New Jersey Department of Environmental Protection

Bureau of Release Prevention

FINANCIAL RESPONSIBILITY UNDER N.J.A.C. 7:1E

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Introduction

The Discharges of Petroleum and Other Hazardous Substances (DPHS) rules, N.J.A.C. 7:1E, require that owners or operators of major facilities subject to DPHS requirements show financial responsibility in the minimum amounts of $1 million per occurrence and $2 million annual aggregate. These funds are to be used to clean up and remove discharges, if they occur at the facility. “Cleanup and removal activities” as defined in the DPHS rules include actions to clean up or remove or attempt to clean up or remove a discharge of a hazardous substance or its source, or to chemically neutralize it. It also includes measures to prevent or mitigate any damages to the public health, safety or welfare. It does not include remediation activities incurred due to a discharge that occurred sometime in the past. "Per occurrence" means the amount of money that must be available to pay the costs of cleaning up and removing one discharge at the facility. The annual aggregate amount is the total amount of financial responsibility that the owner or operator must have to cover all discharges that might occur in one year. However, the establishment of these amounts does not limit the owner or operator’s liability in the event of a discharge. It simply ensures that this minimum amount of funding is available to clean up and remove a discharge.

This guidance document explains the different financial instruments that can be used to demonstrate financial responsibility, how these instruments are to be prepared and submitted to the Department of Environmental Protection (Department), and available exceptions to and reductions in financial responsibility.

The Spill Compensation and Control Act (Spill Act, N.J.S.A. 58:10-23.11a *et seq.*) directs the Department to establish the amount, nature, terms and conditions of this financial responsibility. To that end, the Department adopted N.J.A.C. 7:1E-4.4. The financial responsibility requirements of the federal underground storage tank (UST) rules, codified at 40 CFR 268, were used as a basis for the development of those in the DPHS rules.

There are specific financial instruments to be used to show financial responsibility under any of the available forms: financial test of self-insurance; guarantee; insurance or risk retention group; surety bond; or letter of credit. While there are several options for demonstrating financial responsibility, one of these specified financial instruments, or a combination of them, must be used. **The wording of all financial instruments submitted to the Department to show financial responsibility pursuant to the DPHS rules must be worded as specified in N.J.A.C. 7:1E - Appendix B. Wording changes are not accepted.** When completing the documents, the words in brackets are to be removed and replaced with the appropriate word(s) or phrase. When quotation marks appear around a word or phrase within the brackets, that exact word or phrase is to be used, as appropriate. For example, if the document in N.J.A.C. 7:1E - Appendix B reads “in the amount of at least [insert: dollar amount] per occurrence [insert: "per facility" if multiple facilities are covered by this one document] and [dollar amount] annual aggregate ["per facility" if multiple facilities are covered by this one document]” and multiple facilities are being covered by the document, the completed document should read “in the amount of at least $1 million per occurrence per facility and $2 million annual aggregate per facility.”

The U.S. Environmental Protection Agency's (USEPA) document *Financial Responsibility For Underground Storage Tanks: A Reference Manual* was used in the preparation of this document. It contains further information specific to the UST program, but may prove useful to those working to establish financial responsibility. It can be found on USEPA's website at http://www.epa.gov/ust/financial-responsibility-underground-storage-tanks-reference-manual.

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Financial Test of Self-insurance

Self-insurance often will be the least expensive method of demonstrating financial responsibility. Large, financially viable firms can provide evidence of financial responsibility without paying the costs of procuring financial mechanisms from other entities. Owners or operators that use self-insurance demonstrate financial strength by passing a set of pass/fail criteria, termed a financial test. Although large firms may find passing a financial test easier than smaller firms do, some large firms may not be able to pass the test because it measures more than just size alone.

A financial test of self-insurance is a document used to show that a company has sufficient financial strength to provide, on short notice, the indicated amount of funding. This may be through cash reserves or assets that can be borrowed against. The source of this funding does not need to be specified in the financial document. There are several ways that this financial strength can be demonstrated, and they are dependent, in part, on what type of entity is attempting to self-insure. All of the documents used to demonstrate compliance with the applicable financial test can be found in N.J.A.C. 7:1E - Appendix B. The documents must be worded exactly as presented in the appendix.

For a private company, tangible net worth, a bond rating from Standard and Poor's or Moody's, or net working capital can be the basis of self-insurance. Each of these bases has minimum requirements associated with it in order to demonstrate the $1/$2 million thresholds. Governmental entities have a different set of possible bases, as they do not have tangible net worth or net working capital. For owners or operators that are local governments, bond rating or the ability to tax or charge fees is used as the basis of the financial test. All forms of the financial test require that if year-end statements for the company are independently audited, they cannot have an adverse auditor's opinion or "going concern" disclaimer. These opinions indicate that the reported net worth of the owner or operator may be greater than its actual net worth. A "going concern" qualification indicates that there is a question about the ability of an owner or operator to stay in business. This requirement applies only if the statements are independently audited. It is not required that they be independently audited in order to qualify to use the financial test of self-insurance.

