CERCLA § 108(b)
Financial Responsibility Instrument Specification

Potential Requirements for Insurance, Surety Bonds, Letters of Credit and Trust Agreements and Standby Trust Agreements under CERCLA § 108(b)

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Part 1. Introduction.

1.1. Background.

Section 108(b), 42 U.S.C. 9608 of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) of 1980, as amended, requires in specified circumstances that owners and operators of facilities establish evidence of financial responsibility (FR). Specifically, it requires the promulgation of regulations that require classes of facilities to establish and maintain evidence of FR consistent with the degree and duration of risk associated with the production, transportation, treatment, storage, or disposal of hazardous substances. The Agency has identified classes of facilities within the hard rock mining industry as those for which FR requirements will first be developed.

This draft report identifies required wording specifications for CERCLA § 108(b) insurance, surety bond, letter of credit, and trust agreement instruments. Additionally, the draft report analyzes strengths and weaknesses of alternative instrument specifications laying out the information EPA considered in selecting among the alternatives.

EPA's Section 108(b) FR rulemaking approach proceeds from two premises:

- CERCLA is a response program that addresses CERCLA Section 107 liabilities -- response costs, natural resource damages, and health assessments -- and is distinct from closure and reclamation requirements of federal and state mine permit programs; and
- Section 108(b) rules complement but do not change or substitute for existing Superfund cost recovery and enforcement procedures.

CERCLA 108(b) regulations establish conditions for payment of funds from the financial responsibility instruments. Financial responsibility instruments can be used to pay a party that has sought a judgment or order through the courts for payment of CERCLA response costs, health assessment costs and/or natural resource damages, to make payment as required in a CERCLA settlement with the federal government, or to pay, in certain circumstances, into a trust fund established by the owner or operator pursuant to a federal government unilateral administrative order under §106(a). Independent of these scenarios, under CERCLA Section 108(c), parties (including EPA) could also bring a "direct action" claim against the instrument provider. EPA has thus sought to ensure that it's proposed §108(b) instruments would complement the current Superfund framework for obtaining cleanup and reimbursement from those parties responsible for contamination.

To the extent that the proposed rule is designed to complement the existing Superfund framework 108(b) FR instruments differ from FR instruments under the Resource Conservation and Recovery Act (RCRA) (e.g., for hazardous waste treatment, storage, and disposal facilities (TSDFs) and for underground storage tanks of petroleum (USTs), the Safe Drinking Water Act (SDWA) (e.g., for underground injection facilities), the Toxic Substances Control Act (TSCA) (e.g., for PCB facilities), and the Atomic Energy Act (e.g., facilities of nuclear materials licensees).

1.2. Organization of Document.

This draft report is organized as follows: Part 2 presents general assumptions pertaining to all CERCLA § 108(b) instruments. It has five subparts: (1) Scope of covered liabilities, (2) Payment triggers, (3) use of single and multiple FR instruments, (4) Same standby trust fund requirements, and (5) Choice of law provisions[1] for all instruments.

Part 3 presents provisions specific to insurance. Part 3.1 presents insurance-specific provisions. The provisions in Part 3.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 3.1 includes 6 such insurance provisions: (1) EPA will establish required wording for the 108(b) insurance, (2) Conformance clause, (3) Acceptable types of insurance policies, (4) Policy assignable, (5) Extended reporting periods, and (6) Notices to be given by Insurers.

Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 3.2.

Part 3.2 identifies and analyzes alternative specifications that EPA considered for 13 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Required documentation, (2) Rescission of insurance coverage, (3) Dollar limits of 108(b) insurance, (4) If horizontal layers required, excess to follow form, (5) If horizontal layers required, specification of exhaustion terms and 'drop down' coverage, (6) Multiple insurers for a single facility, (7) Joint and several liability, (8) How many documents can be submitted, (9) Coverage restrictions, (10) Payment triggers, (11) Direct action, (12) Policy cancelations, and (13) standby trust fund requirements. The Agency documented strengths and weaknesses for alternative specifications for each of these issues. The Agency's preferred specifications are identified.

Part 4 presents provisions specific to surety bonds. Part 4.1 presents surety bond-specific provisions. The provisions in Part 4.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 4.1 includes 5 such surety bond provisions: (1) EPA will establish required wording for the 108(b) surety bonds, (2) Conformance clause, (3) Acceptable types of surety bonds, (4) Surety obligations under 108(b), and (5) Cancellation notices.

Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 4.2.

Part 4.2 identifies and analyzes alternative specifications that EPA considered for 6 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Payment triggers, (2) Multiple sureties for a single facility, (3) How many documents can be submitted, (4) Joint and several liability, (5) Standby trust fund requirements, and (6) Direct action authorization and defenses. The Agency documented strengths and weaknesses for alternative specifications for each of these issues.

Part 5 presents provisions specific to letters of credit. Part 5.1 presents letter of credit-specific

[1] These define the jurisdiction and court for resolving disputes.

provisions. The provisions in Part 5.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 5.1 includes 8 such surety bond provisions: (1) EPA will establish required wording for the 108(b) letters of credit, (2) Conformance clause, (3) 'Standby' letters of credit, (4) 'Independent' and 'irrevocable' letters of credit, (5) No named 'beneficiary/ies', (6) 'Evergreen' letters of credit, (7) Reasonable time to honor, and (8) Notices to be given by letter of credit issuing banks.

Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 5.2.

Part 5.2 identifies and analyzes alternative specifications that EPA considered for 7 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Governing law, (2) Draws by sight demand vs. time demand, (3) Presentation of documents, (4) Who can make draws upon the letter of credit, (5) Who can receive payments drawn from the letter of credit, (6) Standby trust fund requirements, and (7) Direct action authorization and defenses. The Agency documented strengths and weaknesses for alternative specifications for each of these issues.

Part 6 presents provisions specific to trust agreements. Part 6.1 presents trust agreement-specific provisions. The provisions in Part 6.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 6.1 includes 34 such trust agreement provisions. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 5.2.

Part 6.2 identifies and analyzes alternative specifications that EPA considered for 5 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Specifying the beneficiary, (2) Payment triggers, (3) Trustee liability under direct action, (4) Holding of other 108(b) instruments in the 108(b) trusts, and (5) Direct action authorization and defenses.

Part 2. Key 108(b) Assumptions for All Instruments Potentially Relevant for Required Wordings.

Part 2 presents general assumptions pertaining to all CERCLA § 108(b) instruments. It has five subparts: (1) Scope of covered liabilities, (2) Payment triggers, (3) use of single and multiple FR instruments, (4) Same standby trust fund requirements, and (5) Choice of law provisions for all instruments.

2.1. Scope of the FR

Under CERCLA § 108(b), EPA will require financial responsibility to cover all liabilities under CERCLA § 107. Under CERCLA § 107, an owner or operator of a facility is liable for the costs of: (A) all removal or remedial action by the United States Government, a State, or an Indian tribe not inconsistent with the national contingency plan;[2] (B) any other necessary response by any other person consistent with the

[2] Liability, 42 U.S.C. § 9607(a)(4)(A).

national contingency plan;[3] (C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such release;[4] and (D) any health assessment or health effects study carried out under section 104.[5]

EPA will not establish any generic rules or instrument-specific rules about priority-of-payments (other than "first come, first served") across the different potential CERCLA liabilities (A) through (D) in the scope of coverage. Draws from the 108(b) instruments will be on a "first come, first served" basis.

2.2. Payment Triggers (general provisions, not instrument specific).

The general provisions for payment of instruments that are applicable to all instruments are described below.

Under the proposed rule, in addition to direct action scenarios, the funds from all types of financial responsibility instruments would be available under three circumstances: payment of an unsatisfied CERCLA judgment, payment for a CERCLA settlement with the Federal government, payment into a trust fund established under an administrative order. EPA is seeking to allow for maximum flexibility in how the instruments pay out, through the payment terms. EPA believes this approach helps integrate the operation of the §108(b) instruments into the various CERCLA enforcement and cleanup processes and therefore will efficiently support the goal of ensuring that funds be made available for the payment of CERCLA response costs, health assessment costs, and natural resource damages. It is EPA's intent that each payment term as well as direct action be available independently of one another, and claimants may use any or any combination of the terms as the circumstances dictate. Again, this is to maximize flexibility in the manner in which the instruments can be payable, to promote the goal of ensuring cleanup while avoiding unnecessary litigation over whether the instruments are in fact payable.

In addition to the three circumstances described in the proposed rules, CERCLA includes a statutory provision authorizing direct action against issuers of financial responsibility instruments in specified situations that EPA expects would operate independently of the three payment triggers described above.[6]

Payment of an unsatisfied CERCLA judgement. The financial responsibility instruments would be available to pay a final judgment from a federal court awarding CERCLA response costs, health assessment costs, and/or natural resource damages associated with the facility against any of the current owners or operators for which payment as required by the judgment has not otherwise been made within 30 days. This is intended to cover all types of CERCLA actions, including those under CERCLA §§ 107 or 113(f). The financial responsibility is intended to cover judgments in favor of both governmental claimants (e.g., EPA or another agency of the United States, a state or Indian tribe) as well as private claimants. EPA is requiring that the claim be reduced to a final judgment under this payment term.

[3] Liability, 42 U.S.C. § 9607(a)(4)(B).
[4] Liability, 42 U.S.C. § 9607(a)(4)(C).
[5] Liability, 42 U.S.C. § 9607(a)(4)(D).
[6] CERCLA 108(c).

Payment for a CERCLA settlement with the federal government. The financial responsibility instruments also would be available to pay for a CERCLA settlement with agencies of the federal Government, including but not limited to administrative settlements entered into under CERCLA § 106 and administrative consent decrees. EPA's current CERCLA model settlements often include a financial responsibility component to ensure that funds are available, should the respondent fail to perform. EPA expects that future settlements could rely on an owner or operator's 108(b) instrument for this purpose if the settling parties agreed to employ the instrument in this manner. Other settlements are structured on a "cash out" basis, where the respondent is not doing work, but is instead resolving liability as a lump-sum payment to the United States. EPA's intent is for this payment term to work in either scenario.

Payment into a trust fund established under an administrative order. The financial responsibility instruments would also be available to pay into a trust fund established pursuant to an administrative order under §106(a) under certain circumstances. Under EPA's existing model orders, EPA requires recipients to provide evidence of financial responsibility to complete the work, should the recipient fail to perform as required under the administrative order. For the instrument to be available to fund this work takeover situation, the owner or operator would have to provide a written statement that the instrument may be used to assure the performance of the work required in the order. These provisions of the proposed rule are intended to complement existing EPA model orders. Under EPA's existing models, EPA requires recipients to provide evidence of financial responsibility to ensure that funds will be available to complete the work, should the recipient fail to perform as required under the unilateral administrative order. In essence, the owner or operator choses the instrument to comply with the financial responsibility provisions of the order.

Payment through the Direct Action provision. Finally, §108(c)(2) contains a "direct action" provision, under which claims can be brought against the guarantor, instead of against the owner or operator. Section 108(c) generally provides that any claim authorized by sections 107, or 111 may be asserted directly against the provider of the financial responsibility instrument in situations where the owner or operator is in bankruptcy or is unavailable.

The proposed §108(b) instruments are intended to account for direct actions authorized by these provisions. If the owner or operator is bankrupt or unavailable, there is uncertainty around the ability to obtain a judgment. Thus, the ability to take direct action against the financial responsibility instrument may be critical for assuring that funds will be made available for necessary cleanup.

2.3. Use of Single and Multiple 108(b) FR Instruments.

2.3.1. Use of single 108(b) instrument for one or more facilities.

An owner or operator would be able to use one financial responsibility instrument to meet the CERCLA 108(b) requirements for more than one facility. Evidence of financial responsibility submitted to the Administrator must include, for each facility, the EPA Identification Number, name, address, and the amount of funds for CERCLA § 108(b) financial responsibility assured by the instrument. If the facilities covered by the instrument are in more than one Region, identical evidence of financial assurance would be required to be submitted to and maintained with the regional delegees of the Administrator, as applicable, of all such Regions. The amount of funds available through the instrument would be required

to be no less than the sum of funds that would be available if a separate instrument had been established and maintained for each facility. EPA is proposing this as it may provide for some administrative ease in the compliance and implementation process.

2.3.2. Use of multiple 108(b) instruments in combination for a single facility.

An owner or operator would be able to satisfy the CERCLA 108(b) financial responsibility requirements by establishing more than one financial instrument per facility. The instruments would be required to meet the regulatory specifications applicable to each instrument except that it would be the combination of instruments, rather than the single instrument, which would have to demonstrate financial responsibility for an amount at least equal to the required amount of CERCLA § 108(b) financial responsibility. If an owner or operator were to use a trust fund in combination with a surety bond, letter of credit or insurance policy, including a trust fund holding a letter of credit, the owner or operator would be able to use the trust fund as the standby trust fund for the other instruments. This would also provide that if the owner or operator obtained a letter of credit issued in the favor of a trust fund trustee in combination with a surety bond or insurance policy, the owner or operator would be able to use the trust fund holding the letter of credit as the standby trust fund for the other mechanisms. A single standby trust fund would be established for two or more instruments. A claimant would be able to elect against which instrument used to provide evidence of financial responsibility to make a claim for CERCLA response and health assessment costs and/or natural resource damages. In this way, there would not be 'primary' or 'excess' instruments where the ability to draw on one instrument may be predicated on the exhaustion of another. EPA is electing to provide for multiple instruments in this fashion as the Agency believes it will be significantly less administratively cumbersome and make implementation of the claims process easier.

2.3.3. Single or multiple instruments for single facility with multiple owners or operators.

A single facility may have multiple owners or operators. For example, Company A may own 25%, Company B also may own 25%, and Company C may own 50% of the covered facility. Similarly, Company X may have a 25% interest in the facility's operations, Company Y also may have a 25% interest in the facility's operations, and Company Z may have a 50% interest in the facility's operations.

EPA had to consider how best to implement the provision for multiple owners or operators at a facility in Section 108(b)(4). The provision provides guidance on how a financial responsibility instrument could provide financial responsibility for the CERCLA liabilities of all the current owners and operators of the facility in instances where there is not one single owner/operator. Under the proposal, where a facility is owned and/or operated by more than one person, evidence of financial responsibility covering the facility may be established and maintained by one of the owners or operators, or, in consolidated form, by or on behalf of two or more owners or operators. In practice, the instruments would follow the same form regardless of whether one of the owners or operators establishes the mechanism, multiple owners or operators establish a mechanism or whether multiple owners or operators each establish a mechanism.

When evidence of financial responsibility is established in a consolidated form, the proportional share of the cost of demonstrating the financial responsibility for each participant would have to be shown in a separate letter submitted to the Regional Administrator. This provision will require the owners and operators to plan out and apportion the responsibility of obtaining and maintaining the instrument up front which EPA believes may help reduce the likelihood of an instrument obtained by multiple parties lapsing due to failure to pay any premiums or fees required by the instrument provider.

The evidence of financial responsibility would have to be accompanied by a statement authorizing the applicant to act for and on behalf of each participant in submitting and maintaining the evidence of financial responsibility as further required in CERCLA 108(b)(4).

2.4. Standby Trust Fund Required for Letter of Credit, Surety Bond, and Insurance.

EPA has decided to require a SBTF to accompany CERCLA 108(b) letters of credit, surety bonds, and insurance to ensure that funds are available to claimants following cancellation/termination/non-renewal of an instrument by an instrument provider and subsequent failure of an owner/operator to provide alternate financial responsibility. If there has been no payment trigger event, as described in Section 2.2, for which the funds in the financial responsibility instrument can be used and there is no receptacle (e.g., a standby trust) to hold the funds until a payment trigger event occurs, funding may be lost after notice of cancellation if the owner/operator fails to demonstrate an acceptable replacement instrument. A standby trust would provide a receptacle to hold funds if they were needed in the future.

Under the RCRA Subtitle C closure/post-closure, RCRA Subtitle I Underground Storage Tanks, and SDWA UIC Class VI wells programs, standby trusts are used as instruments for receiving assured funds after issuer cancellation of a financial instrument if the owner/operator does not obtain an acceptable replacement instrument within a specified timeframe.[7] Under these programs, cancellation without a replacement instrument triggers payment into a standby trust fund for all instruments for which an accompanying standby trust is required.

After considering the precedents set in other EPA programs for use of a SBTF in the event of cancellation and failure to provide alternate financial assurance, EPA has determined that for CERCLA 108(b) letters of credit, surety bonds, and insurance, funds will be directed into the SBTF within 30 days prior to cancellation/termination/non-renewal of an instrument by an instrument provider and subsequent failure of an owner/operator to provide acceptable alternate financial responsibility. This is discussed in more depth for the insurance, surety bond, and letter of credit below.

2.5. Choice of Law (jurisdictions and courts) Provisions Left to Parties to Determine for all Instruments.

EPA believes that choice of law provisions should be left to the parties to determine for all instruments. Choice of law provisions are how parties (e.g., the owner or operator and the instrument provider) to a contract specify which State's substantive laws (e.g., the laws of California) should be used to resolve disputes and which State's courts (e.g., the courts of New York) should try the case. Often, the same

[7] Under the RCRA Subtitle C liability program, a SBTF is provided as an option to accompany LOCs, but is not required. It is not stated as an option for any other instrument.

State (e.g., Colorado) will be chosen by the parties for both purposes. Because parties may have different preferences, the Agency is not in a position itself to determine choice of law.

Part 3. Insurance.

Insurance is a contract by which one party, for compensation called the premium, assumes particular risks of the other party and promises to pay a certain or ascertainable sum of money on a specified event. In the context of CERCLA § 108(b) these two parties are the owner/operator of the regulated facility (i.e., the insured) and the insurance company (i.e., the insurer).

Part 3 presents provisions specific to insurance. Part 3.1 presents insurance-specific provisions. The provisions in Part 3.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 3.1 includes 6 such insurance provisions: (1) EPA will establish required wording for the 108(b) insurance, (2) Conformance clause, (3) Acceptable types of insurance policies, (4) Policy assignable, (5) Extended reporting periods, and (6) Notices to be given by Insurers. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 3.2.

Part 3.2 identifies and analyzes alternative specifications that EPA considered for 13 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Required documentation, (2) Rescission of insurance coverage, (3) Dollar limits of 108(b) insurance, (4) If horizontal layers required, excess to follow form, (5) If horizontal layers required, specification of exhaustion terms and 'drop down' coverage, (6) Multiple insurers for a single facility, (7) Joint and several liability, (8) How many documents can be submitted, (9) Coverage restrictions, (10) Payment triggers, (11) Direct action, (12) Policy cancelations, and (13) standby trust fund requirements. The Agency documented strengths and weaknesses for alternative specifications for each of these issues.

Part 3.1 Issues Specific to Wording of 108(b) Insurance.

Part 3.1 presents insurance-specific provisions. The provisions in Part 3.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 3.1 includes 6 such insurance provisions: (1) EPA will establish required wording for the 108(b) insurance, (2) Conformance clause, (3) Acceptable types of insurance policies, (4) Policy assignable, (5) Extended reporting periods, and (6) Notices to be given by Insurers.

3.1.1 EPA will specify required wordings for the 108(b) insurance instruments.

Required wording of the 108(b) insurance instruments shall be specified in 108(b) regulations, not as guidance.[8] This approach is consistent with RCRA TSDF insurance instruments for closure/post-closure and for liability coverage, for which the required wordings are set out at 40 CFR 264.151(d) and (k),

[8] EPA SDWA Class VI instrument specifications are laid out as guidance, not regulatory requirements. US NRC instrument specifications for decommissioning FR of materials licensees also are laid out as Models and through guidance, not with required wording specified in regulations. The varied potential uses for CERCLA cost recovery argue for having required wording in regulations, which should reduce administrative burdens for all parties.

respectively. For those instruments, the regulations state "[instrument] must be worded as follows except that instructions in brackets are to be replaced with the relevant information and the brackets deleted." Such an approach reduces the administrative burden to the Agency of reviewing the wide range of potential instrument wording that may otherwise be employed.

3.1.2. Conformance clause.

Laws that require an owner or operator to demonstrate financial responsibility (e.g., for motor vehicle use) frequently state that the financial responsibility mechanism must contain certain specifications to satisfy the laws' financial responsibility requirement. If, in addition to requiring specifications for the insurance endorsement, the law states that an insurance endorsement issued pursuant to the law is deemed to contain (or exclude) certain terms, then those specifications deemed to be included (or excluded) are controlling even if not included in (or excluded by) the terms of the insurance policy. This principle is applicable for laws in the form of statutes, regulations, or court rules.

CERCLA § 108(b)(2) does not explicitly require any specifications for any financial responsibility mechanisms nor does it state that a financial responsibility mechanism for CERCLA § 108(b) is deemed to contain specific terms. However, the statute does provide EPA the authority to "specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing such evidence of financial responsibility in order to effectuate the purposes of this Act." Therefore, EPA has the power to require inclusion (or exclusion) of specifications within insurance policies used to satisfy CERCLA § 108(b) financial responsibility requirements and to deem that insurance endorsements issued in satisfaction of 108(b) requirements contain (or exclude) certain specifications.

To ensure that all parties to an insurance policy are in agreement on the terms of 108(b) insurance, the RCRA Subtitle C liability coverage endorsement uses the following conformance clause in its required endorsement language: "Any provision of the policy inconsistent with subsections [as listed] are hereby amended to conform with subsections [as listed]."

The above language also is found in the required language of the insurance endorsement for coverage of corrective action and third-party liability under Subtitle I.

Although EPA did not specify required wording for the RCRA Subtitle C closure/post-closure insurance endorsement, EPA specified the following conformance language for the RCRA Subtitle C closure/post-closure insurance certificate: "It is agreed that any provisions of the policy inconsistent with such regulations is hereby amended to eliminate such...inconsistency."

In addition to the language above, the RCRA Subtitle C closure/post-closure insurance certificate also includes the following warranty by the insurer: "[Insurer] warrants that such policy conforms in all respects with the requirements of the [closure/post-closure financial assurance regulations] as such regulations were constituted on the date shown above."

Based upon the established RCRA precedents shown above, EPA has decided to include a conformance clause similar to the language cited above for Subtitle C closure/post-closure insurance in the required wording of the § 108(b) insurance endorsement.

3.1.3. Acceptable forms of pollution liability policies.

Liability insurance can take two "forms:" either (1) "claims made" or (2) "occurrence." A "claims made" form differs from a traditional "occurrence" form primarily in the scope of risk against which it insures. In a "claims made" form, coverage is given only if a claim is first made and brought to the attention of the insurer during the policy period. In an occurrence form, coverage is given only if the pollution occurred during the period of the policy, regardless of when the claim is made against the insured and reported to the insurer. The Agency notes that "claims made" forms of pollution liability insurance also recognize that pollution may be first discovered by the insured and that claims made policies also may specify that coverage applies only to pollution that is first discovered during the policy period.

Liability insurers are opposed to writing "occurrence" forms (with few exceptions) and generally prefer to write "claims made" forms, especially if there is any potential for retroactive and long tail liabilities. Pollution liability insurance policies for the most part use "claims made" forms to reduce the potential for retroactive[9] and long-tail environmental liabilities[10] that insurers experienced under general liability "occurrence" forms issued prior to about 1985.[11] Claims made forms avoid retroactive and long-tail environmental liabilities through several tools (see discussion of Insuring Agreements and discussion of Coverage Restrictions in Section 3.2.9 below).

The Agency finds that, despite its temporal restrictions, claims made forms of pollution liability insurance define a "claim" broadly (e.g., to include a written demand received by the insured alleging liability or responsibility and seeking a remedy on the part of the insured for covered "loss") and also defines covered "loss" broadly (e.g., to include monetary awards and settlements of compensatory damages; punitive damages; civil fines, penalties, or assessment for bodily injury or property damage (including NRDs); investigation, adjustment and defense costs; and/or cleanup costs). The Agency believes that the modern "claims made" form appears acceptable for 108(b) insurance coverage assuming resolution of issues otherwise eliminating or narrowing coverage (discussed below in Section 3.5 on Coverage Limitations and Section 3.2.9 on Coverage Restrictions) and issues relating to cancellation, termination, or nonrenewal of coverage (discussed below in Section 3.2.12 on Cancellation). The Agency also would accept "occurrence" forms of liability insurance should the industry offer that coverage. Although occurrence forms are not generally available for pollution liabilities at the premises of the insured, the market offers both "claims made" and "occurrence" forms of contractors' pollution liability insurance, discussed next, upon which a CERLCA 108(b) endorsement may be attached.

As noted above, the liability insurance industry's move to "claims made" from "occurrence" forms for pollution liability coverage was intended to avoid the unexpected retroactive and long-tail environmental liabilities experienced by general liability insurers from policies issued prior to about 1985. However, some special features of a contractor's work (and market competition for business) enable pollution liability insurers to offer "occurrence" forms of coverage for contractors. First, as with

[9] Insurers were called upon to pay for cleanup of pollution conditions that had occurred decades earlier.
[10] Insurers were called upon to pay for bodily injury and property damage that took years to manifest after the exposure to pollution.
[11] By 1985, because general liability policies included an "absolute pollution exclusion", insureds wanting pollution cover (especially for "gradual pollution") purchased new "claims made" forms of environmental impairment liability (EIL) insurance which focused on third-party offsite environmental liabilities.

premises coverage, insurers are able to avoid retroactive liability in several ways in contractors' pollution policies: through retroactive dates, through known conditions exclusions,[12] by specifying that any covered bodily injury, property damage (including NRDs), or environmental damage must occur during the policy period, and also by requiring that covered damage must result from the contractor's insured activities at temporary work sites. These provisions exclude or narrow coverage of preexisting pollution conditions.

Second, insurers reduce potential long-tail liabilities by covering only contractor's ongoing activities ("covered operations") in relation to "work sites" that are "temporary" in nature. Sites where the contractor has completed its work would qualify as "completed operations" instead of "covered operations." Contractors' pollution liability insurance may or may not cover a contractor's "completed operations." Coverage of completed operations may be given by endorsement.

Under the occurrence form, the insured contractor must provide the insurer with written notice of any loss, claim, or pollution condition as soon as practicable, and the insured contractor must take all reasonable measures to provide immediate verbal notice in the event of a pollution condition; but reporting is not otherwise required to occur within the policy term (or any extended reporting period) as would be the case with a claims made form.

One expert[13] has noted reasons why he prefers claims made contractors' environmental policies to occurrence-based contractors' environmental policies. First, for pollution and damages that may have taken place during multiple policy periods, he says that it is easier to determine which policy applies with claims made forms. Second, he says that with claims made forms it is easy to correct for past policy deficiencies through the purchase of a new policy with the original retroactive date of the defective policy; in contrast, a coverage gap in an occurrence form cannot be easily erased. After considering other advantages and disadvantages of the two forms, the expert concluded that occurrence and claims-made based contractor environmental liability policies "are more similar than most practitioners realize."[14]

Current Practice. The specifications for RCRA Subtitle C insurance instruments for liability coverage, promulgated in 1982, do not indicate whether coverage is occurrence-based or claims made. The same is true for the more recently-enacted Part 261 liability insurance certificate and endorsement, promulgated in 2008. On the other hand, the Subtitle I (petroleum underground storage tank (UST)) insurance certificate and endorsement (promulgated in 1988) specify alternative language required solely for "claims made" forms of insurance, such as indicating that a 6-month "extended reporting period" must be available to the owner/operator (as required by the UST regulations).

[12] A "known conditions" exclusion explicitly eliminates coverage for pre-existing pollution conditions caused by contractor's activities if any insured knew or reasonably could have foreseen prior to the policy period that such pollution conditions could give rise to a claim.

[13] David Dybdahl, "Contractors Environmental Liability Insurance: Claims-Made versus Occurrence," IRMI Expert Commentary (July 2014).

[14] David Dybdahl, "Contractors Environmental Liability Insurance: Claims-Made versus Occurrence," IRMI Expert Commentary (July 2014).

The Coast Guard's FR requirements under CERCLA 108(a) and Oil Pollution Act of 1990 (OPA) do not specify whether insurance coverage must be occurrence-based or claims made.[15] The Coast Guard's insurance guaranty forms for CERCLA 108(a) and the OPA financial responsibility also do not require any information identifying the form of coverage provided, but require that the insured be covered for liability for costs and damages under section 1002 of OPA 90 as limited by section 1004(a), or section 107(a)(1) of CERCLA, as limited by sections 107(c)(1)(A) and (B).[16] The Coast Guard's insurance certificate indicates that the insurance evidenced by the document shall be applicable to a release or threat of release occurring on or after the effective date and before the termination date of the insurance. This language appears to indicate that the Coast Guard will accept either claims made or occurrence forms, because liability for incidents shall continue beyond the date of date of insurance policy termination.

BOEM's regulations and insurance certificate also do not directly identify whether allowable insurance is occurrence or claims made forms of coverage. BOEM regulations indicate that termination of the policy does not affect the liability of the insurer(s) in connection with an incident (i.e., discharge or substantial threat of discharge) occurring on or before the date of termination.[17] This is similar language to that used by the Coast Guard and implies that the Insurer maintains liability for claims that arise policy termination for an incident that occurs during the effective period of the policy.[18] This language may indicate that BOEM will accept either claims made or occurrence forms of policies. BOEM explained in the Preamble to the 1998 financial responsibility rule that the OPA makes guarantors subject to liability for certain claims made up to six years after a release occurs.[19] Thus BOEM's insurance certificate and accompanying financial responsibility regulations appear consistent with either occurrence forms or claims made forms of insurance that may include a multi-year extended reporting period.

In light of the above, the Agency will accept both forms of pollution liability insurance as long as the entire facility is covered (not just specified work sites within the facility) and the policy affords the coverage required by the regulations.

3.1.4. Policy assignable.

The assignability of an insurance policy refers to whether the interest in the policy can be transferred to a new insured during the life of the policy. In general, an insurance contract does not run with or attach to the insured property but is personal to the insured. Thus, when property is transferred, the insurance covering the property is not automatically transferred with it. A requirement that the insurance policy be assignable is a way of ensuring continuous coverage.

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[15] 33 U.S.C. Chapter 40 § 2716, 33 CFR § 138.80.
[16] See. https://www.uscg.mil/forms/cg/CG_5586.pdf, form CG-5586.
[17] 30 CFR 553.41(a).
[18] BOEM justified this longevity of policy, and the potential for retroactive liability because they indicated that "it is standard practice for insurance companies to pay claims after the policy term ends, as indicated by payments made for damage claims for exposure to asbestos and other hazardous materials several years before. OPA makes guarantors subject to liability for claims made up to 6 years after an oil-spill discharge occurs. Source: 63 Fed Reg. 42704 (August 11, 1998).
[19] 63 FR 42699 (August 11, 1998). Under the OPA, liability for recovery of removal costs for an incident may remain for up to six years following the completion of all removal actions for that incident. 33 U.S.C. 2712(h)(1).

The regulations for RCRA Subtitle C closure/post-closure insurance require that "Each policy must contain a provision allowing assignment of the policy to a successor owner or operator. Such assignment may be conditional upon consent of the insurer, provided such consent is not unreasonably refused."[20] A rulemaking background document provided the following reasoning for this requirement: "If a new owner or operator takes over management of an existing facility covered by a policy, it might be to his advantage to be able to assume the policy rather than establish a new mechanism."[21] This advantage derived from the nature of closure/post-closure insurance, which builds up a funded value over time. However, the regulations for RCRA Subtitle C liability insurance and Subtitle I UST financial responsibility coverage do not include a similar specification about policy assignability. Furthermore, the Coast Guard's FR requirements under CERCLA 108(a) and the Oil Pollution Act of 1990 (OPA), as well as BOEM's OPA financial responsibility requirements, do not require policy assignment. The different treatment is because liability coverage insurance does not build up a funded value over time, unlike closure/post-closure insurance.

The primary benefit to EPA of requiring that insurance policies be assignable is increasing the likelihood that continuous coverage will be available to cover regulated facilities. However, requiring that insurers assign coverage to a new owner/operator at a mining facility could adversely impact an insurer's willingness to participate in the CERCLA 108(b) financial assurance program because the change in ownership or entity responsible for operating a hardrock mine could have a material impact on the level of risk to which the insurer is subject. Moreover, EPA can address continuity of coverage through specifications for extended reporting periods (see discussion at Section 3.1.5 below) and retroactive dates (see discussion at Section 3.2.9.1 below).

Because EPA does not believe that the described benefit relating to continuous coverage outweighs the cost of decreased availability of insurance instruments, EPA chose not to require that 108(b) insurance be assignable.

3.1.5. Extended reporting periods (to specify or not).

Modern pollution liability insurance policies usually are "claims made and reported," as discussed in Section 3.1.3 above. Claims must be first made against the insured (e.g., by a third party) and reported by the insured to the insurer during the policy period. Extended reporting periods allow for reporting of claims that had been made against the insured but not yet been reported by the insured to the insurer, as long as the claims are reported during a specified period of time after termination of the policy (i.e., the extended reporting period). The purpose of an extended reporting period is to prevent a "gap" in coverage, which could occur under two circumstances. The first gap situation occurs where the insured renews his existing policy or purchases a new policy and the renewed or new policy contains a retroactive date subsequent to the retroactive date of the insured's previous insurance policy. The second gap situation occurs where the policy is terminated or is otherwise not renewed and the insured elects a financial assurance mechanism other than insurance (such as a guarantee, surety bond, etc.) as a replacement.[22]

[20] 40 CFR § 264.143(e)(7); 40 CFR § 264.145(e)(7).
[21] Background Document, November 2, 1981, p.8.
[22] 54 FR 47080; November 9, 1989.

Although RCRA Subtitle C liability coverage does not address extended reporting periods, the subsequently promulgated RCRA Subtitle I FR regulations do require insurance policies to have extended reporting periods. The required insurance endorsement and certificate language under 280.97 include the following specification:

> The insurance covers claims otherwise covered by the policy that are reported to the ["Insurer" or "Group"] within six months of the effective date of cancellation or non-renewal of the policy except where the new or renewed policy has the same retroactive date or a retroactive date earlier than that of the prior policy, and which arise out of any covered occurrence that commenced after the policy retroactive date, if applicable, and prior to such policy renewal or termination date. Claims reported during such extended reporting period are subject to the terms, conditions, limits, including limits of liability, and exclusions of the policy.

In the 1989 UST Interim Final Rule, the EPA affirmed the use of an extended reporting period, stating that, "The six-month extended reporting period is essential to avoiding gaps in coverage that could threaten human health and environment, especially in cases where the owner or operator may have as few as 10 days upon receipt of notice of cancellation to obtain substitute coverage."[23]

In addition to avoiding a gap in coverage, advantages of adapting the RCRA Subtitle I language for the 108(b) program include: (1) the language explicitly states that an extended reporting period applies only in situations when the new or renewed policy has a retroactive date after that of the prior policy, thus incentivizing insurers to retain the prior retroactive dates; and (2) the language confirms that claims reported during extended reporting periods are subject to the same terms, conditions, limits, and exclusions of the prior policy. EPA revised its financial assurance regulations in 1989 to clarify its stance on both of these points, and using the RCRA Subtitle I language in a 108(b) context would reduce ambiguity associated with when an extended reporting period applies and what terms, conditions, limits, and exclusions apply. Disadvantages of requiring extended reporting periods include: (1) administrative burden on EPA associated with reviewing policies to confirm that they contain an extended reporting period and (2) fees charged by the insurance industry to provide extended reporting period coverage.

EPA has weighed these advantages and disadvantage and decided not to require an extended reporting period given the other measures to ensure continuity of coverage.

3.1.6. Notices to be given by Insurers.

The insurer has obligations to issue notices in connection with a 108(b) instrument. Current practices for each type of notice are summarized below:

- Cancellation Notice and Other Termination Notice. The insurer must issue advance notice to the insured and the Agency that it intends to cancel, non-renew, or terminate the instrument. This notice is specified in both the rules and the required wordings of the RCRA Subtitle C insurance instruments for closure/post-closure and liability coverage. The RCRA Subtitle I UST rules and required wording of its insurance instruments require notification of the insured but do not

[23] 54 FR 47077; November 9, 1989.

require the insurer to notify the Agency; Subtitle I instead requires the owner or operator to notify the regulator if a substitute instrument is not found to replace the expiring insurance instrument. For 108(b), the Agency prefers to follow the Subtitle C approach and retain in the required wording of the instrument the notice requirement from the insurer to both the insured and the Agency. Also see discussions of Rescission of Insurance in Section 3.2.2 above and Cancellation in Section 3.2.12 below.

- Notice of Payment. The EPA wishes to remain informed of the value of the CERCLA 108(b) financial responsibility. EPA has requirements that EPA be notified by the owner or operator of CERCLA claims against the instruments or against a current owner or operator at the facility. However, because the owner or operator may not be able to provide such notice, EPA has decided to require the language of the insurance instrument itself to specify that the insurer will provide notice to the EPA Regional Administrator of any claims and payments made as a result of a direct action.

The Agency has determined that the required wording of 108(b) insurance instruments shall include notices of cancellation or termination (as is current practice in RCRA Subtitle C) and notices of payment to effectuate the notice requirements.

Part 3.2. Alternative Specifications for Key 108(b) Insurance Provisions with Advantages/Disadvantages of the Options.

Part 3.2 identifies and analyzes alternative specifications that EPA considered for 13 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). The Agency documented strengths/weaknesses for alternative specifications, including alternatives for required documentation, rescission of insurance coverage, dollar limits of 108(b) insurance, if horizontal layers required, excess to follow form, if horizontal layers required, specification of exhaustion terms and 'drop down' coverage, multiple insurers for a single facility, joint and several liability, how many documents can be submitted, coverage restrictions, payment triggers, direct action, policy cancelations, and standby trust fund requirements. The Agency's preferred specifications are identified.

3.2.1. Required documentation to be submitted to EPA (endorsement and/or policy).

When embodied in a written or printed instrument, a contract for insurance is known as an "insurance policy."[24] In other words, an "insurance policy" is a formal written contract containing all of the agreements pertaining to a contract of insurance.[25] A "certificate of insurance" is a form that typically is completed by an insurance broker or agent at the request of an insurance policyholder, which evidences the fact that an insurance policy has been written.[26] A certificate of insurance is only evidence of insurance coverage and not a separate and distinct contract for insurance or part of the insurance

[24] American Jurisprudence (Second), Insurance (2013), § 188.
[25] American Jurisprudence (Second), Insurance (2013), § 188
[26] American Jurisprudence (Second), Insurance (2013), § 189.

contract.[27] Representations in a certificate do not necessarily assure that a policy has been issued or that its terms are as certified. If there is a conflict between the terms of an insurance policy and certificate, the terms of the policy will generally control. A rider or endorsement that is attached to an insurance policy is a valid and binding part of the contract, even if it is unsigned.[28] Endorsements to an insurance policy are considered to be part of the insurance contract and are interpreted in accordance with the principles of contract law. Where there is a conflict in the meaning of an endorsement and the body of the insurance policy, the language in the endorsement will generally control.

Under RCRA Subtitle C requirements an owner or operator is not required to submit a copy of its insurance policy (whether for closure/post-closure or for liability coverage) to EPA unless requested. Rather, EPA will accept specified endorsements or certificates (for third party liability) or a specified certificate (closure/post-closure) as evidence of insurance coverage, which must include specified required wording.

Endorsements are used under federal financial responsibility programs for motor carrier liability. The case law relevant to these programs generally states that when policies are issued to satisfy statutory governmentally-mandated financial responsibility requirements:

- The terms of the statutes requiring financial responsibility will be incorporated by reference into the liability coverage provisions of the policy, or
- The policy will be interpreted in light of the statutory requirements.

Financial responsibility programs for motor carrier coverage may accept certificates as well as endorsements for compliance.

Statutory language in RCRA Subtitle C and CERCLA 108(b) is limited and does not indicate, for example, minimum amounts of required 108(b) coverage or the exact scope of 108(b) coverage. Although this lack of statutory detail may reduce the effect of the general case law principle noted above, recent litigation (see discussion of rescission of insurance at Section 3.2.2 above) concerning RCRA Subtitle I insurance demonstrates that courts will consider regulatory provisions as well as statutory language when interpreting policies.

Although a certificate does not amend the underlying policy, if the terms of the policy are not as certified, the insured owner or operator may have legal recourse against the insurer in some situations. For example, the insured may be able to sue on a misrepresentation theory to require the insurer to pay for any damages that the certificate implies will be covered.

RCRA Subtitle C and I insurance certificates and endorsements contain varying language about the insurance policy as shown on Exhibit 1.

Exhibit 1
Relation of Instruments to Policy Language

	Insurance Certificate	Insurer "warrants that such policy conforms in all respects with the

[27] American Jurisprudence (Second), Insurance (2013), § 189.
[28] American Jurisprudence (Second), Insurance (2013), § 190.

RCRA Subtitle C Closure/ Post-Closure		requirements of the [closure/post-closure financial assurance regulations] as such regulations were constituted on the date shown." It is agreed that any provision of the policy inconsistent with such regulations is hereby amended to eliminate such … inconsistency.
	Insurance Endorsement	Not applicable. (Insurance certificate is required, and, therefore, there is no insurance endorsement required language included in RCRA Subtitle C Closure/Post-Closure.)
RCRA Subtitle C Liability Coverage	Insurance Certificate	No language addressing relation of certificate to insurance policy language included in required wording of the insurance certificate.
	Insurance Endorsement	Any provisions of the policy inconsistent with subsections (a) through (e) of this Paragraph 2 are hereby amended to conform with subsections (a) through (e)
RCRA Subtitle I Liability and Corrective Action Coverage	Insurance Certificate	Certifies (a) through (e) (as applicable) with respect to the insurance described in Paragraph 1.
	Insurance Endorsement	Any provisions inconsistent with subsections (a) through (e) of this Paragraph 2 are hereby amended to conform with subsections (a) through (e)

Many States reportedly now mandate the "does not amend, extend, or alter" language on insurance certificates,[29] although EPA has not determined whether those requirements apply to certificates for insurance provided through "surplus lines" insurers, such as pollution liability insurance. Moreover, EPA may have authority under CERCLA to pre-empt the application of state law to 108(b) insurance certificates.

[29] "Certificate of Insurance, State by State Listing, Laws , Regulations, and DOI Directives," 12th Edition, Independent Insurance Agents and Brokers of America, January 2016.

Insurance policies typically include a provision to the effect that the policy's terms and conditions can be amended or waived only by written endorsement issued by the insurer and made part of the policy. The RCRA insurance endorsements shown on Exhibit 1[30] include a limited number of provisions that explicitly amend any inconsistent policy language. A CERCLA 108(b) insurance endorsement could include similar specifications to those in Exhibit 1 or be written more broadly to refer to all applicable regulatory requirements (e.g., all terms and conditions in the policy conform to Part 320 regulations).

In a December 8, 2015 discussion with representatives of the insurance industry, EPA was told by participants that they were indifferent between certificates and endorsements as the form of the required evidence of 108(b) financial responsibility.

In light of the above, "Required documentation" options for CERCLA 108(b) insurance include:

- **Option 1:** Require an insurance endorsement
- **Option 2:** Require an insurance certificate
- **Option 3:** Require an insurance endorsement or certificate

Option 1: Require an insurance endorsement
Strengths: Provides more assurance than a certificate that an owner or operator has adequate insurance coverage.
Weaknesses: May be more burdensome on owners or operators than the certificate.

Option 2: Require an insurance certificate
Strengths: May be less burdensome on owner or operator than the endorsement.
Weaknesses: Provides less assurance than the endorsement that an owner or operator has adequate insurance coverage.

Option 3: Require an insurance endorsement or certificate
Strengths: Provides greater flexibility to the owner or operator.
Weaknesses: May provide less assurance than requiring an endorsement that an owner or operator has adequate insurance coverage.

In light of the above, the Agency has determined that the required documentation for CERCLA 108(b) insurance shall be in the form of an endorsement. EPA has determined that the required wording of the instrument must state that coverage is given only for 108(b) third-party claims for CERCLA costs and natural resource damages, is not available to the insured (i.e. is for third-party claims), and that insurance coverage conforms to specified provisions in the endorsement and the regulations.

3.2.2. Rescission of insurance coverage.

The Agency is concerned about rescission because it retroactively removes coverage previously thought to be in place. Rescission is an action that may be taken by an insurer that has the effect of voiding all coverage under a policy, returning the parties to the positions they would have had as if the contract had never been made. Synonyms for rescission include voiding and void *ab initio*. In contrast to the

[30] EPA did not specify an endorsement for closure and/or post-closure care insurance.

retroactive nature of rescission, cancellation, termination, and non-renewal (discussed in Section 3.2.12 below) are prospective actions which do not affect any prior coverage or claims.[31] Thus, with rescission, the insurer must return all premiums paid, whereas no prior premium payments must be returned in the event of cancellation, because cancellation is prospective.

Rescission need not be addressed in the policy for it to be available to the insurer, and policy language addressing rescission may be over-ridden by state law. The right to rescind an insurance policy originates in the common law of contracts[32] and has been described as one of the most important weapons insurers hold to combat insurance fraud.[33] Rescission has been justified if the "meeting of the minds" required for effective contracts is not found to have occurred due to fraudulent statements or omissions made by the insured in applying for the insurance or in connection with making claims. Upon initial receipt of the application, the insurer has no duty to independently investigate whether the application includes any significant misstatements or omissions. In the 108(b) context, EPA would not have access to the owner or operator's application and the Agency could not conduct its own independent investigation whether the application includes material misrepresentations or omissions; moreover, such investigations would be burdensome to the Agency and would involve some subjectivity.

Policy rescission often is subject to state statutes or regulations and interpretive case law that limit insurers' right to rescission to instances where the insurer determines that there was fraud or a material misrepresentation or omission by the insured in the insurance application. State statutes about rescission may over-ride rescission language in the policy itself.[34] The Agency understands that the specific circumstances and the extent to which rescission may be allowed by state law vary dramatically. In addressing motor vehicle liability policies issued pursuant to state financial responsibility laws, some states and courts either prohibit rescission after an accident in which an innocent third party was injured or limit rescission to amounts of coverage above those required by state financial responsibility laws. For example, if the State required minimum third-party liability FR of $20,000 per vehicle but the insured purchased $50,000, then the insurer might be allowed rescission for the $30,000 above the minimum required amount. The Agency found no up-to-date state-by-state compilation of rescission law that might be applicable to a government liability coverage program comparable to 108(b).

In recent years, insurers active in Directors and Officers Liability (D&O) coverage have begun offering some explicitly “non-rescindable” coverage. Those D&O policies cover many potential individual claimants who do not want to lose coverage if the applicant corporation made material misstatements or omissions to the insurer. Such non-rescindable D&O policies may simply state that the insurer shall not be allowed to rescind the policy “under any circumstances.”[35] Alternatively, D&O carriers can introduce endorsements that render the entire policy non-rescindable even when fraud or

[31] Rick L. Hammond, A Tale of Two Remedies -- Rescission vs. Cancellation (Defense Research Institute (DRI) Insurance Coverage and Claims Institute, March 2012).
[32] Stafford, "DTCI [Defense Trial Counsel of Indiana]: Rescission of Insurance Policies," The Indiana Lawyer.Com (October 10, 2012).
[33] S. David Childers and Jennifer L. Kraham, "The Future of Insurance Rescission," Federation of Regulatory Counsel, Inc. (FORC) Journal (Fall 2012).
[34] Chicago Illinois, The Voiding of a Policy for Misrepresentation is Controlled by the Insurance Code (January 11 2008).
[35] See the following example D&O policies:
http://www.acegroup.com/us-en/assets/ace-westchester-advantage-private-company-management.pdf
https://bhspecialty.com/wp-content/uploads/2016/02/EP-DIC-001-02-2015-SIDE-A-DIC-POLICY-FORM.pdf

misrepresentation occurred. However, in some situations, those D endorsements of non-rescindable coverage may be accompanied by other endorsements that allow a denial of coverage for such misrepresentations through exclusions or other policy D&O provisions. As a relatively new approach, there is a dearth of case law concerning "fully non-rescindable" policies or endorsements. In no other lines of insurance underlining pollution liability insurance is non-rescindable coverage widely advertised.

The landmark decision of the U.S. Court of Appeals, Ninth Circuit in *Zurich American Insurance Company* v. *Whittier Properties, Inc.*, 356 F.3d 1132 (2004) held that the EPA's financial assurance regulations for liability coverage of underground storage tanks of petroleum (USTs), which the state of Alaska had adopted, preclude rescission as a remedy for misrepresentation and provide only for prospective cancellation of statutorily required UST insurance. The Court assumed that the general Alaska statute allowing for rescission due to misrepresentation could apply even if the insurance be mandated by law and even if the rescission would negatively affect innocent third parties. Nevertheless, the Court found that the Alaska statute did not specifically apply to statutorily-mandated insurance for USTs. The Court found that the EPA regulations specifically govern UST insurance policies and the remedies available in conjunction with such policies. The Court found that prospective cancellation in the event of an insured's misrepresentation was the exclusive remedy available under the UST financial responsibility regulations.[36] The Court found that the EPA regulations do not provide for voiding of the policy *ab initio* in the event of misrepresentation. The Court stated that the EPA's requirements were intended to avoid "gaps" during which an operator would not be insured. The Court noted that EPA had submitted an amicus brief to the court explaining its intent for and interpretation of its regulations.

On the topic of rescission, EPA has four options:

- **Option 1:** Require that 108(b) insurance be non-rescindable
- **Option 2:** Adopt the cancellation approach used in the UST FR regulations
- **Option 3:** Both Options 1 and 2 above.
- **Option 4:** Do not address rescission.

Option 1: Require that 108(b) insurance be non-rescindable
Strengths: Option 1 would clearly address the risk of rescission in the endorsement. Option 1 may provide an incentive to insurers to investigate the completeness and accuracy of statements made in connection with applications for 108(b) coverage.
Weaknesses: However, it may be that State statutes or common law would nevertheless over-ride language in the 108(b) endorsement restricting rescission. Of greater concern to the Agency is whether mandating non-rescindable coverage would discourage insurers from offering 108(b) coverage, given that non-rescindable coverage appears gradually available only in conjunction with D&O coverage, not with pollution liability insurance. EPA has no Agency precedent for requiring non-rescindable liability coverage.

Option 2: Adopt the cancellation approach used in the UST FR regulations

[36] The U.S. District Court, Northern District Florida agreed with the *Whittier* Court that the federal statutes and EPA regulations precluded rescission of the policy for petroleum USTs. (*Mid-Continent Casualty Company* v. *L.B. King*, 552 F.Supp.2d 1309 (2008)).

Strengths: Option 2 is to preclude the remedy of rescission by using similar language to the UST insurance cancellation specification and related language from 40 CFR 280.97 in 108(b) endorsements in order to take advantage of the *Whittier* holding.
Weaknesses: However, as the *Whittier* opinion acknowledged, there are alternate interpretations of the UST regulations. For example, the federal district court determined on the same set of facts that Zurich could rescind the policy. Therefore, this option cannot guarantee that rescission might not ever be allowed. Like Option 1, this Option may discourage participation by insurers in the 108(b) program, even if it is acceptable for UST insurance.

Option 3: Both Options 1 and 2 above.
Strengths: Option 3 would appear to reduce the risk of rescission the furthest of the Options.
Weaknesses: As with Option 1, of great concern to the Agency is whether mandating non-rescindable coverage would discourage insurers from offering 108(b) coverage, given that non-rescindable coverage appears gradually available only in conjunction with D&O coverage, not with pollution liability insurance.

Option 4: Do not address rescission.
Strengths: Option 4 would not force insurers to offer unconventional pollution liability coverage and may encourage the greatest participation by insurers in the 108(b) program.
Weakness: Option 4 would entail the greatest risk of rescission of all the Options. Option 4 would leave rescission to be governed by state law and negotiated policy wording.

On balance, the Agency prefers option 2 and has employed a cancellation approach similar to the UST FR regulations.

3.2.3. Dollar limits of 108(b) insurance.

Issues relating to amounts of FR coverage include both issues common to all instruments and also issues specific to insurance. A single am ount of required 108(b) coverage will be calculated per facility, which is the amount of required FR. The amount shall be inclusive of all CERCLA 107 liabilities, and the required FR instruments shall contain no sub-limits for any specific CERCLA 107 liabilities even when combinations of instruments are being used for a single facility. As stated in Section 2.3.1, when a single instrument is being used for more than one covered facility, sub-limits for each facility must be at least in the minimum required amounts for the respective facilities. As stated in Sections 2.3.2 and 2.3.3, combinations of instruments must add up to the total required amount of coverage per facility.

In reviewing Agency FR regulations for liability coverage and current specimen pollution liability policies, the Agency identified 4 additional topics related to dollar amounts of coverage that are specific to insurance. This Section focuses on dollar-related provisions for 108(b) pollution liability insurance endorsements, including (1) "first dollar" coverage, (2) investigation and/or defense costs inside or outside of policy limits, (3) face amount and sub-limits, and (4) shared or segregated limits, including potential exclusion of other costs unrelated to CERCLA 108(b) from 108(b) limits.

3.2.3.1. Coverage must be “first dollar”.

Issues of "first dollar coverage" are unique to insurance because of its incorporation of deductibles and/or self-insured retentions (SIRs), which are explained below. Because other 108(b) instruments do not include deductibles nor SIRs, they are "first dollar" in nature. Deductibles and SIRs allow insurers

and their customers to adjust the risk transfer provided by a policy to meet the customer's needs at an acceptable premium. Some of the benefits of insurance deductibles and SIRs can be achieved when an owner or operator uses a combination of self-insurance/guarantee together with insurance to cover the total required amount for a facility (see discussion of combinations of instruments in Section 2.3.2 above).

A deductible amount is different from a SIR. A deductible amount is that portion of the insurance coverage that is the responsibility of the insured party. For example, a $20 million policy might include a $1 million deductible. In the event of a claim, the insurer will cover all but $1 million, leaving the insured party either to assume the $1 million loss (if the loss accrues to the first-party insured) or, alternatively, to pay that $1 million amount to a third-party claimant. A "first dollar" requirement, such as found in the required wording of RCRA Subtitle C third-party liability coverage insurance instruments and the Subtitle I third-party liability and corrective action coverage insurance endorsement, requires the insurer to make all payments regardless of the deductible and to seek reimbursement afterward from the insured of the amount of the deductible. Required language in 40 CFR 264.151(i) for the hazardous waste facility liability endorsement states that "The insurer is liable for the payment of amounts within any deductible, with a right of reimbursement by the insured for any such payment made by the insurer." Similar language is found in 40 CFR 280.97(b) for the Subtitle I endorsement. In "first dollar" insurance, the insurer assumes somewhat greater risk (e.g., the risk that the insured may be insolvent and unable to reimburse the insurer for the deductible) for which it may charge a somewhat greater premium.

The SIR differs from a deductible in certain respects although it shares some common features. The SIR is an amount for which the insured party is responsible but it is an amount outside the limits of the policy. For example, a $20 million policy issued on top of a $1 million SIR would cover losses over $1 million and up to $21 million. The SIR is the dollar amount that must be paid (typically by the insured) before the insurance policy will respond to a loss or claim. Under a policy with an SIR, the insured would have to pay legal and claim/loss costs until the total amount of the SIR limit was reached ("exhausted"). After that point, the insurer would make any additional payments covered by the policy. With SIRs, the insurer assumes somewhat lesser risk (e.g., because the insured may be insolvent and unable to pay the SIR thus relieving the insurer from any coverage) for which it may charge a somewhat lesser premium. The required wording of the RCRA instruments do not explicitly address SIRs.

Experts point out that courts treat policies with SIRs as a type of secondary, “excess” insurance coverage in which the insurer’s obligation only arises ("attaches") after the policyholder has first satisfied its own self-retained obligations.[37] Potential problems with excess coverage are discussed in Sections 3.2.4, 3.2.5, and 3.2.6.

Current Practice. Under the RCRA Subtitle C and 40 CFR Part 261 liability programs, insurance certificates and endorsements must specify that coverage is first dollar, regardless of deductibles, with the exception of deductibles for which coverage is demonstrated under a financial test for liability coverage. Neither program addresses SIRs in regulatory or required instrument language. The required certificate and endorsement language under RCRA Subtitle I (40 CFR 280.97) contains a slight variation in requirements, stating that the requirement for first dollar coverage, “does not apply with respect to

[37] Eric Hermanson & Jonathan Toren, “Layers and Gaps: Conflicts between Primary and Excess Insurers,” *The Brief* (American Bar Association, Tort Trial and Insurance Practice Section, Fall 2015).

that amount of any deductible for which coverage is demonstrated under another mechanism or combination of mechanisms." EPA's RCRA financial assurance programs aim to reconcile opposing goals of reducing moral hazard (by accepting that insureds keep some "skin in the game")[38] and supplying needed funds in full by requiring "first dollar coverage" from insurers, regardless of insured's deductibles, with acknowledgment of insurers' rights to seek reimbursement of deductible from their insureds.

Specimen pollution liability policies examined by the Agency use either an SIR or rather than a deductible.[39] In addition to including SIRs in insuring agreements and limits of liability, many pollution liability insurance policies also specify that the bankruptcy or insolvency of an insured does not relieve the insured of its SIR obligations, which must be satisfied before the policy will "attach." The issue of underlying limit "exhaustion" in insurance coverage is discussed in Section 3.2.5 below.

Under RCRA, an owner or operator may self-insure or guarantee all or part of the required amount of 108(b) coverage for a facility and cover the remainder with insurance; such a combination of instruments would not raise SIR issues of exhaustion as a precondition to insurance coverage. Combinations of instruments are discussed in Section 2.3.2 above.

EPA might address issues raised by insurance deductibles and SIRs in the following ways:

- **Option 1:** Require the endorsement to specify "first dollar" insurance coverage regardless of deductibles or SIRs, both of which must be paid by the insurer with a right of reimbursement from the insured, unless those amounts are covered by another acceptable 108(b) instrument.
- **Option 2:** Require "first dollar" coverage only with respect to deductibles, not to SIRs.
- **Option 3:** Do not require "first dollar" coverage.

Option 1: Require instrument language to specify "first dollar" insurance coverage regardless of deductibles or SIRs, both of which must be paid by the insurer with a right of reimbursement from the insured, unless those amounts are covered by another acceptable 108(b) instrument.
Strengths: Option 1 provides the greatest assurance that third-party CERCLA claims will be covered, with the insurer assuming somewhat greater risk for which it would charge somewhat greater premiums. Option 1 would provide greater parity amongst instruments as deductibles and SIRs are relevant only to insurance.
Weaknesses: Could somewhat discourage insurer participation in 108(b) program. Marginally greater administrative burden to check endorsement terms. Possibly higher premiums.

Option 2: Require "first dollar" coverage only with respect to deductibles, not to SIRs.
Strengths: Option 2 is consistent with EPA liability coverage precedents, which address deductibles but not SIRs.

