

EPA Overview of Ability To Pay Guidance And Models

The purpose of this document is to identify and briefly describe documents that are relevant to Superfund ability to pay ("ATP") analyses. The documents fall into two general categories: (1) documents that require or provide for consideration of the ability to pay of potentially responsible parties ("PRPs"); and (2) documents that describe methods to determine ATP settlement amounts. The Regions should use documents in the first group in making Superfund ATP determinations. The Regions may also use documents in the second group in conducting ATP settlements until more specific Superfund ATP settlement guidance is provided by Headquarters. **[Note: Users should not rely solely on this summary document in making ability to pay determinations, but should instead read the relevant document(s) in their entirety.]**

A. GENERAL POLICY DOCUMENTS

The following Agency documents describe situations in which a liable party's ability to pay should be considered. Although some of these documents do not deal specifically with CERCLA liability, they represent general Agency policy regarding the use of ability to pay in enforcement cases. For this reason, the documents should be relied upon in situations relating to the ability to pay potential of Superfund PRPs.

1. General Civil Penalty Policy

The *General Civil Penalty Policy* is composed of two documents: *Policy on Civil Penalties* and *A Framework for Statute-Specific Approaches to Penalty Assessments*:

- a. ***Policy on Civil Penalties***
(EPA General Enforcement Policy # GM-21)
(February 16, 1984)

This is an Agency guidance document that "establishes a single set of goals for penalty assessment in EPA administrative and judicial enforcement actions." Although this document is intended to address penalty considerations, it is important because it sets forth the Agency's basic philosophy on ability to pay issues in enforcement cases.

This philosophy indicates that under the goal of fair and equitable treatment of the regulated community, the policy must allow for flexibility to adjust penalties. The policy lists certain factors that are to be considered in determining penalty amounts. One of these factors is "ability to pay." The policy also cautions that a reduction of a penalty based on ability to pay is only "appropriate to the extent the violator clearly demonstrates that it is entitled to mitigation."

- b. ***A Framework for Statute-Specific Approaches to Penalty Assessments***
(EPA General Enforcement Policy # GM-22)
(February 16, 1984)

A companion to the *Policy on Civil Penalties*, this policy directs EPA staff on the development of medium-specific penalty policies for administratively-imposed penalties and judicial and administrative settlements under statutes enforced by the Agency. It restates and amplifies some of the concepts included in the *Policy on Civil Penalties* document.

Lack of an ability to pay is identified as one circumstance of "compelling public concern" based on which an enforcement case may be settled for less than the economic benefit of noncompliance. This document states that ability to pay settlements are allowed if "[r]emoval of the economic benefit would result in plant closings, bankruptcy, or other extreme financial burden, and there is an important public interest in allowing the firm to continue in business."

Three additional requirements are provided for use in ability to pay determinations: 1) the violator has the burden of demonstrating an inability to pay claim; 2) "EPA reserves the option, in appropriate circumstances, of seeking a penalty that might put a company out of business"; and 3) documenta-

tion of all ability to pay adjustments must be included in case files and other relevant internal documents.

2. Guidance on Determining a Violator's Ability to Pay a Civil Penalty (EPA General Enforcement Policy # GM-56) [December 16, 1986]

This Agency guidance document amplifies the discussion in the *General Civil Penalty Policy* relating to the use of the ability to pay factor in the imposition of civil penalties. This guidance document is directed toward civil penalties imposed on for-profit entities that have not filed for bankruptcy. It establishes a standard for the evaluation of an inability to pay claim by stating that "EPA may consider using the ability to pay factor to adjust a civil penalty when the assessment of a civil penalty may result in extreme financial hardship."

Although this document establishes a standard, it does not determine a specific dollar amount that a party can afford to pay. The guidance requires the examination of various options that a violator has for paying a civil penalty and provides that the Agency may request copies of tax returns and other financial documents to support claims of inability to pay. The document also states that if requested information is not provided, the Agency should seek the full penalty amount.

"ABEL," a computer program that evaluates the financial health of for-profit entities based on the estimated strength of their internally-generated cash flows, is introduced in this guidance. (A more detailed description of ABEL is provided below.) The document notes that, even if the ABEL analysis shows an inability to pay a penalty with internally generated cash flow, the Agency should evaluate other possible sources of payment.

