

January 10, 2012

MEMO TO: Jim Fry, Director, Legislative Research Council

FROM: Steven M. Pirner, Secretary

SUBJECT: 2011 Annual Petroleum Release Compensation Fund Report

As required by SDCL 34A-13-48, please find enclosed a copy of the 2011 Annual Petroleum Release Compensation Fund report from the Department of Environment and Natural Resources. Please consider this an item to include in LRC's "Update" and if appropriate, to subsequently file in the Legislative Research Council library.

Thank you.

Enclosure

cc: Dusty Johnson, Governor Daugaard's Chief of Staff
Alex Hanson, Budget Analyst, Bureau of Finance and Management
Nathan Sanderson, Senior Policy Advisor, Governor's Office

**South Dakota Department of Environment and Natural Resources
Petroleum Release Compensation Fund**

**CURRENT STATUS OF THE
PETROLEUM RELEASE COMPENSATION FUND
AND
AVAILABILITY OF PRIVATE INSURANCE**

BACKGROUND

In 1984, Congress enacted federal legislation requiring the US Environmental Protection Agency (EPA) to develop regulations to address the installation, use, and management of petroleum underground storage tanks. The resulting regulations included requirements to upgrade or replace operating underground storage tanks by December 22, 1998. The regulations also required that corrective action be taken if there was a release from an underground storage tank. In response to concerns regarding future unfunded environmental damages, additional federal legislation was enacted and regulations adopted establishing federal underground storage tank financial responsibility requirements. Owners or operators of petroleum UST's were required to demonstrate financial responsibility for taking corrective action and for compensating third parties for bodily injury and property damage caused by releases. Most sites are required to demonstrate financial responsibility of at least \$1,000,000 per occurrence.

With the enactment of the federal regulations, private insurance essentially abandoned the pollution liability market in the late 1980's. The insurance industry responded to these requirements by adopting "pollution exclusion" clauses in their policies. With private pollution liability insurance essentially unavailable, most of the state's underground storage tank owners had few, if any options for demonstrating financial responsibility.

The South Dakota Petroleum Release Compensation Fund (PRCF) was established by the 1988 Legislature to fill the void left by private insurance, to financially assist tank owners with the cleanup costs of petroleum releases and to meet the federal and state environmental financial responsibility requirements for regulated underground tank owners. The EPA has approved the PRCF as an acceptable mechanism for tank owners to demonstrate financial responsibility for corrective action and third-party compensation as required by state and federal law. The EPA Region VIII further identified the PRCF as a "model program". No additional pollution liability insurance or other method of demonstrating financial responsibility is required by petroleum tank owners in South Dakota.

The PRCF cleanup coverage is comprehensive in that all petroleum tank sites, including abandoned tank sites and aboveground tank sites, as well as UST's, are covered. While other methods of demonstrating financial responsibility such as self-insurance or private insurance are available to a limited group, the PRCF is the only mechanism that is presently available to every petroleum tank owner or operator in the state.

The PRCF had been attached to the Department of Revenue and Regulation since 2003. The program has now been transferred to the South Dakota Department of the Environment through Executive Order 2011-01 in January 2011. A five-member advisory board appointed by the Governor makes recommendations on program policies and acts as a hearing officer in contested case hearings.

Revenues are generated by a \$0.02 per gallon tank inspection fee on petroleum products received in the state. While the fee generates about \$15 million per year, the PRCF receives 10.65% of the fee, or about \$1.6 million per year, with the remainder going to the Ethanol Fuel Fund and the Capital Construction Fund.

The PRCF provides reimbursement of cleanup expenses and third-party liability claims up to \$990,000 (\$1,000,000 less a \$10,000 deductible). Only necessary and reasonable cleanup expenses incurred after April 1, 1988, are eligible for reimbursement. Reimbursement for third party claims can only be made for certain petroleum releases reported after April 1, 1990. The PRCF also pays for all tank removal and cleanup costs incurred through the Abandoned Tank Removal Program, which was enacted through Senate Bill 197 in the 2000 Legislature.