[38] "Moral hazard" is a term of art to describe a circumstance where a site owner's or operator's incentive to properly site, operate, or close its facility is reduced because it is not exclusively responsible for the costs of liabilities.
[39] See also discussion of SIRs in, Christopher Alviggi & Dennis M. Taft, "Using Environmental Insurance as a Tool to Close Transactions," *Natural Resources and Environment* (American Bar Association, Section of Environment, Energy, and Resources, Fall 2014).

Weaknesses: Option 2 provides somewhat less assurance than Option 1 but more than Option 3. Option 2 premiums would be expected to be somewhat less than the premiums under Option 1 but somewhat more than premiums under Option 3.

Option 3: Do not require "first dollar" coverage.
Strengths: Option 3 premiums should be less than premiums under Option 2. Least administrative burden and premiums.
Weaknesses: Option 3 provides the least assurance of these options and would be expected to cost the least in premiums. Option 3 is not consistent with EPA precedents under RCRA Subtitles C and I.

On balance, EPA believes that Option 1 should be specified for 108(b) insurance.

3.2.3.2. Investigation and/or defense costs outside limits.

The 108(b) endorsement al can specify whether costs incurred by the insurer (or the insured) to investigate and defend against third-party CERCLA claims can be paid by the 108(b) insurance ("within the limits") or are outside of the specified 108(b) limits. The Agency is concerned about defense and/or investigation costs (which will be incurred first in time under a pollution liability insurance policy) reducing the limits available for payment of third-party 108(b) claims. This potential issue can be addressed by excluding investigation and/or defense costs from the 108(b) coverage limits.

Investigation costs include, for example, fees for scientific and engineering consultants retained to clarify the extent of, minimize, and effect resolution of any obligation related to first-party remediation. The Agency's review of specimen pollution liability insurance policies found that coverage of such costs was commonly included within the limits of such policies and may be incorporated within the definition of defense costs.

Defense costs include legal costs, charges, and expenses, including for expert witnesses. The Agency's review of specimen pollution liability insurance policies found that coverage of such costs was commonly included within the limits of such policies and may incorporate investigation costs.

Current Practice. Required amounts of coverage under the RCRA Subtitle C and RCRA Subtitle I liability programs for sudden and nonsudden accidental occurrences is “exclusive of legal defense costs,” and the required instrument language for insurance endorsements and certificates under both programs includes this wording. As defined under the RCRA Subtitle C program (40 CFR 264.141), “Legal defense costs means any expenses that an insurer incurs in defending against claims of third parties brought under the terms and conditions of an insurance policy.” There is no explicit mention of investigation costs under the RCRA Subtitle C or RCRA Subtitle I programs.

Options: EPA might address issues raised by defense and investigation in the following ways:

- **Option 1:** Require both defense and investigation costs to be outside of required limits.
- **Option 2:** Require only defense costs to be outside of required limits but not investigation costs.
- **Option 3:** Do not require either defense or investigation costs to be outside of limits.

Option 1: Require both defense and investigation costs to be outside of required limits.

Strengths: This option would not reduce the amount of funds for payment of third-party 108(b) claims due to with defense and investigation costs being paid from an insurance policy. This option is consistent with current EPA practice under the RCRA Subtitle C and RCRA Subtitle I liability programs in requiring defense costs to be outside of the limits of insurance policies.
Weaknesses: This option may be less favorable to insurers because they would be responsible for paying defense and investigation costs.

Option 2: Required only defense costs to be outside of required limits but not investigation costs.
Strengths: This option would not reduce the amount of funds for payment of third-party 108(b) claims due to defense costs being paid from an insurance policy. This option is consistent with current EPA practice under the RCRA Subtitle C and RCRA Subtitle I liability programs in requiring defense costs to be outside of the limits of insurance policies. Including investigation costs within the limits of the policy could incentivize insurers to conduct a more thorough investigation.
Weaknesses: This option may be less favorable to insurers because they would be responsible for paying defense costs. This option would reduce the amount of funds for payment of third-party 108(b) claims if investigation costs are paid from an insurance policy.

Option 3: Do not require defense or investigation costs to be outside of limits.
Strengths: This option would be most favorable to insurers because they would not be responsible for paying defense or investigation costs outside of policy limits. Including investigation costs within the limits of the policy could incentivize insurers to conduct a more thorough investigation.
Weaknesses: This option would reduce the amount of funds for payment of third-party 108(b) claims because investigation and defense costs are paid within insurance policy limits.

On balance, EPA believes that requiring both defense and investigation costs to be outside the required 108(b) limits is optimal as it best assures funds will be available to pay valid third-party CERCLA claims.

3.2.3.3. Single Policy Face Amount Without Sub-limits.

EPA believes that 108(b) insurance should contain no sub-limits but have a single face amount (or "aggregate" amount) equal to the total required amount of coverage for the facility, unless a combination of instruments is being used. EPA believes that sub-limits should not be allowed for 108(b) insurance, including annual limits and limits per claim, per occurrence, per incident, per pollution condition, and the like. EPA believes that per facility sub-limits should be allowed only when a single policy covers multiple facilities, in which case the insurance endorsement or certificate must establish per-facility sub-limits at least equal to the respective facility-specific required amounts of coverage (as discussed in Section 2.5.1 above); such a policy would carry a face amount at least equal to the sum of the individual site-specific amounts for all the facilities covered by the same insurance policy.

Current Practice. The RCRA Subtitle C Insurance Certificate for Closure or Post-Closure Care includes a requirement to enter the "face amount" of the insurance, which should be equal to or greater than the sum of the estimated individual site-specific amounts required for closure or post-closure care for all covered facilities. For example, if the closure or post-closure cost estimate is for $20 million, then the insurance must have a face amount of $20 million, unless a combination of instruments is being used. The Part 261 insurance certificate for removal and decontamination follows the Subtitle C model. These programs do not specify per occurrence or annual aggregate sub-limits.

Following industry practice for liability insurance, the endorsement and insurance certificate for RCRA liability coverage both require entering the dollar amounts for "each occurrence" and the "annual aggregate," exclusive of legal defense costs, which is how the required amounts of liability coverage are specified in the Subtitle C liability coverage regulations. The RCRA required amounts of liability coverage vary slightly depending on the hazardous waste management activities carried out. For a RCRA Subtitle C treatment, storage, or disposal facility, the rules require liability coverage for sudden accidental occurrences of $1 million per occurrence and $2 million annual aggregate. Disposal facilities must also maintain minimum coverage for nonsudden accidental occurrences in the amounts of $3 million per occurrence and $6 million annual aggregate. The Subtitle I FR program for USTs varies the required per occurrence and annual aggregate amount of coverage somewhat depending on the number of covered tanks. For owners/operators of USTs that are located at petroleum marketing facilities or that handle an average of more than 10,000 gallons of petroleum per month, the rules require liability coverage of $1 million per occurrence, and for all other owner/operators, liability coverage must be at least $500,000 per occurrence. For annual aggregate, Subpart I requires owners/operators of 1 to 100 USTs provide $1 million and owners/operators of 101 or more USTs to provide $2 million in liability insurance. The Part 261 instruments for liability coverage follow the RCRA Subtitle C liability coverage model. Unlike closure/post-closure insurance, the amounts of required liability coverage in all these RCRA programs are not the result of site-specific cost estimates but rather come from the FR rules and numbers included in those rules.

"Per occurrence" and/or "annual aggregate" sub-limits typically are used in forms of liability insurance (e.g., commercial general liability insurance, pollution liability insurance) where multiple occurrences (or claims), covered by a single policy, may arise at one or more facilities over time. The "per occurrence" and/or "annual aggregate" sub-limits usually are stated on the Declarations page of the policy. Because pollution liability insurance policies are designed to cover more than one pollution incident, claim, year, or pollution condition (and associated claims and losses) at one or more covered sites, pollution liability policies typically will specify dollar sub-limits of coverage per incident, per claim, per year, or per pollution condition.

EPA has the following options regarding sub-limits in 108(b) insurance:

- **Option 1:** Specify that no sub-limits are acceptable except for per-facility sub-limits when a single policy is covering multiple facilities
- **Option 2:** Do not address sub-limits, allowing policies to include per year, per pollution condition, per incident, per claim, and similar sub-limits.
- **Option 3:** Specify per occurrence, per incident, per claim, and or annual sub-limits of 108(b) endorsements.

Option 1: Specify that no sub-limits are acceptable except for per-facility sub-limits when a single policy is covering multiple facilities.
Strengths: Option 1 is consistent with EPA RCRA FR precedents for closure/post-closure insurance but not consistent with Subtitle C and Subtitle I liability coverage precedents. Option 1 would not constrain the potential availability of 108(b) funding to claimants: If, for example, the required amount of coverage for a facility was $20 million, a sub-limit of $5 million per incident, per claim, per year, or per pollution condition would constrain the amount of coverage available to claimants to less than the required $20 million.

Weaknesses: This option would be expected to result in marginally higher premiums charged to owners or operators. This Option also would entail marginally higher administrative burdens and costs on EPA, compared to Option 2, to verify compliance.

Option 2: Do not address sub-limits, allowing policies to include per year, per pollution condition, per incident, per claim, and similar sub-limits.
Strengths: Option 2 would be expected to result in marginally lower premiums charged to owners or operators, compared to Option 1. This Option would entail marginally lower administrative burdens and costs on EPA, which would not need to verify compliance as with Option 1.
Weaknesses: Option 2 is not consistent with EPA RCRA FR precedents for closure/post-closure insurance but is consistent with Subtitle C and Subtitle I liability coverage precedents. Option 2 would constrain the potential availability of 108(b) funding to claimants: If, for example, the required amount of coverage for a facility was $20 million, a sub-limit of $5 million per incident, per claim, per year, or per pollution condition would constrain the amount of coverage available to claimants to less than the required $20 million.

Option 3: Specify per occurrence, per incident, per claim, and or annual sub-limits of 108(b) endorsements.
Strengths: Option 3 is consistent with RCRA liability coverage.
Weaknesses: Option 3 is not consistent with closure/post-closure insurance. Option 3 would constrain the potential availability of 108(b) funding to claimants, similar to Option 2. EPA lacks a technical basis for specifying such sub-limits, especially given the wide range of total required amounts of 108(b) coverage. Option 3 would be the most burdensome for EPA to develop and implement.

EPA believes that Option 1 is preferable for 108(b) insurance. Except for per-facility sub-limits when an instrument is covering multiple facilities, any other sub-limits would not be appropriate for 108(b) coverage of a facility. Such per incident, per claim, per year, or per pollution condition sub-limits would create a potential undesirable limitation on the amount of 108(b) coverage for the facility. The Agency has opted for a single face amount approach for 108(b) insurance as the limit of liability per covered facility, regardless of how many or few incidents, claims, or pollution conditions may arise at the facility in any given time period. This face (or aggregate) amount would apply to all loss arising out of the same, continuous, repeated or related pollution condition as well as any loss from unrelated pollution conditions. Per-facility sub-limits are required for 108(b) insurance only when a policy is covering more than one facility; per incident, per claim, per year, or per pollution condition sub-limits would not be acceptable whether the policy was covering a single or multiple facilities.

3.2.3.4. Shared or segregated 108(b) limits.

EPA recognizes a robust and well-established market for pollution liability insurance products. Insurers can either create standalone 108(b) coverage policies (drawing upon language developed for commercial pollution liability policies) or bolt-on 108(b) coverage to existing commercial pollution liability policies via the required endorsement. Insurers may believe that some existing commercial pollution liability policies already provide for third-party 108(b) coverage within a broader grant of coverage, for an aggregate amount[40] at least as large as the required amount for 108(b). This scenario

[40] Section 3.2.3.3 stated EPA's position against sub-limits (whether per year, per incident, etc.) which is why this discussion addresses only aggregate amounts of coverage.

raises concerns whether "shared limits" or equivalent policy terms will provide the required amount of 108(b) coverage or whether 108(b) limits would be eroded by other (e.g., first party) covered costs and liabilities included in commercial pollution liability insurance policies. Just as EPA prefers to exclude defense and investigation costs from the limits of 108(b) insurance (as discussed in Section 3.2.3.2 above), other costs covered by a commercial pollution liability insurance policy may similarly erode the dollar limits available to 108(b) claimants in certain circumstances. This section identifies those costs along with EPA's preferred wordings of the 108(b) insurance instrument.

Current Practice. Apart from defense costs, EPA's Subtitle C and Subtitle I liability coverage regulations and required instrument wordings exclude no other costs from being within the required limits.[41] At the time that these RCRA Subtitle C and Subtitle I FR programs were being initiated, the insurance industry was developing environmental policy language specifically for off-site third-party liability coverage and for USTs, respectively. Thus EPA had no concerns that other costs, apart from defense costs, would erode the required limits within the RCRA policies.

EPA recognizes that the current robust commercial market for pollution liability insurance offers a potential platform for 108(b) coverage via insurance. EPA has conducted reviews of specimen policy language and considered the degree to which current commercial pollution liability policies as is might also satisfy 108(b) needs. For example, some commercial policies appear to cover NRDs as well as third-party clean-up claims in connection with coverage of first-party clean-up costs. As described below, commercial pollution liability policies can provide under one umbrella, coverage limits and/or sub-limits of emergency response costs[42], catastrophe management costs[43], first party remediation costs, first-party business interruption costs, investigation and legal defense costs, and first-party pollution liabilities related to non-owned off-site disposal,[44] releases associated with transportation, and pollution claims from off-site jobs the insured performed as a contractor.[45] Assuming acceptable insurance terms, conditions, exclusions, and definitions, via endorsement, as discussed in Section 3.2.9 below, a remaining question is whether limits of liability may be shared between commercial insurance and 108(b), or if 108(b) limits should be segregated in amount from other coverage available under commercial policies. In addition to having the required wording of the 108(b) insurance instrument states affirmatively that policy limits are available only and exclusively for 108(b) claims, such segregation of limits also can be accomplished by excluding costs from 108(b) limits, as with defense and investigation costs discussed in Section 3.2.3.2 above.

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[41] Certain types of claims, typically subject to other insurance products (e.g., workers compensation, employers' liability) are excluded from payment under the RCRA liability coverage rules and required wording of the instruments.

[42] These are very narrowly defined and may be subject to relatively low sub-limits (e.g., $250,000). For example, one specimen policy defines emergency response costs to mean first-party remediation costs incurred within seven (7) days following the discovery of a pollution condition in order to abate or respond to an imminent and substantial threat to human health or the environment arising out of a pollution condition on, at, under, or migrating from a covered location.

[43] This coverage addresses the insured's costs for media and public relations support and some response costs due to adverse media coverage, and may be subject to relatively low sub-limits.

[44] Non-owned location coverage does not apply to the owner or operator's facility.

[45] Coverage of claims for cleanup costs related to owner or operator "covered operations" does not include activities performed at any property which is owned, leased, rented, or managed by the insured owner or operator; "covered operations" in premises policies does not apply to the owner or operator's facility but only to off-site "job sites."

Shared Limits. Assuming otherwise acceptable terms and conditions, if 108(b) coverage were added via endorsement without segregated limits to a commercial pollution liability policy, or if third-party coverage for on-site clean-up and NRDs is already included in the policy coverage, both the 108(b) and the non-108(b) claims would share the same aggregate limits (face amount) unless further specifications were added. Shared limits raises concerns over the adequacy of the amount of coverage.[46] A single shared (non-segregated) dollar limit of liability in a policy would cover payments due in connection with third-party CERCLA claims (including NRDs) as well as payments due under other insuring agreements included in the commercial policy such as for first-party emergency response costs, catastrophe management costs, investigation costs, defense costs, first party remediation costs, business interruption costs, and off-site costs at non-owned disposal sites, non-owned work sites, and for releases associated with transportation. Although shared limits no greater than the 108(b) required amount of coverage appear inadequate, the Agency has no rational basis for setting a higher amount that would be adequate for both 108(b) claims and non-108(b) claims.

Segregated Limits. An alternative to shared limits would be to have segregated limits for 108(b) coverage. That means that the policy would guarantee coverage of the full required amount of 108(b) via endorsement apart from segregated and in addition to any other liabilities (e.g., investigation and defense costs, business interruption, non-owned disposal sites) covered under the commercial policy, which would be subject to their own negotiated limits and sub-limits, about which EPA would have no interest. Insurers might be expected to charge somewhat more for segregated limits than for shared limits, all other things being equal.

The Agency considered individually the types of costs and liabilities covered under specimen pollution liability policies and whether or not such costs should be excluded from the 108(b) limits:

- As discussed in 3.2.3.2, the Agency believes that it is appropriate to exclude from 108(b) coverage limits any coverage of investigation and defense costs.
- The Agency believes that it is appropriate to exclude from 108(b) coverage limits any coverage of off-site liability costs at non-owned disposal facilities and non-owned work sites because those sites are not included within the boundaries of the covered 108(b) facility.
- The Agency believes that it is appropriate to exclude from 108(b) coverage limits any coverage of catastrophe management costs because such costs (e.g., media consultants required due to adverse publicity) do not appear to be 107 liabilities or response costs included in the National Contingency Plan (NCP).
- Similarly, the Agency believes that it is appropriate to exclude from 108(b) coverage limits any coverage of business interruption costs and losses due to covered pollution because such first-party costs and losses (e.g., loss of income, continuing fixed expenses, rental costs) do not appear to be 107 liabilities or response costs included in the NCP.

[46] The Agency recognizes that some pollution liability policies would be issued with an aggregate amount greater than the amount required for 108(b) alone. The Agency lacks a rational basis for determining how much extra limits would be needed to compensate for other coverage for both 108(b) and non-108(b) claims under the higher policy limits of such a policy.

- On the other hand, the Agency does not believe that payments for coverage of NRDs under a commercial pollution liability policy should be excluded from 108(b) insurance limits because NRDs are CERCLA 107 liabilities that EPA intends for 108(b) to cover. In addition, payment of NRD assessment costs and liabilities under the commercial pollution liability policy would be expected to reduce dollar-for-dollar the potential need to pay those NRD liabilities as a 108(b) claim. Payment for NRD liabilities under the 108(b) limits, on the other hand, is consistent with the intent of the rules and required wording of the 108(b) instruments.
- Of the costs covered by current commercial pollution liability insurance, that leaves first-party emergency response costs and first-party remediation costs that would erode 108(b) limits if those first-party costs were allowed to share 108(b) limits. It is unclear whether such first-party costs should be excluded from 108(b) limits because the Agency believes that, all else being equal, insurer payments for first-party emergency response costs under the policy will reduce dollar-for-dollar, more or less, the potential amount of emergency response costs incurred by third-parties for which compensation may be sought under 108(b) FR. Similarly, greater payments for first-party remediation actions may decrease, dollar-for-dollar, more or less, the burden on third-parties to incur response costs, for which compensation might be sought under 108(b) FR.

Assuming the exclusion of investigation and defense costs as discussed above in Section 3.2.3.2, EPA's options for these other types of costs usually included in commercial pollution liability policies include the following:

- **Option 1:** 108(b) limits must be totally segregated and independent of limits for other covered costs and liabilities, including explicit exclusions for all the first party coverage provided by commercial pollution liability insurance.
- **Option 2:** 108(b) limits may be totally shared with other coverage provided by commercial pollution liability insurance, with no exclusions from 108(b) limits except for investigation and defense costs, as discussed above in Section 3.2.3.2.
- **Option 3:** 108(b) limits must be somewhat segregated and independent of limits for other coverage, including explicit exclusions for all other costs covered by commercial pollution liability insurance except for NRDs and first-party emergency response costs.
- **Option 4:** 108(b) limits must be somewhat segregated and independent of limits for other coverage, including explicit exclusions for all the costs covered by commercial pollution liability insurance except for NRDs, first-party emergency response costs, and first-party remediation costs.

Option 1: 108(b) limits must be totally segregated and independent of limits for other covered costs and liabilities, including explicit exclusions for all the non-107 coverage provided by commercial pollution liability insurance.
Strengths: Option 1 would allow 108(b) coverage to be provided in connection with commercial pollution liability insurance thus encouraging participation of insurers in the 108(b) program. Option 1's

totally segregated limits would provide assurance of the greatest amount of required 108(b) third-party coverage. Option 1 would also ensure parity amongst instruments as to the amount of funds available for third-party coverage.
Weaknesses: This option could be expected to increase premiums the most of these options. This option has the highest administrative burden on EPA to confirm exclusions from the 108(b) limits.

Option 2: 108(b) limits may be totally shared with other coverage provided by commercial pollution liability insurance, with no exclusions from 108(b) limits except for investigation and defense costs, as discussed above in Section 3.2.3.2.
Strengths: Option 2 would allow 108(b) coverage to be provided in connection with commercial pollution liability insurance thus encouraging the greatest participation of insurers in the 108(b) program. This option could be expected to increase premiums the least of these options. This option has the least administrative burden on EPA because the Agency would not need to confirm exclusions from the 108(b) limits (except for those discussed in Section 3.2.3.2 above).
Weaknesses: This Option appears to somewhat undermine the rationale for excluding defense and investigative costs from policy limits. Option 2's totally shared limits would provide assurance of the least amount of required 108(b) third-party coverage, with the greatest possible erosion of 108(b) limits of these options

Option 3: 108(b) limits must be somewhat segregated and independent of limits for other coverage, including explicit exclusions for all the other costs covered by commercial pollution liability insurance except for NRDs and first-party emergency response costs.
Strengths: Option 3 would allow 108(b) coverage to be provided in connection with commercial pollution liability insurance, thus encouraging participation of insurers in the 108(b) program. Option 3's partially shared limits would provide assurance of a lesser amount of required 108(b) third-party coverage than Option 1 but a greater amount than Option 2, with the possible erosion of 108(b) limits in between Options 1 and 2. Option 3 could be expected to increase premiums less than Option 1.
Weaknesses: Option 3 could be expected to increase premiums more than Option 2. Option 3 has an administrative burden on EPA similar to Option 1 because the Agency would need to confirm exclusions from the 108(b) limits (except for NRDs, emergency response costs, and those investigation and defense costs discussed in Section 3.2.3.2 above).

Option 4: 108(b) limits must be somewhat segregated and independent of limits for other coverage, including explicit exclusions for all the costs covered by commercial pollution liability insurance except for NRDs, first-party emergency response costs, and first-party remediation costs.
Strengths: Option 4 has strengths and weaknesses in between Option 2 and Option 3. Option 4 would allow 108(b) coverage to be provided in connection with commercial pollution liability insurance, thus encouraging participation of insurers in the 108(b) program. Option 4's partially shared limits would provide assurance of a lesser amount of required 108(b) third-party coverage than Option 3 but a greater amount than Option 2, with the possible erosion of 108(b) limits in between Option 2 and 3.
Weaknesses: Option 4 could be expected to increase premiums less than Option 3 but more than Option 2. Option 4 has an administrative burden on EPA similar to Option 3 because the Agency would need to

confirm exclusions from the 108(b) limits (except for NRDs, emergency response costs, site remediation costs, and those investigation and defense costs discussed in Section 3.2.3.2 above).

On balance EPA has decided to specify that the CERCLA 108(b) limits be segregated and independent of limits for other covered costs and liabilities.

3.2.4. If horizontal insurance layers required or allowed for a single facility, excess to follow form.

As described in Section 3.2.6 coverage concerning use of multiple insurers for a single facility, coverage may be complicated when shares are defined horizontally to include both primary and excess insurance policies. In addition to conflicts of interest affecting coverage, [47] coverage gaps may arise when excess policies do not "follow form" of underlying policies. For example, a gap may arise when the primary policy covers gradual pollution but the excess policy does not. A "follow form" provision means that the excess insurer agrees to abide by the terms of the primary or underlying policy(ies) to the extent that the excess policy does not contain a conflicting parallel term. "Following form", policies are intended to be read in connection with their respective underlying "followed" policies.[48] A "follow form" specification may be stated as follows:

"The insurance afforded by this policy is subject to the same terms, conditions, definitions, and exclusions as are contained in the underlying insurance [insert identification of policy including number and issuer] on the effective date of this policy, except unless otherwise explicitly provided in this policy."[49]

"Follow form" provisions are intended to simplify coverage issues, although those clauses can confuse coverage when the underlying policy is not clearly indicated (e.g., through use of a non-specific placeholder) or where multiple underlying policies contain differing language with respect to the scope or terms of coverage.[50]

Options: If EPA requires or allows multiple insurers using horizontal arrangements to cover a single facility (see discussion at 3.2.6), EPA could:

- **Option 1:** Specify that 108(b) insurance endorsements include language that excess insurance policies used for 108(b) must "follow the form" of the underlying insurance policy.
- **Option 2:** Specify that 108(b) insurance endorsements include language that excess insurance policies used for 108(b) must "follow the form" of the primary insurance policy.
- **Option 3:** Either Option 1 or 2 may be used.

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[47] Eric Hermanson and Jonathan Toren, "Layers and Gaps: Conflicts Between Primary and Excess Insurers," The Brief (American Bar Association Tort Trial and Insurance Practice Section, Fall 2015).

[48] Bert Wells, Excess Insurance, Umbrella Insurance and Multi-Insurer Coverage Programs (January 4, 2010). In contrast, "stand alone" excess policies set forth their insuring agreements, definitions, exclusions, conditions, and other terms without incorporating any of the elements of the underlying coverage.

[49] Drawn from example in William M. Savino, "Excess and Extended Coverages and Excess Coverage Issues," New York State Bar Association (February 2006).

[50] William F. Merlin, Jr., Mary E. Kestenbaum, and Kate Jordan, PLUGGING THE GAPS: Dealing with Inconsistent Terms in Your Layered Insurance, RIMS Session -- April 30, 2007.

- **Option 4:** Do not address the issue.

Option 1: Specify that 108(b) insurance endorsements include language that excess insurance policies used for 108(b) must "follow the form" of the underlying insurance policy.
Strengths: Option 1 address the potential for gaps in coverage in horizontal layers and address the potential for ambiguity in referencing the policy which is to be followed in form.
Weaknesses: Following the form of the primary policy is somewhat more likely to achieve EPA's intent than following the form of an excess underlying layer. Option 1 may reduce the availability of excess insurance because some underwriters will not want to write "follow form" coverage over policy forms with which they are not familiar.[51]

Option 2: Specify that 108(b) insurance endorsements include language that excess insurance policies used for 108(b) must "follow the form" of the primary insurance policy.
Strengths: Option 2 address the potential for gaps in coverage in horizontal layers and address the potential for ambiguity in referencing the policy which is to be followed in form. Following the form of the primary policy is somewhat more likely to achieve EPA's intent than following the form of an excess underlying layer.
Weaknesses: Option 2 may reduce the availability of excess insurance because some underwriters will not want to write "follow form" coverage over policy forms with which they are not familiar.[52]

Option 3: Either Option 1 or 2 may be used.
Strengths: Option 3 would allow either the Option 1 or the Option 2 solution to be used, providing greater flexibility for insureds and insurers; greater flexibility for the parties to the insurance can increase the administrative burden on EPA somewhat.
Weaknesses: Option 3 may reduce the availability of excess insurance because some underwriters will not want to write "follow form" coverage over policy forms with which they are not familiar.[53]

Option 4: Not address the issue.
Strengths: EPA finds that Option 4 is acceptable only if horizontal arrangements are neither mandated nor acceptable as a basis for multiple insurers covering a single facility (see discussion at 3.2.6).
Weaknesses: Option 4 would leave the potential for gaps in coverage and also potential ambiguity.

EPA has decided to require that multiple insurers covering a single facility must form vertical shares as opposed to horizontal layers and thus resolving this issue is not necessary. However, EPA would likely have a strong preference for requiring a "follow form" provision were horizontal layers to be permitted, raising the administrative burden of such an option.

[51] Michael A. Rossi, "Coverage May Not Follow Form with New Umbrella Policies," Insurance Week (March 1, 1997).
[52] Michael A. Rossi, "Coverage May Not Follow Form with New Umbrella Policies," Insurance Week (March 1, 1997).
[53] Michael A. Rossi, "Coverage May Not Follow Form with New Umbrella Policies," Insurance Week (March 1, 1997).

3.2.5. If horizontal insurance layers required or allowed for a single facility, specification of exhaustion terms and conditions, including excess "drop down" coverage.

Exhaustion of underlying limits is a common provision in excess policies, including excess "follow form" policies (see discussion in 3.2.4), that may raise coverage issues should EPA mandate or allow horizontal arrangements when multiple insurers cover a single facility (see discussion at 3.2.6). An exhaustion provision states that an excess layer of coverage cannot be triggered until all primary and underlying layers have been exhausted. Questions concerning exhaustion can arise when a primary insurer settles for less than the primary limits (e.g., with the insured itself covering the balance of the primary limits), and courts have disagreed how to handle such issues with respect to attachment of excess layers. Exhaustion clauses often state that underlying insurers must themselves make the payments exhausting the underlying layer(s), not insured.

Problems in accessing excess layers also can arise when either the insured[54] or an underlying insurer cannot pay due to insolvency. A "drop down" specification can address the situation of insolvency on the part of an underlying insurer, although other terms and conditions in the excess policy will affect whether the coverage will drop down. Notably, a "maintenance of underlying insurance" clause, for example, will typically prevent coverage from dropping down in the event of underlying insurer insolvency. Or an excess policy will include language stating that coverage will not drop down in the event of insolvency and that the insured expressly agrees to self-insure in the event of any underlying insurer insolvency.[55] One expert reports that it is apparently the rule in a majority of states that, absent language obliging an excess insurer to drop down, an excess insurer is not required to drop down and cover that portion of a loss within an insolvent primary insurer's coverage, nor must an excess insurer drop down to provide the defense that an insolvent primary insurer was obligated to fund.[56]

Options: If EPA requires or allows multiple insurers using horizontal arrangements to cover a single facility (see discussion at 3.2.6), EPA could address exhaustion and insolvency by:

- **Option 1:** Specify that exhaustion of primary and other underlying insurance can include payments by the insured as well as the insurer.[57]
- **Option 2:** Specify that exhaustion of primary and other underlying insurance can include payments by any person, including any drop down payments from other excess insurers.
- **Option 3:** Specify that excess coverage will "drop down" if underlying insurers fail or refuse to pay loss for any reason.
- **Option 4:** No action.

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[54] Insured insolvency for CERCLA claims is expressly addressed in CERCLA's "direct action" provisions, which are discussed in Section 3.2.11 below.

[55] Bert Wells, Excess Insurance, Umbrella Insurance and Multi-Insurer Coverage Programs (January 4, 2010).

[56] Robert C. Weill, "The Exhausting Task of Understanding Horizontal and Vertical Exhaustion," Trial Advocate Quarterly (Winter 2011).

[57] Bailey Cavalieri LLC, The Relationship Between Excess Follow Form and Excess Side A Policies: An Important Marriage, undated.

Option 1: Specify that exhaustion of primary and other underlying insurance can include payments by the insured as well as the insurer.[58]
Strengths: Option 1 addresses the potential for gaps in coverage in horizontal layers due to excess insurance with narrower exhaustion clauses. Reportedly, most courts have held that excess policies are obligated to provide coverage if underlying limits are paid either by the insurer or by the insured.[59] Option 1 would help to reduce the potential for unexpected gaps in coverage.
Weaknesses: May discourage insurer participation in 108(b) program.

Option 2: Specify that exhaustion of primary and other underlying insurance can include payments by any person, including any drop down payments from other excess insurers.
Strengths: Option 2 addresses the potential for gaps in coverage in horizontal layers due to excess insurance with narrower exhaustion clauses. Reportedly, most courts have held that excess policies are obligated to provide coverage if underlying limits are paid either by the insurer or by the insured.[60] Option 2 would help to reduce the potential for unexpected gaps in coverage. EPA prefers Option 2 over Option 1 because it allows more parties to exhaust primary limits.
Weaknesses: May discourage insurer participation in 108(b) program.

Option 3: Specify that excess coverage will "drop down" if underlying insurers fail or refuse to pay loss for any reason.
Strengths: Option 3 would require that excess coverage include a "drop down" provision in the event that an underlying party is insolvent and that other inconsistent provisions (e.g., "maintenance of underlying insurance") would not apply. Option 3 would help to reduce the potential for unexpected gaps in coverage.
Weaknesses: Somewhat increases administrative burden on EPA. Premiums may be higher for this option.

Option 4: No action.
Strengths: EPA finds that Option 4 is acceptable only if horizontal arrangements are neither mandated nor acceptable as a basis for multiple insurers covering a single facility (see discussion at 3.2.6).
Weaknesses: Option 4 would leave the potential for gaps in coverage unaddressed.

EPA has decided to require that multiple insurers covering a single facility must form vertical shares as opposed to horizontal layers and thus resolving this issue is not necessary. However, EPA would likely have a strong preference for requiring excess insurance include a "drop down" provision were horizontal layers to be permitted, raising the administrative burden of such an option.

3.2.6. Multiple insurers for a single facility.

An insured may choose to purchase multiple insurance policies to cover an obligation when the total amount of coverage it is seeking is large or for other reasons.[61] The use of multiple policies to assure one total obligation is sometimes described as a "tower of coverage." A tower of coverage may be created in two forms, vertical or horizontal.

[58] Bailey Cavalieri LLC, The Relationship Between Excess Follow Form and Excess Side A Policies: An Important Marriage, undated.
[59] Bert Wells, Excess Insurance, Umbrella Insurance and Multi-Insurer Coverage Programs (January 4, 2010).
[60] Bert Wells, Excess Insurance, Umbrella Insurance and Multi-Insurer Coverage Programs (January 4, 2010).
[61] Bert Wells, Excess Insurance, Umbrella Insurance and Multi-Insurer Coverage Programs (January 4, 2010).

A vertical tower is created using multiple insurers to cover fixed percentages of an obligation. In a vertical tower, several insurers each cover a percentage of total facility liability, and cover that percentage regardless of the size of the claim. For example, four insurers may engage in a vertical tower of coverage for a liability, each insuring 25% of the total liability. If a $10,000,000 claim is made, then each insurer will pay its percent share of the claim, in this instance $2,500,000 each. Vertical relationships among insurers do not change the percentage of liability covered as the dollar amount of claims changes. In a vertical tower, an insurer is responsible for its percent share if the claim is $100 or $100,000,000.

Horizontal towers are constructed by multiple insurers participating in a series of coverage agreements, that, when summed, add up to the required total amount of coverage. Horizontal tower coverage agreements are often described as 'layers' of coverage. Each insurer in the horizontal tower agrees to cover its layer of the tower, not a percentage of the total. For example, four insurers may engage in a horizontal tower to cover $10,000,000. In this example tower, there could be four layers, each covering $2,500,000 (layer 1, $1-$2,500,000; layer 2 $2,500,001-$5,000,000…etc.). If a claim is made for $5,000,000 then the insurer covering layer 1 will pay the first $2,500,000 and the insurer for layer 2 will pay the claim from $2,500,001 to $5,000,000. Because the example claim does not reach into layers 3 and 4, those insurers are not required to pay anything. Insurers of the lowest ("base") layer are often referred to as 'primary insurers' and are the first to respond to a claimed loss. "Excess" insurers – those higher up in the horizontal tower – become responsible on a layer-by-layer basis as the limits of each underlying policy become exhausted.[62] Primary insurers often charge higher premiums (e.g., per million dollars of coverage) than insurers higher up in the tower of coverage because claims are less likely to reach higher limits than to reach lower limits.[63] Environmental insurers are increasingly participating in towers of coverage to make higher insurance limits available.[64]

By participating in towers of coverage, multiple insurers share the risk of covering a facility or transaction, minimizing the amount covered by an individual insurer. Because CERCLA 108(b) FR requirements may be higher in amounts than other EPA liability coverage programs, EPA anticipates that environmental insurers may want to participate in towers of coverage to insure individual 108(b) facilities. Use of multiple insurers has not been an issue for EPA liability coverage programs under RCRA Subtitle C and I, but two other federal programs with required amounts of liability coverage ranging up to $35 and $150 million accept the use of multiple insurers to provide FR for a single facility or vessel. These two federal agencies are the Coast Guard, which requires liability coverage for vessels under CERLCA 108(a) and the Oil Pollution Act of 1990 (OPA 90), and the Bureau of Ocean Energy Management (BOEM) which requires liability coverage for vessels and facilities under OPA 90. The Coast Guard permits only vertical towers while BOEM permits only horizontal layers (with vertical elements). The Agency reviewed the experience of the Coast Guard and BOEM regarding potential insurance tower issues.

Current Practice: Under CERCLA 108(a) and the OPA, the Coast Guard requires that FR be established by any one or a combination of evidence of insurance, surety bond, guarantee, letter of credit, or self-

[62] Bert Wells, Excess Insurance, Umbrella Insurance and Multi-Insurer Coverage Programs (January 4, 2010).
[63] Eric Hermanson & Jonathan Toren, "Layers and Gaps: Conflicts between Primary and Excess Insurers," *The Brief* (American Bar Association, Tort Trial and Insurance Practice Section, Fall 2015).
[64] Willis, *Marketplace Realities & Risk Management Solutions 2007* (Nov. 2006).

insurance.[65] The Coast Guard requires that a covered vessel submit evidence of acceptable FR equal to the total amount required for each vessel.[66] The Coast Guard requires that when a vessel uses insurance to demonstrate FR, the insurer(s) must execute the "Insurance Guaranty" form (FORM CG-5586). Multiple insurers are allowed to participate in the execution of a single Coast Guard Insurance Guaranty form for a vessel.[67]

The Coast Guard's regulations limit this participation to four insurers, stating "four or fewer insurers (a lead under-writer is considered to be one insurer) may jointly execute an Insurance Guaranty (FORM CG-5586)…"[68] When several insurers jointly execute an Insurance Guaranty, those insurers are permitted to participate solely in vertical towers (termed 'layers' by the Coast Guard) based on percentage participation.[69] Participation in a horizontal tower or horizontal layering is not permissible.[70] The Coast Guard has prohibited horizontal layers because of its concern that if the insurer of a layer becomes insolvent or bankrupt, other insurers further up the chain may be under no obligation to pay their liabilities.[71] The Coast Guard's vertical tower program also limits the number of insurers that may participate in the tower to four insurers.[72] The Coast Guard has justified this limit, stating that the Coast Guard "believes this limitation is needed to provide a manageable process for claimants dealing with guarantors."[73]

Although only up to four insurers may jointly execute the Insurance Guaranty, one or more of the four insurers may act as the representative or lead underwriter of multiple other insurers who also wish to participate in the program.[74] A lead underwriter is an insurer who has executed the Insurance Guaranty form and represents additional insurers who have not executed the Coast Guard's Guaranty form. A lead underwriter is liable for the payment of sums in accordance with its stated vertical participation on the Insurance Guaranty form, but may divide its stated coverage among additional sub-insurers. A lead underwriter may have coverage or payment terms with a number of sub-insurers; however, the Coast Guard does not regulate the content or nature of those agreements in its financial assurance regulations or instrument language. Insurers that have executed the Guaranty are directly subject to claims by the insured and other third parties, while sub-insurers that have not signed the Guaranty and are represented by a liable lead underwriter are not subject to direct action claims. By allowing one or more of the four insurers to act as a lead underwriter for other insurers, the Coast Guard promotes broad participation in the FR program while limiting the number of insurers that the Coast Guard or claimants must directly interact with.

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[65] 33 USC § 2716(e), CERCLA 108(a).
[66] The 'total applicable amount' is determined by a combination of CERCLA and OPA 90 liabilities. The applicable amount under CERCLA is determined as follows: For a vessel over 300 gross tons carrying a CERCLA hazardous substance as cargo, the greater of $5,000,000 or $300 per gross ton, for any other vessel over 300 gross tons, the greater of $500,000 or $300 per gross ton. The applicable amount under OPA 90 is equal to the applicable vessel limit of liability under OPA 90 found at 33 CFR § 138.230. (33 CFR § 138.80(f)).
[67] 33 CFR § 138.80(c)(1).
[68] 33 CFR § 138.80(c)(1).
[69] 33 CFR § 138.80(c)(1)(i).
[70] 33 CFR § 138.80(c)(i), 59 FR 34220 (July 1, 1994).
[71] 59 FR 34220 (July 1, 1994).
[72] 33 CFR § 138.80(c)(1).
[73] 59 FR 34220 (July 1, 1994).
[74] 33 CFR § 138.80(c)(1).

The Insurance Guaranty form is formatted so that each insurer participating in coverage expressly documents its percentage share of liability rather than each insurer documenting a dollar layer of liability coverage. The Insurance Guaranty Form does not require that insurers document the required dollar amount of liability coverage, because that value is determined by the sum of liability under the OPA[75] and the liability under CERLCA 108(a).[76] The Coast Guard's Insurance Guarantee Form states that: "If more than one insurer executes this guaranty...each insurer is bound for the payment of sums only in accordance with the percentage of participation set forth opposite the name of the insurer below...." If more than a single insurer executes the form, then the name of the lead guarantor must be provided "having authority to bind all guarantors for actions of all guarantors under [CERCLA 108(a) and OPA] including but not limited to ... receipt and settlement of claims...."[77]

BOEM also allows multiple insurers to provide coverage for a single facility.[78] However, BOEM permits a different coverage arrangement for multiple insurers than the Coast Guard. BOEM allows the required amount of liability coverage to be provided by insurers in no more than four horizontal layers.[79] The first layer covers liability up to $35 million, the second from $35 million to $70 million, the third from $70 million to $105 million, and the fourth and final layer covers from $105 million to $150 million.[80] BOEM implemented this tiered financial responsibility program under OPA 90 based on estimated costs of a worst case oil-spill from a vessel or facility under its jurisdiction.[81] BOEM limited the number of horizontal layers to four because of "past experience that when receiving multiple insurance certificates for a facility, it was often the case that the sum of the insurance certificates did not add up to the total amount of required coverage".[82] As a result, BOEM limited the number of horizontal layers to four and required a single insurance certificate per layer.[83]

BOEM has not limited the number of insurers that may participate in a single layer, but requires that each insurer's participation be expressed as a (vertical) percentage of the layer.[84] Multiple insurers wishing to participate in providing coverage for a layer must divide the liability of the layer vertically, in similar fashion to the Coast Guard's vertical participation program. BOEM permits vertical participation shares on a percentage basis within a layer to encourage multiple insurers to participate in covering a single facility. Insurance certificates for individual layers may not contain additional horizontal sub-layers within each of the four allowed layers. BOEM's rationale for this restriction is that many times the problems of multiple insurance certificates not adding up to the total amount of required coverage was

[75] 33 CFR 138.80(f)(1).
[76] 33 CFR 138.80(f)(2).
[77] FORM CG-5586 (Expiration Date: December 2015), at https://www.uscg.mil/forms/cg/CG_5586.pdf.
[78] 30 CFR § 553.29(a).
[79] See 30 CFR § 553.29 and Form BOEM 1019 (Expiration Date: December 2016), at http://www.boem.gov/Form-BOEM-1019/.
[80] CFR § 553.13(1). Five layers are allowed for a facility not located on the outer continental shelf under OPA 90. $10,000,000; $35,000,000; $70,000,000; $105,000,000; and $150,000,000. (30 CFR § 553.13).
[81] BOEM authority provided by OPA 90.
[82] 63 FR 42704 (August 11, 1998). BOEM has also cited the additional reason for limiting the number of layers to four, "very few designated applicants will use insurance to demonstrate OSFR (Oil Spill Financial Responsibility) for amounts over $35 million… [and those with liabilities over $35 million will] probably use self-insurance or an indemnity."[82]
[83] 30 CFR § 553.29(c)(2).
[84] 30 CFR § 553.29(c)(4).

"associated with 'horizontal layering'", and BOEM prohibited horizontal sub-layering within established FR layers in order to minimize certificate issues.[85]

BOEM's implementation of its combined horizontal and vertical participation program for multiple insurers is outlined in its Insurance Guaranty Form. The Form outlines the format for each horizontal layer as follows:

Exhibit 2 – BOEM Insurance Guarantee Form (Multiple Insurer Participation Pt. 1)

2. The amount of insurance coverage established by the named Insurers as evidence of oil spill financial responsibility (OSFR) for the Responsible Parties, identified in form(s) BOEM-1017 on file or attached, (hereafter the Insured), as represented by the Designated Applicant, in compliance with the Oil Pollution Act of 1990, as amended, 33 U.S.C. §§ 2701-2672 (hereafter the Act) and with Title 30 Code of Federal Regulations (CFR), part 553, for any one incident is:

FROM $_____ (STARTING AMOUNT ABOVE ANY DEDUCTIBLE OR EXCESS AMOUNT) TO: $_____ (UPPER LIMIT OF THIS INSURANCE LAYER)

The following insurance option has been selected to provide this coverage:

☐ Full Option—Insurance is provided for the first full $_____ million without deductible.

☐ Deductible Option—Insurance is provided for the amount of $_____ million less the deductible amount of $ _____.

☐ Excess Option—Insurance is provided for the amount of $_____ million in excess of the amount of of $ _____ million.

The form goes on to require that the applicant certify that the quota share (vertical participation) program within each horizontal layer sums to 100 percent, and requires that each insurer be listed with its quota share.

Exhibit 3 – BOEM Insurance Guarantee Form (Multiple Insure Participation Pt. 2)

10. As an Authorized Representative of the insurance agent or broker identified above, I certify that the information contained in this Insurance Certificate is accurate and correct, that quota shares total 100 percent for this Insurance Certificate, and that this Insurance Certificate and the named Insurers, complies with the requirements stated in 30 CFR 553.29. The identified insurance agent or broker agrees to maintain and provide to the Designated Applicant and BOEM, on demand, any delegations of authority to a broker or an underwriter of another insurer or underwriting manager to bind a named Insurer to all risks and liabilities specified in Title I of the Act.

_____ NAME _____ SIGNATURE

_____ TITLE _____ DATE

11. The named Insurers, listed below, certify that the Insured is insured by the named Insurers for the offshore facilities, as specified below, against liability for removal costs and damages to which the Insured could be subjected under Title I of the Oil Pollution Act and 30 CFR 553 within the insurance layer specified.

The following offshore facility coverage option has been selected:

☐ General Option—All covered offshore facilities for which the named Designated Applicant serves in that capacity.

☐ Schedule Option— All covered offshore facilities on the Designated Applicant's attached information form and schedule of properties forms, effective _____ (DATE).

[85] 63 FR 42704 (August 11, 1998).

14. The following named Insurers hereby certify their participation on this (continued).

BOEM ID NUMBER	INSURER'S NAME	QUOTA SHARE	AUTHORIZED SIGNATURE
SUBTOTAL FROM PREVIOUS PAGE			
	TOTAL QUOTA SHARE (MUST EQUAL 100%)		

Potential EPA Issues and Options related to Multiple Insurers. In light of the above, EPA has three general issues to address: (1) whether or not EPA will allow multiple insurers to participate in providing 108(b) coverage for a single facility, (2) whether or not to cap the number of insurers if EPA chooses to allow multiple insurer participation, and (3) how to structure the relationship among multiple insurers if EPA chooses to allow multiple insurer participation in covering a single facility under 108(b).

Issue 1: Allow multiple insurers to provide 108(b) coverage per facility.

EPA regulatory programs provide little precedent with respect to allowing multiple insurers per facility. The Coast Guard and BOEM both allow multiple insurers to provide coverage for a single facility or vessel.

Potential EPA Options for Multiple Insurers for 108(b):

- **Option 1:** Allow multiple insurers to provide coverage for a single facility.
- **Option 2:** Permit only one insurer to provide coverage for a single facility.[86]

Option 1: Allow multiple insurers to provide coverage for a single facility.
Strengths: Multiple insurers may increase the availability of coverage for 108(b) facilities. Multiple insurers may be able to cover higher amounts than a single insurer. Allowing multiple insurers to provide coverage may increase the number of insurers participating in the 108(b) program. Used by the Coast Guard and BOEM.

[86] Option would allow 1 insurer plus other instruments.

Weaknesses: According to the Coast Guard and BOEM, multiple insurers for a single facility increase administrative burdens on the regulating agency and claimants. Multiple insurers, if organized in horizontal layers, also present the potential for one or more insurers to go bankrupt, voiding the responsibility of higher-level insurers providing coverage for the same facility.

Option 2: Permit only one insurer to provide coverage for a single facility.[87]
Strengths: May ease administrative burdens for the facility, claimants, and the Agency as multiple insurers and certificates can be difficult to manage and enforce (as stated by the Coast Guard and BOEM). Ensures that a single insurer will be responsible if a coverage issue or claim arises.
Weaknesses: May limit insurer participation in the program. A single insurer may not be willing to take on the potentially high amount of coverage necessary for some 108(b) facilities.

Issue 2: Cap the number of insurers eligible to provide coverage for a single facility if multiple insurers are permitted to provide coverage.

EPA regulatory programs provide little precedent for this issue. Therefore, the Agency reviewed the experiences of the Coast Guard and BOEM.

Potential EPA options for capping the number of 108(b) insurers for a single facility:

- **Option 1:** Permit an uncapped number of insurers to participate in providing coverage for a single facility.
- **Option 2**: Cap the number of insurers to a set number.
- **Option 3:** Cap the number of insurers but allow them to act as lead underwriters for other insurers.

Option 1: Permit an uncapped number of insurers to participate in providing coverage for a single facility.
Strengths: Multiple insurers may permit greater amounts of insurance to be covered, because each insurer could cover a smaller amount of liability. Used by BOEM.
Weaknesses: An uncapped number of insurers could create administrative issues for EPA and claimants. As the Coast Guard and BOEM have referenced, a large number of insurers is difficult to oversee and increases the administrative burden following a claim.

Option 2: Cap the number of insurers to a set number.
Strengths: Would limit the administrative burden on the Agency. Would simplify interaction among participating insurers. Would provide clear points of contact for the Agency and claimants.
Weaknesses: May decrease the number of insurers willing to participate in the program.

Option 3: Cap the number of insurers but allow them to act as lead underwriters for other insurers.
Strengths: Would limit the administrative burden on the Agency. Would simplify interaction among participating insurers. Would provide clear points of contact for the Agency and claimants. Allowing lead underwriters would promote increased participation in the 108(b) program. Used by the Coast Guard.

[87] Option would allow 1 insurer plus other instruments.

Weaknesses: May decrease the number of insurers willing to participate in the program. Agency and claimants may encounter unexpected issues with lead underwriter managing multiple insurers.

Issue 3: Structure the relationship among insurers if multiple insurers are allowed to provide coverage.

If EPA decides to allow multiple insurers, it can apply vertical and/or horizontal towers to structure the relationship among multiple insurers.

Potential EPA options for 108(b):

- **Option 1:** Allow only vertical towers of coverage for multiple participating insurers.
- **Option 2:** Allow only horizontal towers of coverage for multiple participating insurers.
- **Option 3:** Allow a combination of horizontal and vertical towers.

Option 1: Allow only vertical towers of coverage for multiple participating insurers.
Strengths: Allowing vertical participation simplifies the relationships among insurers because each insurer has a set percentage of total liability to cover and must cover that percentage of liability regardless of the size of the claim. Potentially less burdensome than horizontal layers because EPA will only have to review percent shares. Consistent with approach for multiple instruments (see discussion at Section 2.3.2). Used by the Coast Guard.
Weaknesses: Some insurers may prefer to insure only as an excess insurer and not be a primary insurer.

Option 2: Allow only horizontal towers of coverage for multiple participating insurers.
Strengths: Horizontal towers or layers may encourage more insurers to participate in providing coverage because insurers will have the option of choosing which layer to insure. An established way for insurers to organize towers of coverage.
Weaknesses: Presents the opportunity for insurer covering higher coverage layers to avoid liability if an insurer on a lower level becomes insolvent and cannot cover the liability within its layer. Burdensome because EPA would need to ensure that each layer of coverage fits with the layers above and below. EPA would also need to ensure that the layers contained exhaustion provisions (see discussion at 3.2.5). Inconsistent with approach for multiple instruments (see discussion at Section 2.3.2).

Option 3: Allow a combination of horizontal and vertical towers.
Strengths: Most likely to attract insurer participation in the program. Allows insurers to choose which level of coverage they wish to provide. Used by BOEM.
Weaknesses: Complexity for Agency and claimants. Presents the opportunity for insurer coving higher coverage layers to avoid liability if an insurer on a lower level becomes insolvent and cannot cover the liability within its layer. Burdensome because EPA would need to ensure that each layer of coverage fits with the layers above and below. EPA would also need to ensure that horizontal layers contained follow form, drop down, and exhaustion provisions. Inconsistent with approach for multiple instruments (see discussion at Section 2.3.2).

In light of the above, the Agency has determined that CERCLA 108(b) insurance documentation shall allow for up to four insurers to provide insurance coverage and that each insurer be liable for their individual vertical percentage share of the total CERCLA 108(b) financial responsibility amount provided by the group of insurers.

3.2.7. Joint and several liability required where multiple insurers involved.

If multiple insurers are permitted to provide coverage for a single facility subject to CERCLA 108(b), EPA researched whether or not to require joint and several liability for claims made under 108(b). With joint and several liability, each insurer would be liable for the full extent of a claim regardless of its stated liability limit (or share of coverage) (see discussion of multiple insurers at Section 3.2.6). If, for example, four insurers each covered 25% of the required amount of coverage, then, under joint and several liability, any one of the insurers would be responsible for up to 100% of the required amount and would have to sue or settle with the other insurers to recover their shares. Joint and several liability has been implemented in environmental statutes and regulations; shifting the risk of the entire liability onto each of the liable parties to reduce the risk that a liability will not be paid by one or more liable parties and to reduce the burden on claimants pursuing multiple insurers. In its RCRA FR programs, the EPA has not directly addressed the issue of multiple insurers for a single facility nor the joint and several liability of multiple insurers and other guarantors. Other federal agencies have addressed these issues and may provide precedent for EPA. Two of these agencies are the Coast Guard and BOEM. The Agency decided to research how the Coast Guard and BOEM addressed the issue of joint and several liability of insurers in their CERCLA 108(a) and OPA regulations and financial instruments.

Current Practice: The Coast Guard, under the authority of CERCLA 108(a) and OPA 90, allows multiple insurers to provide coverage for a single vessel through participation in a vertical quota system (see discussion at Section 3.2.6). In that vertical system, each insurer must state the percentage share of total liability that it will cover for an individual facility. The percentage stated on the Insurance Guaranty Form is the maximum amount of liability that the insurer shall be required to cover.

However, if an insurer(s) does not expressly state its percentage liability to the Coast Guard, the insurer(s) shall be jointly and severally liable for the total of the unspecified portions. Insurers specifying percentages will be liable only up to the respective limits, as required by statute. The Coast Guard clarified the intent of this regulation in the preamble of its 1994 rule saying, "that the Coast Guard considers this an important incentive to permit new providers of financial responsibility to become guarantors under OPA 90 and CERCLA."[88] In addition to requiring joint and several liability when individual insurers fail to specify percentage shares, if the vertical percentages of multiple insurers do not add up to 100%, then the Coast Guard will hold all insurers jointly and severally liable for the unattributed percentage.[89] This appears to be an expansion of authority that may conflict with the requirement that guarantors' liabilities are limited to the amounts assured by their instruments.

The required wording of the Coast Guard's insurance instrument states, "If no percentage of participation is indicated for an Insurer or Insurers, the liability of such Insurer or Insurers shall be joint and several for the total of the unspecified portions."[90]

BOEM, under the authority of OPA 90, allows multiple insurers to provide coverage for a single facility or vessel through participation in a horizontal layer system (see discussion at Section 3.2.6). In that system, an insurer must state its percentage share of liability for each horizontal layer.

[88] 59 FR 34220, (July 1, 1994).
[89] 59 FR 34220, (July 1, 1994).
[90] FORM CG-5586 (Expiration Date: December 2015).

Neither BOEM's regulations nor the required wording of the insurance instrument directly address the issue of joint and several liability although the regulations imply that joint and several liability shall not apply to insurers who state a quota share of insurance participation in the Insurance Guaranty Form.

BOEM clarified the issue of joint and several liability with regards to liability limits in the preamble to BOEM's 1998 final rule. In the preamble, BOEM was asked by a commenter to clarify how OPA's joint and several liability provision applies to a guarantor providing insurance. The commenter expressed concern that an individual insurer might be subject to liability beyond its specified quota share of the guaranty. BOEM responded, "Our intent is to limit an insurer's liability to the quota share of risk indicated on an insurance certificate that we accept as OSFR evidence. This limit to guarantor liability is now specified in § 253.61(b) of the rule."[91] BOEM does not address on whom liability would fall if the total quota share of each layer did not sum to 100% or if an insurer did not list a percentage share on the insurance guaranty form. BOEM's joint and several liability policy is not expanded on in BOEM's insurance instrument, which makes no mention of joint and several liability for insurers.

Potential Joint and Several Liability Options for EPA: EPA has three potential options to consider when deciding about joint and several liability specifications in 108(b) insurance instruments for multiple insurers covering a single facility.

- **Option 1:** Do not impose joint and several liability requirements on multiple insurers providing coverage for 108(b) facilities.
- **Option 2:** Impose joint and several liability requirements for multiple insurers.
- **Option 3:** Impose joint and several liability requirements on multiple insurers only if initial percentage allocations of coverage are less than 100%.

Option 1: Do not impose joint and several liability requirements on multiple insurers providing coverage for 108(b) facilities.
Strengths: Not including a joint and several liability specification in either the regulations or the required wording of the instrument(s) may encourage insurers to participate in the 108(b) program. Consistent with EPA's approach to multiple 108(b) instruments (see discussion at 2.3.2). Consistent with CERCLA approach under 108(d)(1) for direct action. Used by BOEM.
Weaknesses: May enhance the risk that should an individual insurer not pay its share of coverage, that portion of liability may not be covered by any guarantor. Decreases the likelihood that all claims will be paid, regardless of the financial status of insurers.

Option 2: Impose joint and several liability requirements for multiple insurers.
Strengths: Including a joint and several liability provision will ensure that the entire amount of required liability will be covered by insurers regardless of individual insurer financial status.

[91] 63 FR 42704 (August 11, 1998). §253.61 was moved to § 553.

Weaknesses: May discourage insurers from participating in the 108(b) program. May raise questions about EPA authority. Inconsistent with EPA's approach to multiple 108(b) instruments (see discussion at 2.3.2). Inconsistent with CERCLA approach under 108(d)(1) for direct action.

Option 3: Impose joint and several liability requirements on multiple insurers only if initial percentage allocations of coverage are less than 100%.
Strengths: Will ensure that the entire amount of required liability will be covered by insurers regardless of initial gaps; should incentivize insurers to police coverage statements. Used by the Coast Guard.
Weaknesses: May raise questions about EPA authority. Inconsistent with EPA's approach to multiple 108(b) instruments (see discussion at 2.3.2). May discourage insurers from participating in the 108(b) program.

In light of the above considerations, EPA has chosen option 1 - to not impose joint and several liability on multiple insurers.

