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State Funds In Transition:

Models For Underground Storage Tank Assurance Funds

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Introduction: State Funds In Transition

Most states have created cleanup funds to help pay for the remediation of sites contaminated by leaking underground storage tanks (USTs). Increasingly, states are considering changing these funds or moving out of them entirely. The Environmental Protection Agency's Office of Underground Storage Tanks (OUST) has compiled this document for state officials who are considering changes and alternatives to their state funds.

This booklet describes some of the activities states have conducted in making a transition from a state fund program to other financial assurance mechanisms. Chapter 1 provides some general background on the underground storage tank program and the development of state assurance funds. Chapter 2 describes the process by which three states are making a transition from their state fund programs to other alternatives. Chapter 3 briefly analyzes five state programs that might serve as models for other states that have decided to change their current state fund structure.

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Chapter 1

Overview Of The Underground Storage Tank Program And State Funds

Authorizing Legislation

In 1984, Congress responded to the increasing threat to groundwater posed by leaking underground storage tanks (USTs) by adding Subtitle I to the Resource Conservation and Recovery Act. This section of the law required the U.S. Environmental Protection Agency (EPA) to develop a comprehensive regulatory program for USTs. Congress directed EPA to publish regulations that would require owners and operators of new tanks and tanks already in the ground to prevent and detect leaks, clean up leaks, and demonstrate financial responsibility for cleaning up leaks and compensating third parties for resulting damages.

Congress created the Leaking Underground Storage Tank (LUST) Trust Fund in 1986 by amending Subtitle I of the Resource Conservation and Recovery Act. The LUST Trust Fund has two primary purposes. First, it provides money for enforcing and overseeing corrective action at leaking UST sites. Such actions are undertaken by a responsible party, typically the owner or operator of the leaking UST. Second, the Trust Fund provides money for cleanups at UST sites where the owner or operator is unknown, unwilling, or unable to respond, or which require emergency action. Where Trust Fund monies are used directly for cleanup, Congress required under Subtitle I that responsible tank owners and operators be held liable in cost recovery actions for such expenditures.

State Assurance Funds

State assurance funds were originally developed to help pay for cleanup of existing contaminated sites and to enable tank owners to comply with federal financial responsibility requirements for USTs. The use of state assurance funds as a compliance mechanism is allowed in the federal statute enacted in 1986 and in EPA's financial responsibility regulations. In order for tank owners to use a state fund to comply with federal financial responsibility requirements, states are required to submit their funds to EPA so that EPA can determine that the fund is "equivalent" to other compliance mechanisms allowed by the regulation, such as insurance, letters of credit, surety bonds, and corporate guarantees. EPA's regulations provide that once a state submits its fund to EPA for approval, pending the EPA Regional Administrator's determination that the fund is acceptable as a compliance mechanism, UST owners and operators will be considered to be in compliance with the financial responsibility requirements for the amounts and types of costs covered by the state assurance fund.

To date, 42 states have submitted their funds for approval, and EPA has approved 34 of these funds. Another six states have fund programs that have not been submitted to EPA for

approval. While these states currently provide or previously provided funds for UST cleanups, their tank owners cannot use the state fund to demonstrate compliance with the federal financial responsibility requirements.

In general, state assurance funds act as reimbursement mechanisms, paying owners and operators for costs incurred in remediating releases. Typically these owners and operators are known, willing to clean up, and solvent. In contrast, when federal LUST funds are used for a cleanup, it is likely that the owner or operator is unknown, unwilling, or unable to pay for the remediation.

Aside from serving as the primary means for many businesses (especially small businesses) to comply with the financial responsibility requirements, state funds are playing a major role in state cleanup programs, and that role continues to grow in importance. Collectively, existing state assurance funds raise almost $1.2 billion annually to help pay for cleanups. Some of these cleanups, especially those of historical releases, might not have occurred had these funds not been created. Annually, states are raising approximately 20 times more than the most recent federal LUST Trust Fund appropriation. Perhaps more significantly, at a time when LUST Trust Fund appropriations have declined, state assurance fund revenues are increasing. In 1993, the state funds collectively raised about $900 million, increasing revenues by 30% in the three-year period from 1993 to 1996. However, the number of claims against the funds is also increasing. The most recent data collected by states show outstanding claims at $2.8 billion, with the current balance in the funds amounting to $1.3 billion and current income at $1.2 billion per year.

Availability Of Commercial Pollution Liability Insurance

In 1996, commercial pollution liability insurance (which meets the federal financial responsibility requirements) is readily available and generally affordable, especially for "good" tanks meeting all technical requirements. Growth of this insurance market has not been constrained by a lack of supply, but rather by a lack of demand due to competition from state assurance funds. The current market is dominated by about five major insurance companies. These companies operate in most, if not all, states and offer coverage to all types of tank owners. Several other companies provide coverage in a limited number of states.

Given that most potential customers are already covered by state trust funds, demand for commercial insurance has been relatively small. This has led to fierce competition between the big providers and resulted in easier application procedures and lower premiums for tank owners. While each company uses different underwriting criteria and application forms, the general trend has been to require less information and documentation than has been required in the past. When companies first began to offer insurance for USTs, the normal application form was four to five pages long and often required documentation that the tanks were tight and the site clean. (Meeting this one requirement would have added considerable up-front expense to application costs). Today, applicants typically complete a two-page application. Applicants are often also required to submit the results of tank tightness tests. While insurers will not generally insure a

contaminated site, they may insure a site against future contamination if the current contamination can be clearly delineated and the known cleanup costs are the responsibility of another party.

Premiums have also come down since 1989, when some of these commercial programs began. Then, the average premium was approximately $1000 per tank (for good tanks). Today that average has been reduced to roughly $400 per tank. For a double-walled tank and piping system, the cost could drop to $200 per tank. Table I on the next page presents recent price quotes from three major insurance companies. As the Table indicates, premiums for older, unprotected tanks are extremely high, reflecting the risk associated these tanks. The data also demonstrate the savings in insurance costs that can be achieved when tanks are upgraded.

Major insurers have stated their intention to remain in the UST insurance market. All of the insurers that OUST has contacted have indicated that the market will grow to meet demand, which will increase as more state funds are phased-out. Insurers have also indicated that as tanks are upgraded or replaced to meet the 1998 compliance deadline, more insurers may begin to offer coverage.

Impact Of The 1998 Deadline

Federal rules require UST owners to ensure that their tanks have spill protection, overfill protection, and corrosion protection by December 22, 1998. Some owners will upgrade their existing USTs to meet the 1998 requirements. Others will close their USTs and replace them with new ones. Many owners will simply close and remove their tanks. In any event, as owners and operators comply with the 1998 requirements, states can expect to confirm a significant number of new releases. While it is difficult to estimate the number of releases to be discovered in the coming months, states and EPA expect that more than 100,000 new releases may be reported. These releases would represent a substantial increase over the 317,000 releases confirmed as of September 30, 1996.

Even if the number of new releases grows more modestly, the demand placed on state fund resources is likely to increase substantially. Some state fund administrators have attempted to estimate the probable impact of the 1998 deadline on their funds. Generally, their estimates indicate that funds may experience cash flow problems a few years after the deadline, beginning around 2000 or 2001. Some authorities predict that cash flow problems will remain for three to five years unless more stringent cost controls are applied or additional income is provided.

In some states, the increased demand on state fund resources is likely to lead to efforts to limit state fund liability. For example, states might employ more aggressive cost control strategies, or state legislatures may establish sunset dates after which the state fund would cease to accept claims. Setting a sunset date may be viewed as a particularly timely, workable option since all owners and operators presumably will have upgraded or replaced tanks and, in the process, should have discovered the bulk of historical contamination as well. As a result,

Table 1

UST SYSTEM (3 tanks per site)	PREMIUM Company A	Company B	Company C
Fiberglass reinforced tank; double wall piping; suction pump system; automated monitor& inventory	$1,350 ($5,000 deductible)	$825 ($5,000 deductible)	$1,320 ($10,000 deductible)
STI-P3 steel tank (installed 1991); cathodic protection; single wall piping; suction pump system; automated monitor & inventory	$1,500 ($5,000 deductible)	$1,250 ($5,000 deductible)	$1,320 ($10,000 deductible)
Single wall steel tank (installed 1985); cathodic protection; single wall piping; pressurized system; stat. inventory reconciliation; no overfill or spill prevention	$3,500 ($10,000 deductible)	$1,500 ($5,000 deductible)	$2,563 ($10,000 deductible)
Single wall steel tank (installed 1975); no cathodic protection; single wall piping; pressurized system; manual inventory; no overfill or spill prevention	Decline Coverage	$3,800 ($5,000 deductible)	$5,610 ($10,000 deductible)

owners and operators should have clean sites and upgraded tanks and should be able to insure their sites for a reasonable price.

Conclusion

Congress passed legislation establishing the underground storage tank program more than 10 years ago. Since then, more than 317,000 releases from regulated tanks have been identified, and cleanups have been initiated at more than 250,000 sites. In the vast majority of cases, state funds are paying for these cleanups. State funds are providing more than $1 billion annually to pay for cleanups and are expected to continue to do so in coming years. Clearly, without state

fund resources, considerably less progress would have been made in cleaning up sites.

While they have made substantial progress in UST cleanups, however, some states are concluding that the time is right for making the transition from their state funds to private insurance or other mechanisms. These states reason that such a transition will be especially appropriate over the next few years, as the preponderance of historic contamination is discovered and tanks are upgraded to meet the 1998 deadline. In the next chapter, we review the experiences of several states involved in the transition process. The case studies which follow may be valuable to other states as they determine whether to make a change in their fund programs and how such a change might occur.