3.* Interim CERCLA Settlement Policy (OSWER # 9835.0) [December 5, 1984]

This Agency guidance document identifies ten criteria governing private party settlements under CERCLA. One criterion is "ability of the settling parties to pay." This document states that "the settlement proposal should discuss the financial condition of that party, and the practical results of pursuing a party for more than the government can hope to actually recover."

4.* Guidance on Documenting Decisions Not to Take Cost Recovery Actions (OSWER # 9832.11) [July 7, 1988]

This document states that the decision to not take a

cost recovery action may be based on the finding that a PRP is not financially viable or that it is unable to pay a substantial portion of the claim. This guidance references the *PRP Search Manual* (OSWER # 9834.6).

5.* Transmittal of the Superfund Cost Recovery Strategy (OSWER # 9832.13) [July 29, 1988]

The Superfund cost recovery strategy requires the Agency to consider the "financial ability of the potential defendants to satisfy a judgment for the amount of the claim or to pay a substantial portion of the claim" when deciding to issue a cost recovery referral.

6.* Submittal of Ten-Point Settlement Analysis for CERCLA Consent Decrees (OSWER # 9835.14) [August 11, 1989]

Commonly known as the "ten point guidance," this document makes the same reference to ability to pay considerations as the *Interim CERCLA Settlement Policy* document: that the "settlement proposal should discuss the financial condition of [a] party, and the practical results of pursuing a party for more than the government can hope to actually recover."

7.* Interim Policy on CERCLA Settlements Involving Municipalities or Municipal Wastes (OSWER # 9834.13) [December 6, 1989]

This Agency guidance document describes the Agency's interim policy for CERCLA settlements with municipalities. Included in the document is authority to include special settlement provisions "where a municipality has successfully demonstrated to EPA that they are appropriate (e.g., where valid ability to pay or procedural constraints that affect the timing of payment exist)."

8.* Final Penalty Policy for Sections 302, 303, 304, 311 and 312 of the Emergency Planning and Community Right-to-Know Act and Section 103 of the Comprehensive Environmental Compensation and Liability Act (OSWER # 9841.2) [June 13, 1990]

This penalty policy allows for the reduction of a penalty that is "clearly beyond the financial means of the violator." It reiterates much of what is stated in earlier penalty policy documents, including the use of ABEL and the type of information that is to be relied upon in making an ability to pay determination.

B. DOCUMENTS THAT ASSIST IN DETERMINING ABILITY TO PAY AMOUNTS

The following documents identify methodologies that may be relied upon in conducting an ability to pay analysis. Although the documents which follow provide much useful information for determining an ability to pay amount, none of these documents represent formal Agency guidance directed specifically at Superfund cases.

1. The ABEL Computer Model and Supporting Documentation

The Agency has developed a computer model that assists in identifying whether a settlement amount has the potential to create a financial hardship. The computer program is known as ABEL and the following three documents, *ABEL User's Manual*, *ABEL User's Guide*, and *Supplement to the ABEL User's Manual: Superfund ABEL*, describe the use of, and methodologies relied upon in performing, an ABEL ability to pay analysis.

ABEL conducts an ability to pay assessment of a for-profit corporation. ABEL projects the ability of the for-profit corporation to pay for the proposed settlement from future earnings and from a delay in reinvestment of capital assets.

The ABEL model will calculate certain common financial ratios that describe the financial strengths and weaknesses of the for-profit corporation. This part of the analysis is called a phase one analysis and can be performed with a minimum of one year of financial information. ABEL requires at least three years of tax data to make a phase two projection. The phase two projection compares the proposed settlement amount with projected future cash flows of a for-profit corporation. The phase two projection then provides the statistical probability that the corporation can pay the proposed settlement from the projected future cash flows.

ABEL is designed to be used by those who are not familiar with financial information. The ABEL documentation informs enforcement personnel that a person experienced in ability to pay analysis must examine the financial information prior to the reduction of a proposed settlement amount if the ABEL analysis indicates an inability to pay.

