

## Superfund “mega-sites”: How American accounting rules exacerbate difficult challenges

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The term Superfund “mega-site” is nowhere defined in statute or regulation but is used by the U.S. Environmental Protection Agency (EPA) and other stakeholders to refer to those Superfund sites with actual or expected total cleanup costs of \$50 million or greater. While there are individual landfill sites that meet this standard, many, if not most, “mega-sites” are the larger and more complex sites involving sediment and groundwater contamination that is geographically dispersed over a large area.

### **The problem with mega-sites**

Mega-sites pose substantial legal and practical problems. Stakeholders have become increasingly aware that the established paradigm for investigating and remediating Superfund sites does not work very well for [mega-sites](#). The wide geographic dispersal of contaminants inevitably means that, compared to smaller, less complicated Superfund sites, mega-sites have many more sources of contamination and, concomitantly, many more potentially responsible parties (PRPs). The Remedial Investigation/Feasibility Study (RI/FS) phase at a mega-site can easily take 10 to 20 years and cost more than [\\$150 million](#); the schedules and costs for full remediation are equally, often exponentially, inflated. For example, the EPA Record of Decision ([ROD](#)) for the lower 8.3 miles of the Passaic River, which is part of the Diamond Alkali Superfund Site in Newark, New Jersey, requires the removal of 3.5 million cubic yards of sediment over a period of 11 years and at an estimated discounted cost of \$1.386 billion (\$2.3 billion on an undiscounted basis). Yet to come is the remediation of other operable units, including the remainder of the 17 miles of the Lower Passaic River and Newark Bay. It is challenging under the best of circumstances to organize, fund, and manage a group of PRPs to respond to a Superfund site; it may be almost impossible in the case of a mega-site.

### **The use of American accounting principles**

The complexity of the contamination—and of the response—that makes cleaning up mega-sites so difficult raises countless issues for regulators and PRPs. A critical (but often overlooked) issue is the problematic application of long-standing American accounting principles to mega-site liability determinations. Specifically, the accounting principles regarding environmental remediation liabilities, when applied to the facts of a mega-site, have the potential to require a PRP to use an allocation developed for Remedial Investigation/Feasibility Study work to

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establish the PRP's financial statement reserves not only for the Remedial Investigation/Feasibility Study work, but also for the ensuing remediation, once the cost of such remediation can be "reasonably estimated." This outcome can make PRPs less likely to participate in PRP groups.

This problem stems from a set of accounting standards first issued in 1976 by the Financial Accounting Standards Board (FASB). In that year, the FASB issued Financial Accounting Standard [No. 5](#), "Accounting for Contingencies," now called "FASB Accounting Standards Codification (ASC) subtopic 450-20." This standard requires accrual of an estimated loss from a "loss contingency" if it is probable that a liability has been incurred at the date of the financial statement in question and the amount of such loss can be "reasonably estimated." FASB Interpretation No. 14, [Reasonable Estimation of the Amount of a Loss](#), concludes that a contingent loss can be reasonably estimated when a range of loss can be reasonably estimated. Unless an entity determines that a particular number within such range is more likely, it must recognize a liability at the minimum end of the range and establish a financial statement reserve for such liability.

In 1996, the American Institute of Certified Public Accountants issued "Statement of Position 96-1 ([SOP 96-1](#)), Accounting for Environmental Remediation Liabilities (now ASC 410-30)," which provides guidance for recognizing environmental remediation liabilities under Superfund and similar laws. SOP 96-1 provides a two-part analysis: (1) can the liability be reasonably estimated, and (2) if so, what is the allocable share of such liability. Paragraph 138 of the guidance indicates that the three primary sources for estimating liability are (1) the allocation method and percentages to which the PRPs have agreed (whether for the entire remediation effort or to just the costs incurred in the current phase of the remediation process), (2) liability assigned by an allocation consultant, or (c) liability as determined by EPA. Where there is a primary source for estimating liability, a PRP is required to use its allocable share of liability prescribed by the primary source, unless by "objective, verifiable information," it can develop an alternate estimate that is more persuasive. Unfortunately, there is likely to be comparatively little information concerning or available to the majority of PRPs at a mega-site, especially those PRPs whose nexus to the contamination is indirect (e.g., a publicly owned treatment works with releases into the mega-site via storm and other sewers).

In the absence of such information, and given the existence of an allocation for Remedial Investigation/Feasibility Study work to which a PRP has agreed, an accounting firm (and the Securities and Exchange Commission (SEC), if the SEC has jurisdiction) may demand that the allocation for Remedial Investigation/Feasibility Study work be used to calculate a PRP's required financial statement reserves, even if the allocation by its terms is limited to the Remedial Investigation/Feasibility Study work and is irrelevant to the remediation. The risk that an accounting firm and the SEC would consider the allocated share cost to be material is especially great where there has been substantial media coverage of the mega-site and its cost.

This accounting method may appear to be abstract or esoteric, but it can have significant consequences for PRPs. Depending on a PRP's financial circumstances, the PRP may decide to test the judicial waters on the divisibility of harm and apportionment of liability rather than agree to participate in a PRP group Remedial Investigation/Feasibility Study for a mega-site with an interim allocation, at least where the allocation could lead to remediation costs that are catastrophic to the PRP's business.

### **Additional accounting issues may arise**

Other accounting principles exacerbate the huge costs and other problems associated with mega-sites. For example, paragraph 132 of SOP 96-1 provides that measurement of a contingent liability may be discounted to account for the time value of money—but only where the aggregate amount of the liability and the amount and timing of cash payments are fixed or reliably determinable. Given the length of time and complexities of mega-site remedies, the use of undiscounted numbers can easily result in the doubling (or more) of an already astronomically high reserve.

[SEC comment letters](#) have reflected concerns regarding the appropriate horizons for estimating long-tail Superfund liabilities, namely operations and maintenance. In the case of mega-sites, these horizons are long and the obligations costly; a change in assessment of how long a treatment system at a regional groundwater mega-site (e.g., the Baldwin Park Operable Unit of the San Gabriel Superfund Site) will need to be operated can have a sudden and material impact on a PRP's [balance sheet](#).

As previously indicated, the technical, legal, and financial management challenges presented by mega-sites are daunting; to make them less so, the Superfund practitioner involved in mega-sites should ensure that an accountant with Superfund experience is part of the cross-functional team addressing the site.