Relationship to Other Tests

Several state and federal programs, such as the underground storage tank (USTs) program and Resource Conservation and Recovery Act (RCRA) program, also have financial responsibility requirements. When a financial test of self-insurance is used for another program(s), it must be accounted for in the documentation for the DPHS financial test. There are two ways to do this. The first is to separately list all programs for which a financial test is used along with the amount of financial responsibility being provided. There is a place for this on the forms in N.J.A.C. 7:1E - Appendix B. The second way is to include the cost of any financial test in the company's liabilities when filling out the form. Either method is acceptable, but these financial tests must be included because they are a draw on the financial strength of the company.

Tangible Net Worth

When tangible net worth is being used as the basis of self-insurance, that net worth must be at least $10 million. The Federal UST program has determined that the incidence of bankruptcy among firms with less than $10 million in tangible net worth is approximately two times as great as the bankruptcy rate among firms with more than $10 million in tangible net worth. Only tangible assets can be used in determining net worth, thus things like goodwill and patent rights are not included. If a major facility is owned by a company that has national holdings, when tangible net worth is determined, the assets and liabilities considered must be equivalent. Thus, if assets are based only on those held by the major facility, then so are the liabilities, and if the assets are the national assets of the company, the liabilities must be as well. For national liabilities, this includes financial tests used in other states for programs within those states or for federal programs.

The next consideration when using tangible net worth, is that the tangible net worth of the company must be at least ten times the amount of aggregate self-insurance. This aggregate must include all forms of self-insurance used for any state or federal programs, if those costs are not already included in the company's liabilities. The Federal UST program has found that owners or operators with liabilities equal to ten percent or less of their net worth have an associated probability of bankruptcy of approximately one percent. Therefore, owners or operators must be aware that although they may have a tangible net worth of $10 million, they may not be eligible to self-insure using tangible net worth as the basis. For example, an owner or operator can have a tangible net worth of $11 million, but that is not ten times the $2 million annual aggregate, and he or she does not pass the tangible net worth financial test.

A company using tangible net worth must file annual financial statements with one of the organizations listed in N.J.A.C. 7:1E-4.4(g)1ii, or report annually to Dun and Bradstreet and have the requisite financial strength rating.

Owners or operators using tangible net worth to demonstrate financial responsibility in the full amount of $1/$2 million must complete Alternative I in N.J.A.C. 7:1E - Appendix B. In certain circumstances, Alternative II must be used. For example, for a privately-held company that does not submit its financial statements to a regulating body as established in N.J.A.C. 7:1E-4.4(g)2iii, Alternative I cannot be completed and Alternative II must be used.

Bond Rating

If a bond rating is being used as the basis of the financial test, it must be issued by Standard and Poor's or Moody's and must meet the standard established in N.J.A.C. 7:1E-4.4(g)2. In addition, the company must have a tangible net worth at least six times the amount of aggregate self-insurance. This aggregate must include all forms of self-insurance used for any state or federal programs, if those costs are not already included in the company's liabilities. Tangible net worth must be tangible assets, thus things like goodwill and patent rights are not included. If a major facility is owned by a company that has national holdings, when tangible net worth is determined, the assets and liabilities considered must be equivalent. Thus, if assets

are based only on those held by the major facility, then so are the liabilities, and if the assets are the national assets of the company, the liabilities must be as well. Similarly, if the bond rating is for the company as a whole, then national holdings must be used in the financial test. If the bond rating is for a bond issued by the major facility, local assets can be used.

Next, a certain amount of the company's assets must be in the United States: at least 90 percent of total assets, or at least six times the amount of aggregate self-insurance. This ensures that the owner or operator has immediate access to the assets in the event of a discharge.

Finally, a company using a bond rating must file annual financial statements with one of the organizations listed in N.J.A.C. 7:1E-4.4(g)2iii, or have a special report from an independent certified public accountant as specified in N.J.A.C. 7:1E-4.4(g)2iii. A bond rating based test must be documented using Alternative II in N.J.A.C. 7:1E - Appendix B.

Net Working Capital

Net working capital is the excess of current assets over current liabilities. Current assets is a balance sheet entry that identifies cash and resources expected to be sold or consumed during the normal operating cycle of a business, and are relatively liquid assets. Current liabilities is a balance sheet entry that identifies obligations that are expected to be satisfied by using current assets. Net working capital is the difference between the two and identifies a firm's relatively liquid portion of total capital. Unused borrowing capacity is not part of the standard definition of working capital.

If net working capital is being used as the basis of the financial test, the company's tangible net worth and net working capital must both be six times the total aggregate for all self-insurance. This aggregate must include all forms of self-insurance used for any state or federal programs, if those costs are not already included in the company's liabilities. Tangible net worth must be tangible assets, thus things like goodwill and patent rights are not included. If a major facility is owned by a company that has national holdings, when tangible net worth is determined, the assets and liabilities considered must be equivalent. Thus, if assets are based only on those held by the major facility, then so are the liabilities, and if the assets are the national assets of the company, the liabilities must be as well. The net working capital requirement is designed to measure the adequacy of a company's liquid resources, given the potential level of its environmental obligations.

Next, a certain amount of the company's assets must be in the United States: at least 90 percent of total assets, or at least six times the amount of aggregate self-insurance, as explained previously under Bond Rating.

Finally, a company using net working capital must file annual financial statements with one of the organizations listed in N.J.A.C. 7:1E-4.4(g)2iii, or have a special report from an independent certified public accountant as specified in N.J.A.C. 7:1E-4.4(g)2iii. A net working capital based test must be documented using Alternative II in N.J.A.C. 7:1E - Appendix B.