ABEL is not designed to evaluate the ability to pay of other financial entities such as municipalities, partnerships or individuals.

a. *ABEL User's Manual* [October 1991 Version]

This manual provides step-by-step instructions for using the ABEL model. *The ABEL User's Manual*

describes how the ABEL model can be used in assessing a for-profit corporation's ability to pay one or more of the following expenditures: civil penalty; environmental clean-up costs; and/or pollution control equipment costs. The *User's Manual* also provides background information on key assumptions used in the model (e.g., reinvestment rate), and how these can be altered by the user.

b. *ABEL User's Guide* [October 1991]

This guide is available in two versions, an "uncut" version for government users of the ABEL model (which contains confidential information) and a non-confidential version for outside users of the model (which is now available for purchase through the National Technical Information Service (NTIS)).

The government version of this document provides internal enforcement guidance on how EPA staff can effectively use the ABEL computer model in settlement negotiations. Specifically, this document describes what additional analyses should be performed if ABEL predicts that a violator's cash flow will not be sufficient to pay proposed penalty and/or cleanup costs.

The *User's Guide* relies upon 3-5 years of federal income tax returns to perform the analysis and also describes other documents that should be requested from a violator, as well as public sources of information.

c. *Supplement to the ABEL User's Manual: Superfund ABEL* [September 1992 Version]

This supplement to the *ABEL User's Manual* provides information on use of the ABEL model for Superfund calculations. The Superfund ABEL model is easier to use when estimating the present value of costs associated with the work that is agreed to be performed. However, the standard values utilized by the Superfund ABEL model relax the criteria for determining a financial hardship. Accordingly, the Superfund ABEL model may identify more financial hardship situations than the standard ABEL model. If the conclusion reached

by the Superfund ABEL model is that the for-profit corporation has the ability to pay, the chances of the corporation demonstrating an extreme financial hardship are small.

2. Beyond ABEL: Ability to Pay Guidance [February 1993]

This guidance document is designed to assist EPA personnel to "go beyond ABEL" and assess ability to pay in cases where the ABEL computer model produces a negative or ambiguous result. Because ABEL is designed as a conservative screening tool that focuses only on internal cash flow, it may produce a negative or ambiguous result when a violator has the ability to pay through other means, such as reduction of unnecessary expenses, sale of or borrowing against assets, or assumption of additional debt.

The guidance gives step-by-step instructions on how to investigate potential sources of funds, and contains worksheets to guide this analysis and to draw attention to key information in tax returns and/or other financial statements. The analysis focuses on identifying luxury assets, undervalued assets, loans to or from officers and shareholders, unnecessary officers' salaries, and certain other expenses. The result is a more sophisticated analysis than that provided by ABEL.

The guidance suggests methods of adjusting an ABEL input to allow ABEL to estimate the ability to pay of sole proprietors, partnerships, and Subchapter S corporations. Also, the guidance provides additional cautions that help to clarify when a financial analyst should be consulted.

3. Individual Ability to Pay Guidance [June 1992]

If a violator files only an individual federal income tax return, ABEL cannot be used. The *Individual Ability to Pay Guidance* was developed by Industrial Economics, Inc., the EPA contractor that supports the ABEL model, for sole proprietor, partnership and individual inability to pay claims in the State of Iowa's underground storage tank (UST) program.

Although this document was not written by EPA, it can be useful in a case involving an individual's inability to pay claim. This document is not a computer program but provides a method to determine an individual's ability to pay. In a method that is similar to the ABEL model, this document draws information from individual tax forms, including Form 1040, Form 1040A, or Form 1040EZ.

This document characterizes the financial strengths and weakness of an individual in comparison to averages determined from income level, family size and county of residence. The document relies on income and expense information to project the availability of income after the payment of identified expenses and to determine if additional debt capacity exists.

The guidance provides advice on how to make a final ability to pay determination, including instructions on topics such as: how to understand the results, when it is appropriate to do additional research and verification (including consultation with a financial analyst), and how to consider extenuating financial circumstances (e.g., current sale or purchase of real estate).