Chapter 2

Making The Transition: From State Funds. . .

Some states have already begun the process of moving from their state funds to alternative mechanisms. This chapter describes the experiences of three states--Texas, Florida, and Wisconsin--in making this transition.

While states still have limited experience with fund transitions, it appears that solvency problems are a major impetus to moving a state along the transition route. When state officials, including legislators, are faced with a raft of claims that exceeds their fund's balance and/or income, they may decide that part of the solution lies in setting a sunset date and phasing out of the state fund business. That has been the experience in Texas and Florida, and it is likely to be an approach shared by other states facing an increasing number of claims associated with stepped-up 1998 compliance activity.

The Texas Petroleum Storage Tank Remediation Fund

Background

The Texas Petroleum Storage Tank Remediation Fund was created in 1989, both to pay for underground storage tank cleanups and to serve as a financial responsibility mechanism (for cleanups but not for third party claims) for UST owners and operators in Texas.

During the Fund's early years, claims substantially exceeded revenues, mainly due to the lack of mechanisms in place to control costs. By 1992, the Fund had a backlog of unpaid bills totaling about $170 million. This amount alone exceeded the Fund's annual income by approximately 300%. New claims arriving daily added to the backlog.

In its 1993 session, the Texas Legislature considered ways to address the problems facing the Fund but was unable to agree on what needed to be done. The Legislature established a Joint Interim Legislative Committee, charged with evaluating the program and identifying its problems. The Legislature also agreed to loan the Fund $120 million to deal with part of the backlog while the Joint Committee considered a more permanent solution.

Even while the Committee was undertaking its evaluation, however, the Texas Natural Resource Conservation Commission (TNRCC) instituted five significant measures designed to improve cost control. Initially, the program:

1. Promulgated a rule requiring all corrective action activities to be preapproved;

2. Temporarily slowed corrective action activities, except at the most important sites;
3. Certified corrective action specialists and project managers;
4. Adopted reimbursable cost guidelines by rule; and
5. Streamlined and standardized corrective action reports, and reduced the number of reports required.

In addition, Texas instituted a risk-based corrective action (RBCA) process designed to focus resources on the most important and threatening sites.

These changes had an important political effect. During its 1995 session, the Legislature heard from a variety of stakeholders, notably industry, that TNRCC was "getting on top" of problems and that stakeholders generally agreed upon the solutions being implemented. This progress was also verified by the Joint Interim Legislative Committee's report, which supported the actions taken to control costs and was a major influence on the Legislature as it considered changes to the Fund.

The Texas Transition Strategy

The legislation Texas passed in 1995 to change the Fund has several major components. First, the Legislature increased the Fund's income by doubling the bulk delivery fee that supports the Fund. As a result, the Fund's monthly income increased from about $5 million to $10 million. Second, to deal with the existing backlog of claims, the legislation provided for a second $120 million loan, to be repaid by the end of FY1997. Third, the Legislature set a sunset date, December 23, 1998, for accepting new releases at sites. Last, it set a final sunset date of September 1, 2001, at which time the Fund will cease making payouts and close.

With these provisions, the Legislature sent the message that it would increase Fund income to deal with the backlog of claims and releases found while tank owners and operators worked to comply with the 1998 deadline. At the same time, the Legislature set in motion the process by which the state would exit the fund business, limit its liability, and let the private market provide the means for owners and operators to comply with financial responsibility requirements.

The legislation also established several other requirements. First, to be eligible for reimbursement after December 31, 1995, owners and operators must have registered their tanks. After December 31, 1995, new tanks must be registered within 30 days of installation. Next, after September 1, 1995, if a closure letter for a site has been issued and there is a subsequent release, the $10,000 deductible initially in effect rises to $50,000. In addition, owners and operators are required to use appropriately licensed and registered professional engineers for remedial action plans, design, and installation. Finally, to remain under the current deductible, owners and operators must:

- Submit a site assessment before December 23, 1996;

- Have an approved corrective action plan by December 23, 1997; and
- Meet the goals outlined in an approved corrective action plan by December 23, 1998.

For each deadline missed, the deductible doubles. Thus, if the first deadline is missed, the deductible becomes $20,000. The deductible rises to $40,000 and $80,000 for missing the second and third deadlines respectively. An owner who meets the first two deadlines but has missed the third would have an $80,000 deductible.

Discussion

Texas took a two-pronged approach to address its fund problems and limit its long-term exposure to remediation of leaking tanks. It dealt with the growing backlog of claims not only by increasing income but also by instituting a variety of measures intended to control costs. These measures include preapproval and cost guidelines, as well as reliance upon a risk-based corrective action approach to focus resources on the most important sites.

In addition, the Texas program linked a broad range of compliance requirements--including tank registration and compliance with the 1998 deadline--to receiving reimbursement from the state fund. Given that most leaks are found during closure or upgrading, owners and operators have an incentive to begin these activities early while they may still benefit from the lower deductible. The deadlines have the effect of inducing owners and operators to find leaks early, undertake remediation promptly, and keep remediation activity on schedule. Owners and operators who remain out-of-compliance must realize that after December 22, 1998 they will not have a state fund to pay for remediating new releases. Further, these owners and operators will find it difficult if not impossible to secure insurance. The Texas system of increasing deductibles over time promotes early compliance with the 1998 deadline, and the overall approach is designed to leave owners and operators with insurable sites and tanks at the point when the state fund ceases to accept claims.

Clearly, the Texas approach forces owners and operators to convert to another form of financial assurance, most likely insurance, on December 23, 1998. This conversion can potentially benefit both owners and operators and the insurance industry. If the approach is successful, sites in Texas will be upgraded, the state fund will have paid for remediation of any historic contamination found, and insurance companies will have a large number of clean, upgraded sites in need of coverage. The risks will be known to the insurance industry, and, since tanks will be upgraded, premiums should be relatively low.

Obviously, there are ways in which this optimistic scenario may not be realized, at least by the end of 1998. There is a possibility that a substantial minority of tank owners and operators cannot afford to upgrade their tanks and will have historic contamination and tanks that are not in compliance as of December 23, 1998. Even so, there is every reason to believe that the majority of tanks will be upgraded and quite insurable.

Lessons Learned

Just a few years ago, the Texas State Fund was on the edge of insolvency. The changes described above have led to a significant change in the Fund's cash flow and control of cleanup costs. Overall, however, Texas attributes the success of its approach to stakeholder involvement. Stakeholders were involved early and, once all could agree to the approach, became highly effective advocates in indicating their support to the Texas legislature. Based upon Texas' experience, a primary recommendation to other states is to invest in working with all stakeholders in order to agree on an approach and design it to be politically saleable.

A key element to solving the Fund's problems was increased income, to deal with both the backlog of claims and the new claims expected as owners and operators prepared for the 1998 deadline. Since the legislation included a sunset date that would limit the state's long-term financial exposure, the Legislature was willing to provide the extra income, even if the final cost of remediations was not clear. A potential problem does exist should the increased income still be insufficient to pay claims. If such a situation arises, the Legislature may again have to provide loans to the Fund that are paid back by subsequent income. This approach has been used successfully in the past. Some owners and operators may object to having both a bulk delivery fee and the cost of insurance premiums to pass along to customers. However, others would view this as a small price to pay for clean, insurable sites.

Florida State Fund

Background

When Florida began its LUST program in 1986, it identified the protection of groundwater as a critical state priority and decided to invest state resources in the cleanup of contaminated UST sites. In order to locate and address existing releases, Florida developed the Early Detection Incentive (EDI) program. The EDI program provided amnesty to all owners and operators who reported a leak, and the state committed to fully funding the cleanups. Florida expected fewer than 1,000 leaks to be reported; however, the EDI program uncovered 9,470 releases. This unexpected response led to numerous extensions of the EDI program, which ultimately ended on December 31, 1988. By this point it was apparent that the EDI program had not yet uncovered all releases: The UST problem was ongoing and would need to be addressed into the future.

Florida created the Florida Petroleum Liability Restoration and Insurance Program (PLRIP) as a successor to the EDI program. PLRIP became effective on January 1, 1989, following the EDI program, and is still in operation today. PLRIP differs from EDI in that it operates more like an insurance program, providing coverage to owner and operators for future releases. This program was designed to cover active sites, since the EDI program should theoretically have identified all the existing releases. Florida's Inland Protection Trust Fund

(hereafter referred to as the state Fund) pays for remediation of new releases at these sites, but not for third party liabilities. To qualify for PLRIP, owners and operators must be in compliance with the third party liability regulations through some other mechanism, usually insurance. Initially, Florida contracted with one insurance company to provide the necessary third party liability coverage and required owners and operators to have policies with that company before they could qualify for PLRIP. Now, however, the market is open to any insurers that provide the necessary coverage.

Florida has two other smaller and more specialized programs. The Abandoned Tank Restoration Program was created in 1990 to pay for remediation of contamination associated with closed or abandoned tanks. To qualify for this program, owners and operators must prove existing contamination and show that the facility has not been in the petroleum storage business since March 1, 1990. This program was closed in June of 1996, except for covering indigent owners. Finally, to address any sites not covered under other programs, Florida created the Petroleum Contamination Participation Program. Under this program, owners and operators pay a 25% co-payment and perform a limited contamination assessment.