Government Agencies

Sometimes major facilities, such as water treatment facilities or power generation facilities, are owned or operated by local government. Local governments do not have tangible net worth or working capital, and therefore, they need a separate document to demonstrate that they pass a financial test. A local government can use one of two bases for the financial test: bond rating or the ability and authority to assess and levy taxes or to establish fees and charges.

To use a bond rating, the rating must be issued by Standard and Poor's or Moody's and must meet the standard established in N.J.A.C. 7:1E-4.4(g)3. In addition, a general purpose local government must have a current aggregate of at least $1 million in outstanding general obligation bonds that are not backed by credit enhancement other than municipal bond insurance. For a local government other than a general purpose local government, there must be a current aggregate of at least $1 million in outstanding revenue bonds that are not backed by credit enhancement other than municipal bond insurance.

A local government may use the ability and authority to assess and levy taxes or to establish fees and charges, rather than a bond rating, as the basis for its financial test. In this case, the local government must also have year-end financial statements that, if independently audited, do not contain an adverse auditor's opinion or "going concern" disclaimer. This applies only if the statements are independently audited. It is not required that they be independently audited in order to qualify to use the financial test of self-insurance. In addition, the local government cannot have any outstanding issues of general obligation or revenue bonds that are less than investment grade. In order to complete the financial test, the local government must have annual information on total revenues, total expenditures, local revenues, debt service, total funds, and population, as outlined in N.J.A.C. 7:1E-4.4(g)4.

Multiple Facilities

The documents used to demonstrate that a company or local government passes the financial test of self-insurance can be used to cover more than one facility. There are two ways this can be done. A single document can be used for all major facilities to be covered. In this case, all covered facilities must be listed in the document and the total amount of coverage will be $2 million multiplied by the number of facilities covered. For example, if a company operates three major facilities in New Jersey, the amount of annual aggregate coverage must be $6 million. The company must be able to pass the financial test for this amount.

The second way to use the document is prepare a separate one for each facility, with the $1 million per occurrence and $2 million annual aggregate coverage contained in each. In this case, the financial tests covering the other major facilities must be delineated under the other tests section of the document, or must be included in the company's total liabilities. The company must be able to pass the test with these liabilities.

Preparation and Submission of the Test

The letter from the chief financial officer containing the completed test of self-insurance must be prepared within 120 days of the end of the fiscal year that is being used as the basis of the numbers in the test. The letter must be worded exactly as in N.J.A.C. 7:1E - Appendix B and an original, with the signature of the chief financial officer, must be submitted with an initial plan submission or plan renewal; otherwise it only needs to be kept at the location of the major facility and made available to Bureau inspectors. If the owner or operator finds that he or she cannot pass the financial test of self-insurance, an alternative method of financial responsibility must be obtained within 150 days of the end of the fiscal year. The change must be reported to the Bureau as required by N.J.A.C. 7:1E-4.8(e).

Guarantee

A guarantee is prepared for a major facility by a person other than the owner or operator. A guarantor must pass the financial test of self-insurance in order to complete a guarantee. To be a guarantor, one must possess a controlling interest in the owner or operator, possess a controlling interest in a person who possesses a controlling interest in the owner or operator, be controlled through stock ownership by a common parent firm that possesses a controlling interest in the owner or operator, or be engaged in a substantial business relationship, as defined in N.J.A.C. 7:1E-1.6, with the owner or operator.

Controlling interest is defined as direct ownership of at least 50 percent of the voting stock or other equity interest. Thus, an owner or operator of a major facility who is a subsidiary of another company can obtain a guarantee from that company to show financial responsibility. Similarly, an owner or operator can obtain a guarantee from a company that owns the company that has a controlling interest in the owner or operator. Also, a company held by a holding company common to the owner or operator of the major facility can be a guarantor, as they are controlled by the same parent firm. However, a firm that holds less than 50 percent of the voting stock of an owner or operator cannot be a guarantor, even if it is the majority stock holder, unless there is a substantial business relationship between the companies. These eligibility requirements are established for several reasons: to ensure that the guarantee is valid under state law; to avoid conflict with state laws relating to the business of insurance; and to ensure that sufficient unity of interest exists between the guarantor and the owner or operator to provide adequate assurance of financial responsibility.

Multiple Facilities

A guarantee can be issued by the same guarantor for more than one facility. There are two ways this can be done. A single document can be used for all major facilities to be covered, as long as they are owned and operated by a single owner or operator. In this case, all covered facilities must be listed in the document and the total amount of coverage will be $2 million multiplied by the number of facilities covered. For example, if two major facilities in New

Jersey are being covered, the amount of annual aggregate coverage must be $4 million. The guarantor must be able to pass the financial test for this amount.

The second way is to use a separate document for each major facility, with the $1 million per occurrence and $2 million annual aggregate coverage contained in each. In this case, when the guarantor prepares the financial test of self-insurance, all amounts being guaranteed must be delineated under the other tests section of the document, or must be included in the guarantor's total liabilities. The guarantor must be able to pass the financial test with these liabilities.

