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Potential Liability of Property/Casualty Insurers
for Costs of Cleaning Up Hazardous Waste Sites

Statement of
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Before the
Subcommittee on Policy Research and Insurance
Committee on Banking, Finance and Urban Affairs
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We are here today to discuss the potential liability of the property/casualty insurance industry for billions of dollars to clean up the nation's hazardous waste sites, especially Superfund sites. This exposure arises from insurance claims by parties responsible for contaminating the sites, such as waste site owners and industrial users of hazardous substances, who are required by federal or state laws to pay for site cleanup. The responsible parties maintain that their cleanup expenses are recoverable under their liability insurance policies. Some insurance industry representatives say that the solvency of the property/casualty industry could be jeopardized if claims for cleanup costs are found to be valid. Our testimony today will be based largely on reports we have issued in the last few years on pollution insurance issues and the scope of the nation's hazardous waste cleanup problems, and on discussions with Environmental Protection Agency (EPA) and insurance industry officials within the last two months.

In summary, hazardous waste cleanup liability could eventually become a serious problem for property/casualty insurers, but the amount of their liability is uncertain at this time. The amount of claims that insurers will have to pay depends on (1) the size of the nation's cleanup effort, (2) the share of this effort that responsible parties will fund, and (3) legal determinations about whether responsible parties' insurance policies cover cleanup costs. Let me elaborate on each of these issues briefly.

The amount of insurers' liability depends in part on the future size of the nation's cleanup effort and the responsible party contribution to it. The costs of cleaning up all hazardous waste sites could reach \$700 billion or more, according to some estimates. In contrast, at this point, the Congress has authorized \$10.1 billion for Superfund, and the parties responsible for contaminating some Superfund sites have agreed to perform cleanups

valued at about \$4 billion. The amount of future responsible party costs and, therefore, the size of future insurance claims, will depend on federal and state policy decisions about how vigorously to pursue additional hazardous waste site cleanups.

The amount insurers will actually pay out for cleanup costs is also uncertain at this time because court rulings have varied on the issue of insurer liability. Some courts have interpreted policies in favor of the insurer, others have read policies to favor the insured. Insurance industry sources said they were not aware of claim payments to date for cleanup costs that had seriously hurt the overall industry, although they said insurance companies are now paying large legal expenses to defend themselves against claims. Future liability may be financially burdensome but will not be determined until the courts settle insurer liability issues.

I would now like to expand on the factors I mentioned that affect insurers' loss exposure.

SIZE OF THE HAZARDOUS WASTE SITE PROBLEM

The Superfund program was created by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), to clean up the nation's most dangerous abandoned hazardous waste sites. The program, which was at first thought to be a relatively short-lived project to clean up a limited number of sites, has developed into a long-term, expensive effort expected to involve thousands of sites. Currently, there are about 1,200 sites on the National Priorities List, EPA's list of sites included in

the Superfund program.¹ Additionally, EPA expects to add about 1,000 sites to the Superfund program over the next 10 years.

EPA has not estimated the final size or length of the Superfund program,² but the number of sites that could ultimately be added is very large and the program could run well into the next century. In December 1987, we reported that the nation's potential hazardous waste problem appeared to be much larger than EPA's inventory of sites indicated.³ We estimated, largely on the basis of EPA data, that from 130,000 to as many as 425,000 sites might need to be evaluated for Superfund eligibility. The Office of Technology Assessment has reported that a program of site discovery, with improved procedures for examining and selecting sites, could produce a 10,000-site Superfund.⁴

Despite its potentially large size, only a small percentage of the nation's hazardous waste sites will be selected for Superfund cleanup. Cleanup of the rest, generally smaller and less dangerous sites, will be accomplished under state authorities, if it is done at all. Many of the states have enacted cleanup laws modeled after CERCLA. But in August 1989, we reported that most states have not made much progress in identifying and cleaning up sites. We reported that 47 states who responded to our survey said that they knew or suspected the existence of about 28,000 hazardous waste sites not in Superfund. But we pointed out that since many

¹Only sites appearing on the National Priorities List qualify for federal funds for long-term, permanent cleanups.

²EPA is now doing a study to determine the universe of sites that needs to be evaluated for inclusion in the Superfund program.