Florida's cleanup programs were generous and inclusive, but they entailed a huge liability for the state. High cleanup costs--resulting from stringent corrective action standards, high groundwater tables, and policies that were favorable to consultants--multiplied by the huge number of reported releases have created liabilities for Florida that will amount to well over a billion dollars.

Florida's Transition Strategy

By 1992, Florida had accumulated significant liability from its various corrective action programs. The Florida Legislature determined to change the existing system by transferring some of the responsibility for environmental cleanup from the public to tank owners and the insurance industry. The Legislature believed that as tank owners upgraded and replaced their tanks and insurance became more available and affordable, the state could exit the state fund business without significantly jeopardizing the environment. The 1992 Legislature, in addition to increasing the Fund's revenue, passed legislation ultimately to phase out the Fund. The legislation established a phase-out schedule to reduce incrementally the corrective action coverage provided by the state. Tank owners would be required to supplement diminishing state coverage with financial responsibility coverage, as well as third party liability coverage, from another source.

The legislation established the following phase-out schedule:

Through 1993	State provides $1 million in coverage
January 1, 1994	State Fund coverage reduced to $300,000
January 1, 1997	State Fund coverage reduced to $150,000
January 1, 1999	State Fund coverage for new releases ends

Discussion

While Florida planned its eventual exit from the state fund business primarily to limit future liabilities, its transition strategy benefits tank owners and the insurance industry as well. For example, when PLRIP was created, insurance was not widely available. By 1992, however, insurance had become more available and affordable for good tanks in Florida. Florida's transition strategy provides an opportunity for insurance companies to become further established, helping ensure their ability to meet the needs of the UST market when the Fund ceases to provide coverage. Florida's strategy includes three components that will help build a strong insurance market. First, Florida requires that tank owners obtain both third party and supplemental corrective action coverage before they are eligible for the Fund. This guarantees a constant market for UST insurance. Second, since the state covers the first $300,000 of corrective action costs (down to $150,000 in 1997), insurance companies bear minimal risk and can write relatively safe policies. Finally, Florida's stringent technical regulations and intensive compliance program will help ensure safe and well maintained tanks. The combination of a guaranteed market, low risk policies, and new and well maintained tanks creates an environment in which insurance companies can flourish in Florida.

Florida's approach also eases the transition for tank owners. By providing them five more years of state-subsidized insurance, the phase-out plan allows owners and operators plenty of time to bring their tanks into technical compliance, thereby ensuring their eligibility for insurance at a reasonable cost once PLRIP ends. Closing PLRIP without the five-year lead would have left many tank owners with old, potentially uninsurable tanks. Further, any corrective action costs associated with contamination discovered during tank upgrading or replacing would have been the responsibility of owners and operators. Allowing additional time for the insurance market to grow also benefits the tank owners, because the competition associated with a flourishing insurance market should help keep availability high and premiums low.

Finally, Florida benefits by reducing and eventually eliminating future liability (beyond the liability associated with releases that are already in the system). By capping liabilities, the state can concentrate its resources on the large number of existing claims, quantify its liability, and determine how best to address it. The phase-out approach also complements Florida's compliance and enforcement programs. To be eligible for assistance from the state Fund, tank owners must be in compliance with the technical requirements. Upon report of a release, Florida inspectors visit a site to ascertain adequate compliance. This inspection serves as an incentive for technical compliance. Financial responsibility compliance is ensured since tank owners must have third party liability and excess corrective action coverage before they qualify for the state Fund. The phase-out also provides an incentive for owners and operators to comply with Florida's 1998 secondary containment deadline, as they will not be covered for costs associated with existing contamination discovered during tank replacement once the state Fund expires.

Lessons Learned

Florida's transition plan has been well received by tank owners and the insurance industry, and the phase-out is still on schedule. States wishing to adopt a similar approach will, like Florida, need to focus their efforts on compliance to ensure that UST owners will be able to continue operating once the state fund is gone. The phase-out schedule must allow sufficient time for owners and operators to come into compliance, creating sites that will be insurable once the state fund is gone. Further, for the phase-out to be successful, state legislatures must be willing to commit resources to the corrective action program even after the fund stops accepting new claims. Though Florida will incur no additional liability (additional sites) after 1998, the state will be responsible for cleaning up sites already in the system for years. Finally, Florida managers suggest turning over the insurance aspect of state funds to the market as soon as possible and using the fund as an emergency backup for releases that would otherwise not be taken care of.

Though Florida's phase-out provides a means of reducing and ultimately eliminating new liability for the state fund, Florida has, as noted previously, already incurred tremendous liability and a correspondingly large backlog of claims. Thus in addition to the phase-out, Florida has been working to control the costs associated with its existing claims. Based on its experience in trying to control cleanup costs, Florida recommends that other states:

- Adopt a risk-based approach to corrective action (RBCA) to focus first on high priority sites. States should avoid squandering resources on any and all sites if resources needed to address the high priority sites are lacking. Furthermore, states must acknowledge that there simply may not be enough resources available to clean up all sites to stringent drinking water standards.

- Preapprove all costs.

- Stay within the available budget. Avoid situations in which cleanups are performed on credit (and are receiving interest) or in which the most important work is not being addressed.

Wisconsin Petroleum Environmental Cleanup Fund

Background

The Wisconsin Petroleum Environmental Cleanup Fund Act (PECFA) created the Wisconsin Fund in 1987, both to pay for underground storage tank cleanups and to act as the financial responsibility compliance mechanism for certain owners and operators in Wisconsin. PECFA covers federally-regulated petroleum tanks, aboveground storage tanks, small farm tanks, home heating oil tanks, school heating oil tanks, and commercial heating oil tanks. PECFA is a reimbursement fund, and awards are not made until remediation work has been completed and

paid for. Under certain circumstances, the Fund can make progress payments.

PECFA is funded by a $.03/gallon fee on petroleum products. This fee generates between $115 and $120 million per year. Of that, about $100 million is available for paying claims; in recent years, PECFA has paid out the entire $100 million in claims per year. From 1988 to June 1996, the Fund has paid out about $351 million in claims.

The responsibility for approval of the cleanup process for sites with groundwater contamination rests with the Department of Natural Resources (DNR) while PECFA (which is within the Department of Commerce) provides the funding and makes closure decisions for sites with soil contamination only. The responsible party must meet the cleanup requirements specified by the DNR whether or not PECFA provides funding.

Wisconsin's Transition Strategy

At the time Wisconsin officials created PECFA, they recognized the existence of many old tanks and anticipated that replacing, upgrading, and closing these tanks would reveal a great deal of historic contamination and require significant funds for cleanup. That their concerns were well founded is evidenced by the removal of over 40,000 UST systems by Wisconsin owners and operators.

State officials believed that it was good public policy to create a mechanism to help pay for cleaning up this contamination. Thus the purpose of the Fund has always been to clean up historical contamination; the Fund was never intended nor constructed to provide long-term insurance. To provide this coverage, the Fund has worked with industry towards establishing an insurance market. Initially, the Fund tried to develop a relationship with insurers to provide a wrap-around policy. Under such an arrangement, PECFA would have paid the first $195,000 of a claim, and the insurer would provide for coverage above that level. For a variety of reasons (lack of interest on the part of insurers and tank owners' concerns), this plan did not work. As a result, Fund coverage was increased to provide the full $1 million per occurrence coverage.

PECFA had developed good working relationships with the trade associations representing major oil companies, jobbers, and insurers. All stakeholders understood that Wisconsin's political leadership supported the Fund's original purpose, and they held no false expectations that the Fund would become an insurance program. This consistency kept insurers interested in providing coverage in Wisconsin. The state provided tank statistics, data on releases, cost of cleanups, etc. Insurers were waiting until there was sufficient demand for private insurance. By 1994, the conditions seemed right to go the next step.

In 1994, Wisconsin amended PECFA by requiring sites with upgraded equipment or completed remediations to have private pollution liability insurance by January 1, 1996. As of that date, PECFA will cover remediation in progress at upgraded sites. For tanks upgraded after January 1, 1996, any contamination found before or during the upgrade is covered by the Fund.

Financial assurance coverage for new releases ends as soon as USTs are upgraded, meaning that tank owners have to obtain private insurance or use another mechanism to remain in compliance with the financial responsibility requirements. The Fund, however, will continue to provide reimbursements for the original cleanup. In response to tank owners who asked for verification of compliance with the financial responsibility requirements to assure that everyone is being held to the same standard, Wisconsin will verify insurance coverage through its tank permit and inspection program.

Discussion

The 1994 Amendments to PECFA made explicit Wisconsin policy to assign remediation of historic contamination to the Fund and new releases to the UST owner. Wisconsin does not intend to run a pollution liability company on a permanent basis nor to assume a role more appropriate for private companies.

This strategy has created a market for private pollution liability insurance. Further, by using the state fund to clean up historic contamination, Wisconsin removed one of the biggest concerns of private insurers. Currently, about 8,000 UST systems are insured. Premium costs range from $300 to $400 per tank.

Lessons Learned

Wisconsin officials adopted their approach based upon their philosophy of what their state fund should and should not do. Before considering an approach like Wisconsin's, other states would need to make similar, basic decisions. Should state officials elect to adopt this strategy, they may need to change the legislation and regulations governing their state fund.

Wisconsin staff believe that part of their success in making the transition work is due to their generally good working relationships with all stakeholders. Strong and stable political leadership was also a factor.

