims, the Texas legislature established September 1, 2001 as the sunset for the Fund itself; after that date, the Fund would cease to make payments. The final payout date has been extended three times and is currently set for September 1, 2006. At the end of 2004 the number of sites requiring cleanup under the Fund has been reduced to approximately 4,000.

The 1995 Texas legislation created a process by which Texas limited the state's liability and let the private insurance market take over. The transition to private insurance was

⁵ A few states, such as Oregon and Hawaii, never established state UST trust funds; other states, including Maryland and New York, created state UST trust funds that serve as cleanup funds of last resort, and not as reimbursement funds.

coupled with a large deposit into the fund. One interesting note is that during this transition the Oil Marketers Association set up an insurance program for its members.

Florida

In 1986 Florida established the Inland Protection Trust Fund to create a funding source for assessment and cleanup of petroleum contaminated sites. A fee on petroleum products produced or imported into the state generated revenue for the fund. In 1989 an additional program, the Florida Petroleum Liability and Restoration Insurance Program (PLRIP), was created to help UST owners meet federal financial responsibility requirements by providing \$1 million worth of site cleanup coverage. In just a few years, Florida had accumulated liabilities from PLRIP and other corrective action programs in excess of a billion dollars. In 1992 the Florida legislature, in an effort to transfer some of the responsibility from the public to tank owners, approved legislation to sunset the PLRIP. The legislation scheduled gradual reductions in the corrective action coverage provided by the state – the state would provide \$1 million coverage through 1993, but state coverage would be reduced to \$150,000 in 1997 and end completely on December 31, 1998. As a result, tank owners were forced to gradually replace decreasing state coverage with another financial mechanism, such as private insurance, to maintain the coverage required under federal law.

Several elements of Florida's transition helped ensure a smooth transition from a state fund to the private market. First, the phased approach allowed insurers to enter the market at a gradual pace. It also gave tank owners several years to adjust to increasing premiums. Secondly, the Florida transition benefited from specific program requirements. For example, Florida's intensive compliance program helped ensure that tank owners properly maintained their tanks. As a result, insurance companies could offer policies with affordable premiums. Despite these favorable conditions, agency staff received a large number of complaints about the difficulty of finding firms that would write policies for USTs during the transition period. However, agency staff notes that despite these complaints private insurance is working in Florida.

While the Florida model of transitioning to private insurance is instructive, there is one specific issue worth highlighting. Florida's regulations require that all single-walled tanks be replaced with secondary containment tanks by December 31, 2009. These state regulations will likely cause an increase in the discovery of new releases as older single-walled tanks are removed. As a result, the private insurance market for USTs has tightened and tank owners have expressed growing concerns about the continued availability of affordable insurance.

Michigan

In 1989 Michigan established the Michigan Underground Storage Tank Financial Assurance (MUSTFA) Fund. An annual fee on petroleum sales generated revenue for the fund. As early as 1992 the Michigan fund faced increasing claims and rising deficits causing the state to declare the fund insolvent. In an effort to address the shortfall, Michigan passed legislation extending collection of the annual petroleum fee until 2005

and phasing out the Fund by December 22, 1998. By 1994, the Fund was once again in financial trouble with a \$230 million backlog of unpaid claims. In March 1995, Michigan again declared the Fund insolvent and established a deadline of June 1995 for the submittal of all claims. The state also authorized a bond sale to pay for the millions of dollars in claims on the Fund and used revenue from the annual petroleum fee to pay the debt on the bonds.

Michigan's original transition plan was similar to the approach used in Florida. The state adopted a phase-out plan that required owners to obtain private insurance to cover a portion of their cleanup liability. The amount of coverage financed by the tank owners would gradually increase over time while the state's share decreased. For example, in 1995 private insurance would have been required for claims in excess of \$800,000. By 1998 private insurance would have been required for coverage in excess of \$200,000. The Fund's insolvency made it impossible to actually implement the phase-out plan, however, and beginning in June 1995 all tank owners were required to obtain private insurance for the total amount of the required coverage.