3.2.8. One document per facility or per insurer.

If EPA decides to allow multiple insurers to insure a single 108(b) facility, EPA must determine whether to require one insurance document per facility or one insurance document for each insurer participating in providing coverage. If EPA requires one document per facility, then the document would collectively describe each insurer's vertical and/or horizontal shares of the required total amount of coverage. Alternatively, if EPA required one document per insurer, then the document would describe separately each insurer's vertical and/or horizontal shares of the required total amount of coverage.

There are several advantages to having multiple insurers on one EPA endorsement including, decreasing administrative burdens for the Agency and easing the burden of claimants in finding liable insurers. Having multiple insurers sign the same piece of paper would be more efficient for EPA. Currently, the CG and BOEM permit multiple insurers to sign a single endorsement, but have limited the number of insurers that may sign the document. Conversely, FMCSA's MCS-90 endorsement for motor carrier public liability requires insurers to each submit their own endorsements.

While there are significant administrative advantages to requiring multiple insurers to sign a single endorsement, that is not the way the industry prefers to operate and may adversely impact insurer participation in the 108(b) program.

Currently there is little existing EPA precedent regarding the number of FR documents when multiple insurers cover a single facility (see discussion in Section 3.2.6 above). Therefore, EPA reviewed the document procedures in comparable Coast Guard and BOEM FR programs allowing multiple insurers.

Current Practice: As stated in Section 3.2.6, the Coast Guard allows multiple insurers to participate in providing coverage for a single vessel; however, the Coast Guard has limited participation to no more than four insurers.[92] These insurers may execute a single insurance guaranty form that expressly states

[92] 33 CFR § 138.80(c).

each insurer's vertical participation as a percentage share of the FR liability.[93] If multiple insurers provide coverage for a single vessel, then a lead insurer must be designated having the authority to bind all participating insurers for actions required of them under CERCLA and OPA 90.[94] Although the regulations do not indicate that multiple insurers must execute a single insurance guaranty form, the Coast Guard's Insurance Guaranty Form, Form CG-5586, allows for a single form to be submitted by the lead insurer. Although the submission of a single document appears to be implied in the regulations,[95] the regulations and Insurance Guaranty instrument do not expressly prohibit the submission of multiple insurance documents per vessel.

The Coast Guard's rationale for permitting a single document per vessel is not expressly discussed in the preamble to the Coast Guard's 1994 and 1996 rules, but may be intended to decrease administrative burdens. As stated in Section 3.2.6, the Coast Guard expressed concern over dealing with a large number of insurers providing coverage for a single vessel. For this reason, the Coast Guard limited the number of insurers allowed to execute an insurance guaranty to four and required the insurers to designate a lead insurer. Although not expressly stated, the Coast Guard may have chosen to allow a single document to minimize the administrative burdens associated with multiple documents from multiple insurers.

In similar fashion to the Coast Guard, BOEM requires that an insured submit information about its insurers to BOEM on a "completed and unaltered" Form BOEM-1019 if the insured chooses to demonstrate FR through insurance.[96] If multiple insurers are to be used, then information concerning each insurer and its participation "must" be executed on one original insurance certificate (Form BOEM-1019) for each approved layer.[97] Therefore, the maximum number of documents BOEM could receive per facility is four.[98] However, one insurance certificate may be used to cover any number of consecutive OSFR layers.[99] BOEM decided to cap the number of acceptable insurance documents to one per horizontal layer in part due to BOEM's experience that multiple insurance documents from multiple insurers often do not add up to the total amount of coverage required.[100] BOEM also stated that, "insurance certificate problems likely would increase with the number of certificates".[101] By capping the number of submitted documents, BOEM minimizes administrative burdens and reduces potential confusion on the part of claimants. BOEM also stated that problems with documents are most often associated with horizontal layering, and that verifying that the total amount of the aggregate coverage was properly allocated among participating insurers is a burdensome process for regulators and reviewers.[102] As a result, BOEM established discrete insurance layers and required that, if multiple insurers were participating per layer, each layer's document indicate each participant's vertical quota share in the total amount covered by the document.[103] By requiring one document per horizontal layer,

[93] A guaranty form without specified percentage shares for certain insurers is also acceptable, because the liability for an insurer with an unspecified percentage shall be joint and severable for the total of the unspecified portion of the guaranty (33 CFR § 138.80(c)(i)).
[94] 33 CFR § 138(c)(1)(ii).
[95] 33 CFR § 138(b)(1).
[96] 30 CFR § 553.29(b).
[97] 30 CFR § 553.29(b)(2).
[98] Potentially five if the vessel being insured is located off the continental shelf.
[99] 30 CFR § 553.29(c)(3).
[100] 63 FR 42704 (August 11, 1998).
[101] 63 FR 42704 (August 11, 1998).
[102] 63 FR 42704 (August 11, 1998).
[103] Form BOEM-1019 (Expiration Date: December 2016).

with the summed total of any vertical coverage within each horizontal layer clearly stated in the layer's document, BOEM has minimized regulatory burdens by limiting administrative review to up to four completed insurance documents.

EPA has three potential options when considering how many evidentiary insurance documents a single CERCLA 108(b) facility can submit when using multiple insurers to cover a single facility.

Potential EPA Options for the number of documents to allow a single facility using multiple 108(b) insurers to submit:

- **Option 1:** Allow each insurer to submit an individual document that describes the individual insurer's vertical and/or horizontal share (as discussed in Section 3.2.6) of the FR liability.
- **Option 2:** Require no more than one insurance document for each facility. Specify that, when multiple insurers participate, a 108(b) endorsement must describe every insurer's vertical and/or horizontal shares of the required total amount of coverage. Designate one insurer as the lead.
- **Option 3:** If horizontal layering is allowed, require one document per layer. Specify that the single document representing that layer must describe the collective shares of each insurer's participation (vertical/horizontal) in that layer. One document per horizontal layer is used by BOEM.

Option 1: Allow each insurer to submit an individual document that describes the individual insurer's vertical and/or horizontal share (as discussed in Section 3.2.6) of the FR liability.
Strengths: May encourage insurers to participate, and provide an opportunity for higher amounts of insurance to be reached. One document per insurer will allow the Agency to clearly identify the participation of every single insurer.
Weaknesses: Multiple insurance documents may increase administrative burdens for regulators and may confuse claimants, particularly in a direct action claim (as discussed in Section 3.2.11). The sum of individual participation shares may not equal the total amount required for the facility.

Option 2: Require no more than one insurance document for each facility. Specify that, when multiple insurers participate, a 108(b) insurance document describes every insurer's vertical and/or horizontal shares of the required total amount of coverage. Designate one insurer as the lead.
Strengths: Minimizes administrative burdens on EPA. Easier to find the appropriate parties for claimants. Requires that insurers appoint a lead to act on behalf of and have the authority to bind the co-insurers. Used by the Coast Guard.
Weaknesses: Not the way that the insurance industry prefers to operate. May limit the number of insurers participating in the program because insurers may prefer to file their own forms with EPA and not appoint a lead. A single document per facility may not clearly explain the coverage of all parties involved. A lead underwriter may have difficulty binding other insurers.

Option 3: If horizontal layering is allowed, require one document per layer. Specify that the single document representing that layer must describe the collective shares of each insurer's participation (vertical/horizontal) in that layer. One document per horizontal layer is used by BOEM.

Strengths: Less administrative burden for EPA than allowing one document per insurer because of fewer documents to review. Requiring a single document per layer may allow EPA and claimants to see the specific coverage arrangement within each layer without over-complicating the document.
Weaknesses: Greater administrative burden than requiring a single document per facility. Complexity could adversely affect claimants.

In light of the above, the Agency has decided to require one document per insurer. Although there are significant advantages to requiring multiple insurers to sign a single EPA endorsement, insurers have historically preferred to sign and submit their own insurance endorsements. Requiring multiple insurers to sign the same endorsement may adversely impact insurer participation in the 108(b) program. Given that the maximum number of insurers will be limited to four (see Section 3.2.6 Multiple insurers for a single facility) EPA believes allowing up to four documents will be a manageable and slight increase in burden that may help encourage participation.

3.2.9. Potential coverage restrictions from exclusions, conditions, similar clauses, and defenses.

Pollution liability insurance policies[104] are long, complex contracts that operate as a whole to define and restrict the coverage provided. When issued, policies typically start with a "Declarations" page, followed by detailed (e.g., 10-30 pages in length) terms and conditions in the body of the policy, and end with multiple site-specific endorsements and attachments.

- The Declarations page provides a summary of the policy's coverages including dollar limits, term of the policy (i.e., effective and expected termination date),[105] covered operations (for 108(b) the operations would include, at a minimum, hard rock mining and/or mineral processing) at the facility,[106] and any retroactive date (discussed below in Section 3.2.9.1 on Temporal Coverage Restrictions).
- The body of the policy follows no standard format but typically includes the following major sections: Insuring Agreements, Exclusions, Notice and Claims Provisions, Limits of Liability, Conditions, and Definitions. Insurance coverage may be affected by all of these provisions.
- Endorsement pages may modify the policy's terms and conditions, list ("schedule") covered or excluded locations, and/or identify documents provided to the insurer by the insured which disclose the insured's knowledge of site conditions or risks.

Pollution liability policies have no standardized terms and provisions, meaning that each insurer's policies differ from each other's although certain provisions may be similar in language or effect across insurers. The Agency developed the following information about policy terms and conditions after

[104] This report does not analyze the terms and conditions of "Environmental Impairment Liability" (EIL) policies sold in the 1980s which were supplanted in the 1990s by modern pollution liability policies, which may be called premises liability, pollution legal liability, pollution remediation legal liability, and similar labels.
[105] Premises coverage is advertised with up to 5-10 year terms; contractors' policies have shorter terms, typically from 1 to 3 years. Policies can be renewed with mutual consent.
[106] Contractors' operations at hard rock facilities may be more narrowly defined, such as blasting or earthmoving operations, but 108(b) coverage must apply to the entire facility.

compiling more than a dozen "specimen" pollution liability policies[107] posted on-line by seven insurers in 2015, reviewing specimen "premises" and "contractors" policies, and studying applicable expert literature. The major sections of the body of a pollution liability insurance policy are described next.

"Insuring Agreements" list the specific first-party (i.e., the insured's) and/or third-party (i.e., other parties') claims or losses covered by the policy. A policy may contain from one to a dozen insuring agreements. First-party pollution liability coverage includes insurance for clean-up or remediation costs as well as for other loss such as NRDs.[108] Other first-party insuring agreements available for purchase under pollution liability polities include coverage of emergency response costs[109], catastrophe management costs[110], business interruption costs, investigation and legal defense costs, and first-party pollution liabilities related to non-owned off-site disposal,[111] releases associated with transportation, and pollution claims from off-site jobs the insured performed as a contractor.[112] The insuring agreements may be where the insurer states whether defense costs are inside or outside the limits of liability (see Section 3.2.3.2 above for further discussion of defense costs).

Insuring agreements in pollution liability policies may provide different (or no) coverage depending on when pollution conditions first commenced or were first discovered, when claims were first made, and whether the pollution was known, disclosed, or unknown. For example, an insuring agreement may require that the covered pollution conditions resulting in claims must first arise during the policy period, thereby excluding pre-existing pollution conditions, whether or not known to the insured. Other insuring agreements may cover pre-existing pollution conditions that result in claims first made and reported during the policy period. Coverage of pre-existing pollution conditions may differ depending on whether the insured knew of the pre-existing condition (and disclosed it) or whether the pre-existing condition was first discovered during the policy period. Some insuring agreements cover "new" pollution conditions that commence after a specified date of the policy and which the insured first discovers after that date. Some insurers offer more of these distinct coverage options than do other insurers. All of these specific insuring agreements may be limited to first-party clean-up costs of the insured itself.[113]

Insuring agreements in current pollution liability policies also may cover third-party claims. For example, pollution liability policies may cover third-party claims for off-site personal injury, property damage, NRDs, and cleanup beyond the boundaries of the insured property.[114] Coverage of third-party claims for

[107] Insurers do not provide on-line blank specimen forms for either Declarations or Endorsements.
[108] Policies may treat NRDs either as first party property damage or as third-party claims.
[109] These are very narrowly defined and may be subject to relatively low sub-limits (e.g., $250,000). For example, one specimen policy defines emergency response costs to mean first-party remediation costs incurred within seven (7) days following the discovery of a pollution condition in order to abate or respond to an imminent and substantial threat to human health or the environment arising out of a pollution condition on, at, under, or migrating from a covered location.
[110] This coverage addresses the insured's need for media and public relations support and some response costs due to adverse media coverage concerning a pollution condition and may be subject to relatively low sub-limits.
[111] Non-owned location coverage does not apply to the owner or operator's facility, which is the focus of 108(b).
[112] Coverage of claims for cleanup costs related to owner or operator "covered operations" does not include activities performed at any property which is owned, leased, rented, or managed by the insured owner or operator; "covered operations" does not apply to the owner or operator's facility but only to off-site "job sites."
[113] Section 3.2.3.4 above considers the fine line between first-party and third-party claims for on-site clean-up.
[114] This coverage was sold in the 1980s as Environmental Impairment Liability (EIL) insurance. By 1985, because general liability policies included an "absolute pollution exclusion", insureds wanting pollution cover (especially for

on-site pollution liabilities and NRDs also may be offered. Just as with first-party coverage, coverage of third party claims may be differentiated in terms of "new" pollution conditions only, pre-existing pollution conditions known and disclosed to the insurer, and unknown or undisclosed pre-existing conditions.

Exclusions. These describe what is not covered by the insuring agreements, such as the following:

- Insured's intentional, willful, or deliberate non-compliance with any statute, regulation, ordinance, administrative complaint, notice of violation, notice letter, order, or instruction of any governmental agency or body,
- Insured's prior knowledge of pollution conditions not disclosed to the insurer, and
- Pollution conditions at any property owned, leased, rented, or occupied by the insured which the insured sold, leased, gave away, abandoned, or relinquished operational control of prior to the policy's inception date.

Pollution liability policies have numerous exclusions, some of which may raise questions of suitability for 108(b). Potentially problematic provisions include exclusions for pre-existing pollution conditions, pre-existing claims, and/or for prior acts or operations at the facility, exclusions of specific areas within the facility, exclusions for changes in operations, exclusions for the insured's intentional non-compliance with environmental laws and government orders, exclusions for known (but not disclosed) pollution conditions, owned property exclusions, and retroactive dates. Exclusions are addressed below in Sections 3.2.9.1 – 3.2.9.5 which review common exclusions, conditions, or other restrictions (e.g., retroactive dates) on coverage that may raise issues for 108(b).

Conditions. Coverage also depends on the insured's compliance with specified policy "Conditions," such as the following:

- Cooperation in the investigation and defense of claims,
- No voluntary payments or settlements without the consent of the insurer,
- No material misrepresentation by the insured,
- Compliance with the material terms, conditions, or policy obligations including payments of premium, when due, and
- No change in facility operations that materially increases a risk covered under the policy

Conditions describe the actions that the insured must take or continue to take for the insurance policy to remain in force and for the insurer to process a claim. For example, the insured must cooperate with the insurer in defense of a liability suit. And the insured must agree on binding arbitration to resolve disputes. Conditions also may include actions that the insured is not to take, such as agreeing on a settlement without the consent of the insurer or making "voluntary" payments. Conditions on coverage that may raise concerns for 108(b) are discussed in Section 3.2.9.4 below. Cancellation conditions are analyzed separately in Section 3.2.12 below.

"gradual pollution") purchased new "claims made" forms of environmental impairment liability (EIL) insurance which focused on third-party offsite environmental liabilities.

Notice and Claims Provisions. Timely notification is a requirement of pollution liability policies, whether or not described as a condition of coverage. Pollution conditions, whether pre-existing or new, that the insured first discovers during the policy period, must be reported to the insurer (and the appropriate government agency(ies)) even if there is no resulting claim. In addition to requiring notice to the insurer of pollution conditions and claims, at least one specimen policy encourages the insured to give written notice of a "possible claim;" the incentive for so reporting is extension of coverage for 5 years after the end of the insurance (including any renewal) for "possible claims" that become actual claims made and reported.

Claims provisions attempt to clarify treatment of pollution conditions and/or claims that affect more than one policy period. These include continuous, repeated, or related exposures, also known as "gradual" pollution. In order to avoid "stacking" of limits across all affected policies, claims provisions may specify that the claim will be considered as occurring entirely in the first affected policy alone. By adopting a face value approach (discussed in Section 3.2.3.3) rather than a "per condition" or "per incident" approach to limits of liability, the Agency expects that 108(b) insurance can avoid stacking issues.

Limits of Liability. An insurance policy includes information on the specific limits of coverage afforded, typically in dollar terms. A policy also may provide dollar sub-limits for particular elements of coverage and, in so doing, may restrict the scope of the covered elements as well as the available dollar amounts of coverage. The limits of liability section of the policy presents the maximum dollar amounts available for one or more different coverages bought by the insured, including any coverage sub-limits, and per incident, per claim, per occurrence, per year limits (if any), and the maximum aggregate amount available for the policy as a whole. Some of this information is summarized in the Declarations. Each of the coverages purchased by the insured will draw upon the policy's total limits of liability, and each may have its own aggregate sub-limit and/or sub-limits per incident or per occurrence. Monetary limits are discussed further in Section 3.2.3 above.

Definitions. This section of the policy defines key terms which reverberate throughout the policy. The "Definitions" section of a policy can affect scope of coverage, including how the following terms are defined:

- Claim
- Clean-up costs
- Covered property
- Loss
- Natural resource damage
- Pollution and Pollution conditions
- Property damage
- Remediation costs

Notably similar provisions across insurers and specimen policies, relevant to 108(b), include broad definitions of pollutants, pollution conditions, and natural resource damages. For example, one specimen policy defines "pollution condition" to mean:

> The discharge, dispersal, release, escape, migration, or seepage of any solid, liquid, gaseous or thermal irritants, contaminant, or pollutant, including soil, silt, sedimentation, smoke, soot, vapors, fumes, acids, alkalis, chemicals, electromagnetic fields (EMFs), hazardous substances, hazardous materials, waste materials, "low-level radioactive waste", "mixed waste", and medical, red bag, infectious or pathological wastes, on , in, into, or to land and structures thereupon, the atmosphere, surface water, or groundwater.

Other specimen policies reviewed by the Agency employ similarly broad definitions. Although all pollution liability insurance policies do not cover NRDs,[115] those that do define NRDs broadly, as shown in the following example:

> "**Natural resource damage**" means injury to, destruction of, or loss of, including the resulting loss of value of, fish, wildlife, biota, land, air, water, groundwater, drinking water supplies, and other such resources belonging to, managed by, held in trust by, appertaining to, or otherwise controlled by the United States of America (including the resources of the fishery conservation zone established by the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. §1801 et seq.)), any state, commonwealth or local government, or any Native American Tribe, or, if such resources are subject to a trust restriction on alienation, any member of any Native American Tribe, including the reasonable costs of assessing such injury, destruction or loss resulting therefrom.

As seems typical for pollution liability policies covering NRDs, this definition explicitly includes NRD assessment costs.

Specimen premises pollution liability policies reviewed by the Agency appear to provide only limited dollar coverage of third-party on-site clean-up costs and NRDs that may not be sufficient for 108(b) requirements. Full 108(b) coverage of third-party on-site clean-up costs and NRDs, accordingly, would require changes to restrictive policy terms and conditions (see Section 3.2.9.1 and 3.2.9.2 for further discussion of temporal and geographic restrictions via endorsement).

Current Practices. Required insurance wording language for closure financial assurance under both RCRA Subtitle C 40 CFR Parts 264 and 265 and 40 CFR Part 261 does not contain coverage restrictions beyond restricting coverage to the named facilities, for specified activities (e.g., closure/post-closure care), for a specified amount of coverage, and exclusive of defense costs and certain costs/losses typically covered by other forms of insurance (e.g., workers compensation, employers' liability). Liability coverage insurance under RCRA Subtitle C and 40 CFR Part 261 contains similar required language for certificates and endorsements of liability insurance. The RCRA Subtitle I requirements for underground storage tanks contain an additional condition in the required endorsement and certificate language for claims-made policies. These insurance policies must cover claims made and reported within six months of cancellation or non-renewal of the policy (except where a new or renewed policy has a retroactive date on or before the prior policy) that occurred after the retroactive date of the policy and before the date of policy renewal or termination.

[115] J. Kevin Shane, "Environmental Impairment Liability Insurance: Emerging Trends and Coverage Issues," (Marsh and McLennan Companies, September 26, 2006).

In developing required language for a 108(b) endorsement, the Agency reviewed how terms and conditions in specimen pollution liability policies collected in 2015 might restrict intended 108(b) coverage. The discussion starts by summarizing how pollution insurance terms and conditions can restrict coverage temporally and geographically. Then the discussion describes specific exclusions that may be problematic for 108(b) coverage. The subsequent section describes conditions and related clauses that may be problematic for 108(b) insurance. The "known loss" defense is described separately. Finally this Section describes options available to EPA, their strengths and weaknesses, and EPA's preferred option and rationale. (Issues related to potential dollar limitations on amounts of coverage are discussed in Section 3.2.3 above.)

3.2.9.1. Temporal coverage restrictions.

Pollution liability insurance policies include several provisions intended to restrict the temporal scope of coverage. First, a date that may appear on the Declarations would establish the time prior to which the policy does not extend coverage. The "retroactive date" or "continuity date" (terminology varies) establishes the foregoing temporal limits of such policies: pollution conditions commencing before the specified date are not covered, even if a claim about such a pollution condition is first made during the policy term. Similarly, prior and pending claims made before the retroactive date would not be covered. Retroactive dates may precede the "inception date" of the policy itself and may be retained ("carried forward") in policy renewals.[116] Policies do not need to have any retroactive date, such policies without retroactive dates likely will have higher premiums.

The retroactive date is but one tool for restricting the policy's temporal coverage. For example, a policy also may exclude coverage of pre-existing pollution conditions, or pre-existing claims, or prior acts or operations; such restrictions may be specified as policy exclusions, or be incorporated through insuring agreements, definitions, conditions, and/or limits of liability. Premiums likely would be higher for policies without such temporal limitations.

A similar tool to limit retroactive liability is for a policy to specify that covered pollution conditions must be first discovered during the policy period. Another tool that restricts temporal coverage is the common specification in insuring agreements that covered claims (for covered pollution conditions) must be "first made" during the policy period.

EPA believes a retroactive date would be inconsistent with the Agency's intent to cover the full suite of CERCLA 107 liabilities associated with a facility including, for example, response costs incurred addressing a threat of a release that may pre-date the insurance coverage. The Agency believes that retroactive dates should not apply to exclude pollution conditions and releases pre-dating the insurance coverage; however, the Agency believes that valid CERCLA cost and NRD claims pre-dating the insurance policy may be excluded from coverage.

[116] For example, a policy may be issued in December 2020 to take effect on January 1, 2021 with a 5-year term ending December 31, 2025. The policy may include a retroactive date of January 1, 2015. When the policy is renewed for another 5-year term starting January 1, 2026, the retroactive date may be retained as January 1, 2015. Alternatively, the insurer and insured owner or operator may negotiate a later retroactive date of, for example, January 1, 2021 applicable to the renewed policy.

3.2.9.2. Geographic and physical coverage restrictions.

Pollution liability policies may distinguish between on-site and offsite liabilities and between cleanup of pre-existing conditions and of "new" conditions.[117] A given policy may include from one to all four of those coverage options.[118] Because a policy may treat first-party claims the same or differently than third-party claims, the result is a large menu of potential insuring agreements.[119] Omission or exclusion of one or more of those coverage options could pose a compliance question because CERCLA liability does not vary by whether cleanup costs are incurred onsite or offsite,[120] nor by whether a release or threatened release was pre-existing or new, nor by whether a pre-existing pollution condition was known or not known, nor by whether the pre-existing pollution condition was or was not disclosed to the insurer, nor by when the claim was first made or the pollution condition first discovered.

EPA intends for CERCLA 108(b) financial responsibility to cover the full suite of CERCLA costs and natural resource damages associated with a covered facility liable irrespective of whether or not the pollution condition or the CERCLA action was onsite or offsite.

3.2.9.3. Potential coverage restrictions from policy exclusions.

From its review of specimen policies and published literature, the Agency has determined that pollution liability policies typically include exclusions that may be problematic for 108(b) coverage:

- Asbestos Exclusion. A common exclusion is for claims arising from asbestos or any asbestos-continuing materials. The Agency does not believe that this exclusion would be acceptable as asbestos is a CERCLA hazardous substance and thus is intended to be covered by CERCLA 108(b).

- Nuclear Liability Exclusion. Another common exclusion relates to claims or loss based upon or arising out of the radioactive, toxic, or explosive properties of nuclear material, often defined as source material, special nuclear material, or by-product material as defined in the Atomic Energy Act. The Agency does not believe that this exclusion would be acceptable for 108(b) coverage as hard rock minerals such as uranium and thorium are CERCLA hazardous substances which are intended to be covered by CERCLA 108(b).

- Changed Operations Exclusion. This provision excludes claims arising from a change in facility use or operations different from those disclosed to the insurer and which materially increases a covered risk. This type of exclusion protects the insurer from taking on greater risk than expected and priced. This exclusion might appear unobjectionable in an insurance contract intended to primarily benefit only the insured; however, EPA believes that third-party CERCLA claimants may be prejudiced by exclusion of coverage resulting from facility "changes" viewed

[117] A "new condition" is not a pre-existing condition and also may be required to be first discovered during the policy period.
[118] The four coverage options include: (1) onsite and pre-existing, (2) onsite and new, (3) offsite and pre-existing, and (4) offsite and new.
[119] Apart from the insuring agreement and other terms and conditions in the body of the policy, certain portions of a facility (e.g., areas with historic contamination) may be excluded from coverage via site-specific endorsement.
[120] Depending on the location of covered operations within the 108(b) facility's property lines, a facility arguably may have no need for off-site CERCLA coverage.

by the insurer as materially increasing a covered risk. CERCLA liability does not depend on what the insured disclosed to the insurer and how the insurer views the risk. Rather than apply a broad subjective exclusion, material changes in covered mining and mineral processing operations could instead be addressed in other ways (e.g., through the cancellation process) that would allow for increased premium to cover the increased risk or for a change in insurers to one willing to cover the increased risk.

- Intentional Non-compliance Exclusion. This provision excludes any claim arising from a pollution condition based on, due to, or attributable to the insured's intentional, willful, or deliberate noncompliance with any statute, regulation, complaint, notice of violations, notice letter, or instruction of any government agency.[121] Because CERCLA is a "no fault" strict liability law, it does not matter whether PRPs were negligent, deliberately disregarded environmental laws, or followed best practices. EPA believes that one intent of Section 108(b) financial responsibility is to further CERCLA cost recovery and NRDs by third-party claimants when the current owner or operator may have deliberately non-complied with a government cleanup order or injunction, thus causing those third-party claimants to incur response costs and NRDs. Rather than a noncompliance coverage exclusion in the insurance policy, such issues could be addressed in other ways[122] that would not prejudice payments to 108(b) claimants.

- Known Condition Exclusion. This provision excludes coverage of any claim arising from a pollution condition known by the insured but not disclosed to the insurer. Failure to disclose all information about known conditions may lead to a disclaimer of coverage by the insurer or an action by the insurer to void the policy (see discussion of rescission of insurance at Section 3.2.2 above). Experts have noted a general practice of insurers to define known conditions based on a list of known contaminants at the site, regardless of the concentrations or locations of the contaminants. Such policies reportedly would provide no coverage if the same contaminants are found at new, unexpected locations on a site.[123] As to known conditions disclosed to the insurer, a policy may explicitly exclude them from coverage (e.g., via a "Known Pollution Condition Endorsement") or may allow coverage so long as any claim is first made in the policy period.[124] As noted above, CERCLA liability does not depend on what the insured did or did not disclose to its insurer. CERCLA does not provide a "known condition" defense to liability in section 107(b). Although a known condition exclusion may be acceptable in first-party pollution liability policies designed to protect the insured against pollution claims or losses, the Agency believes that the known condition exclusion is not appropriate in 108(b) insurance which are intended to make other claimants (including government agencies) whole, regardless of what the insured may have known but did not disclose to the insurer. The "known conditions" exclusion is related to a common insurance provision for cancelling or voiding the entire policy if the insured has willfully concealed or misrepresented (1) any fact or circumstance material to the granting of the policy,

[121] This exclusion may accept the insured's non-compliance based on good faith reliance upon qualified outside counsel and non-compliance based on insured's reasonable response to emergency circumstances.
[122] The Agency expects, but does not require, that owners or operators will indemnify insurers for any payments made to other parties under 108(b) coverage. Those agreements could call for "double indemnity" when the insured caused the loss by its deliberate non-compliance.
[123] Christopher Alviggi & Dennis M. Taft "Using Environmental Insurance as a Tool to Close Transactions," *Natural Resources and Environment* (American Bar Association, Section of Environment, Energy, and Resources, Fall 2014).
[124] Laura A. Foggan & Michael J. Gridley, "Issues in Coverage for Pre-Existing Pollution Conditions Under Pollution Liability Insurance Policies." *Environmental Claims Journal* (May, 2014).

(2) the description of the insured property, or (3) any of the insured's operations. (Concealment and Misrepresentation are discussed below in Section 3.2.9.4 and Cancellation is discussed in Section 3.2.12.)

- Prior and Pending Claims Exclusion. This provision supports the claims-first-made-and-reported-during-the-policy-term language of insuring agreements by explicitly excluding from coverage any prior or pending claims. This exclusion may be problematic for some facilities because of CERCLA liability claims already made against a current owner or operator, perhaps many years prior to the effective date of the financial responsibility rule (e.g., a 104(e) letter and General Notice Letter may be considered "suits" or "claims" under a pollution liability policy triggering coverage only if "first made" in the policy period). EPA believes an exclusion that would exclude coverage at a facility because a notice letter or CERCLA 104(e) information request letter related to a facility feature or pollution condition had been issued prior to the policy would unreasonably narrow the scope of 108(b) coverage. However, EPA does not intend for valid CERCLA claims that predate the effective date of the insurance coverage to be covered by the policy; such valid CERCLA claims would follow payment triggers, including court judgments/orders, settlements, or UAOs issued prior to the effective date of the policy.

- Owned Property Exclusion. When a pollution liability policy covers only off-site third-party pollution liabilities beyond the boundaries of the insured's[125] property, an exclusion for damage to property in the care, custody, or control of the insured is commonly added to the policy. This is called the "owned property" exclusion. Policies for first-party cleanup costs may also exclude loss arising out of or related to damage to real or personal property owned by, leased to, loaned to, or rented by the insured or otherwise in the care, custody or control of the insured (which losses or damage could be covered under first party property damage insurance). The pollution liability policy may then specifically except from this first-party owned property exclusion, the covered first-party remediation costs, emergency response costs, catastrophe management costs, and other covered costs (e.g., business interruption costs) as defined in the policy.

  Experts note that courts have differed on whether the "owned property" exclusion is relevant in the pollution context. Some courts have treated claims for reimbursement of costs to third-parties as outside the scope of the exclusion (as opposed to costs incurred by the insured to clean-up its own property which were excluded from coverage). A federal district court in Colorado, reportedly held that the costs of remediating mine tailings pollution were excluded from insurance coverage because those costs arose from property damage caused, at least in part, by mine waste tailings that were deposited on property owned, occupied, or otherwise used by the insured.[126] Although the majority view is that groundwater is outside the scope of the "owned property" exclusion, some courts have held otherwise. Similarly courts are divided on whether to apply the exclusion to soil remediation on the insured's property undertaken to prevent further damage to groundwater or other third-party property.[127] In light of this

[125] The Agency understands that "first generation" EIL policies often covered only off-site third-party liabilities. Robert M. Horkovich, Rene F. Hertzog, and Peter Halprin, "Site Pollution Liability Insurance" in David Guevara and Frank J. DeVeau, *Environmental Liability and Insurance Recovery* (American Bar Association, 2012).

[126] As reported in *Leadville Corp. v. USF&G,* 55 Fed 537 (1995 10th Cir.) which found that failure to timely notify the insurer of claims made vitiated coverage.

[127] Michael F. Aylward, "Other Defenses to Coverage" in David F. Guevara & Frank J. Deveau, *Environmental Liability and Insurance Recovery* (American Bar Association, 2012).

uncertainty, EPA does not want to allow owned-property exclusions for 108(b) insurance which is intended to benefit third party claimants.

Some common coverage exclusions in pollution liability policies may not be problematic for 108(b) insurance. Examples include exclusions for clean-up of lead-based paint in buildings; exclusions for employer liabilities; exclusions for criminal fines, penalties, and assessments; and exclusions for war, strike, riot, or civil commotion.

3.2.9.4. Potential coverage restrictions from policy conditions.

Pollution liability policies typically include conditions[128] or similar clauses that may be problematic for 108(b) coverage. These include the following:

- Arbitration Condition. Mandatory arbitration of disputes is a common feature in diverse contracts, though not all. Congress enacted the Federal Arbitration Act in 1925 to establish a strong federal policy in favor of arbitration, which is an alternative to litigation in the over-crowded court system. Concerns have been expressed about the fairness and possible bias of mandatory arbitration, leading to the enactment of provisions in the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010 to study and possibly limit arbitration. Although mandatory arbitration clauses in pollution liability insurance would bind the insurer and the insured, the Agency believes that such clauses are not problematic conditions for 108(b) because such requirements would not bind the third-party claimants that 108(b) insurance is intended to benefit. Binding arbitration of all disputes or differences may be agreed to by insurer and insured with respect to first-party coverage, however the intent of CERCLA 108(b) is to provide funds to third-party claimants with valid CERCLA claims. Binding arbitration should not be binding on third-party 108(b) claimants.

- Consent to Settle or Voluntary Payments Clauses. Pollution liability policies typically provide that no insured, except at the insured's own cost, shall voluntarily enter into any settlement or make any payment or assume any obligations, without the insurer's consent, which shall not be unreasonably withheld.[129] The purpose of voluntary payment prohibitions is to prevent collusion between the insured and the claimant causing insurers to make un-warranted payments. The provision protects the insurer's ability to exercise its right to defend and to ensure that any sums the insured is obligated to pay are the results of an arm's length settlement or adjudication.[130] These provisions are not unique to pollution liability policies but have been included in general liability policies for many years. Insurers take these clauses seriously and may disclaim coverage when their insureds ignore these provisions. Consent to settle and voluntary payments clauses have been frequently litigated. Experts report that different courts have sometimes treated the two clauses differently and that courts have varied

[128] The general rule is that a breach of a policy condition vitiates coverage only if it results in substantial prejudice to the insurer; however, there may be a rebuttable presumption of prejudice that must be overcome by the insured to secure coverage.

[129] The insurer may not apply the condition to emergency response costs (as defined in the policy) or pursuant to environmental laws that require immediate remediation of a pollution condition.

[130] Michael F. Aylward, "Other Defenses to Coverage" in David F. Guevara & Frank J. Deveau, *Environmental Liability and Insurance Recovery* (American Bar Association, 2012).

in requiring "prejudice" to be shown on the part of the insurer in order to support insurers' withholding of coverage. The Pennsylvania Supreme Court ruled in 2015 in a slit decision that insured parties did not lose their right to coverage by settling radiation exposure claims without permission from their insurers; the parties did not have to show bad faith by their insurers as long as the settlements are fair and reasonable.[131] CERCLA was designed to encourage settlements and "voluntary cleanups" regardless of insurers' consent. Under current pollution liability insurance, if settlements or cleanups do not have the consent of the current owner or operator's pollution liability insurer, coverage of third-party claims could be disclaimed. Thus, the Agency believes that consent-to-settle or voluntary payments conditions in pollution liability insurance policies would be problematic for satisfying third-party claims under 108(b) insurance.

- Direct Action Condition. Pollution liability insurance policies may contain various clauses addressing direct action (see discussion of CERCLA 108(c) direct action provisions in Section 3.2.11). For example, as a precondition for direct action against the insurer, the policy may require that the amount of the insured's obligation to pay shall have been finally determined either (1) by judgment against the insured after actual trial or (2) by written agreement of the insured, the claimant, and the insurer. The Agency does not believe that this type of direct action clause in a pollution liability policy would or should limit direct action under 108(c) and such policy clauses might not limit direct action provisions under applicable state statutes. Any clause in the insurance policy limiting the scope of direct action authorized by 108(c) beyond the limitations identified in section 108(d) of CERCLA would be unacceptable.

- Fraud or Misrepresentation by the Insured. Multiple clauses in liability policies emphasize that the insurer is reliant on the insured for information about the facility and that any fraudulent or misrepresented information or omission can be cause for the insurer to cancel or void[132] the policy. Many state statutes and state common law reinforce the insurers' rights to do so.[133] For example, a clause in the pollution liability policy may make "rescission"[134] available to the insurer if the policyholder misrepresented facts about a pre-existing pollution condition in the policy application. CERCLA liability does not depend on what the insured told or failed to tell its insurer. The Agency believes that public policy should favor third-party CERCLA claimants who should not be prejudiced by the insured owner or operator's fraud or misrepresentation to its insurer. EPA believes that the insurer is in a better position to review the insurance application and protect against misrepresentation than EPA or other third-party CERCLA claimants. However, the Agency also recognizes the public policy in insurance law to discourage fraud and misrepresentation. The Agency believes that it has balanced these competing interests in the proposed FR regulations and required mechanism wording. (Cancellation is discussed in Section 3.2.12.)

- "Other Insurance" Condition. These conditions are found in most liability policies, including pollution liability policies. "Other insurance" clauses were intended to address situations when

[131] Babcock and Wilcox Co. v. American Nuclear Insurers (2 WAP 2014, W. Dist. Pennsylvania Supreme Court).
[132] Cancellation would be prospective in effect while "voiding" would be retroactive in effect.
[133] Rick L. Hammond, A Tale of Two Remedies -- Rescission vs. Cancellation (Defense Research Institute (DRI) Insurance Coverage and Claims Institute, March 2012).
[134] "Rescission" often means the same as voiding (see footnote 141 above); when a policy is rescinded the premium paid by the policy holder is returned by the insurer.

various primary and excess policies were purchased over time that covered "gradual"[135] pollution liability claims; these clauses were intended to coordinate coverage across the policies and insurers to prevent the insured from recovering more than its total loss. Other insurance clauses purport to govern the relationship between insurance policies that cover the same insured and same risk.[136] A typical condition states that if "other valid and collectible insurance" is "available to the insured" for loss covered by a pollution liability policy, the "other insurance" clause purports to establish how the various affected insurers and policies will share in making payments. "Other insurance" is a potential coverage concern because an owner or operator may have commercial pollution liability insurance (to protect itself) as well as 108(b) third-party coverage from the same insurer (e.g., through endorsement) to protect other CERCLA claimants from essentially the same pollution conditions. After first receiving a CERCLA claim (e.g., a 104(e) letter, a General Notice letter), the insured owner or operator would seek coverage from its commercial pollution liability insurer, which coverage typically starts with investigation and defense costs (108(b) coverage of defense costs is discussed in Section 3.2.3.2 above); the insurer responsible for defending the claim might want to "share" defense costs with the 108(b) insurance as "other insurance. "To prevent this scenario, in addition to excluded defense costs from 108(b) limits, the Agency proposes that the required wording for 108(b) insurance coverage clearly state that 108(b) coverage is not "available to the insured."[137]

Some common coverage conditions in the pollution liability policies may not be problematic for 108(b) insurance. Examples include access to information, inspection and audit by the insurer, cooperation, condition of payment,[138] subrogation, and changes to policy wording.

3.2.9.5. Other potential coverage restrictions: "Known Loss" defense to coverage.

Although not necessarily based on any language in pollution liability insurance policies, a basic principle of insurance law holds that coverage may be denied for losses that are known or apparent to the insured (but not to the insurer when issuing the policy). Pollution insurers may disclaim coverage of such "known losses." That certain losses are foreseeable is a reason for purchasing insurance and does not, in and of itself, eliminate the possibility of obtaining insurance coverage. Once foreseeable losses actually come to pass, the contingent aspect of insurance disappears; the law does not favor the acquisition of insurance for expected losses. This "known loss" defense has been frequently raised in environmental cases, and much litigation has been reported. Experts point out that courts have differed to some degree as to when an insured has sufficient knowledge of claims against it such that a foreseeable risk has become a substantial certainty of liability. For example, nearly all courts have reportedly held that no coverage is available if the insured has been sued before the policy has been

[135] "Gradual" pollution may be more difficult to associate with a given policy period than pollution that is "sudden and accidental."

[136] William M. Savino, "Excess and Extended Coverages and Excess Coverage Issues," New York State Bar Association (February 2006).

[137] "Available to the insured" language originally was developed to address allocation of costs across general liability policies implicated by the gradual pollution, some of them having pollution exclusions (and thus no pollution coverage available to the insured) and also to account for periods of no insurance coverage due to market failures in the 1980s; subsequently the clause has been used to recognize insurer insolvencies (and thus no pollution coverage available to the insured) when allocating costs across insurers.

[138] With respect to UN, EU, and U.S. sanctions and prohibitions.

issued. Numerous state and federal courts of appeals have reportedly ruled that the "known loss" doctrine is equally applicable to first-party property damage claims and liability claims. However, there is little consensus as to when a loss becomes "known."[139] Courts have variously ruled that a "known loss" occurs when:

- the injury or damage is first discovered by the claimant
- the insured learns that it is allegedly liable for the pollution
- the insured receives a formal notice of claim, administrative order, or PRP letter, or
- a formal judgment is entered, fixing the insured's liability.

Most courts have likened the "known loss" defense to an exclusion.[140] Most of the reported litigation has involved general liability policies and not modern generation pollution liability policies (Defenses are discussed further in Section 3.2.11 below).

Options for Restrictions on Coverage.
EPA may or may not choose to address provisions within a pollution liability insurance policy that restrict 108(b) coverage. Potential options include the following:

- **Option 1:** Address specific, unacceptable restrictive provisions ("rifle shot" option).
- **Option 2:** General performance standard that no provision inconsistent with the intended scope of coverage will apply.
- **Option 3:** Both Option 1 and Option 2.
- **Option 4:** No limitations on terms and conditions found in commercial pollution liability policies.

Option 1: Specific limitations on restrictive provisions for 108(b).
Section 3.2.9 identifies thirteen specific exclusions, conditions, and a defense that may be problematic for 108(b) coverage. This option would list in the required wording of the insurance instruments all the problematic provisions as being non-applicable to 108(b) claims. That language would not affect how those provisions would apply to non-108(b) claims.
Strengths: Addresses the coverage restrictions of greatest concern to the Agency. May have somewhat less impact on insurance premiums and industry willingness to participate in the 108(b) programs than Option 2.
Weaknesses: Alone, may not accomplish the Agency's coverage goals because an insurance contract offers many alternative ways of restricting coverage. May increase premiums more than Option 4. May discourage industry participation more than Option 4.

Option 2: Specify generically that no provision that would restrict the intended scope of 108(b) coverage will apply.
Because there are multiple ways that an insurance policy can restrict coverage, EPA may want to specify a performance requirement rather than attempting to over-ride specific unacceptable exclusions, conditions, definitions, or other clauses or terms that restrict the required scope of coverage. For example, EPA might specify the following: "Notwithstanding any other terms and conditions of the policy, no exclusion, retroactive date, condition, clause, defense, definition, or other term that restricts

[139] Michael F. Aylward, "Other Defenses to Coverage," in David F. Guevara & Frank J. Deveau, *Environmental Liability and Insurance Recovery* (American Bar Association, 2012).
[140] Courts therefore place the burden of proof on the insurer to show that the insured had sufficient knowledge.

the intended scope of 108(b) coverage shall apply." That language would not affect how those provisions would apply to non-108(b) claims.
Strengths: May be more effective in addressing the coverage restrictions of greatest concern to the Agency. Avoids the Agency having to identify up front all potential exclusions that are unacceptable and is consistent with other EPA financial assurance regulations.
Weaknesses: May leave alternative ways of restricting coverage of great concern to the Agency. May discourage industry participation in 108(b).

Option 3: Implement both Option 1 and 2.
Because there are multiple ways that an insurance policy can restrict coverage, EPA may want to both specify a performance requirement (Option 2) and also attempt to over-ride specific unacceptable exclusions, conditions, definitions, or other clauses or terms that restrict the required scope of coverage (Option 1).
Strengths: Greatest assurance of effectively addressing the coverage restrictions of concern to the Agency.
Weaknesses: Greater premium increases than Options 1 and 2. May discourage industry participation in 108(b).

Option 4: No limitations on terms and conditions found in commercial pollution liability policies.
EPA would not implement either a performance requirement (Option 2), nor attempt to over-ride specific unacceptable exclusions, conditions, definitions, or other clauses or terms that restrict the required scope of coverage (Option 1). Agreed to restrictions on coverage found in the policy would apply to 108(b) claims.
Strengths: No incremental effects on premiums. Should encourage greatest participation in 108(b).
Weaknesses: Coverage restrictions could eviscerate 108(b) coverage.

In light of the above, the Agency has determined to implement Option 2 in the required wording of the endorsement by including a general performance standard that ensures that any provision, exclusion, definition, condition, retroactive date, clause, defense, or other term of the policy inconsistent with the regulations or specified elements of the endorsement are amended to conform.

3.2.10. Conditions [triggers] on when payment would be required.

Regulations promulgated by EPA and/or the required insurance language, could specify which events would trigger payment of funds by an insurer. This section discusses the inclusion of such conditions in the required wording of the instrument.

As discussed in more detail in Section 2.2, EPA is considering that the regulations and required wording of the insurance instruments would specify that insurers must make payments from 108(b) insurance policies for third-party CERCLA claims in three scenarios in addition to the direct action scenario. First, the policy would be required to provide for the payment awarded in valid final court judgments against any of the current owners and operators for CERCLA costs and/or natural resource damages associated with the facility to the party obtaining the judgment should such payments not be made within 30 days. Second, the policy would be required to provide for payment as required by a CERCLA settlement associated with the facility between any of the current owners or operators at the facility and EPA or another Federal government agency should such payment not be made as required by the settlement. Third, the policy would also be required to provide for payment into a trust fund established pursuant to

a CERCLA administrative order issued to any of the current owners or operators at the facility that references the policy and is issued by EPA or another Federal agency acting pursuant to CERCLA section 106 in instances where performance does not occur at the facility as required by the order. The owner or operator must have provided a written statement allowing the insurance policy be used to assure performance of the work required in the order.
Additionally, based on the language of CERCLA section 108(c), insurers could be required to make payments in response to a "direct action" claim. Direct action is discussed below in Section 3.2.11. Additionally, payment would be required into a standby trust fund after cancellation and failure to obtain a replacement instrument; this potential trigger is discussed below in Section 3.2.10.

The required wordings of the RCRA Subtitles C and I financial responsibility instruments for liability coverage establish triggers for access to insurance funds based on either (1) a Certification of Valid Claim entered into between the owner/operator and the third-party claimant or (2) a final court order establishing a judgment issued against the owner/operator or financial assurance instrument. Those triggers remove the EPA from third-party liability claims management, making that program self-implementing. The RCRA Subtitle C regulations for closure/post-closure insurance, on the other hand, include a role for the EPA to direct the insurer to pay out funds. Specifically, the EPA may instruct the insurer to make reimbursements to an owner/operator or any other person authorized to conduct closure/post-closure.

Potential options for triggers on when 108(b) payments would be required include:

- **Option 1:** EPA instruction for payment.
- **Option 2:** Instruction for payment from another identified arbiter (e.g., a trustee) of financial assurance funds.
- **Option 3:** Settlement agreement, UAO, or final court order.

Option 1: EPA instruction for payment.
Strengths: Similar to the RCRA Subtitle C regulations for closure/post-closure insurance, payment could be triggered by EPA instruction to the insurer to make payment for specific claim(s). A strength of this option is making timeliness of payment more likely than under a scenario in which the insurer played a more significant role in claims management/defense. Furthermore, under this option EPA would assess the legitimacy and amount of claims and ensure that the funding is being used for the intended purposes.
Weaknesses: However, a weakness is the administrative burden associated with EPA's involvement in managing every claim on the insurance policy. Because EPA also is a potential claimant, its payment decisions may be criticized for conflict of interest. Additionally, limiting the insurer's involvement in claims management/defense, could lead to decreased willingness of insurers to participate in the CERCLA 108(b) program.

Option 2: Instruction for payment from another identified arbiter (e.g., a trustee) of financial assurance funds.
Strengths: Alternatively, payment could be triggered by instruction from another identified arbiter (e.g., a trustee). A strength of this option is the low administrative burden for EPA because another entity would be taking responsibility for assessing the legitimacy of claims on the insurance policy. Because EPA is not making decisions on paying claims, it would not be criticized for conflict of interest. Furthermore, having an entity other than the insurer responsible for reviewing each claim, could lead to easier, timelier access to the funds for legitimate claimants.

Weaknesses: However, a weakness is the availability of an entity willing to play this arbiter role and the potential cost to obtain the arbiter's services. And, insurers may not want to participate in the CERCLA 108(b) program if their involvement in claims management/defense is too strictly limited.

Option 3: Settlement agreement, UAO, or final court order.
Strengths: Alternatively, and more in line with the self-implementing framework in the RCRA Subtitles C and I financial responsibility requirements for liability coverage, payment could be triggered by a successful claim by a third-party claimant without any role for an arbiter outside the judicial system. Compared to the two previous options, this option has the lowest burden because there is no entity responsible for playing gatekeeper between the insurer and the claimant.
Weaknesses: However, a weakness is the possibility that insurers will feel the need for greater participation in claims management/defense, which could lead to slower access to funding.

In light of the above, the Agency has chosen option 3 and determined that the required wording of 108(b) insurance instruments will not require EPA payment instruction or that of another arbiter in the event of a third-party CERCLA claim.[141]

3.2.11. Direct action authorization and/or defenses.

An insurance policy is a contract between an insured and its insurer. Although it may be the intention for the policy to cover claims of third parties, those third parties lack what is termed "privity of contract" with the insurer. Because of that status, third parties typically cannot sue insurers directly but must bring their claims against the insured party responsible for the loss or liability. If the responsible party is bankrupt or otherwise unavailable for suit, third parties usually will have no recourse. To redress this situation, Congress and some states have enacted direct action statutes. Direct action is known in the insurance industry and is authorized in some insurance fields, such as liability coverage.

RCRA and CERCLA each include statutory provisions authorizing direct action against issuers of financial responsibility instruments.[142] The Hazardous and Solid Waste Amendments of 1984 amended RCRA to authorize direct action in two situations:

1. Where the owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. Where, with reasonable diligence, jurisdiction in any State Court or any Federal Court cannot be obtained over an owner or operator likely to be solvent at the time of judgment.

Similarly, in the event of a release or threatened release from a facility, CERCLA 108(c)(2) authorizes direct action in the following situations:

1. If the person liable under CERCLA §107 is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or

[141] However, EPA instruction from the Regional Administrator may be required prior to payment into a standby trust fund after cancellation and failure to obtain a replacement instrument. Regional Administrator instructions are required only if EPA has rejected the "automatic" draw option.
[142] RCRA 3004(t)(2), CERCLA 108(c)(1), and CERCLA 108(c)(2).

2. If, with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA §107 who is likely to be solvent at the time of judgment.[143]

In both RCRA and CERCLA, the first statutory condition for direct action appears more objective than the second condition, where "reasonable diligence" and "likely to be solvent" seem somewhat subjective. The more subjective language may allow an insurer to defend against direct action if no bankruptcy petition has been filed, arguing that the insured was not likely to be insolvent at the time of judgement.

EPA's RCRA financial assurance instruments in Subtitles C and I do not include direct action provisions, providing no precedent for direct action wording in 108(b) instruments.[144] Therefore, EPA reviewed how the Coast Guard and BOEM implemented FR provisions with direct action components.

Current Practice: The Coast Guard's FR authority stems from both CERCLA 108(a) and OPA 90. The Coast Guard's direct action authority comes from CERCLA 108(c)(1). In the event of a release or threatened release from a vessel, CERCLA 108(c)(1) authorizes direct action against guarantors (i.e., instrument providers other than the owner or operator) for any claim authorized by CERCLA 107 or 111. In contrast, in the event of a release or a threatened release from a facility, CERCLA108(c)(2) authorizes direct action against a guarantor (e.g., insurer) for any claim authorized by CERCLA 107 or 111 if the person liable under 107 is in bankruptcy, reorganization, or arrangement, or if with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA 107 who is likely to be solvent at the time of judgment.[145]

In addition to CERCLA, OPA 90 authorizes direct action in three instances:

1. The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles (GAAP),
2. The assured party has filed a petition for bankruptcy, or
3. The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims.[146]

The Coast Guard's regulations require that the wording of the instruments include an accompanying acknowledgment that, "an action in court by a claimant (including a claimant by right of subrogation) for costs or damages arising under the provisions of these Acts [CERLCA and OPA 90], may be brought directly against the insurer."[147] The required wording of the acknowledgment appears in Coast Guard

[143] CERCLA 108(c)(2).
[144] There are references to direct action in Subtitles C and I of RCRA, but no mention in the regulations or instruments. The statute states, "In any case in which an owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the FBC or where with reasonable due diligence jurisdiction in any state court or the federal courts cannot be obtained over an owner likely to be solvent at the time of judgement, any claim arising from conduct for which evidence of FR must be provided under this subsection may be asserted directly against the guarantor providing evidence of the FR." 42 U.S.C. 6991b(d)(2), 42 USC 6924(t)(2).
[145] CERCLA 108(c).
[146] 33 U.S.C. 2716(f)(2).
[147] 33 CFR 138.80(d).

Insurance Form CG-5586, which reads, "The Insurer consents to be sued directly with respect to any claim, including by right of subrogation, for costs and damages arising under section 1002 of OPA 90, as limited by section 1004(a), or section 107(a)(1) of CERCLA, as limited by sections 107(c)(1)(A) and (B), or both, against any Assured."[148]

The Coast Guard's regulations allow for direct action against any insurer related to a spill from a vessel so long as the claim is not limited by provisions of CERCLA or OPA 90.[149] The Coast Guard has put limitations in place, beyond what is stated in the statute and regulations, to confine the scope of direct action claims. The Coast Guard has narrowed the scope of applicable direct action through agency interpretation of own regulations. In the preamble to the 1994 rule, the Coast Guard clarified that limits to direct action under 138.80(d) extend to guarantors' reinsurers. The Coast Guard stated in response to a comment concerning the extent of direct action liability that, "no right of direct action against a guarantor endows a claimant with rights against a guarantor's reinsurer".[150] This limitation is not expressly stated in the regulations but has been clarified in the Coast Guard's preamble.

BOEM's direct action authority stems solely from OPA 90. BOEM's regulations regarding direct action mirror the statutory language of OPA 90. Under OPA 90, a claim may be made directly if one of three requirements is met.[151] BOEM's regulations reaffirm these statutory requirements, stating that an insurer is subject to direct action for any claim asserted by:

1. The United States for any compensation paid by the Fund[152] under OPA, including compensation claim processing costs; and
2. A claimant other than the United States if the designated applicant has:
    a. Denied or failed to pay a claim because of being insolvent; or
    b. Filed a petition in bankruptcy under 11 USC chapters 7 or 11[153]

Although there are subtle differences in language between OPA 90 and BOEM regulations, BOEM has stated that these differences are not substantial and that, "the terms and conditions cited in the

[148] FORM CG-5586 (Expiration Date: December 2015).
[149] CERCLA 107 liability limits: For any vessel, other than an incineration vessel, which carries any hazardous substance as cargo or residue, $300 per gross ton, or $5,000,000 whichever is greater; for any other vessel, other than an incineration vessel, $300 per gross ton, or $500,000, whichever is greater (CERCLA 107(c)(1)(A) and (B)). OPA tank vessel liability shall not exceed the greater of $1,200 per gross ton; or in the case of a vessel greater than 3,000 gross tons, $10,000,000; or in the case of a vessel of 3,000 gross tons or less, $2,000,000. For any other vessel, $600 per gross ton or $500,000, whichever is greater; for an offshore facility except a deepwater port, the total of all removal costs plus $75,000,000; and for any onshore facility and a deep water port, $350,000,000 (OPA 104(a)).
[150] 59 FR 34220 (July 1, 1994).
[151] (1) The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles, (2) The assured party has filed a petition for bankruptcy, or (3) The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims. 33 USC 2716(f)(2).
[152] Oil Spill Liability Trust Fund, established by Section 9509 of the Internal Revenue Code of 1986 as amended (26 U.S.C. 9509).
[153] 30 CFR 553.61(a).

[regulatory] section are consistent with those in OPA. The rule does not 'broaden' the statutory language."[154]

Much like the Coast Guard, BOEM's regulations for the required wording of insurance documents also require that an insurer acknowledge that direct action may be taken against it if certain criteria are met. BOEM's regulations state, "Each instrument you submit as FR evidence must specify that the instrument issuer agrees to direct action for claims made under OPA up to the guaranty amount, subject to the defenses[155] in paragraph (a)(6) of this section".[156] The acknowledgment is specified in the BOEM Insurance Guaranty Form BOEM-1019 which states, "The named insurers agree that any suit or claim for which the Responsible Parties ... may be liable under Title I of the Act may be brought directly against the named Insurers for claims up to the amount of insurance coverage asserted by the U.S. government or by other claimants when a Responsible Party denies or fails to pay a claim on the basis of insolvency or a Responsible Party has petitioned for bankruptcy under Title 11 of the U.S. Code."[157]

In its required instrument wording, BOEM has highlighted a statutory provision in the OPA that any claim made by the U.S. government may be brought directly for any amount of coverage asserted by the government,[158] although claims made by other claimants may not be brought unless a Responsible Party asserts that it is insolvent or if a bankruptcy petition has been filed. Commenters on the BOEM regulations promulgated in 1998 addressed the "assertion of insolvency" provision, recommending that the BOEM implement a strict interpretation of what constitutes insolvency, including greater guidance concerning a responsible party's financial status. BOEM responded that its interpretation of the insolvency condition did not require verification of the owner/operator's financial status at the time of the assertion.[159] BOEM stated, "Our interpretation is that if a responsible party denies or fails to pay a claim asserting that he or she is insolvent and further asserts that the conditions of his or her insolvency are equivalent to the insolvency criteria set forth at OPA section 1016(f)(2), then claimants may proceed against the responsible party's guarantor."[160] BOEM decided not to require an official determination of insolvency, which could be a time-consuming process.[161]

EPA has four potential options when considering how to apply direct action provisions to facilities subject to CERCLA 108(b):

- **Option 1:** Include direct action provisions in the required wording of the instrument. EPA could choose to include a direct action provision in the insurance instrument, creating an explicit

[154] 63 FR 42699 (August 11, 1998).
[155] An instrument issuer will not use any defenses against a claim made under OPA except: (1) the rights and defenses that would be available to a designated applicant or responsible party for whom the guaranty was provided; and (2) the incident leading to the claim for removal costs or damages was caused by willful misconduct or a responsible party for whom the designated applicant demonstrated OSFR.
[156] 30 CFR 553.41(a)(4).
[157] FORM BOEM-1019, (Expiration Date: December 2016).
[158] The government may directly bring a claim for any amount of coverage, however, the guarantor's liability is limited to the amount of financial responsibility which the guarantor has provided for a responsible party. (33 USC 2716(g)).
[159] 63 FR 42699 (August 11, 1998).
[160] 63 FR 42699 (August 11, 1998).
[161] 63 FR 42699 (August 11, 1998).

acknowledgement by insurers that they are subject to direct action claims under applicable circumstances.

