

ARTICLES

Financial Responsibility Assistance for Underground Storage Tanks: Can Washington State Run a Pollution Reinsurance Company?

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I. INTRODUCTION

In 1986, Congress passed the Superfund Amendments and Reauthorization Act (SARA).¹ In part, Congress directed the Environmental Protection Agency (EPA) to adopt regulations requiring owners or operators of petroleum underground storage tanks (USTs) to maintain financial responsibility for "taking corrective action and compensating third parties for bodily injury and property damage caused by sudden and nonsudden accidental releases from operating an underground storage tank."² In other words, owners or operators of USTs must

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1. Superfund Amendments and Reauthorization Act of 1986 (SARA), 42 U.S.C. §§ 9601-9657 (1986) amended Subtitle I of the Resource and Conservation and Recovery Act of 1976 (RCRA) 42 U.S.C. §§ 6901-6987 (1976), as amended by the Hazardous and Solid Waste Amendments of 1984 (HSWA), 42 U.S.C. §§ 6901-6991 (1984).

2. 42 U.S.C. § 6991b (c)(6) (1982 & Supp. IV 1987). The following USTs are exempt from the financial responsibility regulations:

- (1) Any UST system holding hazardous wastes listed or identified under Subtitle C of the Solid Waste Disposal Act, or a mixture of such hazardous waste and other regulated substances.
- (2) Any wastewater treatment tank system that is part of a wastewater treatment facility regulated under Section 402 or 307(b) of the Clean Water Act.
- (3) Equipment or machinery that contains regulated substances for

demonstrate that they have an EPA approved source of funds to pay clean-up costs and to compensate third parties for petroleum leaks.

Owners and operators of USTs can meet these financial responsibility requirements through a variety of methods: "insurance, guarantee, surety bond, letter of credit, qualification as a self-insurer,"³ or participation in an EPA approved state financial responsibility program.⁴ In addition, the different methods may be used in combination to meet financial responsibility requirements. Whatever method is used, the minimum level of financial responsibility is set at one million dollars per occurrence, per release or leak. The EPA may set lower limits of financial responsibility, however, for owners and operators of tanks without large capacity who are not engaged in producing, refining, or marketing petroleum products.⁵

As a last resort, if the EPA determines that statutorily recognized methods of financial responsibility are generally unavailable, the EPA may suspend enforcement of financial responsibility requirements in a particular state for periods not exceeding 180 days.⁶ But, the EPA must also find that "steps are being taken to form a risk retention group . . . or . . . such state is taking steps to establish a fund [that will provide financial responsibility]."⁷

On October 26, 1988, the EPA published its final regula-

operational purposes such as hydraulic lift tanks and electrical equipment tanks.

(4) Any UST system whose capacity is 110 gallons or less.

(5) Any UST system that contains a "de minimis" concentration of regulated substances.

(6) Any emergency spill or overflow containment UST system that is expeditiously emptied after use.

40 C.F.R. § 280.10(b) (1989)

Other USTs that are exempt from the financial responsibility regulations include UST systems containing radioactive wastes and materials, 40 C.F.R. § 280.10(c)(2); field-constructed tanks, 40 C.F.R. § 280.10(c)(5); backup diesel tanks at nuclear facilities, 40 C.F.R. § 280.10(d); airport hydrant fueling systems, 40 C.F.R. § 280.10(c)(4); heating oil tanks, 40 C.F.R. § 280.12 (1989); USTS owned by state and federal government entities whose obligations are the obligations of a state or the United States, 40 C.F.R. § 280.90(e) (1989).

3. 42 U.S.C. § 6991b (d)(1) (1982 & Supp. IV 1987).

4. 42 U.S.C. § 6991b (d)(1)(D)(ii).

5. 42 U.S.C. § 6991b (d)(5).

6. 42 U.S.C. § 6991b (d)(5)(D).

7. *Id.*

tions governing financial responsibility.⁸ The regulations establish different financial responsibility limits and compliance deadlines for various classes of owners and operators.⁹ Owners or operators who market petroleum¹⁰ or who handle an average of more than 10,000 gallons of petroleum per month must have financial responsibility limits of \$1 million per occurrence.¹¹ All other owners and operators must have per occurrence limits of \$500,000.¹² Owners and operators must have an annual aggregate limit of \$2,000,000 if more than 100 tanks are owned or operated,¹³ and \$1,000,000 if less than 100 tanks are owned or operated.¹⁴

Petroleum marketing firms must be in compliance with the financial responsibility regulations by January 1989 if more than 1000 tanks are owned,¹⁵ by October 1989 if 100-999 tanks are owned,¹⁶ by April 1991 if 13-99 tanks are owned,¹⁷ and by October 1991 if 1-12 tanks are owned.¹⁸ A non-marketing owner must comply by January 1989 if the owner has a net worth of more than \$20,000,000.¹⁹ All other non-marketing owners, including local governments, must comply by October of 1991.²⁰

Despite the variety of methods available to satisfy EPA financial responsibility regulations, few owners or operators have the financial resources necessary to satisfy the self-insurance standards or have a parent or similar company willing to issue a guarantee that conforms to regulations.²¹ Few, if any,

8. 53 Fed. Reg. 43,322-383 (1988) (to be codified at 40 C.F.R. §§ 280-281).

9. 53 Fed. Reg. 43,346-353 (1988) (to be codified at 40 C.F.R. § 280.97).

10. Marketers are defined as those owners and operators whose tanks are located at a petroleum marketing facility. 40 C.F.R. § 280.92(j) (1989). Petroleum marketing facilities include "all facilities at which petroleum is produced or refined and all facilities from which petroleum is sold or transferred to other petroleum marketers or to the public." 40 C.F.R. § 280.92(i).

11. 40 C.F.R. § 280.93 (a)(1). Occurrence is defined as "an accident, including continuous or repeated exposure to conditions, which results in a release from an underground storage tank." 40 C.F.R. § 280.92(g).

12. 40 C.F.R. § 280.93 (a)(2).

13. 40 C.F.R. § 280.93 (b)(1).

14. 40 C.F.R. § 280.93 (b)(2).

15. 40 C.F.R. § 280.90(a).

16. 40 C.F.R. § 280.90(b).

17. 40 C.F.R. § 280.90(c).

18. 40 C.F.R. § 280.91(d). The year of compliance was extended from 1990 to 1991 by the EPA on March 15, 1990. See 55 Fed. Reg. 24,693.

19. 40 C.F.R. § 280.91(a).

20. 40 C.F.R. § 280.91(d).

21. General Accounting Office, Report to Congress No. GAO/RCED-88-39, SUPERFUND Insuring Underground Petroleum Tanks, at 35-6 (1988) [hereinafter

financial institutions or other corporations will issue a surety bond or letter of credit conforming to EPA regulations.²² Therefore, most owners and operators will be forced to purchase insurance or similar coverage from a risk retention group unless a state fund is available.²³

Unfortunately, financial responsibility coverage through insurance companies and risk retention groups has become less rather than more available in the past year because of several factors. First, the cost of such insurance is very high. Second, owners and operators have difficulty in qualifying for coverage. Third, a few major providers of pollution liability coverage have withdrawn from the insurance market.²⁴ Given the inability of owners and operators to comply with financial responsibility regulations, Washington state owners and opera-

GAO Report]. The financial requirements are specified at 40 C.F.R. §§ 280.95 and 280.96.

22. GAO Report, *supra* note 21, at 39-40. The GAO Report concluded:

Because of the gaps in coverage and the currently limited availability, methods other than insurance may not provide tank owners and operators with adequate alternatives to insurance for complying with UST financial responsibility requirements at this time. As a result, the majority of tank owners may be faced with the dilemma of how to comply with the impending financial responsibility requirements.

Id. at 43.

23. Risk retention groups were created and authorized by Congress under the Risk Retention Act of 1981, 15 U.S.C. § 3901-06 (1989). The Act authorizes the formation of entities that operate in a fashion similar to insurance companies but exempt the entities from most state insurance regulations. The Act generally permits commercial and pollution liability risks to be transferred to a risk retention group that is owned by the persons covered. A risk retention group must comprise owners with similar risks and a group cannot sell coverage to the public. See General Accounting Office, Report HRD-86-120BR, "Insurance: Activity Under the Product Liability Risk-Retention Act of 1981," July 1986.

24. In February 1990, Petromark, a pollution liability risk retention group and major issuer of pollution coverage, discontinued writing coverage after it was placed under Tennessee state supervision. The group's actuary projected that the group had a negative net worth of \$10.5 million as of December 31, 1989 as a result of loss forecasts. Letter from Scott F. Blankenship, President of Petromark, to policyholders (February 8, 1990) (copy on file with the University of Puget Sound Law Review) [hereinafter *Petromark Letter*].

Additionally, Federated Mutual, an insurance company and a major insurer of underground storage tanks, has significantly increased insurance rates after unexpected losses. *Oil Express*, Dec. 12, 1988, at 2.

In January 1990, Environmental Protection Insurance Company, a major risk retention group, discontinued business. *Pollution Liability News*, January 15, 1990, at 4. Other insurance companies are expressing an interest in entering the pollution insurance market and some have recently announced plans to market coverage. *Crittenden Excess & Surplus Insider*, January 29, 1990, at 2-3. However, this availability of coverage does nothing to assist owners and operators if the price for coverage is too high.

tors sought creation of a state program of financial responsibility assurance.²⁵

This Article reviews Washington state efforts to create a state financial responsibility assurance program; it analyzes EPA financial responsibility regulations; it examines the risks associated with insuring underground petroleum storage tanks; and it assesses the problems and merits of the state pollution liability insurance program as a potential solution to owner and operator financial responsibility needs. The Article concludes that the Washington program reflects the best efforts of the legislature to compromise the competing interests of the public, owners and operators of USTs, and environmental groups. If pollution insurers bargain in good faith with the state, the program will succeed in creating an affordable pollution insurance market in Washington while creating a profitable business opportunity for insurers.

II. PROGRAM DEVELOPMENT

In 1988, the Washington State Legislature created the Joint Select Committee on Underground Storage Tanks to study and recommend legislation to assist owners and operators of USTs in complying with federal financial responsibility regulations.²⁶ In the months before the 1989 legislative session, the Joint Committee met, in part to consider various proposals to create a financial responsibility insurance program for owners and operators.²⁷ The Committee sought to answer three basic questions: first, the kind of insurance coverage the state is being asked to provide; second, its cost; and third, the manner in which it should be provided.

25. See Independent Business Assoc. of Washington Report (1988) (copy on file with the University of Puget Sound Law Review).

26. 1988 Wash. Laws, ch. 215 § 3(4). The legislation directed the Committee to make recommendations on

the advisability of and methods for establishing an owner and operator funded program that assures compliance with the federal requirements and which limits the state's liability, including the advisability of state administration of risk retention pools designed to provide financial responsibility for owners and operators who cannot obtain adequate and reasonably priced private insurance.

Id.

27. "Issues—Underground Storage Tank Bill," memorandum from Bonnie Austin, Counsel, to House Environmental Affairs Committee, to Representative Roy Ferguson and Senator Mike Kriedler, Chairmen of the Joint Select Committee on Underground Storage Tanks (August 11, 1988) (copy on file at the University of Puget Sound Law Review).

A. Financial Responsibility Insurance Coverage

Obviously, Washington state could choose to reject any request for pollution insurance coverage assistance. However, if the state provides such assistance, the amount and kind of insurance coverage that the owner or operator requires must meet EPA regulations. EPA financial responsibility regulations establish the qualifying standards for any contract, agreement, or insurance policy which will serve as proof of compliance with financial responsibility assurance.²⁸ These regulations hold a state program to the same standards that are applied to other methods of obtaining financial responsibility assurance.²⁹ Thus, a state program providing complete financial responsibility assurance must cover owner or operator liabilities at least to the same extent as an insurance company issuing a qualifying pollution liability policy.

Owners or operators of petroleum USTs "must maintain evidence of all financial assurance mechanisms used to demonstrate financial responsibility"³⁰ Evidence of financial responsibility must conform word for word to the certification form adopted by the EPA for each method of assurance.³¹ These forms incorporate the required terms and conditions of financial responsibility coverage.³² However, the EPA recognized that too narrowly defined terms and conditions would conflict with and potentially kill private insurance as a method of financial responsibility assurance, the method most owners or operators will use.³³

An insurance policy meets EPA standards if it covers the insured's liability for corrective action, and third party bodily injury and property damage "caused by accidental releases arising from the operation of USTs."³⁴ Coverage limits must

28. 40 C.F.R. § 280 (1989).

29. 40 C.F.R. § 280.101(a). An owner or operator may satisfy EPA financial responsibility through a state assurance program "if the Regional Administrator determines that the state's assurance is at least equivalent to the financial mechanisms specified in this subpart." *Id.*

30. 40 C.F.R. § 280.107(a).

31. 40 C.F.R. § 280.107(b).

32. *Id.*

33. 53 Fed. Reg. 43,348-49. "The Agency recognizes that insurance and state financial assurance programs are likely to be the most feasible mechanisms for most owners and operators to comply with [the financial responsibility regulations]." *Id.* at 43,325. Therefore, the EPA declared as one of its goals "the need to preserve flexibility in policy specifications to allow insurers to develop acceptable policies." *Id.* at 43,348.

34. 40 C.F.R. § 280.97 (b).

be exclusive of defense costs and in an amount appropriate for the owner or operator insured.³⁵ Coverage may be provided on a claims-made basis and must offer a six month extended reporting period.³⁶ The policy may be cancelled only after the insured receives 60 days prior written notification of cancellation,³⁷ or 10 days notice in the case of cancellation for nonpayment of premiums.³⁸ Finally, the insurer must provide coverage within the policy limits without regard to the insured's payment of any deductible³⁹ and without regard to the insured's bankruptcy or insolvency.⁴⁰

Each of these elements of coverage are partially defined in the financial responsibility regulations.⁴¹ Coverage for accidental releases must include both sudden and nonsudden releases "neither expected nor intended by the tank owner or operator."⁴² As noted earlier, regulatory definitions were intended

35. 40 C.F.R. § 280.97. The EPA did not want coverage limits for corrective action to be reduced by defense costs. However, "the insurer is free, as many insurers are currently doing, to limit defense costs in some way outside of policy limits." 53 Fed. Reg. 43,352 (1988). On November 9, 1989, the EPA published an interim final rule amending the certification of financial responsibility form required for insurance policies by requiring the form to indicate that legal defense costs are subject to a separate limit of coverage. 54 Fed. Reg. 47,081 (1989).

36. 40 C.F.R. § 280.97(b)(1)2. e. Claims-made as compared to "occurrence" policies eliminate the "long tail" of insurance company exposure to claim losses by requiring a loss to occur and be reported during the policy period. Occurrence based policies require only that the loss occur during the policy period. The EPA extended reporting period requires companies issuing claims-made policies to permit the insured an additional six months after the policy period to report a claim that occurred during the policy period. See 53 Fed. Reg. 43,349-50 (1988).