Preparation and Submission of the Guarantee

The guarantee letter must be prepared within 120 days of the end of the fiscal year that is being used as the basis of the numbers in the test and must be accompanied by the letter from the chief financial officer containing the completed test of self-insurance. Both of these documents must be worded as specified in N.J.A.C. 7:1E - Appendix B. The letter and financial test, both with original signatures, must be submitted with an initial plan submission or plan renewal, otherwise these documents only need to be kept at the location of the major facility and made available to Bureau inspectors. If the guarantor finds that he or she cannot pass the financial test of self-insurance, he or she must inform the owner or operator and the Bureau by certified mail that the guarantee will be terminated. The owner or operator then has 30 days to obtain an alternative method of financial responsibility. The change must be reported to the Bureau as required by N.J.A.C. 7:1E-4.8(e).

Insurance or Risk Retention Group Coverage

An owner or operator of a major facility can show financial responsibility through a stand-alone insurance policy or an endorsement to an existing policy. The coverage must be for the entire facility and cannot be limited to storage tanks alone. Any possible source of a discharge of a hazardous substance at the facility must be covered because the coverage is for cleanup and removal activities, not a given piece of equipment.

Liability insurance must be obtained from a company authorized to provide such insurance in New Jersey. As such, they must be licensed to transact the business of insurance or be eligible to provide insurance as an excess or surplus lines insurer. The endorsement or certificate must certify that one of these conditions is met by the insurer or risk retention group.

The period of coverage can be more than one year, as long as it is specified in the document. Existing policies can be renewed for new periods of coverage. The owner or operator can obtain a standard policy or a claims-made policy. On a claims-made policy, there is additional time for reporting of covered activities. This is only an additional reporting time. The discharge must have occurred prior to the cancellation or non-renewal date of the policy, and cleanup and removal activities must have commenced after the retroactive date of the policy.

The inclusion of a claims-made clause usually entails a higher premium for the policy or endorsement.

Note that standard industry practice is to include on insurance certificates a statement that the certificate does not amend, extend, or alter the coverage afforded by the policy. This language must not appear on an insurance certificate used for coverage under the DPHS program.

Multiple Facilities

An insurance policy or endorsement can cover more than one facility. A single document can be used for all major facilities to be covered. In this case, all covered facilities must be listed in the document and the annual aggregate coverage amount must apply to **each facility individually**. The total aggregate amount of coverage for the policy cannot be simply $2 million dollars. It must be clear that this aggregate coverage is applicable to each facility separately.

Alternatively, a separate policy or endorsement can be obtained for each major facility, with the $1 million per occurrence and $2 million annual aggregate coverage contained in each.

Preparation and Submission of the Policy or Endorsement

A copy of the current policy or endorsement must be submitted with an initial plan submission or plan renewal; otherwise, it only needs to be kept at the location of the major facility and made available to Bureau inspectors. For the copy kept at the location, when a policy is renewed on the same terms, evidence of payment of the premium and the new end date of the policy must be available from the owner or operator of the major facility. This evidence of payment must display the same policy number as the policy or endorsement submitted with the plan or plan renewal. If the insurer or risk retention group cancels the policy, within 60 days of receipt of the notice of cancellation, the owner or operator must obtain an alternative form of financial responsibility. The new financial document must be submitted to the Bureau as required by N.J.A.C. 7:1E-4.8(e).

Surety Bond

Surety bonds are used when one party, in order to protect itself in a transaction, insists that another party obtain such a bond. A surety bond is a contract which the owner or operator (the principal) can enter into with a qualified surety company (the surety). Under the surety contract, the surety guarantees to the beneficiary that the obligations of the principal will be fulfilled. The principal must pay the surety for this guarantee, because the surety will be liable for these obligations should the principal fail to fulfill them. Therefore, there are three parties to the surety agreement. A surety bond is drawn on when the owner or operator fails to perform clean up and removal activities for a discharge originating from his or her major facility, as guaranteed by the bond. Surety bonds must be obtained from companies acceptable as sureties

in New Jersey. A list of acceptable surety companies can be found at http://www.state.nj.us/dobi/division_insurance/surety.htm.

The DPHS rules require that a stand-by trust be established when the surety bond is obtained. The form of this stand-by trust is not specified. The owner or operator may use a form of his or her preference, as long as the trustee has the authority to act as a trustee and has trust operations regulated and examined by a Federal or New Jersey agency. It is recommended that owners or operators use the stand-by trust format established in the Federal UST rules at 40 CFR 280.103. A sample trust agreement can be found in Attachment 1.

> **NOTE**: The use of a standby trust is necessary because without such a mechanism, any funds drawn under the letter of credit that are payable to the Department would have to be paid into the State Treasury and could not be used without Legislative action to pay for the corrective action or third-party compensation for which the funds were intended.

Surety bonds automatically renew unless cancelled by the principal or the surety.

Multiple Facilities

A surety bond can cover more than one facility. A single document can be used for all major facilities to be covered. In this case, all covered facilities must be listed in the document under the Scope of Coverage and the penal sums of the bond for per occurrence and annual aggregate must apply to each facility individually. Alternately, a surety bond can be obtained for each major facility, with the $1 million per occurrence and $2 million annual aggregate coverage contained in each.