Chapter 3

Making The Transition: . . . To A New Model

The previous chapter discussed the strategies used by three states that are making the transition from state funds to other mechanisms. In this chapter, we examine four existing programs that might serve as new models for states interested in moving away from more conventional state funds. The first case, Michigan, presents the experience of a state that has already made a transition to a program in which owners and operators rely primarily on private insurance. The next two examples, Idaho and West Virginia, represent state-subsidized insurance programs. These programs share some similarities with the fourth program discussed, Washington's state-financed reinsurance program. Finally, we examine the experience of the New York fund, a fund of last resort which pays for cleanups only when the owner or operator is unwilling or unable to do so.

Michigan Underground Storage Tank Financial Assurance Act

Background

In 1988, the Michigan Underground Storage Tank Financial Assurance Act (MUSTFA) established a Fund to help owners and operators meet federal financial responsibility requirements. The MUSTFA program, which EPA's Region 5 approved for use as a financial responsibility mechanism in 1990, reimburses owners for the cost of remediating contaminated sites and paying third-party claims. Funding for the program was generated by an annual fee of 7/8 cent for every gallon of refined petroleum sold in the state.

Due to mounting deficits, Michigan declared the Fund insolvent in November 1992. As a result of pressure from the Governor, legislature, large and small business owners, and other groups within the state, however, a quick legislative fix was crafted. By extending collection of the annual petroleum fee until January 1, 2005, Michigan was able to declare the Fund solvent. The fix also included a plan for phasing out Fund coverage by December 22, 1998.

By late 1994, the number and cost of reimbursement claims being filed again raised serious concerns about the long-term solvency of the Fund. A state auditor report issued in February 1995 determined that the Fund had a $230 million backlog of known claims, with more claims coming in. The report projected that the Fund would be insolvent before 1999. In April 1995, the State again declared its Fund insolvent. All claims had to be submitted by June 29, 1995 in order to be eligible for reimbursement. It was unclear, however, when reimbursement payments would be made. In the best possible case, claimants might expect payment in about ten years. At worst, claims would not be paid at all, since the state legislature held that if there was no money in

the Fund (and no more revenue would be collected), the State would neither pay nor be liable for the payment. After June 29, 1995, all UST owners and operators had to obtain their own pollution liability insurance or use another approved mechanism to remain in compliance with the financial responsibility requirements.

By establishing the date by which all claims had to be filed, Michigan was able to get a handle on its total liabilities. Of course, this knowledge did not address the difficulties that many tank owners and their cleanup contractors faced in getting paid. Many cleanup contractors who had already spent money completing cleanups were on the verge of bankruptcy. Some of them were beginning to place liens on the tank owners for whom they had worked. This caused a great deal of concern, especially among small business owners, who feared losing their businesses or homes to satisfy these liens.

The Michigan Model

Fortunately, Michigan did not have to worry about tank owners' ability to purchase private pollution insurance. Since the 1993 amendment requiring full phase-out of Fund coverage in 1998, the State had been working with the three largest insurers of USTs at the time (AIG, AESIC, and Zurich-American) to provide coverage in Michigan. In 1994, the State legislature had adopted a phase-out plan under which, beginning in April 1995, tank owners had to obtain private insurance to cover cleanup and third-party claims in excess of $800,000. Simply put, this meant that the Fund would cover $800,000 of the $1 million per occurrence limit; insurance would cover $200,000. That ratio would change over time until, by 1998, the Fund would provide only $200,000 in coverage and tank owners would have to buy insurance policies providing $800,000 in per occurrence coverage. Fund staff had been working with the three insurers and EPA staff to determine that all three companies' policies met EPA's requirements.

These insurers were all set to provide insurance beginning in April 1995 when the phase-out would begin. With the insolvency declaration, every tank owner had to obtain insurance beginning on June 30, 1995. Given this guaranteed demand, a competitive market developed, with five firms writing policies. Tank owners and operators are buying insurance not only to meet the financial responsibility requirement, but also to comply with a state law prohibiting suppliers from dropping fuel if a tank has a "Red Tag," signifying that the tank is not in compliance with all regulations (including financial responsibility).

The Michigan legislature addressed the Fund's financial problems and the resulting hardship placed on small businesses and cleanup contractors by authorizing the sale of bonds and commercial paper, which would raise enough money to pay within one year all of the $150 million in claims that the Fund had accepted. Revenue from the annual petroleum fee would be used to pay this debt.

Discussion

Michigan focused its efforts on addressing both the Fund's immediate and long-term financial problems. The State acknowledged the claims as its liabilities and took steps to address them, reserving for the time being the questions of whether a state fund is still needed and what type of fund it might be. Michigan staff did not waste time and energy trying to resurrect a dead program with gimmicks and fixes that would not address the basic financial problems. This approach may serve as an example for states facing similar problems.

Idaho Petroleum Clean Water Trust Fund

Background

In 1990, Idaho passed the Petroleum Clean Water Trust Fund Act to create a state-run, non-profit insurance company. As established by the Trust Fund Act, the insurance company is financed by a transfer fee of $.01 per gallon collected from the first licensed distributor of petroleum in the state and an annual $25 per tank application fee. The insurance company is regulated by the Director of Insurance and is required to meet the usual solvency and fair dealing requirements of Idaho's insurance laws. Under the Act, the state issues UST owners and operators insurance contracts that meet the federal financial responsibility requirements for corrective action and payment of valid claims for bodily injury and property damage caused by leaking petroleum tanks. However, the law strictly excludes cleanup and liability costs for prior contamination.

Soon after the Trust Fund Act was signed into law, Idaho's Director of Insurance conducted an actuarial study of the program. The study demonstrated that initially only 10,000 tanks could be insured. The Legislature amended the Trust Fund Act to create a phased-in underwriting approach to provide coverage first to those tanks requiring insurance under federal regulation. To maintain solvency of the Fund, underwriting of farm and heating oil tanks was deferred until sufficient revenues were available.

To operate the insurance program, Idaho created the Petroleum Storage Tank Fund (PSTF) Bureau which performs the underwriting and related functions necessary to issue insurance to eligible UST owners and operators and process claims. To streamline management, accounting, and personnel structures, the PSTF was established within the State Insurance Fund, which administers the workers compensation insurance program. Separate operating accounts ensure there is no co-mingling of monies.

In 1991, after the Fund was established, Idaho set up the Underground Storage Tank Upgrade Assistance Program to assist small business owners in satisfying federal tank upgrade requirements. The Upgrade Assistance Program is a cooperative effort between the Idaho State Treasurer's Office, the U.S. Small Business Administration (SBA), and private financial

institutions. The Program provides owners/operators loans of up to $500,000, at an interest rate of six percent for ten years, to upgrade or replace tank systems or to refinance existing upgrade loans. The loans can also be applied to certain designated cleanup costs which may be required to qualify the tank for insurance.

As of September 1996, Idaho's regulated tank population was 5,729. Of these, the Fund covers 2,909 USTs and 384 aboveground tanks at 1,110 sites, representing 87% of the state's retail marketers. Receipts as of September 30, 1996 from the transfer fee, annual $25 tank application fee, and accrued interest amount to $51,514,812. Operating costs ran $5,707,275; underwriting costs ran $3,713,533, and claims totaled $5,376,753. The current total in the Fund is approximately $36,717,250, with 41 active claims and a cap of $30 million. It is permissible for the Fund to be over its legal cap because it is an insurance company. Enough money is kept in reserve (encumbered) to pay for leaks incurred but not reported. The balance in the Fund which exceeds the cap is unencumbered money.

The Idaho Model

The Idaho Petroleum Clean Water Trust Fund is a bona fide insurance company with the powers and privileges of a non-profit corporate entity operating within the state. However, the Fund must be actuarially sound at all times or suffer revocation of its certificate of registration. Supported by the transfer fee, the Fund can provide insurance coverage to owners and operators for $25 per tank per year, with no annual premium and a $10,000 deductible.

The law established strict eligibility requirements in order for a tank to be insured. Under the Idaho statute, for example, tanks and lines must successfully pass a tank tightness test before owners and operators can obtain insurance through the PSTF. Idaho has established an UST Technician Certification Board to certify contractors to perform these tank tightness tests to determine whether owners and operators meet the eligibility requirements for insurance.

Section 4911 of the Idaho Code provides that eligible storage tanks are those tanks that meet all of the following criteria:

- All application fees have been paid;
- The tank, if an underground storage tank, is in compliance with all applicable federal and state laws and regulations;
- The tank is used only for the storage of petroleum products (not hazardous waste);
- The tank passes a tank tightness test by a certified tank tightness tester;
- The tank, if an aboveground tank, is in compliance with federal and state laws and regulations including the Uniform Fire Code;
- Any existing contamination has been cleaned up or is being cleaned up under the approval of Idaho's Division of Environmental Quality (DEQ).

Additionally, owners and operators who are insured by the Fund are required to remain in

compliance with applicable federal and state regulations. To assure this compliance, the Bureau inspects each insured site at least annually. If a tank is found to be out of compliance, the Bureau gives the owner or operator an opportunity to come into compliance. When there is egregious disregard for the compliance requirements, an owner or operator will be dropped from the Fund.

The law also established criteria for dealing with prior contamination. Basically, a tank can be insured if existing contamination has been or is being cleaned up with DEQ oversight. As noted previously, any cleanup and liability costs associated with prior contamination are excluded. Further, a site with moderate contamination may still be eligible for insurance provided the contamination has not or is not likely to:

- Migrate off the site and contaminate property owned by others;
- Contaminate groundwater;
- Exceed federal or state contamination levels;
- Pose a fire, explosion, or other safety hazard;
- Pose a threat to public health, safety or the environment.