37. 40 C.F.R. § 280.97(1)2. d.

38. 54 Fed. Reg. 47,082 (1989) (to be codified at 40 C.F.R. § 280.105 (a)(2)).

39. 40 C.F.R. § 280.97(1)2. b.

40. 40 C.F.R. § 280.97(1)2. a. Because an insurance company will be responsible for the policyholder's deductible, insurers will need to examine a prospective policyholder's ability to pay a deductible in order to guarantee that the insurer will be able to recover the deductible amount from the policyholder. Insurers will be reluctant to provide insurance with a high deductible and corresponding reduction in premium if the insurer would be stuck with paying the deductible. In some instances, an insurer would be better advised to charge a high premium with a very low deductible or to require the policyholder to formally set aside or segregate the deductible amount from the policyholder's assets in a manner guaranteeing payment of the deductible. See 53 Fed. Reg. 43,349 (EPA discussion of first dollar coverage).

Third party claims and corrective action claims may be asserted directly against an insurance company "[i]n any case where the owner or operator is in bankruptcy, reorganization, or arrangement pursuant to the Federal Bankruptcy Code or where with reasonable diligence jurisdiction in any State court of the [sic] Federal Courts cannot be obtained over an owner or operator likely to be solvent at the time of judgment" 42 U.S.C. § 6991b(d)(2) (1982 & Supp. VI 1988).

41. 40 C.F.R. § 280.92 (1989).

42. 40 C.F.R. § 280.92 (a). Thus, the EPA regulations require coverage of gradual

to coincide with standard insurance industry usage to avoid conflict with existing pollution liability insurance policies. The EPA went so far as to include this philosophy in a note to the definition of "occurrence":

This definition is intended to assist in the understanding of these regulations and is not intended to limit the meaning of "occurrence" in a way that conflicts with standard insurance usage or to prevent the use of other standard insurance terms in place of "occurrence."⁴³

Despite this reticence, the EPA reserved the right to develop more specific coverage standards in the future.⁴⁴

In contrast, corrective action is not defined in the financial responsibility regulations. In the preamble to the regulations, the EPA notes that "corrective action coverage will be required only for cleanup of releases required by [40 CFR subpart F and section 280.72] of the technical standards or ordered by the implementing agency."⁴⁵ Assuming the EPA approves

pollution. Before liability insurance companies amended their comprehensive general liability policy forms in the mid-eighties to exclude pollution claims absolutely, policies covered pollution "if such discharge, dispersal, release or escape is *sudden* and *accidental*." *United Pac. Ins. v. Van's Westlake Union*, 34 Wash. App. 708, 712, 664 P.2d 1262, 1265 (1983) (emphasis added). The *United Pacific* court held that this pollution exclusion did not exclude third party claims caused when an underground pipe at a gas station leaked 80,000 gallons of gasoline over a three month period. *Id.* See also Brett, *Insuring Against Superfund*, 6 J. OF ENVTL. L. 1, 47-48 (1986); Cross, *Hazardous Waste Insurance Law, The Quest for Coverage*, 28 NEW HAMPSHIRE B. J., 245, 249-51 (1987) [hereinafter *Hazardous Waste Insurance Law*].

The EPA decided not to address the meaning of such words as "expected" or "intended" in the definition of accidental release because such words are common to insurance policy definitions and "interpretation of such terms [should be left] to private insurance law." 53 Fed. Reg. 43,334 (1988).

43. 40 C.F.R. § 280.92 (g). An occurrence includes "continuous and repeated exposure to conditions, which results in a release from an underground storage tank." *Id.* However, insurers are free to use any phrase of choice to describe the coverage triggering event, e.g. "pollution incident." 53 Fed. Reg. 43,333 (to be codified at 40 C.F.R. § 280.92).

44. 53 Fed. Reg. 43,334. "The Agency has the authority under RCRA [42 U.S.C.] § 9003(d)(1) to specify acceptable and unacceptable liability insurance policy terms in the future." *Id.*

45. 53 Fed. Reg. 43,348 (to be codified at 40 C.F.R. § 280.97). Subpart F of the technical regulations governs owner or operator initial response action, 40 C.F.R. § 280.61; initial abatement measures and site check, 40 C.F.R. § 280.62; initial site characterization, 40 C.F.R. § 280.63; free product removal, 40 C.F.R. § 280.64; investigations for soil and ground-water cleanup, 40 C.F.R. § 280.65; and corrective action plans, 40 C.F.R. § 280.66. Corrective action may also be required under subpart F if the site assessment required at the time of site closure or a change in the service status of the tanks reveals contamination. 40 C.F.R. § 280.72.

Site assessments mandated by § 280.72 should be excluded by an insurer to avoid

of Washington's underground storage tank regulatory program, the implementing agency will be the Washington State Department of Ecology (Department of Ecology).⁴⁶

These corrective action regulations provide only an outline of owner and operator liability and thus, create difficulty for insurers who must predict the costs of providing corrective action coverage. Insurers must cover the costs of corrective action that are necessary to "protect human health and the environment."⁴⁷ This open-ended requirement includes initial action to stop any leak,⁴⁸ contain the damage,⁴⁹ and conduct a site assessment;⁵⁰ action to recover petroleum;⁵¹ and action to develop⁵² and implement a cleanup plan.⁵³ Moreover, EPA corrective action requirements serve only as baseline standards that can be enlarged by the Department of Ecology.⁵⁴

Ultimately, insurance claim payments for corrective action will be partially determined by the skill and aggressiveness of the insurance company in negotiating with the Department of Ecology for a settlement agreement covering corrective action

any question as to whether a policy affords coverage of these costs. Such costs are routine maintenance costs that may be excluded. 53 Fed. Reg. 43,348 (to be codified at 40 C.F.R. § 280.97). Some pollution liability insurers cover the costs of a site assessment when the assessment reveals contamination covered by the policy. For example, Petromark's policy, which was filed with the Washington State Insurance Commissioner's Office, excludes from the definition of covered "damages," the costs of "testing for a suspected Environmental Impairment if the results of the testing indicate that there has been no Environmental Impairment." Petromark Insurance Company, Policy Form and Rating Plan in Effect as of February 9, 1988, Policy Form, § II B(3)(d) (copy on file with the University of Puget Sound Law Review).

46. To gain EPA approval, a state underground storage tank regulatory program must be "no less stringent than the corresponding federal [UST regulations]" and the state "must also demonstrate that it has a program that provides adequate enforcement of compliance with these requirements." 40 C.F.R. § 281.11(b).

47. 42 U.S.C. § 6991b(a) (1982 & Supp. V 1987).

48. 40 C.F.R. § 280.61(a)(2) (1987).

49. *Id.*

50. *Id.*

51. *Id.*

52. 40 C.F.R. § 280.63(c).

53. 40 C.F.R. § 280.64(c).

54. 40 C.F.R. § 280.61(c). Each of the corrective action sections of the EPA technical regulations grant authority to the state implementing agency to supersede, enlarge, and otherwise apply corrective action standards. *Id.* For example, EPA requirements for owner and operator initial abatement measures are preceded by the conditioning phrase "unless directed to do otherwise by the implementing agency." 40 C.F.R. § 280.62(c) (1987). The only standards that owners and operators must follow and that may not be changed by the implementing agency are those concerning initial response to a leak, 40 C.F.R. § 280.61(a) (1987); and those concerning product removal from the environment, 40 § C.F.R. 280.64.

liability.⁵⁵ This skill will be particularly important in devising cleanup plans that require a "site specific" approach taking into consideration both developing cleanup technology and site environmental factors.⁵⁶ Incompetence in devising such plans will result in greater than necessary expenditures to satisfy cleanup standards. However, insurers issuing liability policies in Washington will remain in the dark as to their exposure to liability for corrective action until the Department of Ecology clarifies the state policy approach to cleanup by adopting rules governing cleanup standards and negotiating several UST cleanups.⁵⁷

Even after the Department of Ecology establishes such cleanup standards, the insurer must consider how it will treat the liability that could arise if "factors not known at the time of entry [into] the settlement agreement are discovered and present a previously unknown threat to human health or the environment."⁵⁸ To add another complication to determining the extent of corrective action coverage, the owner or opera-

55. The Model Toxics Control Act allows owners and operators to settle their liability under the Act by consent decree. WASH. REV. CODE § 70.105D.040(4)(b) (1989). To obtain the consent decree, the Department of Ecology must find, after public notice and hearing, that the "proposed settlement would lead to a more expeditious cleanup of hazardous substances in compliance with cleanup standards" WASH. REV. CODE § 70.105D.040(4)(a) (1989).

56. 53 Fed. Reg. 37,174 (to be codified at 40 C.F.R. §§ 280.60-280.70). Cleanup plans must consider the following site factors:

- (1) The physical and chemical characteristics of the regulated substance, including its toxicity, persistence, and potential for migration;
- (2) The hydrogeologic characteristics of the facility and the surrounding area;
- (3) The proximity, quality, and current and future uses of nearby surface water and ground water;
- (4) The potential effects of residual contamination on nearby surface water and ground water;
- (5) An exposure assessment; and
- (6) Any information assembled in compliance with this subpart.

40 C.F.R. § 280.66.

57. On January 3, 1990, the Department of Ecology published proposed rules implementing the state Model Toxics Control Act which also governs petroleum releases, 90-91 Wash. St. Reg., at 225 (WSR 90-02-098). On March 9, 1990, the Department of Ecology issued draft cleanup standards for hazardous substances. On March 22, 1990, the Department of Ecology issued draft corrective action standards for USTs to be incorporated into the proposed corrective action regulations under the Model Toxics Control Act. These new UST rules are intended to meet EPA standards for delegation of UST regulatory responsibility to the state and to duplicate EPA UST corrective action regulations. Memorandum from Phyllis Baas to the Department of Ecology Cleanup Standards Advisory Committee (March 22, 1990) (copy on file with the University of Puget Sound Law Review).

58. WASH. REV. CODE § 70.105D.040(4)(c). Every settlement agreement must contain this liability reopener provision. *Id.*

tor's permanent potential liability for these factors defeats the purpose of claims-made insurance policy forms, which is to eliminate the need for long term claim reserves.⁵⁹ While the lack of a clearer definition or explanation of corrective action generates uncertainty, the EPA attempted to limit uncertainty by establishing some definitional standards for other aspects of coverage.

For example, the EPA provided limited definitions for "bodily injury"⁶⁰ and "property damage."⁶¹ These terms are subject to state law interpretations except for those liabilities traditionally excluded by insurers.⁶² The EPA expressed concern that uniform national definitions would create confusion and complications if lawsuits were brought in state courts by third party claimants requiring a judicial review of both national and state definitions of these terms.⁶³ However, the EPA prohibited property damage coverage exclusions related to corrective action.⁶⁴

States are split over the question of whether comprehensive general liability policy definitions of property damages include the cost of correction action.⁶⁵ Insurers have long argued that property damages do not include costs related to government ordered corrective action because corrective action costs are injunctive or restitutionary in nature.⁶⁶ In Washington, this argument was settled when the state supreme court held that "response costs in response to actual releases of haz-

59. If the insurance policy treats a potential reopened claim as a claim that has been previously reported, the insurer must calculate the probability of future corrective action and must reserve accordingly. If the insurance policy treats a potential reopened claim as a new claim requiring the owner or operator to have coverage at the time the claim is reopened, the insurer faces renewed exposure to policy limits. Of course, this discussion presumes that that an insurer will have the option of drafting a policy that treats reopened claims as new claims and presumes such policy terms would be sustained if challenged by an owner or operator.

60. 40 C.F.R. § 280.91 (1987).

61. *Id.*

62. *Id.*

63. 53 Fed. Reg. 43,334 (to be codified at 40 C.F.R. § 280.92).

64. 40 C.F.R. § 280.92 (k).

65. For cases holding that damages do not include cleanup costs see: *Maryland Casualty Co. v. Armco Inc.*, 822 F.2d 1348 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988); *Continental Insurance Co. v. Northeastern Pharmaceutical ("NEPACCO")*, 842 F.2d 977 (8th Cir. 1988). For cases holding that damages include cleanup costs see *New Castle v. Hartford Accident and Indemnity Co.*, 673 F. Supp. 1359 (D. Del. 1987); *United States Fidelity and Guaranty Co. v. Thomas Solvent*, 683 F. Supp. 1139 (W.D. Mich. 1988).

66. See *Hazardous Waste Insurance Law*, *supra* note 42, at 252-55.

ardous wastes are 'damages' within the meaning of [comprehensive general liability] coverage clauses at issue."⁶⁷ Perhaps in anticipation of insurers' attempt to redefine property damage to clearly exclude corrective action costs, the EPA prohibited such exclusions in policies issued for compliance with the financial responsibility regulations.⁶⁸

The EPA did not directly address allowable insurance policy exclusions. As a result, the acceptability of particular policy exclusions must be inferred from EPA's explanations of its regulations. For example, many pollution liability insurance policies exclude coverage of on-site cleanup costs.⁶⁹ While the regulations do not explicitly prohibit on-site cleanup exclusions, policies that contain such an exclusion do not qualify as a method of financial responsibility assurance under the EPA regulations.⁷⁰ Despite this overall uncertainty, some exclusions are indirectly allowed by EPA regulations addressing other forms of financial responsibility assurance.⁷¹

Regulations governing financial responsibility assurance through the use of guarantees, letters of credit, surety bonds, and trust funds incorporate five specific exclusions.⁷² These forms of financial responsibility assurance have no generally accepted private market counterparts that can be relied upon to provide guidance concerning standards, terms, and conditions related to pollution liability exposure.⁷³ Unlike the

67. *Boeing v. Aetna Casualty & Surety Co.*, 113 Wash. 2d 869, 887, 874 P.2d 507, 516 (1990).

68. 40 C.F.R. § 280.92(k).

69. 53 Fed. Reg. 43,361.

70. The EPA notes in the preamble to the regulations that since liability for corrective action does not differentiate between owned and non-owned property, "the Agency is requiring that on-site corrective action be covered by all financial responsibility mechanisms . . ." 53 Fed. Reg. 43,348.

A puzzling aspect of the EPA's discussion of on-site cleanup is the statement that the "EPA is not mandating that acceptable insurance policies cover response actions that are part of routine maintenance of the tank site, *site restoration* and enhancement." *Id.* (emphasis added). What does the EPA mean when it says that insurers need not cover site restoration? More importantly, what happens to an insurance company's liability under a policy containing a limited exclusion for certain kinds of cleanup and the implementing agency requires cleanup which conflicts with the exclusion? Afterall, the policy must cover "corrective action" and "corrective action" is whatever the environmental agency legally demands.