Preparation and Submission of the Surety Bond

The surety bond, containing original signatures, must be submitted with an initial plan submission or plan renewal, and a copy needs be kept on-site and made available to Bureau inspectors. Evidence that the surety fee has been paid for the current year of coverage may be requested by the Bureau. If the surety cancels the bond, within 60 days of receipt of the notice of cancellation, the owner or operator must obtain an alternative form of financial responsibility. The replacement financial document(s) must be submitted to the Bureau as required by N.J.A.C. 7:1E-4.8(e).

Letter of Credit

A letter of credit is a mechanism by which the credit of one party, such as a bank or other financial institution, called the issuer, is extended on behalf of a second party, called the account party, to a third party, the beneficiary. The issuer allows the beneficiary to draw funds upon the

presentation of documents in accordance with the terms of the letter of credit, in this case a sight draft. The parties do not expect that the standby letter of credit will ever be drawn upon because the account party is expected to perform its obligations. A letter of credit may be revocable or irrevocable, but for coverage under the DPHS rules, it must be irrevocable because it would not serve its purpose if the issuer could revoke or modify the letter of credit at any time without notice to or consent of the account party or beneficiary.

When financial responsibility is demonstrated by a letter of credit, it must be obtained from an entity that has the authority to issue letters of credit in New Jersey and whose letter-of-credit operations are regulated and examined by a State agency. The letter of credit must be irrevocable with a specified term and automatic renewal for the same term.

The DPHS rules require that a stand-by trust be established when the letter of credit is obtained. The form of this stand-by trust is not specified. The owner or operator may use a form of his or her preference, as long as the trustee has the authority to act as a trustee and has trust operations regulated and examined by a Federal or New Jersey agency. It is recommended that owners or operators use the stand-by trust format established in the Federal UST rules at 40 CFR 280.103. A sample trust agreement can be found in Attachment 1.

> **NOTE**: The use of a standby trust is necessary because without such a mechanism, any funds drawn under the letter of credit that are payable to the Department would have to be paid into the State Treasury and could not be used without Legislative action to pay for the corrective action or third-party compensation for which the funds were intended.

Multiple Facilities

A letter of credit can cover more than one facility. A single document can be used for all major facilities to be covered. In this case, all covered facilities must be listed in the document. The annual aggregate amount must be $2 million for each facility individually. Thus, if three major facilities are being covered by one letter of credit, the aggregate amount on the letter of credit must be $6 million. Alternately, a letter of credit can be obtained for each major facility, with the $1 million per occurrence and $2 million annual aggregate coverage contained in each.

Preparation and Submission of the Letter of Credit

The letter of credit, containing original signatures, must be submitted with an initial plan submission or plan renewal, and a copy needs to be kept at the location of the major facility and made available to Bureau inspectors. Because a letter of credit automatically renews, there is no need to obtain a new document for each new authorized period of coverage. However, the Bureau may request evidence that the letter of credit fee has been paid for the current period of coverage. If the issuing institution cancels the letter of credit, within 60 days of receipt of the notice of cancellation, the owner or operator must obtain an alternative form of financial

responsibility. The alternate financial document must be forwarded to the Bureau as required by N.J.A.C. 7:1E-4.8(e).

Multiple Forms of Coverage

The owner or operator of a major facility does not need to show the full amount of financial responsibility through one form of coverage. If an owner or operator can pass the financial test of self-insurance for some portion of the $2 million annual aggregate, he or she could then obtain an insurance policy or surety bond, for example, for the rest. It is recommended that owners or operators complete and submit the Alternative II financial test for any deductible they have on an insurance policy or endorsement. However, an owner or operator cannot combine the financial test of self-insurance and a corporate guarantee where the financial statements of the owner or operator and the guarantor are consolidated (i.e., combined). This restriction prevents double counting of assets available for coverage.

Reduced Coverage

While the DPHS rules establish a minimum financial responsibility amount of $1 million per occurrence and $2 million annual aggregate, there is also a provision for reduced coverage. N.J.A.C. 7:1E-4.4(b) allows the Department to accept a demonstration for a lesser amount, provided that the owner or operator has demonstrated to the satisfaction of the Department that the lesser amount is sufficiently protective of the environment and public health, safety and welfare. There are several ways to demonstrate this sufficient protection.

One way is if the owner or operator has evidence of actual cleanup and removal costs for a worst case scenario at his or her facility. For example, if sometime in the past the owner or operator had a discharge involving his or her largest tank, and had all the invoices for the cleanup and proper disposal of the discharged material, those costs could be adjusted for inflation and used as the basis of a reduced amount of financial responsibility, if those actual costs were lower than the established minimum.

Another means of demonstrating sufficient protection is based on information from a discharge cleanup organization (DCO). If the owner or operator can obtain an estimate from a DCO on the costs of cleaning up the worst case discharge that could occur at his or her facility, and that cost estimate is lower than the established minimum, it can be used as the basis for proposing a reduced amount of financial responsibility.

A third basis for reduced coverage is a minimal worst case at the major facility. For example, a warehouse that stores nothing larger than a 400-gallon tote and performs no loading or unloading of tank cars or tank trucks, has a much lower risk of affecting areas off-site, and may be eligible for a reduced amount of financial responsibility depending upon the nature of the substances stored.