³Superfund: Extent of Nation's Potential Hazardous Waste Problem Still Unknown (GAO/RCED-88-44, Dec. 1987).

⁴Coming Clean: Superfund Problems Can Be Solved, Office of Technology Assessment (OTA-ITE-433, Oct. 1989), p. 11.

states have not identified all their sites, the state count may be very understated.⁵

LIABILITY OF RESPONSIBLE
PARTIES FOR CLEANUP COSTS

CERCLA made the parties responsible for contaminating the sites primarily liable for their cleanup. As a result, the Superfund will absorb cleanup costs only when financially viable responsible parties cannot be found. Because responsible party liability is retroactive, these parties include not only the present owners or operators of sites but also any parties who previously owned or operated the sites when wastes were placed in them, and all present and former generators and certain transporters of these wastes.

In addition, courts have consistently held that Superfund liability is strict, and joint and several. Strict liability means that a party may be liable for costs even if the disposal of the waste was not done negligently. For example, site owners and operators are liable regardless of whether they caused the presence or release of the hazardous substance. Generators are liable even where they turned wastes over to a transporter and had no role in the selection of a disposal site. Under the joint and several liability standard, one party sometimes can be responsible for all cleanup costs even if others contributed to the contamination.⁶ The effect of these liability standards is to spread cleanup responsibility widely and expose any responsible party to possibly

⁵Hazardous Waste Sites: State Cleanup Status and Its Implications for Federal Policy (GAO/RCED-89-164, Aug. 1989).

⁶Joint and several liability applies in most cases because wastes have been commingled. However, if the harm is divisible and there is a reasonable basis for apportionment of costs, the responsible party will be held liable only for the portion of harm it caused.

large costs. Through July 1990, EPA had sent notices to about 15,000 parties informing them of their potential liability for cleanup at 470 of the 1,200 current Superfund sites.

Estimating how much these parties and others still to be identified will pay for Superfund cleanups throughout the program's life is difficult. The Congress has so far authorized about \$10.1 billion for Superfund, but on the basis of data we obtained from EPA, the total cost of cleaning up currently listed sites may reach about \$40 billion. Cleanup costs for the 1,000 sites EPA expects to add to Superfund in the 1990s have not been estimated by EPA, but current cleanup costs per site, excluding study and overhead costs, average about \$26 million, according to one EPA official. If this average held, the cost of cleaning up the projected 1,000 new sites might approach \$26 billion in today's dollars. According to an EPA official, EPA expects to find financially viable responsible parties for 90 percent of the sites. Thus, a large part of the cleanup costs could ultimately be borne by these parties. However, EPA's latest data show that responsible parties have agreed to perform cleanups valued by EPA at \$3.9 billion and reimburse Superfund for another \$433 million in cleanup costs.

Estimated costs of a long-term cleanup, beyond the approximately 2,200 sites EPA anticipates having listed by the year 2000, are enormous. The Office of Technology Assessment reported that, "Over many decades, spending by all parties on cleaning up toxic waste sites could total \$500 billion, unless there are major technological innovations that bring the costs of permanent remedies down." Some industry estimates for cleaning up all sites are \$700 billion or more.

In addition to their liability for Superfund, responsible parties may be confronted with the cleanup bill for hazardous waste sites cleaned up under state law. Because cleanup programs in many states are just getting started, the ultimate size of these

costs are even harder to predict than the Superfund costs. Three of the states we visited in preparing our 1989 report on state cleanup programs--New Jersey, California and Massachusetts--had well established programs and tough cleanup laws. These three had laws on their books for at least five years to compel responsible parties to clean up sites, had authorized at least \$100 million for cleanups, and employed 100 or more people in their programs. The other states we visited--Indiana, Montana, Oregon, and Virginia--had newer programs and were only beginning to address their hazardous waste site problems. Most states had not made major financial commitments to the cleanup of non-Superfund sites. A study by a national association found that of 41 states reporting data, only 11 had more than \$5 million available, at least in part, for non-Superfund sites.⁷ Lacking major cleanup funds, most states were heavily dependent on finding responsible parties to pay for cleanups.

POSSIBLE IMPACT ON PROPERTY/
CASUALTY INSURERS

I would like now to briefly describe the present condition of the property/casualty industry and how it might be affected by liability for cleanup costs.

