Small Business

RESEARCH SUMMARY

United States Small Business Administration
Office of Advocacy
RS 150

Environmental Financial Responsibility

by Robert E. Burt

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Purpose

The objectives of financial responsibility programs, as envisioned by Congress, are to ensure that funds are available when needed and that firms internalize the costs of environmental protection. In mandating these requirements, Congress made little or no provision to ensure that suitable mechanisms for demonstrating financial assurances are available to small businesses; that the assured funds will, in fact, be readily available if needed; or that the tax treatment of these mechanisms is reasonable and equitable.

This study examined environmental financial responsibility programs to determine what problems they pose for small businesses and whether they can be redesigned to have lesser impacts on small businesses while continuing to achieve their intended legislative goals.

Scope and Methodology

This research addressed a variety of financial responsibility mechanisms, the extent to which they can meet the objectives of the legislation, and the cost and availability of these mechanisms to small business. Both public and private sector funding mechanisms were examined.

Private sector mechanisms included trust funds and related financial instruments, surety bonds, letters of credit, insurance for environmental damages and corrective action, and insurance against business failure.

Public sector mechanisms included publicly provided insurance for environmental damages and corrective action, public bond pools, and other arrangements based on fees or taxes on either affected firms or the general public.

Highlights

- Financial responsibility programs have helped significantly by avoiding delays in locating sources of funding, failure of firms to take adequate care, and financial distortions by firms attempting to evade or mitigate responsibility. Different financial responsibility requirements cover different events, such as closing a facility and post-closure care, corrective actions, land reclamation and environmental restoration, and third-party liability involving property damage and bodily injury. Federal financial responsibility programs have been developed for third-party liability, future corrective actions and activities designed to prevent future corrective actions.
- Generally, publicly administered financial mechanisms - such as the government-provided insurance, assigned risk

pools and public funds set up by many states - provide adequate funds, internalize costs and generally meet the needs of small businesses. Private mechanisms however, are unable to serve the small business market consistently, tending to force small firms to over-internalize costs and driving out many smaller firms.

- In 1978, the Environmental Protection Agency (EPA) issued the first ruling to establish financial responsibility requirements in response to the Resource Conservation and Recovery Act (RCRA). RCRA required owners/operators of hazardous waste management facilities to demonstrate that funds would be available, when needed, to cover contingencies resulting from the operation of these facilities. The EPA assumed that most operators could obtain insurance, letters of credit or surety bonds from the private sector. However, because most small operators were unable to obtain the necessary financial support to demonstrate financial responsibility, or because the cost was more prohibitive than anticipated, thousands of small businesses were closed during the 1980s.
- As of the date of this report, the EPA had left a number of very substantial gaps in its financial responsibility programs. For example, the EPA has no financial responsibility requirements and no financial relief mechanisms for covering corrective actions at hazardous waste treatment, storage and disposal facilities (TSDF); third-party liability after facility closure; or post-closure care beyond 30 years. Because the remaining small businesses are forced to rely solely on private financial responsibility mechanisms, many will be forced to close. As a result of the lack of private funding, the EPA has begun reviewing each facility on a case-by-case basis before implementing financial responsibility requirements.
- The critical importance of matching financial responsibility mechanisms to particular problems must be addressed. Because private sector alternatives do not address the small business markets consistently, public funding programs must also be provided if the very basic goals of financial responsibility programs are to be met. Public funding programs must also consider reducing the total values that a firm must meet by allowing build-up periods to meet future financial responsibility programs; allowing firms to use reasonable interest rates in calculating funds needed to address future events; limiting the number of years for which financial responsibility is required for post/closure care or corrective action periods; and requiring financial responsibility only in the amount needed to actually address the problems at the site.
- Tax and bankruptcy laws have a major effect on the cost and usefulness of various private financial alternatives. Tax laws treat funds set aside for financial responsibility as if they were still under the control of the firm, taxing these funds as part of the firm's income or property. Taxes on such funds would be considerably lower if such funds were not treated as assets. The cost of setting such funds aside also would be lower. If bankruptcy laws were changed to give high priority to financial responsibility obligations, simple managed accounts - without trustees or guarantors - could be used to meet a firm's financial obligations. Such an approach would permit small firms to meet the financial test of self-insurance.

Ordering Information

The complete report is available from:

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