If there is moderate contamination that falls within these guidelines, the tanks at such a site can be insured, but again, cleanup and any liability costs are excluded.

The UST Technician Certification Board also certifies contractors to perform site assessment and remediation work. Contractor certification accomplishes several things for the Bureau:

- It provides a cadre of pre-approved contractors sufficient to support ongoing operations;
- It assures that all work is performed by qualified contractors;
- It allows the Bureau to approve work to be performed using predetermined rate schedules;
- It requires the contractor to provide cost estimates and a project timeline estimating completion date;
- It generates a contract between the Bureau and the contractor approving only services and fees that have been negotiated;
- It generates permit applications, analytical laboratory and field data, reports and other information materials through the contractor's performance of service, thus eliminating the necessity for the Bureau to obtain these documents.

Discussion

Under a state "assurance" fund, owners and operators of eligible tanks are entitled to reimbursement for cleanup of releases. Sometimes assurance funds have large unfunded liabilities which can result in owners and operators having to wait some period of time before their expenses can be reimbursed. In contrast, an insurance company trust fund such as Idaho's has several advantages:

- By design, the Fund is backed by sufficient monies in the State Treasury to fulfill all obligations assumed when insurance contracts are issued. The Idaho Fund is subject to annual audits by the legislative auditors' office and to a comprehensive examination by the Department of Insurance every three years. When a claim is presented, the insured tank owner can be confident that the Fund has the resources to respond to the claim up to the limits set by the federal government.

- The Fund provides coverage on an "occurrence" basis. Once a tank is insured, accidental releases that occur while the policy is in force are covered even if the release is not discovered until a later date. This type of coverage benefits the insured tank owner more so than does insurance written by many private companies which is on a "claims made" basis. Under private insurance only claims that are reported during the life of the policy are covered, unless the policy has been endorsed for an extended reporting period.

- The $10,000 reimbursable deductible allows the Bureau to pay the first dollar of cleanup costs and compensatory damages to third parties for valid bodily injury or property damage. The Bureau and responsible party then work out a repayment schedule for the deductible amount. This policy enables the Bureau to begin cleanup activities immediately and pay cleanup costs as they are incurred.

The eligibility requirements of the Idaho Fund provide a direct link to the December 1998 federal deadline for spill, overfill, and corrosion protection. Several elements work together to advance compliance. First, in order to enter into a contract with the state, owners and operators must comply with all applicable state and federal laws. Thus to obtain or keep their coverage, owners and operators will have to come into compliance with the 1998 deadline as well. Second, the Bureau takes an active "outreach" role by hosting informational workshops throughout the state and by publishing its educational newsletter, "Pipeline." Articles on the 1998 deadline and other compliance issues help owners and operators maintain their coverage. Finally, the 1991 legislation creating the UST Tank Upgrade Assistance Program helps tank owners finance major system upgrades. The availability of this loan program will encourage owners and operators to meet the 1998 deadline.

Because it operates as a business, the Idaho Fund enhances private market activities in a few important ways. For example, because an insurance contract entered into between a tank owner and the state is transferable to a new owner upon sale of the property without any lapse in coverage, the value of property is not jeopardized. In fact, when compared to uninsured tank sites, property values are enhanced. Policies can be assigned to protect the interest of lenders, allowing any property with tanks to be used as collateral for a loan. This is important in light of 1991 legislation which created the UST Tank Upgrade Assistance Program to help tank owners finance major system upgrades. A loan may be used for financing or refinancing tank upgrades or replacement. Loans may also be used for site cleanup which may be required to qualify the tank for insurance under the Fund. If not previously insured, the upgraded or replaced tank must be insured following the improvement.

Lessons Learned

Taken in its entirety, Idaho's Fund legislation creates a system containing few holes or cracks through which a tank owner or operator can fall while attempting to comply with both technical and financial regulations. "Mom and Pop" establishments are able to continue in business because they have opportunities to upgrade their tanks and obtain insurance. The legislation has also helped to increase market activities in related industries involving cleanup contractors, lenders, and realtors.

Recently, however, serious problems have arisen regarding the constitutionality of funding the Idaho program through a transfer fee. Idaho's constitutional law, like that of many other states, requires all gasoline tax revenues be spent only on highway/transportation improvement projects. In 1990, Idaho's Attorney General issued a formal opinion concluding that the transfer fee imposed on petroleum products under the IPCW Trust Fund Act is a fee for actual services rendered and not a gasoline "tax." In 1993, the constitutionality of the transfer fee was challenged in a district court by one marketer, the V-1 Oil Company. In 1994, the judge hearing the case concluded that the transfer fee was, in fact, a tax on motor fuel which is being used unconstitutionally and thus charged unconstitutionally. Upon appeal, the State Supreme Court ruled that the State could continue to collect the transfer fee and operate the Fund until a decision was handed down by the Supreme Court.

In August 1995, the case was brought before the Supreme Court. In a three-two decision, the Court ruled the transfer fee unconstitutional. In September, Fund officials and the Attorney General's Office filed a petition for the State of Idaho and the Legislature seeking to intervene in support of the Fund's request for a rehearing. In April 1996, the Supreme Court heard the case again and this time ruled five-zero that the fee supporting the fund is actually a gas tax and, therefore, unconstitutional. In July, the Court issued a substitute opinion to its previous opinion which stated that it would apply its decision ruling the transfer fee unconstitutional in a "modified prospective fashion." The court concurred that the "reliance of a significant number of individuals and enterprises on the existence of that insurance is very strong," so the decision would not be applied retroactively to those insurance contracts issued to Idaho tank owners prior to the 1995 ruling. The PSTF was not required to forfeit the $35 million already collected for paying claims. The Fund is still actuarially sound and will continue to operate on an interim basis until a permanent legislative source of funding can be provided.

In general, however, the Fund and Upgrade Assistance programs have helped to keep tank owners and operators in business by providing affordable insurance and loans to upgrade their tank systems. By requiring tank systems to comply with all applicable state and federal laws before they are eligible for coverage, the Fund fosters compliance.

The Fund's healthy cash position results in part from earned-interest income. With the interest added to the $.01 per gallon transfer fee, the Fund generates more money than needed to run the program and pay claims. When the Fund reaches its cap or ceiling, collection of transfer

fees can be suspended and then reinstated when funds are depleted.

A drawback of this model is that, like private insurance companies, the Fund does not cover pre-existing or historical contamination. While it is not a cleanup fund and does not operate like one, it does impose regulatory eligibility requirements. As a result, owners and operators who either resist or avoid bringing their tanks into compliance are both uninsurable and in violation of the law, extending the problem that the Fund was set up to solve.

A final concern associated with a state insurance organization like Idaho's is virtual elimination of the private insurance market because of the price differential between the two types of premiums. The state Fund is non-profit and issues premiums that are not risk-based. Private insurance companies operate for profit and must issue policies that are risk-based as required by state insurance regulations. Before private insurance will do much business in Idaho, the Fund will either have to cease to exist or evolve into a program that leaves room for private pollution liability underwriters.

West Virginia Petroleum Underground Storage Tank Insurance Trust Fund

Introduction

In response to federal and state statutes requiring underground storage tank owners/operators to demonstrate financial responsibility, West Virginia passed regulations in 1991 to establish an Underground Storage Tank Insurance Trust Fund. The Fund was developed cooperatively by the West Virginia Petroleum Marketers Association, the Gasoline Retailers, the Petroleum Council, the Department of Natural Resources, and the Board of Risk and Insurance Management (BRIM). The Trust Fund, a state-run insurance liability program, was initially implemented by BRIM, which set the annual premium rates. Today the insurance program falls under the jurisdiction of the WV Division of Environmental Protection (DEP).

The Trust Fund regulations also created a five-member Advisory Committee comprising representatives from both industry and government, including the Director of the DEP and the Insurance Commissioner. The Committee has the authority to review all claims and to function as an appeals board for resolving disputes. The Committee can also direct BRIM to use funds to pay for cleanups when owners and operators demonstrate they are unable to pay costs not covered by the Trust Fund or when the DEP requests the cleanup.

The West Virginia regulations established the Insurance Trust Fund in three phases. Phase I required that all owners and operators, whether participating in the insurance program or not, be assessed a capitalization fee of $100 per tank to develop a "capitalization pool." (If a tank site was purchased from an owner or operator who had already paid the fee, the fee could be transferred to the new owner.) BRIM was granted the legal authority to collect this capitalization

fee three times in order to establish the Fund. That authority has been used twice to date and is not expected to be used a third time.

Phase II of the Trust Fund start-up activities involved collecting individual tank data. Once owners and operators paid the capitalization fee and requested coverage under the Fund, supplemental data forms were completed for each tank owned. Along with the forms, owners and operators paid a $100 per tank insurance deposit premium. In addition, owners and operators must perform tank tightness tests on each tank to be insured no more than 12 months in advance of the effective date of the policy. (While tank tightness tests were not a part of the original mandate, the UST Advisory Committee soon instituted the requirement to avoid insuring leaking tanks.)

During Phase III, BRIM issued policies and billed premiums. BRIM calculated that the "premium pool"--the money collected in premiums--must be maintained at $2 million. Should the Fund go bankrupt and the premium pool be exhausted, the capitalization pool would be used to pay remaining claims.