Private insurance companies were already preparing to enter the market because of the phase-out plan that required some private insurance coverage in 1995. The Fund's insolvency and the requirement for tank owners to have private insurance by 1995 created a guaranteed demand and several companies began writing policies.

Wisconsin

In 1987, the Wisconsin Petroleum Environmental Cleanup Fund Act (PECFA) was created to pay for cleanups and provide a mechanism for financial assurance. PECFA is funded by revenue from fees charged for inspecting the quality of oil products brought into the state. In 1994, Wisconsin amended PECFA and required sites with new or upgraded UST systems (systems with corrosion protected tanks and spill containment and overfill devices) to obtain private insurance by the end of 1995. Tank owners in the process of upgrading their systems would lose access to the state fund once the upgrade was completed. Wisconsin used the federal deadline for the upgrading of all UST systems (December 22, 1998) as the deadline for all tank owners to obtain private insurance. The state fund would not cover new releases after that date.

By 1999 the backlog on claims was so large that tank owners were waiting as long as three years for reimbursement of a claim. In that same year, the legislature authorized the issuance of \$270 million in revenue bonds for PECFA, with the petroleum fees supporting repayment of the debt. Agency staff notes that during the transition, private insurance was available and affordable for tank owners.

Missouri

Since 1992, Missouri's Petroleum Storage Tank Insurance Fund (PSTIF) has been providing insurance for tank owners. Over the last decade the fund has paid out approximately \$100 million in claims for cleanups. A transport fee charged on all

petroleum coming into Missouri provides most of the revenue, with a smaller portion coming from an annual \$100 premium on tanks. In 2001, the state legislature approved a bill to sunset the fund by December 31, 2010. After this date, the fund will operate only to complete payment of claims made prior to the sunset. The legislation also more than doubled the revenue coming into the fund by raising the petroleum transport fee.

The state legislature approved the sunset date with the expectation that by 2010 private insurance would be available at affordable rates for tank owners. The state has not taken steps to ensure a viable market, but in a recent report to the Missouri legislature the PSTIF Board recommended that a study on private insurance be completed 2 to 3 years in advance of the scheduled sunset in 2010.

Arizona

For many of the states discussed above, a sunset on coverage by the state fund and transition to private insurance was linked to the 1998 federal deadline for the upgrading of UST systems. Arizona represents a more recent example of a state making the decision to phase out its state UST trust fund. Arizona's State Assurance Fund (SAF) was set up in 1990 and funded by revenues from a one cent per gallon excise tax and a \$100 tank registration fee generating approximately \$29 million in revenue annually. A state law approved in 1996 was intended to make the SAF the secondary payer, not the primary funding source for cleanups. However, this requirement was often overlooked and the SAF continued to serve as the primary funding source for cleanups. In 2002, the Arizona UST program tightened its policies on reimbursement and began denying claims from tank owners covered by private insurance.

After this change in policy, UST owners lobbied for legislation to require reimbursement for claims denied under the 2002 policy change. In 2004 tank owners were successful in getting the legislation approved, but only after agreeing that the state fund would not cover releases reported after June 30, 2006. The legislation completely phases out the Fund by 2013.

To address the tank owners' original complaint, the Arizona legislation established coverage from the state fund for up to \$500,000 retroactive to December 31, 2002 for all eligible corrective action costs. Tank owners denied coverage after January 1, 2003 could reapply for reimbursement. The Arizona example may be unique because the phase out of the fund came about in response to a demand by UST owners for reimbursement of previously denied claims.

Common Elements of a Transition to Private Insurance

States that have undertaken a transition to private insurance did so in the face of large demands on the existing UST trust funds. Mounting fund liabilities created a concern that no matter how much money the state put into its UST trust fund, more would continue to be needed in the future.