- **Option 2:** Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
- **Option 3:** Do not include direct action provisions in the instrument or regulations.
- **Option 4:** Expand direct action authorization under CERCLA 108(c)(2). EPA could expand direct action authorization under 108(c)(2) to allow more direct action claims. For example, EPA could expand direct action to reinsurers of guarantors or allow any claim made by the government to be made directly.
- **Option 5:** Narrow direct action authorization under CERCLA 108(c). EPA could place greater restrictions on by whom and when a direct action claim could be brought against an insurer of a 108(b) facility. For example, EPA could prohibit direct action extending to a guarantor's reinsurer, or narrow the scope of the solvency provision, creating fewer opportunities or greater burdens for claimants to apply direct action.

Option 1: Include direct action provisions in the required wording of the instrument. EPA could choose to include a direct action provision in the insurance instrument, creating an explicit acknowledgement by insurers that they are subject to direct action claims under applicable circumstances.
Strengths: Increases transparency and ensures that the insurers participating in coverage and potential claimants are aware of the direct action authorization. Used by the Coast Guard and BOEM.
Weaknesses: May discourage insurers from participating. Not needed because of statutory authorization. Adds to insurance document verbiage which Agency would need to confirm.

Option 2: Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
Strengths: A direct action provision in the instrument is not needed because of statutory authorization. The regulations may already sufficiently address the topic. Less required verbiage for EPA to confirm.
Weaknesses: The lack of an acknowledgment in the instrument itself decreases transparency and may fail to ensure that the participating insurer and potential claimants are aware of the direct action authorization.

Option 3: Do not include direct action provisions in the instrument or regulations.
Strengths: A direct action provision in the instrument or regulations is not needed because of statutory authorization. May encourage participation from insurers.
Weaknesses: The lack of an acknowledgment in the regulations or instrument may decrease transparency and may fail to ensure that the insurer and potential claimants are aware of the direct action authorization. Inconsistent with Coast Guard and BOEM.

Option 4: Expand direct action authorization under CERCLA 108(c)(2). EPA could expand direct action authorization under 108(c)(2) to allow more direct action claims. For example, EPA could expand direct action to reinsurers of guarantors or allow any claim made by the government to be made directly.
Strengths: Expanded direct action could provide claimants faster CERCLA cost and liability payments, and therefore expedite claims proceedings.
Weaknesses: May discourage insurance companies from participating in 108(b) program. May interfere with first come, first served approach (see discussion at Section 2.1 above) or equal treatment of all

types of liabilities (see discussion at Section 2.1 above). May raise question of regulatory authority to expand statutory direct action.

Option 5: Narrow direct action authorization under CERCLA 108(c). EPA could place greater restrictions on by whom and when a direct action claim could be brought against an insurer of a 108(b) facility. For example, EPA could prohibit direct action extending to a guarantor's reinsurer, or narrow the scope of the solvency provision, creating fewer opportunities or greater burdens for claimants to apply direct action.
Strengths: By narrowing direct action authorization, EPA may increase insurer participation in the program. BOEM has narrowed direct action provisions with regards to reinsurers.
Weaknesses: Narrowing direct action authorization may make it more difficult for some claimants to expeditiously file claims and receive payments. May raise question of regulatory authority to narrow statutory direct action.

EPA has decided to include language in required wording of the CERCLA 108(b) insurance endorsement acknowledging and authorizing direct action without attempting to narrow or expand the scope from what is provided in the statute.

Defenses Available to §108(b) Insurers Under Direct Action. CERCLA 108(c) authorizes guarantors (i.e., providers) of 108(b) instruments to be subject to direct action claims. CERLCA 108(c) provides those guarantors with available defenses against such claims. Both the RCRA[162] and CERCLA statutes specify that under direct action, a guarantor is entitled to invoke all rights and defenses which would have been available to the owner or operator if any action had been brought against the owner or operator by a claimant under the respective Acts.[163] EPA's RCRA Subtitle C and I regulations and required wording of insurance instruments do not contain specifications for defenses to direct action.[164] Therefore, EPA reviewed how the Coast Guard and BOEM addressed defenses to direct action.

In developing financial responsibility regulations for vessels under CERCLA 108(a) and OPA 90, the Coast Guard specified direct action defenses in its regulations and financial instruments.[165] Under CERCLA, the guarantor is "entitled to invoke all rights and defenses which would have been available to the person liable under section 107 if any action had been brought against such person by the claimant and all rights and defenses which would have been available to the guarantor if an action had been brought against the guarantor by such person".[166] Under OPA 90, a guarantor may invoke, (1) all rights and defenses which would be available to the responsible party under this Act [OPA 90], (2) any defense authorized under subsection (e)[167]; and (3) the defense that the incident was caused by the willful misconduct of the responsible party.[168]

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[162] Subtitle C 3004, Subtitle I 9003, 9004.
[163] CERCLA 108(c)(1) also includes a willful misconduct provision as a defense for a release from a vessel, but not a facility under 108(c)(2).
[164] Nothing in regulations or instruments from Subtitle C (40 CFR 265) or Subtitle I (40 CFR 280.90).
[165] 33 CFR 138.80(d).
[166] CERCLA 108(c)(2).
[167] The Secretary or President, as appropriate, may specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing evidence of financial responsibility to effectuate the purposes of this Act. 1016(e).
[168] 33 USC 2716(f)(1).

From this statutory authority, the Coast Guard's regulatory direct action defenses include the CERLCA statutory defenses outlined in 108(c)(1) as well as agency developed administrative defenses to direct action.[169] Coast Guard regulations state that a guarantor may invoke only the following rights and defenses with respect to a direct action claim:

1. Any defense that a person for whom the guaranty is provided may raise under the Acts,
2. The incident, release, or threatened release was caused by the willful misconduct of the person for whom the guarantee is provided,
3. A defense that the amount of a claim or claims, filed in any action in any court or other proceeding, exceeds the amount of the guaranty with respect to an incident or with respect to a release or threatened release,
4. A defense that the amount of a claim exceeds the amount of the guaranty, which amount is based on the gross tonnage of the vessel as entered on the vessel's International Tonnage Certificate or other official, applicable certificate of measurement, except when the guarantor knew or should have known that the applicable tonnage certified was incorrect, and
5. The claim is not one made under either of the Acts. [170]

The Coast Guard's direct action defenses include a willful misconduct provision, but do not include a defense for fraud or misrepresentation. The Coast Guard rejected a public comment to allow fraud or intentional misrepresentation as an insurer's defense in the preamble to the 1996 rule.[171] The Coast Guard insurance form reiterates the same defenses found in the regulations and does not include additional defenses. The required wording of the Coast Guard insurance instrument states that "the Insurer hereby agrees that the Insurer shall be entitled to invoke, in any direct action, only the rights and defenses set forth in 33 CFR 138.80(d)."[172]

BOEM's defenses against direct action are similar to the Coast Guard's. Under OPA 90, BOEM is authorized to permit a guarantor subject to direct action to invoke, (1) all rights and defenses which would be available to the responsible party under this Act [OPA 90], (2) any defense authorized under subsection (e)[173]; and (3) the defense that the incident was caused by the willful misconduct of the responsible party.[174] Under this authority, BOEM chose to mirror its direct action defenses regulations to the OPA 90 statute.[175] BOEM direct action defenses include:

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[169] 33 CFR 138.80(d). Defenses 1 and 2 are requirements from CERCLA 108(c). Defenses 3, 4, and 5 are directly related to specific 'total applicable amount' regulations in 33 CFR 138.80(f).
[170] 33 CFR 138.80(d)(1).
[171] The Coast Guard has indicated that to adopt this recommendation would be inconsistent with the purpose of the guaranty – to ensure that the polluter pays for removal costs and damages. 61 FR 9270 (March 7, 1996).
[172] FORM CG-5586 (Expiration Date: December 2015). See. https://www.uscg.mil/forms/cg/CG_5586.pdf.
[173] The Secretary or President, as appropriate, may specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing evidence of financial responsibility to effectuate the purposes of this Act. 1016(e).
[174] 33 USC 2716(f)(1).
[175] OPA allows all rights and defenses which would be available to the liable party; any defense authorized administratively; and the defense that the incident was caused by the willful misconduct of the responsible party.

1. The rights and defenses which would be available to a designated applicant or responsible party for whom the guaranty was provided; and the liable party; and
2. The incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated OSFR.[176]

The BOEM insurance certificate required wording reiterates these defenses, stating that the named insurers agree, "not to use any defense except those that would be available to a Responsible Party for whom the insurance was provided or that the incident leading to the claim for removal costs or damages was caused by willful misconduct of a Responsible Party covered by this insurance."[177] Outside of the allowed defenses, and in similar fashion to the Coast Guard, BOEM declined to allow insurance companies a defense to direct action if an insured commits fraud or makes misrepresentations in the course of procuring an insurance policy. BOEM has indicated that allowing a defense for fraud or misrepresentation would be inconsistent with two OSFR program objectives: (1) Ensure that claims for oil-spill damages and cleanup costs are paid promptly, and (2) make responsible parties or their guarantors pay claims rather than the Oil Spill Liability Trust Fund. The Agency also stated that as of 1998 there was no evidence that fraud and misrepresentation had been a problem in the current OSFR program.[178]
Potential EPA Options for Direct Action Defense Under 108(b):

EPA has four main options regarding direct action defenses for 108(b) guarantors (insurers):

- **Option 1:** Include direct action defense provisions in the required wording of the instrument. EPA could require a direct acknowledgement from insurers about the available direct action defenses.
- **Option 2:** Do not include direct action defense provisions in the required wording of the instrument.
- **Option 3:** Expand upon CERCLA 108(c)(2) defenses to direct action. EPA could expand upon CERCLA 108(c) defenses, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
- **Option 4:** Narrow CERCLA 108(c) defenses to direct action claims. EPA could narrow the statutory language of defenses to direct action allowing insurers fewer defense options against a direct action claim.

Option 1: Include direct action defense provisions in the required wording of the instrument. EPA could require a direct acknowledgement from insurers about the available direct action defenses.
Strengths: An acknowledgment in the required wording of the instrument increases transparency and ensures that the participating insurer and potential claimants are aware of available defenses. Used by the Coast Guard and BOEM.
Weaknesses: More verbiage for EPA to confirm..

Option 2: Do not include direct action defense provisions in the required wording of the instrument.

[176] 30 CFR 553.41(a)(6).
[177] FORM BOEM-1019 (Expiration Date: December 2016).
[178] 63 FR 42707 (August 11, 1998).

Strengths: Direct action defense provisions in the required wording of the instrument may be unnecessary if they simply mirror the statute. Reduces verbiage for EPA to confirm.
Weaknesses: The lack of a defense specification in the required wording of the instrument decreases transparency and may fail to ensure that participating insurers and potential claimants are aware of the direct action defenses.

Option 3: Expand upon CERCLA 108(c)(2) defenses to direct action. EPA could expand upon CERCLA 108(c) defenses, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
Strengths: Expanding defenses will be in the interest of insurers and may make adversely affect claimants.
Weaknesses: Expanding defenses will not be in the interest of claimants. Could raise questions about EPA's authority.

Option 4: Narrow CERCLA 108(c) defenses to direct action claims. EPA could narrow the statutory language of defenses to direct action allowing insurers fewer defense options against a direct action claim.
Strengths: Narrowing defenses will be in the interest of claimants.
Weaknesses: Narrowing 1 and include a specific acknowledgment of the defense provisions provided in the statute.defenses to direct action could discourage insurers from participating in 108(b). Could raise questions about EPA's authority.

In light of the above considerations, EPA has decided to propose option one and include a specific acknowledgment of the defense provisions provided in the statute.

3.2.12. Insurance cancellation restrictions.

EPA financial assurance programs use similar if not identical provisions for cancellation, termination, and nonrenewal. States may have the same or different provisions in their insurance codes, and state common law also may be pertinent to insurance cancellation, termination, and non-renewal. For example, failure to pay the premium often is recognized as a basis for an insurer to cancel, terminate, or fail to renew a policy, as is the case under RCRA Subtitle C financial assurance for closure and post-closure. This section discusses restrictions that could be included in EPA 108(b) regulatory text or instrument language for insurance that would restrict the conditions under which an insurer can cancel, terminate, or fail to renew a policy.

Time-Dependent Restriction. The most common cancellation restriction in EPA programs prohibits cancellation from occurring within a specified number of days of receipt of a notice of cancellation by the owner/operator and EPA Regional Administrator.[179] Time-dependent requirements are typically included in both the regulatory text and required instrument language. The following are three models for time-dependent restrictions in EPA programs reviewed, including example regulatory and instrument text as applicable:

[179] Under the RCRA Subtitle I (UST) program, the provider of financial assurance is only required to notify the owner/operator of termination. If after 60 days, the owner/operator has not obtained alternate financial assurance and the reason for termination is not incapacity of the provider, the owner/operator must notify the EPA.

1) **Fixed limit for all kinds of termination:** Under the RCRA Subtitle C closure/post-closure program and the 40 Part 261 (excluded secondary hazardous materials) financial assurance program, an insurer cannot cancel/terminate/fail to renew a policy within 120 days of receipt of notification by the owner/operator and the EPA Regional Administrator (as evidenced by return receipts). The use of a 120-day requirement is common for letters of credit and surety bonds and is required under the Part 261, RCRA Subtitle C, and RCRA Subtitle I (UST) programs.
    a. **Example Regulatory Text:** "Cancellation, termination, or failure to renew may not occur, however, during the 120 days beginning with the date of receipt of the notice by both the Regional Administrator and the owner or operator, as evidenced by the return receipts."[180]
    b. **Example Instrument Text:** N/A

2) **Differing limits by kind of termination:** The liability programs under RCRA Subtitle C and Part 261 have differing requirements for cancellation versus other kinds of termination. Under these programs, cancellation cannot occur within 60 days of receipt of notification, and all other kinds of termination cannot occur within 30 days of receipt of notification.
    a. **Example Regulatory Text:** N/A
    b. **Example Instrument Text:** "Cancellation of this endorsement, whether by the Insurer, the insured, a parent corporation providing insurance coverage for its subsidiary, or by a firm having an insurable interest in and obtaining liability insurance on behalf of the owner or operator of the hazardous waste management facility, will be effective only upon written notice and only after the expiration of 60 days after a copy of such written notice is received by the Regional Administrator(s) of the EPA Region(s) in which the facility(ies) is(are) located…Any other termination of this endorsement will be effective only upon written notice and only after the expiration of thirty (30) days after a copy of such written notice is received by the Regional Administrator(s) of the EPA Region(s) in which the facility(ies) is (are) located."[181]

3) **Differing limits by reason for termination:** The RCRA Subtitle I program prohibits termination within 10 days of receipt of notice for termination for non-payment of premium or misrepresentation by the insured. For all other kinds of termination, termination cannot occur within 60 days or receipt of notice.
    a. **Example Regulatory Text:** "Termination of insurance or risk retention coverage, except for non-payment or misrepresentation by the insured, or state-funded assurance may not occur until 60 days after the date on which the owner or operator receives the notice of termination, as evidenced by the return receipt. Termination for non-payment of premium or misrepresentation by the insured may not occur until a minimum of 10

[180] 40 CFR 264.143(e)(8).
[181] 40 CFR 264.151(i), (j).

days after the date on which the owner or operator receives the notice of termination, as evidenced by the return receipt."[182]

b. **Example Instrument Text:** "Cancellation or any other termination of the insurance by the ["Insurer" or "Group"], except for non-payment of premium or misrepresentation by the insured, will be effective only upon written notice and only after the expiration of 60 days after a copy of such written notice is received by the insured. Cancellation for non-payment of premium or misrepresentation by the insured will be effective only upon written notice and only after expiration of a minimum of 10 days after a copy of such written notice is received by the insured."[183]

In some programs, time-dependent requirements are more restrictive (i.e., prohibit cancellation for a longer period) for other financial instruments (e.g., surety bonds, letters of credit) than for insurance. In some cases this may be because other requirements (see Premium Restriction discussion below) make it more difficult for an insurance policy to be cancelled than other instruments. While the RCRA Subtitle I program allows for cancellation only 10 or 60 days after receipt of notice (depending on the cause for termination), the required instrument language for claims-made policies under this program requires the insurer to cover claims made under the policy that are reported within six months of termination. This addition helps alleviate concerns associated with ripe claims made after the effective date of termination by extending the reporting period.

Premium Restriction. The RCRA Subtitle C closure/post-closure program and the Part 261 financial assurance program only allow for cancellation/termination/non-renewal of an insurance policy in the event of owner/operator failure to pay a premium. This restriction is addressed exclusively through regulatory text and is not included in the required instrument text. (For example, 40 CFR 264.143(e)(8) states, "The policy must provide that the insurer may not cancel, terminate, or fail to renew the policy except for failure to pay the premium.") While this requirement reduces concerns associated with an owner/operator not being able to provide alternate financial assurance, it may be less accepted by the insurance industry because it would not allow for cancellation in the event of misrepresentation by the insured, among other potential reasons for cancellation.

Contingencies Related to Qualifying Events. RCRA Subtitle C regulations (e.g., 40 CFR 264.143(e)(8)) for closure/post-closure insurance specify the implications of the following events:

- The Regional Administrator deems the facility abandoned
- The permit is terminated or revoked or a new permit is defined
- Closure is ordered by the Regional Administrator or a U.S. district court or other court of competent jurisdiction
- The owner or operator is named as debtor in a voluntary or involuntary proceeding under Title 11 (Bankruptcy) U.S. code

If any of the specified events occur before the date of policy expiration, then cancellation, termination, or failure to renew may not occur and the closure/post-closure policy will remain in full force and effect. The contingencies are not specified in the RCRA Subtitle C insurance instruments for closure/post-

[182] 40 CFR 280.109(a)(2).
[183] 40 CFR 280.97(b)(1), (2).

closure care, but are found in the regulations. These contingencies are meant to ensure availability of funds for performance of closure/post-closure activities. Other potential contingencies could address the possibility of qualifying events at the site, including the issuance of a notice letter of potential CERCLA liability to the owner/operator or the occurrence of a cost recovery action under Section 107 of CERCLA against the owner/operator.

Standby Trust Fund Contingency. Another potential contingency would address the requirement for the insurer to deposit the remaining balance of the policy into a SBTF in the event of cancellation and owner/operator failure to provide alternate FR. The advantages and disadvantages of the use of a SBTF to accompany insurance are discussed in Section 3.2.13 below. Such requirements are common for surety bonds and letters of credit under other EPA programs reviewed. The RCRA Subtitle C closure/post-closure program and the Part 261 financial assurance program require the standby trust fund to be funded (either directly by the provider of financial assurance or by EPA after draws on the instrument) if the owner/operator has not provided alternate financial assurance within 90 days of receipt of a notice of termination. The RCRA Subtitle I program requires the SBTF to be funded within 60 days of receipt of a notice of termination if certain qualifying events have occurred.

Rescission. The insurer's right to rescission from the start (i.e., *ab initio*) originates in common law but also has been codified in many states. Rescission is distinguished from cancellation/termination/non-renewal because a rescinded policy is deemed to have not existed from the start. Current EPA programs analyzed do not specifically address rescission in the regulatory text or required instrument language.

The decision of the U.S. Court of Appeals, North Circuit in *Zurich American Insurance Company* v. *Whittier Properties, Inc.*, 356 F.3d 1132 (2004) held that the EPA's financial assurance regulations for underground storage tanks of petroleum (UST) preclude rescission and provide only for prospective termination of statutorily required UST insurance policies following notice to insured as a remedy for misrepresentation. In this case, rescission was distinguished from termination (and thus cancellation, which is a subset of "termination") because termination is defined to result in a "gap in coverage," whereas a policy that is rescinded is determined to never have existed. The Court found that prospective cancellation in the event of an insured's misrepresentation was the exclusive remedy available under the UST financial responsibility regulations.[184] If EPA were to include the following cancellation specification language from the UST endorsement (40 CFR 280.97(b)(1)) and the UST certificate of insurance (40 CFR 280.97(b)(2)), this would allow EPA to take advantage of the *Whittier* holding:

> d. Cancellation or any other termination of the insurance by the ["Insurer" or "Group"], except for non-payment of premium or misrepresentation by the insured, will be effective only upon written notice and only after the expiration of 60 days after a copy of such written notice is received by the insured. Cancellation for non-payment of premium or misrepresentation by the insured will be effective only upon written notice and only after expiration of a minimum of 10 days after a copy of such written notice is received by the insured.

[184] The U.S. District Court, Northern District Florida agreed with the *Whittier* Court that the federal statutes and EPA regulations precluded rescission of the policy for petroleum USTs. (*Mid-Continent Casualty Company* v. *L.B. King*, 552 F.Supp.2d 1309 (2008)).

EPA has chosen to require a time-dependent cancellation provision irrespective of the reason for cancellation. Specifically, the required wording of the endorsement must state that cancellation, failure to renew or any other termination of the insurance by the insurer will be effective only upon written notice to the owner operator and the Regional Administrator by certified mail and only after the expiration of 120 days beginning with the date of receipt of the notice by both the Regional Administrator and the owner or operator, as evidenced by the return receipts.

3.2.13. Standby trust fund requirement and cancellation without an acceptable replacement instrument.

EPA has traditionally not required the use of a SBTF to accompany insurance and similarly has not required insurers to pay out the remainder of a policy into a fund in cases of instrument cancellation, owner/operator failure to perform, etc. (as is often required for surety bonds and letters of credit). In the NRC context, public comments received from the Nuclear Energy Institute (NEI) (a nuclear trade association) may provide an explanation. Specifically, NEI took issue with NRC's proposed requirement that insurance proceeds be payable into a decommissioning trust: "It is commercially unreasonable to expect an insurer to make a lump sum payment before any costs are actually incurred . . . ." Furthermore, NEI specifically objected to the requirement of paying out the full face amount following notice of cancellation when the licensee does not provide a replacement instrument; NEI posited that NRC should be willing to accept payment of a different (presumably lesser) amount in the event of cancellation with no provision of replacement assurance.[185]

California's solid waste financial assurance program offers one example of a requirement for insurance to provide for lump sum payment. The certificate of insurance for closure/post-closure maintenance and reasonably foreseeable corrective action requires a provision guaranteeing that the insurer will pay out funds should the owner operator fail to satisfy one of the assured regulatory requirements. Specifically, the certificate states:

> If either partial or complete closure, post-closure maintenance, or corrective action activities are ordered by … government entity or court of competent jurisdiction as a result of failure of the operator or other authorized person to conduct such activities, the insurance policy shall also guarantee that the insurer will be responsible for paying out funds … for deposit into a special account established for such activities.[186]

In a meeting with representatives from the insurance industry on December 8, 2015, EPA asked whether insurers would have an appetite for participating in a program that required payment of the funds (e.g., into a standby trust fund) assured by the insurance policy in the event that the insurer cancelled the policy and the owner/operator failed to obtain a replacement instrument. Insurance industry representatives stated that such a requirement would be consistent with and acceptable in a closure framework (where funds are built up in the policy) but not in the risk transfer/liability framework. One

[185] NEI Comments on NUREG-1577, Rev. 1, 69 FR 43278 (July 19, 2004), available at http://www.nrc.gov/reading-rm/doc-collections/commission/comm-secy/2004/2004-0068comscy-attach3.pdf.
[186] Title 27 of the California Code of Regulations, Div. 2, Subd. 1, Chapter 6 Financial Assurances, Subchapter 3 Allowable Mechanisms, Section 22248(h) Closure and/or Post-closure Maintenance and/or Reasonably Foreseeable Corrective Action Insurance.

representative stated that for policies based on the risk transfer/liability model, insurers typically do not pay lump sums, but rather "pay as we go" following adjustment and settlement of individual claims.

The primary advantage of the use of a SBTF is a reduction of the risk that 108(b) FR funds will not be available in the event that the insurer cancels the policy and the owner/operator fails to provide alternate financial responsibility. The primary disadvantage is that payment into the SBTF in the event of insurer cancellation and failure of the owner or operator to provide acceptable alternate assurance may cause insurers to raise the price of obtaining coverage.

Under the RCRA Subtitle C LOC provisions, if the owner or operator does not establish alternate financial assurance within 90 days from the receipt of notice of cancellation/termination/non-renewal (or within the last 30 days of any extension to the LOC), the Regional Administrator will draw on the LOC for transfer into the SBTF. Requirements for use of a SBTF to accompany 108(b) insurance could be structured similarly – allowing for a specified time for an owner/operator to find a replacement instrument, after which an insurer would be required to deposit into the SBTF. This approach could be implemented through requirements in the regulatory text and required instrument text.

Regulatory text wording could mirror that in any of several EPA programs requiring the use of a SBTF for LOCs or surety bonds. For example, 40 CFR 261.143(c)(3) specifies that, "An owner or operator who uses a letter of credit to satisfy the requirements of this section must also establish a standby trust fund," and outlines basic requirements for such a SBTF. The regulatory text also includes a condition requiring deposit into a SBTF in the event of cancellation and failure of owner/operator to provide alternate FR, as mentioned above.

Options EPA Considered.

Potential options for provisions related to payments into SBTF after notice of cancellation and owner or operator failure to obtain an acceptable replacement instrument include:

- **Option 1:** No payments authorized
- **Option 2**: Payments authorized only after certain "triggering events" have occurred
- **Option 3:** Payments into SBTF authorized regardless of "triggering events"
- **Option 4:** Automatic deposits of available balance

Option 1: No payments authorized.
Strengths: Option 1, no payments authorized, would minimize the Agency's § 108(b) administrative burden, by reducing the burden associated with cancellation related payments into standby trust funds. A strength of this option, as compared to the other options considered, is a reduced likelihood that the insurer would have to make payment on the policy in circumstances where there is no reason to believe that the parties will be unable or unwilling to pay for CERCLA claims and liabilities.
Weaknesses: This option would provide the least financial assurance if a CERCLA claim became ripe after cancellation where the owner/operator failed to obtain an acceptable FR instrument.

Option 2: Payments authorized only after certain "triggering events" have occurred before cancellations
Strengths: Compared to Option 1, Option 2 would provide better assurance that funding would be available if a covered CERCLA liability occurred before cancellation. A strength of this option, as compared to Options 3 and 4, is a reduced likelihood that the insurer would have to make payment in

circumstances where there is no reason to believe that the owner/operator will be unable or unwilling to pay for CERCLA claims and liabilities.
Weaknesses: Option 2, payments authorized only after specified triggering events have occurred, would increase the Agency's § 108(b) administrative burden as compared to Option 1. Option 2 would provide less assurance than Option 3 and 4 that funding would be available in the future because facilities at which the specified triggering events have not occurred can present risks and require Superfund actions despite the absence of a triggering event before cancellation. Also, there would be an additional administrative burden, as compared to Options 3 and 4, in assessing whether specified triggering events have occurred.

Option 3: Payments into SBTF authorized regardless of "triggering events" at Regional Administrator's discretion
Strengths: Option 3 would have a lower administrative burden than Option 2 because the Agency would not be required to assess whether specified triggering events have occurred to trigger payment into the standby trust fund. Option 3 would provide EPA greater assurance than Options 1 and 2 that funding would be available if needed in the future, regardless of the circumstances existing at the facility at the time of cancellation.
Weaknesses: Option 3, payments authorized regardless of "triggering events," would increase the Agency's § 108(b) administrative burden as compared to Options 1 and 4 because it would require the EPA to determine whether or not to require the insurer to transmit the available balance to a standby trust fund following notice of cancellation and failure of the owner or operator to provide an acceptable replacement § 108(b) FR instrument. Option 3 also creates uncertainty for the EPA, regulated community, and instrument providers about when a payment may occur. Insurers would likely prefer Options 1 and 2 over Option 3 because Option 3 creates a scenario in which it is more likely that the insurer may be required to pay out assured funds where there is greater uncertainty whether parties will be unable or unwilling to pay for CERCLA claims and liabilities.

Option 4: Automatic deposits of available balance
Strengths: Option 4, automatic deposits of available balance, would minimize the Agency's § 108(b) administrative burden because EPA would not have a role in determining whether or not the payment should be made. Option 4 would provide EPA assurance that funding would be available if needed in the future, regardless of the circumstances existing at the facility at the time of cancellation.
Weaknesses: Insurers would be expected to dislike Option 4 because it allows no flexibility as to whether payment would be required after cancellation and failure of the owner/operator to provide acceptable replacement § 108(b) FR. Also may result in paying out funds that may never be used.

In light of the above considerations, the Agency prefers Option 4.

Part 4. Surety Bond.

The surety bond is one[187] of the instruments CERCLA authorizes for use in connection with § 108(b) FR. A surety bond is a written agreement based upon a three-party relationship. In the context of CERCLA § 108(b) these three parties include the current owner/operator of the regulated facility, the issuer of

[187] CERCLA authorizes one, or any combination, of the following: insurance, guarantee, surety bond, letter of credit, or qualification as a self-insurer.

the surety bond, and the oblige claimant(s) (e.g., U.S. Government or injured 3rd party) who is owed the required payment/performance under CERCLA. Figure 1 below illustrates the responsibilities that are characteristic of this three-party relationship.

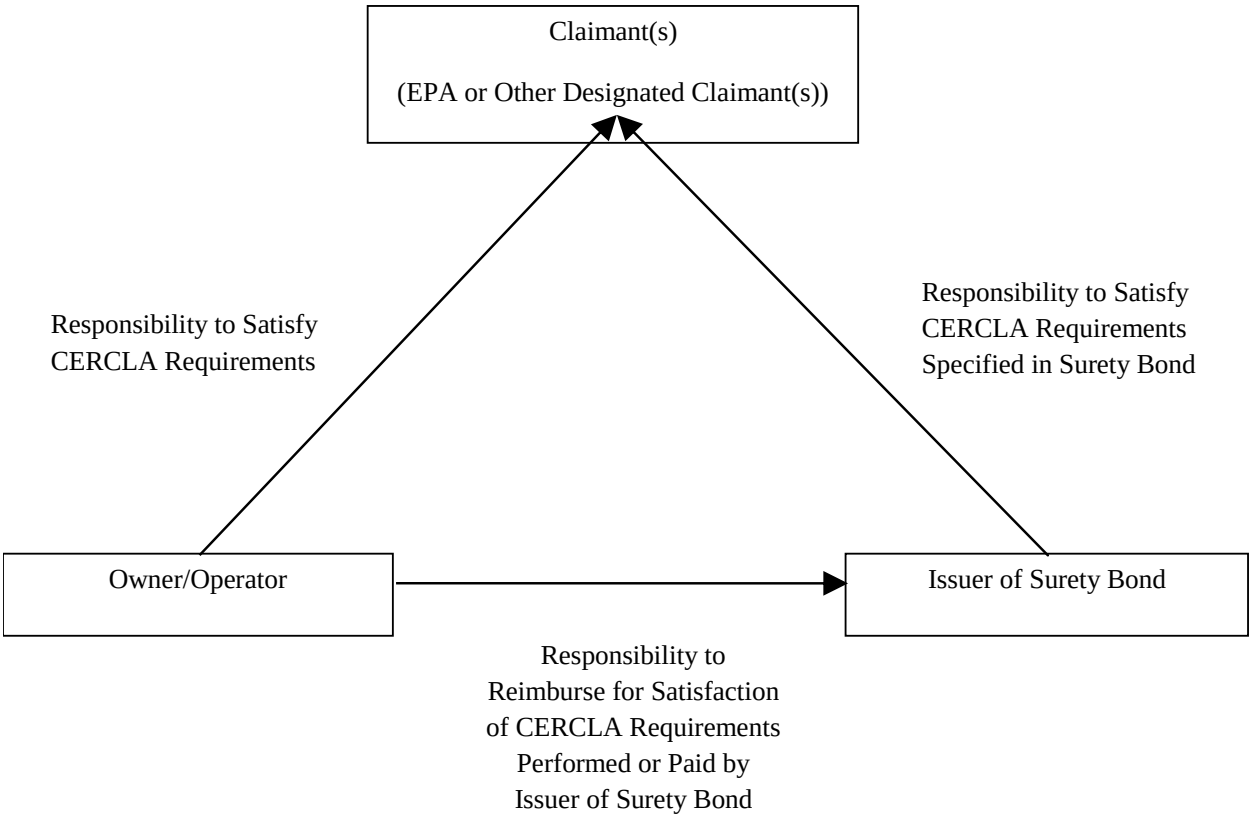
The relationship between the owner/operator and the claimant(s) originates from the owner/operator's participation in an activity that is subject to CERCLA. Participation in the covered activity creates the owner/operator's responsibility to satisfy all CERCLA requirements.

The relationship between the owner/operator and the issuer of the surety bond originates from the owner/operator's decision to obtain a surety bond to satisfy its CERCLA § 108(b) requirement to demonstrate FR to ensure payment/performance of specified CERCLA requirements (e.g., remediation, compensatory liability).

A surety bond creates two relationships for the issuer - one between the issuer of the surety bond and the claimant and the other between the issuer of the surety bond and the owner/operator. Upon issuance of the surety bond, the issuer becomes responsible to satisfy, up to a specified maximum amount known as the "penal sum," the CERCLA requirements identified in the surety bond if the owner/operator fails to do so (often termed "default"). Simultaneously with the creation of the surety bond issuer's responsibility to pay/perform, the owner/operator becomes responsible to reimburse the issuer of the surety bond for payment/performance made in accordance with the terms of the surety bond.[188] The surety bond issuer's right to reimbursement helps to ensure that it is the owner/operator rather than the issuer of the surety bond that ultimately bears the cost of fulfilling the CERCLA obligations owed to the claimant.

[188] Restatement of the Law, Third,f Suretyship and Guaranty (1996), § 22.

Figure 1. Relationships Between Parties to a Surety Bond



This draft report identifies required wording specifications for CERCLA § 108(b) surety bonds. Additionally, the draft report analyzes strengths and weaknesses of alternative surety bond specifications, and identifies the Agency's rationales for selecting among the alternatives.

Part 4.1 presents surety bond-specific provisions. The provisions in Part 4.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 4.1 includes 5 such surety bond provisions: (1) EPA will establish required wording for the 108(b) surety bonds, (2) Conformance clause, (3) Acceptable types of surety bonds, (4) Surety obligations under 108(b), and (5) Cancellation notices. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 4.2.

Part 4.2 identifies and analyzes alternative specifications that EPA considered for 6 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Payment triggers, (2) Multiple sureties for a single facility, (3) How many documents can be submitted, (4) Joint and several liability, (5) Standby trust fund requirements, and (6) Direct action authorization and

defenses. The Agency documented strengths and weaknesses for alternative specifications for each of these issues.

Part 4.1. Instrument-specific Provisions for 108(b) Surety Bonds.

Part 4.1 presents surety bond-specific provisions. The provisions in Part 4.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 4.1 includes 5 such surety bond provisions: (1) EPA will establish required wording for the 108(b) surety bonds, (2) Conformance clause, (3) Acceptable types of surety bonds, (4) Surety obligations under 108(b), and (5) Cancellation notices. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 4.2.

4.1.1. EPA will specify required wordings for the 108(b) surety bonds.

Required wording of the 108(b) surety bonds will be specified in 108(b) regulations, not as guidance.[189] This approach is consistent with RCRA TSDF surety bond instruments for closure/post-closure and for liability coverage, for which the required surety wordings are set out at 40 CFR 264.151(b), (c), and (l). For those instruments, the regulations state "[instrument] must be worded as follows, except that instructions in brackets are to be replaced with the relevant information and the brackets deleted."[190] The Agency intends that the required wordings for 108(b) are complete and include the relevant instructions.

4.1.2. Conformance clause.

Laws that require an owner/operator to demonstrate financial responsibility frequently state that the financial responsibility mechanism must contain certain specifications to satisfy the financial responsibility requirement. If, in addition to requiring specifications for the surety bond, the law states that a surety bond issued pursuant to the law is deemed to contain (or exclude) certain terms, then those specifications deemed to be included (or excluded) in the surety bond are controlling even if not included in (or excluded by) the terms of the surety bond. This principle is applicable for laws in the form of statutes, regulations, or court rules.[191]

CERCLA § 108(b)(2) does not explicitly require any specifications for any financial responsibility mechanisms nor does it state that a financial responsibility mechanism for CERCLA § 108(b) is deemed to contain specific terms. However, the statute does provide EPA the authority to "specify policy or

[189] EPA SDWA Class VI instrument specifications are laid out as guidance, not regulatory requirements. US NRC instrument specifications for decommissioning FR of materials licensees also are laid out as Models and through guidance, not with required wording specified in regulations. The varied potential uses for CERCLA cost recovery argue for having required wording in regulations, which should reduce administrative burdens for all parties.
[190] In some instances, the required wordings fail to include the actual instruction in brackets (e.g., the required language did not state "[insert X here]"), but the Agency believes that the required RCRA instrument wording does not lack for clarity. This omission was criticized in Thomas Volet, "Problematic Provisions in Standby Auto-Extension Clauses," Documentary Credit World (April, 2014).
[191] Restatement of the Law, Third, Suretyship and Guaranty (1996), § 71.

other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing such evidence of financial responsibility in order to effectuate the purposes of this Act." Therefore, EPA has the power to require inclusion (or exclusion) of specifications within surety bonds used to satisfy CERCLA § 108(b) financial responsibility requirements and to deem that surety bonds issued in satisfaction of such requirements contain (or exclude) certain specifications.

To ensure that all parties to a surety bond are in agreement on the terms of a surety bond, the American Institute of Architects (AIA) uses the following conformance clause in its model payment bond language:[192]

> When this bond has been furnished to comply with a statutory or other legal requirement . . . . , any provision in this Bond conflicting with said statutory or legal requirement shall be deemed deleted herefrom and provisions conforming to such statutory or other legal requirement shall be deemed incorporated herein. When so furnished, the intent is that this Bond shall be construed as a statutory bond and not as a common law bond.[193]

EPA has decided to include a conformance clause similar to the language cited above in the required wording of the § 108(b) surety bond to ensure all parties are in agreement on the terms of the surety bond.

4.1.3. Required type of allowable surety bond.

Surety bonds come in two types: payment bonds and performance bonds. The type of surety bond can impact how the issuer of the surety bond is required to respond to owner/operator default. A payment bond is a promise from the issuer of the surety bond that it will provide funds to certain specified classes of claimants and/or the standby trust fund up to the amount of the penal sum of the surety bond if the owner/operator does not pay or perform according to specified requirements. In the case of § 108(b) bonds, performance default means that a current owner or operator fails to pay a demand for cost recovery or for NRD liabilities. A performance bond is a promise from the issuer of the surety bond that it will either pay up to the amount of the penal sum of the surety bond or otherwise ensure that all obligations assured by the surety bond are performed, if the owner/operator does not perform according to specified requirements.

The RCRA Subtitle C closure/post-closure financial responsibility program accepts both payment and performance bonds for permitted facilities.[194] However, during interim status, these facilities are not allowed to demonstrate financial responsibility using a performance bond. The Agency reasoned that this restriction was necessary because the actual required performance may not be specified in detail

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[192] AIA model bond language was developed through an extensive process involving stakeholder consultation with the goal of creating the industry standard. Most recently, in 2009 the AIA began the process of revising the longstanding Payment Bond and solicited the support and feedback of members of the construction and surety industries. After this collaborative process, AIA released a revised Payment bond in 2010 that was expected to "continue as the industry standard, representing the fair and balanced interests of their users." http://www.aia.org/aiaucmp/groups/aia/documents/pdf/aiab083075.pdf.

[193] AIA Document AD12 – 2010, § 14 of Payment Bond, available at https://constructiondocuments.aia.org/Products/ProductDescription.aspx?productId=89890088-248b-43dd-bdcc-681c77564302.

[194] 40 CFR 264.151(b) and (c).

while the facility is in interim status.[195] The RCRA Subtitle C liability coverage financial responsibility program accepts payment bonds only.[196] In this case, the Agency reasoned that performance bonds "are not adaptable to liability coverage."[197] The Coast Guard allows the use of a payment bond as a financial responsibility mechanism for CERCLA § 108(a).[198]

Because the actual required performance at a covered facility is not spelled out (e.g., in a permit or approved plan) in advance of establishing the financial responsibility, the Agency decided to limit the types of allowable surety bonds to a payment bond only.

4.1.4. Amount of surety's obligation under § 108(b) surety bond.

Issues relating to amounts of FR coverage include both issues common to all instruments and also issues specific to surety bonds. A single amount of required 108(b) coverage will be calculated per facility, which is the amount of required FR. The amount shall be inclusive of all CERCLA 107 liabilities, and the required FR instruments shall contain no sub-limits for any specific CERCLA 107 liabilities even when combinations of instruments are being used for a single facility. As stated in Section 2.3.1, when a single instrument is being used for more than one covered facility, sub-limits for each facility must be at least in the minimum required amounts for the respective facilities. As stated in Sections 2.3.2 and 2.3.3, combinations of instruments must add up to the total required amount of coverage per facility.

The Agency identified 2 additional topics related to dollar amounts of coverage that are specific to surety bonds. This Section focuses on dollar-related provisions for 108(b) surety bonds, including (1) Investigation and defense costs outside penal sum and (2) Single penal sum per facility without sub-limits.

4.1.4.1. Investigation and defense costs outside penal sum.

Upon issuance of the surety bond, the surety becomes responsible to satisfy, up to a specified maximum amount known as the "penal sum," the CERCLA requirements identified in the surety bond if fails to do so. The Agency is concerned about claim, investigation, and defense costs incurred by the surety reducing the amount of available financial assurance for payment of third-party § 108(b) claims. This potential issue can be addressed by separating investigation defense costs from the penal sum of the bond. For example, the agency could include in the required wording of the § 108(b) surety bond something similar to the following wording from the American Institute of Architects's model payment bond language: "The Surety's total obligation shall not exceed the amount of this Bond, plus the amount of reasonable attorney's fees provided under Section 7.3 . . ."[199]
EPA has opted to include language in the bond stating that in no event shall the obligation of the Surety exceed the amount of the penal sum plus the amount of any investigation or legal defense fees.

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[195] 47 FR 15040 (April 7, 1982).
[196] 40 CFR 264.151(l).
[197] 53 FR 33940 (Sept. 1, 1988). Surety Bond Guarantee, Form CG-5586-2 (Expiration Date: December 2015), available at http://www.uscg.mil/forms/cg/CG_5586_2.pdf. No explanation from the Coast Guard for requiring a payment bond was identified.
[198] Financial Responsibility, how established, 33 CFR § 138.80(b)(2).
[199] AIA Document AD12 – 2010, §8 of Payment Bond, available at https://constructiondocuments.aia.org/Products/ProductDescription.aspx?productId=89890088-248b-43dd-bdcc-681c77564302.

4.1.4.2. Single penal sum per facility without sub-limits.

EPA believes that § 108(b) surety bonds should contain no sub-limits but have a single penal sum equal to the total required amount of coverage for the facility, unless a combination of instruments is being used. EPA believes that sub-limits should not be allowed for 108(b) surety bonds, including annual limits and limits per claim, per occurrence, per incident, per pollution condition, and the like. EPA believes that per facility sub-limits (penal sums) should be allowed only when a single bond covers multiple facilities, in which case the bond must establish per-facility sub-limits (penal sums) at least equal to the respective facility-specific required amounts of coverage (as discussed in Section 2.3.1 above).

The required wording of the RCRA Subtitle C closure/post-closure surety bond follows this approach, establishing a penal sum without sub-limits. However, the required wording of the RCRA Subtitle C liability surety bond does allow for per occurrence or annual aggregate sub-limits. These sub-limits reflect the required sub-limits of liability coverage that are specified in the Subtitle C liability coverage regulations. The RCRA Subtitle C required amounts of liability coverage vary depending on the hazardous waste management activities carried out by a facility. For a RCRA Subtitle C storage and treatment facility the minimum required amounts of liability coverage are $1 million per occurrence and $2 million annual aggregate. The Subtitle I FR program for USTs follows a similar approach. The amounts of required liability coverage in both of these programs are not the result of site-specific cost estimates but rather come from the FR rules and numbers included in those rules.

EPA believes that for the 108(b) program it is preferable to follow the approach used in the RCRA Subtitle C closure/post-closure FR program, where no sub-limits are specified. Except for per-facility sub-limits when an instrument is covering multiple facilities, any other sub-limits would not be appropriate for 108(b) coverage of a facility. Such per incident, per claim, per year, or per pollution condition sub-limits would create a potential undesirable limitation on 108(b) coverage for the facility. The Agency has opted for a single penal sum approach for 108(b) surety bonds as the limit of liability per covered facility, regardless of how many or few incidents, claims, or pollution conditions may arise at the facility in any given year. This penal sum would apply to all loss arising out of the same, continuous, repeated or related pollution condition as well as any loss from unrelated pollution conditions.

4.1.5. Required cancellation notice to be given by surety bond issuers.

The surety bond issuer has the obligation to issue a notice of cancellation in advance of cancelling the surety bond. The Agency must decide whether these notification obligations should be reflected in the required wording of § 108(b) surety bonds. In the RCRA Subtitle C surety bond for liability and closure/post-closure care the surety bond issuer must issue advance notice to the owner/operator and the Agency that it intends to cancel the instrument. This notice requirement is specified in both the rules and the required wordings. The RCRA Subtitle I UST rules and required surety bond wording require cancellation notification by the surety to the Principal (owner or operator), but not to the Agency; Subtitle I instead requires the owner or operator to notify the regulator if an acceptable instrument is not found to replace the expiring surety bond.[200] For § 108(b), the Agency prefers to

[200] 40 CFR 280.98.

follow the Subtitle C approach and retain in the required wording of the instrument the cancellation notice requirement from the surety to both the owner/operator and the Agency.

Part 4.2. Alternative Specifications for Key § 108(b) Surety Bond Provisions with Advantages/Disadvantages of the Options.

Part 4.2 identifies and analyzes alternative specifications that EPA considered for 6 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). The Agency documented strengths/weaknesses for alternative specifications including, payment triggers, multiple sureties for a single facility, how many documents can be submitted, joint and several liability, standby trust fund requirements, and direct action authorization and defenses.

4.2.1. Payment triggers.

For surety bonds, EPA must develop the criteria governing payments from the bond to claimants. These criteria may be referred to as "payment triggers." As discussed in more detail in Section 2.2, EPA is considering that the regulations and required wording of the surety instruments would specify that sureties must make payments from 108(b) surety bonds in three circumstances: Payment of an unsatisfied CERCLA judgment, payment as required in a CERCLA settlement with the federal government, and payment into a trust fund established under an administrative order.

Among other considerations related to the options for payment trigger(s) are the number of claimants with whom the surety would have to negotiate. During the meeting between the EPA and the surety community held by EPA on January 14, 2016, surety providers expressed an interest in having to deal with as few claimants as possible.

Payment also may be required in a direct action scenario as allowed under CERCLA § 108(c). The payment triggers related to direct action could be specified separately from the payment triggers discussed in this section or could be identical to them.

Current Practice. Under the RCRA Subtitle C required wordings of the closure/post-closure surety bonds, the payment trigger is notification by an EPA Regional Administrator to the surety of owner/operator default.[201] Such a framework would require EPA participation in every draw on the surety bond. This framework would require the surety to negotiate with only the EPA. In contrast, under the RCRA Subtitle C required wording of the third-party liability coverage bond, the final action needed to trigger payment is either (1) receipt by the surety of a certification from the Principal and the third party claimants that the liability claim should be paid or (2) receipt by the surety of a valid final court order.[202] As compared to the closure/post-closure program approach, EPA is not required to participate in each draw on the liability surety bond and accessibility to the assured funds is available to a broader range of claimants than under the closure/post-closure care program. The availability of the

[201] 40 CFR § 264.151(b)-(c).

[202] 40 CFR § 264.151(l), "(a) Certification from the Principal and the third party claimant(s) that the liability claim should be paid. The certification must be worded as follows, except that instructions in brackets are to be replaced with the relevant information and the brackets deleted . . . or (b) A valid final court order establishing a judgment against the Principal for bodily injury or property damage caused by sudden or nonsudden accidental occurrences arising from the operation of the Principal's facility or group of facilities."

assured funds to a broader range of claimants opens up the corresponding potential for the surety to have to negotiate with a broader range of individuals and/or organizations.

Options EPA Considered.

Potential options for payment triggers for CERCLA § 108(b) surety bonds include:

- **Option 1:** EPA written instruction for payment (similar to RCRA Subtitle C closure/post-closure model). The EPA payment instructions would be in addition to the settlement agreement, administrative order, or judgment.
- **Option 2:** Written payment instruction from another identified arbiter (e.g., a trustee). The arbiter payment instructions would be in addition to the settlement agreement, administrative order, or judgment.
- **Option 3:** Required documents such as a settlement agreement, administrative order, or final court order/judgment (similar to RCRA Subtitle C liability coverage model).
- **Option 4:** No payment trigger described in wording of surety bond.

Option 1: EPA written instruction for payment (similar to RCRA Subtitle C closure/post-closure model). The EPA payment instructions would be in addition to the settlement agreement, administrative order, or judgment.
Strengths: Option 1 would provide the greatest assurance of funding for EPA of all of the options considered because EPA would be responsible for claims management and settlement of claims. Surety bond providers may prefer Option 1 over Option 3, leading to greater participation in § 108(b) by sureties because Option 1 limits the number of claimants with whom the surety may have to negotiate.
Weaknesses: Option 1 would place the claims management burden on the EPA, which is a disadvantage. EPA would need to interpret whether the settlements, orders, or judgments support payment of claims.[203] Another drawback of Option 1 is that EPA would be in the awkward position of both administering claims and also being a potential claimant.

Option 2: Written payment instruction from another identified arbiter (e.g., a trustee). The arbiter payment instructions would be in addition to the settlement agreement, administrative order, or judgment.
Strengths: An advantage of Option 2 is that it would not place the claims management burden on the EPA. Another advantage of Option 2 is that EPA would not be in the awkward position of both administering claims and also being a potential claimant. Surety bond providers may prefer Option 2 over Option 3, leading to greater participation in § 108(b) by sureties because Option 2 limits the number of claimants with whom the surety may have to negotiate.
Weaknesses: Similar to Option 3, Option 2 would provide less assurance of funding for EPA than Option 1 because EPA would not be responsible for claims management and settlement of claims. A potential weakness is the availability of an entity willing to play this arbiter role and the potential cost of the arbiter's services. The arbiter would likely want protection for the consequences of its decisions such as trust law affords to fiduciaries.

[203] The recent case of Florida Power Corp. v. FirstEnergy Corp. 2015 WL 6743513 (8th Cir. Nov.5, 2015) reiterates prior holdings that whether or not CERCLA liability is resolved through a settlement is not a question that can be decided by a universal rule.

Option 3: Required documents such as a settlement agreement, administrative order, or final court order/judgment relating to the facility covered by the surety bond but without written payment instructions (similar to RCRA Subtitle C liability coverage model).
Strengths: Option 3 would not place the claims management burden on the EPA, which is an advantage. Another advantage of Option 3 is that EPA would not be in the awkward position of both administering claims and also being a potential claimant.
Weaknesses: Option 3 may make demands on surety providers to interpret whether the settlements, orders, or judgments support payment of claims; sureties are well-equipped and experienced in such claims management. Similar to Option 2, Option 3 would provide less assurance of funding for EPA than Option 1 because EPA would not be responsible for claims management and settlement of claims. Because under this option the surety provider may be required to negotiate with a larger pool of potential claimants than under the first two options, surety provider participation in the CERCLA § 108(b) program may be more limited if this option is pursued.

Option 4: No payment trigger described in wording of surety bond.
Strengths: Option 4 places no administrative burden on EPA.
Weaknesses: Option 4 would provide no guidance to surety bond providers, which is a major drawback. The potential that EPA may have to participate in some efforts in the future to resolve misunderstanding due to the lack of guidance in the required wording could lead to some amount of burden. Furthermore, the uncertainty associated with Option 4 would provide the least assurance and the slowest access to funding of all of the options considered. Surety bond providers would not likely prefer this arrangement because of the uncertainty and the larger pool of potential claimants with whom the surety provider might be required to negotiate. Therefore, surety provider participation in the CERCLA § 108(b) program may be most limited if this option is pursued.

The Agency has determined that a combination of the described options is preferable depending on the type of enforcement action (e.g., court judgement, settlement, or UAO) that is pursued. Specifically, EPA has determined to implement EPA or other Federal agency instruction as the payment trigger associated with a settlement or UAO and submission of the final court judgement, without the need for agency instruction, for a court judgement.

4.2.2. Multiple sureties for a single facility.

A responsible party may choose to purchase multiple surety bonds to cover an obligation when the total amount of coverage it is seeking is large or for other reasons. The use of multiple bonds to assure one total obligation is sometimes described as a "tower of coverage." A tower of coverage may be created in two forms, vertical or horizontal.

A vertical tower is created using multiple sureties to cover fixed percentages of an obligation. In a vertical tower, several sureties each cover a percentage of total facility liability, and cover that percentage regardless of the size of the claim. For example, four sureties may engage in a vertical tower of coverage for a liability, each insuring 25% of the total liability. If a $10,000,000 claim is made, then each surety will pay its percent share of the claim, in this instance $2,500,000 each. Vertical relationships among sureties do not change the percentage of liability covered as the dollar amount of claims changes. In a vertical tower, a surety is responsible for its percent share if the claim is $100 or $100,000,000.

Horizontal towers are constructed by multiple sureties participating in a series of coverage agreements, that, when summed, add up to the required total amount of coverage. Horizontal tower coverage agreements are often described as 'layers' of coverage. Each surety in the horizontal tower agrees to cover its layer of the tower, not a percentage of the total. For example, four sureties may engage in a horizontal tower to cover $10,000,000. In this example tower, there could be four layers, each covering $2,500,000 (layer 1, $1-$2,500,000; layer 2 $2,500,001-$5,000,000…etc.). If a claim is made for $5,000,000 then the surety covering layer 1 will pay the first $2,500,000 and the surety for layer 2 will pay the claim from $2,500,001 to $5,000,000. Because the example claim does not reach into layers 3 and 4, those sureties are not required to pay anything. Sureties of the lowest ("base") layer are often referred to as 'primary guarantors' and are the first to respond to a claimed loss. "Excess" guarantors – those higher up in the horizontal tower – become responsible on a layer-by-layer basis as the limits of each underlying policy become exhausted. Primary guarantors often charge higher premiums (e.g., per million dollars of coverage) than guarantors higher up in the tower of coverage because claims are less likely to reach higher limits than to reach lower limits.

By participating in towers of coverage, multiple sureties share the risk of covering a facility or transaction, reducing the amount covered by an individual surety. Because CERCLA 108(b) FR requirements may be higher in amounts than other EPA liability coverage programs, EPA anticipates that sureties may want to participate in towers of coverage for individual 108(b) facilities. Use of multiple sureties has not been an issue for EPA liability coverage programs under RCRA Subtitle C and I, but two other federal programs with required amounts of liability coverage ranging up to $35 and $150 million accept the use of multiple sureties to provide FR for a single facility or vessel. These two federal agencies are the Coast Guard, which requires liability coverage for vessels under CERLCA 108(a) and the Oil Pollution Act of 1990 (OPA 90), and the Bureau of Ocean Energy Management (BOEM) which requires liability coverage for vessels and facilities under OPA 90. The Coast Guard permits only vertical towers while BOEM does not expressly stipulate how multiple sureties may interact. The Agency reviewed the experience of the Coast Guard and BOEM regarding potential issues with multiple sureties.

Current Practice. Under CERCLA 108(a) and the OPA, the Coast Guard requires that FR be established by any one or a combination of evidence of insurance, surety bond, guarantee, letter of credit, or self-insurance.[204] The Coast Guard requires that a covered vessel submit evidence of acceptable FR equal to the total amount required for each vessel.[205] The Coast Guard requires that when a vessel uses surety bonds to demonstrate FR, the surety(s) must execute the "Surety Bond Guaranty" form (FORM CG-5586-2). Multiple sureties are allowed to participate in the execution of a single Coast Guard Surety Bond Guaranty form for a vessel.[206]

The Coast Guard's regulations limit this participation to ten sureties, stating "Ten or fewer sureties (including lead sureties) may jointly execute a surety bond guaranty form (FORM CG-4486-2)…"[207] When several sureties jointly execute a Surety Bond Guaranty, those sureties are permitted to

[204] 33 U.S.C 2716(e), CERCLA 108(a).
[205] The 'total applicable amount' is determined by a combination of CERCLA and OPA 90 liabilities. The applicable amount under CERCLA is determined as follows: For a vessel over 300 gross tons carrying a CERCLA hazardous substance as cargo, the greater of $5,000,000 or $300 per gross ton, for any other vessel over 300 gross tons, the greater of $500,000 or $300 per gross ton. The applicable amount under OPA 90 is equal to the applicable vessel limit of liability under OPA 90 found at 33 CFR § 138.230. (33 CFR § 138.80(f)).
[206] 33 CFR § 138.80(c)(1).
[207] 33 CFR § 138.80(c)(1).

