

Some Problems With Superfund Settlement Premiums



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A settling party may have opportunities to substitute for the “cash-out” covenant not to sue at lower cost than the premium. That may create settlement negotiation opportunities, and may even call into question the amount of any premium demanded by the government. In addition, nonsettling parties may have issues arising from the application of the premium and its impacts on remaining claims.

These issues point up the problem of intentionally enhanced shares in order to be conservatively high in assigning the settling party’s settlement amount, and therefore on the internal allocation used by the government or applied by a third-party allocator. And while these issues may formally arise primarily in the context of a settlement involving the United States, they are also common in settlements with states under CERCLA and state “Little Superfund” statutes, and also in private party cash-out settlements.

As is familiar, Section 107(a) of CERCLA, 42 U.S.C. Section 9607(a), imposes liability on certain parties associated with a “facility” (that is, a building, vehicle, or site) that has experienced a release or a threatened release of a hazardous substance that causes a “response.” The liability is either for the response action—the work—under Section 106(a) or the costs of response incurred by the United States, a state or tribe, or “any other person.” In the

case of costs of response incurred by someone other than a government, in some procedural circumstances that “other person” must sue for contribution under Section 113(f)(1) or (3)(B), and in others, that “other person” may sue for cost recovery under Section 107(a)(1-4)(B).

Multiple responsible parties may share joint and several liability for the whole of the response at a site. Settlements typically occur in pieces; not all parties settle at the same time. If the statute or practice required all parties to settle all at once, each one would have a veto. That sort of bilateral monopoly would make settlement quite difficult.

When a party settles separately with the government, the government typically must recover at least what it considers to be a fair estimate of the settling party’s equitable share of the total. When the settling party “cashes out,” it pays up front an estimate of that share and receives a covenant not to sue for the response action or costs it is settling. The United States typically requires that the component of the settlement payment made on account of costs not yet incurred or work not yet done be enhanced by a “premium.” That is a multiple of the settlement amount, typically half—again as much for costs of fully designed projects and double or more for less completely specified future costs.

The EPA guidance regarding premiums in cash-out settlements applies to de minimis party settlements and “peripheral party” settlements. De minimis parties typically have less than a 1% share of liability and “peripheral parties” are parties that may not be de minimis, but are not large enough or positioned in such a way that they could realistically be asked to implement the work.

The premium covers three risks: cost overruns, calls for additional or different work because of a remedy failure or other reasons, and funding shortfalls because the primary responsible parties cannot or do not complete the work. A cash-out settlement presupposes that someone other than the settling parties will undertake the future work or bear the future costs not funded by the settlement. If those parties do not perform, then the Superfund must make up the shortfall.

In addition to a premium, many settlements have embedded within them an enhancement to the estimated fair share of the settling party. This is sometimes called a “conservative” or “aggressive” estimate.

A party’s fair share under Section 113(f)(1) of CERCLA is not knowable with certainty, even in principle. One cannot know in advance what factors the court will choose or how it will weight them. That is true even if one had perfect knowledge of each party’s activity concerning the site. This is not a circumstance under which more discovery will ultimately reveal the one, true allocation. Therefore, parties to a settlement who do not necessarily know how the court will ultimately define “fair” must predict shares. If they predict a share for a settling party on the high side, they can have more confidence that the settling party will not underpay and the remaining parties will not be left with an unfairly large share. Most of the time, of course, the enhanced share will be higher than the “true” share, and then a premium will be applied to it, resulting in a relative overpayment by the settling party.

The issue of a premium only arises if the settling party receives in return a covenant not to sue for the full response action at issue, no matter what it costs and no matter the availability of the other parties to complete the work. Often those risks are insurable. In addition, sometimes the risk of remedy failure—having to do additional work because the original remedy did not succeed—is insurable. If one can obtain insurance for those risks, then a settling party may compare the cost of the insurance to the amount of the premium to determine whether the cash-out covenant is too expensive. While the government will typically not want to accept insurance in lieu of the premium, depending on circumstances it may be willing to leave a cost reopener in the settlement agreement and in exchange to reduce or to eliminate the premium. The settling party can then insure the risk of the cost reopener.

Notice, by the way, that risk of the other parties’ default is generally priced into the premium as a multiple of the settling party’s fair share, when the amount of the risk is really proportional to the *other parties’* shares. The risk-management vehicle and the settlement premium are calculated on different bases, and either can turn out to be more attractive.

Other forms of risk shifting can also substitute for a cash-out settlement. A contractor may accept a guaranteed fixed price to closure contract, in effect creating a synthetic cash-out. The contractor will take a front-loaded stream of payments calculated to be temporally ahead of the project’s costs. That creates a balance that the contractor will invest. The contractor pays itself out of the balance as increased by the investment returns. It will

set the payment schedule to be highly unlikely to result in a negative balance at any time during the life of the project.

The United States may not obtain a double-recovery under CERCLA. The amount of any settlement payment must reduce the liability of any non-settling party by the amount of the payment under Section 113(f)(2) of CERCLA. The premium, though, is designed to compensate for future risks that may or may not materialize. If the government places the premium payment in an account restricted to use in the event of cost overruns, party default, or remedy failure, then the government must recover 100% of the nearer-term costs from nonsettling parties. If the risks do not eventuate, then there will be a remaining balance, an over-recovery from the non-settling parties, and a double-recovery by the government. No one will know if that occurs for decades. Thus, one might argue that however the government applies a premium, nonsettling parties are entitled to an immediate dollar-for-dollar reduction in their liability by the amount of the premium.

An enhanced share obscures this application and settlement credit issue. Some of the enhanced share is a premium, but the amount is unclear. Should it be saved for a contingency, or applied immediately? Should settlement credit be given to nonsettling parties for the full amount?

All these are negotiation and litigation points for the parties, and prudent lawyers will consider them at the time of settlement.

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