In most cases the transition to private insurance was linked to the 1998 federal deadline for the upgrading of UST systems. The rationale was fairly simple: the states expected that once UST systems were upgraded, petroleum releases would decrease significantly - lowering the potential liability for private insurers and making premiums more affordable for tank owners. The states benefited from having a date certain after which no new claims could be filed against the state UST trust fund, giving a complete (and finite) picture of state trust fund liabilities.

Another key element in most transitions to private insurance is a gradual phase-in over a period of time. The lead-time for acquiring private insurance for new UST releases has ranged from three years in Texas to nearly ten years in Missouri.⁶ Florida provided five years of state-subsidized insurance at gradually decreasing levels of coverage, allowing tank owners and insurance companies to adjust to the changing marketplace.

In most states, the transition to private insurance came out of a two-part decision. The states put a significant amount of new money into their state UST funds, but also set a date to sunset the fund and end the state's financial obligation for cleanup. Essentially these state legislatures agreed to rescue the state UST fund, but only under the condition that the fund would eventually be eliminated. An infusion of state money sufficient to at least address the backlog of unpaid claims against the state fund was probably also necessary to make a transition to private insurance work. Insurers could not come into the market and cover a large backlog of old, unreimbursed claims at rates that tank owners could manage.

Insurance Market in North Carolina

Federal financial responsibility requirements can be met through private pollution liability insurance, self-insurance, letters of credit, or a state trust fund. To be eligible for coverage under North Carolina's Commercial UST Fund, tank owners must pay an annual fee and also demonstrate that they can meet the state fund deductibles.⁷

A small number of insurance companies currently offer policies in North Carolina to cover the deductibles required by the state's UST Funds. The demand for broader private insurance coverage for USTs in North Carolina is very limited because the Commercial UST Fund covers most cleanup liability.

On the national level the major insurance companies that issue pollution liability policies for USTs include AIG Environmental and Zurich Environmental. When issuing policies, these companies consider a number of different variables. The most important factors in setting rates for UST policies are the amount of coverage provided and the size of the

⁶ Missouri is representative of several states that have established significant transition periods for their state UST trust funds with the expectation that private insurance will be available in the future. For example, Maine's UST fund sunsets in 2010 and California's UST fund sunsets in 2011.

⁷ North Carolina law requires that tank owners are financially responsible for the deductibles for cleanup (\$20,000) and third-party liability (\$100,000).

deductible. The companies also consider other factors related to the tanks themselves, such as age and capacity, in setting premium rates.

Over the last decade, premiums for pollution liability policies on USTs have decreased significantly. As recently as ten years ago, annual premiums were in the range of \$1,000 per tank. Today, premiums are closer to \$500 per tank and may be even lower for new tanks.

Some of the major insurance companies view North Carolina as a viable market for private insurance. AIG has recently written the Division of Waste Management to provide information about its TankGuard policy for USTs. This policy satisfies federal financial assurance requirements and is an admitted policy in North Carolina.⁸ The basic AIG TankGuard policy has limits of \$1 million per incident, a \$5,000 deductible and a \$500 annual premium. The policy allows for reduced premiums for operators using state-of-the-art equipment.

Other major insurance companies offer similar policies. Zurich Environmental offers a UST pollution liability policy, also admitted in North Carolina, with a minimum premium of \$350 for a new double-walled tank and a \$5,000 deductible. Another carrier, Great American, is admitted in North Carolina for coverage of the state trust fund's deductible, but not admitted for higher amounts of coverage. Great American is admitted in about ten states for full UST pollution liability policies. Under its standard pollution liability policy Great American has a minimum premium of \$375 for state-of-the-art tanks. Colony Insurance offers a similar policy at a similar rate. There are several other providers of pollution liability insurance for USTs, each with their own individual coverage requirements.⁹

Another factor considered by some of the insurers writing UST policies seems to be the strength of state UST programs. Of the ten states where it writes full UST policies, Great American does more marketing in states with strong regulatory programs. Both Great American and Colony Insurance indicated that they monitor state enforcement efforts because the companies believe that a good state enforcement program will result in fewer claims for petroleum releases.