According to A. M. Best Company, Inc., which evaluates and rates insurance industry financial performance, the assets of the 2,274 property/casualty insurance companies that it tracked⁸ totaled \$527 billion at the end of 1989. Their policyholders' surplus--the safety cushion for policyholders in the event that

⁷Survey Results-State Funding Mechanisms for Cleanup of Non-NPL and NPL Hazardous Waste Sites, Association of State and Territorial Solid Waste Management Officials, June 1988.

⁸According to an A. M. Best representative, these companies account for the vast majority of property/casualty premiums written.

insurers suffer adverse results--was \$134 billion.⁹ Pollution insurance is one of many forms of liability insurance in the property/casualty industry's "general liability" (or "other liability") line. Twenty insurance organizations accounted for about two-thirds of the \$22 billion in direct premiums written in this line in 1989. According to Standard & Poor's Corporation, which provides information for investors, the top general liability organizations include firms that have large exposures to pollution claims, but reinsurers,¹⁰ and much of the rest of the industry, are also at risk.

The possible liability of property/casualty insurers for hazardous waste cleanup arises out of general liability or environmental impairment policies written mostly before 1986. Since then insurers have usually excluded pollution coverage from their standard policies, and the environmental pollution market has shrunk.

Representatives of insurance companies and insurance industry organizations were not aware of any pollution claim payments that had seriously hurt the overall industry so far. The 2,274 companies included in Best's 1990 report had a consolidated net operating income of over \$7 billion in 1989. A representative of Standard & Poor's recently told us that no firms he was aware of are in financial trouble presently because of pollution claim payments and none have had their Standard & Poor's rating reduced for this reason.

⁹Best's Aggregates and Averages: Property/Casualty, 1990.

¹⁰Reinsurance is a form of insurance for an insurance company. Under a reinsurance contract, the primary insurer transfers to another insurer (the "reinsurer") all or part of the risk of loss on its policies. The reinsurer, for a premium, agrees to indemnify or reimburse the primary insurer for all or part of the losses the latter may sustain from claims.

Although claim payments may not have been a major cash drain on the overall industry so far, there have been some financial consequences. For example, A. M. Best recently reported that the loss ratio¹¹ for one of the biggest writers of general liability insurance more than doubled in this insurance line from 1988 to 1989. According to Best, environmental claims accounted for the increase.¹² In addition, according to industry representatives, the property/casualty industry is incurring millions in legal fees to defend against claims.

Also, future impacts of pollution claims, if sustained in the courts, could be severe. In 1988 Standard & Poor's reported that "The pollution liability burden would have a negative implication for the claims-paying ability and debt ratings of insurers"¹³ Last year in reference to its 1988 report, Standard & Poor's said that "... pollution liability was one issue facing the property/casualty insurance industry that could seriously impair its health" But at the same time, Standard & Poor's said it did not expect the industry's survival to be threatened. It anticipated that regulators would prevent the undue impairment of the industry's health and expected some companies to face a greater challenge managing pollution liability than others.¹⁴

There have been some problems in the property/casualty industry in recent years aside from pollution liability exposure. From 1983 through 1989, about 105 multistate property/casualty insurers became insolvent. According to a congressional committee

¹¹The ratio of incurred losses and loss adjustment expenses to net premiums earned expressed as a percent.

¹²A. M. Best Company, Best's Insurance Management Reports, Property/Casualty Release No. 15 (July 30, 1990).

¹³Industry Comment, Standard & Poor's Corporation, Third Quarter 1988.

¹⁴Standard & Poor's Insurance Rating Services, 1989 Series.

report, losses from the failures of two large insurers alone could exceed \$5 billion.¹⁵ The number of insurers that became insolvent annually in the 1980s, although still less than 1 percent of firms in the industry each year, was over 3 times higher than the average annual rate in the 1970s. In addition, from 1983 to 1989, the number of property/casualty insurers marked by the National Association of Insurance Commissioners¹⁶ for closer regulatory attention increased from 205 to 622. During an earlier GAO review, insurance industry officials indicated that the following contributed to property/casualty insurer failures: underpricing premiums, underreserving for losses, problems with risk-sharing arrangements, fraud or incompetence, and overexpansion.¹⁷

In a 1987 report on pollution insurance mandated by the Superfund Amendments and Reauthorization Act of 1986, we noted that the insurance industry does not have centralized, comprehensive data on payments for Superfund cleanups and related third-party bodily injury and property damage.¹⁸ This lack of data makes assessments of the industry's hazardous waste liability difficult. The problem is further compounded by the lack of pollution loss reserves on insurers' books. According to Standard & Poor's, "... the industry's reserves for the most part have failed to reflect the exposure to environmental claims that are extremely difficult to reserve." Few companies, said Standard &

¹⁵Failed Promises: Insurance Company Insolvencies, House Committee on Energy and Commerce, Committee Print 101-P, Feb. 1990.