Money in both the premium and capitalization fee pools accrues interest which is designated by the West Virginia Act to remain in the Fund at the end of each fiscal year and ". . .shall not be transferred to the general revenue fund. . . ." As stated above, BRIM does not expect to collect the capitalization fee a third time because enough interest has been generated on what has been collected to meet the required $2 million baseline in the premium pool. As of April 30, 1996, the capitalization fee pool had a balance of $2,520,180 and the premium pool a balance of $5,877,418 for a combined total of $8,397,598. Claims paid from 1991 through June 3, 1996 totaled $3,401,248.

In addition to the funding mechanisms described above, the insurance program is "assessable" by state statute. If the premium pool falls below $2 million, participating owners and operators can be assessed an equally divided portion of the shortfall. These assessment calculations are based on the money in the premium pool only; they do not include funds collected from the capitalization fee. An early 1989 census estimated West Virginia's tank population between 20,000 and 22,000 tanks. As of March 1996, that population had shrunk to 8,680, and of this number, 4,262 tanks at 1,399 facilities are currently insured by the Fund.

In 1995, West Virginia legislators enacted a law informally referred to as "the Carrier Rule." This bill requires that all drivers making petroleum deliveries to regulated tanks must be shown proof that the tanks are registered with the state and that the owner or operator can show financial responsibility, either through the Fund or with private insurance. Legislators anticipated that compliance with the Carrier Rule would add 2,000 to 3,000 tanks to the Fund. In fact, the number of tanks in the Fund has increased by only 771 since the bill became effective on July 1, 1995. West Virginia officials attribute the lower number of tanks being added to the Fund to an increase in privately written insurance.

Since September 1995, Front Royal Environmental Insurance Management, Inc. (FREIM) has replaced BRIM as third party administrator for the Fund, and BRIM has left the UST insurance business altogether. The third party administrator receives applications, issues policies and cancellations, collects premiums, evaluates claims, and coordinates activities with the Advisory Committee and DEP.

The West Virginia Model

The West Virginia Petroleum Insurance Trust Fund functions as a liability insurance company with the powers and privileges of a non-profit corporate entity doing business within the state. The Fund provides coverage at the federally regulated rate of $1 million per occurrence and $2 million annual aggregate for cleanup and third party liability. Coverage under this program requires owners and operators to comply with all federal and state petroleum UST regulations. Failure to comply voids coverage.

Owners and operators participating in the program pay premiums based on the age of their tanks and the deductible rate they choose. For example, the annual premium for tanks one to four years old with a $5,000 deductible is $340; with a $50,000 deductible the premium becomes $170. For tanks 20 years or older, the lower deductible sets the annual premium at $1,750; with the higher deductible the premium drops to $875. Any tank owner or operator selecting the $50,000 deductible must show proof of financial responsibility for that amount in one of three forms: an irrevocable letter of credit from a bank, supplemental insurance coverage, or a bond. If owners and operators cannot show proof of coverage for the $50,000 deductible, then their policies are automatically renewed at the $5,000 deductible level. The policy year begins on the date the policy is issued by the third party administrator.

In addition to performing a tank tightness test at the time of application, coverage under the Fund requires all owners and operators to:

- Be in compliance with federal or state operational requirements;
- Install overfill/spill prevention devices if two incidents with expenses in excess of the insured's deductible are reported within a twelve-month period;
- Pay the premium when due; and
- Pay deductible expenses when due.

If the Fund cancels a policy, unearned premiums are refunded to the owner or operator on a pro-rated basis. If an owner or operator cancels his insurance policy, the request must also include proof that the insured's tank facility is no longer eligible or required to be insured, or that it is now covered by private insurance.

The Fund's third party administrator maintains a 24-hour toll-free number for claim reporting. When notification of a release is received, coverage is verified and a level of response is decided. If a Level One response is identified, the tank owner is provided with the names of

emergency contractors on an emergency response network. A Level Four notification requires no response.

Regardless of response level, the third party administrator sends an adjuster to the claim site within 48 hours of the notice of release to do an initial investigation. After the site visit, a report is prepared for the UST Advisory Committee summarizing basic facts of the release, identifying any coverage or subrogation issues, and reviewing the potential for third party damages. The report provides the Committee with an opinion on coverage of the claim and an estimate of cost to administer the claim.

The tank owner cannot assume any financial obligations for cleanup without clearance from the Fund. All work plans, proposals, and corrective action plans have to be submitted to the third party administrator for review and approval. It is then determined whether the correct technology is being used, costs are reasonable, and appropriate cost saving alternatives have been considered. Only those proposals representing reasonable and necessary expenses are approved. Claims for third party damages are handled in much the same way as claims for notices of release.

The procedures used by the third party administrator described above simplify review of requests for reimbursement since billings are expected to reflect approved proposals. However, once a reimbursement request is received it again goes through a review process. Each request is completed within 10 working days of receipt and is reviewed for completeness, coverage, and reasonableness.

Tank owners and operators in West Virginia must also pay an annual $50 tank registration fee which is used to fund the UST/LUST program in DEP. West Virginia is divided into six regions, and a DEP inspector will conduct an on-site inspection of every release. RBCA is not used formally. The state relies on groundwater regulations with soil cleanup levels determined on a site-specific basis. The inspector determines the impact of a release. There is no coordination between the UST/LUST and Trust Fund programs beyond that provided in the reports to the UST Advisory Committee by the Fund's third party administrator.

Discussion

Owners and operators who participate in the insurance program meet federal and state financial responsibility requirements. As stated above, to remain in the program, they must also be in compliance with federal and state technical requirements. The insured tank owner in West Virginia is confident that his or her coverage meets the limits set by the federal government.

As in the private insurance industry, coverage is provided on a "claims made" basis. This means that only claims which are reported during the life of a policy are covered, unless the policy has been endorsed for an extended reporting period. (In contrast, coverage on an "occurrence" basis as is provided, for example, by the Idaho Fund, means that releases that occur while the policy is in force are covered even if the release is not discovered until a later date.)

The West Virginia Fund's requirements for coverage provide a direct tie to the December 24, 1998 federal deadline for spill and overfill protection. As stated above, owners and operators who report two release incidents in a 12-month period in excess of their deductible are required to install overfill/spill prevention devices. Some owners and operators may have already brought their tanks into full compliance with the 1998 deadline to ensure that their insurance coverage will not lapse. However, as West Virginia's UST Act prohibits the state from regulating or enforcing requirements more stringent than the federal requirements, early and total compliance with the 1998 deadline becomes purely voluntary on the part of owners and operators. As mentioned above, coverage requires compliance with regulations, including the 1998 upgrading deadline. As a result, owners and operators know they must upgrade to keep coverage after December 1998.

Lessons Learned

Early in the development of the insurance program, the Governor assigned responsibility for program implementation to the BRIM. BRIM was not anxious to undertake the program and, as a result, put few resources into doing so. Data collection and records management were inadequate. In addition, BRIM relied upon adjusters who lacked specific UST knowledge and were thus poorly qualified to review cleanup costs. As a result of these initial difficulties, West Virginia recognized the necessity of identifying and involving all stakeholders before establishing a new program and defining how the process is to be run. The state is now working with the third party administrator to get the program back on track and costs under control. The data management system has been expanded to capture all the elements required by the program. Finally, because the third party administrator has prior UST experience, both the adjusters who perform site visits and their underwriters are equipped with the technical expertise their work requires.

Another lesson lies in the structure of West Virginia's capitalization fee. Unlike Idaho's transfer fee paid on fuel, which was declared unconstitutional by the Idaho Supreme Court, West Virginia's capitalization fee is levied on tanks, not tank contents. Also, since West Virginia's capitalization fee is not an ongoing fee but rather a one, two, or three time assessment, it has not been perceived to be a tax as was Idaho's transfer fee.

Washington's Pollution Liability Insurance Program

Introduction

In 1988, the Washington State Legislature created the Joint Select Committee on Underground Storage Tanks to study and recommend legislation to assist UST owners and operators in complying with federal financial responsibility regulations.

The Committee faced two unique legal issues, which directly impacted the program that would eventually be adopted. On November 8, 1988, Washington voters approved Initiative 97,

which has subsequently been codified as the state's Model Toxics Control Act (MTCA). Administered by the Department of Ecology, the MTCA is patterned on the Federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) as amended by the Superfund Amendments and Reauthorization Act (SARA). MTCA established that the responsibility for cleanup of contamination was solely that of the party responsible for causing the contamination. MTCA established a cleanup fund that provides limited public funding to assist potentially liable persons, but only after a finding that public funding would achieve both "(A) a substantially more expeditious or enhanced cleanup than would otherwise occur, and (B) the prevention or mitigation of unfair economic hardship." These MTCA provisions precluded implementation of a cleanup fund for remediation of petroleum UST releases.

A further constraint that legislators needed to consider in designing a program was a provision in the state constitution that prohibits any state program that directly benefits owners and operators in such a manner that appears to constitute a lending of state credit or a gift of public funds to an individual or company. Therefore, to be protected from constitutional challenge, a state pollution liability insurance program would have to "sell" financial responsibility assurance rather than collect taxes and "give" assurance.

The Washington Model

The legislature chose to meet the objective of providing available and affordable insurance by designing a program in which the state sells reinsurance to pollution liability insurance companies at a price well below the private market price for similar reinsurance. The legislature chose the reinsurance program over competing alternatives for several reasons. First, a reinsurance program would minimize state participation in investigating and settling pollution liability claims. Second, the reinsurance program would minimize state exposure to liability for pollution claims. Finally, the reinsurance program would encourage private insurance company participation, allowing the state eventually to discontinue the program.