These are only some examples of ways that an owner or operator can establish that a reduced amount of financial responsibility is sufficient. An owner or operator can always propose an alternative amount for approval by the Department. **However, it must be pointed out that the level of financial responsibility demonstrated by an owner or operator in no way limits his or her liability in the event of a discharge. The person responsible for the discharge is always liable for the full cost of the cleanup and removal activities.**

Conditional Approval or Establishing an Alternate Minimum

The Bureau acknowledges that there are some circumstance under which an owner or operator cannot demonstrate financial responsibility of any type. A major facility that already has contaminated soil or water generally cannot obtain insurance, a letter of credit or a surety bond, because of the liability concerns of the issuing institutions. If the owner or operator does not have the financial strength to pass the financial test of self-insurance and does not have an entity that can act as a guarantor, there is no form of financial responsibility available to him or her. This is one example of when conditional approval can be requested.

The owner or operator must document the attempts made to obtain financial responsibility. As part of this demonstration, the Bureau may request financial statements and copies of responses from issuing institutions. In lieu of conditional approval, an alternative minimum amount of coverage may be established for the owner or operator, who would then be responsible for obtaining that alternate amount of coverage. In these cases, the Bureau may request periodic updates on the owner or operator’s financial strength, such as annual reports; improvement in the owner or operator’s financial situation may result in a requirement for an increase in the financial responsibility to be demonstrated, up to the full amount.

It must be pointed out that a conditional approval or an alternate level of financial responsibility in no way limits the owner or operator’s liability in the event of a discharge. The person responsible for the discharge is always liable for the full cost of the cleanup and removal activities.

Bankruptcy

Bankruptcy affects financial responsibility in different ways, depending on which entity is bankrupt. If the owner or operator undergoes a bankruptcy proceeding, that will not affect an insurance policy, surety bond, or letter of credit for which the premium has already been paid. When the current term of the financial instrument is completed, the issuing institution may not renew such instrument if there is a prospect of not receiving payment for the renewal. In the case of the financial test, an owner or operator in bankruptcy can no longer pass the test. If the bankruptcy of the owner or operator has little or no effect on the company acting as guarantor, then as long as the guarantor can still pass the financial test, the guarantee will still be valid.

If the provider of the financial instrument is the one in bankruptcy, the owner or operator of the major facility using that provider will be deemed to be without financial responsibility.

In all cases of bankruptcy, the Department must be notified of the commencement of the proceeding. This notice must be made within 10 days of that commencement when it is the owner or operator of the major facility, and within 40 days when it is the issuing institution. Within thirty days of receiving notice that the issuing institution is in bankruptcy, the owner or operator must demonstrate alternate financial responsibility.

Facility no Longer Major or Ownership Transfer

When the capacity at a major facility is reduced below the regulatory threshold or all storage is removed and the major facility closes, financial responsibility is no longer required under the DPHS rules. Financial responsibility used to demonstrate compliance under N.J.A.C. 7:1E does not provide coverage as required under any other state or federal regulations. The owner or operator should ensure that the DPHS program conducts an inspection to verify the non-major status of the facility. Following the inspection, the DPHS program will send the owner or operator a letter confirming that status. Until the DPHS program has verified that the facility no longer meets the definition of "major facility", financial responsibility must be maintained. Once the facility status has been confirmed in writing to the owner or operator, financial responsibility no longer needs to be maintained.

The owner or operator can use the letter from the program to substantiate to the issuer of an insurance policy, letter of credit, or surety bond that financial responsibility pursuant to N.J.A.C. 7:1E is no longer necessary, and then can cancel the financial instrument. In cases where self-insurance or a guarantee is used, the supporting documents for these financial instruments no longer need to be prepared. If the issuer of the financial instrument needs additional verification beyond the non-major status letter, the owner or operator should contact the program. Financial responsibility required by other environmental programs must be continued to be maintained as required. The letter from the DPHS program applies only to financial responsibility under the DPHS rules.

If the owner or operator of a major facility sells it, or is no longer responsible for the facility for some other reason such as divesture or spin-off, that owner or operator is no longer responsible to demonstrate financial responsibility. The DPHS program may ask for confirmation that the owner or operator no longer has responsibility for a given facility. Once responsibility for a facility is passed to a new owner or operator, that owner or operator must provide a demonstration of financial responsibility.

Attachment 1
Sample Stand-by Trust Agreement

TRUST AGREEMENT

Trust agreement, the "Agreement," entered into as of [date] by and between [name of the owner or operator], a [name of state] [insert "corporation," "partnership," "association," or "proprietorship"], the "Grantor," and [name of corporate trustee], [insert "Incorporated in the state of ____________" or "a national bank"], the "Trustee."

Whereas, the New Jersey Department of Environmental Protection, "Department," an agency of the New Jersey State Government, has established certain regulations applicable to the Grantor, requiring that an owner or operator of a major facility shall provide assurance that funds will be available when needed for cleanup and removal activities caused by discharges arising from the operation of the major facility. The attached Schedule A lists the name(s) and address(es) of the facility(ies) that are covered by the standpoint trust agreement.

Whereas, the Grantor has elected to establish a [insert either "surety bond," or "letter of credit"] to provide all or part of such financial assurance for the major facility(ies) identified herein and is required to establish a standby trust fund able to accept payments from the instrument;

Whereas, the Grantor, acting through its duly authorized officers, has selected the Trustee to be the trustee under this agreement, and the Trustee is willing to act as trustee;

Now, therefore, the Grantor and the Trustee agree as follows:

Section 1. Definitions

As used in this Agreement:

(a) The term "Grantor" means the owner or operator who enters into this Agreement and any successors or assigns of the Grantor.