71. 53 Fed. Reg. 43,348. See also R. LEVY & L. FOSTER, UNDERGROUND TANK LEAK INSURANCE . . . MAXIMIZING YOUR COVERAGE (1988).

72. 53 Fed. Reg. 43,364. These exclusions are found at 40 C.F.R. § 280.96(c)(8) (guarantee exclusions); 40 C.F.R. § 280.98(b)(a)-(e) (surety bond); 40 C.F.R. § 280.99(b)(2)(a)-(e) (letter of credit); and 40 C.F.R. § 280.103(b)(1) (trust agreement).

73. 53 Fed. Reg. 43,361.

EPA's flexibility with respect to acceptable insurance policy exclusions, the explicit exclusions for other forms of assurance are mandatory. The exclusions are contained in the coverage description for each alternative method of assurance and must be followed verbatim.⁷⁴

Claims covered by workers' compensation, disability benefits, unemployment compensation, or similar laws are excluded,⁷⁵ as are employee bodily injury claims arising from, and in the course of employment of the owner or operator.⁷⁶ Bodily injury or property damage claims arising from the ownership, maintenance, or use of aircraft, motor vehicles, or watercraft are excluded.⁷⁷ Property damage claims for property owned, leased, in the care, custody, or control of the owner or operator, are excluded if the damage is not the direct result of an underground storage tank release.⁷⁸ Finally, claims arising from the owner or operator's assumption of liability under a contract or agreement are excluded so long as the contract or agreement was not made for purposes of financial responsibility assurance.⁷⁹ Clearly, these exclusions would be permitted in an insurance policy.⁸⁰ However, if an insurance policy contains exclusionary terms that the EPA believed failed to meet financial assurance standards, the EPA would refuse to recognize the policy as proof of financial responsibility.⁸¹

The EPA also recognizes exclusions for pre-existing conditions.⁸² However, unless a pre-existing release is fairly old, not only is it nearly impossible to prove that an underground stor-

74. See, e.g., 40 C.F.R. § 280.96(c), which provides:

(c) The guarantee must be worded as follows . . . (8) The guarantor's obligation does not apply to any of the following: . . . (a) Any obligation of [insert owner or operator] under a workers' compensation, disability benefits, or unemployment compensation law or other similar law; . . .

75. 53 Fed. Reg. 43,362 (to be codified at 40 C.F.R. § 280.111).

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

80. The permitted exclusions for non-insurance forms of financial responsibility "are patterned on existing standard exclusions found in insurance coverage . . . The five exclusions do not represent all common insurance policy exclusions, but were selected because they were considered most relevant to the financial assurance mechanisms for liability . . ." *Id.* at 43,361.

81. *Id.* at 43,334.

82. 53 Fed. Reg. 43,350. The EPA also acknowledged that insurers would establish strict underwriting standards to prevent issuance of a policy to an owner or operator who has a leaking tank or otherwise has an existing pollution problem and noted that

age tank leak pre-dates the policy coverage period, but it is also difficult, if not impossible, to differentiate between new and old releases.⁸³ An insurer should not rely upon expert services to deny claims for prior releases when the insurer can avoid the claim entirely by refusing coverage for polluted sites. Nevertheless, the rejection of applications to insure polluted sites requires a thorough and time consuming UST site assessment that many owners and operators can neither afford nor await.⁸⁴

The preceding description of financial responsibility establishes the minimum coverage requirements that a state program must meet to qualify as a method for complete financial responsibility assurance. Nevertheless, a state program may provide a lower level of benefits such as corrective action coverage only.⁸⁵ Such a program would require owners and operators to find private sources to supplement the limited state benefits.⁸⁶

B. The Cost of Financial Responsibility Insurance Coverage

Financial responsibility coverage requirements define the risks that a state program will assume, namely, the risk of third party and corrective action liability. These risks must be analyzed in conjunction with information related to individual owners and operators and to those UST sites that have been proposed for coverage by a state program. This analysis, coupled with an understanding of the expenses associated with administering coverage, provide a framework for projecting probable insurance program costs.

Stated differently, projecting the costs of a state reinsurance program first requires a generic understanding of the characteristics of underground storage tanks and the practices of UST owners or operators that affect the potential frequency and severity of pollution claims. The second step requires a specific understanding of the characteristics of tanks and the

"insurers will be able to require correction of existing releases as a condition for coverage." *Id.*

83. Applied Geotechnology, Consultation Report on UST Release Risks and Remediation Costs for the Washington State Pollution Liability Reinsurance Program, (November 8, 1989) [hereinafter "Consultation Report"] (on file with the University of Puget Sound Law Review).

84. *Id.* at 5. See also Pollution Liability News, January 15, 1990, at 1.

85. 40 C.F.R. § 280.94 (1988).

86. *Id.* The EPA allows owners and operators to use several methods of financial responsibility assurance in combination to satisfy regulatory requirements. *Id.*

practices of owners or operators covered by a state program. The second step also requires an understanding of the procedures and activities necessary both to grant and administer coverage under a state program. Ultimately, the design of the state program determines the second step of the analysis.

A state cannot affect the scientific reality of the risk of loss associated with certain tank and site characteristics. However, a state can affect the degree of risk assumed through selectivity in granting coverage and through adoption and enforcement of regulations that change the risk assumed. A state need not insure every tank and site. Furthermore, a state can require the installation of more reliable tanks and related systems.

This ability to directly affect risks through regulation gives a state critical advantages over private insurance companies. The state can control both the financial responsibility assurance program and the enforcement of underground storage tank technical regulations.⁸⁷ However, lack of close cooperation between the agency responsible for providing financial assurance and the agency enforcing UST regulation destroys the advantages over the private insurance market.

Much of the information regarding tank and site characteristics that affects the risk of pollution comes from public and private studies. Unfortunately, the best and most traditional source of this information is limited, namely, insurance company loss statistics.⁸⁸ "Pollution claims are a relatively recent phenomenon and insurers, although paying claims based on past policies, do not have extensive data on exposures and losses."⁸⁹ Moreover, the value of any historic data decreases as clean-up and storage tank technology changes.⁹⁰ Thus, projecting the costs associated with UST insurance coverage requires an ability to shoot at and hit a moving target. At a minimum, UST regulations that require improvements in tanks and related systems present insurers with a constantly changing pollution liability risk.⁹¹ Therefore, cost projections

87. Technical regulations govern the design, construction, and installation of USTs and state regulations must be no less stringent than EPA technical standards. 40 C.F.R. §§ 280.110-112 (1989).

88. D'Arcy & Herricks, *Pricing Insurance for Pollution Damage*, 42 CPCU J. 74, 74-84 (June 1989) [hereinafter D'Arcy & Herricks].

89. *Id.* at 79.

90. *Id.*

91. EPA regulations governing the upgrade of underground storage tank systems

are extremely dependent on the time period during which they were made. Such cost projections therefore require an ongoing appraisal of pollution risks as well as a knowledge of clean-up technology.⁹²

The frequency and severity of potential losses arising from underground storage tank releases are primarily dependent upon site and tank characteristics.⁹³ Relevant site characteristics include the geography, location, and history of the site. Relevant tank characteristics include tank age and material, tank corrosion protection systems, and pollution control systems.

1. Site Characteristics

Site geography contributes both to the risk that a tank and piping will corrode and to the degree of damage that can be expected should a release occur. The degree to which a tank and piping will corrode depends upon soil type and chemistry;⁹⁴ moreover, "corrosion more than any other cause results in tank failures."⁹⁵ Corrosion is an electro-chemical process whereby the tank material degrades to a more natural state.⁹⁶ The EPA describes this process as follows:

The metal UST system and its underground surroundings

are phased in over a period of years depending, in part, upon the age and material of the existing tank. These regulations are summarized in U.S. ENVIRONMENTAL PROTECTION AGENCY, MUSTS FOR USTs, (September 1988) [hereinafter MUSTS FOR USTs].

92. Katzman, *Pollution Liability Insurance and Catastrophic Environmental Risk*, 55 J. OF RISK AND INS., 75, 85 (1988) [hereinafter Katzman]. As Katzman notes, "[b]ecause chemical disasters are such rare events, the computation of premiums on the basis of loss experience is virtually impossible. Even if historical loss data were available, they would reflect outmoded safety technologies." *Id.*

93. Gullidge, *Developing a Pollution Liability Insurance Underwriting Model: Managing for the Potential Exposure from Toxic Releases*, 11 THE ENVTL. PROF., 447, 447-453 (1989) [hereinafter Gullidge].

94. Katzman, *supra* note 92, at 92. See also Predpall, Rogers, & Lamont, *An Underground Tank Spill Prevention Program*, PROCEEDINGS OF THE NWWA/API CONFERENCE ON PETROLEUM HYDROCARBONS AND ORGANIC CHEMICALS IN GROUND WATER— PREVENTION, DETECTION, AND RESTORATION, at 17-30, (1984) (discussion of mathematical modeling and analysis system to measure soil corrosivity and leak risk) [hereinafter Predpall, Rogers, & Lamont]. "The relevant variables governing electrochemical reaction in the tank environment are electrical resistivity of the soil, pH (acidity), moisture content, sulfide content of the soil and size of the tank." *Id.* at 24. Use of the soil corrosion test described by the authors "is a quick, reliable, and cost-effective technique for estimating the risk of tank leakage." *Id.* at 27.

95. Ecology and Environment, Inc. and Whitman, Requardt & Associates, TOXIC SUBSTANCE STORAGE TANK CONTAINMENT 80 (1985) [hereinafter TOXIC SUBSTANCE].

96. *Id.* at 80-92.

act like a battery. Part of the UST can become negatively charged and another part positively charged. Moisture in the soil provides the connecting link that turns these UST "batteries" on. Then, the negatively charged part of the UST system—where the current exits from the tank or its piping—begins to deteriorate. As electrical current passes through this part, the hard metal begins to turn into soft ore, holes form, and leaks begin.⁹⁷

A 1984 study of leaking USTs considered soil conditions as a contributing factor to tank corrosion and concluded that the most "important factor affecting electrical conductivity is soil moisture content."⁹⁸ On this basis, the report found that the Puget Sound Region in Washington has a soil corrosion potential that ranked from high to very high.⁹⁹ However, other experts warn that "tank leak prediction is site specific and requires on-site investigation. Regional generalizations, even to small regions, are invariably wrong and misleading."¹⁰⁰

Soil conditions also affect the speed with which petroleum products reach ground water and thus, soil conditions and the presence and use of ground water in turn affect the severity of expected losses.¹⁰¹ The speed with which a leak of petroleum products will reach ground water is dependent upon the porosity, permeability, and absorptive capacity of the soil; the depth and conditions of ground water at the time of leak; and the size of the leak.¹⁰² In other words, a tank located in highly corrosive, porous soil above ground water that is used by nearby residents as a source of drinking water presents a very high risk compared to a tank located in moderately corrosive soil in a dry, remote region of the state.¹⁰³

97. MUSTS FOR USTs, *supra* note 91, at 6-6.

98. Versar, Inc., LEAKING UNDERGROUND STORAGE TANKS CONTAINING ENGINE FUELS, report prepared under EPA contract No. 68-02-3968, at 38 (September 5, 1984) [hereinafter *Leaking USTs*].

99. *Id.* at 39-42.

100. Rogers, "Predicting and Detecting Tank Leaks: The Economics of UST Integrity," paper presented at University of New Mexico UST conference at 4 (April 1989) [hereinafter Rogers] (copy on file at the University of Puget Sound Law Review).

101. Predpall, Rogers, & Lamont, *supra* note 94, at 23-30; see also Yaniga, HYDROCARBON RETRIEVAL AND APPARENT HYDROCARBON THICKNESS: INTERRELATIONSHIPS TO RECHARGING/DISCHARGING AQUIFER CONDITIONS, in PROCEEDINGS OF THE NWWA/API CONFERENCE ON PETROLEUM HYDROCARBONS AND ORGANIC CHEMICALS IN GROUND WATERS—PREVENTION, DETECTION, AND RESTORATION, at 299-329 [hereinafter Yaniga].

102. Yaniga, *supra* note 101, at 299-300.

103. See generally Gullede, *supra* note 93, at 450.

The location of a site also affects the severity of a potential loss. A tank site in a densely populated residential neighborhood constitutes a far greater potential risk of damage and/or injury than a tank site located miles from any other business or residence.¹⁰⁴ For example, "depending upon site conditions, the greatest risk to the population may be due to explosion since gasoline vapors can find their way into buried utilities, basements, and other such structures."¹⁰⁵ Adjacent property use and value may result in higher costs to compensate third parties, such as businesses, whose operations are disrupted by clean-up efforts.¹⁰⁶

Site history is relevant in determining the risk of loss for existing or prior pollution.¹⁰⁷ Because of the technical difficulties in pinpointing the timing of gradual leaks, an insurer may be unable to deny coverage for pollution that occurred prior to issuance of the policy despite an exclusion for pre-existing conditions.¹⁰⁸ At a minimum, an insurer must discover whether the site has previously been the target of a government cleanup action or the target of third party claims or lawsuits for pollution related damages. Prior property uses may also reveal risks related to other hazardous substances that could create problems when attempting settlement of corrective action liability related to petroleum releases. How could an insurer successfully argue for, let alone accomplish, cleanup of only petroleum products? Finally, prior owners or operators of

104. See SOILS CONTAMINATED BY PETROLEUM: ENVIRONMENTAL & PUBLIC HEALTH EFFECTS, 231-255 (E. Calabrese & P. Kostecki ed. 1988). For example, when a neighborhood service station's 4,000 gallon capacity tank leaked over 100,000 gallons of gasoline, residences in the neighborhood were contaminated. As part of a settlement agreement with the state of New York, "the spiller will offer to purchase 21 homes (five have already been purchased), and proceed with a testing program that will protect the families that remain." *Id.* at 255.

105. *Id.* at 184. In discussing risk assessment at sites where leaks have occurred, the authors include both current and future land use and the presence of buried utilities in considering the public health risks associated with releases in urban and rural areas. *Id.*

106. See *United Pac. Ins. v. Van's Westlake Union*, 34 Wash. App. 708, 664 P.2d 1262 (1983). The facts of *Union Pac.* indicate that 80,000 gallons of gasoline leaked through a small hole in an underground pipe over a period of months at a Union 76 gas station located on the corner of Westlake Avenue North and Mercer Street in downtown Seattle. The area was shut off to traffic for several weeks resulting in "third party claims for damages resulting from the approximate 6-week closure of the nearby businesses while the spilled gasoline was being pumped out of the ground" *Id.* at 713, 644 P.2d at 1266.