The Pollution Liability Insurance Agency (PLIA) was created as an independent state agency to develop and administer Washington's reinsurance program . Under the program, the state assumes part of the risk for each loss, insulating the insurer in case of a large loss. On behalf of the state, PLIA has entered into contracts to act as the reinsurer of three commercial insurance companies. In turn, these insurers are required to provide pollution liability insurance to owners and operators of petroleum USTs located in Washington. The policies must meet the requirements of the EPA and Department of Ecology.

Actuarial studies conducted by PLIA concluded that 80 to 85% of all claims should be settled for an amount under $75,000. In the case of a $1,000,000 policy, for example, PLIA as the reinsurer is responsible for settlements over $75,000. Because the state sells reinsurance to pollution liability insurance companies at a price well below the private market price for similar reinsurance, insurers are required to pass this discount on to owners and operators of petroleum USTs.

PLIA programs and agency administrative expenses are paid from the Pollution Liability Insurance Agency Trust Account. The principal source of funding for the Trust Account is the Petroleum Products Tax, an excise tax of 0.05% on the wholesale value of petroleum upon its first introduction into the state. The excise tax was in effect from July 1, 1989 through June 30, 1992. The state ceased collecting the tax when the Trust Account had reached its statutory limit. As of June 30, 1996, the balance in the Trust Account was $33,387,220. If the cash balance of the Trust Account falls below $7,500,000, the excise tax will be reimposed.

Discussion

The PLIA reinsurance program has been successful in its mission of providing affordable pollution liability insurance to the owners and operators of petroleum USTs. Under the PLIA program, UST operators save approximately 75 to 80% over the premiums they previously paid, or would have paid if they had been insured as currently required. UST owners also enjoy much lower deductibles than were available prior to the PLIA program. When the program began in December 1990, the minimum annual premium for a state-of-the-art UST system was $2500 per site. Today, the premium is $500 per year for one UST, or $1300 per year for a site with up to five state-of-the-art USTs. The maximum premium has been reduced from about $14,000 per site per year to $5,500. Over the past five years, the lower premiums have resulted in direct savings to Washington business operators of more than $27,000,000.

As with any insurance program, premiums directly reflect the risk associated with the site to be insured. A state-of-the-art UST system, including an automated inventory and alarm system, constitutes a very low risk to the insurer. Therefore, owners and operators can expect to pay a minimum premium with a low deductible amount. On the other hand, an UST system that has tanks over 20 years of age, depends on a manual inventory system, and has no cathodic protection or spill and overfill protection is a very high risk. In that case, the owner or operator can expect to pay a high premium.

Community Assistance Grant Program

In 1991, the Washington State Legislature responded to the serious dilemma facing many rural communities in the state which have only a single source, or perhaps two sources, of petroleum. Commerce, emergency vehicles, school buses and similar services depended greatly on these one or two sources. These rural gas stations, however, did not generate the profit necessary to upgrade or replace their underground storage tank systems as required by federal and state statutes. In response to this problem, PLIA was directed to establish the UST Community Assistance Program.

Washington's Community Assistance Program provided grants for the upgrade or replacement of USTs at remote and rural gas stations. To be eligible for a Community Assistance Program grant a station must be rural and remote; the owner must demonstrate serious financial hardship; and the local government entity must certify that the continued operation of the station

is vital to the community for public safety, education, or health reasons. "Rural and remote" was eventually defined to mean that no more than one other retail source of petroleum is located within five miles. Financial hardship was evaluated by an independent small business financial analyst who thoroughly reviewed the financial records of the business. PLIA began processing applications for grants in January 1992. Each grant was limited to $150,000, of which no more than $75,000 could be spent on remediation of contamination. A total of 112 grants was awarded to privately-owned businesses and local government entities; of these, 99 grants were awarded throughout the state to rural gas stations or convenience stores with gasoline sales.

In requiring that the rural gas station provide vital community public safety, education, or health services, the Community Assistance Program avoided the prohibition noted earlier regarding any state program that directly benefits owners and operators in such a manner that appears to constitute a lending of state credit or a gift of public funds to an individual or company. A 15-year real property lien is placed on each business to ensure compliance with service requirements, and a quarterly report of sales to government entities and emergency service units is required.

In evaluating grant applications, PLIA carefully reviewed the financial status of each grant applicant--revenue, taxes, debt service, past and projected sales, etc.--and determined not only financial hardship, but also the viability of the business to remain in operation for a period of 15 years. Such analysis was necessary because if the state were to invest a large sum in improvements to a small business to ensure emergency services, there should be a high probability that the business would survive. Because low-volume service stations are more likely to fail, no grants were awarded to businesses selling less than 120,000 gallons per year.

The Small Business Administration's experience with businesses comparable to those receiving the Community Assistance Grants showed a failure rate of almost 30% within the first five years. In Washington to date, however, only three grant recipient businesses have closed because of financial problems. PLIA is confident that this low failure rate is the direct result of its scrutiny of the financial status of applicants.

PLIA is able to document a significant savings in the grant program because the work proposals of contractors, as well as all change orders, were carefully reviewed and approved prior to execution. Only those costs and expenses judged to be appropriate were approved. As a result, in the execution of 111 contracts totaling $11,500,000, a savings of $1,500,000 was achieved.

Heating Oil Pollution Liability Insurance Program

The 1995 Legislature added an additional program to PLIA's responsibilities: providing pollution liability insurance coverage for the owners of heating oil tanks, whether the owners are homeowners, churches, or small businesses. Heating oil tanks are exempt from EPA and Department of Ecology regulations, but homeowners or small business operators are not exempt

from the liability associated with contamination should there be a leak or release from the tank.

Washington's Heating Oil Pollution Liability Insurance Program began coverage on January 1, 1996. The program is funded by a fee of $0.006 per gallon of heating oil, imposed by the dealers on themselves. PLIA, which administers the program, has purchased insurance from a commercial insurer and is reinsuring the policy from the PLIA Trust Account. During the initial phase of program implementation, PLIA paid particular attention to claims management, including establishment of testing, response, and treatment protocols and developing a group of reliable service providers.

PLIA and its programs are currently scheduled to expire on June 30, 2001. The state must still develop a strategy for making the transition to private pollution liability insurance that considers the advantages and disadvantages of various alternatives, as well as the desires of the legislature and interests of various stakeholders. The state of the commercial pollution liability insurance market, as well as the resolution of a class action suit involving third party claims recently filed in Alabama and other states, will likewise impact plans for program expiration. Any phase-out or transition strategy must also allow for continuing compliance reviews of rural gas stations receiving grants under the Community Assistance Program.

Lessons Learned

When Washington's program was being developed and proposals were sought from the insurance industry for participation in this unique enterprise, response was less than enthusiastic. Over the years, insurance companies had had little contact with state government entities other than legislative oversight committees and the regulatory authority of the state insurance department. Further, involvement with the insurance department usually occurred only if the insurance company was domiciled (licensed) in the particular state. In general, relationships with most state insurance departments tend to be somewhat laissez-faire, focusing on rate changes, annual financial statements, and an audit every few years unless the insurance company is in trouble. To introduce a new, independent state government entity, particularly with the state in the role of reinsurer, was not the sort of thing most traditional and relatively conservative insurance companies wanted to consider, especially in areas as uncertain as pollution liability or environmental impairment liability coverage.

The lesson learned is that if a state is considering a relationship with an insurance company, it must make serious efforts to explain to insurers all aspects of the program: capital availability or requirements, tank population data, actuarial data. As in most business ventures, there is no substitute for personal contact. The experience of Washington, Iowa, Florida, and other states working with the insurance industry over the past several years should make insurers more willing to consider participating and less skeptical of state government involvement.

The traditional role of reinsurer does not normally include involvement in or supervision of underwriting or claims management. PLIA has been in an unusual position of balancing its role as

a reinsurer (normally not proactive) with that of a state agency operating a state-sponsored program, replete with expectations of legislators, stakeholders, and consumers that business be conducted proactively. Underwriting has not proved to be a difficulty, although PLIA has periodically been called upon to resolve issues involving acceptable testing methods, restrictions on the use of statistical inventory reconciliation (SIR), and the like.

Claims management has proved to be a far different matter. With PLIA responsible for such a potentially high amount for each claim (all costs above $75,000), it is imperative that effective cost controls be implemented if the program is to survive financially. Each insurance company has its own system and organization for claims management, and PLIA has been in the position of evaluating the effectiveness of the system. It has been necessary for PLIA to depart from the conventional role of reinsurer to exert influence on the methods and manner of claims management--heavy influence in the case of one insurer, light in the case of another.

The lesson to be learned is not to assume that insurance companies, by definition, have effective, efficient, timely claims management systems. Any program which involves a relationship between the state and an insurance company must pay attention to this area. Although the structure of the Washington program differs from that of states with cleanup funds, in the area of claims management the objective is the same: effective, efficient, timely claims management.

New York State Fund

Background

In 1977, as part of an overall spill response and cleanup program within the state, the New York legislature created the New York Environmental Protection and Spill Compensation Fund to address petroleum releases that threatened surface- or groundwater from any source. The Fund pays for corrective action and property damage costs in the event that the responsible party is unknown, unwilling, or financially unable to perform the cleanup. The Fund was modeled after existing cleanup funds created under the Clean Water Act for use by EPA and the Coast Guard to address spills in navigable waters.