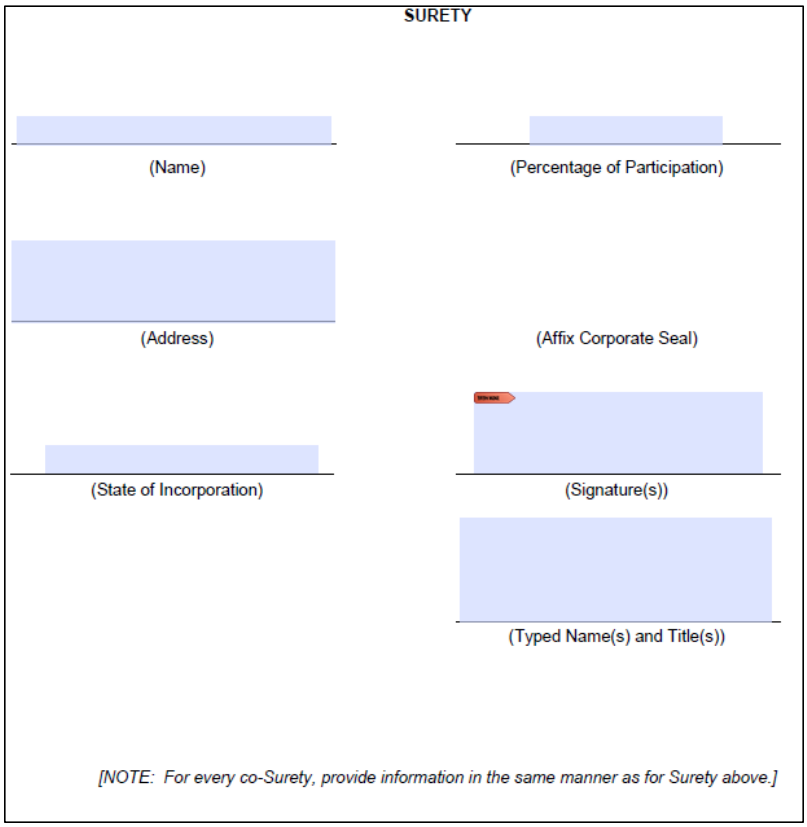
participate solely in vertical towers[208] based on percentage participation.[209] Participation in a horizontal tower or horizontal layering is not permissible.[210] The Coast Guard has prohibited horizontal layers because of its concern that if the guarantor of a layer becomes insolvent or bankrupt, other guarantors further up the chain may be under no obligation to pay their liabilities.[211] The Coast Guard's vertical tower program also limits the number of sureties that may participate in the tower to ten sureties.[212] The Coast Guard has justified limiting the number of sureties, stating that the Coast Guard "believes this limitation is needed to provide a manageable process for claimants dealing with guarantors."[213] Allowing a maximum of ten sureties was included in the regulations as a response to a public comment that recommended that up to ten guarantors be allowed to participate in a surety bond guaranty as this would "expand the availability of high-dollar limit surety bond guaranties, due to the United States Treasury-imposed underwriting limits on individual surety companies."[214] Although a maximum of ten sureties may jointly execute the Surety Bond Guaranty, one or more of the ten sureties may act as the representative or lead surety of multiple other sureties who also wish to participate in the program.[215] By allowing one or more of the ten sureties to act as a lead underwriter for other sureties, the Coast Guard promotes broad participation in the FR program while limiting the number of sureties that the Coast Guard or claimants must directly interact with.

The Surety Bond Guaranty form is formatted so that each surety participating in coverage expressly documents its percentage share of liability rather than each surety documenting a dollar layer of liability coverage. The Surety Bond Guaranty Form does not require that sureties document the required dollar amount of liability coverage. This amount is determined by the sum of liability under the OPA[216] and the liability under CERCLA 108(a).[217] The Coast Guard's Surety Bond Guarantee Form states that: "If there is more than one surety company executing this guaranty...the Sureties, bind ourselves…for the payment of the percentage of the penal sum only as is set forth opposite the name of each Surety." If more than a single surety executes the form, then the name of the lead guarantor must be provided "having authority to bind all guarantors for actions of all guarantors under [CERCLA 108(a) and OPA] including but not limited to ... receipt and settlement of claims...."[218]

Form CG-5586-2 is formatted as follows:[219]

[208] The Coast Guard uses the term "layers" to refer to vertical towers.
[209] 33 CFR § 138.80(c)(1)(i).
[210] 33 CFR § 138.80(c)(i), 59 FR 34220 (July 1, 1994).
[211] 59 FR 34220 (July 1, 1994).
[212] 33 CFR § 138.80(c)(1).
[213] 59 FR 34220 (July 1, 1994).
[214] 61 FR. 9263 (March 7, 1996).
[215] 59 FR 34220, (July 1, 1994).
[216] 33 CFR § 138.80(f)(3).
[217] FORM CG-5586-2 (Expiration Date: December 2015).
[218] FORM CG-5586-2 (Expiration Date: December 2015).
[219] FORM CG-5586-2 (Expiration Date: December 2015).

Exhibit 4 – Coast Guard Surety Guarantee Form



BOEM also allows multiple sureties to provide coverage for a single facility.[220] Under OPA 90, FR may be demonstrated by any one, or by any combination of evidence of insurance, surety bond, guarantee, letter of credit, qualification as a self-insurer, or other evidence of financial responsibility.[221] OPA 90 and BOEM's regulations do not stipulate how many sureties may participate in providing coverage for a single facility or how multiple sureties may arrange themselves to provide coverage.[222]

BOEM's Surety Bond Financial Responsibility form, Form BOEM-1020, also does not address the issue of multiple sureties demonstrating FR for a single facility. The Form is written for a single surety and does not provide an opportunity for multiple sureties to submit evidence of Financial Responsibility on a single Surety Bond Form. However, BOEM-1020 does not prohibit the submission of multiple 1020 forms from multiple sureties. It appears that BOEM does not intend for multiple sureties to provide FR coverage for a single facility on a single BOEM-1020 form; however, sureties may divide the dollar amount of required liability coverage among multiple sureties by submitting multiple BOEM-1020 forms that in the aggregate, sum to the total applicable amount of coverage required by 30 CFR 553.13(b).[223]

[220] 30 CFR § 553.31.
[221] 33 U.S.C. 2716(e).
[222] 30 CFR § 553.31.
[223] Although not expressly stated in their regulations with regards to Surety Bonds, BOEM has indicated that multiple guarantors submitting separate financial responsibility certificates can create administrative issues for overseeing agencies. 63 FR 42704 (August 11, 1998).

BOEM has not directly limited the number of potential sureties eligible to provide FR for a single facility, nor have they expressly limited how multiple sureties may arrange themselves (i.e. vertical vs. horizontal layers).

EPA Issues and Options related to Multiple Sureties.

In light of the above, EPA has three general issues to address:

- Issue 1. Whether or not EPA will allow multiple sureties to participate in providing 108(b) coverage for a single facility,
- Issue 2. Whether or not to cap the number of sureties if EPA chooses to allow multiple surety participation, and
- Issue 3. How to structure the relationship among multiple sureties if EPA chooses to allow multiple surety participation in covering a single facility under 108(b).

Issue 1: Allow multiple sureties to provide 108(b) coverage per facility.

Under the RCRA Subtitle C closure/post-closure, RCRA Subtitle I Underground Storage Tanks, and SDWA UIC Class VI wells programs, EPA allows multiple sureties to participate in providing coverage for a single facility. Similarly, the Coast Guard and BOEM both allow multiple sureties to provide coverage for a single facility or vessel.

Potential EPA Options for Multiple Sureties for 108(b):

- **Option 1:** Allow multiple sureties to provide coverage for a single facility.
- **Option 2:** Permit only one surety to provide coverage for a single facility.[224]

Option 1: Allow multiple sureties to provide coverage for a single facility.
Strengths: Multiple sureties may increase the availability of coverage for 108(b) facilities. Multiple sureties may be able to cover higher amounts than a single surety. Allowing multiple sureties to provide coverage may increase the number of sureties participating in the 108(b) program. Used by EPA, the Coast Guard, and BOEM.
Weaknesses: According to the Coast Guard, guarantors for a single facility increase administrative burdens on the regulating agency and claimants. Multiple sureties, if organized in horizontal layers, also present the potential for one or more guarantors to go bankrupt, voiding the responsibility of higher-level guarantors providing coverage for the same facility.

Option 2: Permit only one surety to provide coverage for a single facility.[225]
Strengths: May ease administrative burdens for the facility, claimants, and the Agency as multiple surety and certificates can be difficult to manage and enforce (as stated by the Coast Guard and BOEM). Ensures that a single surety will be responsible if a coverage issue or claim arises.
Weaknesses: May limit surety participation in the program. A single surety may not be willing to take on the high amount of coverage necessary for 108(b) facilities.

[224] Option would allow 1 surety plus other instruments.
[225] Option would allow 1 surety plus other instruments.

Issue 2: Cap the number of sureties eligible to provide coverage for a single facility if multiple sureties are permitted to provide coverage.

EPA regulatory programs provide little precedent for this issue. Therefore, the Agency reviewed the experiences of the Coast Guard and BOEM.

Potential EPA options for capping the number of 108(b) sureties for a single facility:

- **Option 1:** Permit an uncapped number of sureties to participate in providing coverage for a single facility.
- **Option 2:** Cap the number of sureties to a set number.
- **Option 3:** Cap the number of sureties but allow them to act as lead underwriters for other sureties.

Option 1: Permit an uncapped number of sureties to participate in providing coverage for a single facility.
Strengths: Multiple sureties may permit greater dollar amounts to be covered, because each surety could cover a smaller amount of liability.
Weaknesses: An uncapped number of sureties could create administrative issues for EPA and claimants. As the Coast Guard has referenced, a large number of sureties is difficult to oversee and increases the administrative burden following a claim.

Option 2: Cap the number of sureties to a set number.
Strengths: Would limit the administrative burden on the Agency. Would simplify interaction among participating sureties. Would provide clear points of contact for the Agency and claimants.
Weaknesses: May decrease the number of sureties willing to participate in the program.

Option 3: Cap the number of sureties but allow them to act as lead underwriters for other sureties.
Strengths: Would limit the administrative burden on the Agency. Would simplify interaction among participating sureties. Would provide clear points of contact for the Agency and claimants. Allowing lead underwriters would promote increased participation in the 108(b) program. Used by the Coast Guard.
Weaknesses: May decrease the number of sureties willing to participate in the program. Agency and claimants may encounter unexpected issues with lead underwriter managing multiple sureties.

Issue 3: Structure the relationship among sureties if multiple sureties are allowed to provide coverage.

If EPA decides to allow multiple sureties for a single facility, the Agency can apply vertical and/or horizontal towers to structure the relationship among multiple sureties.

Potential EPA options for 108(b):

- **Option 1:** Allow only vertical towers of coverage for multiple participating sureties
- **Option 2:** Allow only horizontal towers of coverage for multiple participating sureties.
- **Option 3:** Allow a combination of horizontal and vertical towers.

Option 1: Allow only vertical towers of coverage for multiple participating sureties.

Strengths: Allowing vertical participation simplifies the relationships among sureties because each surety has a set percentage of total liability to cover and must cover that percentage of liability regardless of the size of the claim. Potentially less burdensome than horizontal layers because EPA will only have to review percent shares. Consistent with approach for multiple instruments (see discussion at Section 2.3.2). Used by the Coast Guard.
Weaknesses: Some sureties may prefer to provide coverage only as an excess guarantor and not be a primary guarantor.

Option 2: Allow only horizontal towers of coverage for multiple participating sureties.
Strengths: Horizontal towers or layers may encourage more sureties to participate in providing coverage because sureties will have the option of choosing which layer to provide coverage for.
Weaknesses: Presents the opportunity for sureties coving higher coverage layers to avoid liability if a surety on a lower level becomes insolvent and cannot cover the liability within its layer. Burdensome because EPA would need to ensure that each layer of coverage fits with the layers above and below. EPA would also need to ensure that the layers contained exhaustion provisions. Inconsistent with approach for multiple instruments (see discussion at Section 2.3.2).

Option 3: Allow a combination of horizontal and vertical towers.
Strengths: Most likely to attract surety participation in the program. Allows sureties to choose which level of coverage they wish to provide.
Weaknesses: Complexity for Agency and claimants. Presents the opportunity for sureties covering higher coverage layers to avoid liability if a surety on a lower level becomes insolvent and cannot cover the liability within its layer. Burdensome because EPA would need to ensure that each layer of coverage fits with the layers above and below. Inconsistent with approach for multiple instruments (see discussion at Section 2.3.2).

In light of the above, the Agency has determined that the proposed regulations will allow for an uncapped number of sureties to provide for vertical towers of coverage for a single facility.

4.2.3. One document per facility or per issuer.

If EPA decides to allow multiple issuers to cover a single 108(b) facility, EPA must determine whether to require one surety bond document per facility or one surety bond document for each issuer participating in providing coverage. If EPA requires one document per facility, then the document would collectively describe each issuer's vertical and/or horizontal shares of the required total amount of coverage.[226] Alternatively, if EPA required one document per issuer, then the document would describe separately each issuer's vertical and/or horizontal shares of the required total amount of coverage (see discussion of vertical and/or horizontal shares in Section 4.2.2 above).

Currently there is little existing EPA precedent regarding the number of FR documents when multiple issuers cover a single facility (see discussion in Section 4.2.2 above). Therefore, EPA reviewed the document procedures in comparable Coast Guard and BOEM FR programs allowing multiple issuers for a single facility.

[226] See, e.g., Coast Guard Surety Bond Guarantee Form CG-5586-2 (Expiration Date: December 2015).

Current Practice. As stated in Section 4.2.2, the Coast Guard allows multiple surety bond issuers to participate in providing coverage for a single vessel; however, the Coast Guard limited participation to no more than ten issuers.[227] These issuers may execute a single surety bond guaranty form that expressly states each issuer's vertical participation as a percentage share of the FR liability.[228] If multiple sureties provide coverage for a single vessel, then a lead surety must be designated having the authority to bind all participating issuers for actions required of them under CERCLA and OPA 90.[229] Although the regulations do not indicate that multiple issuers must execute a single surety bond guaranty form, the Coast Guard's Surety Bond Guaranty Form, Form CG-5586-2, allows for a single form to be submitted by the lead issuer. Although the submission of a single document appears to be implied in the regulations,[230] the regulations and Surety Bond Guaranty instrument do not expressly prohibit the submission of multiple issuer documents per facility.

In similar fashion to the Coast Guard, BOEM requires that a facility submit information about its surety bond issuers on a Form BOEM-1020 if the facility chooses to demonstrate FR through a surety bond(s). If multiple issuers are to be used, then each issuer must submit its own Form BOEM-1020.[231]

Options EPA Considered.

EPA has two potential options when considering how many evidentiary surety bond documents a single CERCLA 108(b) facility can submit when using multiple surety bond issuers to cover a single facility.

- **Option 1:** Allow each surety to submit an individual document that describes the individual issuer's vertical and/or horizontal share of the FR liability.
- **Option 2:** Require no more than one surety bond document for each facility. Specify that, when multiple issuers participate, a 108(b) surety bond document describes every issuer's vertical and/or horizontal shares of the required total amount of coverage.

Option 1: Allow each surety to submit an individual document that describes the individual issuer's vertical and/or horizontal share of the FR liability.
Strengths: Option 1 allows each issuer to submit an individual document that describes the individual issuer's vertical and/or horizontal share (as discussed in Section 4.2.2) of the FR liability. Strengths of this option are that it may encourage issuers to participate in the program, and provide an opportunity for higher amounts of coverage to be reached. One document per issuer will allow the Agency to clearly identify the participation of every single issuer.
Weaknesses: Weaknesses of this option include the potential issue that multiple surety bond documents may increase administrative burdens for regulators and may confuse claimants, particularly in a direct action claim (as discussed in Section 4.2.6). The sum of individual participation shares submitted on multiple documents also may not equal the total amount of required coverage for a single facility.

[227] 33 CFR § 138.80(b)(2).
[228] A guaranty form without specified percentage shares for certain issuers is also acceptable, because the liability for an issuer with an unspecified percentage shall be joint and severable for the total of the unspecified portion of the guaranty (33 CFR § 138.80(c)(1)(i)).
[229] 33 CFR § 138.80(c)(1)(ii).
[230] 33 CFR § 138.80(b)(2).
[231] 30 CFR § 553.31(a).

Option 2: Require no more than one surety bond document for each facility. Specify that, when multiple issuers participate, a 108(b) surety bond document describes every issuer's vertical and/or horizontal shares of the required total amount of coverage.
Strengths: Strengths of this option are that one document minimizes administrative burdens on EPA. One document also makes it easier to find the appropriate parties for claimants.
Weaknesses: Weaknesses of this option include that it may limit the number of issuers willing to participate in the program because issuers may prefer to file their own forms with EPA. A single document per facility may also not clearly explain the coverage of all parties involved.

In light of the above, the Agency will propose Option 2.

4.2.4. Joint and several liability of multiple surety bond issuers.

EPA expects the required amounts of CERCLA § 108(b) financial responsibility may be relatively large. In addition to potentially meeting this requirement by obtaining multiple forms of financial responsibility, as discussed in Section 2.3 above, an owner/operator may obtain surety bonds from multiple issuers to provide the required sum. If multiple sureties are permitted to provide coverage for a single facility subject to CERCLA 108(b), EPA researched whether or not to require joint and several liability for claims made under 108(b). With joint and several liability, each insurer would be liable for the full extent of a claim regardless of its stated liability limit (or share of coverage) (see discussion of multiple sureties at Section 4.2.2). Joint and several liability has been implemented in multiple environmental statutes and regulations (the Coast Guard and BOEM); shifting the risk of the entire liability onto each of the liable parties to reduce the risk that a liability will not be paid by one or more parties and to reduce the burden on claimants pursuing multiple sureties.

The Coast Guard addresses joint and several liability in its vertical participation system by requiring sureties to specify their vertical participation in providing coverage and stating that sureties specifying percentages will be liable only up to their expressed participation limits. However, if a surety(ies) does not expressly state its percentage liability to the Coast Guard or the total vertical participation does not sum to 100%, the surety(ies) shall be jointly and severally liable for the total of the unspecified portions.[232]

When there are multiple surety bond issuers on a single surety bond, each issuer is liable to claimants in accordance with the terms of the surety bond.[233] Therefore, EPA can require specifications within the surety bond to govern the relationship among the sureties and their combined duties to the claimant(s).

Three possible specifications involving multiple surety bond issuers for a single facility include:

- **Option 1:** Each issuer of the surety bond is responsible for a specified share of the penal sum and the claimant must pursue recovery from each surety bond issuer individually ("several liability").
- **Option 2:** Each issuer of the surety bond is responsible for the entire penal sum and the claimant can pursue recovery up to the penal sum from any issuer ("joint liability").

[232] FORM CG-5586-2 (Expiration Date: December 2015).
[233] Restatement of the Law, Third, Suretyship and Guaranty (1996), § 52 cmt. a.

- **Option 3:** Impose joint and several liability requirements on multiple insurers only if initial percentage allocations of coverage are less than 100%.

Option 1: Each issuer of the surety bond is responsible for a specified share of the penal sum and the claimant must pursue recovery from each surety bond issuer individually ("several liability").
Strengths: Option 1 may increase surety bond issuer willingness to issue CERCLA § 108(b) surety bonds because issuers can have greater certainty of their respective responsibilities without concern with how other sureties may behave. Additionally, Option 1 may increase surety bond issuers' capacity to collectively cover greater amounts of financial responsibility because the surety's level of coverage would not be impacted by the potential risk for non-payment by other sureties.
Weaknesses: Option 1 would likely increase the administrative burden for EPA and also subject claimants to the risk of insolvency by individual surety bond issuers.

Option 2: Each issuer of the surety bond is responsible for the entire penal sum and the claimant can pursue recovery up to the penal sum from any issuer ("joint liability").
Strengths: Option 2 is favorable to the claimant because it increases the available options for accessing funds efficiently and protects the claimant from the insolvency of individual surety bond issuers because the surety could recover the entire penal sum from any of the issuing sureties. All financial responsibility programs reviewed, including the Coast Guard § 108(a), RCRA Subtitle C liability coverage, RCRA Subtitle C closure/post-closure, and RCRA Subtitle I UST, require sureties to bind themselves jointly and severally for purposes of allowing a joint action(s) against the issuers of the surety bond, but allow for payment based on pre-determined proportions of the penal sum (several liability).
Weaknesses: Option 2 increases the potential liability of each individual issuer of the surety bond and could reduce surety bond issuer willingness to participate.

Option 3: Impose joint and several liability requirements on multiple insurers only if initial percentage allocations of coverage are less than 100%.
Strengths: Option 3 will ensure that the entire amount of required liability will be covered by insurers regardless of initial gaps in coverage and could have the effect of incentivizing sureties to police coverage statements. Option 3 is currently used by the Coast Guard. Alternatively, Option 3 may raise questions concerning EPA authority and may be inconsistent with EPA's approach to multiple 108(b) instruments (see discussion at 2.3.2).
Weaknesses: May also discourage sureties from participating in the 108(b) program.

For the reasons explained above and consistent with other programs reviewed, the Agency intends to require sureties to bind themselves jointly and severally for the purposes of allowing a joint action or actions against the surety bond while allowing each surety to retain its individual penal sum.

4.2.5. Standby trust fund requirement and cancellation without an acceptable replacement instrument.

EPA has decided to require a SBTF to accompany a surety bond under the 108(b) program. The purpose of the SBTF will be to serve as a receptacle for funds in the event of cancellation/termination/non-renewal of a surety bond and failure of the owner/operator to provide alternate financial assurance. In many EPA programs reviewed by the Agency, a SBTF is required to accompany a surety bond. Specifically, a SBTF is required to accompany a surety bond in the RCRA Subtitle C closure/post-closure

program, the RCRA Subtitle I UST program, and the SDWA UIC Class VI wells program. As discussed above, the Agency has decided to follow this precedent.

One issue of particular concern for EPA is continuity of financial responsibility coverage to ensure that funding is available when needed. Cancellation of a surety bond by the provider of the surety bond without the owner or operator providing acceptable substitute FR raises the question about continuity of coverage and availability of funding when needed. If a surety bond is cancelled by the surety bond provider and the owner/operator subsequently fails to provide an acceptable replacement § 108(b) FR instrument within a specified time, the required wording of the bond or regulatory language must specify the surety's liability for draws on the bond prior to its termination.

Current Practice. The RCRA Subtitle C liability program and the CERCLA § 108(a) and OPA FR programs do not include a requirement for draws on the surety bond associated with the cancellation procedures. Under the RCRA Subtitle C closure/post-closure program, the surety is required to make payment into the standby trust fund upon EPA Regional Administrator notification of the owner/operator's failure to provide an acceptable alternate instrument after notice of bond cancellation.[234] In contrast, the RCRA underground storage tanks program requires surety payment after owner/operator failure to provide an alternative instrument after notice of cancellation only if one of the following "triggering events" have occurred:

- EPA "determines or suspects" that a release has occurred or the owner/operator has notified EPA that a release has occurred;
- EPA has received certification that a third-party liability claim should be paid; or
- EPA determines that the owner/operator hasn't satisfied a court order establishing a judgment for bodily injury or property damage caused by an accidental release from an underground storage tank.

Options EPA Considered.

Potential options for provisions related to draws after notice of cancellation and owner or operator failure to obtain an acceptable replacement instrument include:

- **Option 1:** No draws authorized
- **Option 2:** Draws authorized only after certain "triggering events" have occurred
- **Option 3:** Draws authorized regardless of "triggering events"
- **Option 4:** Automatic deposit of available balance

Option 1: No draws authorized
Strengths: Option 1, no draws authorized, would minimize the Agency's § 108(b) administrative burden, by reducing the burden associated with cancellation draws and standby trust funds. A strength of this option, as compared to the other options considered, is a reduced likelihood that the surety would have to make payment on the surety bond in circumstances where there is no reason to believe that the owner/operator will be unable or unwilling to pay for CERCLA claims and liabilities.
Weaknesses: This option would provide the least financial assurance if a CERCLA claim became ripe after cancellation where the owner/operator had failed to obtain an acceptable FR instrument.

[234] 40 CFR s. 264.151(b).

Option 2: Draws authorized only after certain "triggering events" have occurred
Strengths: Compared to Option 1, Option 2 would provide better assurance that funding would be available if a covered CERCLA liability occurred in the future. A strength of this option, as compared to Options 3 and 4, is a reduced likelihood that the surety would have to make payment on the surety bond in circumstances where there is no reason to believe that the owner/operator will be unable or unwilling to pay for CERCLA claims and liabilities.
Weaknesses: Option 2, draws authorized only after specified triggering events have occurred, would increase the Agency's § 108(b) administrative burden as compared to Option 1. Option 2 would provide less assurance than Options 3 and 4 that funding would be available in the future because facilities at which the specified triggering events have not occurred can present risks and require Superfund actions despite the absence of a triggering event at the time of cancellation. There would be an additional administrative burden, as compared to Options 3 and 4, in assessing whether specified triggering events have occurred.

Option 3: Draws authorized regardless of "triggering events"
Strengths: Option 3 would have a lower administrative burden than Option 2 because the Agency would not be required to assess whether specified triggering events have occurred to trigger payment into the standby trust fund. Option 3 would provide EPA greater assurance than Options 1 and 2 that funding would be available if needed in the future, regardless of the circumstances existing at the facility at the time of cancellation.
Weaknesses: Option 3, draws authorized regardless of "triggering events," would increase the Agency's § 108(b) administrative burden as compared to Options 1 and 4 because it would require the EPA to determine whether or not to require the surety to transmit the available balance to a standby trust fund following notice of cancellation and failure of the owner or operator to provide an acceptable replacement § 108(b) FR instrument. Sureties would likely prefer Options 1 and 2 over Option 3 because Option 3 creates a scenario in which it is more likely that the surety may be required to pay out assured funds where there is greater uncertainty whether the owner/operator will be unable or unwilling to pay for CERCLA claims and liabilities.

Option 4: Automatic deposit of available balance
Strengths: Option 4, automatic deposits of available balance, would minimize the Agency's § 108(b) administrative burden because EPA would not have a role in determining whether or not the payment should be made. Option 4 would provide EPA assurance that funding would be available if needed in the future, regardless of the circumstances existing at the facility at the time of cancellation.
Weaknesses: Sureties would be expected to dislike Option 4 because it allows no flexibility as to whether payment would be required after cancellation and failure of the owner/operator to provide acceptable replacement § 108(b) FR.

In light of the above considerations, the Agency prefers Option 4.

4.2.6. Direct action authorization and defenses.

This section discusses issues and options posed for the required wording of surety bonds by the direct action provisions of CERCLA 108(c)(2) and 108(d). The required wording of the 108(b) surety bond is expected to specify that it is to be established for the favor of any and all third-party CERCLA cost recovery and liability claimants. CERCLA provides in 108(c)(2) for a conditional right of direct action against the "guarantor" in the event of a release or a threatened release from a facility, if the person

liable under CERCLA 107 is bankrupt or otherwise unlikely to be available for suit as a solvent party. Direct action statutes are enacted with principal regard to insurance as FR, where claimants may lack the legal status (e.g., "privity of contract") to sue insurers when the insured parties are bankrupt or insolvent, thus leaving those insurance claimants with no recourse.[235] Direct action may be less useful for accessing 108(b) surety bonds, as compared to other acceptable financial assurance instruments, because claimants can bring their claims to the issuer of the surety bond for payment, whether the owner/operator is or is not bankrupt or insolvent. It is generally accepted and frequently stated within the terms of the surety bond that the issuer of the surety bond and the owner/operator have joint and several liability to the claimant, unless otherwise provided in the surety bond. In bringing a claim directly against the issuer of the surety bond, the claimant must notify the surety that the owner/operator has failed to satisfy its obligations. The claimant is entitled to receive total payment/performance up to the penal amount of the bond but not more. After the claimant recovers from the owner/operator or the issuer of the surety bond, the latter two parties will subsequently reallocate the cost of payment/performance between themselves in accordance with the terms of the surety bond.[236]

Current Practice. RCRA and CERCLA each include statutory provisions authorizing direct action against "guarantors" of financial responsibility instruments without distinction among differing types of guarantors.[237]

The Hazardous and Solid Waste Amendments of 1984 amended RCRA to authorize direct action in two situations:

1. Where the owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. Where, with reasonable diligence, jurisdiction in any State Court or any Federal Court cannot be obtained over an owner or operator likely to be solvent at the time of judgment.

Similarly, in the event of a release or threatened release from a facility, CERCLA 108(c)(2) authorizes direct action in the following situations:

1. If the person liable under CERCLA §107 is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. If, with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA §107 who is likely to be solvent at the time of judgment.[238]

Because the required wordings of EPA's RCRA financial assurance instruments in Subtitles C and I do not include direct action specifications,[239] EPA reviewed how the Coast Guard and BOEM implemented

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[235] See H.R. Rep. 253, Pt. 4, 99th Cong. 2d Sess. 51-52 (1986). Also see Mark Mese, "Direct Action Statutes" CGL Reporter ((15) 520-523, 2003).

[236] Restatement of the Law, Third, Suretyship and Guaranty (1996), § 1 cmt. p.

[237] RCRA 3004(t)(2), CERCLA 108(c)(1), and CERCLA 108(c)(2).

[238] CERCLA 108(c)(2).

[239] Subtitles C and I of RCRA include direct action provisions, but the associated RCRA regulations and instruments are silent on direct action. The statute states, "In any case in which an owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the FBC or where with reasonable due diligence jurisdiction in any state court or the federal courts cannot be obtained over an owner likely to be solvent at the time of judgement, any claim arising from conduct for which evidence of FR must be provided under this subsection may be asserted directly against the guarantor providing evidence of the FR."42 U.S.C. 6991b(d)(2), 42 USC 6924(t)(2).

analogous FR provisions with direct action components. Both the Coast Guard and the BOEM FR programs allow for the use of a surety bond as an acceptable form of financial responsibility.

The Coast Guard's FR authority stems from both CERCLA 108(a) and the Oil Pollution Act of 1990 ("OPA 90"). For CERCLA, the Coast Guard's direct action authority comes from CERCLA 108(c)(1) for vessels. In the event of a release or threatened release from a vessel, CERCLA 108(c)(1) authorizes direct action against guarantors (i.e., instrument providers other than the owner or operator) for any claim authorized by CERCLA 107 or 111.[240]

In addition to CERCLA, OPA 90 authorizes direct action in three instances:

1. The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles (GAAP),
2. The assured party has filed a petition for bankruptcy, or
3. The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims.[241]

The Coast Guard's regulations on direct action require that the wording of the instruments must include an accompanying acknowledgment that, "an action in court by a claimant (including a claimant by right of subrogation) for costs or damages arising under the provisions of these Acts [CERLCA and OPA 90], may be brought directly against the insurer or other guarantor."[242] The Agency considers such wording desirable in the CERCLA 108(b) surety bond.

With regards to direct action, BOEM has indicated in its regulations that direct action shall apply to all guarantors.[243] BOEM's regulations regarding direct action mirror the statutory language of OPA 90. As identified above, under OPA 90, a claim may be made directly if one of three requirements is met.[244] BOEM's regulations reaffirm these statutory requirements, stating that a guarantor is subject to direct action for any claim asserted by:

1. The United States for any compensation paid by the Fund[245] under OPA, including compensation claim processing costs; and
2. A claimant other than the United States if the responsible party has:
    a. Denied or failed to pay a claim because of being insolvent or

[240] In contrast, in the event of a release or a threatened release from a facility, CERCLA108(c)(2) authorizes direct action against a guarantor for any claim authorized by CERCLA 107 or 111 if the person liable under CERCLA 107 is in bankruptcy, reorganization, or arrangement, or if with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA 107 who is likely to be solvent at the time of judgment.
[241] 33 U.S.C. 2716(f)(2).
[242] 33 CFR 138.80(d).
[243] 30 CFR 553.61(a).
[244] (1) The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles, (2) The assured party has filed a petition for bankruptcy, or (3) The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims. 33 USC 2716(f)(2).
[245] Oil Spill Liability Trust Fund, established by Section 9509 of the Internal Revenue Code of 1986 as amended (26 U.S.C. 9509).

b. Filed a petition in bankruptcy under 11 USC chapters 7 or 11.[246]

Although there are subtle differences in language between OPA 90 and BOEM direct action regulations, BOEM has stated that these differences are not substantial and that, "the terms and conditions cited in the [regulatory] section are consistent with those in OPA. The rule does not 'broaden' the statutory language."[247]

Much like the Coast Guard, BOEM's regulations for the required wording of FR instruments also require an acknowledgement that direct action may be taken against the issuer of the instrument if certain criteria are met. BOEM's regulations state, "Each instrument you submit as FR evidence must specify that the instrument issuer agrees to direct action for claims made under OPA up to the guaranty amount, subject to the defenses[248] in paragraph (a)(6) of this section. . . ."[249]

In its regulations, BOEM has highlighted a statutory provision in OPA 90 that any claim made by the U.S. government may be brought directly, although claims made by other claimants may not be brought directly unless a Responsible Party asserts that it is insolvent or if a bankruptcy petition has been filed. Commenters on the BOEM regulations promulgated in 1998 addressed the "assertion of insolvency" provision, recommending that the BOEM implement a strict interpretation of what constitutes insolvency, including greater guidance concerning a responsible party's financial status. BOEM responded that its interpretation of the insolvency condition did not require verification of the owner/operator's financial status at the time of the assertion.[250] BOEM stated, "Our interpretation is that if a responsible party denies or fails to pay a claim asserting that he or she is insolvent and further asserts that the conditions of his or her insolvency are equivalent to the insolvency criteria set forth at OPA section 1016(f)(2), then claimants may proceed against the responsible party's guarantor."[251] BOEM decided not to require an official determination of insolvency, which could be a time-consuming process.[252]

Potential EPA Direct Action Options for 108(b).

EPA has five potential options when considering how to apply direct action provisions to CERCLA § 108(b) surety bonds, some of which could be combined:

- **Option 1:** Include direct action provisions in the required wording of the surety bond, such as an explicit acknowledgement by sureties that they are subject to direct action claims under applicable circumstances.
- **Option 2:** Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
- **Option 3:** Do not include direct action provisions in the instrument or regulations.

[246] 30 CFR 553.61(a).
[247] 63 FR 42699 (August 11, 1998).
[248] An instrument issuer may not use any defenses against a claim made under OPA except: (1) the rights and defenses that would be available to a designated applicant or responsible party for whom the guaranty was provided; and (2) the incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated OSFR.
[249] 30 CFR 553.41(a)(4).
[250] 63 FR 42699 (August 11, 1998).
[251] 63 FR 42699 (August 11, 1998).
[252] 63 FR 42699 (August 11, 1998).

- Expand direct action authorization under CERCLA 108(c)(2). For example, EPA could expand direct action explicitly to allow direct access to the surety bond is a wider range of circumstances than that specified in 108(c)(2).
- **Option 5:** Narrow direct action authorization under CERCLA 108(c)(2). EPA could place greater restrictions on, by whom, and when a direct action claim could be brought against trustees of 108(b) trusts. For example, EPA could require a formal finding of pending insolvency, creating greater burdens for claimants to use direct action.

Option 1. Include direct action provisions in the required wording of the surety bond, such as an explicit acknowledgement by sureties that they are subject to direct action claims under applicable circumstances.
Strengths: Increases transparency and ensures that the surety and potential claimants are aware of the direct action authorization. Used by the Coast Guard and BOEM for other FR instruments authorized under CERCLA and OPA 90.
Weaknesses: May discourage sureties from participating in the § 108(b) program if subject to direct action. Not needed because of statutory authorization. Adds to surety bond verbiage which the Agency would need to confirm.

Option 2. Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
Strengths: A direct action provision in the instrument is not needed because of statutory authorization. Less required verbiage for EPA to confirm. May encourage participation from sureties.
Weaknesses: The lack of an acknowledgment in the instrument itself decreases transparency and may fail to ensure that the surety and potential claimants are aware of the direct action authorization. Inconsistent with Coast Guard and BOEM.

Option 3. Do not include direct action provisions in the instrument or regulations.
Strengths: A direct action provision in the instrument or regulations is not needed because of statutory authorization. May encourage participation from sureties.
Weaknesses: The lack of an acknowledgment in the regulations or instrument may create uncertainty as to the scope of the direct action provision. May also decrease transparency and fail to ensure that the surety and potential claimants are aware of the direct action authorization. Inconsistent with Coast Guard and BOEM.

Option 4. Expand direct action authorization under CERCLA 108(c)(2). For example, EPA could expand direct action explicitly to allow direct access to the surety bond is a wider range of circumstances than that specified in 108(c)(2).
Strengths: Expanded direct action could provide claimants with faster cost recovery and liability payments.
Weaknesses: May discourage sureties from participating in 108(b) program. May interfere with first come, first served approach (see discussion at Section 2.1 above) or equal treatment of all types of liabilities (see discussion at Section 2.1 above). May raise question of EPA's authority to expand statutory direct action.

Option 5. Narrow direct action authorization under CERCLA 108(c)(2). EPA could place greater restrictions on, by whom, and when a direct action claim could be brought against trustees of 108(b) trusts. For example, EPA could require a formal finding of pending insolvency, creating greater burdens for claimants to use direct action.

Strengths: By narrowing direct action authorization, EPA may increase surety participation in the 108(b) program. Consistent with BOEM, that may have narrowed direct action provisions (i.e., with regards to reinsurers).
Weaknesses: Narrowing direct action authorization may make it more difficult for some claimants to expeditiously file claims and receive payments. May raise question of EPA's authority to narrow statutory direct action.

In light of the above considerations, EPA has decided to include language in required wording of the CERCLA 108(b) surety bond acknowledging and authorizing direct action without attempting to narrow or expand the scope from what is provided in the statute.

Defenses Available Under Direct Action. According to the authoritative *Restatement of the Law: Suretyship and Guaranty*, the issuer of the surety bond may raise as a defense to its responsibility to pay/perform any defense that the owner/operator could have raised as a defense to pay/perform the same responsibilities, except the owner/operator's defense of bankruptcy.[253] The owner/operator's bankruptcy is an exception because the surety bond protects against the inability or unwillingness of the owner/operator to satisfy its obligations to the claimant. Accordingly, the issuer of the surety bond may not raise the defense of the owner/operator's bankruptcy.[254]

As described above, CERCLA 108(c)(2) makes guarantors subject to direct action claims. CERLCA 108(c)(2) and (d) provide those guarantors with specified defenses against such claims. Both the RCRA[255] and CERCLA statutes specify that under direct action, a guarantor is entitled to invoke all rights and defenses which would have been available to the owner or operator if any action had been brought against the owner or operator by a claimant under the respective Acts.[256] Because EPA's RCRA Subtitle C and I FR regulations and required wordings of FR instruments do not contain specifications for defenses to direct action, EPA reviewed how the Coast Guard and BOEM addressed defenses to direct action in their FR programs.

In developing FR regulations for vessels under CERCLA 108(a) and OPA 90, the Coast Guard specified direct action defenses in its FR regulations and instruments.[257] Under CERCLA 108(c)(1), the guarantor is "entitled to invoke all rights and defenses which would have been available to the person liable under § 107 if any action had been brought against such person by the claimant and all rights and defenses which would have been available to the guarantor if an action had been brought against the guarantor by such person." Under OPA 90, a guarantor may invoke, (1) all rights and defenses which would be available to the responsible party under OPA 90, (2) any defense authorized under subsection (e);[258] and (3) the defense that the incident was caused by the willful misconduct of the responsible party.[259]

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[253] Restatement of the Law,Third, of Suretyship and Guaranty (1996), § 34(1)(a).
[254] Restatement of the Law,Third, of Suretyship and Guaranty (1996), § 34 cmt. b.
[255] Subtitle C 3004, Subtitle I 9003, 9004.
[256] CERCLA 108(c)(1) also includes a willful misconduct provision as a defense for a release from a vessel, but not a facility.
[257] 33 CFR 138.80(d).
[258] The Secretary or President, as appropriate, may specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing evidence of financial responsibility to effectuate the purposes of this Act. 1016(e).
[259] OPA 90 1016(f)(1).

From its CERCLA statutory authority, the Coast Guard's direct action defense regulations include the CERLCA statutory defenses outlined in 108(c)(1) as well as Coast Guard developed administrative defenses to direct action.[260] Coast Guard regulations state that a guarantor may invoke only the following rights and defenses with respect to a direct action claim:

1. Any defense that a person for whom the guaranty is provided may raise under the Acts,
2. The incident, release, or threatened release was caused by the willful misconduct of the person for whom the guarantee is provided,
3. A defense that the amount of a claim or claims, filed in any action in any court or other proceeding, exceeds the amount of the guaranty with respect to an incident or with respect to a release or threatened release,
4. A defense that the amount of a claim exceeds the amount of the guaranty, which amount is based on the gross tonnage of the vessel as entered on the vessel's International Tonnage Certificate or other official, applicable certificate of measurement, except when the guarantor knew or should have known that the applicable tonnage certified was incorrect, and
5. The claim is not one made under either of the Acts.[261]

The Coast Guard's direct action defenses include a willful misconduct provision, but do not include a defense for fraud or misrepresentation. In the preamble to its 1996 rule, the Coast Guard rejected a public comment to allow fraud or intentional misrepresentation as a guarantor's defense.[262]

BOEM's defenses against direct action are similar to the Coast Guard's. Under BOEM's OPA 90 authority, BOEM chose to mirror its direct action defenses regulations to the OPA 90 statute.[263] BOEM direct action defenses include:

1. The rights and defenses which would be available to a responsible party for whom the guaranty was provided; and
2. The incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated OSFR.[264]

All of the expressly approved FR instruments in BOEM's regulations include a specification reiterating the enumerated direct action defenses from the regulations. For example, BOEM's insurance certificate states that the named insurers agree, "not to use any defense except those that would be available to a Responsible Party for whom the insurance was provided or that the incident leading to the claim for removal costs or damages was caused by willful misconduct of a Responsible Party covered by this insurance."[265] Outside of the allowed defenses, and in similar fashion to the Coast Guard, BOEM has declined to allow guarantors a defense to direct action if a Responsible Party commits fraud or makes misrepresentations in the course of procuring an FR instrument. BOEM indicated that allowing a defense

[260] 33 CFR 138.80(d). Defenses 1 and 2 are requirements from CERCLA 108(c). Defenses 3, 4, and 5 are directly related to specific 'total applicable amount' regulations in 33 CFR 138.80(f).
[261] 33 CFR 138.80(d)(1).
[262] The Coast Guard has stated that to adopt this recommendation would be inconsistent with the purpose of the guaranty – to ensure that the polluter pays for removal costs and damages. 61 FR 9270 (March 7, 1996).
[263] OPA allows all rights and defenses which would be available to the liable party; any defense authorized administratively; and the defense that the incident was caused by the willful misconduct of the responsible party.
[264] 30 CFR 553.41(a)(6).
[265] FORM BOEM-1019 (Expiration Date: December 2016).

for fraud or misrepresentation would be inconsistent with two FR program objectives: (1) Ensure that claims for oil-spill damages and cleanup costs are paid promptly, and (2) Make responsible parties or their guarantors pay claims rather than the Oil Spill Liability Trust Fund. BOEM also stated that as of 1998 there was no evidence that fraud and misrepresentation had been a problem in the FR program.[266]

Potential EPA Options for Direct Action Defenses for 108(b) Surety Bonds.

EPA has four main options regarding direct action defenses for 108(b) sureties, some of which could be combined:

- **Option 1.** Include direct action defense provisions in the required wording of the surety bond, such as a direct acknowledgement from guarantors about the available direct action defenses.
- **Option 2.** Do not include direct action defense specification in the required wording of the instrument.
- **Option 3.** Expand upon CERCLA 108(c)(2) defenses to direct action, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
- **Option 4.** Narrow CERCLA 108(c)(2) defenses to direct action claims.

Option 1. Include direct action defense provisions in the required wording of the surety bond, such as a direct acknowledgement from guarantors about the available direct action defenses.
Strengths: An acknowledgment in the required wording of the instrument increases transparency and ensures that the participating sureties and potential claimants are aware of available defenses. May encourage participation of sureties in the 108(b) FR program. Used by the Coast Guard and BOEM for other FR instruments.
Weaknesses: More verbiage for EPA to confirm. Direct action defense provisions in the required wording of the surety bond may be unnecessary if they simply mirror the statute.

Option 2. Do not include direct action defense specification in the required wording of the instrument.
Strengths: Direct action defense provisions in the required wording of the instrument may be unnecessary if they simply mirror the statute. Reduces verbiage for EPA to confirm. Consistent with RCRA instruments.
Weaknesses: The lack of a defense specification in the required wording of the instrument decreases transparency and may fail to ensure that participating sureties and potential claimants are aware of the direct action defenses.

Option 3. Expand upon CERCLA 108(c)(2) defenses to direct action, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
Strengths: Expanding defenses will be in the interest of guarantors and may encourage surety participation in 108(b) FR program.
Weaknesses: Claimants may not be able to bring direct action claims as easily. Could raise questions about EPA's authority to expand defenses.

Option 4. Narrow CERCLA 108(c)(2) defenses to direct action claims.
Strengths: Narrowing defenses to direct action will be in the interest of claimants.

[266] 63 FR 42707 (August 11, 1998).

Weaknesses: Narrowing defenses to direct action could discourage sureties from participating in the 108(b) FR program. Could raise questions about EPA's authority to narrow defenses.

In light of the above considerations, EPA has decided to propose option 1 and include a specific acknowledgment of the defense provisions provided in the statute.

Part 5. Letter of Credit.

A letter of credit (LOC) is an independent agreement by the issuer (bank) to pay up to a specified amount to parties upon the presentation of certain documents. The LOC is one[267] of the instruments CERCLA authorizes for use in connection with § 108(b) FR. The LOC brings speed, convenience, and certainty to payment. The LOC is an established tool used in commerce (e.g., since the North Atlantic trade following the Napoleonic Wars) although the standby LOC (see Section 5.1.2 below) is a 20th century invention. The LOC is not considered a contract and is not subject to laws about contracts (see Section 5.2.1 below).

This draft report identifies required wording specifications for CERCLA § 108(b) LOCs. Additionally, the draft report analyzes strengths and weaknesses of alternative LOC specifications, and identifies the Agency's rationales for selecting among the alternatives.

Part 5.1 presents letter of credit-specific provisions. The provisions in Part 5.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 5.1 includes 8 such surety bond provisions: (1) EPA will establish required wording for the 108(b) letters of credit, (2) Conformance clause, (3) 'Standby' letters of credit, (4) 'Independent' and 'irrevocable' letters of credit, (5) No named 'beneficiary/ies', (6) 'Evergreen' letters of credit, (7) Reasonable time to honor, and (8) Notices to be given by letter of credit issuing banks. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 5.2.

Part 5.2 identifies and analyzes alternative specifications that EPA considered for 7 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Governing law, (2) Draws by sight demand vs. time demand, (3) Presentation of documents, (4) Who can make draws upon the letter of credit, (5) Who can receive payments drawn from the letter of credit, (6) Standby trust fund requirements, and (7) Direct action authorization and defenses. The Agency documented strengths and weaknesses for alternative specifications for each of these issues.

Part 5.1. Instrument-specific Provisions for 108(b) LOCs.

Part 5.1 presents letter of credit-specific provisions. The provisions in Part 5.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 5.1 includes 8 such surety bond provisions: (1) EPA will establish required wording for the 108(b) letters of credit, (2) Conformance

[267] CERCLA authorizes one, or any combination, of the following: insurance, guarantee, surety bond, letter of credit, or qualification as a self-insurer.

clause, (3) 'Standby' letters of credit, (4) 'Independent' and 'irrevocable' letters of credit, (5) No named 'beneficiary/ies', (6) 'Evergreen' letters of credit, (7) Reasonable time to honor, and (8) Notices to be given by letter of credit issuing banks. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 5.2.

5.1.1. EPA will specify required wordings for the 108(b) LOC.

Required wording of the 108(b) LOC shall be specified in 108(b) regulations, not as guidance.[268] This approach is consistent with RCRA TSDF LOCs for closure/post-closure and LOCs for liability coverage for which the required wordings are set out at 40 CFR 264.151(d) and (k), respectively. For those instruments, the regulations state "[LOC] must be worded as follows except that instructions in brackets are to be replaced with the relevant information and the brackets deleted." In some instances, the required wordings fail to include the actual instruction "insert" in brackets (e.g.,"[X here]" vs. "[insert X here]"), but the Agency believes that the required instrument wording does not lack for clarity.[269] The Agency intends that the required wordings for 108(b) are complete and include the relevant instructions.

5.1.2. Conformance Clause.

Laws that require an owner or operator to demonstrate financial responsibility (e.g., for motor vehicle use) frequently state that the financial responsibility mechanism must contain certain specifications to satisfy the laws' financial responsibility requirement. If, in addition to requiring specifications for the LOC, the law states that LOCs issued pursuant to the law are deemed to contain (or exclude) certain terms, then those specifications deemed to be included (or excluded) in the LOC are controlling even if not included in (or excluded by) the terms of the LOC. This principle is applicable for laws in the form of statutes, regulations, or court rules.

CERCLA § 108(b)(2) does not explicitly require any specifications for any financial responsibility mechanisms nor does it state that a financial responsibility mechanism for CERCLA § 108(b) is deemed to contain specific terms. However, the statute does provide EPA the authority to "specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing such evidence of financial responsibility in order to effectuate the purposes of this Act." Therefore, EPA has the power to require inclusion (or exclusion) of specifications within LOCs used to satisfy CERCLA § 108(b) financial responsibility requirements and to deem that LOCs issued in satisfaction of such requirements contain (or exclude) certain specifications.

To ensure that all parties to an LOC are in agreement on the terms of the LOC, RCRA Subtitle C uses the following conformance clause in its required language for LOCs: "We certify that the wording of this letter of credit is identical to the wording specified in 40 CFR 254.151(d) as such regulations were constituted on the date shown immediately below."

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[268] EPA SDWA Class VI instrument specifications are laid out as guidance, not regulatory requirements. US NRC instrument specifications for decommissioning FR of materials licensees also are laid out as Models and through guidance, not with required wording specified in regulations. The varied potential uses for CERCLA cost recovery argue for having required wording in regulations, which should reduce administrative burdens for all parties.

[269] This omission was criticized in Thomas Volet, "Problematic Provisions in Standby Auto-Extension Clauses," Documentary Credit World (April 2014).

LOCs used as financial mechanisms under RCRA and as proposed for CERCLA 108(b) are relatively concise guarantees unlikely to contain provisions inconsistent with the regulations; therefore, certification language such as shown above, serves a similar function to more extended conformance clauses found in other proposed 108(b) instruments. In view of the RCRA precedent, the EPA has decided to include a conformance certification clause similar to the language cited above in the required wording of the § 108(b) LOC.

5.1.3. 108(b) LOCs must be "standby" LOCs.

Most LOCs are used to ensure and facilitate payment between two distant parties. These are called "commercial letters of credit." The issuer of a commercial LOC expects to make payments related to the performance of specified services. These are considered relatively short-term obligations.

The issuer of a "standby" LOC, in contrast, will typically only be called upon to pay in the event of a default by its customer, which is not expected and may never occur. This is considered a relatively long-term obligations. "Long-term obligations invariably require standby letters of credit rather than commercial letters of credit...."[270]

For both the RCRA Subtitle C closure/post-closure LOC and the liability coverage LOC, the required wordings at 40 CFR 264.151(d) and 151(k), respectively, are described as a "standby letter of credit." EPA has determined that 108(b) LOCs should have required wording that includes the term "standby." EPA expects the 108(b) LOC to be a relatively long-term obligation because draws (payment) require time for a mature claim (e.g. third parties to incur costs and liabilities and for seeking recoveries). Claims for third-party CERCLA response costs (including government health assessments) from 108(b) FR mechanisms depend on several contingencies: (1) the occurrence of a release or threatened release at the facility warranting response under CERCLA, (2) failure of the current owner or operator to take appropriate actions, (3) other parties taking response actions and incurring costs or the US issuing an administrative order or settling with the owner operator, and (4) failure to pay third-party demands for cost recovery or comply with terms of orders or settlments. Third-party claims for NRD liability depends on similar contingencies: (1) the occurrence of a release or threatened release at the facility warranting response under CERCLA, (2) assessment of NRD loss, and (3) failure of the owner or operator to pay third-party demands for NRD losses. Thus, 108(b) instrument payments would be made only following the owner or operator's default. Therefore, the Agency has determined that the 108(b) LOC necessarily is a standby LOC.

5.1.4. 108(b) LOCs must be "independent" and "irrevocable."

[270] Institute of International Banking Law and Practice, Brief of Amicus Curiae (2006) in Golden West Refining Company vs. Suntrust Bank.

The standby LOC is an "independent" undertaking. The bank has no obligation to investigate the performance (or default) of its customer as a pre-condition for payment, but must make payment solely based on its review of the documents presented versus those specified in the LOC. This "independence" attribute is inherent to LOCs and does not need to be stated in the wording of the LOC.[271] For both the RCRA Subtitle C closure/post-closure LOC and the liability coverage LOC, the required wordings at 40 CFR 264.151(d) and 151(k), respectively, do not incorporate the terms "independent" or "independence." EPA has determined that 108(b) LOCs do not require wording that includes the terms "independent" or "independence."

Letters of credit may be established either as revocable or irrevocable. These terms do not denote the duration of the LOC. A revocable LOC may be withdrawn or modified for any reason and at any time by the issuer unilaterally, without notification to the current owner or operator nor to other parties (see discussion of notices below at Section 5.1.8). In contrast, an irrevocable LOC may not be revoked or amended without the agreement of all parties to the letter.[272]

Governmentally-mandated LOCs that EPA reviewed are all termed "irrevocable." For example, the RCRA Subtitle C required wordings for LOCs at 40 CFR 264.151 (d) and (k), state in their headers and bodies that they are "irrevocable."[273] The Agency understands that the 108(b) LOC need not state that it is irrevocable in order to be irrevocable.[274] However, EPA has concluded that there is no harm in retaining current usage.

5.1.5. No named "beneficiary/ies."

A standby LOC requires the issuer to treat only the named beneficiary or its transferee as the beneficiary. The required wording of the 108(b) LOC need not literally name one or more entities as "beneficiaries." That is consistent with prior Agency practice, as seen in the RCRA Subtitle C Subpart H required wordings for LOCs for closure/post-closure care and liability coverage, at 40 CFR 264.151(d) and (k). An LOC is issued "in favor of" or "in your favor [following addresses]," may or may not specify who can present documents in order to draw upon the instrument (see below at 5.2.4), and may include provisions governing to whom payments are to be made (e.g., trustee of standby trust) (see below at 5.2.5). As discussed in 5.2.4, it may not be feasible to name all potential "beneficiaries" of a 108(b) LOC.

5.1.6. 108(b) LOCs must be "evergreen" not "perpetual" in duration.

[271] See U.C.C. Article 5, the Uniform Customs and Practices for Documenting Credits (UCP), the International Standby Practices (ISP 98), and the U.N. Convention on Independent Guarantees and Standby Letters of Credit (UNCIGSLC).
[272] See U.C.C. Article 5, the Uniform Customs and Practices for Documenting Credits (UCP), the International Standby Practices (ISP 98), and the U.N. Convention on Independent Guarantees and Standby Letters of Credit (UNCIGSLC).
[273] The Federal Acquisition Regulations (FAR) at 48 CFR 52.228-14 require that an LOC used in place of a surety bond (e.g., as financial assurance for construction projects) must be irrevocable.
[274]The Uniform Commercial Code (U.C.C.) Article 5-106(a) and UCP art. 6(a) (discussed below under "Governing Bodies of Law" at 5.2.1) make it clear that an LOC is presumed to be irrevocable unless it says otherwise. The ISP98 (discussed below under "Governing Bodies of Law" at 5.2.1) states in Rule 1.06(a) that all standbys are irrevocable.

A standby LOC typically is established for a specific, finite period of time prior to its expiration. Although a "perpetual" standby LOC may seem to reduce administrative burden, compared with periodic (typically annual) renewals of expiring LOCs, recent law has made it clear that "perpetual" standby LOCs will be presumed to have a five year expiration. That 5-year limitation was confirmed in the recent case of *Golden West Refining Co. vs. SunTrust Bank*,[275] citing U.C.C. Article 5, which has an invariable prohibition against perpetual letters of credit.[276] However, an LOC that continues indefinitely is not considered "perpetual" as long as the issuer has the right to terminate it upon prior notice. The Agency prefers an LOC that continues indefinitely.

To minimize administrative burden, EPA will specify in the required wording that 108(b) LOCs both have an expiration date and also will be automatically renewed without amendment unless the issuer notifies its intent not to renew. Such specifications sometimes are termed "evergreen" clauses. Such clauses were found in required or recommended wordings for standby LOCs reviewed by the Agency.[277]

For example, the required LOC wording for closure/post-closure at 40 CFR 264.151(d) reads as follows:

> "This letter of credit is effective as of [date] and shall expire on [date at least one year later], but such expiration date shall be automatically extended for a period of [at least one year] on [date] and on each successive expiration date, unless ...."

One authority has criticized the highlighted wording, stating that "Even if all the blanks are filled in with appropriate dates, after a first automatic extension there will be no determinable expiration date."[278] The Agency finds this criticism to be overly formalistic, assuming that the extension period in the LOC will be an uncertain "at least one year" or "at least two years" rather than the more likely and definitive "one year" or "two years." The authority did not provide alternative wording, but, by implication, would prefer to see "at least" deleted. The Agency concludes that such deletions would reduce the flexibility offered by the 108(b) LOC to the issuer.

The required LOC wording at 264.151(d) continues as follows:

> "... unless, at least 120 days before the current expiration date, we notify both you and [owner's or operator's name] by certified mail that we have decided not to extend this letter of credit beyond the current expiration date."

That language above is sometimes referred to as an "Evergreen Clause" and includes references to "the current expiration date." Required LOC wording at 264.151(k) is substantially similar.

However, the required language at 264.151(d) goes on as follows:

> "In the event you are so notified, any unused portion of the credit shall be available upon presentation of your sight draft for 120 days after the date of receipt by both you and [owner's or operator's name], as shown by the signed return receipts."

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[275] 538 F3d 1233 (9th Cir. 2008).
[276] U.C.C. 5-103(c).
[277] The FAR requires similar language for standby LOCs. See 48 CFR 52.228-14(c)(2).
[278] Thomas Volet, "Problematic Provisions in Standby Auto-Extension Clauses," Documentary Credit World (April, 2014).

The required wording at 264.151(k) does not include the above clause.[279] In order to make clear that draws would be allowed after notice of termination, the Agency has decided to use language similar to that in 264.151(d).

5.1.7. Reasonable time to honor.

All applicable rules (described in Section 5.2.1 and 5.2.2 below) for draws on LOCs give the issuer a maximum of seven business days either to honor the draw or to provide notice of specific discrepancies justifying dishonor.[280] EPA believes that there is no need to specify a shorter period.

5.1.8. Notices to be given by LOC-issuing banks.

The issuing bank has several obligations to issue notices in connection with a 108(b) LOC. The Agency must decide whether those notification obligations should be reflected in the required wording of 108(b) LOCs. Current practices for each type of notice are summarized below:

- Non-Extension Notice. The issuing bank must issue a notice that it does not intend to extend the current expiration date of the LOC. This notice is specified in both the rules and the required wordings of the RCRA LOCs for closure/post-closure and liability coverage. The RCRA Subtitle I UST rules do not require the bank to make such a notice, but instead require the owner or operator to notify the regulator if a substitute instrument is not found to replace the expiring LOC. For 108(b), the Agency prefers to follow the Subtitle C approach and retain the notice requirement from the bank in the required wording of the instrument.

- Notice of Discrepancy. If an issuing bank refuses to honor a draw when the documents presented do not comply with what is required by the LOC itself, the bank must identify the problem(s) and give a Notice of Discrepancy. By notifying the claimant of the discrepancies, the claimant can attempt to cure them. The requirement to make such a notice of discrepancies is found neither in the required wordings of the RCRA Subtitle C LOCs nor in the accompanying rules. Rather, notices of discrepancies are governing by bank procedures as codified in the UCC, the UCP, and/or the ISP, which are discussed in Section 5.2.1 below. Under the UCP and ISP, for example, a notice of discrepancy must be given by telecommunications, not regular mail, thus allowing for their prompt correction. The Agency sees no reason to add this type of notice to the required wording of the instrument because notice of discrepancy is inherent to the administration of LOCs.