107. Gullidge, *supra* note 93, at 450.

108. Katzman, *supra* note 92, at 87.

the site may be held responsible for contribution toward corrective action costs.¹⁰⁹

2. Tank Characteristics

Tank characteristics relevant to determining the frequency and severity of potential losses include age, material, corrosion protection systems, and pollution control systems. The age of a tank and the material of which it is comprised determine its susceptibility to corrosion and leakage. In a national study of documented tank leaks, the median tank age was seventeen years at the time of leak.¹¹⁰ Of these leaking tanks, 81 percent were constructed of steel and 19 percent of fiberglass.¹¹¹ The study found that the major cause of leaks for tanks over ten years old was corrosion.¹¹² For tanks under ten years of age, structural failure, loose pipe fittings, and improper tank installation were the major causes of leaks.¹¹³ Other studies have shown that age is not directly related to risk because site conditions play a greater role in determining the risk of a leak.¹¹⁴ In other words, the age of a tank alone is not determinative of whether it can be expected to leak; rather, the determining factor is the tank age in combination with the relative adversity of site conditions.

Tank corrosion protection can reduce the risk of corrosion related leaks and can extend the useful life of a steel tank.¹¹⁵ Coating steel tanks with asphalt, which has historically been used to lower the risk of corrosion, offers very limited protection from corrosion.¹¹⁶ Other types of tank coatings or linings, such as a fiberglass coating or lining, can significantly reduce the risk of corrosion related leaks.¹¹⁷ The installation of cathodic protection devices is a common method used to reduce

109. WASH. REV. CODE § 70.105D.040 (1989).

110. *Analysis of the National Data Base of Underground Storage Tank Release Incidents*, EPA CONTRACT NO. 68-01-7053, by Versar, Inc., July 12, 1986 at 1-5 [hereinafter *Analysis of the National Data Base*] (copy on file with University of Puget Sound Law Review).

111. *Id.*

112. *Id.* at 6-6.

113. *Id.*

114. *Rogers, supra* note 100, at 3. While tank age is relevant to the probability of leak, the corrosive influences of the fill material surrounding a tank determines its useful life. *Id.* at 5.

115. *Leaking USTs, supra* note 98, at 12. See also TOXIC SUBSTANCE, *supra* note 95, at 80-106.

116. *Leaking USTs, supra* note 98, at 13.

117. *Id.* at 18.

the risk of leak by corrosion¹¹⁸ and is one of the EPA required alternatives for the installation of new tanks and for the upgrading of existing tanks.¹¹⁹ Cathodic protection is designed to prevent metal tank corrosion by reversing the natural electrochemical flow from a tank to the surrounding soil.¹²⁰

Obviously, early detection of a leak is necessary to limit the severity of a loss. In the national survey of reported leak incidents, more than 70 percent of the leaks were discovered by sight or smell, and a significant number of leaks were discovered unintentionally.¹²¹ Owners and operators may use many different leak detection systems to indicate that an underground tank is losing petroleum products. The EPA requires certain leak detection systems depending upon the age and characteristics of the tank.¹²² Such systems include manual inventory control (the "dipstick" method), automatic inventory control (tank gauges), soil and water monitoring equipment, and interstitial monitoring (automatic detection of a leak in the space between the first and second wall of a double walled tank system).¹²³ These methods differ in effectiveness. For example, a national survey noted that the most common method of leak detection in use, the manual inventory control method, detected only 11 percent of the reported leaks.¹²⁴

Apart from tank technology, another important factor in minimizing the frequency and severity of losses is owner or operator management practices. At a minimum, if the operator is completely unaware of the risks involved or the regulations governing tank operation, then the operator is neither

118. *Id.* at 16.

119. 40 C.F.R. §§ 280.20-21.

120. TOXIC SUBSTANCE, *supra* note 95, at 98. The two most common methods of cathodic protection are the sacrificial anode and impressed current methods. With the sacrificial anode method, a metal more corrosive than the tank's metal, is connected to the tank so that the anode corrodes rather than the tank. Metals of this type include magnesium, zinc, or aluminum. With the impressed current method, a direct electrical current is applied to the soil to reverse the soil's corrosive effect by causing a greater electrical flow to the tank rather than from the tank to the soil. *Id.* at 98-102. *See also Leaking USTs, supra* note 98, at 16-18.

121. *Leaking USTs, supra* note 98 at 16-18.

122. 40 C.F.R. §§ 280.40-45 (1989).

123. *Id.* *See also* MUSTS FOR USTs, *supra* note 91, at 10-11, 34-35; TOXIC SUBSTANCE, *supra* note 95, at 71-74; Scheinfeld, Robertson, and Schwenderman, *Underground Storage Tank Monitoring: Observation Well Based Systems*, 6 GROUND WATER MONITORING REV., 49, 49-55 (1986).

124. *Analysis of National Data Base, supra* note 110, at 7:1-3.

likely to respond effectively to a leak nor likely to comply with regulations designed to minimize risk. Most private insurers require owners and operators to adhere to strict tank management guidelines.¹²⁵ These guidelines include owner and operator training in emergency response procedures, a regular tank inspection and maintenance program, and strict recordkeeping.¹²⁶

3. Prediction of Cost of a State Financial Responsibility Program

In order to develop a more specific risk analysis and to predict the probable costs of a state financial responsibility program, it is necessary to acquire information concerning the tanks that are likely to be covered by the program. Site and tank characteristics are generic risk factors which are used to create an analytic model of the probability of losses.¹²⁷ Insurance companies then apply this risk assessment to information obtained from insurance applications. Finally, an actuary estimates the insurance rate necessary to cover losses and other expenses for those tanks ultimately eligible for insurance coverage.¹²⁸

In 1984, as part of the Hazardous and Solid Waste Amendments (HSWA)¹²⁹ to the Resource Conservation and Recovery Act (RCRA),¹³⁰ Congress directed underground petroleum storage tank owners to notify the state in which the tank is located of the existence, age, size, type, location, and uses of the tank.¹³¹ In February of 1987, in compliance with HSWA and RCRA requirements, the Department of Ecology issued a report on Washington USTs.¹³² The report included information gathered by the Department of Ecology from UST notification forms filed in response to HSWA reporting requirements.¹³³ This information profiles the tank characteristics and site locations needing financial responsibility in

125. Fireman's Fund Insurance, *Pollution Liability Insurance Application*, at 5 (copy on file with the University of Puget Sound Law Review).

126. *Id.*

127. D'Arcy & Herricks, *supra* note 88, at 74-84.

128. *Id.*

129. 42 U.S.C. §§ 6901-6991 (1984).

130. 42 U.S.C. §§ 6901-6987 (1976).

131. 42 U.S.C. § 6991a(a) (1982).

132. T. Lufkin, "A Report on Underground Storage Tanks" (prepared for the Washington State the Department of Ecology) (February, 1987) [hereinafter Lufkin].

133. *Id.* at vi-x.

Washington.¹³⁴

In a June 1988 update of its 1987 report to the legislature, the Department of Ecology reported that it had received notification forms from 9,000 owners covering 34,000 tanks at 12,000 sites across Washington.¹³⁵ Approximately eighty percent of the tanks for which the Department of Ecology received notification forms are privately owned, and the remaining twenty percent are owned by different government entities. Of these privately owned tanks, twenty-six percent are owned by service stations.¹³⁶ Sixty-eight percent of the tanks are located in Western Washington, most of which are located in King County areas designated as having a high or very high soil corrosion potential.¹³⁷

As to other characteristics of underground storage tanks for which the Department of Ecology received notification forms, sixty percent of the reported tanks are over 10 years of age, and twenty-five percent are over 20 years of age.¹³⁸ Over ninety percent of all reported tanks are constructed of bare steel with no corrosion protection.¹³⁹ Twenty-seven percent of reported tank owners employ no method of leak detection.¹⁴⁰ Another twenty-nine percent employ daily inventory of tank contents as the sole method of leak detection.¹⁴¹

These facts translate into a rather high risk group of USTs. The Department of Ecology's report to the legislature, in surveying research on the probability of leaks from underground tanks, found a range of leak rate estimates from 1 to 35 percent.¹⁴² The Department of Ecology estimated that over 1,600 tanks in Washington were leaking petroleum products at the time of the report, and that more than three times that number may be leaking by the year 1992.¹⁴³ In part, these estimates of leak rates vary widely because of the many factors that affect the probability of a leak.

The factors discussed above can be used to estimate clean-

134. *See id.*

135. "Underground Storage Tank Briefing," Washington State the Department of Ecology (June 21, 1988) [hereinafter UST Briefing].

136. *Id.* at 4.

137. *Id.* *See also Leaking USTs, supra* note 98, at 38.

138. UST Briefing, *supra* note 135, at 6.

139. *Id.* at 8.

140. *Id.*

141. *Id.*

142. Lufkin, *supra* note 132, at 57.

143. *Id.*

up costs of UST leaks. In a study conducted by Tillinghast for the State of Indiana, the average estimated cost for clean-up of UST leaks in that state for 1990 was projected to be \$110,000.¹⁴⁴ The Tillinghast study notes that studies conducted in other states estimate the average annual cost for clean-up of UST leaks to be between \$200,000 and \$300,000.¹⁴⁵ However, Tillinghast points out that these cost projections are distorted by the inclusion of large losses and the omission of claims smaller than \$50,000.¹⁴⁶

A study conducted by Applied Geotechnology (AGI) for the State of Washington correlated average clean-up costs to the size of UST leaks.¹⁴⁷ Milliman and Robertson (M&R) used these correlations to project estimated clean-up costs for Western Washington. It found that clean-up costs would be \$35,000 per leak under 1,000 gallons, \$100,000 per leak of 1,000 to 10,000 gallons, and \$250,000 per leak over 10,000 gallons.¹⁴⁸ Estimating the probability of clean-up costs, M & R found that approximately 86% of the losses would occur below \$102,000.¹⁴⁹

These loss costs do not include costs to compensate third party claimants nor do they include expenses associated with investigating, administering, and settling claims. Such peripheral, non-cleanup costs can average 10% of clean-up costs.¹⁵⁰ M&R estimated that 5% of the leaks in Washington would result in third party claims with an average cost in excess of \$250,000 and an average expense cost of 50% of these liability claims.¹⁵¹ Moreover, loss costs do not adequately reflect the experiences described by some owners and operators. For example, a Wisconsin petroleum marketer reported that he hired a consultant to study the pollution at his sites.¹⁵² He paid

144. "State of Indiana—Analysis of Funding Requirements for the Petroleum Underground Storage Tank Excess Liability Fund" (Jan. 2, 1990), at 15-11 [hereinafter *Tillinghast Report*].

145. *Id.* at 14-16.

146. *Id.* at 16.

147. Letter to Robert L. Wilkerson from John E. Newby, Table 4 (Nov. 16, 1989) (copy on file with the University of Puget Sound Law Review).

148. Letter to Bob Wilkerson from Roger Hayne, Exhibit A-4, (Nov. 14, 1989) (copy on file with the University of Puget Sound Law Review).

149. *Id.* Exhibit A-5.

150. *Id.* Exhibit A-3. See also *Tillinghast Report*, *supra* note 144, at 9. The *Tillinghast Report* estimated 10 percent of the costs for administrative expenses and 15 percent of the third party liability costs for the payment of owner or operator legal defense. *Id.*

151. *Id.* at A-4 and Exhibit A-6.

152. *Oil Express*, March 5, 1990 at 5.

\$90,000 for the consultant report and \$60,000 for soil tests, but his final cost for actual clean-up work was \$35,000.¹⁵³

This degree of uncertainty and risk of huge financial loss that can arise from a petroleum release are precisely the reasons why private insurance companies either refuse to provide pollution liability insurance for underground tanks or charge a high premium for coverage. Knowledge of UST risk factors and an awareness of the characteristics of the Washington state USTs do not necessarily permit a reasonably accurate prediction of the costs of a state program. Even if the state could use UST data to accurately forecast the frequency and severity of petroleum releases, the state must still consider several other factors. First, the number and characteristics of tanks in use is continually changing. Second, the number of owners and operators who would take advantage of a state program is uncertain. Finally, people have differing opinions as to the application of UST characteristics as predictors of petroleum releases. In short, the best forecast of the loss costs of a financial responsibility program amounts to an educated guess.

4. Administrative Expenses

The uncertain costs of administering a financial responsibility assurance program compound the difficulty of predicting expected losses. Compensation to third parties and cleanup contractors may constitute only 50 to 65 percent of the overall costs on a particular insurance claim.¹⁵⁴ Administrative and loss adjustment expenses are major elements of insurance costs. Up to 25 percent of each dollar collected to provide benefits can be allocated to expenses.¹⁵⁵ Program expenses will depend upon the method used to market program coverage, the method used to underwrite each application for coverage, and the method used to settle claims and defend the owners and operators against lawsuits.¹⁵⁶

153. *Id.*

154. See Institute of Public Law, Univ. of New Mexico, "Insuring Underground Storage Tanks: State-Sponsored Insurance Programs A Program Development Handbook," prepared for Region VI of the EPA (EPA Assistance I.D. No. X-006432-01-0), January 1989 [hereinafter *UNM Handbook*]. An insurer of underground tanks estimated administrative expenses of 10-15 percent exclusive of agent and broker commissions and claims handling expenses. *Id.* at 4-5.

155. *Tillinghast Report, supra* note 144, at 9.

156. *UNM Handbook, supra* note 154, at 4-5. "A program's actual expenses as a percentage of premium will vary depending on the size of the program, its complexity and whether services are contracted out or performed by staff or agency employees."

Any assurance program will incur routine administrative expenses. Agents and brokers who sell program coverage and assist in the application process must be paid a commission. Underwriters must be paid to review applications and set individual policy premiums. Actuaries must be paid to review claim reserves and coverage rates. Claims adjustors must be paid to investigate and settle claims. Accountants must be paid to manage funds collected and invested. Environmental consultants must be paid to analyze loss claims and negotiate with environmental regulators. Attorneys must be paid to defend against lawsuits and represent the insured in administrative proceedings. Finally, clerical staff must be paid to handle the blizzard of paper generated by typical insurance operations.

Beyond these routine expenses, insurance companies confront the possibility that someone within the organization will make a mistake or that management will resist a claim that results in a lawsuit against the company by the insured for breach of contract or bad faith.¹⁵⁷ Whether or not the insurer wins such a suit, the insurer must spend money to defend itself. If the insurer loses such a lawsuit, the insurer can be held liable for amounts in excess of the policy limits.¹⁵⁸

For example, the risk of legal action against the state for breach of duty owed to an owner/operator is greater where the state has contracted directly with an owner or operator and must fight against another state agency, such as the Department of Ecology.¹⁵⁹ If the owner/operator faces liability for

Id. The Handbook includes a table of potential administrative expenses. *Id.* at 4-4. See also EPA Office of Underground Storage Tanks, "Financial Assurance Programs: A Handbook for States," at 4-3 (1988) [hereinafter *EPA Handbook*].

