

**American Bar Association
Section of Environment, Energy and Resources**

**How U.S. Accounting Rules and Guidance May Create Disincentives for Participation in
Remedial Investigation/Feasibility Study at a Superfund “Mega-site”**

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ABSTRACT

Sites with contaminated soils, sediments and groundwater dispersed over a wide geographic area pose significant environmental investigation and remediation challenges beyond those posed by a landfill or industrial property. The size and complexity of such “mega-sites” make their investigation and remediation take much longer and cost much more than a typical landfill or industrial property and create logistical nightmares for both government and private parties involved in addressing them. This paper addresses how the application of American accounting standards to such large, complex “mega-sites” exacerbate an already difficult challenge in ways that may not be well understood by environmental practitioners and suggests that American accounting standards be clarified to specifically address such large, complex sites.

Introduction

U.S. Generally Accepted Accounting Principles (GAAP) are those standards, conventions and rules that U.S. accountants follow to record and summarize those data contained in financial statements and have been adopted by the U.S. Securities and Exchange Commission (SEC) and codified by the Financial Accounting Standards Board. GAAP addresses environmental costs and liabilities, including those associated with the investigation and remediation of soil and groundwater contamination under CERCLAⁱ, also known as “Superfund,” in various accounting standards. Unfortunately, GAAP was not developed with extremely large and highly complex Superfund sites in mind. The application of GAAP to such sites has the presumably unintended consequence of obstructing one of CERCLA’s primary goals, the organization and funding of groups of “potentially responsible parties” under CERCLA (PRPs) to undertake investigation and remediation actions at such sites.

Background

The overwhelming majority of Superfund sites addressed to date have involved landfills. U.S. Environmental Protection Agency (EPA) regulations and guidance have therefore naturally focused on industrial properties or landfills. Mega-sites, given their size and complexity, pose a much more difficult challenge because they each in effect constitute multiple sites, each with unique soil, sediment, and/or groundwater contamination issues, each with its own sources of contamination and corresponding PRPs associated with such contamination. The Remedial Investigation/Feasibility Study (RI/FS) phase at a mega-site can easily take 10 to 20 years to complete and cost more than \$150 million.ⁱⁱ

The remediation phase of a mega-site also is much longer and more expensive than a single landfill or industrial property. For example, the EPA Record of Decision (ROD)ⁱⁱⁱ 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 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. While it is difficult to organize and fund a PRP Group to address a Superfund site consisting of a landfill or industrial property, it may be almost impossible to do so in the case of a mega-site.^{iv}

Application of U.S. Accounting Principles to Superfund Mega-sites

In 1976, the Financial Accounting Standards Board (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." In the case of a Superfund site, it is presumed that a loss is probable if litigation has commenced or assertion of a claim is probable and the reporting entity determines it is liable under CERCLA respecting the site, e.g., it arranged for the disposal of hazardous substances at such site, or owned or operated such site. Respecting whether such loss can be "reasonably estimated," FASB Interpretation No. 14, Reasonable Estimate 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, 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). 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.

SOP 96-1 requires a reporting entity to determine its allocable share based on its estimate of the allocation method and its resulting allocation percentage for the entire remediation. Note that SOP 96-1 provides that there is a rebuttable presumption that costs will be allocated only among PRPs that are participating at the site at the time the reporting entity issues its financial statements. Beyond 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), or where releases impacting the site took place long ago, with no witnesses still living and little, if any, documentary evidence available.

In the absence of “objective, verifiable information,” and given the existence of an allocation for Remedial Investigation/Feasibility Study (RI/FS) work to which a PRP has agreed, an accounting firm (and the SEC, if it has jurisdiction) may demand that the allocation for RI/FS work be used to calculate a PRP’s required financial statement reserves once the cost of the remediation could be reasonably estimated (e.g., costs estimated by EPA in a Record of Decision), even if the allocation by its terms was limited to the Remedial Investigation/Feasibility Study costs and was expressly not applicable to any other costs. Given the substantial media coverage of many mega-sites and the magnitude of current and likely future costs, both the SEC and the entity’s accounting firm would be under pressure to require an entity to establish a financial statement reserve using such allocation at whatever point in time the costs of future work at the Site became reasonably estimable.

It should also be noted that SOP 96-1 would not allow potential recoveries against recalcitrant or other non-participating PRPs or insurers to offset the amount of environmental liability to be recognized. SOP-96-1, *inter alia*, prescribes that such recoveries can only be recognized when realization of the claim is deemed probable and further that where such claim is the subject of litigation, a rebuttable presumption exists that realization of such claim is not probable. Even if such presumption can be rebutted, the reporting entity would still need to determine that the parties against whom it sought recoveries had sufficient financial resources to pay such claim; in the case of mega-sites, where there can be hundreds, or even thousands of PRPs, the necessary investigation would be costly and time consuming, and given the lack of available evidence, unlikely to be productive.

Given the consequences of the application of GAAP at a mega-site as described above, a PRP would have need to carefully consider any decision to participate in a PRP group under any circumstances. For various reasons beyond the scope of this paper, EPA is often in a position where it is unable to conduct adequate PRP searches prior to initiating enforcement action against a subset of likely PRPs to begin investigatory work. A PRP in such case would typically be required to agree to participate in a PRP group prior to evaluating the available evidence that it has nexus to the mega-site, prior to the completion of sufficient site investigation and remedial design work to reasonably estimate the ultimate future costs at such mega-sites, and before a PRP search could be completed, with the nexus evidence and financial condition for each PRP evaluated.

Depending on the financial circumstances of a particular reporting entity, given the magnitude of costs as a mega-site, even a small allocable share for the cost of the entire site could be catastrophic, given the risk that GAAP may not permit recording potential recoveries against non-participating PRPs as an asset. Depending on the applicable facts, the entity may determine it is better off not participating in a PRP group at an early stage at a mega-site, take the risk of subsequent enforcement, and challenge at that time the application of joint and several liability, making the case that the harm is divisible and that liability should be appropriately apportioned.

GAAP also exacerbates 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 also reflected concerns regarding the appropriate horizons for estimating long-tail Superfund liabilities, namely operations and maintenance.^v 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.^{vi}

Given the significance of investigation and remediation of CERCLA mega-sites, consideration should be given by the FASB to specifically address such sites and their unique challenges in GAAP.

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ⁱ The Comprehensive Environmental Response, Compensation & Liability Act, 42 U.S.C. § 9601, *et seq.*

ⁱⁱ Testimony of Steven C. Nadeau, Hearing on "Oversight of CERCLA Implementation" Before the House of Representatives Committee on Energy and Commerce, Subcommittee on Environment and the Economy July 13, 2016.

ⁱⁱⁱ Record of Decision for the Lower 8.3 Miles of the Passaic River Part of the Diamond Alkali Superfund Site, Essex and Hudson Counties, New Jersey, U.S. Environmental Protection Agency, Region II, New York, New York, March 16, 2016.

^{iv} See generally, Emerging Challenges on the Administrative Side of Superfund Practice; David C. Batson and Walter Mugdan, Superfund Master Class: Today's Issues and Tomorrow's Reforms, June 16, 2016, Chicago, IL.

^v Navigating Pitfalls in Estimating Costs of Environmental Remediation Liabilities for Financial Reporting Purposes, Joe M Young, Deloitte Financial Advisory Services, TAEP Conference, ECIC 12, January 15, 2015.

^{vi} United States Securities and Exchange Commission, Form 10-K for the fiscal year ended November 30, 2015, Aerojet Rocketdyne Holdings, Inc., Washington, D.C. 20549.