AVAILABILITY OF INSURANCE

Pursuant to SDCL 34A-13-48, "the board [Petroleum Release Compensation Board] shall endeavor to integrate private insurance as the primary or secondary risk taker... ". This statute also requires the board to meet at least annually with members of the insurance industry who have registered with the board. The purpose of the meeting is to evaluate the availability of private insurance coverage for petroleum contamination cleanup and third party liability coverage. After meeting with the public on this matter, the board is required to report its findings to the legislature by January 10th of each year. This year the meeting was held in Sioux Falls, South Dakota on December 15, 2011.

Preparations for the Meeting

In preparation for the meeting, written invitations were extended to members of the insurance industry and associations representing industry groups in South Dakota with a possible interest in the program. Additionally, notices of the meeting were sent to members of the Senate and House Appropriation Committees. This year input was sought from the following representatives of insurance and associations:

- Independent Insurance Agents of South Dakota;
- Western Dakota Insurers;
- Federated Insurance Company;
- Accordia of Minnesota;
- National Association of Insurance and Financial Advisors;
- Petroleum Marketers Management Insurance Company;
- Zurich North America Environmental;
- AIG Insurance;
- South Dakota Truckers Association;
- Associated School Boards of SD;
- SD Association of Realtors;

- SD Municipal League;
- SD Bankers Association;
- SD Association of County Commissioners;
- SD Association of County Officials;
- SD Petroleum & Propane Marketers Association;
- SD Association of Cooperatives;
- SD Agri-Business Association; and
- SD Farm Bureau.

Comments from Insurance Industry Representatives

This year, written comments were received from Eric Lehrer (Federated Insurance), Pat Rounds (Petroleum Marketers Management Insurance Company), and Kelli Fuhrmann (National Association of Insurance and Financial Advisors - SD). The written comments from Federated Insurance indicate that they can provide pollution liability insurance for tank owners who meet their underwriting criteria and who purchase their property and casualty insurance coverage. But as long as the State of South Dakota continues to provide storage tank cleanup and liability coverage, Federated's plan is to continue offering additional environmental coverage to wrap around gaps left by the fund. The written comments from NAIFA-SD indicate that their position remains the same as in past years; they don't believe there is enough company interest in providing blanket coverage for petroleum spills for the entire petroleum industry in South Dakota.

Additionally, Pat Rounds of Petroleum Marketers Management Insurance Company (PMMIC) and Dawna Leitzke, Executive Director of the South Dakota Petroleum & Propane Marketers (SDP₂MA) provided testimony to the Board. Pat Rounds testified that insurance coverage is available in the private market for most petroleum storage tank systems, and PMMIC is interested selling insurance coverage for tank systems in South Dakota that meet their underwriting criteria. Dawna Leitzke testified that her board considers this issue on a regular basis, but at the present time the board is not in support of transitioning to private insurance.

Discussion

Since its enactment in 1988, the PRCF has provided more than \$83 million for corrective action at 4,352 different petroleum release sites. While much of the past efforts have been to finance corrective action at old release sites, the PRCF's mission continues to be that of providing ongoing financial assurance for tank owners so that they can demonstrate financial responsibility as required by federal law and in removing orphaned underground tanks and non-regulated tanks that are no longer in use.

In reviewing the letters from Pat Rounds, Kelli Fuhrman, and Eric Lehrer and considering testimony and discussion at their meeting, the Board recognizes that commercial insurance is available for new construction and for tank owners who meet qualifications of the insurance companies. However, the Board concluded they could find no reason to change their recommendation from last year. The Board saw no advantage of going to private insurance to meet the financial assurance requirements for underground petroleum tank owners.

Recommendation

The Board's recommendation is to continue the PRCF under the same process that is presently in place. While more than 1,440 petroleum tank sites have been cleaned up in the PRCF's regular program with all claims settled, there are currently 94 sites with ongoing or pending cleanups. In addition to the current open cases, there are approximately 50 new spill cases each year in the regular program, of which about 10 result in corrective actions large enough to require PRCF funding. Additionally, approximately 40 new sites are funded through the Abandoned Tank Program each year. Finally, the PRCF still serves as a mechanism for all regulated underground storage tank owners to comply with the federal EPA financial assurance requirements.