- Notice of Payment. Finally, should banks be instructed to make payments to named assignees (see discussion at Section 5.2.5 below), EPA may want to include a requirement that the bank

[279] One authority notes that although the 264.151(k) required wording does not affect the current expiration date, the additional clause in 264.151(d) allows the issuing bank to shorten the period during which draws on the letter may be made to before the current expiration date, depending on when the notice is sent and received.[279] If the notice is sent and received 180 days before the current expiration date, for example, the Agency will have about 60 fewer days during which to draw upon the letter and not be able to make draws for the last 60 days before the letter's current expiration date. Thomas Volet, "Problematic Provisions in Standby Auto-Extension Clauses," Documentary Credit World (April, 2014).

[280] U.C.C. 5-108(b); UCP art. 13(b); and ISP98 Rule 5.01(a).

notify EPA when it completes such payments. Such notices of payments to assignees may be governed by the UCC, the UCP, and/or the ISP, which are discussed in Section 5.2.1 below. For example, the ISP98 Model Form 11.1 advises adding the following clause to the LOC itself should payments be made to assignees: "A notice of such payment shall be sent to beneficiary's above-stated address." Adding the clause would enable the drawer to keep track of payments made by the bank. With the exception of a direct action payment, the Agency does not believe it is necessary to add this type of notice to the required wording of the instrument.

In light of the above, the Agency has determined that the required wording of 108(b) LOCs shall include only notices of non-extension (as is current practice in RCRA Subtitle C) and notices for payment made as a result of a direct action under CERCLA 108(c).

Part 5.2. Alternative Specifications for Key 108(b) LOC Provisions with Advantages/Disadvantages of the Options.

Part 5.2 identifies and analyzes alternative specifications that EPA considered for 7 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). The Agency documented strengths and weaknesses for alternative specifications including, governing law, draws by sight demand vs. time demand, presentation of documents, who can make draws upon the letter of credit, who can receive payments drawn from the letter of credit, standby trust fund requirements, and direct action authorization and defenses.

5.2.1. Governing law.

Standby LOCs can seem to be subject to "a bewildering array of rules and laws."[281] EPA may choose to specify the governing body of law on the face of the standby LOC as part of the required wording. Potential candidates include one or more of the following:

- Uniform Commercial Code, Article 5 (UCC)
- Uniform Customs & Practices for Documentary Credits (UCP) (International Chamber of Commerce), including both UCP 500 and UCP 600
- UN Convention on Independent Guarantees and Standby LCs (UNCIGSLC)
- International Standby Practices (ISP 98)

UCC. In the U.S., use of standby letters of credit is governed by state laws that track Article 5 of the Uniform Commercial Code (U.C.C.).[282] Article 5 was last revised in 1995 to address weaknesses in the prior version and to reflect decades of changes and development in LOC law, including the emergence of

[281] Casius Pealer, Use of Standby Letters of Credit in Public and Affordable Housing Projects (2014), accessed at http://www.coatsrose.com/use-of-standby-letters-of-credit-in-public-and-affordable-housing-projects/
[282] Uniform Commercial Code. Article 5, "Letters of Credit."

standby LOCs.[283] All U.S. States reportedly adopted the revised changes, although individual States may have specific, minor alterations.

The Uniform Customs and Practices (UCP) was written specifically for commercial letters of credit but can apply to standby LOCs.[284] The first version of the UCP dates to 1933. Published by the International Chamber of Commerce (ICC), the "UCP 500" (1993) was revised in 2007 as the "UCP 600." In 2002, the International Chamber of Commerce issued an addendum to the Uniform Customs and Practices for Documentary Credits called the eUCP. This document contemplates electronic presentation (not just fax presentation) of documents to draw upon the LOC.

The UN Convention on Independent Guarantees and Standby LOCs was completed in 1995 and involved many of the same persons and organizations responsible for the 1995 UCC Article 5 revision.[285] This Convention is intended to apply to international standbys, meaning where the places of business of the issuer, applicant ("principal"), and the beneficiary are in different nations. Although the United States signed the Convention in 1997, it did not subsequently ratify it, and the Convention has not entered into force in the U.S. Only eight small countries have ratified the Convention as of 2015.[286] However, a financial institution could want to specify the UNCIGSLC as governing its LOCs.

International Standby Practices (ISP 98). One of the consequences of the UN Convention and the work revising UCC Article 5 was said to be "the realization of the necessity for specific rules of practice for standby letters of credit."[287] In 1998, the ICC published a separate set of rules especially for standby LOCs.[288] The "International Standby Practices"("ISP98") rules were written primarily by the Institute of International Banking Law and Practice and endorsed by the ICC. The forward to the ISP98 states that standbys also can be subject to the UCP if the parties wish to do so.

One of the strengths of these bodies of laws is that they provide "default" provisions when the parties have neglected to include them, whereas the EPA-specified required wording covers all necessary items. Authorities have identified weaknesses and/or gaps in each of these individual bodies of governing law. For example, by its own terms UCC Article 5 is not intended to be comprehensive and the 1995 revision expressly allowed for the incorporation of other rules by reference, in particular the UCP. The UCP although written for commercial LOCs can be applied to standbys. However, the UCP does not state how its articles should be applied to standbys or modified to apply to standbys.[289] The UCP includes many provisions irrelevant for standby LOCs and is said to include provisions that may be "harmful to

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[283] Casius Pealer, Use of Standby Letters of Credit in Public and Affordable Housing Projects (2014), accessed at http://www.coatsrose.com/use-of-standby-letters-of-credit-in-public-and affordable-housing-projects/.
[284] International Chamber of Commerce, Uniform Customs and Practices for Documentary Credits, Publication 500 (1993), Publication 600 (2007). These publications are available for purchase from ICC Publishing, Inc.
[285] Institute of International Banking Law and Practice, Brief of Amicus Curiae (2006) in Golden West Refining Company vs. Suntrust Bank.
[286] Status : United Nations Convention on Independent Guarantees and Standby LCs (New York, 1995) (2015)
[287] Institute of International Banking Law and Practice, Brief of Amicus Curiae (2006) in Golden West Refining Company vs. Suntrust Bank.
[288] International Chamber of Commerce, International Standby Practices (1998) ("ISP98") Publication 590. This publication is available for purchase from ICC Publishing, Inc.
[289] Janis Penton and Jacob A. Manning, "Governmentally Mandated Standby Letters of Credit Update," Commercial Law Newsletter (Summer 2014).

parties involved in a standby transaction."[290] One authority published a detailed description of why the UCP rules on commercial letters of credit are not ideal for standby LOCs.[291]

ISP 98 is more detailed and specific than the UCP with regard to default situations, force majeure, and partial drawings. However, one authority states that "even ISP's rules are not all encompassing."[292] The advantages of using the ISP 98 are said to be more significant the more complex the standby LOC; standby LOCs used for financial assurance (e.g., in lieu of surety bonds), as in governmentally-mandated FR, are among the least complicated standbys. Some authorities criticize when governmentally-mandated LOCs allow for them to be governed by UCP 600 rather than ISP98 or allow a choice between the two.[293] In a meeting with EPA, banking industry representatives indicated preference for ISP98.

A comparison of these bodies of rules, which vary in many specifics, does not reveal any one to be superior to the others.[294] The Agency understands that the issuing bank typically specifies whether the standby LOC is subject to the UCP or ISP98 but that the U.C.C always applies in the background. Almost all standby LOCs are governed by either the UCP or the ISP.[295] Until 1998, almost all letters of credit were issued subject to the UCP. Banks issuing standby LOCs tend to reference the UCP, "either out of habit or unwillingness to fix something that is not obviously broken."[296] ISP98 has gained acceptance and is reportedly the regime of choice in over half of the standbys issued by U.S. banks and U.S. branches of foreign banks.[297] The other 20-40% of the volume of standbys is issued subject to the UCP.[298] Major banks report that the ISP is used in about 70-80% of their standbys.[299] The required wording of the RCRA Subtitle C LOC (see 40 CFR 264.151(d) and (k)) gives the issuer the option of specifying either the most recent edition of the UCP (i.e., UCP 600) or the UCC. The FAR wording, unchanged since 1999, in contrast, refers only to the UCP 500.[300] Even where an LOC incorporates another body of law, the U.C.C. Article 5 will still operate in the background.

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[290] Casius Pealer, Use of Standby Letters of Credit in Public and Affordable Housing Projects (2014), accessed at http://www.coatsrose.com/use-of-standby-letters-of-credit-in-public-and affordable-housing-projects/.
[291] James E. Byrne, "Standby Rulemaking: A Glimpse at the Elements of Standardization and Harmonization of Banking Practices," New Dev. in Int'l Commercial and Consumer Law (1998). The author served as Chair of the Legal Advisory Council of the Institute of International Banking Law and Practice.
[292] Carter H. Klein, "Standby Letter of Credit Rules and Practices Misunderstood or Little Understood by Applicants and Beneficiaries," Uniform Commercial Code Law Journal (Vol. 40 No. 2) (Fall 2007).
[293] Janis Penton and Jacob A. Manning, "Governmentally Mandated Standby Letters of Credit Update," Commercial Law Newsletter (Summer 2014). Also, Carter H. Klein, "Letters of Credit: in Business and Commercial Transactions," prepared for Practical UCC-- Understanding and Drafting Letters of Credit in Business Transactions Teleseminar (November 30, 2012).
[294] See, for example, FabrizioJuez, A Brief Overview Comparison UCP 600, ISP98, and URDG 758, Citigroup 2014.
[295] Carter H. Klein, "Standby Letter of Credit Rules and Practices Misunderstood or Little Understood by Applicants and Beneficiaries," Uniform Commercial Code Law Journal (Vol. 40 No. 2)(Fall 2007).
[296] Casius Pealer, Use of Standby Letters of Credit in Public and Affordable Housing Projects (2014), accessed at http://www.coatsrose.com/use-of-standby-letters-of-credit-in-public-and affordable-housing-projects/.
[297] Carter H. Klein, "Standby Letter of Credit Rules and Practices Misunderstood or Little Understood by Applicants and Beneficiaries," Uniform Commercial Code Law Journal (Vol. 40 No. 2)(Fall 2007), citing statistics collected by the FDIC and reported in Documentary Credit World.
[298] Carter H. Klein, "Letters of Credit: in Business and Commercial Transactions," prepared for Practical UCC-- Understanding and Drafting Letters of Credit in Business Transactions Teleseminar (November 30, 2012).
[299] Carter H. Klein, "Letters of Credit: in Business and Commercial Transactions," prepared for Practical UCC-- Understanding and Drafting Letters of Credit in Business Transactions Teleseminar (November 30, 2012).
[300] 48 CFR 52.228-14 (last revised in 1999).

In light of the above, "Governing Law" options for wording of 108(b) LOCs include:

- **Option 1:** RCRA provision for choice of UCP 600 or U.C.C. Article 5
- **Option 2:** FAR specification of UCP 500
- **Option 3:** choice between either the UCP or ISP98
- **Option 4:** no required wording in 108(b) LOCs that prevents the issuer from specifying any particular governing body of law.

Option 1: RCRA provision for choice of UCP 600 or U.C.C. Article 5.
Strengths: Familiar from Subtitle C Subpart H LOCs.
Weaknesses: This Option ignores ISP98.

Option 2: FAR specification of UCP 500.
Strengths: Familiar from FAR LOC.
Weaknesses: Outdated, choice too constrained.

Option 3: choice between either the UCP or ISP98.
Strengths: Recognizes current standby practices of issuing banks.
Weaknesses: Constrains choices and options.

Option 4: no required wording in 108(b) LOCs that prevents the issuer from specifying any particular governing body of law.
Strengths: Provides greatest flexibility.
Weaknesses: Inconsistent with Agency precedents.

In light of the above, the Agency has determined that the required wording of 108(b) LOCs shall require the most recent edition of either the UCP or ISP98.

5.2.2. Draws by sight demand vs. time demand.

A party intending to draw on a LOC may present a demand that directs the issuer to pay. There are two types of demands: (1) sight demands and (2) time demands.

Sight demands are payable as soon as they are presented for payment; however, the bank is allowed a reasonable time to review the sight demand and related documents before making payment. Time demands are not payable until the lapse of a specified period of time stated on the demand (e.g., within 30 days). The issuer must accept the time demand upon presentation, and may take a reasonable time to review the documents, but it is not required to pay out until the specified time.

The financial assurance standby LOCs reviewed by EPA specify on the face of the LOC that the funds be payable upon presentation of a sight demand. The RCRA Subtitle C FR instruments, for the most part, are not intended to be used for cost recovery, but are designed to be drawn upon and used to fund actions to protect human health and the environment (e.g., closure, post-closure care) or to compensate for past harms/losses suffered by third parties. Those uses argued for sight demands.

108(b) standby LOCs, on the other hand, are not solely intended to fund needed response actions when the owner/operator fails to do so. Instead, 108(b) LOCs are also intended for cost recovery by parties that already have funded needed actions. However, 108(b) LOCs also are intended to be available to

fund a trust in the event of performance failure under a unilateral administrative order or for payment when payment does not occur as required by a CERCLA settlement and compensate for NRD liabilities. In the 108(b) context, the Agency believes that either a time demand or a sight demand may be acceptable. To avoid potential problems, in either case, it is recommended that the LOC state that the demand be dated, reference the original LOC itself (as by number), and specify the amount demanded.[301] There are two arguments that might favor sight demands over time demands. First, because EPA desires 108(b) to provide an incentive for PRPs and other parties to take response actions in accordance with the NCP, their being able to recover their costs through sight demands instead of time demands may provide an incrementally stronger incentive. Second, to the extent that EPA may direct funds from 108(b) instruments into Superfund Special Accounts or trust funds established pursuant to a UAO, those monies may be used for future site-specific response actions; those funds would be sooner available through sight demands than time demands, permitting somewhat more rapid re-deployment to protect human health and the environment.

Issuers may be more inclined to provide time demand LOCs than sight demand LOCs because time demands offer greater flexibility for the management of funds. Required amounts of FR per facility are expected to be substantial amounts. On the other hand, most banks issuing large standby LOCs will have substantial assets and liquidity; in addition, sight demands on multi-million dollar standby LOCs usually are readily available to owners or operators.

EPA has several options regarding sight demand vs. time demand:

- **Option 1:** Time demand
- **Option 2:** Sight demand
- **Option 3:** Do not specify type of demand, allowing parties to choose
- **Option 4:** Do not require a demand to be presented to make a draw

Option 1: Time demand
Strengths: Bankers may prefer to work with Time demands instead of sight demands.
Weaknesses: Time demands may result in a delay in receiving money. Time demands are also not used in government letters of credit.

Option 2: Sight demand
Strengths: No delay in receiving money with a sight demand. This option is also consistent with government letters of credit.
Weaknesses: Issuers may prefer time demands over sight demands because time demands offer greater flexibility for the management of funds.

Option 3: Do not specify type of demand, allowing parties to choose
Strengths: Provides a great amount of flexibility for both parties.
Weaknesses: May create some confusion among parties. This option is also not used in government letters of credit.

Option 4: Do not require a demand to be presented to make a draw

[301] Casius Pealer, Use of Standby Letters of Credit in Public and Affordable Housing Projects (2014), accessed at http://www.coatsrose.com/use-of-standby-letters-of-credit-in-public-and affordable-housing-projects/.

Strengths: Believed to be the most modern of the four options provided. Option 4 would reduce burden on claimants.
Weaknesses: Option 4 may create confusion among parties. Not used in government letters of credit.

In light of the above, the Agency has determined that the required wording of 108(b) LOCs shall not specify the type of demand required, allowing the issuing bank and the owner or operator to negotiate that aspect of the LOC.

5.2.3. Presentation of which documents?

A key provision of LOCs is the specification of which documents must be presented to the issuing bank in order to draw funds from the LOC. Options include:

Nothing but the Demand. Standby LOCs used in place of sureties are said to typically require only a demand for payment.[302] A so-called "clean" LOC is one requiring only a demand and no other supporting documents.

Demand Plus Another Document. In addition to the sight or time demand itself (discussed above in Section 5.2.2), the 108(b) LOC requires that the party attempting to draw on the funds present specified forms or other documentary materials. The following example from RCRA Subtitle C regulations at Part 264, Subpart H (closure and post-closure) shows that the required LOC wording requires the submission of a signed statement certifying that the draft is payable:

> We hereby establish our Irrevocable Standby Letter of Credit … up to the aggregate amount of [in words] U.S. dollars $_____, available upon presentation … of (1) your sight draft, bearing reference to this letter of credit No. ____, and (2) your signed statement reading as follows: "I certify that the amount of the draft is payable pursuant to regulations issued under authority of the Resource Conservation and Recovery Act of 1976 as amended"[303]

Following this example, the 108(b) LOC could require a signed statement reading as follows: "I certify that the amount of the demand is payable pursuant to regulations issued under authority of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 as amended." Issuing banks will expect that the quoted material will be presented verbatim in the signed statement. EPA is concerned that such a requirement for 108(b) might make draws too easy, especially if draws may be made by all claimants (discussion of who can make draws appears in Section 5.2.4 below). The concern is lessened if EPA or other Federal agency acting pursuant to CERCLA authority alone can make draws.

RCRA Subtitle C regulations at Part 264, Subpart H (liability coverage) shows that the required LOC wording includes the submission of a sight draft, and, if the LOC is being used without a standby trust fund, either a "certificate of valid claim" or a "valid final court order establishing a judgment against" the owner or operator. The LOC provides the required wording for the certificate of valid claim, which must be signed by the claimant(s) as well as the owner or operator that established the LOC. [304] If the

[302] Casius Pealer, Use of Standby Letters of Credit in Public and Affordable Housing Projects (2014), accessed at http://www.coatsrose.com/use-of-standby-letters-of-credit-in-public-and affordable-housing-projects/.
[303] 40 CFR 264.151(d).
[304] 40 CFR 264.151(k).

liability coverage LOC is being used with a standby trust fund, only the sight draft is required to draw upon the LOC. For 108(b) EPA would like to adopt the draw requirement of presenting a valid final court order establishing a judgment against the owner or operator of the covered facility, but the Agency recognizes that parties may settle before a court makes such an order, which would ensure court oversight over the validity of those claims and consistency of any actions with the National Contingency Plan. Moreover, it may not be possible to achieve either a valid final court order if the owner or operator declares bankruptcy. That scenario would seem to frustrate the ability of claimants to seek satisfaction from a 108(b) LOC. The Agency recognizes that, in the event that the owner or operator is bankrupt, insolvent, or unavailable, CERCLA 108(c) authorizes direct action against a current issuer of the FR instrument (direct action is discussed in Section 5.2.7 below). Although EPA does not need to make its LOC regulations consistent with how direct action against the issuing bank might work, direct action remains a consideration for the Agency in resolving the issue of which documents must be presented to draw upon the LOC (i.e., the same documents must be presented for direct action). Alternatively, as allowed in the liability coverage regulations, the Agency could require that 108(b) payments be made into a standby trust fund without either a final court order or a certificate of valid claim needed to draw upon the LOC.

Original LOC Itself. Another option is for EPA to require that the original LOC itself be presented together with the draft and any other documentation in order to draw upon the LOC. EPA's programs under RCRA Subtitle C (closure/post-closure LOCs and liability coverage LOCs) do not require presentation of the original LOC itself. Presentation of the original LOC would increase the administrative burden on EPA, although the bank's noting on the LOC any prior payments will help keep EPA informed of the remaining balance. Presentation of the original LOC would require other claimants authorized to draw (e.g., government agencies, PRPs, and other persons seeking liability and cost recovery) to coordinate with EPA, the holder of the original LOC; such coordination would likely occur in any case, however. Problems may arise if the original LOC is lost, stolen, or destroyed; banks may not be willing to issue a replacement. The 108(b) administrative burden will be incrementally increased by requiring presentation of the original LOC.

- **Option 1:** Demand alone
- **Option 2:** Demand plus signed statement, or final court order
- **Option 3:** Demand plus original LOC
- **Option 4:** Demand plus signed statement plus original LOC

Option 1: Demand alone
Strengths: Least administratively burdensome for EPA.
Weaknesses: Option 1 may leave the letter of credit open to improper claims.

Option 2: Demand plus signed statement, or final court order
Strengths: Reduces the potential for improper draws on the letter of credit.
Weaknesses: increases the administrative burden on EPA.

Option 3: Demand plus original LOC
Strengths: Limits the potential for improper draws on the letter of credit.
Weaknesses: Significant administrative burden to maintain original letter of credit. Bank may be reluctant to issue replacement if original is lost or destroyed. May make it more difficult for claims to get cost recovery.

Option 4: Demand plus signed statement plus original LOC
Strengths: Limits potential for improper draws on letter.
Weaknesses: Option 4 would present the highest level of administrative burden. Also, banks may be reluctant to issue replacement if original is lost or destroyed. May make it more difficult for claimants to get cost recovery.

In light of the above, the Agency has determined that the required wording of 108(b) LOCs shall not require presentation of the original LOC but should require a demand plus signed statement, or final court order.

5.2.4. Who can present to make draws upon the LOC?

Among the most important issue in the wording of an LOC is the specification of who can draw upon the instrument, in part because payment by an issuer to a beneficiary is final and without recourse even if the owner or operator is insolvent or otherwise does not reimburse the issuer.[305] When the LOC is intended to be used for third-party claims by multiple governmental entities and private parties such as CERCLA PRPs, NRD trustees, and volunteers, as in 108(b), *who* may access the funds by presenting the required documents becomes an issue for the required wording of the instrument. EPA has many options in this regard. EPA could require that the required wording specify parties who may present required documents and sign when a signed statement is required as one of the documents that allow drawing funds from the issuing bank. For example, EPA could specify the following potential parties who may draw on the letter:

- **Option 1:** EPA Regional Administrator for region where facility is located (or EPA Headquarters official)
- **Option 2:** only named federal government claimants (e.g., EPA, BLM, FS, NRC, CDC)
- **Option 3:** named state government agencies for state(s) where the facility is located named PRPs
- **Option 4:** named PRPs
- **Option 5:** named volunteers
- **Option 6:** NRD trustees for state(s) where facility is located trustee of standby trust fund
- **Option 7:** Trustee of Standby Trust Fund
- **Option 8:** Avoid Naming Who Can Draw

Option 1: Single Named Federal Party. Under this option, the LOC would state that only one named party may draw upon the LOC, such as EPA specified for the Subtitle C LOC for closure/post-closure. The party could either be a responsible official at EPA HQ or the Regional Administrator where the facility is primarily located. Naming a single party authorized to draw upon the LOC is the norm. Other parties with claims would need to work their claims through the EPA (see discussion of who may receive payments in Section 5.2.5 below). By, in essence, channeling all CERCLA claims through a single point, naming EPA as the only person that can draw upon the 108(b) LOC, allows and requires EPA to assess the merits of other parties' CERCLA claims prior to EPA drawing funds from the instrument to pay those claims (see Section 5.2.5 below). This channeling may be important because the required amount of

[305] U.C.C. 5-103(d), UCP 500 Art. 3,UCP 600 Art.4, ISP Rule 1.06(c).

108(b) coverage for a facility may turn out to not be sufficient for recovery of all liabilities and costs under CERCLA § 107. Even if the required amount of 108(b) FR is sufficient, this option keeps EPA directly "in the loop" compared to other options. Although avoiding the "multiple beneficiary" problem noted in options below, this option has the highest administrative burden on EPA and place the Agency in the awkward position of administering the claims process in which it may be a claimant. This option also raises the question whether it is inconsistent with CERCLA "direct action" provisions under § 108(c).

Option 2: Named Federal Government Agencies. Under this option, the LOC would allow multiple named Federal government claimants to perform all draws on the LOC. Such Federal claimants could include EPA, BLM/DOI (when facilities are located on BLM land or where BLM is the federal trustee for NRDs), FS/USDA (when facilities are located on FS land or where FS is the federal trustee for NRDs), NRC (for uranium facilities), and CDC (for health assessments). Regardless of the specific hard rock facility type and location, at least two Federal agencies (i.e., EPA and CDC) would be potentially relevant; hard rock mining on land administered by the BLM and/or FS could lead to claims by those agencies. LOC issuers may need to modify their LOC application forms to request information needed to determine whether to list EPA, BLM, CDC, FS, and/or NRC on the instrument, which adds to administrative burden. Note that if the LOC has two or more named federal agencies as beneficiaries then they typically all must agree to and collectively provide the proper documentation for every single draw, which increases administrative burden.[306] Under this option, liability and cost recovery actions by PRPs, non-PRP volunteers, state agencies, and state NRD trustees would need to be channeled through the named Federal parties (see Section 5.2.5 below). Under this option, EPA would be in a position to assess the merits of other parties' liability and cost recovery claims prior to drawing funds from the instrument. This option offers no reduced administrative burdens for EPA. This option also raises the question whether it is inconsistent with CERCLA "direct action" provisions under § 108(c).

Option 3: Named State Agencies. Under this option, named State agencies would perform all draws on the instrument. Based on facility location, more than one State may have an interest in a single hard rock facility. A facility located well within the boundaries of a single state, may have multiple state agencies (e.g., natural resources agency, water quality agency) with oversight roles. LOC issuers may need to modify their LOC application forms to request data needed to determine which state agencies to list by name on the instrument, which adds to administrative burden. There may be disagreement within a State as to which party(ies) should be listed. If the LOC has two or more named state agencies as beneficiaries, then they typically all must agree to and collectively provide the proper documentation for every single draw, which increases administrative burden.[307] Under this option, liability and cost recovery actions by Federal agencies, PRPs, and non-PRP volunteers would need to be channeled through the named State parties (see Section 5.2.5 below). A drawback of this option is that it may blur the important distinction between Federal 108(b) FR for CERCLA liabilities and state FR requirements for facility closure, land reclamation, and post-closure care (if any). Moreover, unlike other EPA statutes (e.g., the Clean Air Act, Resource Conservation and Recovery Act), CERCLA does not delegate any

[306] However, EPA can insert "by any one of you" to address this problem, as it did in the required wording for 264.151(d) for closure/post-closure LOCs. After identifying that more than one EPA Regional Administrator may be a beneficiary, the required wording states that funds will be available upon presentation “by anyone of you” of the required documents.

[307] However, EPA can insert "by any one of you" to address this problem, as it did in 264.151(d) required wording for closure/post-closure LOCs. After identifying that more than one EPA Regional Administrator may be a beneficiary, the required wording states that funds will be available upon presentation “by anyo ne of you” of the required documents.

programs to the States, making such a role for State agencies more administratively complex. Not naming state agencies as parties who may draw on the 108(b) LOC would not mean that such agencies could not have appropriate claims for liability and cost recovery under CERCLA. Under this option, EPA may not be in a position to assess the merits of other parties' liability and cost recovery claims prior to States' drawing funds from the instrument. This option offers reduced administrative burdens for EPA. As with the other options above, this option also raises the question whether it is inconsistent with CERCLA "direct action" provisions under section 108(c).

Option 4: Named PRPs. Under this option, named PRPs would perform all draws on the instrument. PRPs could include previous owners or operators of the facility and any person who arranged for disposal of hazardous substances. One major drawback of this option is that, at the time of initiating CERCLA 108(b) FR coverage, there would have been no reason for the Agency to undertake the costly and time-consuming action of identifying PRPs. These search costs would be relatively high for mining facilities with long histories and multiple previous owners and operators. Another major drawback is that the more likely Federal claimants would be channeled through PRPs to access LOC funds (see Section 5.2.5 below). If the LOC has two or more named PRPs as beneficiaries then they typically all must agree to and collectively provide the proper documentation for every single draw, which increases administrative burden.[308] PRPs do not necessarily share common interests, despite the joint and several nature of their liability under CERCLA. Under this option, liability and cost recovery actions by Federal agencies (including Federal NRD trustees) , non-PRP volunteers, and state agencies (including State NRD trustees) would need to be channeled through the named PRPs (see Section 5.2.5 below), which could be an awkward process. Under this option, EPA may not be in a position to assess the merits of other parties' liability and cost recovery claims prior to PRP's drawing funds from the instrument. This option offers reduced administrative burdens for EPA. As with the other options above, this option also raises the question whether it is inconsistent with CERCLA "direct action" provisions under section 108(c).

Option 5: Named Volunteers. Under this option, named volunteers would perform all draws on the instrument. CERCLA allows for non-PRP "volunteers" that perform response actions in conformance with the NCP to seek cost-recovery from PRPs, which could include recovery from current owners/operators and their applicable 108(b) FR instruments. One major drawback of this option is that, at the time of initiating CERCLA 108(b) FR coverage, there would have been no reason for the Agency or the owner/operator to undertake to identify such future volunteers. Although identifying PRPs is a costly task, identifying future volunteers would be extremely speculative, and multiple parties may seek to be so named, adding to the administrative burden. Volunteers do not necessarily share common interests. If the LOC has two or more named volunteers as beneficiaries then they typically all must agree to and collectively provide the proper documentation for every single draw, which increases administrative burden.[309] Under this option, liability and cost recovery actions by Federal agencies, state agencies, and PRPs would need to be channeled through the named volunteers (see Section 5.2.5 below), which could be an awkward process. Under this option, EPA may not be in a position to assess the merits of other

[308] However, EPA can insert "by any one of you" to address this problem, as it did in 264.151(d) required wording for closure/post-closure LOCs. After identifying that more than one EPA Regional Administrator may be a beneficiary, the required wording states that funds will be available upon presentation “by anyone of you” of the required documents.

[309] However, EPA can insert "by any one of you" to address this problem, as it did in 264.151(d) required wording for closure/post-closure LOCs. After identifying that more than one EPA Regional Administrator may be a beneficiary, the required wording states that funds will be available upon presentation “by anyone of you” of the required documents.

parties' liability and cost recovery claims prior to volunteers' drawing funds from the instrument. This option offers reduced administrative burdens for EPA. As with the other options above, this option also raises the question whether it is inconsistent with CERCLA "direct action" provisions under section 108(c).

Option 6: NRD Trustee(s) for areas where the facility is located or nearby areas. These are considered above in connection with named Federal agencies and named state agencies.

Option 7: Trustee of Standby Trust Fund. Another option would be for all draws upon the LOC to be made by the trustee of the standby trust established in connection with the 108(b) FR instrument. All parties with liability and cost recovery claims would need to work them through the trustee of the standby trust (see Section 5.2.5 below). The trustee most likely would serve a purely ministerial role of submitting required documents to the bank and ensuring that the proper sums are dispatched to the appropriate claimants, on a "first come, first served" basis. The trustee also could be charged with making any appropriate reductions in the amounts of liability and cost recovery sought should it receive requests totaling more than the remaining available funds through the LOC. Although EPA should have other means of tracking pending liability and cost recovery actions, the trustee could be required to report to EPA about liability and cost recovery actions being channeled through the trustee. Typical trustees of standby trusts at banks would not be prepared to assess the merits of cost recovery claims (e.g., whether the response action was consistent or not inconsistent with the NCP) prior to drawing funds from the instrument although, depending on the triggers, that need not be necessary. For example, having a payment trigger be the presentation of a court judgment awarding payment for CERCLA costs and/or natural resource damages ensures that a court has already assessed the merits of the claim. Although it may not be a requirement that standby trusts be established at the same bank as the one issuing the 108(b) LOC, it may be a common scenario, which could result in lower administrative charges and virtually seamless coordination. Even the purely ministerial role would entail fees. Trustee fees typically are charged against the funds in the standby trust when the customer does not pay them; however, there may not be any funds in the standby trust to pay the charges unless the trustee draws funds from the LOC. Under this option, liability and cost recovery actions by Federal agencies, state agencies, PRPs, volunteers, and NRD trustees would need to be channeled through the named trustee of the standby trust fund (see Section 5.2.5 below). Under this option, EPA may not be in a position to assess the merits of other parties' liability and cost recovery claims prior to the trustees' drawing funds from the instrument. This option offers reduced administrative burdens for EPA.

Option 8: Avoid Naming Who Can Draw. Finally, the required wording of the instrument need not specify who can present the required documents. This option does not channel presentations through a single named party or a small number of named parties authorized to perform draws. This option reduces administrative burdens by avoiding the problem of naming multiple parties who then typically must all agree to collectively provide the proper documentation for every single draw. By not specifying who can make the draws upon the LOC, EPA may nevertheless allow multiple parties to draw upon the letter. EPA chose this option for the Subtitle C Part 264 liability coverage LOC. The required LOC wording of the RCRA Part 264.151(k) Subpart H liability coverage requirements states:

> We hereby establish our Irrevocable Standby Letter of Credit No. ___ … in the favor of [insert "any and all third party liability claimants ..."] available upon presentation of a sight draft bearing reference to this Letter of Credit No. ___] and [other required documents]….

The required LOC language provides for presentation of documents, but it does not state who may or may not make the presentation. Under this option, unnamed claimants would perform all draws on the instrument. This language does not limit who may present the required documents. In the RCRA Subtitle C liability coverage context, there is great uncertainty as to who may be entitled to draw upon the LOC for compensation of third-party liabilities. Under that program, if a standby trust is not used to receive draws from the LOC, then either a certificate of valid claim or a valid final court order establishing a judgment must be presented along with the sight draft; that RCRA document requirement ensures due process so that it is not "open season" on RCRA liability coverage LOCs by any and all claimants (see discussion of which documents should be required for draws in Section 5.2.3 above). In the CERCLA context, although there may be somewhat less uncertainty about potential claimants than in the RCRA liability coverage context, there is a large number of potential claimants such as multiple Federal and state agencies (including NRD trustees), PRPs who are not the current owner or operator of the facility, and volunteers performing response actions in conformance with the NCP. This option has the least administrative costs for EPA. Under this option, EPA may not be in a position to assess the merits of liability and cost recovery claims prior to claimants' drawing funds from the instrument. This option appears consistent with CERCLA "direct action" provisions under § 108(c).

In light of the above, the Agency has determined that the required wording of 108(b) LOCs shall provide for two constructs: one which does not limit who can make draws and one in which only the trustee of a trust fund may make draws.

5.2.5. Who can receive payments drawn from 108(b) LOC?

Unless the LOC otherwise states, an issuer is not required to pay anyone other than the party drawing upon the LOC (see Section 5.2.4 above) or an "acknowledged assignee of proceeds." The party drawing upon the LOC may direct all or a portion of the proceeds of the drawing to be paid to a third party. That action is termed an "assignment of proceeds"[310] rather than a "transfer of drawing rights." Assignees of proceeds do not themselves have drawing rights. Ordinarily, requests for assignments of proceeds are made after standby issuance. However the required wording of the LOC can facilitate future payments to assignees. EPA could restrict having right solely to itself and then assign payments to claimants. The prospect of assigning draws upon the instrument to another party can be reflected in the following language in the 108(b) LOC:

> "Payment. Payment against a complying presentation shall be made within three business days after presentation at the place for presentation or by wire transfer to a duly requested account of [insert name of party authorized to draw]. Alternatively, [insert name of party authorized to draw] requests that payment be made to [insert name of party authorized to draw]'s assignee of proceeds identified in the demand with the [insert assignee's name and address, the name and routing number of assignee' bank in the United States, and the name and number of assignee's account to be credited]."[311]

If only the EPA is authorized to draw upon the LOC, for example, the required wording of the payment clause could include other named parties hardwired as potential assignees.

[310] Assignments of proceeds are governed by UCC Article 5-114 and UCC Article 9, UCP 600 Art. 39, and ISP Rules 6.06-6.10.
[311] ISP 98 Model Form 11.1.

This additional wording would constitute the issuer's advance acknowledgement of a possible future assignment(s) of proceeds to one or more assignees to be adequately identified in a future complying demand directing payment to the named assignee. It is recommended adding text to the LOC similar to the following:

> "The assignee will be holding proceeds as a trustee, custodian, or the like representing one or more third parties with government recognized claims against the applicant."

The above verbiage lists information that the issuer might consider before agreeing in advance to acknowledge an assignment of standby proceeds.[312]

The issue of who can receive payments from an LOC, discussed here, is related to the issue of who can present documents to make draws on the LOC, discussed above in Section 5.2.4 above. How the one question is handled may influence how the other issue is handled. For example, if all parties can make draws upon the LOC, there would be no reason to hardwire potential assignees. If only standby trustee can make draws there would be little reason to hardwire potential assignees because the trustee would handle and pay all claims. However, these issues of who is authorized to make draws and who may receive payments as assignees are treated separately in this document because parties who are not authorized to draw on the letter nevertheless may be allowed to receive payments as assignees under the specifications of the LOC. If EPA's required LOC wording limits the party or parties authorized to make draws (see Section 5.2.4 above), then the required wording of the LOC should anticipate that payments may be made to assignees of the party with drawing rights. That language could be generic or could also hardwire more or less likely future claimants as assignees. What person or entity ultimately receives the draw proceeds is a matter of "payment instruction" or "payment order." The payment instruction or order is contained in the draft or demand for payment submitted to effect the draw.[313]

Potential parties who may be specified by name in the LOC ("hardwired") to receive payments as assignees under the LOC include:

- **Option 1:** Hardwire single named federal party as assignee
- **Option 2:** Hardwire Named Federal Government Agencies as Assignees
- **Option 3:** Hardwire Named State Agencies as Assignees
- **Option 4:** Hardwire Named PRPs as Assignees
- **Option 5:** Hardwire Named Volunteers as Assignees
- **Option 6:** Hardwire Trustee of Standby Trust Fund as Assignee
- **Option 7:** No Hardwiring of Any Named Potential Assignees

Option 1: Hardwire Single Named Federal Party as Assignee. The LOC may hardwire only one named federal party to receive payments as assignee of the party drawing upon the LOC. Such language would not necessarily limit the drawing party from establishing other payment assignees at a later date. Depending on which party (e.g., EPA or standby trustee) has the right to draw upon the LOC, the single named assignee could be a responsible official/office at EPA HQ or the Regional Administrator where the facility is primarily located. This option would not be necessary if multiple federal agencies were authorized to make draws themselves. LOC issuers may need to modify their LOC application forms to seek information needed to determine which federal party to name (e.g., EPA, BLM, CDC, FS, and/or

[312] Includes additional text from note 23 to ISP98 Model Form 11.1.

[313] Carter H. Klein, "Standby Letter of Credit Rules and Practices Misunderstood or Little Understood by Applicants and Beneficiaries," Uniform Commercial Code Law Journal (Vol. 40 No. 2)(Fall 2007).

NRC) on the instrument, which adds to administrative burden. Except for the single named federal assignee, all other parties with liability and cost recovery claims would need to work their claims through the party or parties authorized to make draws; these other claimants would need to be paid as assignees of the party with drawing rights unless the trustee of the standby trust were authorized to make draws, which would enable claimants to be paid by the trustee. If there are no limits on who may make draws (see Section 5.2.4 above), this option would appear to have very limited utility. This option is somewhat inefficient because payments to other Federal agencies, to state agencies, to PRPs, and to non-PRP volunteers would not be hardwired in the original LOC. This option entails some administrative burden on EPA. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Option 2: Hardwire Named Federal Government Agencies as Assignees. The LOC may hardwire multiple named federal parties to receive payments as assignees of the party drawing upon the LOC. Such language would not necessarily limit the drawing party from establishing other assignees at a later date. Depending on which party (e.g., EPA or standby trustee) has the right to draw upon the LOC, the multiple named federal assignees could include the EPA, BLM/DOI (when facilities are located on BLM land or BLM is the NRD trustee), FS/USDA (when facilities are located on FS land or FS is the NRD trustee), NRC (for uranium facilities) and/or CDC (for health assessments). Regardless of the specific hard rock facility type and location, at least two Federal agencies (i.e., EPA and CDC) could be hardwired in the LOC as potential recipients of payments. This option may be desirable when one federal agency is the only party authorized to make draws. Except for the named federal assignees, all other parties with liability and cost recovery claims (e.g., other federal agencies and NRD trustees, state agencies including state NRD trustees, PRPs, and non-PRP volunteers) would need to work their claims through the party or parties authorized to make draws; these other claimants would need to be paid as assignees of the party with drawing rights, unless the trustee of the standby trust is authorized to make draws. If there are no limits on who may make draws or if the trustee of the standby trust is the only party authorized to make draws (see Section 5.2.4 above), this option would appear to have very limited utility. This option is somewhat inefficient because payments to other federal agencies including federal NRD trustees, state agencies, to state NRD trustees, to PRPs, and to non-PRP volunteers would not be hardwired in the original LOC. This option entails some administrative burden on EPA. LOC issuers may need to modify their LOC application forms to seek information needed to determine whether to list EPA, BLM, CDC, FS, and/or NRC on the instrument, which adds to administrative burden. This option offers the same administrative burdens for EPA as the option above. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Option 3: Hardwire Named State Agencies as Assignees. The LOC may hardwire multiple named state agencies to receive payments as assignees of the party drawing upon the LOC. Such language would not necessarily limit the drawing party from establishing other payment assignees at a later date. Based on facility location crossing state borders, more than one State may have an interest in a single hard rock facility. Even a facility located well within the boundaries of a single State, may have multiple state agencies (e.g., natural resources agency, water quality agency, state NRD trustee) as stakeholders. There may be disagreements among State agencies as to which party(ies) should be hardwired as potential assignees. LOC issuers may need to modify their LOC application forms to collect information needed to determine which state agencies to list as potential assignees on the instrument, which adds to administrative burden. This option may be desirable when a single federal agency is the only party authorized to make draws or when only federal agencies are authorized to make draws. Except for the named state assignees, all other parties with liability and cost recovery claims would need to work their

claims through the party or parties authorized to make draws; these other claimants would need to be paid as assignees of the party with drawing rights unless the trustee of the standby trust is authorized to make draws. Not hardwiring state agencies in the LOC as assignees who may receive payments from the 108(b) LOC does not mean that such agencies could not have appropriate claims for liability and cost recovery under CERCLA and receive payments as assignees. A drawback of this option is that it may blur the important distinction between Federal 108(b) FR for CERCLA liabilities and state FR requirements for mining facility closure, land reclamation, and post-closure care (if any). If there are no limits on who may make draws or if the trustee of the standby trust is the only party authorized to make draws (see Section 5.2.4 above), this option would appear to have very limited utility. This option is somewhat inefficient because payments to PRPs and to non-PRP volunteers would not be hardwired in the original LOC. This option entails no administrative burden on EPA. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Option 4: Hardwire Named PRPs as Assignees. The LOC may hardwire multiple named PRPs to receive payments as assignees of the party drawing upon the LOC. PRPs could include previous owners or operators of the facility and any person who arranged for disposal of hazardous substances for the facility. PRPs do not necessarily share common interests, despite the joint and several nature of their liability under CERCLA; potential PRPs may disagree as to which PRPs should or should not be hardwired on the LOC as potential assignees. LOC issuers may need to modify their LOC application forms to collect information needed to determine which PRPs to list as potential assignees on the instrument, which adds to administrative burden. One major drawback of this option is that, at the time of initiating CERCLA 108(b) FR coverage, there would have been no reason for the Agency or the owner or operator to undertake the costly and time-consuming action of identifying PRPs. These costs would be relatively high for covered mining and mineral processing facilities with long histories and multiple previous owners and operators. Not hardwiring PRPs in the LOC as assignees who may receive payments from the 108(b) LOC does not mean that such PRPs could not have appropriate claims for liability and cost recovery under CERCLA and receive payments as later assignees. This option may be desirable when a single federal agency is the only party authorized to make draws or when only federal and state agencies are authorized to make draws. If there are no limits on who may make draws or if the trustee of the standby trust is the only party authorized to make draws (see Section 5.2.4 above), this option would appear to have very limited utility. This option is negligibly inefficient because payments to non-PRP volunteers would not be hardwired in the original LOC. This option entails no administrative burden on EPA. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Option 5: Hardwire Named Volunteers as Assignees. The LOC may hardwire named volunteers to receive payments as assignees of the party drawing upon the LOC. CERCLA allows for non-PRP "volunteers" that perform response actions in conformance with the NCP to seek cost recovery from PRPs, which could include recovery from current owners or operators and their 108(b) FR instruments. Volunteers do not necessarily share common interests; potential volunteers may disagree about which volunteers should be listed on the LOC as potential assignees. LOC issuers may need to modify their LOC application forms to collect information needed to determine which volunteers to list as potential assignees on the instrument, which adds to administrative burden. One major drawback of this option is that, at the time of initiating CERCLA 108(b) FR coverage, there would have been no reason for the Agency or the owner/operator to undertake to identify such future volunteers. Identifying future volunteers would be extremely speculative, and multiple parties may seek to be named, adding to the administrative burden. Not hardwiring volunteers as assignees in the LOC does not mean that such

volunteers could not have appropriate claims for cost recovery under CERCLA and receive payments as assignees at a later date. This option may be desirable when only federal and state agencies are authorized to make draws. If there are no limits on who may make draws or if the trustee of the standby trust is the only party authorized to make draws (see Section 5.2.4 above), this option would appear to have very limited utility. This option entails no administrative burden on EPA. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Option 6: Hardwire Trustee of Standby Trust Fund as Assignee. The LOC may hardwire the trustee of the standby trust, established in connection with the 108(b) FR LOC, to receive payments as assignee of the party drawing upon the LOC. All parties with liability and cost recovery claims (e.g., EPA other Federal agencies, state agencies, PRPs, and volunteers) would be channeled through the standby trust fund. This option may be unnecessary if the trustee of the standby trust is authorized to make draws. This option may be desirable if only the EPA or federal agencies are authorized to make draws. This option may be useful in the event of receipt of notice of cancellation by issuer and failure of owner or operator to provide substitute FR (see Section 5.2.6 below). The trustee most likely would serve a purely ministerial role of receiving claims from claimants, receiving payments drawn from the LOC (see Section 5.2.5 above), and ensuring that the proper sums are dispatched to the appropriate claimants. The trustee could be charged with making appropriate reductions in the amount of payments sought should it receive requests totaling more than the remaining available funds received from the LOC. Although EPA should have other means of tracking pending liability and cost recovery actions, the trustee could be required to report to EPA about liability and cost recovery claims submitted to the trustee. Typical trustees of standby trusts at banks would not be prepared to assess the merits of cost recovery claims (e.g., whether the response action conformed with the NCP). LOC issuers may need to modify their LOC application forms to collect information needed to determine who to list as potential assignees on the instrument, which adds to administrative burden. Although it may not be an EPA regulatory requirement that 108(b) standby trusts be established at the same bank issuing the 108(b) LOC, it may be common, which could result in lower administrative charges and virtually seamless coordination between the LOC and the standby trust. If there are no limits on who may make draws or if the trustee of the standby trust is the only party authorized to make draws (see Section 5.2.4 above), this option would appear to have very limited utility. This option entails no administrative burden on EPA. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Option 7: No Hardwiring of Any Named Potential Assignees. Finally, the required wording of the LOC need not hardwire any potential assignees who can receive payments from draws upon the LOC. By not specifying who can receive payments from the LOC as assignees, EPA may nevertheless allow multiple parties to receive payments from the LOC as assignees later. This option is appropriate if there are no limits on who can draw on the LOC or if the trustee of the standby trust is the only party authorized to make draws, because the trustee will be empowered to make payments to any claimant in accordance with directions in the trust document. LOC issuers would not need to modify their LOC application forms to collect information needed to determine whom to list as potential assignees on the instrument, which reduces administrative burden. This option entails no administrative burden on EPA. This option does not appear inconsistent with CERCLA "direct action" provisions under 108(c) because it does not necessarily limit who may receive payments as assignees.

Bank's consent typically is needed for assignments of proceeds otherwise payable to the party making the draw. An issuer's acknowledgement may be provided in a separate acknowledgement form that protects the issuer against any additional risks associated with paying someone other than the party

making the draw. Many issuers regularly acknowledge assignments of proceeds on standard assignment forms following the bank's standard screening of the proposed assignee.

The ISP98 Model Government Standby Form[314] 11.1[315] recommends including a payment clause as follows in the wording of the LOC:

> "Payment. Payment against a complying presentation shall be made within three business days after presentation at the place for presentation or by wire transfer to a duly requested account of Beneficiary. Alternatively, Beneficiary requests that payment be made to Beneficiary's assignee of proceeds identified in Beneficiary's demand with the assignee's name and address, the name and routing number of assignee' bank in the United States, and the name and number of assignee's account to be credited. Issuer shall acknowledge any such request for an assignment of proceeds, subject only to compliance with mandatory applicable law."

In light of the above, the Agency has determined that the required wording of 108(b) LOCs will not hardwire any potential assignees who can receive payments from draws upon the LOC.

5.2.6. Standby trust fund requirement and cancellation without an acceptable replacement instrument.

EPA has decided to require a SBTF to accompany a LOC under the 108(b) program even under the construction where the letter of credit is issued in favor of any and all third-party CERCLA claimants[316]. The purpose of the SBTF will be to serve as a receptacle for funds in the event of cancellation/termination/non-renewal of a LOC and failure of the owner/operator to provide alternate financial assurance. In other EPA programs reviewed by the Agency, a SBTF is either required or listed as an option to accompany a LOC.

Letters of credit must be accompanied by a SBTF under the following FR programs: RCRA Subtitle C (closure/post-closure), RCRA Subtitle I (UST), SDWA Underground Injection Control (UIC) Class VI Wells, and 40 CFR Part 261 (excluded secondary hazardous materials). Under these programs, all disbursements from LOCs are required to be made into a SBTF, and the required instrument language for this requirement is very similar among programs. The RCRA Subtitle C language under 40 CFR 264.151(d)(3) provides a typical example:

> Whenever this letter of credit is drawn on under and in compliance with the terms of this credit, we shall duly honor such draft upon presentation to us, and we shall deposit the amount of the draft directly into the standby trust fund of [owner's or operator's name] in accordance with your instructions.

[314] Institute of International Banking Law and Practice available from www.iiblp.org.
[315] Includes additional text from note 23 to Form 11.1.
[316] Under the construct where the letter of credit is issued in favor of a trust fund trustee it is envisioned that the trust fund holding the letter of credit could also serve as the receptacle for funds in the event of cancellation/termination/non-renewal of a LOC and failure of the owner/operator to provide alternate financial assurance.

A SBTF is optional under the RCRA Subtitle C liability program to accompany a LOC and was added as an option in a September 1, 1988 RCRA Subtitle C rulemaking. The September 1, 1988 rulemaking did not require SBTFs for liability coverage, stating that, "Because the mechanisms will pay third parties directly, a standby trust is not necessary for liability coverage."[317] As a result of the Chemical Waste Management (CWM) settlement agreement, EPA agreed in 1991 to allow for a SBTF in connection with liability LOCs so that the standby trustee, rather than the LOC issuer, would be responsible for distributing funds to claimants. EPA included this option in the liability provisions because it "would make the letter of credit more available to owners and operators without reducing its integrity."[318] A SBTF is also included as an option for LOCs under the 40 CFR Part 261 liability FR program.

As discussed in Section 2.4 above, EPA has decided to require a SBTF to accompany all 108(b) instruments to act as a receptacle in the event of cancellation/termination/non-renewal and failure to provide alternate financial responsibility.

If an issuer elects not to renew, cancels, or terminates a 108(b) FR LOC and the owner/operator subsequently fails to provide an acceptable replacement 108(b) FR instrument in time, the instrument or regulatory language[319] must specify the issuer's liability for draws on the LOC. Options include:

- **Option 1:** No draws authorized
- **Option 2:** Draws authorized only after certain "triggering events" have occurred
- **Option 3:** Draws authorized before new termination date
- **Option 4:** Draws authorized before original termination date
- **Option 5:** Balance automatically mailed to standby trust fund (no draws required)

Combinations of these options may also be employed effectively to accommodate 108(b) FR needs. Under any of these options, the failure of an owner/operator to replace a terminated 108(b) instrument within a specified period of time would be a significant regulatory violation. The options describe below provide varying levels of liability for the LOC issuer should an owner/operator fail to replace an instrument.

Option 1: No draws authorized after receipt of notice of termination.
Authorizing no draws could be a matter of EPA policy or could be hardwired into the FR regulations and required instrument wording. A "no draws" approach would minimize the Agency's 108(b) administrative burden, by reducing the burden associated with draws and SBTFs. This option would provide the least assurance that funds would be available for valid third-party CERCLA claims should a qualifying event/claim occur after the receipt of a notice of termination of the LOC.

Option 2: Draws authorized only after certain specified triggering events have occurred.
For this option, after receipt of the cancellation notification, the LOC could be called upon only if one or more triggering events have occurred. This option could be a matter of EPA policy or could be hardwired into the 108(b) FR regulations. As mentioned in Section 5.2.2 above, conditions regarding triggering events should not be included in the required wording of the LOC because in general, non-

[317] 53 FR 33945.
[318] 58 FR 30214.
[319] Under current EPA programs reviewed, regulatory language is generally used to specify conditions related to draws after triggering events (i.e., Option 2) and deposits into the SBTF (i.e., Option 5), while required instrument language is used to address availability of draws until the termination date (i.e., Option 3).

documentary conditions in standby LOCs are typically ignored. A "no draws unless triggering events have occurred" approach would reduce the Agency's 108(b) administrative burden compared to Options 3 and 4 below but would not reduce the burden associated with SBTFs. This option would provide less assurance than options 3, 4 or 5 that funds would be available for valid third-party CERCLA claims should a qualifying event/claim occur after the receipt of a notice of termination of the LOC. There would be an additional administrative burden, as compared to Options 3 , 4 and 5, in assessing whether specified triggering events have occurred

Option 3: Draws before revised termination date.
This option needs to be hard-wired into the required wording of the LOC. The following required instrument wording from U.S. Department of Interior Office of Surface Mining and Reclamation and Enforcement (OSM) allows drawing on the LOC beginning 30 days prior to the then-applicable expiration date:

> Upon receipt of such notice [of refusal to renew the letter of credit], you may draw on us at sight for the amount of this Letter of Credit beginning thirty (30) days or less prior to the then-applicable expiration date....[320]

An issuer may send a notice of cancellation at any time, and by doing so, may reduce the time period during which the LOC is effective under this option. The wording above highlights this change by inserting the phrase "then applicable" before "expiration date...." The following required LOC wording from the RCRA Subtitle C closure/post-closure program, specifies how long a party has to draw on the letter after the date of receipt of the notice but does not emphasize the effective change in termination date:

> … any unused portion of the credit shall be available upon presentation of your sight draft for 120 days after the date of receipt by both you and [owner's or operator's name], as shown on the signed return receipts.[321]

Option 4: Draws before original termination date.
This option needs to be hard-wired into the required wording of the LOC. It would establish that the original month and day of termination applies regardless of when the advance notification of cancellation is received, which must provide the specified amount of notice before the original termination date. Compared to Option 3, this option reduces the risk that draws happen before the original termination date (but after the revised termination date) and are dishonored.

Option 5: Automatic mailing of remaining balance to standby trustee.
This option needs to be hard-wired into the required wording of the LOC. It would establish that following notice of cancellation and failure of the owner or operator to provide acceptable replacement 108(b) FR, that the issuing bank would send/transmit or the Agency would draw/transmit any remaining balance to the standby trust fund. An example in which the residual amount is automatically mailed to a named party can be found in the Montana Department of Environmental Quality Open Cut Mining Program LOC:

[320] U.S. Department of Interior, Office of Surface Mining Reclamation and Enforcement. "Irrevocable Letter of Credit," found at: http://www.osmre.gov/resources/forms/loc.pdf.
[321] 40 CFR 264.151(d).

> In the event that we have provided you with the notice of election not to renew this Letter of Credit and, on or before the Expiration Date, we have not received from you a certificate confirming that the Operator has provided you with bond(s), letter(s) of credit, undertaking(s), agreement(s) of indemnity, or other instrument(s), satisfactory to you as a replacement for this Letter of Credit, we shall forward to you on the Expiration Date, a bank check for the full amount of this Letter of Credit less any amount previously drawn by you.[322]

Specifying that the residual amount be automatically mailed to the trustee of the standby trust fund unless the owner or operator provides acceptable replacement FR could provide further assurance that EPA can access the funds if needed, and reduces the burden on EPA staff (e.g., no need to make an affirmative draw, no need to keep track of changed termination dates). As compared to Option 3, this option virtually eliminates the risk that draws happen after the revised termination date (but before the original termination date) and are duly dishonored.

Overall, advantages of the options above include lower administrative burden (either associated with reduced draws or with SBTFs) and the elimination of a SBTF. Establishment of a SBTF will be an administrative burden on the owner/operator and the Agency. Disadvantages address the possibility of 108(b) FR being unavailable, the possibility of unnecessary draws, and the possibility of draws that are duly dishonored. As discussed above, the failure to provide alternate FR would be a significant regulatory violation and could create a situation in which no 108(b) FR is available when needed. In Options 3 through 5, there is a possibility that draws would occur from the LOC and no triggering event would occur. In Options 2 through 5, even if a triggering event does occur, there is a possibility that no 108(b) FR would be needed. Options 3 and 4 include the possible disadvantage of draws that occur after the revised termination date (but before the original termination date) that are duly dishonored.

EPA programs researched apply three approaches in the case of failure to provide alternate FR for a LOC. The RCRA Subtitle C and 40 CFR Part 261 (excluded secondary hazardous materials) liability programs simply apply Option 3, allowing the unused portion of a LOC to be drawn upon until the termination date. The second approach, employed under RCRA Subtitle C closure/post-closure and Part 261 financial assurance, is a combination of Option 3 and Option 5 outlined below. Namely, after receipt of a notice of cancellation/termination/nonrenewal, the LOC must be available for draws up until the expiration date (i.e., Option 3). If the owner or operator has not secured alternate FR within 30 days of the expiration date or the end date of many extension issued to the term of credit, the Regional Administrator will then draw on the LOC and place the balance into the SBTF (i.e., Option 5). The third approach, employed under RCRA Subtitle I (UST), is a slight variation on the second approach and combines Options 2, 3, and 5 outlined below. After receipt of a notice of cancellation/termination/nonrenewal, the LOC must be available for draws up until the expiration date (i.e., Option 3), but if the owner or operator fails to provide alternate financial assurance within 60 days of receiving notice and one of several triggering events has occurred, the Director of the implementing agency will draw on the LOC and place funds (up to the remaining balance) into the SBTF (i.e., Options 2 and 5).

As reflected in these EPA programs, Option 5 would be more appropriate in a closure/post-closure framework than a risk-transfer/liability framework. In a risk-transfer framework, payments are made

[322] Montana Department of Environmental Quality, Open Cut Mining Program. "Irrevocable Letter of Credit," found at: *http://deq.mt.gov/Land/opencut/opencutpermitforms.*

when qualifying claims are made and not as a lump sum. Therefore, the transfer of a lump sum payment into a SBTF would be a departure from this framework and an increase in responsibility for the issuer. For this reason, Option 2 is more commonly used for liability coverage, allowing funds to be made available should qualifying claims be made up until the termination date. The process employed under RCRA Subtitle I represents a compromise between these two approaches. By requiring placement of funds into a SBTF should triggering events occur, the UST program provides more assurance that funds would be available after the termination date for any claims resulting from these events.

