9477.1983(03)

CLOSURE COST ESTIMATES

12/9/83

Mr. Allan B. Mitchell
Mitchell & Schultz, Inc.
P.O. Box 190
310 E. Lee
Sapulpa, Oklahoma 74066

Dear Mr. Mitchell:

Thank you for your letter of October 23 in which you question the net working capital requirement of the financial test for assurance of closure and post-closure care at hazardous waste management facilities. The financial test is a means by which a financially sound firm may demonstrate its ability to cover the costs of closure and post-closure.

The financial test differs from other acceptable mechanisms for assurance of financial responsibility. In the event of abandonment or bankruptcy, there is no special fund of money that EPA can use to properly close and maintain a facility. Therefore, it is imperative that the Agency be assured that a firm passing the test is viable and that sufficient funds would remain available even in the event of a change in the financial position of the firm.

In developing the financial test, the Agency extensively analyzed over 300 possible tests, applying them to known bankruptcies to determine which test would provide the needed safety margin while allowing as many viable firms as possible to pass the test. The result was the two alternative sets of criteria found at 40 CFR Parts 264 and 265.

The first alternative, the "ratios" test, requires a net working capital of at least six times the sum of the closure and post-closure cost estimates. To assure that the closure and post-closure costs themselves would not cause insolvency, the Agency originally determined that a firm should have net working capital of at least twice the cost estimates. However, in studying bankruptcies, the Agency

discovered that many firms experienced a rapid deterioration of financial condition in the two to three years prior to business failure. In such cases, net working capital fell by an average of 66% in two years. Thus, a multiple of six (a factor of two - to ensure ability to pay - times three - to protect against rapid deterioration) was found necessary.

The second alternative, the "bond rating" test, is not directly comparable to the "ratios" test. While both options provide EPA with the needed assurance, they do it in different ways. While the "ratios" are designed as predictors of bankruptcy, the "bond rating" assures viability and credit-worthiness. In fact, both Moody's and Standard & Poor's look at many factors, including ratios, in assigning a rating. For example, they consider a firm's size to be very important. Most firms assigned investment grade bond ratings have net worth in the $100 million to $200 million range and above. Firms which pass the "bond rating" test are able to raise money easily, and they have a statistically lower business failure rate than those that pass the "ratios" test.

It is important to note that over 90% of those firms wishing to use the financial test are able to pass it. I can certainly understand the frustration of those unable to use the test, but believe that our requirements are appropriate to meet our overriding responsibility to protect human health and the environment.

Sincerely yours,

William D. Ruckelshaus