Meeting Financial Assurance Needs in North Carolina

Over the last two years, North Carolina's UST Funds have experienced the same kind of gap between fund revenues and claims seen in many other states. The gap has been most pronounced in the Commercial UST Fund. As the backlog of claims increased, the state took both administrative and legislative steps to minimize the costs of cleanups and

⁸ An admitted policy guarantees that in the event an insurer becomes insolvent that the claim would be paid through a guaranty fund. In North Carolina the North Carolina Guaranty Fund Association provides payment of claims up to \$300,000.

⁹ A list of insurance providers for USTs can be found at the EPA website at <http://www.epa.gov/swerust1/pubs/inlist.htm>. The list was most recently updated in September, 2004.

shorten reimbursement times. Some of the cost-containment measures put in place have just begun to have an effect. The large infusion of revenue in 2004 addressed the backlog of unpaid claims, but did not eliminate the fundamental gap between revenue going into the UST Funds and demands against the UST Funds. The structural deficit was addressed instead through measures designed to slow down the pace of remediation work to match the availability of funds.

Implementation of the 2004 legislation has meant that cleanup work is now being ordered only on 153 of the 2680 sites classified as high risk under state rules. Of those 153 sites, around 40 have been deemed emergencies. No remediation work is being ordered on sites classified as low risk.¹⁰ In effect, North Carolina has exchanged a backlog of unpaid claims for a backlog of sites requiring remediation.

Addressing the Problem

North Carolina's Commercial UST Fund continues to serve two different functions – to assist in cleanup of historic contamination from leaking underground storage tanks and to help commercial UST owners meet the financial responsibility requirements in federal law. Most states making the transition to private insurance have found it necessary to approach the two needs differently, recognizing that private insurers would be reluctant or unable to take on the historic contamination. A transition to private insurance may be able to provide, into the future, assurance that the UST owners and operators can meet the financial responsibility requirements of federal law with respect to newly reported petroleum releases. In doing so, it can put an end date on the State's financial commitment to cleanup of petroleum releases from USTs. A workable transition would likely require many of the same elements that have made the transition to private insurance work in other states.¹¹

A Transition Period

Given the importance of the UST Funds to tank owners and the unfamiliarity of private insurance, an immediate transition would likely be impractical. Rather, North Carolina could follow a model similar to those states that have chosen to transition to private insurance by continuing state coverage for cleanup costs for existing contamination up to some specified date. In those states, the state trust fund finances the cleanup of past contamination, while providing an incentive for discovery and reporting of releases before the sunset date. Beyond the sunset date, tank owners are responsible for cleanup costs and the financial responsibility requirements. A specific example is the Florida model, which required a phased approach with the state coverage gradually decreasing

¹⁰ The 2004 legislation did not affect a tank owner's legal duty to take immediate steps to stop a petroleum release and perform an initial assessment of the extent of the contamination. The legislation also allows a tank owner who wants to begin remediation of a low risk site (to facilitate a real estate transaction, for example) to do so as long as the tank owner acknowledges that those activities will only be reimbursed after the State has paid for activities ordered to be undertaken on higher risk sites.

¹¹ It is important to note that this paper is intended to evaluate a transition to private insurance for the Commercial UST Fund only, and not the Noncommercial UST Fund.

over a five year period, thereby allowing tank owners to purchase private insurance at reduced rates and at the same time creating a market for private insurance.

One aspect of a transition period that must also be considered is the likelihood that the state will see a spike in the number of claims submitted to the UST Fund as a deadline for private insurance approaches. A move to private insurance would have the effect of increasing the claims on the UST Fund and the need for increased revenues in the short term. However, the short-term burden would be offset by the state receiving a complete picture of its liability for future cleanups.