Under EPA programs reviewed, required LOC wording typically includes a sight draft and a signed statement ("…in accordance with regulations issued under the Comprehensive Response, Compensation and Recovery Act.") for draws. For the three options authorizing draws (Options 2 through 4), a variation on the signed statement may be included. As addressed in Section 5.2.3 above, if EPA wanted to limit payment from the LOC, it could specify required documents that would represent those conditions. The following LOC wording example from Illinois Department of Natural Resources, Land Reclamation Division requires both: (a) a sight draft, and (b) a signed statement about owner's or operator's failure to provide acceptable replacement instrument:

> This Irrevocable Letter of Credit authorizes the Department to draw on the Issuing Bank, up to the amount of $ _____, by sight draft presented for payment to the Issuing Bank. The sight draft shall include a signed statement from the Department that the [owner/operator] failed to submit [sic] acceptable replacement bond, pursuant to [regulatory code provision] .....[323]

In light of the above, the Agency has determined that the required wording of 108(b) LOCs shall allow draws before the revised termination date following the approach used in the RCRA Subtitle C closure/post-closure program at 40 CFR 264.151(d).

5.2.7. Direct action authorization and/or defenses.

This section discusses issues and options posed for LOCs by the direct action provisions of 108(c)(2) and 108(d). Direct action is a statutory right that is largely independent of the 108(b) regulations and required wording of the LOC. However, the required wording of the LOC and the associated regulations may more or less moot direct action. The required wording of the 108(b) LOC is expected to specify that it is to be established for the favor of any and all third-party CERCLA claimants or the trustee of a trust fund (see discussions of beneficiaries in Section 5.1.5 above), who may make draws (see discussion in Section 5.2.4 below) and who may receive payments (see discussion in Section 5.2.5 below) upon presentation of the specified documents (see discussion at Section 5.2.3 below). Depending on the Agency's resolution of those various issues and options, third-party claimants may or may not normally have direct access to the LOC for satisfaction of claims, although that possibility remains under consideration. Regardless of the Agency's resolution of those inter-related issues, CERCLA provides in 108(c)(2) for a conditional right of direct action against the instrument provider in the event of a release or a threatened release from a facility, If the person liable under CERCLA 107 is bankrupt or otherwise unlikely to be available for suit as a solvent party. Direct action statutes (e.g., "privity of contract") are enacted with principal regard to insurance as FR, where claimants may lack the legal status to sue insurers when the insured parties are bankrupt or insolvent, thus leaving those claimants with no

[323] Illinois Department of Natural Resources. "Irrevocable Letter of Credit Bonding Form," found at: https://www.dnr.illinois.gov/mines/LRD/Documents/C-ILC.pdf.

recourse. Direct action can also be applied to other FR instruments, such as a 108(b) LOC. RCRA and CERCLA each include statutory provisions authorizing direct action against issuers of financial responsibility instruments.[324] The Hazardous and Solid Waste Amendments of 1984 amended RCRA to authorize direct action in two situations:

1. Where the owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. Where, with reasonable diligence, jurisdiction in any State Court or any Federal Court cannot be obtained over an owner or operator likely to be solvent at the time of judgment.

Similarly, in the event of a release or threatened release from a facility, CERCLA 108(c)(2) authorizes direct action in the following situations:

1. If the person liable under CERCLA §107 is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. If, with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA §107 who is likely to be solvent at the time of judgment.[325]

In both RCRA and CERCLA, the first statutory condition for direct action appears more objective than the second condition, where "reasonable diligence" and "likely to be solvent" seem somewhat subjective. The more subjective language may allow a LOC issuer to defend against direct action if no bankruptcy petition has been filed by the person liable under CERCLA 107, arguing that the liable party was not likely to be insolvent at the time of judgement.

The required wordings of EPA's RCRA financial assurance instruments in Subtitles C and I do not include direct action specifications.[326] EPA reviewed how the Coast Guard and BOEM implemented analogous FR provisions with direct action components.

Current Practice: The Coast Guard's FR authority stems from both CERCLA 108(a) and OPA 90. Under CERCLA, direct action authority comes from CERCLA 108(c)(1) for vessels. In the event of a release or threatened release from a vessel, CERCLA 108(c)(1) authorizes direct action against guarantors (i.e. instrument providers other than the owner or operator) for any claim authorized by CERCLA 107 or 111.[327]

In addition to CERCLA, OPA 90 authorizes direct action in three instances:

[324] RCRA 3004(t)(2), CERCLA 108(c)(1), and CERCLA 108(c)(2).
[325] CERCLA 108(c)(2).
[326] There are references to direct action in Subtitles C and I of RCRA, but no mention in the regulations or instruments. The statute states, "In any case in which an owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the FBC or where with reasonable due diligence jurisdiction in any state court or the federal courts cannot be obtained over an owner likely to be solvent at the time of judgement, any claim arising from conduct for which evidence of FR must be provided under this subsection may be asserted directly against the guarantor providing evidence of the FR."42 U.S.C. 6991b(d)(2), 42 USC 6924(t)(2).
[327] In contrast, in the event of a release or a threatened release from a facility, CERCLA108(c)(2) authorizes direct action against a guarantor for any claim authorized by CERCLA 107 or 111 if the person liable under CERCLA 107 is in bankruptcy, reorganization, or arrangement, or if with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA 107 who is likely to be solvent at the time of judgment.

1. The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles (GAAP),
2. The assured party has filed a petition for bankruptcy, or
3. The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims.[328]

The Coast Guard has elected not to incorporate the LOC as an acceptable instrument of FR in its regulations, except by petition. Nevertheless, the Coast Guard has addressed direct action and direct action defenses for its other authorized FR instruments.

The Coast Guard's regulations on direct action require that the wording of the instruments must include an accompanying acknowledgment that, "an action in court by a claimant (including a claimant by right of subrogation) for costs or damages arising under the provisions of these Acts [CERLCA and OPA 90], may be brought directly against the insurer or other guarantor."[329]

The Coast Guard has put limitations in place, beyond what is stated in the statute, to confine the scope of direct action claims. The Coast Guard has narrowed the scope of applicable direct action through agency interpretation. In the preamble to the 1994 rule, the Coast Guard stated in response to a comment concerning the extent of direct action liability that, "no right of direct action against a guarantor endows a claimant with rights against a guarantor's reinsurer".[330] This limitation is not expressly stated in the regulations.

BOEM has elected not to incorporate the LOC as an acceptable FR instrument in their OPA 90 regulations for offshore facilities and vessels. However, BOEM allows applicants to petition the Director if the applicant wishes to use an alternative instrument to demonstrate FR. Letters of credit are specifically referenced in the regulation as a type of alternative instrument that Director 'may' accept.[331] With regards to direct action, BOEM has indicated in its regulations that direct action shall apply to all guarantors.[332] BOEM's regulations regarding direct action mirror the statutory language of OPA 90. Under OPA 90, a claim may be made directly if one of three requirements is met.[333] BOEM's regulations reaffirm these statutory requirements, stating that a guarantor is subject to direct action for any claim asserted by:

1. The United States for any compensation paid by the Fund[334] under OPA, including compensation claim processing costs; and
2. A claimant other than the United States if the designated applicant has

[328] 33 U.S.C. 2716(f)(2).
[329] 33 CFR 138.80(d).
[330] 59 FR 34220 (July 1, 1994).
[331] 30 CFR 553.32.
[332] 30 CFR 553.61(a).
[333] (1) The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles, (2) The assured party has filed a petition for bankruptcy, or (3) The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims. 33 USC 2716(f)(2).
[334] Oil Spill Liability Trust Fund, established by Section 9509 of the Internal Revenue Code of 1986 as amended (26 U.S.C. 9509).

a. Denied or failed to pay a claim because of being insolvent or
b. Filed a petition in bankruptcy under 11 USC chapters 7 or 11[335]

Although there are subtle differences in language between OPA 90 and BOEM regulations on direct action, BOEM has stated that these differences are not substantial and that, "the terms and conditions cited in the [regulatory] section are consistent with those in OPA. The rule does not 'broaden' the statutory language."[336]

Much like the Coast Guard, BOEM's regulations for the required wording of FR instruments also require an acknowledgement that direct action may be taken against it if certain criteria are met. BOEM's regulations state, "Each instrument you submit as FR evidence must specify that the instrument issuer agrees to direct action for claims made under OPA up to the guaranty amount, subject to the defenses[337] in paragraph (a)(6) of this section".[338]

In its regulations, BOEM has highlighted a statutory provision in OPA 90 that any claim made by the U.S. government may be brought directly, although claims made by other claimants may not be brought unless a Responsible Party asserts that it is insolvent or if a bankruptcy petition has been filed. Commenters on the BOEM regulations promulgated in 1998 addressed the "assertion of insolvency" provision, recommending that the BOEM implement a strict interpretation of what constitutes insolvency, including greater guidance concerning a responsible party's financial status. BOEM responded that its interpretation of the insolvency condition did not require verification of the owner/operator's financial status at the time of the assertion.[339] BOEM stated, "Our interpretation is that if a responsible party denies or fails to pay a claim asserting that he or she is insolvent and further asserts that the conditions of his or her insolvency are equivalent to the insolvency criteria set forth at OPA section 1016(f)(2), then claimants may proceed against the responsible party's guarantor."[340] BOEM decided not to require an official determination of insolvency, which could be a time-consuming process.[341]

EPA has four potential options when considering how to apply direct action provisions to CERCLA 108(b) LOCs:

- **Option 1:** Include direct action provisions in the required wording of the LOC, such as an explicit acknowledgement by issuers that they are subject to direct action claims under applicable circumstances.
- **Option 2:** Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
- **Option 3:** Expand direct action authorization under CERCLA 108(c)(2).

[335] 30 CFR 553.61(a).
[336] 63 FR 42699 (August 11, 1998).
[337] An instrument issuer may not use any defenses against a claim made under OPA except: (1) the rights and defenses that would be available to a designated applicant or responsible party for whom the guaranty was provided; and (2) the incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated OSFR.
[338] 30 CFR 553.41(a)(4).
[339] 63 FR 42699 (August 11, 1998).
[340] 63 FR 42699 (August 11, 1998).
[341] 63 FR 42699 (August 11, 1998).

- **Option 4:** Narrow direct action authorization under CERCLA 108(c)(2). EPA could place greater restrictions on, by whom, and when a direct action claim could be brought against an issuers of a 108(b) LOC.

Option 1: Include direct action provisions in the required wording of the LOC, such as an explicit acknowledgement by issuers that they are subject to direct action claims under applicable circumstances.
Strengths: Increases transparency and ensures that the issuers and potential claimants are aware of the direct action authorization. Used by the Coast Guard and BOEM for other FR instruments authorized under CERCLA and OPA 90.
Weaknesses: May discourage LOC issuers from participating in the 108(b) program if subject to direct action. Not needed because of statutory authorization. Adds to LOC document verbiage which Agency would need to confirm.

Option 2: Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
Strengths: A direct action provision in the instrument is not needed because of statutory authorization. Less required verbiage for EPA to confirm. May encourage participation from LOC issuers
Weaknesses: The lack of an acknowledgment in the instrument itself decreases transparency and may fail to ensure that the issuers and potential claimants are aware of the direct action authorization. Inconsistent with Coast Guard and BOEM.

Option 3: Expand direct action authorization under CERCLA 108(c)(2). For example, EPA could expand direct action to reinsurers of guarantors or allow any claim made by the government to be made directly.
Strengths: Expanded direct action could provide LOC claimants faster cost recovery and liability payments.
Weaknesses: May discourage issuers from participating in 108(b) program. May interfere with first come, first served approach (see discussion at Section 2.1 above) or equal treatment of all types of liabilities (see discussion at Section 2.1 above). May raise question of EPA's authority to expand statutory direct action.

Option 4: Narrow direct action authorization under CERCLA 108(c)(2). EPA could place greater restrictions on, by whom, and when a direct action claim could be brought against an issuers of a 108(b) LOC. For example, EPA could require a formal finding of pending insolvency, creating greater burdens for claimants to use direct action.
Strengths: By narrowing direct action authorization, EPA may increase LOC issuer participation in the 108(b) program. BOEM has narrowed direct action provisions with regards to reinsurers.
Weaknesses: Narrowing direct action authorization may make it more difficult for some claimants to expeditiously file claims and receive payments. May raise question of EPA's authority to narrow statutory direct action.

EPA has decided to include language in required wording of the CERCLA 108(b) LOC if specified in favor of any and all third-party CERCLA claimants acknowledging and authorizing direct action without attempting to narrow or expand the scope from what is provided in the statute. If the LOC is specified in favor of a trust fund trustee, it is envisioned direct actions would be made against the trust fund as opposed to the institution issuing the LOC and, as such, no language authorizing direct action would be

necessary in the letter of credit when issued in favor of a trustee.

Defenses Available to 108(b) LOC Issuers Under Direct Action. CERCLA 108(c)(2) authorizes guarantors (i.e., providers) of 108(b) instruments) to be subject to direct action claims. CERLCA 108(c)(2) and (d) provide those guarantors with defenses against such claims. Both the RCRA[342] and CERCLA statutes specify that under direct action, a guarantor is entitled to invoke all rights and defenses which would have been available to the owner or operator if any action had been brought against the owner or operator by a claimant under the respective Acts.[343]EPA's RCRA Subtitle C and I regulations and required wordings of instruments do not contain specifications for defenses to direct action.[344] EPA reviewed how the Coast Guard and BOEM addressed defenses to direct action in their FR programs.

In developing financial responsibility regulations for vessels under CERCLA 108(a) and OPA 90, the Coast Guard specified direct action defenses in its regulations and financial instruments.[345] Under CERCLA 108(c)(1), the guarantor is "entitled to invoke all rights and defenses which would have been available to the person liable under § 107 if any action had been brought against such person by the claimant and all rights and defenses which would have been available to the guarantor if an action had been brought against the guarantor by such person".[346] Under OPA 90, a guarantor may invoke, (1) all rights and defenses which would be available to the responsible party under this Act [OPA 90], (2) any defense authorized under subsection (e);[347] and (3) the defense that the incident was caused by the willful misconduct of the responsible party.[348]

From this statutory authority, the Coast Guard's direct action defense regulations include the CERLCA statutory defenses outlined in 108(c)(1) as well as agency developed administrative defenses to direct action.[349] Coast Guard regulations state that a guarantor may invoke only the following rights and defenses with respect to a direct action claim:

1. Any defense that a person for whom the guaranty is provided may raise under the Acts,
2. The incident, release, or threatened release was caused by the willful misconduct of the person for whom the guarantee is provided,
3. A defense that the amount of a claim or claims, filed in any action in any court or other proceeding, exceeds the amount of the guaranty with respect to an incident or with respect to a release or threatened release,
4. A defense that the amount of a claim exceeds the amount of the guaranty, which amount is based on the gross tonnage of the vessel as entered on the vessel's International Tonnage Certificate or other official, applicable certificate of measurement, except when the guarantor knew or should have known that the applicable tonnage certified was incorrect, and

[342] Subtitle C 3004, Subtitle I 9003, 9004.
[343] CERCLA 108(c)(1) also includes a willful misconduct provision as a defense for a release from a vessel, but not a facility.
[344] Nothing in regulations or instruments from Subtitle C (40 CFR 265) or Subtitle I (40 CFR 280.90).
[345] 33 CFR 138.80(d).
[346] CERCLA 108(c)(2).
[347] The Secretary or President, as appropriate, may specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing evidence of financial responsibility to effectuate the purposes of this Act. 1016(e).
[348] OPA 90 1016(f)(1).
[349] 33 CFR 138.80(d). Defenses 1 and 2 are requirements from CERCLA 108(c). Defenses 3, 4, and 5 are directly related to specific 'total applicable amount' regulations in 33 CFR 138.80(f).

5. The claim is not one made under either of the Acts.[350]

The Coast Guard's direct action defenses include a willful misconduct provision, but do not include a defense for fraud or misrepresentation. The Coast Guard rejected a public comment to allow fraud or intentional misrepresentation as a guarantor's defense in the preamble to the 1996 rule.[351]

BOEM's defenses against direct action are similar to the Coast Guard's. Under BOEM's OPA 90 authority, BOEM chose to mirror its direct action defenses regulations to the OPA 90 statute.[352] BOEM direct action defenses include:

1. The rights and defenses which would be available to a designated applicant or responsible party for whom the guaranty was provided; and the liable party; and
2. The incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated OSFR.[353]

All of the expressly approved FR instruments in BOEM's regulations include a specification reiterating the enumerated defenses in the regulations. For example, BOEM's insurance certificate statesthat the named insurers agree, "not to use any defense except those that would be available to a Responsible Party for whom the insurance was provided or that the incident leading to the claim for removal costs or damages was caused by willful misconduct of a Responsible Party covered by this insurance."[354] Outside of the allowed defenses, and in similar fashion to the Coast Guard, BOEM has declined to allow guarantors a defense to direct action if a Responsible Party commits fraud or makes misrepresentations in the course of procuring an FR instrument. BOEM indicated that allowing a defense for fraud or misrepresentation would be inconsistent with two OSFR program objectives: (1) Ensure that claims for oil-spill damages and cleanup costs are paid promptly, and (2) make responsible parties or their guarantors pay claims rather than the Oil Spill Liability Trust Fund. BOEM also stated that as of 1998 there was no evidence that fraud and misrepresentation had been a problem in the OSFR program.[355]

EPA has the option to decide what defenses to allow guarantors to use against direct action claims related to 108(b) facilities. EPA has four main options regarding direct action defenses for 108(b) LOC issuers:

- **Option 1:** Include direct action defense provisions in the required wording of the LOC instrument, such as a direct acknowledgement from guarantors about the available direct action defenses
- **Option 2:** Do not include direct action defense specification in the required wording of the instrument.
- **Option 3:** Expand upon CERCLA 108(c)(2) defenses to direct action. EPA could expand upon CERCLA 108(c) direct action defenses, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.

[350] 33 CFR 138.80(d)(1).
[351] The Coast Guard has indicated that to adopt this recommendation would be inconsistent with the purpose of the guaranty – to ensure that the polluter pays for removal costs and damages. 61 FR 9270 (March 7, 1996).
[352] OPA allows all rights and defenses which would be available to the liable party; any defense authorized administratively; and the defense that the incident was caused by the willful misconduct of the responsible party.
[353] 30 CFR 553.41(a)(6).
[354] FORM BOEM-1019 (Expiration Date: December 2016).
[355] 63 FR 42707 (August 11, 1998).

- **Option 4:** Narrow CERCLA 108(c)(2) defenses to direct action claims.

Option 1: Include direct action defense provisions in the required wording of the LOC instrument, such as a direct acknowledgement from guarantors about the available direct action defenses.
Strengths: An acknowledgment in the required wording of the instrument increases transparency and ensures that the participating issuers and potential claimants are aware of available defenses. Used by the Coast Guard and BOEM for other FR instruments.
Weaknesses: More verbiage for EPA to confirm.

Option 2: Do not include direct action defense specification in the required wording of the instrument.
Strengths: Direct action defense provisions in the required wording of the instrument may be unnecessary if they simply mirror the statute. Reduces verbiage for EPA to confirm.
Weaknesses: The lack of a defense specification in the required wording of the instrument decreases transparency and may fail to ensure that participating issuers and potential claimants are aware of the direct action defenses.

Option 3: Expand upon CERCLA 108(c)(2) defenses to direct action. EPA could expand upon CERCLA 108(c) direct action defenses, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
Strengths: Expanding defenses will be in the interest of guarantors and may encourage their participation.
Weaknesses: Claimants may not be able to bring direct action claims as easily. Could raise questions about EPA's authority.

Option 4: Narrow CERCLA 108(c)(2) defenses to direct action claims.
Strengths: Narrowing defenses to direct action will be in the interest of claimants.
Weaknesses: Narrowing defenses to direct action could discourage LOC issuers from participating in 108(b). Could raise questions about EPA's authority.

In light of the above considerations, EPA has decided to propose option 1 and include a specific acknowledgment of the defense provisions provided in the statute when direct action language is required in the letter of credit.

Part 6. Trust Fund.

This part analyzes key issues for the wording of CERCLA § 108(b) trust agreements and standby trust agreements,[356] including issues that were raised and discussed at a meeting on January 28, 2016 between the US EPA and representatives of the banking industry with expertise in trust funds. CERCLA encourages the EPA to meet with the financial industry in connection with rulemaking for CERCLA § 108(b).

A CERCLA 108(b) trust fund would be created by and administered in accordance with a trust agreement, signed by both a current owner or operator of the facility and a corporate trustee.[357] The trust would be intended for the benefit of third-party CERCLA claimants (see discussion of beneficiaries

[356] Trust funds and standby trust funds would have many common provisions and can be addressed together.
[357] A corporate trustee means an eligible institution, not an individual (personal) trustee. Trustee eligibility requirements are discussed in a companion report.

below in Section 6.2.1) payments are made for CERCLA response costs and natural resource damages that are the responsibility of any current owners or operators (see discussion of payment triggers below in Section 6.2.2). The following sections analyze alternative specifications for the wording of CERCLA § 108(b) trust and standby trust agreements or the corresponding regulations.

Part 6.1 presents trust agreement-specific provisions. The provisions in Part 6.1 were believed strongly supported by prior practice and authority. These instrument-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications. Part 6.1 includes 34 such trust agreement provisions. Assumptions about these provisions also were considered relevant in assessing alternative specifications for instrument language analyzed in Part 6.2.

Part 6.2 identifies and analyzes alternative specifications that EPA considered for 5 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). These issues include: (1) Specifying the beneficiary, (2) Payment triggers, (3) Trustee liability under direct action, (4) Holding of other 108(b) instruments in the 108(b) trusts, and (5) Direct action authorization and defenses. Each topic starts with a presentation of the issue. Next, we describe current practice, if any, about that issue, drawing from EPA and other Federal agency FR programs and focusing on required wordings of instruments. Then, we identify potential EPA options, including strengths and weaknesses of each. Finally, EPA identifies any dominant or preferred option. The Agency's preferred specifications are identified.

Part 6.1. Issues Specific to Wording of 108(b) Trust Funds.

In the context of CERCLA § 108(b), a trust fund or standby trust fund would be established by a written agreement ("trust agreement") between a current owner or operator (termed the "Grantor"[358]) and the corporate trustee, with respect to the management and disbursement of property held in trust (see Section 6.2.4 below for discussion of what that property might include) for specified purposes. EPA would not execute the trust agreement. The key parties, "grantor" and "trustee," are defined in each trust agreement. Common definitions are as follows:

> *The term "Grantor" means the owner or operator who enters into this Agreement and any successors or assigns of the Grantor.*
>
> *The term "Trustee" means the Trustee who enters into this Agreement and any successor Trustee.*

Part 6.1 presents specifications for 108(b) trust agreements. The specifications in Part 6.1 are believed to be strongly supported by prior practice and authority. These trust agreement-specific provisions were not deemed by the Agency to require detailed analysis of alternate specifications, including their advantages and disadvantages. Part 6.13 includes over 30 such provisions, presented largely in the order of their appearance in the RCRA trust agreement. Assumptions about these provisions also were

[358] Although the owner or operator is referred to in this document as the grantor of the trust, a financial responsibility trust is classified as a "non-grantor" trust because it must be "irrevocable" (see discussion in Section 6.1.2). In addition, although modern usage favors the term "settlor" over the term "grantor," given the specialized nature of FR trust funds, the Agency has chosen to retain the term "grantor" when referring to the party (i.e., a current facility owner or operator) executing the trust agreement and establishing the trust fund.

considered relevant in assessing alternative specifications for trust fund specifications analyzed in Part 6.2.

6.1.1. EPA will specify the required wording for the 108(b) trust agreement.

Required wording of the 108(b)trust fund shall be specified in 108(b) regulations, not as guidance.[359] This approach is consistent with RCRA Subtitle C TSDF trust funds for closure/post-closure and trust funds for liability coverage for which the required wordings are set out at 40 CFR 264.151(a) and (m), respectively.

Development of specifications for the required wording of RCRA FR trust funds occurred over several years. A trust fund was the first and only instrument proposed for RCRA Subtitle C closure and post-closure care FR in 1978; the proposal did not include required wording for a complete trust agreement. The Agency provided more required language for the FR trust in its re-proposal of May 1980, reasoning that standard language "should increase availability because it will reduce the time, effort, and costs of preparation that would otherwise be required of the owner or operator and the trustee in establishing a trust fund to meet the requirements" of the regulations.[360] The re-proposal of May 1980 nevertheless did not include complete specifications for a RCRA FR trust fund because the Agency reasoned that such specifications would either be covered by state trust law or were best resolved by agreement between the owner or operator and the trustee. Some commenters strongly objected to that approach and said that financial institutions would not act as trustees if the trust instrument did not specify the responsibilities and rights of the trustees. For the January 12, 1981 interim final rule, with the assistance of the American Bankers Association and other commenters, the Agency developed a standard trust agreement which incorporated necessary provisions.[361] The Agency made a number of revisions, mainly clarifications and corrections, to the 1981 required wording of the RCRA closure and post-closure care FR trust agreement in the revised interim final rules of April 7, 1982. These changes resulted from evaluation of suggestions from the banking community.[362] For RCRA third-party liability coverage FR, the trust fund was added as an FR option in the final rule of September 1, 1988[363]; the required wording of the RCRA trust fund for liability coverage is similar but not identical to the required wording of the trust fund for closure and post-closure care. Significant differences in the required RCRA trust fund language appear with respect to beneficiaries (see discussion below at Section 6.2.1) and payment triggers (see discussion below at Section 6.2.2).

Whether used for RCRA Subtitle C TSDF closure/post-closure care FR or for third-party liability coverage FR, the RCRA regulations state that the "trust agreement must be worded as follows except that

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[359] EPA SDWA Class VI instrument specifications are laid out as guidance, not regulatory requirements. US NRC instrument specifications for decommissioning FR of materials licensees also are laid out as Models and through guidance, not with required wording specified in regulations. The varied potential uses for CERCLA FR instruments and past history with RCRA Subtitles C, D, and I FR argue for having required instrument wording in regulations, which should reduce administrative burdens for all parties.

[360] US EPA, Background Document Parts 264 and 265, Subpart H Financial Requirements Final Regulations (December 31, 1980).

[361] See 46 FR 2824 (January 12, 1981).

[362] See 47 FR 15032 (April 7, 1982).

[363] See 53 FR 33938 (September 1, 1988). The Agency had received several comments supporting the use of the trust fund to demonstrate FR for third-party liability coverage in response to EPA's August 21, 1985 NPRM.

instructions in brackets are to be replaced with the relevant information and the brackets deleted."[364] The Agency intends that its 108(b) regulations provide the required wording for CERCLA 108(b) trust funds including the relevant instructions.

6.1.2. Conformance clause.

Laws that require an owner or operator to demonstrate financial responsibility (e.g., for motor vehicle use) frequently state that the financial responsibility mechanism must contain certain specifications to satisfy the laws' financial responsibility requirement. If, in addition to requiring specifications for the trust agreement , the law states that a trust agreement issued pursuant to the law is deemed to contain (or exclude) certain terms, then those specifications deemed to be included (or excluded) in the trust agreement are controlling even if not included in (or excluded by) the terms of the trust agreement. This principle is applicable for laws in the form of statutes, regulations, or court rules.

CERCLA § 108(b)(2) does not explicitly require any specifications for any financial responsibility mechanisms nor does it state that a financial responsibility mechanism for CERCLA § 108(b) is deemed to contain specific terms. However, the statute does provide EPA the authority to "specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing such evidence of financial responsibility in order to effectuate the purposes of this Act." Therefore, EPA has the power to require inclusion (or exclusion) of specifications within trust agreements used to satisfy CERCLA § 108(b) financial responsibility requirements and to deem that trust agreements issued in satisfaction of such requirements contain (or exclude) certain specifications.

To ensure that all parties to a trust agreement are in agreement on the terms of a trust agreement, required wording under RCRA Subtitle C uses the following conformance clause in its required language for trust agreements: "The parties below certify that the wording of this Agreement is identical to the wording specified in 40 CFR 264.151(a) as such regulations were constituted on the date first above written."

Trust agreements used as financial mechanisms under RCRA and as proposed for CERCLA 108(b) are relatively long and spell out all aspects of trust funds used as financial responsibility; therefore certification language such as shown above, serves a similar function to more extended conformance clauses found in the required wording of other proposed 108(b) instruments. In view of the RCRA precedent, the EPA has decided to include a conformance certification clause similar to the language cited above in the required wording of the § 108(b) trust agreement.

6.1.3. CERCLA 108(b) trust funds must be "irrevocable."

Section 17 of the required wordings of RCRA trust agreements states that "this trust shall be irrevocable and shall continue until terminated...." Trust funds may be established either as revocable or

[364] In some instances, the required RCRA trust fund wordings fail to include the actual instruction in brackets (e.g., the required language did not state "[insert X here]" but said ""[X here]"), but the Agency believes that the required RCRA instrument wording does not lack for clarity. This omission in the trust fund instrument was criticized in Thomas Volet, "Problematic Provisions in Standby Auto-Extension Clauses," Documentary Credit World (April, 2014).

irrevocable. Trust law[365] and tax law both treat trusts differently depending on whether or not the trust instruments are "irrevocable." A revocable trust may be withdrawn or modified for any reason and at any time by the Grantor unilaterally, without notification to other parties.[366] The settlor of a revocable trust can properly direct the trustee in the performance (or nonperformance) of acts involving the management or distribution of the trust estate, even if contrary to the terms of the trust.[367] In contrast, an irrevocable trust agreement may not be revoked or amended without the agreement of key parties to the instrument. For example, those parties would include the Grantor, the trustee, and the applicable EPA Regional Administrator(s), for CERCLA liability coverage trusts. The trustee of an irrevocable trust may not be directed by the Grantor (see discussion of Grantors' instructions in Section 6.1.16 below) in the management or distribution of the trust estate. To avoid any presumption that the Grantor intends that the trust agreement be revocable,[368] the terms of the CERCLA 108(b) trust agreement should specify that it is "irrevocable."

Governmentally-mandated trusts that EPA reviewed are all termed "irrevocable." For example, the RCRA Subtitle C required wordings for trusts at 40 CFR 264.151 (a) and (m), state in Section 17 that they are "irrevocable." EPA has decided that CERCLA 108(b) trust funds shall be "irrevocable."

6.1.4. Multiple Parties Contributing Property to a 108(b) Trust Fund.

As discussed in Section 2.3.3 above, if a facility has multiple current owners or operators, financial responsibility may be demonstrated by one current owner or operator on behalf of all the current owners or operators, and, alternatively, financial responsibility may be demonstrated by each owner or operator separately. The Agency does not envision a "consolidated form" of trust agreement which multiple grantors would sign. The required wording of the RCRA FR trust agreements specify that they are made between "*the* owner or operator" (emphasis added) and a corporate trustee and similarly refer to "the Grantor" in the singular in establishing the trust fund (and throughout the trust agreement). The RCRA trust agreement gives powers and responsibilities only to "the grantor" and the trustee. For example, "the grantor" receives annual valuation statements confirming the value of the trust fund and "the grantor's" failure to object bars "the grantor" from asserting any claim or liability against the trustee with respect to matters disclosed in the statement (Section 10); trustee compensation must be agreed upon in writing from time to time with "the grantor" (Section 12); "the grantor" may replace trustees and appoint successor trustees (Section 13); "the grantor" may convey orders, requests, and instructions in writing to the trustee (Section 14); the trust agreement may be amended or terminated by an instrument in writing executed by "the grantor", the trustee, and an appropriate EPA Regional Administrator (Sections 16 and 17);

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[365] Although EPA refers, by default, to The American Law Institute's Restatement of the Law, Third, Trusts, the Agency recognizes that by its terms that Restatement excludes material on the law relating to the use of a trust as a security device or as an arrangement for the benefit of creditors (Volume 1, page 7).

[366] See, for example, the Restatement of the Law, Third, Trusts (2007) § 74 "Effect of the Power of Revocation."

[367] See, the Restatement of the Law, Third, Trusts (2007) § 74 "Effect of the Power of Revocation," Comment on Subsection (1), Clause (a).

[368] See, for example, the Restatement of the Law, Third, Trusts (2003) § 63 "Modification and Termination of Trusts, Comment c *Presumptions Regarding Revocability*."

upon termination, all remaining trust property, less final trust administration expenses, shall be delivered to "the grantor" (Section 17). Trust management and administration would be significantly complicated if multiple grantors were permitted at the same time with all having to agree on the actions summarized above.[369]

Where there are multiple current owners or operators, the grantor could be charged by a separate agreement to represent their interests through use of a single FR trust fund to which multiple contributions could be made. The required language of the RCRA trust agreement mentions in Section 3 *Establishment of Fund* "property subsequently transferred to the trustee."[370] That property subsequently transferred to the trustee may be contributed by parties other than the designated "grantor" who are other current owners or operators of the facility (see discussion of multiple owners and operators in Section 2.3.3). Alternatively, each current owner or operator could establish individual FR trust funds that would add up to the total required amount of coverage. The Agency cannot envision a "consolidated form" of the trust agreement that would provide for efficient management and administration with multiple grantors having to agree upon the execution of their powers and responsibilities.

6.1.5. Business Form of Owner or Operator.

The required language of the RCRA trust agreement requires the Grantor owner or operator to choose its business form from among "corporation," "partnership," "association," or "proprietorship." These choices appear sufficient to accommodate businesses that might take the form of limited liability companies (LLCs) and joint ventures.[371]

6.1.6. Whereas Clauses.

The RCRA trust agreements include three "whereas" clauses that describe facts leading up to the making of the trust agreements. The first clause describes EPA's establishment of applicable FR regulations; the second clause describes the Grantor's decision to use a trust to assure all or a part of the required FR; and the third clause describes Grantor's selection of the Trustee and the Trustee's willingness to act as trustee. EPA intends to modify the first and second whereas clauses to describe the 108(b) FR program and specifically acknowledge that the trust may hold a letter of credit and retain the third clause in a 108(b) trust agreement.

6.1.7. Section 1 Definitions.

EPA intends to retain the RCRA definitions of Grantor and Trustee for the CERCLA 108(b) trust agreement.

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[369] The Restatement of the Law, Third, Trusts (2003) § 63, "Modification and Termination of Trusts, Comment c *Presumptions Regarding Revocability*," in the context of revocable trusts, contains detailed discussion of the potential complexities posed by multiple settlors.

[370] See Section 3 *Establishment of Fund*."

[371] The Agency recognizes that the federal government has proposed (October 20, 2015) adding a category of "other" to its standard forms for surety bonds.

6.1.8. Section 2 Identification of Facilities.

EPA intends to retain the RCRA Section 2 clause identifying covered facilities for the CERCLA 108(b) trust agreement.

6.1.9. Section 3 Establishment of Fund.

EPA intends to modify the first paragraph of the RCRA trust agreement for the 108(b) trust agreement so that it tracks the 108(b) program. The language following "for the benefit of any and all third parties" would continue as follows: "with valid third-party CERCLA claims against the Grantor or other current owners and operators arising from the operation of the facilities covered by this Agreement."

To respond to concerns from potential 108(b) trustees concerned about direct action, EPA is proposing to specify within the required wording that the Grantor and Trustee do not intent for the Trustee to qualify as a "guarantor" for purpose of direct action in the 108(b) context. As discussed in Section 6.2.3, the financial community expressed concerns to EPA about being subject to direct action suits as trustees of 108(b) trust funds. Section 6.2.3 discusses, in the context of CERCLA direct action, how the required wording of the RCRA trust agreement provides various protections against potential trustee liability, and Section 6.2.3 assesses EPA options for providing greater protections. Representatives of banks with trust expertise expressed their preference that CERCLA § 108(c) direct actions be made against the 108(b) "trust fund" itself as opposed to direct actions being brought against the trustee of the 108(b) trust fund. A way to accomplish that result might be through a regulatory definition of "guarantor" that would not include trustees. The Agency finds precedent in such a definition in the finding of the court in *Port Allen Marine Services, Inc. v. Chotin*, 765 F. Supp. 887 (M.D.La. 1991) that "an insurer is not necessarily a guarantor." That finding was cited with approval by the court in *City of New Orleans v. Kernan*, 933 F Supp. 565 (E.D. La. 1996).[372] If an insurer is not necessarily a guarantor then, a fortiorari, a trustee is not necessarily a guarantor. Therefore, the Agency proposes to specify in the required wording of the trust agreement that the trustee is not intended to be considered to be a guarantor.[373] Rather the proposed trust fund includes language that the grnator and trustee intend for the trust fund itself to qualify as a guarantor.

6.1.10. Section 3 Establishment of Fund, Exclusions from Coverage.

The wording of the RCRA liability coverage trust agreement identifies certain third-party liability claims which the RCRA trust is not intended to cover, including liabilities that could fall within the terms of other types of commercial liability insurance. Subsections (a) through (e) and the lead-in clause would be dropped for the CERCLA 108(b) trust agreement because they are not relevant to CERCLA 107/111 costs and NRD liability.

[372] The Port Allen Marine Court's reasoning was criticized as "flawed" in Peter R. Mounsey, "The Direct Action Against Insurers " in 18 Wm. And Mary Environmental Law and Policy Rev. (1993).
[373] Similarly, in the required wording of the 108(b) insurance instrument, the term "guarantor" could be defined for purposes of direct action as "a person other than the insurer."

6.1.11. Section 3 Establishment of Fund, Designation of Trust Fund as "Primary" or "Excess" When Multiple Instruments Are Used for a Single Facility.

The required wording of the RCRA liability coverage trust agreement includes in Section 3. *Establishment of Fund* the following clause: "In the event of combination with another mechanism for liability coverage, the fund shall be considered [insert "primary" or "excess"] coverage." This language is inconsistent with the Agency's CERCLA "vertical" approach to coverage of a single facility with multiple FR instruments (see discussion in Sections 2.3.2 and 2.3.3). If the CERCLA FR program were based on "horizontal" coverage when multiple instruments are used for a single facility (see discussion in Section 2.3.2), such a clause would be appropriate. However, the Agency has determined to follow a "vertical" share approach for 108(b) when multiple instruments are used for a single facility. Therefore, a specification whether the trust is "primary" or "excess" is not needed for CERCLA 108(b) trust agreements. This "primary" vs. "excess" language is not included in the RCRA FR trust agreement for closure/post-closure care although combinations of FR instruments are allowed in that program.

6.1.12. Section 3 Establishment of Fund, Trustee Responsibility for Discharge of Grantor Liabilities.

The wording of the RCRA liability coverage trust agreement includes a clause in Section 3 stating, "The Trustee shall not be responsible nor shall it undertake any responsibility for the amount or adequacy of, nor any duty to collect from the Grantor, any payments necessary to discharge any liabilities of the Grantor established by EPA." This clause shall be retained in the 108(b) trust agreement as an element of protecting the trustee (see discussion at Section 6.2.3).

6.1.13. Section 4 Payment Triggers.

For the CERCLA 108(b) trust agreement, EPA will modify the RCRA liability trust agreement Section 4 header from "Payment for Bodily Injury or Property Damage" to read "Payments from the Fund."

See further discussion of payment triggers in Section 6.2.2 below.

6.1.14. Signatory of certification of valid claim and deletion of that form.

The RCRA liability coverage trust agreement specifies that the Certification of Valid Claim must be signed by the Grantor and the Claimant(s). To allow for CERCLA claims against other current owners or operators, not just the Grantor, EPA proposes to allow any current owner or operator of the covered facility to enter into a settlement instead of requiring only the Grantor to submit a signed settlement (certificate of valid claim).

6.1.15. Section 5 Payments Comprising the Fund.

The required wording of Section 5 of the RCRA FR trusts specifies "cash or securities acceptable to the Trustee." For the CERCLA 108(b) trust agreement, EPA intends to modify this clause as follows: "cash, securities acceptable to the Trustee, or a 108(b) standby letter of credit." See discussion in Section 6.2.4 below concerning property being held in trust.

6.1.16. Section 6 Trustee Management: Grantor Communications Regarding Investment Policies and Guidelines.

The opening clause of Section 6 of the required wording of the RCRA FR trust agreements states, "The Trustee shall invest and re-invest the principal and income, *in accordance with general investment policies and guidelines which the Grantor may communicate in writing to the Trustee from time to time,*[374] subject, however, to the provisions of this section." The subsequent "provisions" of Section 6 lay out a modified prudent man rule for investment management, which EPA intends to replace with a modified "prudent investor" rule, as discussed in Section 6.1.18 below.

The prudent investor rule acknowledges that the Trustee may choose to use agents with specialized skills and knowledge in the management of trust property and/or delegate to trust investment experts. Given the comprehensive approach of the prudent investor standard and the nature of 108(b) FR trusts and standby trusts, the Agency cannot envision how the Grantor's periodic communication of "general investment policies and guidelines" to the trustee adds value.

The strict duty of undivided loyalty to trust beneficiaries prohibits the trustee from investing in a manner that is intended to serve interests other than those of the beneficiaries or the purposes of the settlor.[375] Moreover, the Agency does not want to encourage aggressive investment management, as may be more appropriate for future closure and long-term post-closure care first-party trusts; in the context of CERCLA third-party liability claims FR trusts, which will be fully-funded. the trustee need not aspire to significant growth in the value of the trust. How the trustee as a prudent investor is to weigh Grantor communications (given the trustee's duty of loyalty to beneficiaries) is unclear; trustees may well prefer that the clause be deleted.

Instead, the Agency proposes to substitute the following language: "The Trustee shall invest and re-invest the principal and income, in accordance with the Grantor's disclosures communicated in writing to the Trustee from time to time of the names of all current owners and operators and their affiliates including issuers of securities or other obligations, subject, however, to the provisions of this section." This information about other current owners and operators and their affiliates is needed to effectuate exception (i) (see 6.1.17 below) about which securities or other obligations are not to be acquired or held; the Grantor is most likely to have this information readily available.

6.1.17. Section 6. Trustee Management: Disallowed Holdings.

Among the exceptions to the prudent investment standard included in the required wording of the RCRA trust agreement is the following: "(i) Securities or other obligations of the Grantor, or any other owner or operator of the facilities, or any of their affiliates as defined in the Investment Company Act .... shall not be acquired or *held* ...." For this prohibition to be most effective, EPA believes that the wording

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[374] The italicized language seems a relic and presumes that the Grantor has more investment acumen than the professional corporate trustee. If a mining facility itself had been left in trust to be developed as an investment, then the Grantor could well have specialized insights and knowledge for the development of that mine. That is not applicable for 108(b) FR property, which must be cash, securities acceptable to the Trustee, and/or a 108(b) standby LOC

[375] Restatement of the Law, Third, Trusts (2007) § 90 cmt. c "General requirements of loyalty and impartiality."

should be changed to state that the Grantor must provide to the trustee the legal names (as known) of any other owner or operator of the covered facility and the legal names (as known) of their affiliates. That would be more efficient and effective than the trustee having to determine the names itself.

6.1.18. Section 6 Trust Management: Prudent Man Rule vs. Prudent Investor Rule.

Current Required Trust Fund Language. In the May 1980 re-proposal of the RCRA trust fund regulation for closure/post-closure FR, the Agency provided purpose, property, and period clauses as well as specifications for the operation of the trust and the duties of the trustee. The 1980 re-proposal did not contain an investment clause and other specifications for the trust fund agreement because the Agency believed that those issues would either be covered by State law or be best resolved by negotiation between the owner or operator and the trustee. Some commenters strongly objected to this approach and said that financial institutions would not act as trustees if the trust instrument did not specify the rights and responsibilities of trustees. In response, the Agency developed a standard trust agreement which incorporated the investment clause and other necessary provisions with the assistance of the American Bankers Association and other commenters.[376] The clause developed for the RCRA closure/post-closure care trust fund was carried over into the required wording of the trust fund for liability coverage. The investment clause adopted was a modified "prudent man" clause. The "prudent man" clause was "modified" by a prohibition against investments in the securities of the owner or operator or its affiliates. The "prudent man" rule requires the trustee to invest with the judgment and care that persons of prudence would exercise in managing an enterprise of like character and aims.

Current Trust Law and Practice. In subsequent years, an alternative investment concept became prevalent in trust fund law and practice: the "prudent investor" rule, which is described in the *Restatement of the Law, Third, Trusts § 90* (1992, 2007) as follows:

> The trustee has a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust. [Specifically], [t]his standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.

As of the 2007 edition of the *Restatement*, 45 states had reportedly enacted legislation codifying the prudent investor principles, most by enacting the Uniform Prudent Investor Act, which was promulgated in 1994; the remaining states were said to have adopted comparable, modernized statutes.

The prudent investor rule, which reflects modern portfolio management theory, explicitly requires that the trustee "diversify the investments of the trust unless, under the circumstances, it is prudent not to do so." The terms of a trust, regulation, or statute may make a particular type of investment or course of action impermissible, such as under the RCRA trusts. However, generally, under the prudent investor rule, assets and techniques are not classified as permissible or impermissible investments in isolation.[377] Although investment techniques are not subject to some universal standard of acceptable or

[376] 46 FR 2824 (January 12, 1981).
[377] Restatement of the Law, Third, Trusts (2007) § 90 cmt. k.

unacceptable risk, specific types of investments and courses of action certainly differ significantly in the nature and degree of the risks associated with them.[378] And in all matters, including investments, the trustee must act with undivided loyalty solely in the interests of trust beneficiaries.[379] The prudent investor rule requires the trustee to "act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents", while incurring only costs that are reasonable and appropriate to the trustee's investment responsibilities. The modern rule recognizes that the trustee may use agents in carrying out its responsibilities.

EPA is proposing to use languae in Section 6 "Trustee Management" of the trust agreement that reflects the current state of trust law as described in the *Restatement of the Law, Third, Trusts*, as follows:

> *In investing, reinvesting, exchanging, selling, and managing the Fund, the Trustee shall discharge his duties with respect to the trust fund with undivided loyalty and solely in the interest of the beneficiaries and with the reasonable care, skill, and caution of a prudent investor, in light of the purposes, terms, distribution requirements, and other circumstances of the trust; except that:*
>
> > *(i) Securities or other obligations of the Grantor, or any other owner or operator of the facilities, or any of their affiliates as defined in the Investment Company Act of 1940, as amended, 15 U.S.C. 80a–2(a), shall not be acquired or held, unless they are securities or other obligations of the Federal or a State government;*
> > *(ii) The Trustee is authorized to invest the Fund in time or demand deposits of the Trustee, to the extent insured by an agency of the Federal or a State government;*
> > *(iii) The Trustee is authorized to hold and draw upon standby letters of credit specified as in 40 CFR 320.50(b); and*
> > *(iii) The Trustee is authorized to hold cash awaiting investment or distribution uninvested for a reasonable time and without liability for the payment of interest thereon.*[380]

6.1.19. Section 7 Commingling vs. Common or Collective Investments.

Current Required Trust Fund Language. As stated above in Section 6.1.18, the May 1980 re-proposal of the RCRA trust fund regulation for closure/post-closure FR did not contain an investment clause and other specifications for the trust fund agreement because the Agency believed that those issues would either be covered by State law or be best resolved by negotiation between the owner or operator and the trustee. In response to commenters, the Agency developed a standard trust agreement which incorporated an investment clause and other necessary provisions with the assistance of the American Bankers Association and other commenters. The wordings developed for the RCRA closure/post-closure care trust agreement (40 CFR 264.151(a)) were carried over into the required wordings of the trust and standby trust agreements for liability coverage (40 CFR 264.151(m) and (n)).

Many larger banks had raised concerns to EPA about acting as trustees for small trust funds. The Agency had been informed that more banks would be willing to act as trustees for the smaller trust funds if the funds could be commingled for investment purposes but that such commingling might not be consistent

[378] Restatement of the Law, Third, Trusts (2007) § 90 cmt. k.
[379] Restatement of the Law, Third, Trusts (2007) § 78.
[380] 40 CFR § 264.151(a).

with Federal securities laws.[381] To encourage financial institutions to act as trustees for small trusts, EPA requested the Securities and Exchange Commission (SEC) to issue a "no action" letter concerning commingling, if appropriate. The Agency received such a letter dated October 20, 1980. The Interim Final Rule of January 12, 1981 included the addition and clarification of language regarding the duties, investment activity, compensation, replacement, and liability of trustees. Since that time, the required language of the RCRA trust and standby trust agreements allow the trustee to "commingle" trust assets for economical administration and investment diversification.

Trust Practices and Trust Law. Many banks and trust companies have traditionally operated one or a variety of common trust funds in order to pool the investment resources of many individual trusts under their administration, allocating to each an appropriate number of shares in the common fund. Use of common trust funds is supported under state laws either by special statutory or regulatory regimes or by enabling legislation (usually the Uniform Common Trust Fund Act) that relies on Regulation 9 promulgated by the U.S. Comptroller of the Currency to govern the operation of these types of bank funds. Common trust fund practices are intended to facilitate economical fund management and diversification of investments for small trusts.[382] However, the trustee must also comply with the rule set out in the *Restatement of the Law, Third, Trusts § 84,* "[t]he trustee has a duty to see that trust property is designated or identifiable as property of the trust, and also a duty to keep the trust property separate from the trustee's own property and, so far as practical, separate from other property not subject to the trust." The comment following this rule of law explains that "a trustee has a duty not to commingle property of the trust with the trustee's own property. . . The general prohibition against commingling trust property with the trustee's own is strictly applied, based on the duty of loyalty's prohibition against a trustee's creation of potentially conflicting interests."[383] Commingling is generally not allowed in order to prevent conflicts of interests. The term "commingling" is used in only this context within the *Restatement*.

In order to allow the trustee to determine the most economical investment strategy, EPA should specify 108(b) trust language that explicitly allows for "common" and "collective" investment practices for 108(b) trusts. Use of such pooled investment vehicles by trustees is expressly allowed by statute in many states.[384] The use of pooling arrangements does not violate prohibitions on "commingling." However, in order to more clearly distinguish the acceptability of "common" and "collective" trust funds from the unacceptability of "commingled" funds, as defined in the *Restatement of Law, Third, Trusts*, EPA chose to omit the "commingling" language present in the 40 C.F.R. 264.151 and 261.151 trust language as follows:

> *The Trustee is expressly authorized in its discretion:*
>
> > *(a) To transfer from time to time any or all of the assets of the Fund to any common, or collective trust fund created by the Trustee in which the Fund is eligible to participate, subject to all of the provisions thereof, to be jointly invested with the assets of other trusts participating therein; and*

[381] See 46 FR2825 (Januray 12,1981). The Background Document for the Final Subpart H Rules (December 31, 1980) refers to the Glass-Steagull Banking Act of 1933 (P.L. 66-89, 48 Stat. 184) as prohibiting banks from managing commingled trust funds.
[382] Restatement of the Law, Third, Trusts (2007) § 90 cmt. m.
[383] Restatement of the Law, Third, Trusts (2007) § 84 cmt. b.
[384] Restatement of the Law, Third, Trusts (2007) § 90 cmt. m

(b) To purchase shares in any investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a–1 et seq., including one which may be created, managed, underwritten, or to which investment advice is rendered or the shares of which are sold by the Trustee. The Trustee may vote such shares in its discretion.[385]

6.1.20. Section 8 Express Powers of the Trustee.

The wording of the RCRA liability coverage trust agreement includes a Section 8 enumerating five distinct powers of the Trustee. This Section shall be retained in the CERCLA 108(b) trust agreement but expanded to also make clear that the trustee has the authority to hold and draw upon 108(b) standby letters of credit.

6.1.21. Section 9 Taxes and Expenses.

In the required wordings of the RCRA trust agreements, Section 9 states that taxes and brokerage commissions shall be paid from the trust fund. Section 9 then continues to specify that all other expenses incurred in the administration of the trust fund, "including fees for legal services rendered to the Trustee, the compensation of the Trustee to the extent not paid directly by the Grantor, and all other proper charges and disbursements" shall be paid from the trust fund. There is some ambiguity around what the phrase "not paid directly by the Grantor" modifies. The required wording of Section 9 implies that only the Trustee's compensation might be paid directly by the Grantor (but if not, then the compensation would be paid from the trust fund). That reading would not apply the phrase "not paid directly by the Grantor" either to legal expenses or to "other proper charges and disbursements." However, Section 18 states that the Trustee shall be indemnified and saved harmless from and against certain personal liability "including all expenses reasonably incurred in [the Trustee's] defense in the event the Grantor fails to provide such defense." Section 18 implies that the Grantor has primary responsibility for paying legal expenses, which would nevertheless be paid from the trust fund if not paid directly by the Grantor.

Unless and until the Grantor ceases to exist, the Agency believes that the Grantor, not the trust fund, should be primarily responsible for paying the trustee's compensation, legal expenses, and "other proper charges and disbursements." Such payment arrangements create incentives not to overcharge; a mute fund may have little to no recourse against unreasonable charges, but the Grantor is well-positioned to complain. In addition, should the trust hold a 108(b) standby LOC and no other liquid assets, the trustee would need to look to the Grantor for paying for legal services, trustee compensation, and other charges or else the trustee would have to draw upon the standby LOC to cover those expenses, which seems administratively inefficient and burdensome. Therefore, EPA proposes to change these specifications for the CERCLA 108(b) trust agreement, as follows:

> Section 9 *Taxes and Expenses*. All taxes of any kind that may be assessed or levied against or in respect of the Fund and all brokerage commissions incurred by the Fund shall be paid from the Fund. All other expenses shall be paid directly by the Grantor. All other expenses incurred by the Trustee in connection with the administration of this Trust including fees for legal services rendered to the Trustee, the compensation of the Trustee, and all other proper charges and

[385] 40 CFR § 264.151(a); 40 CFR § 261.151 (m).

disbursements of the Trustee to the extent not paid directly by the Grantor shall be paid from the Fund.

6.1.22. Section 10 Annual Valuations.

The required wording of the RCRA trust agreements includes a Section 10 on annual valuations. This Section shall be retained in the CERCLA 108(b) trust agreement but expanded to clarifyhow annual valuations should treat any letters of credit held in the trust fund.

6.1.23. Section 11 Advice of Counsel.

The required wording of the RCRA trust agreements includes a Section 11 on advice of counsel. The Trustee may seek the advice of counsel, who may be counsel to the Grantor. This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.24. Section 12 Trustee Compensation.

The required wording of the RCRA trust agreements includes a Section 12 on trustee compensation. This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.25. Section 13 Successor Trustee.

The required wording of the RCRA trust agreements includes a Section 13 on successor trustee. This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.26. Section 14 Instructions to the Trustee.

The required wording of the RCRA trust agreements includes a Section 14 on instructions to the Trustee. This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.27. Section 15 Notice of Payment.

The required wording of the RCRA trust agreements includes a Section 15 on notice of nonpayment. This section has to do with the aftermath of making of payments to claimants from the trust fund[386] including a notice of payment requirement and either the Grantor's replenishment of the trust fund or notifying the trustee about the establishment of a supplemental FR instrument such that the responsible current owner or operator maintains the amount of coverage required. This Section shall be retained, specifically the notice of payment provision, but modified in the CERCLA 108(b) trust agreement to make appropriate references to the 108(b) program. Furthermore, in contrast to the RCRA trust fund language, the CERCLA 108(b) required wording will not address replenishment and/or supplemental FR demonstration rules because those issues are addressed elsewhere and are not instrument-specific.

[386] Such payments from the trust fund may or may not mean that the total required amount of coverage has changed for the facility.

6.1.28. Section 16 Amendment of Agreement.

The required wording of the RCRA trust agreements includes a Section 16 on amendment of the agreement. Such amendment must be agreed to by the Grantor, the Trustee, and the appropriate EPA official(s), unless the Grantor has ceased to exist. The agreement may be amended by the Trustee and the appropriate EPA official(s) if the Grantor has ceased to exist. This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.29. Section 17 Irrevocability and Termination.

The required wording of the RCRA trust agreements includes a Section 17 on termination of the agreement. Such termination must be agreed to by the Grantor, the Trustee, and the appropriate EPA official(s), unless the Grantor has ceased to exist. The agreement may be terminated by the Trustee and the appropriate EPA official(s) if the Grantor has ceased to exist. This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.30. Section 18 Immunity and Indemnification.

The required wording of the RCRA trust agreements includes a Section 18 on immunity and indemnification. Section 18 protects against the personal liability of the Trustee from any acts or omissions made in good faith and from carrying out the orders of the Grantor or the EPA. The trustee also is indemnified and saved harmless from any act or conduct in its official capacity. (Also see discussion of trustee's personal liability in Section 6.2.3.) This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.31. Section 19 Choice of Law.

This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.32. Section 20 Interpretation.

This Section shall be retained in the CERCLA 108(b) trust agreement.

6.1.33. In Witness Whereof.

This Section shall be retained in the CERCLA 108(b) trust agreement.

Part 6.2. Other Specification Issues for Wording of Trusts and Standby Trust Agreements.

Part 6.2 identifies and analyzes alternative specifications that EPA considered for 5 key issues for the drafting of the Insurance required wording under CERCLA § 108(b). The Agency documented strengths and weaknesses for alternative specifications, including specifying the beneficiary, payment triggers,

trustee liability under direct action, holding of other 108(b) instruments in the 108(b) trusts, and direct action authorization and defenses.

6.2.1. Specifying the beneficiary.

Specifying the beneficiary is both a legal requirement for trust funds and an operational issue of concern to potential trustees and EPA. Banking representatives, meeting with EPA to discuss the potential for 108(b) trust funds and standby trust funds, raised concerns about the specification of the trust fund beneficiary, expressing a preference that EPA take on the role of beneficiary, especially given that different parties could well make 108(b) claims and that claims could exceed the amount of FR provided under trust funds.[387] However, EPA is concerned about the added burden of functioning as beneficiary.

Current Practice. The "beneficiary" of a trust fund need not be formally defined as such in the trust agreement. Rather, the beneficiary may be indicated by language stating in whose "favor" the trust fund has been established. Both approaches are used in the RCRA trust agreements. Whether the EPA is the RCRA FR trust fund's beneficiary varies depending on programmatic needs. For example, the required wordings of the RCRA Subtitle C FR trust agreements and standby trust agreements for closure/post-closure care[388] state in *Section 3. Establishment of Fund* that the fund is established "for the benefit of EPA." On the other hand, the required wordings of the RCRA Subtitle C FR trust agreements and standby trust agreements for liability coverage[389] state in *Section 3. Establishment of Fund* that the fund is established "for the benefit of any and all third parties injured or damaged by [sudden and/or non-sudden] accidental occurrences arising from operation of the facility(ies) covered by" the trust agreement. Thus, current practice under RCRA Subtitle C provides two alternative models for the language of 108(b) trust funds in terms of designation of beneficiary.

