PROVIDING ASSURANCES:
WHAT IS FINANCIAL ASSURANCE?
AND WHY SHOULD I CARE ABOUT IT?

Owners of permitted hazardous waste management facilities (HWMFs) often spend the first several months of a new fiscal year busily updating or making changes to the financial instruments and documents used to demonstrate the financial wherewithal to close any hazardous waste management units (HWMUs) at the facility, monitor and care for closed HWMUs, and pay claims associated with releases from HWMUs.[1] Under the financial assurance provisions of the hazardous waste management regulations, an owner of a permitted HWMF must either rely on the financial strength of the corporate parent or secure a financial instrument such as a letter of credit or insurance policy in order to demonstrate the ability to perform or pay for these activities or claims.

Financial assurance is one of the most confounding aspects of hazardous waste management.[2] This is so for a variety of reasons, chief among them being the minutiae and detail in the wording of the financial instruments. Nonetheless, with planning and foresight, an owner of a permitted HWMF can successfully navigate these requirements. In so doing, it can minimize its compliance risks, minimize the compliance costs associated with financial assurance, and help the organization optimize its liquidity position.

This article provides a general overview as to what financial assurance is, and why everyone involved in hazardous waste management compliance – even hazardous waste generators who do not have permitted HWMUs – should have at least a general understanding of these requirements.

Financial Assurance: The Basics

The owner of a permitted HWMF must be able do demonstrate that it has the financial means to undertake the following:

[1] The terms “hazardous waste management unit” (HWMU) and “hazardous waste management facility” (HWMF) appear throughout this article. The term HWMU refers to an individual hazardous waste management operation such as a container storage area or storage tank, while a HWMF generally refers to an operating facility, such as a chemical manufacturing plant, that may have several or more HWMUs.

[2] It is important to note that financial assurance comes into play in a number of federal and state regulatory programs, including solid waste management and federal and state cleanup activities just to name a few. This article focuses only on financial assurance for permitted hazardous waste management facilities.

1.) Close HWMUs in accordance with regulatory requirements.
2.) Monitor and manage the certain HWMUs following closure.
3.) Pay claims arising from releases from permitted HWMUs.
4.) Pay for corrective action.[3]

There are two ways in which a permitted HWMF can comply with financial assurance. It can either: (i) use the financial test and corporate guarantee to demonstrate the strength of the financial condition of the parent corporation and its willingness to stand behind the subsidiary that owns the permitted HWMF; or (ii) secure a financial instrument such as a letter of credit or an insurance policy.

Since there is no associated cost or impact on liquidity, the financial test is typically the preferred option. A permitted HWMF seeking to rely on the financial condition of the parent corporation must be able to demonstrate that the parent can meet at least one of two financial tests.[4] Generally speaking, these tests are designed to ensure that the corporate parent has sufficient tangible assets to cover the sum of the estimated costs associated with closure and post-closure care, and the regulatorily-established amounts for liability arising from releases. In addition, the corporate parent must guarantee the performance of the facility's operating subsidiary.

If the parent corporation of the operating subsidiary cannot meet the financial test, the owner of the permitted HWMF must secure a financial instrument to meet its financial assurance obligation. In theory, the facility operator can choose any one or a combination of the following alternatives: (i) letter of credit; (ii) trust fund; (iii) insurance policy; (iii) performance bond; or (iv) payment bond. For closure and post-closure care, the only feasible alternative is usually the letter of credit. The reason for this is that the issuer of a financial instrument such as surety bond will often require collateral in the form of a letter of credit to back up its obligation. Since any liability associated with a release from a HWMU is a contingency which may never occur, a letter of credit or an insurance policy is a feasible alternative for demonstrating financial assurance to pay any claims related to such liability.

<u>I Don't Have any Permitted HWMUs, So Why Should I Care About Financial Assurance?</u>

The universe of owners of permitted HWMFs is quite a bit smaller than the universe of hazardous waste generators. Many hazardous waste generators either do not operate any HWMUs, or operate HWMUs that are exempt from permitting requirements because they

[3] While financial assurance is required for corrective action under the hazardous waste management regulations, financial issues tend to arise more frequently in the context of closure, post-closure care, and liability for releases. Thus, this article and the other companion articles on the topic of financial assurance focus on financial assurance for closure, post-closure care, and liability for releases.
[4] Both tests are quite technical and detailed and thus beyond the scope of this article.

accumulate hazardous wastes for limited periods of time and meet certain other requirements. Financial assurance is not required for such HWMUs. There are plenty of reasons why a hazardous waste generator would prefer not to operate its HWMUs as permitted units. These include a desire to avoid having to comply with the design and operations standards for permitted HWMUs, and a desire to avoid onerous corrective action requirements for facilities with permitted HWMUs.

Given these disincentives, the need to comply with financial assurance is probably not the most significant disincentive for developing or operating permitted HWMUs. Nonetheless, financial assurance is cumbersome and complex. Getting a handle on the deadlines, the details of the financial test, the details of the regulatorily required templates for the various financial instruments (which must be complied with *verbatim*) can be quite challenging. In addition, because financial assurance incorporates a hybrid of environmental compliance and financial risk management, it is not always clear which function of the organization should be responsible for compliance with these requirements. Over the course of my career, I have seen financial assurance compliance housed within corporate EHS management departments, facility-level EHS departments, and even corporate finance departments.

Key Challenges Associated With Financial Assurance Compliance

The challenges associated with financial assurance usually do not come into full relief until the owner of a permitted HWMF has the opportunity or is compelled to change its method of demonstrating such compliance. More specifically, these challenges usually do not come into full relief until the owner of the HWMF is required to switch from the financial test to a letter of credit or is presented with the opportunity to switch back. In *Providing Assurances: Letters of Credit* and *Providing Assurances: Tying Up Loose Ends*, I discuss some of these challenges and how to tackle them. In *Financial Assurances: Transactional Considerations*, I discuss some of the particular issues relating to financial assurance that come up in asset sales and other related transactions. These companion articles can be found in the March 3, 2021 edition of *The Cubical* – the monthly e-mail newsletter from Daniel J. Brown, L.L.C. on topics of general interest in the EHS arena – and on the website for Daniel J. Brown, L.L.C. (www.djbrownlaw.com).