Increased Emphasis on Compliance and Inspections

In 2003, the compliance rate for commercial UST facilities was only at 55%, one of the lowest compliance rates of all DENR regulatory programs.¹² In that same year, the UST program was able to conduct only 1200 inspections -- a level of inspections that would allow the program to inspect a regulated UST facility about once every five years. Some of the insurance companies issuing UST policies in other states have noted the link between a strong UST compliance program and lower environmental insurance premiums. Whether North Carolina moves toward private insurance for UST cleanups or retains the state UST Funds, a stronger enforcement program could reduce the number of new releases and lower the costs of cleanup. In the long term, higher compliance rates could reduce the demand on the State's Commercial UST Fund. Under private insurance programs, higher compliance rates translate into lower premiums.

Any type of transition to private insurance will also bring new regulatory considerations. A transition to private insurance creates the need for some type of insurance verification process. In recent years, Florida has discovered a large number of violations of its private insurance requirement, including many instances of tank owners allowing insurance policies to lapse. North Carolina's current situation of infrequent inspections makes the need for some additional process to verify insurance and monitor policy cancellations an integral piece of any private insurance scheme that the state might adopt.

Assistance to Tank Owners

Another element that will help ensure a smooth transition to private insurance is limiting the burden placed on tank owners at the time of transition. As noted above, Florida took this approach by subsidizing the costs of private insurance over several years before moving completely to a private insurance market. In Texas, the oil marketers trade association set up an insurance program to serve its members. Another option that policy-makers should consider is reducing the cost of tank fees in order to offset the costs of insurance premiums.

¹² The compliance rate is calculated by the following formula: [(number of violation-free initial inspections ÷ total number of initial inspections) × 100]. The compliance rate for the UST program is based on violations of administrative rules and the North Carolina General Statutes. Violations for which tank owners and operators can be cited for include: failure to meet leak detection, corrosion protection and overfill control requirements; as well as failure to have a valid operating permit, failing to investigate suspected releases and installing UST systems too close to water supply wells or sensitive surface waters.

Conclusion

A transition from a state UST trust fund to private insurance could result in higher costs to some UST tank owners. Nationally, insurance premiums tend to be \$375-\$500 per tank for the \$1 million dollar coverage required under federal UST rules. By comparison, North Carolina's commercial UST owners pay tank fees of \$200-300 per tank to be eligible for coverage under the state's Commercial UST Fund. On the other hand, some UST policies currently available offer significantly lower deductibles than the State's \$20,000 Commercial UST Trust Fund deductible. There will also be a need to address concerns about availability of coverage. It is possible that the State would need to retain some role even in an insurance-based UST program to protect against significant gaps in coverage.

The benefits of moving toward an insurance model lies in limiting the state's financial liability for cleanup, addressing the threat to public health and the environment posed by petroleum releases, and creating stronger incentives for the upgrading and responsible operation of UST systems. The State has created the right conditions for a transition by enacting cost containment measures and addressing the backlog of claims against the UST Funds.

Appendix I

UST States List

No state trust fund ever set up

Oregon
Hawaii

Transition from state trust fund to private insurance

Texas
Florida
Wisconsin
Michigan

State trust fund for cleanups as last resort—private insurance required for cleanup coverage

Alaska
Delaware
New York
Maryland

State insurance program

Washington
West Virginia
Iowa

Have enacted a sunset date for the state UST trust fund

Minnesota	2007
Missouri	2010
Maine	2010

March 24, 2005

California 2011
Arizona 2013
Kansas 2014

The remaining states operate state trust funds for financial assurance and cleanup coverage similar to North Carolina's UST Funds.

Appendix II

Southeastern States Comparison of # of Tanks and Sites with Approximate Annual Revenue

<u>State</u>	<u># of Sites</u>	<u>Annual Revenue</u>
<i>North Carolina</i>	<i>19,504</i>	<i>\$27 million (commercial)</i>
Alabama	2,249	\$18 million
Arkansas	118	\$5.15 million
Georgia	5,676	\$25 million
Kentucky	4,662	\$44 million
Mississippi	813	\$10.5 million
South Carolina	8,212	\$17.69 million
Tennessee	3,084	\$20 million
Virginia	19,995	\$36 million

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