157. See *Escalante v. Sentry Insurance*, 49 Wash. App. 375, 743 P.2d 832 (1987); *Safeco Insurance Company of America v. JMG Restaurants Inc.*, 37 Wash. App. 1, 680 P.2d 409 (1984); *Tank v. State Farm Fire and Casualty Company*, 105 Wash. 2d 381, 715 P.2d 1133 (1986).

158. See *Tyler v. Grange Insurance Association*, 3 Wash. App. 167, 473 P.2d 193 (1970).

159. Whether a state can be held liable for failure to perform a duty depends upon program design. The liability risk is greatest when the state enters into a contractual relationship with owners or operators. In Washington, a person seeking a tort recovery from a government entity must, in part, overcome the "public duty" doctrine, which requires a showing that government owed a duty to the person individually rather than to the public in general. *J & B Dev. Co. v. King County*, 100 Wash. 2d 299, 699 P.2d 468 (1983). However, the "public duty" doctrine does not apply when the government acts in a proprietary capacity. *Hoffer v. State*, 110 Wash. 2d 415, 755 P.2d 781 (1988). "A government acts in a proprietary capacity 'when it engages in a business-like venture as contrasted with a governmental function.'" *Id.* at 422, 755 P.2d at 786.

clean-up costs in excess of coverage limits, the owner/operator could argue that the state program had an inherent conflict of interest in negotiating with the Department of Ecology. The owner/operator could successfully require the state to pay in excess of coverage limits if the owner/operator could show that this conflict caused a greater liability for clean-up costs.¹⁶⁰ Political and social pressure for clean-up of polluted sites would contribute to an insurance program's efforts to pay losses with more regard for public satisfaction than owner/operator or program exposure to financial loss.¹⁶¹

C. Providing Financial Responsibility Coverage

Many states have created or are in the process of creating financial responsibility assurance programs.¹⁶² These state assurance programs approach the problem of providing financial responsibility assurance in different ways. Many options exist; but no one option completely meets the objectives of both the state and UST owners/operators.¹⁶³

Any state financial responsibility assurance program that covers existing losses faces substantially higher program costs than a program that covers only prospective losses.¹⁶⁴ In Washington, program coverage of existing petroleum releases would conflict with the voter approved Model Toxics Act¹⁶⁵

160. See *Tyler v. Grange Ins. Ass'n*, 3 Wash. App. 167, 473 P.2d 193 (1970).

161. Of course, the public participation requirements of the state Model Toxics Act and implementing regulations may cause this same result of anxiety driven cleanup action. WASH. REV. CODE § 70.105D.030(2)(a) (1989). Furthermore, public perception of the health risks associated with a release can result in compensation for this anxiety or general malaise and additional costs for ongoing monitoring of public health risks. Katzman, *supra* note 92, at 84.

162. See, e.g., FLA. STAT. § 376.3072 (1990); MONT. CODE ANN. §§ 75-11-301-321 (1989); OR. REV. STAT. § 466.795 (1990); VA. CODE ANN., §§ 62.1-44 & 34:10-12 (1990).

163. For a discussion of various state program options see *EPA Handbook, supra* note 156.

164. Memorandum from Bill Bafus, Senate Fiscal Analyst, to Members of the Joint Select Committee on Underground Storage Tanks, (July 18, 1990) (discussing the financial implications of the risk retention pool legislation, SB 6741, that the legislature had rejected in forming the Joint Committee).

See also *UNM Handbook, supra* note 154, at 3-8.

If the primary goal [of a state program] is to clean up problem sites, a guarantee or cleanup fund supported by sufficient public funds to perform this expensive task would be an appropriate mechanism. If the program's purpose is to offer tank owners and operators a means of demonstrating financial responsibility with minimal state support, a state sponsored insurance program . . . will meet the state's needs.

Id.

165. WASH. REV. CODE § 70.105D (1989).

that created a cleanup fund for hazardous waste sites including underground tank sites where a petroleum release has occurred.¹⁶⁶

The cleanup fund established by the Model Toxics Act 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."¹⁶⁷ A parallel state assurance program covering existing petroleum releases would render these conditions for obtaining state cleanup funds meaningless because such a program would provide a duplicate source of recovery. Careful program design also requires conformance with other state statutes such as the Administrative Procedures Act,¹⁶⁸ Insurance Code,¹⁶⁹ state/private contracting procedures,¹⁷⁰ and accounting rules.¹⁷¹

Apart from statutory conflicts with program design, state programs must contend with state constitutional constraints on program design.¹⁷² A Washington state program could face a state constitutional challenge on the basis that the program directly benefits owners and operators in such a manner that appears to constitute a lending of state credit or gift of public funds to individuals or companies.¹⁷³ Therefore, to be some-

166. WASH. REV. CODE chapter 70.105D; Attorney General Opinion No. 25, Oct. 31, 1988. In comparing legislation creating a risk retention pool to cover both past and future cleanup of releases from underground storage tanks, the Attorney General concluded that such a pool would constitute an amendment to the voter-approved Initiative 97 (RCW 70.105D) requiring a two-thirds vote for implementation. *Id.* at 10-11. Legislators face political risks in amending a voter-approved initiative shortly after it has been adopted, especially when the voters simultaneously rejected a Legislative version of the initiative as was the case in adoption of Initiative 97. Ultimately, the Committee's recommended financial assurance plan was adopted unanimously, thereby avoiding any potential challenge based upon an insufficient vote count. See *infra* text accompanying notes 189-190.

167. WASH. REV. CODE § 70.105D.070 (2)(d)(xi) (1989).

168. WASH. REV. CODE § 34.05 (1989).

169. WASH. REV. CODE § Title 48 (1989).

170. WASH. REV. CODE § Title 39 (1989).

171. *UNM Handbook*, *supra* note 154, at 3-14 & 3-15.

172. *Id.* at 3-12 & 3-13. These constraints include constitutional prohibitions on the guaranteeing of private debt, extending state credit or aid to private individuals, giving state funds to persons or businesses not controlled by the state, limitations on state indebtedness, and restrictions on the use of specific revenue sources. *Id.*

173. WASH. CONST. art. VIII § 5 provides: "The credit of the state shall not, in any manner be given or loaned to, or in aid of, any individual, association, company or corporation." This provision has been interpreted to include the prohibition found in WASH. CONST. art. VIII § 7 which provides: "No county, city, town, or other municipal

what insulated from constitutional challenge, a Washington state insurance program would have to "sell" financial responsibility assurance rather than collect taxes and "give" assurance.¹⁷⁴ No amount of constitutional analysis and legislative proclamation will immunize a program from constitutional attack; rather, program design must accommodate constitutional restrictions while preserving program goals.¹⁷⁵

Perhaps the most important technical issue pertains to limits on a state's liability for petroleum releases and adequate funding for these circumscribed liabilities.¹⁷⁶ No state program should be allowed to assume owner or operator liabilities without strict monetary limits and coverage definitions.¹⁷⁷ At a

organization shall hereafter give any money . . . in aid of any individual . . . except for the necessary support of the poor and infirm . . ." *Johnson v. Johnson*, 96 Wash. 2d 255, 261, 634 P.2d 877, 880 (1981). See Spitzer, *An Analytical View of Recent 'Lending of Credit' Decisions in Washington State*, 8 UNIV. PUGET SOUND L. REV. 195, 195-219 (1985).

174. The theory behind "selling" financial responsibility coverage rather than "giving" coverage to owners and operators rests upon an assumption that the program will meet constitutional requirements if adequate consideration has been given for the state benefit; this consideration can be below actual benefit costs. See *Scott Paper Co. v. City of Anacortes*, 90 Wash. 2d 19, 32-33, 578 P.2d 1292, 1300 (1978) (sale of water by the City of Anacortes at less than actual cost was not a gift). Arguably, a state financial responsibility assurance program obtains adequate consideration through the purpose and use of funds expended—the cleanup of pollution caused by a release of petroleum products and protection of ground water supplies through the program's expeditious intervention to mitigate pollution damage. "Where the public receives sufficient consideration, and benefit to an individual is only incidental to and in aid of the public benefit, no unconstitutional gift has occurred." *Tacoma v. Taxpayers of City of Tacoma*, 108 Wash. 2d 679, 705, 743 P.2d 793, 806 (1987).

175. As the Washington Supreme Court noted in the *Tacoma v. Taxpayers* case, the legislature's responsibility does not include determining the constitutionality of legislation, rather the legislature should focus on the purpose, strategy, and result of its legislation. *Tacoma v. Taxpayers*, 108 Wash. 2d at 688, 743 P.2d at 798. See also Memorandum from C. Gavigan to Members of the House Committee on Housing (July 28, 1988) (regarding lending of credit). As Gavigan notes in his advice to the committee regarding housing finance programs:

The uncertainty that exists in lending of credit cases may make spending too much time on lending of credit questions by the Legislature counterproductive. Legislation that is well thought out, helps a major section of the public with a significant need or problem, and does not contain factors that would have concerned the framers of the constitution will likely be upheld as constitutional by the court.

Id. at 7.

176. *UNM Handbook*, *supra* note 154, pp. 3-10 - 3-11.

177. *Id.* at 7. See Anderson, "Financial Responsibility for Underground Storage Tanks," 12 *The Risk Report* 1 (1989). "Many of the [state financial responsibility] funds are severely undercapitalized, with no consideration being given to potential liabilities in the decision of funding levels. Most do not impose annual aggregate limitation." See also Anderson, *State UST Financial Assurance Funds: Disasters*

minimum, these limits and definitions are necessary to predict program costs and budget accordingly. Funding for these costs must be both sufficient and flexible.¹⁷⁸ As one commentator has noted, “[i]ronically, although these funds are established as programs to improve states’ environmental conditions, inability to cover claims under these programs can lead to delayed cleanups and increased hazards to the environment and public health.”¹⁷⁹

One of the purposes for requiring financial responsibility assurance from UST owners/operators is to enhance “protection of public health and the environment by increasing the incentive for tank upgrading and replacement” through the demands made by providers of assurance.¹⁸⁰ A program that financially rewards owners/operators who improve their tanks and employ sound risk management practices reduces the need for regulatory intervention and enforcement.

In contrast, a program that provides benefits without regard to risk creates disincentives for early compliance with regulatory standards that decrease the risk of loss.¹⁸¹ As one commentator has noted, “[i]nsurers establish underwriting criteria and premium structures that will eliminate marginal risks and encourage loss prevention, but some state funds that cover all tanks for the same fee eliminate incentives for tank owners and operators to upgrade their systems.”¹⁸² To incorporate insurance industry practice, a state program should condition eligibility for participation upon sound risk management

Waiting to Happen, 1 ENVTL. CLAIMS J. 313, 313-321 (1989) [hereinafter Anderson, *State Funds*].

178. Some states use tax revenue “ceilings” and “floors” designed to keep program funding within a predetermined range. A tax is imposed until the revenue collected reaches the “ceiling” amount, at which time the tax is discontinued. When the program fund balance falls below the “floor” amount, the tax is reactivated until the “ceiling” is again reached. *EPA Handbook*, *supra* note 156, at 4-1. Most state revenue limitations, including ceilings and floors, result in critically underfunded programs and initial funding levels, however financed, are inadequate. Anderson, *State Funds*, *supra* note 177, at 318. See also *UNM Handbook*, *supra* note 154.

179. Anderson, *State Funds*, *supra* note 177, at 319.

180. 53 Fed. Reg. at 43,363.

181. 53 Fed. Reg. at 43,324. As the EPA noted in announcing financial responsibility regulations:

Because the providers of financial assurance mechanisms may require UST owners and operators to install leak detection and corrosion protection systems as a condition of coverage, the financial responsibility requirements may accelerate compliance with the technical standards.

Id.

182. Anderson, *State Funds*, *supra* note 177, at 319.

and require owner or operator contribution to program funding reflective of the owner or operator's risk.

Another incongruity of state assurance programs is that many of these programs completely displace or eliminate the possibility of a private insurance market while proclaiming the need for state action because of the limited private insurance market.¹⁸³ As the EPA warns, "[i]f few insurers are currently willing to offer UST insurance, your State could provide financial assurance in the short-run. In the long-run, however, this short-term solution may preclude insurers from ever offering coverage in the State, thus perpetuating the problem."¹⁸⁴ Thus, a state program providing complete coverage without the involvement of the private market would create a state coverage monopoly, and would prolong any transition from state to private provision of financial responsibility assurance.

On the other hand, strict voluntary participation by owners/operators without below market financial incentives to participation would result in state coverage of only the worst risks. Insurance underwriting standards and prices that are attractive to high risks and unattractive to low risks result in adverse selection. Good risks are accepted by the private market while poor risks have no other alternative but a state assurance program. The consequence of this adverse selection is that the state program experiences higher than average losses without the premium income from good risks to fund these losses. Eventually, prices must climb to reflect large losses, forcing another round of departure of risks which can obtain a better price elsewhere.

Thus, a state program must obtain good risks by offering prices competitive with the private market in order to maintain stable prices and losses. Predictability and stability of program costs requires a broad crosssection of risks, and sufficient numbers of owners/operators.¹⁸⁵ Therefore, a state should involve private insurers, include both good and bad risks, and strive to transfer the state's role to the private sector.

If private insurers express concern over the risks associated with insuring USTs and over their inability to adequately manage pollution claims, a state contemplating the creation of

183. *EPA Handbook*, *supra* note 156, at 2-2. See also Anderson, *State Funds*, *supra* note 177, at 320.

184. *EPA Handbook*, *supra* note 156, at 2-2.

185. D'Arcy & Herricks, *supra* note 88, at 74-75.

an assurance program should be extremely cautious. Given the complexities of underwriting and managing underground storage tank risks, no state possesses the inherent ability to assume these responsibilities. Other states' existing assurance programs employ "no clear mechanisms for controlling losses and claims costs, and attention to administrative costs and needs appears to be woefully lacking."¹⁸⁶ Program mismanagement and failure hurts the groups intended to benefit from any program and results in political, as well as social disaster.¹⁸⁷

Similarly, many of the owners and operators do not have the technical capabilities or money to respond to corrective action requirements. Thus, a program that provides reimbursement rather than direct and immediate assistance could financially drain owners and operators and could delay effective corrective action before owners/operators obtained program benefits. More importantly, state involvement and assistance at the first sign of petroleum release is necessary to limit liability, control expenditures, and mitigate damage.¹⁸⁸

III. THE WASHINGTON POLLUTION LIABILITY INSURANCE PROGRAM

In 1989, the legislature adopted the Joint Committee's recommendation to create a pollution liability reinsurance program.¹⁸⁹ However, the legislature prohibited full

186. Anderson, *State Funds*, *supra* note 177, at 318.

187. "A damning appraisal of the Florida amnesty and insurance programs is contained in the committee report which accompanied the bill enacting the insurance program . . ." Memorandum from LeBouef, Lam, Leiby & MacRae to the NAIC Environmental Liability Insurance Task Force Advisory Committee at 4 (October 28, 1988) (reviewing options for state intervention to provide UST coverage). The memorandum highlights the large deficits and lack of state cleanup action on thousands of reported claims. However, the memorandum primarily faults lack of adequate funding for these problems. *Id.* at 5.

