DEPARTMENT of ENVIRONMENT and NATURAL RESOURCES

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January 8, 2016

MEMO TO: Jason Hancock, Director, Legislative Research Council

FROM: Steven M. Pirner, Secretary

SUBJECT: 2015 Annual Petroleum Release Compensation Fund Report

As required by SDCL 34A-13-48, please find enclosed a copy of the 2015 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: Nathan Sanderson, Director of Policy and Operations, Governor's Office
Matt Konenkamp, Senior Policy Advisor, Governor's Office
Derek Johnson, Budget Analyst, Bureau of Finance & Management

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SOUTH DAKOTA DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

2015 ANNUAL REPORT

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

RECOMMENDATION

The Petroleum Release Compensation Board's recommendation is to continue having the South Dakota Petroleum Release Compensation Fund (PRCF) serve as the primary financial assurance mechanism in South Dakota as that will continue to provide the broadest coverage for all petroleum tanks in the state, and ensures a level playing field for all owners and operators of regulated petroleum underground storage tanks who must meet the federal financial assurance requirements.

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 underground storage tanks 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 8 further identified the PRCF as a "model program".

The PRCF cleanup coverage is comprehensive in that all petroleum tank sites, including abandoned tank sites and aboveground tank sites, as well as underground storage tanks, 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.

A five-member advisory board appointed by the Governor makes recommendations on program policies. 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 $1.75 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 Pierre, South Dakota on December 10, 2015.

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. This year input was sought from the following representatives of insurance and associations:

- Independent Insurance Agents of South Dakota;
- Western Dakota Insurors;
- Federated Insurance Company;
- National Association of Insurance and Financial Advisors;
- Petroleum Marketers Management Insurance Company;
- South Dakota Truckers Association;
- SD Association of Realtors;
- SD Municipal League;
- SD Bankers Association;
- SD Association of County Commissioners;
- 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 Federated Insurance and Petroleum Marketers Management Insurance Company. 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. Federated indicated there would be certain sites that would not be eligible for coverage due to concerns related to leaking tanks, existing contamination not fully defined, questionable tank or pipe quality, poor tank management practices, or accounts that do not purchase their property and casualty program. The written comments from Petroleum Marketers Management Insurance Company indicate that if South Dakota decides to integrate private insurance as a risk taker, they are interested in providing insurance coverage for petroleum tanks in South Dakota.

Discussion
Since its enactment in 1988, the PRCF has provided $87.7 million for corrective action at 4,626 petroleum release sites in South Dakota. Under the direction of the five-member citizen board, the PRCF has accomplished this over the past 28 years while reducing annual cleanup costs from a high of nearly $7 million to less than $600,000, while reducing staff from a high of 15 to the current staff of five. Additionally over this time period the revenue allocations to the PRCF have been reduced from a high of $0.02/gallon to about 1/5 of a penny per gallon.

Although much of the past and on-going efforts have been to finance corrective action at old release sites, the PRCF's primary mission continues to be that of providing ongoing financial assurance for regulated underground storage tank owners so that they can demonstrate financial responsibility as required by state

and federal law. In addition to providing the financial responsibility mechanism for regulated petroleum UST owners, the PRCF also covers cleanup costs for petroleum tanks that are not required to have a financial responsibility mechanism such as regulated above ground petroleum bulk tanks, and non-regulated gasoline, diesel fuel and heating oil underground and above ground storage tanks.

While there has been a significant reduction in claims since the early 2000s, the Petroleum Release Compensation board believes that this trend will reverse in the near future due to the age of the tank systems in South Dakota and new regulations for underground storage tanks. The current average age of the tank systems in South Dakota is about 25 years. While there are no regulatory or industry standards dictating or establishing the useful life of a petroleum tank system, the longer tank systems are in service the more likely they are to fail and leak. In addition to the aging tank systems, the Environmental Protection Agency recently enacted new regulations for underground storage tank systems that the State must implement within three years. These regulations will require many of the existing underground storage tank systems to upgrade certain components, which will likely result in discovery of petroleum releases that are currently unknown.

In reviewing the letters from Federated Insurance and Petroleum Marketers Management Insurance Company, and considering testimony and discussion at their meeting, the Board recognizes that private insurance may be available for some tank owners who meet qualifications of the insurance companies. However, dual coverage would be required for sites with existing releases and for those that did not meet the insurance companies' underwriting criteria. Additionally, tank owners not required by regulation to have a financial responsibility mechanism would not likely purchase insurance, and as a result many would not have the financial resources to pay for cleanups when a release occurs from their tank system. The Board concluded they could find no reason to change their recommendation from last year. The Board saw no advantage to the public or tank owners of going to private insurance to meet the financial assurance requirements for underground petroleum tank owners.