4. Guidance for Calculating Municipal and Not-for-Profit Organizations' Ability to Pay Civil Penalties Using Current Fund Balances [March 1993]

This is a pilot guidance document developed by the Office of Prevention, Pesticides, and Toxic Substances (OPPTS) for use in determining the ability of governmental entities (municipalities) and other not-for-profit (NFP) organizations to pay civil penalties. The document suggests a method of determining the ability to pay from unreserved funds. It does not evaluate other methods of paying for the proposed settlement such as borrowing, raising taxes or paying over time.

The document describes how to use NFP financial statements to perform an ability to pay assessment for three types of organizations: (1) municipalities and states; (2) private colleges and universities; and (3) NFP hospitals. This document also contains background information on financial accounting practices and types of financial statements used by NFP entities, which differ from those used by for-profit companies.

5. The Road to Financing, Assessing and Improving Your Community's Creditworthiness [September 1992]

Developed by the Office of Water, this document provides brief descriptions of municipal financial characteristics and discusses how changes in these financial characteristics will project improvement in a municipality's financial health. It is a useful tool in describing some of the concepts of assessing the ability to pay of a municipality. This document may be useful for those who are unfamiliar with municipal financial characteristics.

6. Financial Capability Guidebook
[March 1984]

This Office of Water document is to be used to determine whether a municipality can demonstrate that it can ensure adequate building, operation, maintenance and replacement of a publicly owned treatment works. The most important section of this guidebook is the Supplemental Information Sheet and instructions (pages 52-68). The instructions allow for a characterization of a municipality that is equivalent to what the ABEL analysis does for a business. However, there is one major note of caution. The analysis is not intended for a Superfund ability to pay analysis but for the construction and operation of a publicly owned treatment works. For this reason, the *Guidebook* provides a higher ability to pay estimate than may be applicable.

7. Financial Review Methodology for Wastewater Discharge Noncompliance Cases
[September 17, 1984]

This document was prepared by Peat Marwick, an accounting firm, for EPA Region V. The methodology is similar to that in the *Financial Capability Guidebook*, but it allows for a greater number of years of financial information to be examined and a more detailed discussion of the financial indicators. The document has the same limitation as the *Financial Capability Guidebook*, in that it subjects the municipality to a more rigorous standard than Superfund ability to pay settlements.

8. Ability to Pay Interrogatories
[June 16, 1994]

This draft OECA document provides model interroga-

tories, requests for production, and judicial and administrative subpoenas for discovery of information and documents in cases where ability to pay is an issue. The interrogatories are intended to be tailored to specific cases, taking into account the size and structure of the violating entity.

Separate model interrogatories and requests for production of documents are provided for: (1) corporations; and (2) individuals and sole proprietors. Interrogatories to corporations request information on: corporate structure and management; equity and debt; parent and subsidiary entities; insurance coverage; tax and financial information; assets; liquidation of assets; and claims and judgments. Interrogatories to individuals and sole proprietors request information on personal and business assets, liabilities, income, expenses, and other financial matters. **[NOTE: This document can be released only to government employees.]**

9. Ability to Pay Case Memorandum
[August 1, 1993]

This Office of Enforcement document summarizes all the significant cases in the area of ability to pay, as of the date of issuance. The memorandum summarizes environmental case law related to topics such as: application of statutory provisions that require ability to pay to be considered in civil penalty assessments (e.g., section 109(a)(3) of CERCLA); which party has the burden of proving an ability (or inability) to pay; factors that may be considered in assessing ability to pay; alternative payment plans; and types of financial information that may be presented to a court on ability to pay issues. **[NOTE: This document can be released only to government employees.]**

ADDITIONAL INFORMATION

If you have any questions or comments on this Fact Sheet, please contact **Bob Kenney (703-603-8931)** or **Leo Mullin (703-603-8975)** of the OSRE Policy and Program Evaluation Division (PPED).

If you would like copies of the documents summarized in this Fact Sheet, they are available from the following sources. Documents identified by an asterisk (*) are found in the *CERCLA Enforcement Policy Compendium*. Copies of the complete Compendium or individual documents may be ordered by EPA personnel from the **Superfund Document Center (703-603-8917)**. [If requesting the complete Compendium, ask for Documents # PB-93-963623 and PB-92-963623; if requesting specific documents, ask for the OSWER document number listed above.] Other referenced documents are available from **Tracy Gipson (202-260-3601)** of the OSRE Regional Support Division.