188. *Gulledge*, *supra* note 93, at 447 (1989). Gulledge advises:

Rapid response to an environmental contamination incident is critical in order to operate a successful [pollution] insurance program. The longer the response time, the more severe the incident can become. A multidisciplinary team that is available 24 hours a day is necessary for [pollution] claims management. A network of professionals should be established, and they would be available for rapid cleanups and have the technical expertise to evaluate the extent of the contamination. They would provide legal assistance and insurance claims adjustment expertise. This pro-active claims approach . . . [is] the foundation for understanding and insuring potential environmental exposures.

Id. at 448-449.

189. 1989 Wash. Laws, ch. 383.

implementation of the program and expenditure of program funds until further review and approval of the program during the 1990 legislative session.¹⁹⁰ Before the legislature would authorize full program implementation, the legislature wanted a report analyzing its costs and effectiveness.¹⁹¹

On January 1, 1990, the administrator of the newly formed Pollution Liability Reinsurance Program delivered his report to the legislature.¹⁹² In part, the report was based upon research and advice provided by consulting firms under contract to the agency.¹⁹³ Based upon recommendations contained in the report and after further review of program objectives, the legislature amended the governing statute and authorized full implementation of the program.¹⁹⁴

The state program's fundamental objective is to guarantee the availability and affordability of pollution liability insurance for owners/operators of underground storage tanks.¹⁹⁵ The state proposes to meet the objective of affordability by selling reinsurance to a pollution liability insurance company at a price well below the private market price for similar reinsurance. The insurer is required to pass this discount on to owners/operators of underground storage tanks who meet underwriting standards established by the program director.¹⁹⁶

190. WASH. REV. CODE § 70.148.100 (1990).

191. WASH. REV. CODE § 70.148.100(1) "The administrator shall report to the legislature by January 1, 1990, on the estimated costs to the insured and the state of implementing the program including proposed coverage, rates, and underwriting the insurer recommended by the administrator." *Id.*

192. Jim Sims, Administrator's Report to the Legislature, Pollution Liability Reinsurance Program (Jan. 1, 1990).

193. Warren, McVeigh & Griffin, Inc., State of Washington Pollution Liability Reinsurance Agency with the assistance of Milliman and Robertson, Inc. for actuarial services, and Applied Geotechnology for technical environmental information (Nov. 16, 1989).

194. 1990 Washington Laws ch. 64 §§ 1-14.

195. WASH. REV. CODE § 70.148.005(2)(d)(1989).

196. WASH. REV. CODE § 70.148.005(2) provides in part:

[T]his chapter establishes a program to provide pollution liability reinsurance at a price that will encourage a private insurance company or risk retention group to sell pollution liability insurance in accordance with the requirements of this chapter to owners and operators of underground petroleum storage tanks, thereby allowing owners and operators to comply with the financial responsibility regulations of the EPA.

Reinsurance is insurance issued to an insurance company that allows the insurance company to pass a part of its risk to the reinsurer. In its simplest form, reinsurance is a method of spreading the financial burdens assumed by an insurance company when it issues policies to individuals, businesses and other entities. *See generally*, REINSURANCE (R. Strain ed. 1980) [hereinafter REINSURANCE].

The state proposes to meet the object of availability by requiring the insurer to accept a greater degree of risk than the insurer would otherwise accept without state involvement. Therefore, the success or failure of the program rests upon the state's ability to convince a private insurer to enter a reinsurance contract with the State of Washington.

The legislature chose the reinsurance program over competing alternatives for several reasons. First, a reinsurance program will minimize state participation in investigating and settling pollution liability claims. Second, the reinsurance program will minimize state exposure to liability for pollution claims. Finally, the reinsurance program will encourage private insurance company participation to allow the state to eventually discontinue the program.¹⁹⁷

However, the program must accomplish these goals in a manner that "[p]arallels generally accepted principles of insurance and risk management."¹⁹⁸ The legislature warned that

[i]t is not the intent of this [program] to permit owners and operators . . . to obtain pollution liability insurance without regard to the quality or condition of their storage tanks or without regard to the risk management practices of the tank owners and operators nor is it the intent of this [program] to provide coverage or funding for past or existing petroleum releases.¹⁹⁹

The program can deviate from standard insurance industry practices "only to the extent necessary and within the tax revenue limits provided to make . . . insurance reasonably affordable and available to owners and operators who meet [program requirements]."²⁰⁰ In particular, the program must help those owners/operators whose USTs meet a vital economic need within the affected community.²⁰¹

Clearly, the legislature wanted to avoid both program mismanagement and runaway program costs. As if the intent statements were not enough, the legislature buttressed its concerns by requiring the program director to contract with experts as necessary and to report to the legislature before

197. WASH. REV. CODE §§ 70.148.005(2) (3).

198. WASH. REV. CODE § 70.148.005(2)(d).

199. WASH. REV. CODE § 70.148.005(3).

200. *Id.*

201. WASH. REV. CODE § 70.148.005.

entering into any reinsurance contract.²⁰² As a last resort, the legislature created an escape hatch from the program:

[t]he legislature reserves the right to amend or repeal all or any part of this [program] at any time, and there is no vested right of any kind against such amendment or repeal. All the rights, privileges, or immunities conferred by this chapter or any acts done under it exist subject to the power of the legislature to amend or repeal [the program] at any time.²⁰³

In essence, the legislature told program management, 'here is our investment in the reinsurance company that you must create and manage in a business-like manner. If you do not perform in accordance with our wishes, we will liquidate the company.' To owners and operators, the legislature effectively said, 'the program will do its best to keep you in business by providing insurance; however, not all of you will be saved and none of you have legal rights against us if the program fails.' To the insurance industry, the legislature said, 'this program presents you with an opportunity for state assistance in creating and maintaining a pollution insurance market; however, we guarantee nothing, and expect favors in return.'

Mindful of the risks involved, the legislature devised an experiment to determine whether the state could invent an insurance market by acting as an entrepreneur without a profit motive. The legislature gave the program as many tools as possible to succeed as a business venture. It is administered through a newly created, independent state agency and its director has broad authority to design the program.²⁰⁴ The enabling legislation specified no deductibles, coverage prices, reinsurance contract terms, underwriting standards, or cover-

202. 1990 Wash. Laws ch. 64 § 4(2) provides in part:

[t]o the extent necessary to protect the state from unintended liability and ensure quality program and contract design, the director shall contract with an organization or organizations with demonstrated experience and ability in managing and designing pollution liability insurance and with an organization or organizations with demonstrated experience and ability in managing and designing pollution liability reinsurance.

1990 Wash. Laws ch. 64 § 6(1) provides in part:

[b]efore initially entering into a reinsurance contract, the director shall provide a report to the chairs of the senate ways and means, senate financial institutions, house of representatives revenue, and house of representatives financial institutions committees and shall include an actuarial report describing the various reinsurance methods considered by the director and describing each method's costs.

203. WASH. REV. CODE § 70.148.110.

204. WASH. REV. CODE § 70.148.030.

age limitations because these aspects of the program will be subject to negotiation with an insurer.²⁰⁵ Instead, the legislature provided a simple plan of operation that requires the director to use sound business judgment in determining these insurance and reinsurance variables.²⁰⁶

As a last measure of freedom, the legislature exempted the program and its participating insurer from public disclosure laws to protect sensitive information.²⁰⁷ The program and the participating insurer are exempt from most provisions of the state insurance code; however, the program and the participating insurer are subject to state insurance statutes governing Insurance Commissioner examination of insurers; statutes pertaining to insurance company annual reports, assets, liabilities, and investments; statutes prohibiting unfair and deceptive acts and practices; and statutes governing risk retention groups.²⁰⁸ To balance this broad exemption, the program and its participating insurer are not covered by the state insurance guaranty fund which covers insurer liabilities in the event of company insolvency.²⁰⁹

The insurer contracting with the state will charge owners and operators a premium to meet the insurer's obligations. To fund reinsurance program obligations, a petroleum products tax of 0.50 percent is levied on the wholesale value of any petroleum product upon first possession in the state.²¹⁰ Petroleum products exported for use or sale as fuel outside of the state, as well as petroleum products packaged for sale to ultimate consumers, are exempt from taxation.

Proceeds from the tax are deposited into the pollution liability reinsurance program trust account to fund the reinsurance program. Collection of this tax must cease whenever the account balance exceeds \$15 million and collection may resume when the balance drops below \$7.5 million.²¹¹ However, in determining whether the account balance exceeds \$15 million,

205. WASH. REV. CODE § 70.148.070.

206. WASH. REV. CODE § 70.148.050.

207. WASH. REV. CODE § 70.148.060(1). "All examination and proprietary reports and information obtained by the administrator . . . in soliciting bids from insurers and in monitoring the insurer . . . shall not be made public or otherwise disclosed to any person, firm, corporation, agency, association, governmental body, or other entity." *Id.*

208. WASH. REV. CODE § 70.148.090.

209. WASH. REV. CODE § 70.148.090(2).

210. WASH. REV. CODE § 82.23A (1989).

211. 1990 Wash. Laws ch. 64, § 12(4).

surplus and loss reserves may not be counted.²¹² Four times a year, the director must establish the necessary reserve amounts and report these to the legislature, the Insurance Commissioner, and the Department of Revenue.²¹³ Thus, revenue collections are determined by the capital needs and loss experience of the program limited only by the tax rate itself.

The extraordinary grant of power to the program director by the legislature was both necessary and desirable. Unlike most other government programs, no blueprint exists to build a state owned reinsurance company. Until recently, no separate, clearly defined insurance coverage existed for corrective action of UST releases. Market development of this insurance product proceeded from the statutory mandate that UST owner/operators obtain such coverage. Therefore, the state must concentrate upon goals and results. The state cannot succeed in this new venture by statutorily predetermining all aspects of program structure and insurance coverage before negotiation and development has occurred in partnership with the insurance company that will risk its capital.

However, while the legislature granted the program a broad berth, the legislature also imposed some constraints on the program. The program cannot provide coverage in excess of \$1 million per occurrence and \$2 million annual aggregate.²¹⁴ While coverage cannot include losses occurring prior to the inception date of coverage under the program, polluted sites are eligible for coverage subject to the following conditions:

- (a) The owner or operator must have a plan for proceeding with corrective action; and
- (b) If the owner or operator files a claim with the insurer, the owner or operator has the burden of proving that the

212. *Id.* " 'Loss reserve' means the amount traditionally set aside by commercial liability insurers for costs and expenses related to claims that have been made. 'Loss reserve' does not include losses that have been incurred but not reported to the insurer." *Id.*, § 2(9) (to be codified at Wash. Rev. Code § 70.148.010(9)). " 'Surplus reserve' means the amount traditionally set aside by commercial property and casualty insurance companies to provide financial protection from unexpected losses and to serve, in part, as a measure of an insurance company's net worth." *Id.*, § 2(17) (to be codified at Wash. Rev. Code § 70.148.010(17)).

213. 1990 Wash. Laws ch. 64, § 3(2). The program established a surplus reserve of \$8 million on April 10, 1990. Pollution Liability Insurance Agency, "Request for Proposal," at 7 (Apr. 30, 1990). Revenue collections from the period beginning July 1989 to January 1990, totaled approximately \$9.6 million exclusive of interest income. *Id.* at 4.

214. WASH. REV. CODE § 70.148.050(1)(c).

claim is not related to a preexisting release until the owner or operator demonstrates to the satisfaction of the director that corrective action has been completed.²¹⁵

The program director may use program funds to subsidize the costs incurred by an owner or operator for the tank or site analysis which is required by an insurer as part of the process for determining whether to issue a policy to the owner or operator.²¹⁶ An owner or operator may appeal the insurer's decision to reject an application for coverage or cancel an existing policy to the program director.²¹⁷ The director must compel the insurance company contracting with the state to condition issuance of an insurance policy upon the owner/operator's compliance with laws governing USTs,²¹⁸ and upon the owner/operator's exercise of prudent risk management practices.²¹⁹ Finally, the insurer must cover the owner/operator's costs in defending against liability,²²⁰ must use a variable premium rate structure based upon tank and other characteristics, and must impose a coverage deductible upon owner/operators.²²¹

The legislature placed additional restraints on the program. First, any reinsurance contract between the program and an insurer must include a provision to arbitrate disputes between the state and the insurer.²²² Additionally, the contract must contain a clause disclaiming liability for the insurer's portion of policy coverage in the event of the insurer's insolvency.²²³ However, the legislature allowed the

215. WASH. REV. CODE § 70.148.070(5).

216. 1990 Wash. Laws ch. 64, § 11 provides:

The director may design the program to cover the costs incurred in determining whether a proposed applicant for pollution insurance under the program meets the underwriting standards of the insurer. In covering such costs the director shall consider the financial resources of the applicant, shall take into consideration the economic impact of the discontinued use of the applicant's storage tank upon the affected community, shall provide coverage within the revenue limits provided under this chapter, and shall limit coverage of such costs to the extent that coverage would be detrimental to providing affordable insurance under the program.

Id.

217. WASH. REV. CODE § 70.148.080 (1989).

218. WASH. REV. CODE § 70.148.050(5) (1989).

219. WASH. REV. CODE §§ 70.148.050(5) & 70.148.070(2)(d).

220. WASH. REV. CODE § 70.148.070(2)(a).

221. WASH. REV. CODE § 70.148.070(2).

222. WASH. REV. CODE § 70.148.050(1)(d).

223. WASH. REV. CODE § 70.148.050. This statutory provision is intended to protect the program from "drop-down" liability common in reinsurance disputes involving insolvent primary insurers. Policyholders will often attempt to force the reinsurance

director to recommend methods for providing program benefits.²²⁴

The program director reviewed two methods for providing program benefits in his January 1990 report to the legislature—traditional excess of loss reinsurance and “gap” reinsurance.²²⁵ “Excess of loss” reinsurance provides an insurance company with a contract by which the state agrees to reimburse a company for claim payments and other costs that exceed an agreed upon amount.²²⁶ In other words, the state will sell an insurance policy to an insurance company and will pay claims exceeding the insurance company’s deductible (retention).