¹⁶The National Association of Insurance Commissioners consists of the heads of insurance departments of the 50 states, the District of Columbia, and four U.S. territories. Its basic purpose is to encourage uniformity and cooperation among the states and territories as they individually regulate the insurance industry.

¹⁷Insurer Failures: Property/Casualty Insurer Insolvencies and State Guaranty Funds (GAO/GGD-87-100, July 1987).

¹⁸Hazardous Waste: Issues Surrounding Insurance Availability (GAO/RCED-88-2, Oct. 1987).

Poor's, "... have established significant environmental reserve levels."¹⁹ To provide more information on the scope of the industry's problem, our 1987 report proposed that the Congress consider requiring insurers or responsible parties, as appropriate, to report to EPA the amounts of indemnity payments made to cover pollution cleanup and related third-party bodily injury and property damage.

STATUS OF LAW ON INSURERS'
OBLIGATIONS

I'd like to turn now to the status of court rulings on the contractual obligations of property/casualty insurers for responsible party cleanup costs.

For our 1987 report, we reviewed court cases involving disputes over insurance coverage between insurers and their policyholders who were being held responsible for hazardous waste site cleanups. We reported that court interpretation of insurance contracts varied--sometimes favoring the insurer, sometimes favoring the insured party. These decisions focused on key contract terms or issues, including disputes over whether an insurance contract's pollution exclusion clause applied to the insured's release and disputes over whether pollution cleanup costs are considered covered damages as defined in an insurance policy.

Our recent review of cases indicates that court decisions remain split. For example, in 1987, we reported that the only two Federal Circuit Courts of Appeals to address the issue of whether cleanup costs are covered damages had reached conflicting conclusions. Since then the court that had ruled in favor of the insured reconsidered that decision and ruled instead that cleanup costs are not covered damages as defined by the policy. However,

¹⁹Standard & Poor's Insurance Rating Services, 1989 Series.

another Federal Circuit Court has recently ruled in favor of a policyholder on this issue.

Our review of Federal district court and state court cases revealed a similar lack of uniformity in the decisions. Court decisions still vary not only among states, but within states. This split in court decisions is not surprising for at least two reasons. First, all of these decisions, including those made in federal courts, are based on interpretations of state insurance contract law, which varies from state to state. Second, the decisions within some states seem to vary according to the specific facts of each case.

In short, three years after our 1987 report, the question of the extent of insurers' obligations to pay responsible party cleanup costs remains unresolved.

CONCLUSIONS

In summary, there is insufficient information to accurately predict whether property/casualty insurers will be seriously harmed by liability for hazardous waste site cleanups. In a worse case scenario, cleanup costs paid by insurers could seriously affect insurance industry surpluses. However, it is not clear at this point how aggressively federal and state governments will pursue the cleanup of the nation's hazardous waste problems and how far courts will hold insurers responsible for cleanup costs. Thus, the full dimensions of insurer liability may not be known for many years. However, because of the potential impact on the insurance industry, this situation certainly warrants close tracking by the Congress and state regulators.

In our October 1987 report, we concluded that the extent to which insurers pay for pollution cleanups will almost certainly continue to be an issue when CERCLA is up for reauthorization. We

said that determining the amounts that insurers were paying was difficult because the industry did not have centralized, comprehensive data on these claim payments. This is still the case. We suggested that the Congress consider requiring insurers or responsible parties, as appropriate, to report to EPA the amounts of claim payments made to cover pollution cleanups and other related expenses. As this information would give some early warning of the possible impact of pollution claims on insurers, we believe our proposal still has merit as an aid to congressional policy-making in this area.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Subcommittee may have.