As the December 1993 financial responsibility deadline for small marketers and non-marketers approached, insurance was still relatively expensive and, in some cases, impossible for owners and operators to obtain without immediately upgrading or replacing their tanks. Many small owners were concerned that they would not be able to comply with the financial responsibility requirements. In response to these concerns, the petroleum marketers lobbied to create a state reimbursement or insurance program similar to the funds that other states had designed to cover owners and operators in the event of a leak. A bill was introduced to develop such a fund; however, the legislature ultimately decided against creating a new fund, reasoning that the Spill Compensation Fund already served as an emergency fund to protect human health

and the environment from UST releases. Under the existing Spill Compensation Fund program responsible parties were held liable for the cleanups, but the Fund would step in to clean up a release if the responsible party was unable or unwilling to pay.

New York legislators and Department of Environmental Conservation (DEC) staff believed that the Fund as it currently operated could qualify as an acceptable assurance mechanism under the federal financial responsibility regulations. So in December 1993, New York officially submitted the Fund for approval. EPA subsequently approved the Fund as a partial financial responsibility compliance mechanism providing assurance for cleanup costs and third-party property damage. Owners and operators must satisfy federal financial responsibility requirements for third-party bodily injury through some other means. New York requested approval of the Fund as a mechanism only for marketers with fewer than 99 USTs and for non-marketers with less than $20 million in net worth (Category 3 and 4 tank owners), determining that Category 1 and 2 tank owners would self-insure or use another mechanism, such as insurance or bonding, to meet the requirements.

The New York Model

As noted earlier, New York's Fund is an assurance fund, not an insurance fund. It is a dedicated fund for use by the State for appropriate actions associated with petroleum spills and releases to surface- or groundwater. "Appropriate actions" include coverage of corrective action and property damage costs (including loss of income) in the event that the responsible party is unknown, unwilling, or financially unable to perform the cleanup. When responsible parties can be identified, the DEC attempts to compel them to conduct the cleanup, reserving use of Fund money for instances in which the responsible party is deemed unable or is still unwilling to pay.

When Fund money is used at a site where the responsible party is partially or completely able to pay for the cleanup, New York seeks to recover Fund expenditures, with penalties if warranted. Though the State has an aggressive cost recovery program, it has the flexibility to consider an owner's ability to pay and to structure an appropriate payment plan, in some cases negotiating the settlement based on site-specific and responsible party-specific factors. If the responsible party is able only to pay a portion of the cost, the State can structure a payment plan for an appropriate portion. The Fund attempts to ease the financial burden on owners and operators by providing for payment over time, lien placements, etc.; however, responsible parties must eventually pay what they owe.

New York's Fund is a non-lapsing, revolving fund financed by a $.04 per barrel fee on petroleum imports (assessed on the first transfer of petroleum to a major petroleum facility in the State) as well as by recoveries and penalties on responsible parties. If the balance of the Fund exceeds $25 million, the fee is lifted, to be reimposed when the balance of the fund falls below $20 million or when pending claims exceed 50% of the balance. New York has not increased the fee in a number of years and is currently evaluating the future solvency of the Fund. The increase in costs due to inflation, coupled with the increase in UST releases expected to be reported as

owners and operators comply with the 1998 deadline, may compel the State to raise its fee.

The Fund was created to clean up and remove any discharge or release of petroleum, regardless of its source. This includes aboveground tanks, vehicles, and pipelines, as well as USTs. The Fund covers all USTs containing petroleum, not just federally-regulated USTs. There is no limit on the amount of money the Fund can expend for cleanup activities.

Due to the nature of the Fund, an owner's or operator's compliance with technical requirements is not a factor in including or excluding him from the Fund. Since the Fund is an emergency fund for the protection of human health and the environment, it would not be in keeping with the goals of the Fund to reject a site because of its compliance situation. In fact, the Fund has been in existence since before the State or EPA developed technical requirements for USTs.

Discussion

New York did not create its Fund specifically to address the UST issues that most states deal with in establishing a state fund. Unlike other states, New York was not trying to create a financial responsibility compliance mechanism for owners and operators nor trying to protect small business tank owners. New York established its Spill Compensation Fund years before the UST regulatory program was developed with the goal of creating a safety net to capture petroleum spills and releases.

However, implementation of the UST regulations did bring significant pressure upon New York to assist owners and operators in complying with the approaching financial responsibility deadline. Lacking a state fund, New York owners and operators would have had to find alternative coverage which, in most cases, meant buying insurance. At the time, many of the smaller owners and operators would have needed to upgrade or replace their USTs in order to be eligible for insurance, in effect shortening the compliance lead time from 10 years to five years.

New York considered establishing reimbursement and insurance type programs, but ultimately decided to use the existing Compensation Fund to help owners and operators meet the financial responsibility requirements. A number of considerations figured in New York's decision not to create a new fund. One factor that could not be overlooked was the high cost of a new state fund. Drawing upon the experience of other state funds, New York estimated the real cost of a cleanup fund and recognized that substantial funding would be required to keep such a fund solvent. A number of other questions posed obstacles to creating a new state fund:

- How does government finance the cost of individual liability for cleanup and third-party damages?
- Should the new state program extend to home heating oil spills and other non-UST releases?
- How can the state assure that no abuses of the program would occur?

- Would the state's assumption of cleanup responsibility be a disincentive to good environmental stewardship by tank owners?

The various problems associated with establishing a new fund, weighed with the financial hardship that would be imposed on owners and operators if a state fund were not created, led New York to submit its existing Fund to EPA for approval. The State concluded that the Fund could reasonably address federal financial responsibility requirements and still meet its intended goal: environmental protection.

Submission of the Fund for approval had no real impact on its operation or use, but did relieve owners and operators from the financial responsibility requirement. The decision on whether or not to buy insurance was thus left to the owner/operator. Since the Fund does not insure owners and operators against cleanup and liability costs, buying insurance is still a sound business decision. Though the Fund obviates the need for insurance to meet regulatory obligations, the DEC still encourages owners and operators to obtain insurance and has taken steps to assist them in this endeavor.

Though tank owners lobbied for a reimbursement fund and would still like New York to create one, they were satisfied with the decision to use the existing Fund. While, as noted earlier, owners and operators have the legal obligation to pay all expended costs and damages, the Fund is able to finance part, most, or even all of a cleanup if the owner/operator is unable to pay. So even though the Fund is intended as an emergency environmental protection fund, the flexibility built into its cost recovery program has made it possible in many cases to save owners and operators from financial ruin.

Lessons Learned

Thus far, the primary lesson New York has learned is that its approach to protecting the environment works. If a state's goal is to protect human health and the environment and not necessarily to assist owners and operators with cleanup costs, this version of state fund can be and has been successful. A program modeled on New York's Fund may be a good fall-back program for states looking to reduce their financial burden while still maintaining an environmental safety net.

New York suggests making the fund broad enough to cover all tanks, and even all petroleum releases, because the federal regulations exclude a large percentage of the petroleum storage and transportation industry (such as heating oil tanks and trucks). New York officials believe such a comprehensive program provides a more realistic approach to protecting the environment.

Finally, for this program to be successful, it must be adequately funded and staffed, especially as 1998 approaches. Though this type of fund requires lower funding, it must still be kept solvent.

Chapter 4

Conclusions

A number of states are beginning to consider whether to make a transition from their state fund to other assurance mechanisms. Some have already begun the transition process. According to the most recent survey completed by the Association of State Underground Storage Tank Cleanup Funds, 14 states have set dates after which they will no longer cover new releases. Ten of these dates fall before the year 2000. Thus, we can expect more states to make transitions in the near future.

Some states may never make a transition, due in part to the support of owners and operators who are satisfied with their state funds. Some state fund administrators, including several representing smaller states, are concerned that insurance companies will focus their efforts on larger states with larger and potentially more lucrative tank populations. They fear that as a result, owners and operators in smaller states may not be as well served as their counterparts in larger states. In addition, some administrators as well as tank owners and operators are concerned that insurance rates will increase when the competition offered by state funds disappears. Still others wonder if commercial insurance providers will offer adequate coverage for sites with historic contamination that are or will be undergoing cleanup under coverage provided by a state fund. Certainly these and other issues will be addressed in the years ahead as more states make a transition from state funds to other mechanisms. In time, a track record will be established that can help states judge for themselves whether such a transition makes sense.

Already the limited experience of states with funds currently in transition has been educational. Among the lessons that stand out is the need for state funds to develop a clear idea of how the transition should proceed, to communicate that idea to stakeholders and obtain their active support, and to use that support to "sell" the transition plan to state officials in both administrative and legislative positions. Thus far, states have designed somewhat different approaches to transition although, in general, they are gradually phasing out their coverage and allowing owners and operators to choose among the other financial responsibility options, most notably commercial insurance. While some owners and operators are large enough to self-insure and some will choose one of the other financial responsibility mechanisms, most owners and operators will turn to commercial insurance. As states gain more experience with transition processes, a larger base of experience will be available to those states that will make a transition near or after the turn of the century. In the future, states can draw upon this base as they decide whether to make a transition and, if so, how best to accomplish it.

As the preceding case studies indicate, state fund administrators can take various avenues to position their funds for the potential changes that they face. Obviously, not all the information included here will be relevant to every state, and state fund administrators will need to evaluate the specific transition issues facing their funds. The Office of Underground Storage Tanks

(OUST) hopes that this document has provided ideas and insights that state fund administrators can use to help make decisions about the future of their funds. To continue to provide state fund administrators with the most current information, OUST plans to reissue this document periodically as more is learned about how states are making transition decisions and implementing transition strategies.

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