In contrast to “excess of loss” reinsurance, “gap” reinsurance reverses the positions of the insurer and reinsurer in the reinsurance agreement.²²⁷ Ordinarily, the so-called “gap” reinsurance would be viewed simply as the agency providing the primary coverage to the policyholder with the insurance company acting as excess insurer. However, under the proposal discussed in the director’s report, the insurance company would be the only party contracting with an owner or operator; the director’s report proposes that the insurance company seek reimbursement from the agency for coverage expenditures falling between the policyholder deductible and the insurer’s coverage responsibility.²²⁸ Of the two methods discussed in the legislative report, the director recommended the traditional “excess of loss” reinsurance method.²²⁹ Nevertheless, the legis-

company providing excess insurance (coverage that exceeds the amount of liability retained by the reinsured insurance company) to “drop-down” and cover the insolvent primary insurer’s portion of liability. For example, if an owner insured under the state program suffers a \$250,000 loss and the insurer that is reinsured by the state was responsible for the first \$100,000 of any policyholder loss but becomes insolvent, the owner could attempt to force the state to provide the insurance company’s portion of the loss. *See generally* Lanzzone & Burke, *The Drop-Down Liability of Excess Insurers*, THE BRIEF (A.B.A. SEC. TORT AND INS. PRAC.) (1989) at 36-40 & 48-55. *See also* REINSURANCE, *supra* note 196, at 90-92.

224. 1989 Wash. Laws ch. 383 § 6(1). As originally adopted, the program could consider only “excess of loss” reinsurance. 1989 Wash. Laws ch. 383, § 6(1). For a discussion of excess of loss reinsurance, *see* REINSURANCE, *supra* note 196, at 213-251. This restriction on the form of reinsurance allowed under the program was repealed when the Legislature revised the program in 1990. 1990 Wash. Laws ch. 64, § 2(6).

225. Pollution Liability Reinsurance Agency, Report to the Legislature, 42 (Jan. 1, 1990) at 22-27 [hereinafter *Report to the Legislature*].

226. *See* REINSURANCE, *supra* note 196, at 213-251.

227. *Report to the Legislature*, *supra* note 225, at 23.

228. *Id.* at 26.

229. *Id.* at 27. “This alternative would result in favorable premiums and would

lature permitted the director to consider any method of providing coverage.²³⁰

The legislature also provided for both program oversight and expertise through a variety of reporting and consulting requirements. First, the Governor must appoint a standing technical advisory committee to the program.²³¹ This committee is to be comprised of representatives of "the public, the petroleum marketing industry, business and local government owners of USTs, and insurance professionals."²³² Second, the director must consult with the Department of Ecology in developing and adopting regulations governing insurance coverage exclusions affecting corrective action coverage under the program.²³³ Third, the director must also prepare an annual report to the legislature analyzing the financial viability of both the program and the insurer covered by the program.²³⁴ Fourth, the director must continually evaluate the success of the program and its effects on private insurance market development,²³⁵ and make recommendations to the legislature regarding the need for its continuance.²³⁶

IV. PROGRAM SUCCESS

Because the state program cannot directly insure owners and operators, its success rests upon the director's ability to contract with a pollution liability insurance company.²³⁷ Program success also rests upon the number of owners and operators who are able to obtain affordable insurance and hence remain in business. A contract with an insurance company has no value unless a majority of tank owners and operators are covered under the contract.

Program success requires a delicate balancing of state and private interests. The program director cannot ignore the political reality that the reinsurance program was created by

minimize state involvement in reimbursing the insurer for losses [T]he involvement of the state in reimbursement for the settlement of virtually every claim would require even more extensive auditing responsibilities. It would also result in potentially extensive obligations against the [agency's] Trust account." *Id.*

230. See 1990 Wash. Laws ch. 64 § 2.

231. WASH. REV. CODE § 70.148.030(3).

232. *Id.*

233. WASH. REV. CODE § 70.148.070(3).

234. WASH. REV. CODE § 70.148.050(7).

235. WASH. REV. CODE § 70.148.050(8).

236. WASH. REV. CODE § 70.148.050(6).

237. See *supra* text accompanying notes 189-197.

the legislature in response to pleas by owners and operators who predicted dire social and economic consequences without state financial responsibility assistance.²³⁸ Nor can the director ignore the legislature's fear of program deficits and potential state liability.²³⁹ Therefore, the director must utilize program features to creatively blend competing private and public interests to meet program objectives.

The program offers insurance companies many incentives to contract with the state including direct and indirect financial incentives. The most direct financial incentive is the offer of reinsurance at a substantial market discount. Normally, an insurer can expect to pay a percentage of each premium dollar collected to the reinsurer depending upon the type and amount of reinsurance.²⁴⁰ Under the program, state tax revenues provide a steady stream of income to the program as a substitute for investment capital and premium payments. Therefore, the program can afford to charge the insurer a nominal reinsurance premium²⁴¹ and the insurer can retain owner/operator premium dollars that would normally pass to the reinsurer. The insurer not only saves on the cost of reinsurance but retains the investment income earned on owner/operator premium payments.²⁴²

238. Letter from Gary L. Smith, Executive Director, Independent Business Association to Mike Kreider and Roy Ferguson, Co-Chairs, Joint Select Committee on Storage Tanks (Nov. 28, 1988) (predicting failure of small businesses unless Washington legislature passes state UST reinsurance program) (copy on file with University of Puget Sound Law Review).

239. See *supra* text accompanying notes 195-203.

240. REINSURANCE, *supra* note 196, at 213.

241. *Report to Legislature, supra* note 225, at 38. The program director has recommended setting the reinsurance rate in an amount necessary to cover the program's administration costs. *Id.*

242. An issue that must be addressed by the insurer and the program is responsibility for unearned premium reserves. When an insurer receives payment for a policy, the premium collected is not fully earned until the end of the policy period. State insurance codes require insurers to set aside unearned premiums in a reserve account to permit a refund of premiums should the policyholder cancel before the policy period expires. In a reinsurance transaction, the reinsurer is required to set aside an unearned premium reserve in amount corresponding to the percentage of premium passed to the reinsurer by the insurer. Under the state program, the insurer will retain most of the premium collected from owners and operators while the state will assume responsibility for the largest portion of the policy limits. Presumably, the insurer should create and maintain a full unearned premium reserve for policyholders despite the state's assumption of a percentage of the risk. The insurer could ask the state to assume its appropriate share of unearned premium reserve consistent with the role that the state has assumed by entering into a normal reinsurance transaction. However, to accomplish this result, the insurer would have to calculate the probable

Indirect financial incentives to attract insurer participation in the state program include exemptions from provisions of the Washington insurance code. For example, the insurer contracting with the state program will enjoy a premium tax exemption resulting in a savings in an amount equaling two percent of the premiums collected for policies written through the program.²⁴³ In addition, premiums received by an insurer through participation in the program cannot be included in the assessment base used to determine each insurer's required contribution toward financing the state Insurance Commissioner's Office.²⁴⁴ Statutory and regulatory exemptions will also lower overhead costs associated with compliance with policy form and rate filing requirements.²⁴⁵

Apart from the financial benefits derived from insurance code exemptions, insurers contracting with the state program will enjoy unprecedented freedom to design, price, and market insurance. Although the contracting insurer must conform to EPA financial responsibility regulations, they may design policies without regard to any state insurance statute or regulation governing liability policies.²⁴⁶ In addition, the program director

"real" cost of reinsurance to serve as a guide to the state's program for maintaining an appropriate amount of unearned premium reserve.

243. WASH. REV. CODE § 70.148.090 provides an exemption from WASH. REV. CODE § 48.14.020 governing premium taxes for insurers authorized to do business in Washington and from WASH. REV. CODE § 48.15.120 governing premiums taxes for unauthorized (surplus lines) companies issuing policies in Washington.

244. WASH. REV. CODE § 70.148.090.

245. WASH. REV. CODE ch. 48.18 (regulating insurance contracts) & 48.19 (regulating insurance rates).

246. For example, WASH. REV. CODE § 48.18.180 provides:

(1) The premium stated in the policy shall be inclusive of all fees, charges, premiums, or other consideration charged for the insurance or for the procurement of insurance.

(2) No insurer or its officer, employee, agent, solicitor, or other representative shall charge or receive any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy.

Despite this statutory provision, the program can create a separate compensation system for program marketing, underwriting and application processing. Such a compensation system would allow the program to directly cover the costs related to site analysis and testing for underwriting purposes, as contemplated under the program's enabling legislation, through payments to insurance brokers or environmental consultants rather than payments to owners or operators.

As another example, WASH. REV. CODE § 48.18.190 provides that "[n]o agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy." Despite this statutory provision, the program can require and the insurer can issue policies made subject to program regulations. Moreover, given the insurance code exemptions, no policy need be issued. Instead, the insurer could, upon request, issue a financial responsibility certificate

could insulate the contracting insurer from the uncertain costs of judicial interpretation of policy provisions by adopting the insurer's policy form as a regulation directed at the insurer.²⁴⁷ By requiring the insurer to issue coverage in language required by regulation, the proper judicial inquiry in a coverage dispute would be based upon administrative rather than insurance law principles.²⁴⁸

Unlike the financial assurance programs in other states, Washington's program strives to mimic insurance business practices. The governing statute clearly prohibits coverage of existing or past losses, requires prospective policyholders to

required by the EPA indicating that pollution liability coverage is governed by program regulations. Thus, policy provisions could be quickly amended to reflect changes in law and technology without the time and cost associated with traditional policy changes.

247. If a policyholder and the insurance company disagree as to what a particular policy provision means, a court will interpret the provision from the point of view of an ordinary purchaser of insurance. *Prosser Comm'n Co. v. Guaranty Nat'l Ins.*, 41 Wash. App. 425, 429, 700 P.2d 1188, 1190 (1985). This standard of judging in accordance with the understanding of an average lay person is not adjusted to reflect the wit or sophistication of the particular policyholder such as a major corporation. *Boeing Co. v. Aetna Casualty & Sur.*, 113 Wash. 2d 869, 882, 784 P.2d 507, 514 (1990). If a court finds the disputed provision ambiguous, the court will interpret the provision in favor of the policyholder and against the drafter of the contract. *Kowal v. Grange Ins. Ass'n.*, 110 Wash. 2d 239, 247-48, 751 P.2d 306, 310 (1988). "However, there is no doubt that a policy provision cannot contravene the mandate of the state as judicially interpreted." *Kenworthy v. Pennsylvania Gen. Ins.*, 113 Wash. 2d 309, 315, 779 P.2d 257, 260 (1989) (citations omitted). The contrary should also be true—if a statute requires a certain provision, a rule of strict construction against the insurer does not apply. *Inter Insurance Exch. of Auto. Club of Southern Cal. v. Marquez*, 116 Cal. App. 3d 652, 656 172 Cal. Rptr. 263, 264 (1981).

248. If the financial responsibility assurance program adopts a regulation incorporating the insurer's policy form in its entirety and directs the insurer to provide coverage accordingly, the insurer has not drafted the contract but rather is administering coverage in accordance with a state law. Therefore, a dispute over the meaning of a particular policy provision would constitute a dispute over the meaning of a regulation. The regulation will be presumed valid and "neither the reasonableness of the rule nor the factual basis which leads an agency to adopt a rule is properly the concern of the court." *American Network v. Washington Utils. & Transp. Comm'n.*, 113 Wash. 2d 59, 71, 776 P.2d 950, 957 (1989). More importantly, the agency's interpretation of the meaning of its own rules is given great weight by courts. *Hart v. Bowen*, 799 F.2d 567, 569 (9th Cir. 1986), *Washington State Liquor Control Bd. v. Washington State Personnel Bd.*, 88 Wash. 2d 368, 379, 561 P.2d 195, 201 (1977). Therefore, if an owner or operator disputed the meaning and coverage of a policy whose content is completely governed by state regulation, then the dispute is an administrative law question rather than an insurance law issue. This difference requires a court to favor the state and its interpretation over the policyholder's understanding. See *Federated American Ins. v. Marquardt*, 108 Wash. 2d 651, 741 P.2d 18 (1987). (Insurance Commissioner's interpretation of own rule governing required level of auto medical benefits was entitled to great weight, court will not review the wisdom or desirability of a rule).

meet underwriting standards, and mandates the use of sound actuarial principles in designing and managing the program.²⁴⁹ Each of these provisions should provide some degree of comfort to an insurer contemplating a business relationship with Washington. However, an insurer will most likely wait to see how the program director implements these legislative directives. For example, if the director requires a bidding insurer to agree to accept a class of tanks that the insurer views as extreme risks, the bidding insurer may decide to forgo the state reinsurance contract. Other potential disincentives to insurer participation in the state program could affect the benefits obtained by the insurer.

The greatest potential disincentive to insurer participation in the program is the risk of a state default on its reinsurance obligations. Reinsurance contract relationships are typically long term and require the utmost of good faith in dealings between the parties.²⁵⁰ However, an insurer cannot have much faith when the state plans to terminate the reinsurance program on June 1, 1995, and the legislature has declared that "all the rights, privileges, and immunities conferred by the [program] or any acts done under it exist subject to the power of the legislature to amend or repeal [the program] at any time."²⁵¹

By this provision, then, the legislature may void the director's act of entering into a reinsurance contract at a later date.²⁵² Of course, this risk may be remedied through an

249. WASH. REV. CODE §§ 70.148.005(d)(3) & 70.148.070(d).

250. See generally REINSURANCE, *supra* note 196.

251. WASH. REV. CODE § 70.148.110 (1989).

252. It is not clear how Washington courts would react to a legislative attempt to rescind a reinsurance agreement through statutory repeal. Generally, the state is bound to observe the same rules of contract as is required of its citizens. *State v. Clausen*, 94 Wash. 166, 162 P. 1 (1917). The state is held to resolute good faith in its contractual dealings. *Eagles v. General Electric Co.*, 5 Wash. 2d 20, 104 P.2d 912 (1940). "When a statute has been repealed, the rights or liabilities created by the statute fall; however, this does not extirpate vested rights, which remain enforceable despite repeal." *Ward v. Washington State University*, 39 Wash. App. 630, 632, 695 P.2d 133, 135 (1985). Nevertheless, the legislature has clearly stated that "there is no vested right of any kind against such amendment or repeal [of the program]." WASH. REV. CODE § 70.148.110. In *Carlstrom v. State*, 103 Wash. 2d 391, 694 P.2d 1 (1985), the supreme court reviewed a statutory provision providing that written contracts governing salary agreements with employees of community colleges would "not be binding upon future actions of the Legislature." *Id.* at 398, 694 P.2d at 6. The court found that this language was insufficient to permit the state to modify its preexisting contracts with the community college faculty and held that the provision violated the state and federal constitutional provisions prohibiting impairment of contracts. The

owner/operator insurance policy provision cancelling coverage when the state cancels reinsurance coverage. This risk of state default may constitute sufficient consideration on the part of the insurance company to constitutionally justify a low price for state reinsurance, thereby avoiding state "lending of credit" prohibitions.²⁵³

Apart from an intentional default, the state could unintentionally default if obligations exceed revenues.²⁵⁴ But this is a customary business risk. The insurer can use traditional methods to determine whether the program is a sufficiently capitalized and reserved reinsurance 'company.'²⁵⁵ Moreover, an insurer contracting with Washington will be challenged by other states' insurance regulators to prove that Washington state reinsurance should be counted in an analysis of insurer reserves and liabilities.²⁵⁶ Other states' regulating the insurer may require that in order to count Washington reinsurance, Washington must give the insurer some form of financial guarantee proving the existence of state program surplus and reserves.²⁵⁷

The legislature's 1990 amendments to provisions regarding program revenues should ensure the existence of sufficient state funds because state revenue collections will reflect pro-

court stated that "the Legislature knows how to use plain English to make existing contracts subject to future modification. It could have written [in the statute] . . . 'these agreements shall be subject to subsequent modification by the Legislature.'" *Id.* The court nevertheless suggested that such an impairment still would be subject to independent judicial analysis to determine whether the impairment was "reasonable and necessary." *Id.* at 399, 694 P.2d at 6 (citing *U.S. Trust Co. v. New Jersey*, 431 U.S. 1 (1977) (describing the "reasonable and necessary" standard)). *Id.* at 394, 694 P.2d at 4. The best solution to this problem is for the program director to ensure that the reinsurance agreement conditions contract performance upon revenue sufficiency and future legislative actions. *Id.* at 394, 694 P.2d at 4.