(b) The term "Trustee" means the Trustee who enters into this Agreement and any successor Trustee.

Section 2. Identification of the Financial Assurance Mechanism

This Agreement pertains to the [identify the financial assurance mechanism, either a surety bond, or letter of credit, from which the standby trust fund is established to receive payments].

Section 3. Establishment of Fund

The Grantor and the Trustee hereby establish a trust fund, the "Fund," for the benefit of the Department. The Grantor and the Trustee intend that no third party have access to the Fund except as herein provided. The Fund is established initially as a standby to receive payments and

shall not consist of any property. Payments made by the provider of financial assurance pursuant to the Commissioner of the Department's instruction are transferred to the Trustee and are referred to as the Fund, together with all earnings and profits thereon, less any payments or distributions made by the Trustee pursuant to this Agreement. The Fund shall be held by the Trustee, IN TRUST, as hereinafter provided. The Trustee shall not be responsible nor shall it undertake any responsibility for the amount or adequacy of, nor any duty to collect from the Grantor as provider of financial assurance, any payments necessary to discharge any liability of the Grantor established by the Department.

Section 4. Payment for Cleanup and Removal Activities

The Trustee shall make payments from the Fund as the Commissioner of the Department shall direct, in writing, to provide for the payment of the costs of cleanup and removal activities arising from discharges resulting from operating the major facility(ies) covered by the financial assurance mechanism identified in this Agreement.

The Fund may not be drawn upon to cover any of the following:

(a) Any obligation of [insert name of owner or operator] under a workers' compensation, disability benefits, or unemployment compensation law or other similar law;

(b) Bodily injury to an employee of [insert name of owner or operator] arising from, and in the course of employment by [insert name of owner or operator];

(c) Bodily injury or property damage arising from the ownership, maintenance, use, or entrustment to others of any aircraft, motor vehicle, or watercraft;

(d) Property damage to any property owned, rented, loaned to, in the care, custody, or control of, or occupied by [insert name of owner or operator] that is not the direct result of a discharge from the major facility;

(e) Bodily injury or property damage for which [insert name of owner or operator] is obligated to pay damages by reason of the assumption of liability in a contract or agreement other than a contract or agreement entered into to meet the requirements of N.J.A.C. 7:1E.

The Trustee shall reimburse the Grantor, or other persons as specified by the Commissioner of the Department, from the Fund for cleanup and removal activities and/or third-party liability claims in such amounts as the Commissioner of the Department shall direct in writing. In addition, the Trustee shall refund to the Grantor such amounts as the Commissioner of the Department specifies in writing. Upon refund, such funds shall no longer constitute part of the Fund as defined herein.

Section 5. Payments Comprising the Fund

Payments made to the Trustee for the Fund shall consist of cash and securities acceptable to the Trustee.

Section 6. Trustee Management

The Trustee shall invest and reinvest the principal and income of the Fund and keep the Fund invested as a single fund, without distinction between principal and income, in accordance with general investment policies and guidelines which the Grantor may communicate in writing to the Trustee from time to time, subject, however, to the provisions of this Section. In investing, reinvesting, exchanging, selling, and managing the Fund, the Trustee shall discharge his duties with respect to the trust fund solely in the interest of the beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing which persons of prudence, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims; except that:

(i) Securities or other obligations of the Grantor, or any other owner or operator of the tanks, or any of their affiliates as defined in the Investment Company Act of 1940, as amended, 15 U.S.C. 80a-2(a), shall not be acquired or held, unless they are securities or other obligations of the federal or a state government;

(ii) The Trustee is authorized to invest the Fund in time or demand deposits of the Trustee, to the extent insured by an agency of the federal or state government; and

(iii) The Trustee is authorized to hold cash awaiting investment or distribution uninvested for a reasonable time and without liability for the payment of interest thereon.

Section 7. Commingling and Investment

The Trustee is expressly authorized in its discretion:

(a) To transfer from time to time any or all of the assets of the Fund to any common, commingled, or collective trust fund created by the Trustee in which the Fund is eligible to participate, subject to all of the provisions thereof, to be commingled with the assets of other trusts participating therein; and

(b) To purchase shares in any investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., including one which may be created, managed, underwritten, or to which investment advice is rendered or the shares of which are sold by the Trustee. The Trustee may vote such shares in its discretion.