Trust Fund Law. State laws govern the creation and workings of trust funds; despite some variations across states, legal scholars and practitioners have fostered uniformity in state trust fund law.[390] Thus, in all states, it is fundamental that the terms of a trust agreement provide a beneficiary who is ascertainable at the time that the trust is created or who may later become ascertainable.[391] The beneficiary must be described by name, relationship to grantor, or in such other way that a court can be sure of who the person or persons are that the grantor intended to benefit. However, the exact beneficiary of a trust need not be known at the time of the creation of the trust.[392] Instead, the trust can provide a formula or description by which the beneficiary or class of beneficiaries can be identified when payments need to be made from the trust. For example, the required wording of the RCRA Subtitle C liability coverage trust fund describes the beneficiary as “any and all third-parties injured or damaged by

[387] For example, claims could exceed the amount in a 108(b) trust fund during the incremental FR build-up period specified in 108(b)(3). Also, the required amount of FR coverage is an estimate that does not represent a worst case scenario for claims.
[388] See, for example, 40 CFR 264.151(a)(1).
[389] See, for example, 40 CFR 264.151(m)(1).
[390] State trust law may draw from the *Uniform Trust Code (Last Revised or Amended in 2010) of the National Conference of Commissioners on Uniform State Laws (January 15, 2013)*, which itself draws upon the *Restatement of Trusts*.
[391] Restatement of the Law, Third, Trusts (2003) § 44.
[392] Restatement of the Law, Third, Trusts (2003) § 44.

accidental occurrences arising from the operation" of the covered facility; the specific identities of those RCRA liability coverage beneficiaries can be ascertained only with the passage of time.

It is well-established that the beneficiary of a trust is the one intended by the grantor to receive the benefit of the trust property from the trustee, and not one who in the course of the trust administration will incidentally receive an advantage.[393] The Agency recognizes the importance of being a beneficiary: no one except a beneficiary or one suing on his behalf can maintain a suit against the trustee to enforce the trust or to enjoin or obtain redress for a breach of trust.[394] Persons who may incidentally benefit in some manner from the performance of the trust are not beneficiaries and cannot enforce it.[395]

Regarding the designation of beneficiary for 108(b) trust funds and standby trust funds, EPA has the following options:

- **Option 1:** Designate EPA as the sole beneficiary
- **Option 2:** Designate "any and all" third party CERCLA claimants as beneficiaries
- **Option 3:** Do not designate any beneficiary

Option 1: Designate EPA as the sole beneficiary.
Strengths: Designating EPA as the sole beneficiary is consistent with the laws governing trusts. Option 1 allows EPA to enforce the terms of the trust. Option 1 is consistent with the approach used in the RCRA Subtitle C trust funds and standby trust funds for closure/post-closure care,[396] which state in *Section 3. Establishment of Fund* that the fund is established "for the benefit of EPA." Option 1 may make serving as a 108(b) trustee more attractive to the banking and trust company community (as expressed by banking representatives in a meeting with EPA).
Weaknesses: Option 1 is not consistent with the approach used in the required wordings of the RCRA Subtitle C trust funds and standby trust funds for liability coverage. Option 1 places any claims management burdens on the EPA, such as adjusting claims and conveying sums to CERCLA claimants. Because EPA could be a 108(b) claimant, it might be awkward for EPA also to manage claims.

Option 2: Designate "any and all" third party CERCLA claimants as beneficiaries**.**
Strengths: Designating "any and all" third party CERCLA claimants as beneficiaries is consistent with the laws governing trusts. Option 2 allows EPA to enforce the terms of the trust because EPA could be a third-party cost recovery claimant itself. Option 2 is consistent with the approach used in the required wordings of the RCRA Subtitle C trust funds and standby trust funds for liability coverage,[397] which state in *Section 3. Establishment of Fund* that the fund is established "for the benefit of any and all third parties injured or damaged by [sudden and/or non-sudden] accidental occurrences arising from operation of the facility(ies) covered by" the trust agreement.

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[393] Restatement of the Law, Third, Trusts (2003) § 48.
[394] Restatement of the Law, Second, Trusts (1959) § 200.
[395] Restatement of the Law, Third, Trusts (2003) § 48 cmt. a. In order to retain enforcement powers under the circumstance where EPA is not named as a beneficiary, EPA may choose to include explicit language reserving certain administrative and/or enforcement powers to the agency.
[396] See, for example, 40 CFR 264.151(a)(1).
[397] See, for example, 40 CFR 264.151(m)(1).

Weaknesses: Option 2 is not consistent with the approach used in the required wordings of the RCRA Subtitle C trust funds and standby trust funds for closure/post-closure care. Option 2 does not place any claims management burdens on the EPA. Option 2 may make serving as 108(b) trustee less attractive to the banking and trust company community.

Option 3: Do not designate any beneficiary.
Strengths: Not designating any beneficiaries is inconsistent with the laws governing trusts. Option 3 does not allow EPA to enforce the terms of the trust. Option 3 is inconsistent with the approaches used in the required wordings of the RCRA Subtitle C trust funds and standby trust funds for closure/post-closure care and for liability coverage. Option 3 does not place any claims management burdens on the EPA.
Weaknesses: Option 3 may make serving as 108(b) trustee less attractive to the banking and trust company community.

In light of the considerations summarized above, EPA prefers Option 2.

6.2.2. Payment triggers for trust agreements and standby trust agreements under CERCLA § 108(b).

EPA must develop the criteria governing payments from trust funds and standby trusts to claimants. These criteria may be referred to as "payment triggers." These criteria may be referred to as "payment triggers." As discussed in more detail in Section 2.2, EPA is considering that the regulations and required wording of the trust agreement would specify that trustees must make payments from 108(b) trust funds in three circumstances: Payment of an unsatisfied CERCLA judgment, payment for a CERCLA settlement with the federal government if payment is not otherwise made, and payment into a trust fund established under an administrative order in limited circumstances.

Trust Fund Agreement Language Considerations. RCRA provides two different models for payments from trust funds used as FR. Some of the trust agreement language is simi lar between the closure/post-closure wording and the liability coverage wording. Relevant payment trigger language to guide trustees of RCRA closure/post-closure trusts in making payments[398] can be found in *Section 3. Establishment of Fund*, in *Section 4. Payment for Closure and Post-Closure Care,* and in *Section 8. Express Powers of the Trustee*. The definition of beneficiary in *Section 3* establishes EPA as the beneficiary and states that no third-party shall have access to funds except as provided elsewhere. *Section 4* states that the "trustee shall make payments from the Fund as the Regional Administrator shall direct, in writing, to provide for the payment of the costs of closure and/or post-closure care of the facilities covered by" the Agreement; *Section 4* goes on to describe that the Regional Administrator may direct the trustee to make reimbursement payments and refunds to the Grantor. And *Section 8(e)* expressly authorizes and empowers the trustee to "compromise or otherwise adjust all claims in favor of or against the Fund." The required wording of the RCRA closure/post-closure trust agreement does not mention direct action.

Relevant language to guide trustees of RCRA liability coverage trusts in making payments[399] can be found in the definition of beneficiary (*Section 3. Establishment of Fund*), in *Section 4. Payment for Bodily Injury or Property Damage,* and in *Section 8. Express Powers of Trustee*. The definition of beneficiary in

[398] 40 CFR 264.151(a)(1).
[399] 40 CFR 264.151(m)(1).

Section 3 includes a list of third-party claims that the Fund is not intended to cover. *Section 4* states that the "trustee shall satisfy a third-party liability claim by making payments from the Fund only upon receipt" of either a "certification" signed by the Grantor (see discussion above in Section 6.1.14 about whether other current facility owners or operators may enter into a settlement) and third-party claimant(s) that the liability claim should be paid (the required wording of the Certification of Valid Claim is not included in the instrument) or a "valid final court order establishing a judgment" against the Grantor for bodily injury or property damage caused by sudden or non-sudden accidental occurrences arising from the operation of the Grantor's facility. *Section 8(e)* expressly authorizes and empowers the trustee to "compromise or otherwise adjust all claims in favor of or against the Fund." The required wording of the RCRA liability coverage trust agreement does not mention direct action.

Because 108(b) is intended to cover CERCLA liability claims for costs and NRDs, EPA intends to use the RCRA third-party liability coverage trust agreement as a starting point. Accordingly, a CERCLA § 108(b) trust could include as payment triggers either a settlement agreement, an administrative order (as further defined in the regulations), or a final court order of CERCLA liability (as further defined in the regulations). EPA intends that the 108(b) FR covers payment of response costs and NRDs which are, in some part, the responsibility of a current owner or operator.[400]

Trust Law Considerations. Trustees have much greater discretion to make decisions about distributions from trust funds to claimants than do banks issuing LOCs. The trustee has the obligation to investigate the default of the owner or operator as a pre-condition for payment, unlike the LOC where the bank must make payment decisions solely based on its review of the documents presented versus those specified in the LOC. As provided in the required language for trust agreements and standby trust agreements under the RCRA Subtitle C FR programs, trustees may seek out and rely on the advice of counsel (see *Section 11 Advice of Counsel*), and fees for legal services may be charged against the trust to the extent not paid by the Grantor (see *Section 9. Taxes and Expenses*). Consequently, trustees can work with less specific payment triggers than can issuers of LOCs.[401]

Direct Action Considerations. EPA intends for direct action to be an additional payment scenario that operates independently of the three other specified payment tirggers. Direct action would provide an avenue for third-party claimants to make valid CERCLA claims under §§ 107 and 111 when the owner operator may not be available as in the situations laid out in 108(c).

As discussed in Section 6.2.3 below, CERCLA § 108(c) allows direct action against the FR "guarantor", as opposed to the owner or operator, under certain conditions. CERCLA direct action is a Federal "cause of action" that requires no regulations because it is self-implementing; however, the Coast Guard and BOEM (as discussed in Section 6.2.5 below) have promulgated regulations regarding direct action and have included language in their FR instruments to reference direct action.[402] EPA recognizes that a

[400] Although the current owner or operator establishing 108(b) FR is by definition a 107 liable party, the current owner or operator may have little to no direct responsibility for the release or threatened release for which prior owners or operators (or other parties) may have greater responsibility; consequently, settlements, orders, and judgments may be directed at parties that may not include the current owner or operator that established the FR for the facility.

[401] Banks issuing LOCs would not expect to need the advice of counsel in processing claims, and their LOCs do not provide for covering the issuer's legal expenses.

[402] Coast Guard and BOEM do not include trust funds as primary FR instruments.

CERCLA § 108(b) FR instrument may be subject to direct action claims authorized under CERCLA § 108(c), with certain defenses authorized to the guarantor.[403] The Agency believes that CERCLA established direct action as a way for claimants to reach assured funds when the current owner(s) or operator(s) are insolvent or bankrupt and a release or threatened release is associated with the facility.

To address payment triggers for 108(b) trusts and standby trusts, EPA has the following specification options:

- **Option 1:** EPA written instruction for payment (the RCRA closure/post-closure model for trusts and standby trusts).
- **Option 2:** Written payment instruction from another identified arbiter (e.g., a trustee).
- **Option 3:** Settlement agreement, administrative order, or final court order/judgment (the RCRA liability coverage model)
- **Option 4:** No payment triggers in the wording of trust or standby trust agreements.

Option 1: EPA written instruction for payment (the RCRA closure/post-closure model for trusts and standby trusts). The EPA payment instructions **to the trustee** would be in addition to the settlement agreement, administrative order, or judgement.
Strengths: Option 1 would provide the greatest assurance of funding for EPA claims of all of the options considered because EPA would be responsible for claims management and settlement of claims. Potential trustees might prefer EPA's making payment instructions, leading to greater participation in 108(b) by banks/trust companies. Option 1 is consistent with the RCRA FR trusts for closure/post-closure.
Weaknesses: A disadvantage of Option 1 is that it would place the claims management burden on EPA. EPA would need to interpret whether the settlements, orders, or judgments support payment of claims.[404] Another drawback of Option 1 is that EPA would be in the awkward position of both administering claims and also being a potential claimant.

Option 2: Written payment instruction from another identified arbiter (e.g., a trustee). The arbiter payment instructions **to the trustee** would be in addition to the settlement agreement, administrative order, or judgement.
Strengths: An advantage of Option 2 is that it would not place the claims management burden on EPA. Another advantage of Option 2 is that EPA would not be in the awkward position of both administering claims and also being a potential claimant.
Weaknesses: Similar to Option 3, Option 2 would provide less assurance of funding for EPA than Option 1 because EPA would not be responsible for claims management and settlement of claims. Option 2 would require the services of a willing and qualified arbiter. The arbiter would need to interpret whether the settlements, orders, or judgments support payment of claims.[405] The arbiter would likely want

[403] EPA is considering whether the 108(b) rules should define "guarantor" to exclude trustees of standby trusts. See 6.1.6 above.
[404] The recent case of Florida Power Corp. v. FirstEnergy Corp. 2015 WL 6743513 (8th Cir. Nov. 5, 2015) reiterates prior holdings that whether or not CERCLA liability is resolved through a settlement is not a question that can be decided by a universal rule.
[405] The recent case of Florida Power Corp. v. FirstEnergy Corp. 2015 WL 6743513 (8th Cir. Nov.5, 2015) reiterates prior holdings that whether or not CERCLA liability is resolved through a settlement is not a question that can be decided by a universal rule.

protection for the consequences of its decisions such as trust law affords to fiduciaries. This Option is not consistent with either of the RCRA FR trust agreements.

Option 3: Settlement agreement, administrative order, or final court order/judgment (the RCRA liability coverage model).
Strengths: An advantage of Option 3 is that it would not place the claims management burden on EPA. Another advantage of Option 3 is that EPA would not be in the awkward position of both administering claims and also being a potential claimant. Option 3 would require trustees to interpret whether the settlements, orders, or judgments support payment; trustees are well-equipped to handle such claims management and are generally protected from suits by unhappy claimants. Potential trustees might prefer Option 3, leading to greater participation in 108(b) by banks/trust companies. Option 3 is consistent with the RCRA FR trust agreements for liability coverage.
Weaknesses: Requires trustee to exercise some judgment, which may lead trustees to charge higher fees and rely on outside counsel.

Option 4: No payment triggers in the wording of trust or standby trust agreements.
Strengths: Option 4 places no administrative burden on EPA. However, the potential that EPA may have to participate in some efforts in the future to resolve misunderstanding due to the lack of guidance in the required wording could lead to some amount of burden.
Weaknesses: A major drawback to Option 4 is that it would provide no guidance to trustees. Another major disadvantage is that Option 4 likely is inconsistent with trust law. Furthermore, the uncertainty associated with Option 4 would provide the least assurance and the slowest access to funding of all of the options considered. Potential trustees would not likely prefer this arrangement, leading to little participation in 108(b) by banks/trust companies. Option 4 is not consistent with either of the RCRA FR trust agreements.

The Agency has determined that a combination of the described options is preferable depending on the type of enforcement action (e.g., court judgement, settlement, or UAO) that is pursued. Specifically, EPA has determined to implement EPA or other Federal agency instruction as the payment trigger associated with a settlement or UAO and submission of the final court judgement, without the need for agency instruction, for a court judgement.

6.2.3. Trustee liability under direct action.

Banking representatives, meeting with EPA to discuss the potential for 108(b) trust funds and standby trust funds, raised concerns about the trustee's potential liability under the direct action provisions of 108(c) and (d), especially given that different parties could well make claims and that claims could exceed the amount of FR provided under trust funds.[406] EPA explained that direct action was a statutory provision in CERCLA, for which the Agency had no prior experience.[407] CERCLA § 108(c) allows direct action against the FR "guarantor", as opposed to the owner or operator, under certain conditions, as follows:

[406] For example, claims could exceed the amount in a 108(b) trust fund during the incremental FR build-up period specified in 108(b)(3). Also, the required amount of FR coverage is an estimate that does not represent a worst-case scenario for claims.
[407] Some consideration of CERCLA direct action were reported in *Port Allen Marine Services, Inc. v. Chotin*, 765 F. Supp. 887 (M.D.La. 1991) and in *City of New Orleans v. Kernan*, 933 F Supp. 565 (E.D. La. 1996).

> In the case of a release or threatened release from a facility, any claim authorized by section 107 or 111 may be asserted directly against *any guarantor providing evidence of financial responsibility for such facility* under [CERCLA § 108(b)], if the person liable under section 107 is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or if, with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under section 107 who is likely to be solvent at the time of judgment (emphasis added).

Under CERCLA 101(13), the term "guarantor" means "any person, other than the owner or operator, who provides evidence of financial responsibility for an owner or operator under this Act."[408] The term "person" is defined broadly under CERCLA to mean "an individual, firm, corporation, association, partnership consortium, joint venture, commercial entity" and various public sector entities. CERCLA's definition of "person" does not literally include "a trustee," although a trustee is likely to be a firm, corporation, or commercial entity. CERCLA does not directly define the meaning of "provides evidence of financial responsibility," although CERCLA § 108(d)(1) does so indirectly when it refers to "the policy of insurance, guarantee, surety bond, letter of credit, or similar instrument obtained from the guarantor" for the purpose of satisfying the requirement for evidence of financial responsibility. Representatives of the banking community expressed concerns with the direct action provisions, especially with the prospect of the trustee being sued directly and having any liability.

Current Practice. In addition to authorizing direct actions against "guarantors" under 108(c) and limiting guarantor liability under 108(d), CERCLA also provides for actions against guarantors under CERCLA § 112, which concerns claims against the Hazardous Substance Superfund (the "Superfund"). CERCLA refers to guarantors in two specific subsections of Section 112. First, claims may not be asserted against the Fund for response costs pursuant to 111(a) unless the claim is "presented in the first instance to the owner, operator, or guarantor..." allowing 60 days for satisfaction from presentation.[409] Second, when a claim against the Fund has been paid, CERCLA recognizes a right of subrogation, stating that "such an action may be commenced against any owner, operator, or guarantor..."[410] There are no further references to "guarantors" in CERCLA. The regulations and forms implementing Section 112 provisions contain no mention of guarantors.[411]

Trustee Liability under CERCLA § 107(n). Section 107(n) of CERCLA addresses fiduciary liability when releases or threatened releases of hazardous substances occur at, from, or in connection with a vessel or facility "held in fiduciary capacity." CERCLA defines the term "fiduciary" to mean, among others, a person acting for the benefit of another party as a bona fide trustee.[412] Although not directly applicable to potential trustee liability under 108(b) FR, CERCLA § 107(n) provisions arguably are instructive. For example, CERCLA § 107(n)(1) states that the liability of the fiduciary shall not exceed the assets held in the fiduciary capacity; that provision mirrors CERCLA § 108(d)(1) which states that "the total liability of any guarantor in a direct action suit shall be limited to the aggregate amount of the monetary limits of the policy of insurance, guarantee, surety bond, letter of credit, or similar instrument obtained from the

[408] The court in *Port Allen Marine Services, Inc. v. Chotin*, 765 F. Supp. 887 (M.D.La. 1991) found without explanation that "an insurer is not necessarily a guarantor." That finding was cited with approval by the court in *City of New Orleans v. Kernan*, 933 F Supp. 565 (E.D. La. 1996).
[409] CERCLA § 112(a).
[410] CERCLA § 112(c)(3).
[411] See 40 CFR Part 307, including Appendix A and B.
[412] CERCLA § 107(n)(5)(A).

guarantor" for the purpose of satisfying the requirement for evidence of financial responsibility. CERCLA appears to draw an important distinction between the trustee and the trust administered by the trustee in Section 107(n)(8), where it states that this subsection does not preclude a claim against the assets of the estate or trust administered by the fiduciary.

Direct Action Regulations. EPA has not made any regulations respecting CERCLA direct action. RCRA regulations do not address direct action under RCRA. As described in Section 6.2.5 below, both the U.S. Coast Guard and the Bureau of Offshore Energy Management (BOEM) refer to direct action in the required wordings of FR instruments and in their FR regulations. Section 6.2.5 below discusses EPA options with respect to direct action itself as well as EPA options for defenses to direct action. Those options include replicating statutory provisions, expanding statutory provisions, narrowing statutory provisions, and taking no action. Some of those options may raise issues about EPA's legal authority to expand or narrow the statutory language. In discussions with the banking community, EPA was encouraged to explore ways of protecting trustees from direct action suits, such as by changes to the definition of "guarantor," discussed in Section 6.1.9 above. Given prior judicial interpretation cited above (see footnotes 425 and 426), providing regulatory definitions or clarifications of the term "guarantor" may be beneficial.

RCRA Trust Agreements. The basic terms and conditions of the trust agreement were defined by EPA in close consultation with trust experts at the American Banking Association and legal practitioners in the late 1970s and early 1980s. Additionally, the trust agreement was published for public comment multiple times. The required wordings of the RCRA trust agreements have served as templates adopted by other FR programs, both within EPA and across many States. The required wordings of the RCRA FR trust and standby trust agreements for liability coverage[413] address the trustee's liability in 5 sections. In *Section 3. Establishment of Fund*, the wording states that the "trustee shall not be responsible for nor shall it undertake any responsibility for the amount or adequacy of, nor any duty to collect from the Grantor, any payments necessary to discharge any liabilities of the Grantor established by EPA." *Section 10. Annual Valuation*s specifies that the Grantor's failure to object within 90 days after receipt of the valuation "shall constitute a conclusively binding assent by the Grantor barring the Grantor from asserting any claim or liability against the Trustee with respect to matters disclosed in the [valuation] statement." *Section 11. Advise of Counsel* states that "the Trustee shall be fully protected, to the extent permitted by law, in acting upon the advice of counsel." *Section 14. Instructions to the Trustee* similarly states that "the Trustee shall be fully protected in acting" without inquiry in accordance with the orders, requests, and instructions of the Grantor or of the EPA. Finally, *Section 18. Immunity and Indemnification* provides that "the Trustee shall not incur personal liability of any nature in connection with any act or omission, made in good faith, in the administration of this Trust, or in carrying out any directions" by the Grantor or the EPA. Furthermore, "the Trustee shall be indemnified and saved harmless by the Grantor or from the Trust Fund, or both, from and against any personal liability to which the trustee may be subjected by reason of any act or conduct in its official capacity."

In total, the required wordings of RCRA trusts and standby trusts provide many protections to the trustee with respect to potential liability, which is significant because RCRA provides for direct action in terms almost identical to the CERCLA direct action provisions. Because the RCRA trust agreement is executed between the owner or operator as Grantor and the trustee, and does not include the EPA as a signatory, the terms of the agreement protecting trustees may not be binding on the EPA or on a court facing a 108(c) direct action.

[413] 40 CFR 264.151(m)(1).

Trust Fund Law. The law of trusts has long addressed the potential liabilities of trustees for issues related to their management of trust funds. State trust laws[414] typically include statutory provisions addressing the liability of trustees and rights of persons dealing with trustees. State trust codes list duties that the trustee must not breach and also hold trustees accountable for profits made from the trust even in the absence of a breach of trust. State codes specify defenses available to trustees (e.g., statutes of limitations). Trustees typically are protected when they act in reasonable reliance on the terms of a written trust instrument. Provisions protect a trustee who has exercised reasonable care to ascertain the happening of events that might affect distributions. State codes describe the effect and limits on the use of an exculpatory clause. Many provisions negate personal liability of the trustee in relation to persons other than the beneficiary, especially if the trustee was not personally at fault. Much of this trust law is not subject to override in the terms of trust agreements. Trust law affords many protections to the trustee, including provisions found in the required wordings of the RCRA trust agreements.

To address potential concerns about trustee liability under CERCLA § 108(c) direct action, EPA has the following options:

- **Option 1:** Retain for the required wordings of CERCLA 108(b) trust and standby trust agreements the language in the required wordings of RCRA trusts and standby trusts, with the protections against trustee liability contained therein.
- **Option 2:** Expand or strengthen language in Option 1 to address direct action trustee liability explicitly.
- **Option 3:** Develop regulatory provisions for direct action, such as defining "guarantor" to explicitly exclude "trustees" of 108(b) instruments.
- **Option 4:** Pursue Options 2 and 3.

Option 1: Retain for the required wordings of CERCLA § 108(b) trust and standby trust agreements the language in the required wordings of RCRA trust and standby trust agreements, with the protections against trustee liability contained therein.
Strengths: Option 1 would provide 108(b) FR trustees with several distinct protections from liability. Option 1 would be consistent with the required language in RCRA FR trust and standby trust agreements, which have been made available for public comment on multiple occasions and revised accordingly.
Weaknesses: Option 1 protections would not necessarily shield the trustee from suit under CERCLA § 108(c). Language in the 108(b) trust fund agreement may have no binding effect on CERCLA direct actions.

Option 2: Expand or strengthen language in Option 1 to address direct action liability explicitly.
Strengths: Option 2 would possibly provide more protections against trustee liability under 108(c) direct action in the required wordings of the instruments than are provided in Option 1.
Weaknesses: Option 2 would have a larger administrative burden on EPA for verifying inclusion of the additional language in trusts and standby trusts submitted by owners and operators. Option 2 would be inconsistent with the required wordings of RCRA trust funds and standby trust funds. Option 2

[414] State trust law may draw from the *Uniform Trust Code (Last Revised or Amended in 2010) National Conference of Commissioners on Uniform State Laws* (January 15, 2013), which itself draws upon the *Restatement of Trusts*.

protections would not necessarily shield the trustee from suit under CERCLA § 108(c). Expanded language in the trust fund agreement may have no binding effect on CERCLA direct actions.

Option 3: Develop regulatory provisions for direct action, such as defining "guarantor" to explicitly exclude "trustees" of 108(b) instruments.
Strengths: Option 3 would involve EPA promulgating further regulations for CERCLA § 108(c) such as to clarify the definition of 108(b) "guarantor" by excluding FR trustees from the definition (see discussion in Section 6.1.9 above) and providing other protection to 108(b) FR trustees in direct action. This Option may provide the most protection against trustee liability. Because this option would not affect the required wording of the instruments, it would not directly affect EPA's implementation burden.
Weaknesses: This Option may raise issues about EPA's authority, although there are precedents at the U.S. Coast Guard and BOEM. Option 3 protections would not necessarily shield the trustee from suit under CERCLA § 108(c) because language in EPA 108(b) regulations and instruments may have no binding effect on CERCLA direct actions.

Option 4: Pursue Options 2 and 3.
Strengths: Option 4 would provide the greatest degree of protection to 108(b) trustees that EPA can provide administratively.
Weaknesses: Option 4 would include the administrative burden on EPA as in Option 2 due to changes in the trust agreement. Changes to the required wording of the 108(b) trust agreement would be inconsistent with the required wording of the RCRA trust and standby trust agreements. Option 4 may raise issues about EPA's authority to issue regulations affecting direct action, although there are precedents at the U.S. Coast Guard and BOEM. Option 4 protections would not necessarily shield the trustee from suit under CERCLA § 108(c); language in the trust fund agreements and the EPA regulations may have no binding effect on CERCLA direct actions.

In light of the above considerations, EPA prefers Option 2 while at the same time maintaining the many protections against trustee liability contained within the RCRA Subtitle C trust funds. For example, EPA has included languge in the trust agreement stating that the intent is for the trust fund itself, rather than the trustee, qualify as a guarantor as that term is used in CERCLA. Further, the trust agreement languge specifies that in instances of direct action, the trust fund is available for paying and defending claims.

6.2.4. Holding of other 108(b) FR instruments in the 108(b) trust.

In discussions between EPA and representatives of the banking community concerning potential 108(b) trust and standby trust agreements, the prospect was raised that 108(b) trusts might contain other 108(b) instruments which the trustees could administer. Banking representatives stated that trustees could be responsible for ensuring timely renewals, responding to cancellation notices, handling changes in names, and the like, thus relieving EPA of administrative burdens associated with maintenance of FR. Holding of a 108(b) LOC in a 108(b) trust was believed to possibly respond to concerns expressed by other banking representatives with LOC expertise in their meeting with EPA; those representatives expressed concerns about dealing with multiple claimants and being subject to direct action. EPA agreed to consider the holding of 108(b) FR instruments in 108(b) trusts and standby trusts.

Which 108(b) instruments could be held in the trust fund? EPA's discussions with representatives of the banking community touched upon the various other 108(b) instruments being considered by the Agency, such as letters of credit, surety bonds, insurance, and corporate guarantees. Banking

representatives with trust expertise indicated familiarity with letters of credit and the need for their regular renewal. Banking representatives also stated that trustees had experience with trusts holding insurance[415] and surety bonds,[416] and would be familiar with handling renewals and notices of cancellation. Banking representatives were less confident about handling 108(b) corporate guarantees; their comments about the challenges of evaluating corporate financial statements may have reflected a lack of understanding of EPA's use of formal pass/fail "financial tests," which take most of the subjectivity out of annual financial statement reviews for corporate guarantees. (Holding of corporate guarantees would most directly conflict with the current required wording of RCRA trust and standby trust agreements, as discussed below.) With regard to which 108(b) instruments could be held in trust, EPA need not require an "all or none" approach to trusts' holding of 108(b) FR instruments. For example, EPA could allow only 108(b) LOCs to be held in the 108(b) trust, and not allow the holding of 108(b) guarantees, surety bonds, nor insurance.

Which activities could the trustees perform? Time did not allow for a detailed discussion with banking representatives of which FR instrument activities might be performed by trustees. Conceivably, the trustee may perform both "EPA activities" and "owner/operator activities" entailed by FR instruments. The following summarizes those activities, in general:

- Activities performed by EPA (or another designated party in some cases) include: (1) reviewing and approving of FR instruments for conformity with the required wordings in the regulations, including the initial instruments and substitute or replacement instruments; (2) ensuring that the amount of the instrument equals the required amount of CERCLA coverage for the facility, which may change over time; (3) verifying that the provider of the instrument always satisfies the eligibility criteria in the regulations; (4) receiving a variety of FR notices from the guarantor and the facility owner or operator, which must be maintained in the administrative record; and (5) monitoring of FR notices as necessary to ensure that FR coverage is maintained and drawing upon the instrument before its cancellation, termination, or non-renewal as necessary.
- Activities performed by the owner or operator include: (1) establishing and maintaining FR for its facility in an amount equal to the required amount of 108(b) coverage, which is calculated by the owner or operator using formula provided by the EPA in the regulations; (2) providing instruments whose wordings match the required wordings in the regulations, including the wording of substitute and replacement instruments; (3) obtaining the FR instruments from eligible providers; (4) maintaining the FR instruments and pay any required fees, premiums, and the like; and (5) providing certain notices (to EPA, to the instrument issuer) and responding as needed, including notices related to cancellation, termination, and non-renewal of the instrument.

Inherently governmental FR activities could not be performed by the trustee in place of the government.

Trust fund agreement issues. The basic terms and conditions of the trust instrument agreement were defined by EPA in close consultation with trust experts at the American Banking Association and legal practitioners in the late 1970s and early 1980s. Additionally, the trust instrument was published for public comment multiple times. The required wordings of the RCRA trust agreements have served as

[415] The Agency notes reports of widespread holding of life insurance policies within trusts in order to avoid probate.

[416] The Agency understands that bankruptcy trustees for construction companies in reorganization would be very familiar with surety bonds.

templates adopted by other FR programs, both within EPA and across many States. Changes to the required wordings of the trust and standby trust agreement may be required to specify the changes to the roles and responsibilities of the trustees for any FR instruments held in the trust; although, arguably, the current wording may be sufficient to allow the holding of 108(b) FR instruments. For example, as in the current required wording of the RCRA liability coverage trust agreement, the proposed wordings of the 108(b) trust agreement would empower the 108(b) trustee to be responsible for the satisfaction of conforming claims (*Section 4. Payment for Bodily Injury or Property Damage*) and to "compromise or otherwise adjust all claims in favor of or against" the trust fund (*Section 8. Express Powers of Trustee*). *Section 8. Express Powers of Trustee* could continue to provide that the trustee "may make, execute, acknowledge and deliver" any and all "instruments that may be necessary or appropriate to carry out the powers herein granted." *Section 15. Notice of Nonpayment* could continue to require the trustee to notify the Grantor of payments made to satisfy proper claims[417]; subsequently, the trustee would be required to notify the EPA if the Grantor has not either returned the trust to the required amount nor provided the trustee with proof that other FR has been obtained in the necessary amount.[418] However, further specifications beyond those found in the current wordings may be needed in the trustee's express powers regarding FR instruments held in the trust fund. For example, trustees might well appreciate guidance on the "valuation" of other FR instruments, which have no market value per se, not being negotiable instruments.

In addition, other significant changes may be required to enable the trust to hold FR instruments. *Section 5. Payments Comprising the Fund* of the RCRA liability coverage trust agreement required wording states that such payments "shall consist of cash or securities acceptable to the trustee;" FR instruments are neither cash nor securities. *Section 6. Trustee Management* discusses investment of principal and income, which would not be applicable to FR instruments held in trust; language could be added to state that such FR instruments would not constitute investments. *Section 6* goes on to describe what cannot be acquired or held by the trustee including "obligations of the Grantor or any other owner or operator of the facilities, or any of their affiliates...;" a 108(b) corporate guarantee issued by an owner or operator or any affiliate would be excluded by that provision.[419] Depending on which responsibilities are transferred to the trustee, it may be necessary to change *Section 3. Establishment of Fund* which states that the trustee shall not "undertake any responsibility for the amount or adequacy of, nor any duty to collect from the Grantor, any payments necessary to discharge any liabilities of the Grantor established by the EPA." The above provisions appear to pose potential obstacles to the holding of FR instruments in the trust fund, as currently worded.

Direct Action Issues. CERCLA creates a federal cause of action available in Federal court for any claim to be asserted directly against "the guarantor" in certain conditions. This cause of action needs no implementation by any regulatory agency. The Agency has identified a few instances of Federal statutory direct action (including under the Oil Pollution Act) and a minority of U.S. States with direct

[417] The required wording might be changed to also require notice to the EPA of payments made.
[418] These arguably are "EPA activities" that are not inherently governmental.
[419] A letter of credit is not an obligation of the owner or operator; it is an independent obligation of a bank, whose obligation is secured by a repayment agreement from the owner or operator. Similarly, although the owner or operator must agree to indemnify its surety, the surety bond itself would not be an obligation of the owner or operator. Although an insurance policy may contain a deductible requiring payment by the insured, the policy would not likely be considered an obligation of the owner or operator.

action statutory and legal provisions, most of which appear to be directed to insurers.[420] The relative paucity of direct action experience is insufficient to analyze whether a claim may be brought directly against the issuer of a 108(b) FR instrument that is held in trust or whether such direct action claims could be brought only against the trust (and/or the trustee) itself. Judicial construction of direct action in Louisiana appears to respect the language of the insurance instrument such that, for example, failure to timely report a claim under a "claims made and reported" policy would deny insurance coverage of the claim despite direct action.[421]

Trust fund law. Many kinds of "property" can be held in trust, with no apparent exclusions of FR instruments such as standby LOCs. Trust law states that any property may be trust property.[422] The "prudent investor" rule allows investments in many types of property, properly diversified. Under the prudent investor rule (see discussion at Section 6.1.18), the trustee has a duty to exercise caution, which means that trustees ordinarily have a duty to diversify investments.[423] Trust fund law itself would not appear to be an obstacle for this concept despite diversification duties, which can reasonably be interpreted as applying to investments; an LOC held in a 108(b) trust would not be an investment.

In light of the above, EPA has the following options:

- **Option 1:** Limit the holding concept only to 108(b) LOCs and to 108(b) trustees' authorization to draw upon the LOC and make payments to claimants under the trust ("narrow option").
- **Option 2:** Implement the holding concept for more instruments and/or activities ("broad option").
- **Option 3:** Allow trusts and standby trusts to hold acceptable "property" beyond and including FR instruments.
- **Option 4:** Retain current RCRA trust agreement wordings.

Option 1: Limit the holding concept only to 108(b) LOCs and to 108(b) trustees' authorization to draw upon the LOC and make payments to claimants under the trust ("narrow option"). Rather than maintain distinct LOCs and accompanying standby trusts, this option would allow the trust to hold the LOC and would eliminate the standby trust.
Strengths: Option 1 would address a concern expressed by banking industry representatives with LOC expertise about managing multiple un-named claimants under 108(b) LOCs (also see Section 5.2.4 and 5.2.5 for discussion of issues and options) and would be expected to increase the banking community's participation in the 108(b) FR program. By eliminating the standby trust for 108(b) LOCs, this Option would reduce administrative burden on EPA and owners or operators. Special consideration of LOCs is precedented in RCRA FR programs.[424]

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[420] Louisiana has been in the forefront of the development of direct action statutes, having started in 1918. Mark Mese, Kean Miller Hawthorne D'Armond McCowan & Jarmon LLP, "Direct-Action Statutes," CGL Reporter (15) 520-3 (2003).
[421] See. Steven Plitt, “Louisiana’s Direct Action Statute does not substantially modify claims made policy notices provisions”, in Claims Journal (October 22, 2014).
[422] Restatement of the Law, Third, Trusts § 40 (2003).
[423] Restatement of the Law, Third, Trusts (2003) § 90 cmt e, cmt. f, and cmt. g..
[424] After finding that a standby trust "is not necessary for liability coverage" (53 FR 33945, September 1, 1988), the Agency agreed in a February 23, 1990 settlement with Chemical Waste Management to amend the regulations to

Weaknesses: This Option may cause confusion in the regulated community or the financial community by having different wordings of trust instruments for RCRA and CERCLA. Depending on the activities to be performed by the trustees holding LOCs, further administrative savings would accrue to EPA.

Option 2: Implement the holding concept for more instruments and/or activities ("broad option"). Rather than maintain distinct FR instruments and accompanying standby trusts, this option would allow the trust to hold the FR instruments and would eliminate the standby trust.
Strengths: Option 2 would implement an opportunity suggested by banking representatives with trust expertise and would be expected to increase the banking community's participation in the 108(b) FR program. By eliminating the standby trust for 108(b) FR instruments, this Option would reduce administrative burden on EPA and owners or operators. Depending on the activities to be performed by the trustees holding FR instruments, further administrative savings would accrue to EPA.
Weaknesses: Option 2 will require additional language to address other instruments and a wider array of trustee activities, which will add to administrative burden and complexity of the instrument. This Option may cause confusion in the regulated community or the financial community due to substantively different wordings of trust instruments for RCRA and CERCLA.

Option 3: Allow trusts and standby trusts to hold acceptable "property" beyond and including FR instruments. The current "prudent investor" rule already allows the trustee to invest in a broad array of property properly diversified. The potential illiquidity of certain property (e.g., real estate, life insurance policies) arguably may be of less concern in the 108(b) cost recovery and NRD liability context. This option could be limited to only where the bank "invests" the trust fund property in a larger collective investment fund (see discussion in Section 6.1.19 above), thus mitigating the risk posed by illiquid property; this option also could be limited by specifying certain unacceptable types of property (e.g., life insurance policies on employees and owners of 108(b) facilities).
Strengths: Option 3 would have the benefits of Options 1 and 2 as well as the benefits of opening the trust fund to accepting and holding other types of property acceptable to the trustee.
Weaknesses: Option 3 poses some potential risk to the assurance provided, although the risk posed by holding certain types of property already exists to some degree because of the latitude afforded by the "prudent investor" rule. This Option may cause confusion in the regulated community or the financial community by having different wordings of trust instruments for RCRA and CERCLA.

Option 4: Retain current RCRA trust agreement wordings. This option would maintain distinct FR instruments and accompanying standby trusts; this option would not allow the trust to contain the FR instruments. This option would not allow the owner or operator to fund the 108(b) trust with "property" even if such property would be acceptable to the trustee, with the exception of cash and negotiable securities. This option poses no issues of potential illiquidity of certain property (e.g., real estate, life insurance policies) held in 108(b) trust funds.
Strengths: Option 4 would retain the approach found in the current wording of the RCRA trusts and standby trust agreements and cause no increase in administrative burden and no confusion in the regulated community or the financial community by having different wordings of instruments.
Weaknesses: This Option may discourage issuers of LOCs from participating in the 108(b) program.

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allow (but not require) use of a standby trust with a liability coverage LOC and the designation of an independent trustee as an LOC beneficiary (57 FR 42833, September 16, 1992), saying "Thus, the trustee rather than the issuer of the letter of credit, is responsible for distributing funds to the claimants when a claim for [third party] damages is filed against the owner or operator."

In light of the above considerations, EPA has determined to propose Option 1 (narrow option) and is proposing required wording of the trust agreement intended to clarify this possible role and authority of the trustee.

6.2.5. Direct action authorization and defenses.

This section discusses issues and options posed for the required wording of trust agreements by the direct action provisions of CERCLA 108(c)(2) and 108(d). Direct action is a statutory right that is largely independent of the regulations and required wording of the trust agreement. The required wording of the 108(b) trust agreement is expected to specify that it is to be established for the favor of any and all third-party CERCLA cost recovery and liability claimants (see discussions of beneficiaries in Section 6.2.1 above and payment triggers in Section 6.2.2 above). CERCLA provides in 108(c)(2) for a conditional right of direct action against the "guarantor" (e.g., instrument provider) in the event of a release or a threatened release from a facility, if the person liable under CERCLA 107 is bankrupt or otherwise unlikely to be available for suit as a solvent party. Direct action statutes are enacted with principal regard to insurance as FR, where claimants may lack the legal status to sue insurers when the insured parties are bankrupt or insolvent, thus leaving those insurance claimants with no recourse. Direct action may be less useful for accessing FR trusts because claimants can always bring their claims to the trustee of the trust fund for payment, whether the Grantor is or is not bankrupt or insolvent. RCRA and CERCLA each include statutory provisions authorizing direct action against "guarantors" of financial responsibility instruments without distinction.[425]

The Hazardous and Solid Waste Amendments of 1984 amended RCRA to authorize direct action in two situations:

1. Where the owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. Where, with reasonable diligence, jurisdiction in any State Court or any Federal Court cannot be obtained over an owner or operator likely to be solvent at the time of judgment.

Similarly, in the event of a release or threatened release from a facility, CERCLA 108(c)(2) authorizes direct action in the following situations:

1. If the person liable under CERCLA §107 is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code, or
2. If, with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA §107 who is likely to be solvent at the time of judgment.[426]

In both RCRA and CERCLA, the first statutory condition for direct action appears more objective than the second condition, where “reasonable diligence” and “likely to be solvent” seem more subjective. The more subjective language may allow a guarantor to defend against direct action if no bankruptcy petition has been filed by the person liable under CERCLA 107, arguing that the liable party was likely to

[425] RCRA 3004(t)(2), CERCLA 108(c)(1), and CERCLA 108(c)(2).
[426] CERCLA 108(c)(2).

be solvent at the time of judgement. Because the required wordings of EPA's RCRA financial assurance instruments in Subtitles C and I do not include direct action specifications,[427] EPA reviewed how the Coast Guard and BOEM implemented analogous FR provisions with direct action components.

Current Practice: The Coast Guard's FR authority stems from both CERCLA 108(a) and the Oil Pollution Act of 1990 ("OPA 90"). For CERCLA, the Coast Guard's direct action authority comes from CERCLA 108(c)(1) for vessels. In the event of a release or threatened release from a vessel, CERCLA 108(c)(1) authorizes direct action against guarantors (i.e., instrument providers other than the owner or operator) for any claim authorized by CERCLA 107 or 111.[428]

In addition to CERCLA, OPA 90 authorizes direct action in three instances:

1. The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles (GAAP),
2. The assured party has filed a petition for bankruptcy, or
3. The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims.[429]

The Coast Guard has elected not to incorporate the trust as an acceptable instrument of FR in its regulations, except by petition. Nevertheless, the Coast Guard has addressed direct action and direct action defenses for its other authorized FR instruments.

The Coast Guard's regulations on direct action require that the wording of the instruments must include an accompanying acknowledgment that, "an action in court by a claimant (including a claimant by right of subrogation) for costs or damages arising under the provisions of these Acts [CERLCA and OPA 90], may be brought directly against the insurer or other guarantor."[430] The Agency considers such wording desirable in the CERCLA 108(b) trust agreement.

BOEM, like the Coast Guard, has elected not to incorporate the trust as an acceptable FR instrument in their OPA 90 regulations for offshore facilities and vessels. However, BOEM allows applicants to petition the Director if the applicant wishes to use an alternative instrument to demonstrate FR. With regards to direct action, BOEM has indicated in its regulations that direct action shall apply to all guarantors.[431]

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[427] There are references to direct action in Subtitles C and I of RCRA, but no mention in the RCRA regulations or instruments. The statute states, "In any case in which an owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the FBC or where with reasonable due diligence jurisdiction in any state court or the federal courts cannot be obtained over an owner likely to be solvent at the time of judgement, any claim arising from conduct for which evidence of FR must be provided under this subsection may be asserted directly against the guarantor providing evidence of the FR."42 U.S.C. 6991b(d)(2), 42 USC 6924(t)(2).

[428] In contrast, in the event of a release or a threatened release from a facility, CERCLA108(c)(2) authorizes direct action against a guarantor for any claim authorized by CERCLA 107 or 111 if the person liable under CERCLA 107 is in bankruptcy, reorganization, or arrangement, or if with reasonable diligence, jurisdiction in the Federal courts cannot be obtained over a person liable under CERCLA 107 who is likely to be solvent at the time of judgment.

[429] 33 U.S.C. 2716(f)(2).

[430] 33 CFR 138.80(d).

[431] 30 CFR 553.61(a).

BOEM's regulations regarding direct action mirror the statutory language of OPA 90. Under OPA 90, a claim may be made directly if one of three requirements is met.[432] BOEM's regulations reaffirm these statutory requirements, stating that a guarantor is subject to direct action for any claim asserted by:

1. The United States for any compensation paid by the Fund[433] under OPA, including compensation claim processing costs; and
2. A claimant other than the United States if the responsible party has:
    a. Denied or failed to pay a claim because of being insolvent or
    b. Filed a petition in bankruptcy under 11 USC chapters 7 or 11.[434]

Although there are subtle differences in language between OPA 90 and BOEM direct action regulations, BOEM has stated that these differences are not substantial and that, "the terms and conditions cited in the [regulatory] section are consistent with those in OPA. The rule does not 'broaden' the statutory language."[435]

Much like the Coast Guard, BOEM's regulations for the required wording of FR instruments also require an acknowledgement that direct action may be taken against it if certain criteria are met. BOEM's regulations state, "Each instrument you submit as FR evidence must specify that the instrument issuer agrees to direct action for claims made under OPA up to the guaranty amount, subject to the defenses[436] in paragraph (a)(6) of this section."[437]

In its regulations, BOEM has highlighted a statutory provision in OPA 90 that any claim made by the U.S. government may be brought directly, although claims made by other claimants may not be brought directly unless a Responsible Party asserts that it is insolvent or if a bankruptcy petition has been filed. Commenters on the BOEM regulations promulgated in 1998 addressed the "assertion of insolvency" provision, recommending that the BOEM implement a strict interpretation of what constitutes insolvency, including greater guidance concerning a responsible party's financial status. BOEM responded that its interpretation of the insolvency condition did not require verification of the owner/operator's financial status at the time of the assertion.[438] BOEM stated, "Our interpretation is that if a responsible party denies or fails to pay a claim asserting that he or she is insolvent and further asserts that the conditions of his or her insolvency are equivalent to the insolvency criteria set forth at

[432] (1) The assured party has denied or failed to pay a claim on the basis of being insolvent, as defined under §101(32) of the Bankruptcy Code and applying generally accepted accounting principles, (2) The assured party has filed a petition for bankruptcy, or (3) The claim is asserted by the United States for removal costs and damages or for compensation and costs for processing compensation claims. 33 USC 2716(f)(2).
[433] Oil Spill Liability Trust Fund, established by Section 9509 of the Internal Revenue Code of 1986 as amended (26 U.S.C. 9509).
[434] 30 CFR 553.61(a).
[435] 63 FR 42699 (August 11, 1998).
[436] An instrument issuer may not use any defenses against a claim made under OPA except: (1) the rights and defenses that would be available to a designated applicant or responsible party for whom the guaranty was provided; and (2) the incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated OSFR.
[437] 30 CFR 553.41(a)(4).
[438] 63 FR 42699 (August 11, 1998).

OPA section 1016(f)(2), then claimants may proceed against the responsible party's guarantor."[439] BOEM decided not to require an official determination of insolvency, which could be a time-consuming process.[440]

EPA has four potential options when considering how to apply direct action provisions to CERCLA 108(b) trust agreements:

- **Option 1:** Include direct action provisions in the required wording of the trust agreements, such as an explicit acknowledgement by trustees that the trust fund is subject to direct action claims under applicable circumstances
- **Option 2:** Do not include direct action provisions in the instrument. Leave provisions in the regulations alone
- **Option 3:** Expand direct action authorization under CERCLA 108(c)(2). For example, EPA could expand direct action explicitly to trustees or allow any claim made by the a state or federal government to be made directly
- **Option 4:** Narrow direct action authorization under CERCLA 108(c)(2). EPA could place greater restrictions on, by whom, and when a direct action claim could be brought against trustees of 108(b) trusts. For example, EPA could require a formal finding of pending insolvency, creating greater burdens for claimants to use direct action.

Option 1: Include direct action provisions in the required wording of the trust agreements, such as an explicit acknowledgement by trustees that the trust fund may be subject to direct action claims under applicable circumstances and they may need to pay or defend such claims on behalf of the fund.
Strengths: Increases transparency and ensures that the trustees and potential claimants are aware of the direct action authorization. Used by the Coast Guard and BOEM for other FR instruments authorized under CERCLA and OPA 90.
Weaknesses: Adds to trust agreement verbiage which the Agency would need to confirm. Inconsistent with the required wording of RCRA Subtitles C and I FR instruments.

Option 2: Do not include direct action provisions in the instrument. Leave provisions in the regulations alone.
Strengths: A direct action provision in the instrument is not needed because of statutory authorization. Less required verbiage for EPA to confirm. May encourage participation from trustees. Consistent with RCRA Subtitles C and I instruments.
Weaknesses: The lack of an acknowledgment in the instrument itself decreases transparency and may fail to ensure that the trustees and potential claimants are aware of the direct action authorization. Inconsistent with Coast Guard and BOEM.

Option 3: Expand direct action authorization under CERCLA 108(c)(2). For example, EPA could expand direct action explicitly to trustees or allow any claim made by a state or federal government to be made directly.
Strengths: Expanded direct action could provide claimants with faster cost recovery and liability payments.

[439] 63 FR 42699 (August 11, 1998).
[440] 63 FR 42699 (August 11, 1998).

Weaknesses: May discourage trustees from participating in 108(b) program. May interfere with first come, first served approach (see discussion at Section 2.1 above) or equal treatment of all types of liabilities (see discussion at Section 2.1 above). May raise question of EPA's authority to expand statutory direct action.

Option 4: Narrow direct action authorization under CERCLA 108(c)(2). EPA could place greater restrictions on, by whom, and when a direct action claim could be brought against trustees of 108(b) trusts. For example, EPA could require a formal finding of pending insolvency, creating greater burdens for claimants to use direct action.
Strengths: By narrowing direct action authorization, EPA may increase trustee participation in the 108(b) program. Consistent with BOEM, that may have narrowed direct action provisions (i.e., with regards to reinsurers).
Weaknesses: Narrowing direct action authorization may make it more difficult for some claimants to expeditiously file claims and receive payments. May raise question of EPA's authority to narrow statutory direct action.

EPA has decided to include language in required wording of the CERCLA 108(b) trust agreement acknowledging and authorizing direct action against the trust fund without attempting to narrow or expand the scope from what is provided in the statute.

Defenses Available Under Direct Action. CERCLA 108(c)(2) makes guarantors (i.e., providers of 108(b) instruments) subject to direct action claims. CERLCA 108(c)(2) and (d) provide those guarantors with specified defenses against such claims. Both the RCRA[441] and CERCLA statutes specify that under direct action, a guarantor is entitled to invoke all rights and defenses which would have been available to the owner or operator if any action had been brought against the owner or operator by a claimant under the respective Acts.[442] Because EPA's RCRA Subtitle C and I financial responsibility regulations and required wordings of financial responsibility instruments do not contain specifications for defenses to direct action,[443] EPA reviewed how the Coast Guard and BOEM addressed defenses to direct action in their financial responsibility programs.

In developing financial responsibility regulations for vessels under CERCLA 108(a) and OPA 90, the Coast Guard specified direct action defenses in its financial responsibility regulations and instruments.[444] Under CERCLA 108(c)(1), the guarantor is "entitled to invoke all rights and defenses which would have been available to the person liable under § 107 if any action had been brought against such person by the claimant and all rights and defenses which would have been available to the guarantor if an action had been brought against the guarantor by such person".[445] Under OPA 90, a guarantor may invoke, (1) all rights and defenses which would be available to the responsible party under OPA 90, (2) any defense

[441] Subtitle C 3004, Subtitle I 9003, 9004.
[442] CERCLA 108(c)(1) also includes a willful misconduct provision as a defense for a release from a vessel, but not a facility.
[443] Nothing in regulations or instruments from Subtitle C (40 CFR 265) or Subtitle I (40 CFR 280.90).
[444] 33 CFR 138.80(d).
[445] CERCLA 108(c)(2).

authorized under subsection (e)[446]; and (3) the defense that the incident was caused by the willful misconduct of the responsible party.[447]

From its CERCLA statutory authority, the Coast Guard's direct action defense regulations include the CERLCA statutory defenses outlined in 108(c)(1) as well as Coast Guard developed administrative defenses to direct action.[448] Coast Guard regulations state that a guarantor may invoke only the following rights and defenses with respect to a direct action claim:

1. Any defense that a person for whom the guaranty is provided may raise under the Acts,
2. The incident, release, or threatened release was caused by the willful misconduct of the person for whom the guarantee is provided,
3. A defense that the amount of a claim or claims, filed in any action in any court or other proceeding, exceeds the amount of the guaranty with respect to an incident or with respect to a release or threatened release,
4. A defense that the amount of a claim exceeds the amount of the guaranty, which amount is based on the gross tonnage of the vessel as entered on the vessel's International Tonnage Certificate or other official, applicable certificate of measurement, except when the guarantor knew or should have known that the applicable tonnage certified was incorrect, and
5. The claim is not one made under either of the Acts.[449]

The Coast Guard's direct action defenses include a willful misconduct provision, but do not include a defense for fraud or misrepresentation. In the preamble to its 1996 rule, the Coast Guard rejected a public comment to allow fraud or intentional misrepresentation as a guarantor's defense.[450]

BOEM's defenses against direct action are similar to the Coast Guard's. Under BOEM's OPA 90 authority, BOEM chose to mirror its direct action defenses regulations to the OPA 90 statute.[451] BOEM direct action defenses include:

1. The rights and defenses which would be available to a responsible party for whom the guaranty was provided, and available to the liable party; and
2. The incident leading to the claim for removal costs or damages was caused by willful misconduct of a responsible party for whom the designated applicant demonstrated FR.[452]

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[446] The Secretary or President, as appropriate, may specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing evidence of financial responsibility to effectuate the purposes of this Act. 1016(e).
[447] OPA 90 1016(f)(1).
[448] 33 CFR 138.80(d). Defenses 1 and 2 are requirements from CERCLA 108(c). Defenses 3, 4, and 5 are directly related to specific 'total applicable amount' regulations in 33 CFR 138.80(f).
[449] 33 CFR 138.80(d)(1).
[450] The Coast Guard has indicated that to adopt this recommendation would be inconsistent with the purpose of the guaranty – to ensure that the polluter pays for removal costs and damages. 61 FR 9270 (March 7, 1996).
[451] OPA allows all rights and defenses which would be available to the liable party; any defense authorized administratively; and the defense that the incident was caused by the willful misconduct of the responsible party.
[452] 30 CFR 553.41(a)(6).

All of the expressly approved FR instruments in BOEM's regulations include a specification reiterating the enumerated direct action defenses from the regulations. For example, BOEM's insurance certificate states that the named insurers agree, "not to use any defense except those that would be available to a Responsible Party for whom the insurance was provided or that the incident leading to the claim for removal costs or damages was caused by willful misconduct of a Responsible Party covered by this insurance."[453] Outside of the allowed defenses, and in similar fashion to the Coast Guard, BOEM has declined to allow guarantors a defense to direct action if a Responsible Party commits fraud or makes misrepresentations in the course of procuring an FR instrument. BOEM indicated that allowing a defense for fraud or misrepresentation would be inconsistent with two FR program objectives: (1) Ensure that claims for oil-spill damages and cleanup costs are paid promptly, and (2) Make responsible parties or their guarantors pay claims rather than the Oil Spill Liability Trust Fund. BOEM also stated that as of 1998 there was no evidence that fraud and misrepresentation had been a problem in the FR program.[454]

EPA has four main options regarding direct action defenses for 108(b) trustees:

- **Option 1:** Include direct action defense provisions in the required wording of the trust agreement, such as a direct acknowledgement from guarantors about the available direct action defenses.
- **Option 2:** Do not include direct action defense specification in the required wording of the instrument.
- **Option 3:** Expand upon CERCLA 108(c)(2) defenses to direct action, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
- **Option 4:** Narrow CERCLA 108(c)(2) defenses to direct action claims.

Option 1: Include direct action defense provisions in the required wording of the trust agreement, such as a direct acknowledgement from guarantors about the available direct action defenses.
Strengths: An acknowledgment in the required wording of the instrument increases transparency and ensures that the participating trustees and potential claimants are aware of available defenses. May encourage participation of trustees in the 108(b) FR program. Used by the Coast Guard and BOEM for other FR instruments.
Weaknesses: More verbiage for EPA to confirm. Inconsistent with RCRA instruments. Direct action defense provisions in the required wording of the trust agreement may be unnecessary if they simply mirror the statute.

Option 2: Do not include direct action defense specification in the required wording of the instrument.
Strengths: Direct action defense provisions in the required wording of the instrument may be unnecessary if they simply mirror the statute. Reduces verbiage for EPA to confirm. Consistent with RCRA instruments.
Weaknesses: The lack of a defense specification in the required wording of the instrument decreases transparency and may fail to ensure that participating trustees and potential claimants are aware of the direct action defenses.

[453] FORM BOEM-1019 (Expiration Date: December 2016).
[454] 63 FR 42707 (August 11, 1998).

Option 3: Expand upon CERCLA 108(c)(2) defenses to direct action, listing specific defenses that may limit direct action. For example, EPA could include a fraud or misrepresentation defense to direct action.
Strengths: Expanding defenses might be in the interest of guarantors and may encourage trustee participation in 108(b) FR program.
Weaknesses: Claimants may not be able to bring direct action claims as easily. Could raise questions about EPA's authority to expand defenses.

Option 4: Narrow CERCLA 108(c)(2) defenses to direct action claims.
Strengths: Narrowing defenses to direct action will be in the interest of claimants.
Weaknesses: Narrowing defenses to direct action could discourage trustees from participating in the 108(b) FR program. Could raise questions about EPA's authority to narrow defenses.

In light of the above considerations, EPA has decided to propose option 1 and include a specific acknowledgment of the defense provisions provided in the statute.