253. See *supra* text accompanying notes 195-203.

254. See *supra* text accompanying notes 203-206.

255. See REINSURANCE, *supra* note 196, at 599-614.

256. See, e.g., WASH. REV. CODE § 48.12.160 for standards governing insurer credit for reinsurance. Generally, the Washington Insurance Commissioner, and other commissioners, must be satisfied that Washington state, as a non-licensed reinsurer, "maintains sufficient assets in the United States for the protection of policyholders in the United States and operates its business in [a manner similar to licensed reinsurers] and that it is able to pay losses in the United States." WASH. REV. CODE § 48.12.160(1)(a).

257. *Id.* § (1)(b)(ii) provides that an insurer may take credit for reinsurance from a non-licensed reinsurer in an amount not exceeding: "[t]he amount of a clean and irrevocable letter of credit issued by a bank which is a member of the federal reserve system"

gram liabilities.²⁵⁸ As the insurer issues policies to owners and operators, the program director can expand surplus reserves to compensate for program growth.²⁵⁹ As claims are made, the director can create loss reserves for liabilities that will require state program payments.²⁶⁰ In addition to these reserves, the insurer may always increase owner/operator insurance premiums with the director's approval.²⁶¹

Another factor affecting insurer interest in providing insurance under the Washington program is the state's enforcement of underground storage tank technical and financial responsibility regulations.²⁶² Lack of promulgation and enforcement of technical regulations by the Department of Ecology requires the insurer to duplicate the Department's functions by verifying that a potential policyholder has complied with all appropriate environmental regulations prior to policy issuance. Moreover, if an insurer has no faith in the Department of Ecology's ability to enforce regulations, then

258. See 1990 Wash. Laws ch. 64, § 12; WASH. REV. CODE § 82.23A.020(4) (1990).

259. See WASH. REV. CODE § 70.148.020(2) (1989). The director determines surplus and loss reserves quarterly. 1990 Wash. Laws ch. 64, § 3(2). Surplus reserves serve:

- 1) to absorb underwriting losses or operating costs beyond those envisioned in the rate level used;
- 2) to absorb declines in the value of the investment portfolio;
- 3) to allow for adequate loss reserves, and
- 4) to finance future growth in written premiums.

REINSURANCE, *supra* note 196, at 600.

260. WASH. REV. CODE § 70.148.020(2). Petromark's experience in providing pollution liability coverage to underground tank owners and operators serves as a warning of the difficulty in setting loss reserves and underscores insurer fears in dealing with Washington state. On January 29, 1990, Petromark's actuary reported that liability claims were underreserved by one-third. In a single quarter, despite following actuary advice in setting loss reserves, Petromark went from a positive net worth of \$9.5 million to a negative net worth of \$10.5 million. Another actuarial firm hired by Petromark for a second opinion reported a lower figure of needed reserves. Petromark is now undergoing voluntary rehabilitation by the State of Tennessee. See "Petromark in Rehabilitation", *National Underwriter*, April 16, 1990, at 3; *Petromark Letter*, *supra* note 24. An insurance company considering business with Washington has no assurance that the state program will be any more capable than Petromark in adequately projecting and funding liabilities.

261. WASH. REV. CODE § 70.148.070(2)(g) (1989).

262. "State Options for Implementing Financial Responsibility Requirements for Petroleum Underground Storage Tanks," Report from the Environmental Liability Insurance (D) Task Force Advisory Committee to the full Task Force (Nov. 1, 1988). In part the committee concluded:

The ability and willingness of the EPA and state environmental regulatory agencies to enforce new technical and financial responsibility requirements directly impacts the availability of an insurable tank population for the tank insurance market.

Id. at 3 (copy on file at the University of Puget Sound Law Review).

the insurer will duplicate the Department of Ecology's functions irrespective of the Department's performance of these same functions. The resulting costs of verifying compliance with environmental regulations will be added to the costs of insurance. Ironically, tank owners and operators are paying fees to the state for the Department of Ecology administration and enforcement of UST regulations²⁶³ and may be forced to pay the insurer to duplicate this effort.

Lack of enforcement of the financial responsibility regulations limits the market for insurance.²⁶⁴ Few tank owners and operators willingly purchase pollution liability insurance. Without sufficient numbers of prospective policyholders, the fixed costs of an insurance operation cannot be adequately recouped and the variable costs associated with the risks assumed cannot be adequately predicted. Strict enforcement of financial responsibility regulations by the program will ensure a large market for the contracting insurer because of the price advantages that the program insurer will enjoy over non-contracting insurance competitors.

The legislature recognized the relationship between enforcement of financial responsibility regulations and insurance availability by amending the program statute to require enforcement of these regulations when the program became operational.²⁶⁵ However, on the day the Governor signed this

263. WASH. REV. CODE §§ 90.76.090-100 (1989). Given an insurer's vested financial interest in avoiding or minimizing losses, an insurer will employ whatever underwriting and ongoing monitoring methods of USTs necessary to prevent coverage of USTs that fail to comply with technical regulations or fail to meet certain risk standards. Therefore, an insurer will know sooner than the Department of Ecology whether an owner or operator complies with regulations and will give the owner or operator the choice of compliance or cancellation of coverage. Cancellation of coverage puts the owner or operator in violation of law and forces the owner or operator to discontinue operations until financial responsibility assurance is obtained. Therefore, one can logically conclude that any owner or operator who has obtained insurance has also complied with all appropriate UST regulations.

264. N. Ashford & R. Stone, Executive Summary Presented to the Environmental Liability Insurance Task Force (May 22, 1989). The executive summary notes:

The lack of enforcement of financial responsibility provisions, ostensibly justified by concern about the difficulties in obtaining risk coverage, is particularly troubling, since it represents a cause-and-effect confusion . . . the market for environmental liability insurance will perish if (stringent) financial responsibility provisions are *not* vigorously enforced.

Id. at ES-5 (emphasis in original).

265. 1990 Wash. Laws ch. 64 § 8(6) provides:

When a reinsurance contract has been entered into by the agency and insurance companies, the director shall notify the department of ecology of the letting of the contract. Within thirty days of that notification, [the

legislation, the EPA announced a one-year extension of the April and October 1990 deadlines for compliance with the financial responsibility regulations.²⁶⁶ This extension created two problems. First, state law requires financial responsibility compliance sooner than federal law. The Department of Ecology can probably ignore the legislative directive to enforce the regulations since the directive references EPA regulations.²⁶⁷ However, the Department of Ecology may not be able to avoid the statute's requirement that owners and operators declare their intended method of compliance because the requirement exists independent of any EPA requirement or regulation. If this requirement is enforced, the program can obtain better information as to the number and types of owners and operators likely to rely upon the program.

The second problem raises the question of whether insurance companies will seek to participate in the state program given the enforcement delay. Even if some companies choose to participate in the state program despite this delay, other more qualified companies could avoid the program. In either case, the program will not and cannot accept an insurer's bid unless the insurer is fully qualified and capitalized to insure Washington tank owners and operators.²⁶⁸

Finally, two program provisions related to insurer acceptance of owner and operator insurance applications may cause an insurer to balk at the prospect of doing business with the state program. First, owners and operators may obtain coverage even if their site is polluted.²⁶⁹ Second, owners and operators who have been rejected or cancelled may appeal the insurer's decision to the program director.²⁷⁰

At first glance, requiring insurers to accept polluted sites

department of ecology] shall notify all known owners and operators of petroleum underground storage tanks that appropriate levels of financial responsibility must be established by October 26, 1990, in accordance with federal [EPA] requirements, and that insurance under the program is available. All owners and operators of [USTs] must also be notified that declaration of method of financial responsibility or intent to seek to be insured under the program must be made to the state by November 1, 1990 . . . [The department of ecology] shall . . . prohibit the owner or operator . . . from . . . receiving petroleum products until such time as financial responsibility has been established.

266. EPA press release, Thursday, March 15, 1990. 1990 Wash. Laws ch. 64 § 8(b).

267. See WASH. REV. CODE §§ 70.148.005(d)(3) & 70.148.070(d).

268. WASH. REV. CODE §§ 70.148.070(1) & .050(1).

269. See *supra* text accompanying note 215.

270. See *supra* text accompanying notes 216-219.

contradicts other program provisions prohibiting payment for cleanup of pre-existing pollution. The fundamental problem associated with insuring polluted sites is the difficulty in successfully rejecting a claim for a pre-existing condition because of the insurer's burden in proving that a release predates the policy coverage period.²⁷¹ However, under the program the policyholder has the burden of proof until the program director determines that the owner/operator has a plan for corrective action²⁷² and that the pre-existing pollution has been corrected.²⁷³ Consequentially, many owners and operators of polluted sites will not be able to afford clean-up and thus, these owners and operators will go out of business rather than apply for insurance.

The director is placed in an awkward position because enforcement of environmental regulations and monitoring of clean-up action is the responsibility of the Department of Ecology. However, the Department of Ecology cannot declare that a site has been cleaned up.²⁷⁴ The Department of Ecology can only certify that the owner or operator has fulfilled any required corrective action.²⁷⁵ Any decision by the program director concerning the completion of clean up action that conflicts with the Department of Ecology's determinations of required clean up action will cause inter-agency disputes. From the owner or operator's perspective, the Department of Ecology will have the final word on required clean up action. Given the insurer's direct interest in the program director's decision that an insured site has been cleaned of prior contamination, the director may be forced to accept the insurer's analysis of the site or the director may face either complete alienation of the insurer or potential litigation with the insurer. The director may declare the insured's site clean and therefore, the insured owner or operator would no longer have the burden of proving that a pre-existing release was unrelated to a new claim. Nevertheless, subsequent investigation may reveal that the director was wrong in declaring a site clean, creating disputes between the program and the insurer or the

271. See *supra* text accompanying notes 82-84 and 107-109.

272. WASH. REV. CODE § 70.148.070(5)(a).

273. WASH. REV. CODE § 70.148.070(5)(b).

274. Letter from Thom Lufkin, Department of Ecology to John Conniff, (Jan. 30, 1989) (copy on file at the University of Puget Sound Law Review).

275. *Id.*

insured owner/operator as to who should bear the consequences of such misjudgment.

The second provision creates a more complicated problem. By permitting owners and operators to appeal the insurer's decision to reject or cancel insurance coverage the program director is placed in the position of "super-underwriter." The director can substitute his or her own underwriting judgment for the insurance company's judgment. While it can be expected that the director will carefully incorporate the insurer's underwriting standards into program regulations and will attempt to set objective standards for purposes of judging insurer adherence to program requirements, many insurance underwriting decisions call for subjective judgment in close cases. Given that denial of insurance may mean business failure resulting from noncompliance with financial responsibility regulations, the director will face extraordinary pressure to override an insurer's denial of coverage.

The director must also find an objective way to incorporate the legislative directive to favor owners and operators whose USTs are relied upon by the local community. In other words, despite the insurer's clear adherence to underwriting standards, the director may be compelled to override the insurer's rejection of a site because of the impact a tank closure would have upon the affected community. The director and insurer must come to a clear agreement as to the appropriateness and application of this economic consideration or else an insurer may avoid business with the state, concluding that political and social considerations will override sound underwriting standards. The director must allay such insurer fears or few, if any, insurers will bid to participate in the state program.

V. CONCLUSION

Washington state has created a unique program to provide financial responsibility assurance to owners and operators of underground petroleum storage tanks. Rather than attempt direct provision and management of coverage for corrective action and third party damages, the state will reinsure the liabilities of an existing pollution liability insurance company who agrees to sell insurance to Washington owners and operators at a price and upon conditions established by the program director.

The program allows voluntary participation by owners and operators but, conditions acceptance of owners and operators into the program upon sound underwriting principles. The program will deviate from sound insurance business practices only to the extent necessary to assure the availability and affordability of insurance. For communities relying upon the presence of particular owners or operators for petroleum needs, the program can bend the rules to ensure the continuing presence of these owners or operators.

Revenue to fund the program will vary to meet its liabilities and expenses. These liabilities and expenses must be projected in an actuarially sound manner with appropriate reserves established. Prices for insurance and reinsurance must comport with generally accepted liability insurance standards. If the program financially collapses, the state has created avenues to escape direct liability for program obligations.

In effect, Washington has created a public reinsurance corporation whose stockholders expect a product sale without a profit. The state has given program management extraordinary freedom from existing and customary program and insurance statutory restraints. The program director was granted as many tools as necessary to bargain with and attract an insurer capable of meeting the program's goals and objectives.

Insurance companies were similarly granted freedom from insurance statutes and taxes to the extent of their participation in the program. Unlike traditional state responses to the unavailability or unaffordability of insurance, no insurance company will be impressed into state service. The insurance industry can ignore the Washington program or the industry can work with the director to create a unique market opportunity.

The success or failure of the Washington reinsurance experiment will be measured by the number of owners and operators whose financial responsibility needs are met. Program success will also be measured by the degree to which the state is protected from unwanted and unanticipated financial exposure. The pollution liability insurance industry holds the keys to this success. If the industry ignores or takes unfair advantage of the program, the program will fail and the opportunity for similar private/public insurance ventures will be lost. Washington has gambled that by allowing the state and

the private sector to do what they each do best, both will achieve success.