Section 8. Express Powers of Trustee

Without in any way limiting the powers and discretions conferred upon the Trustee by the other provisions of this Agreement or by law, the Trustee is expressly authorized and empowered:

(a) To sell, exchange, convey, transfer, or otherwise dispose of any property held by it, by public or private sale. No person dealing with the Trustee shall be bound to see to the

application of the purchase money or to inquire into the validity or expediency of any such sale or other disposition;

(b) To make, execute, acknowledge, and deliver any and all documents of transfer and conveyance and any and all other instruments that may be necessary or appropriate to carry out the powers herein granted;

(c) To register any securities held in the Fund in its own name or in the name of a nominee and to hold any security in bearer form or in book entry, or to combine certificates representing such securities with certificates of the same issue held by the Trustee in other fiduciary capacities, or to deposit or arrange for the deposit of such securities in a qualified central depository even though, when so deposited, such securities may be merged and held in bulk in the name of the nominee of such depository with other securities deposited therein by another person, or to deposit or arrange for the deposit of any securities issued by the United States Government, or any agency or instrumentality thereof, with a Federal Reserve bank, but the books and records of the Trustee shall at all times show that all such securities are part of the Fund;

(d) To deposit any cash in the Fund in interest-bearing accounts maintained or savings certificates issued by the Trustee, in its separate corporate capacity, or in any other banking institution affiliated with the Trustee, to the extent insured by an agency of the federal or state government; and

(e) To compromise or otherwise adjust all claims in favor of or against the Fund.

Section 9. Taxes and Expenses

All taxes of any kind that may be assessed or levied against or in respect of the Fund and all brokerage commissions incurred by the Fund shall be paid from the Fund. All other expenses incurred by the Trustee in connection with the administration of this Trust, including fees for legal services rendered to the Trustee, the compensation of the Trustee to the extent not paid directly by the Grantor, and all other proper charges and disbursements of the Trustee shall be paid from the Fund.

Section 10. Advice of Counsel

The Trustee may from time to time consult with counsel, who may be counsel to the Grantor, with respect to any questions arising as to the construction of this Agreement or any action to be taken hereunder. The Trustee shall be fully protected, to the extent permitted by law, in acting upon the advice of counsel.

Section 11. Trustee Compensation

The Trustee shall be entitled to reasonable compensation for its services as agreed upon in writing from time to time with the Grantor.

Section 12. Successor Trustee

The Trustee may resign or the Grantor may replace the Trustee, but such resignation or replacement shall not be effective until the Grantor has appointed a successor trustee and this successor accepts the appointment. The successor trustee shall have the same powers and duties as those conferred upon the Trustee hereunder. Upon the successor trustee's acceptance of the appointment, the Trustee shall assign, transfer, and pay over to the successor trustee the funds and properties then constituting the Fund. If for any reason the Grantor cannot or does not act in the event of the resignation of the Trustee, the Trustee may apply to a court of competent jurisdiction for the appointment of a successor trustee or for instructions. The successor trustee shall specify the date on which it assumes administration of the trust in writing sent to the Grantor and the present Trustee by certified mail 10 days before such change becomes effective. Any expenses incurred by the Trustee as a result of any of the acts contemplated by this Section shall be paid as provided in Section 9.

Section 13. Instructions to the Trustee

All orders, requests, and instructions by the Grantor to the Trustee shall be in writing, signed by such persons as are designated in the attached Schedule B or such other designees as the Grantor may designate by amendment to Schedule B. The Trustee shall be fully protected in acting without inquiry in accordance with the Grantor's orders, requests, and instructions. All orders, requests, and instructions by the Commissioner of the Department to the Trustee shall be in writing, signed by the Commissioner, and the Trustee shall act and shall be fully protected in acting in accordance with such orders, requests, and instructions. The Trustee shall have the right to assume, in the absence of written notice to the contrary, that no event constituting a change or a termination of the authority of any person to act on behalf of the Grantor or the Commissioner hereunder has occurred. The Trustee shall have no duty to act in the absence of such orders, requests, and instructions from the Grantor and/or the Commissioner, except as provided for herein.

Section 14. Amendment of Agreement

This Agreement may be amended by an instrument in writing executed by the Grantor and the Trustee, or by the Trustee and the Commissioner of the Department if the Grantor ceases to exist.

Section 15. Irrevocability and Termination

Subject to the right of the parties to amend this Agreement as provided in Section 14, this Trust shall be irrevocable and shall continue until terminated at the written direction of the Grantor and the Trustee, or by the Trustee and the Commissioner of the Department, if the Grantor ceases to exist. Upon termination of the Trust, all remaining trust property, less final trust administration expenses, shall be delivered to the Grantor.

Section 16. Immunity and Indemnification

The Trustee shall not incur personal liability of any nature in connection with any act or omission, made in good faith, in the administration of this Trust, or in carrying out any directions by the Grantor or Commissioner of the Department issued in accordance with this Agreement. The Trustee shall be indemnified and saved harmless by the Grantor, from and against any personal liability to which the Trustee may be subjected by reason of any act or conduct in its official capacity, including all expenses reasonably incurred in its defense in the event the Grantor fails to provide such defense.

Section 17. Choice of Law

This Agreement shall be administered, construed, and enforced according to the laws of the state of New Jersey, or the Comptroller of the Currency in the case of National Association banks.

Section 18. Interpretation

As used in this Agreement, words in the singular include the plural and words in the plural include the singular. The descriptive headings for each section of this Agreement shall not affect the interpretation or the legal efficacy of this Agreement.

In Witness whereof the parties have caused this Agreement to be executed by their respective officers duly authorized and their corporate seals (if applicable) to be hereunto affixed and attested as of the date first above written.

[Signature of Grantor]
[Name of the Grantor]
[Title]

Attest:
[Signature of Trustee]
[Name of the Trustee]
[Title]
[Seal]
[Signature of Witness]
[Name of the Witness]
[Title]
[Seal]