



State of Nevada
Governor's Office of Finance
Division of Internal Audits

Audit Report

**Division of Environmental Protection
Petroleum Fund**

DIA Report No. 19-05
June 25, 2019

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Division of Environmental Protection
Petroleum Fund

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**Objective: Improve Management and Operational Accountability
of the Petroleum Fund**

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Adhering to the legislative intent for the Petroleum Fund could benefit the state by up to \$7.5 million annually, prevent large corporations from taking advantage of small business funds, and make more funding available for grants to business and homeowners that have a financial need. Petroleum Fund legislation was intended to help small businesses by leveling the playing field. To date, only 2 percent of Petroleum Fund reimbursements have gone to small businesses.

Follow Statute for Third-Party Liability Fundspage 7

Following the statute for third-party liability funds would save the Petroleum Fund \$25 million on currently open cases.

The Petroleum Fund should comply with statute and limit the use of third-party funds to their intended use. Third-party liability funds are being used to pay for clean-up activities, in violation of statute. Statute requires an owner/operator to submit a settlement agreement or judgment to receive third-party liability funds. Over \$11 million in third-party liability funds have been improperly spent for clean-up activities.

Non-compliant owner/operators have taken advantage of third-party liability funding to complete clean-up. Owner/operators who received a reduced reimbursement amount due to non-compliance with regulatory requirements have been allowed to use third-party liability funds to complete clean-up activities once they expended all of their allotted clean-up funds.

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Implementing internal controls and processes to reduce the risk of fraud and abuse of the Petroleum Fund could allow the state to recoup between \$2.3 million and \$11.5 million from fraudulent or misused funds. Petroleum Fund staff has not conducted audits on the \$230 million spent on Fund cases. Project sites are not audited to ensure reimbursements are appropriate. Other states conduct audits and reclaim funds that have been misspent.

The Petroleum Fund does not have written policies and procedures that ensure consistent practices. Fund staff can improve bid oversight by developing specific language for purchasing and bid processes that reflect state purchasing requirements. Internal controls will safeguard the assets of the state, increase operational efficiency, prevent malfeasance, and ensure adherence to statutes and regulations.

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Implementing a risk-based approach would ensure remediation activities are necessary, industry best practices are used, and could have saved the state \$21.5 million. The Petroleum Fund can reduce costs and decrease clean-up times while ensuring public safety by developing and implementing risk-based decision-making tools. Other states have successfully implemented risk-based decision-making tools to reduce costs and clean-up times.

Revise Enrollment and Reimbursement Policiespage 22

Revising enrollment policies would prevent Underground Storage Tank (UST) owners from taking advantage of the Petroleum Fund, would reduce Fund expenditures and could have saved the state at least \$19,000 during fiscal year 2018. The Petroleum Fund’s current enrollment and reimbursement policies do not prevent UST owners from enrolling in the Fund when they are not in compliance with federal UST regulations. Additionally, these policies do not preclude UST owners from enrolling in the Fund after a leak has been discovered or should have been discovered. Other states have created statutes, regulations, or policy to deny petroleum fund enrollment or reimbursement for owners of non-compliant UST systems.

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INTRODUCTION

At the direction of the Executive Branch Audit Committee, the Division of Internal Audits conducted an audit of the Nevada Division of Environmental Protection (NDEP), Petroleum Fund (Fund). Our audit focused on improving management and operational accountability of the Fund. The audit's scope and methodology, background, and acknowledgements are included in Appendix A.

Our audit objective was to develop recommendations to:

- ✓ Improve management and operational accountability of the Petroleum Fund.

Division Response and Implementation Plan

We provided draft copies of this report to NDEP for its review and comments. NDEP's comments have been considered in the preparation of this report and are included in Appendix B. In its response, NDEP accepted all of our recommendations. Appendix C includes a timetable to implement that recommendation.

NRS 353A.090 requires within six months after the final report is issued to the Executive Branch Audit Committee, the Administrator of the Division of Internal Audits shall evaluate the steps NDEP has taken to implement the recommendations and shall determine whether the steps are achieving the desired results. The administrator shall report the six month follow-up results to the committee and NDEP officials.

The following report (DIA Report No. 19-05) contains our *findings, conclusions, and recommendations*.

Improve Management and Operational Accountability of the Petroleum Fund

The Division of Environmental Protection (NDEP) can improve management and operational accountability of the Petroleum Fund (Fund) by:

- Adhering to legislative intent to provide clean-up funds to small businesses and residential properties;
- Following statute for using third-party liability funds to protect other property owners;
- Adopting adequate internal controls and processes to monitor costs and reduce the risk of fraud and/or abuse of the fund by auditing cases and conducting site visits;
- Developing additional risk-based decision-making tools to assist in reducing clean-up times and to expedite closure of legacy cases; and
- Revising enrollment and reimbursement policies.

Improving management and accountability of the Fund will benefit Nevada by \$56.3 million to \$65.5 million from decreased spending and highway tax relief.

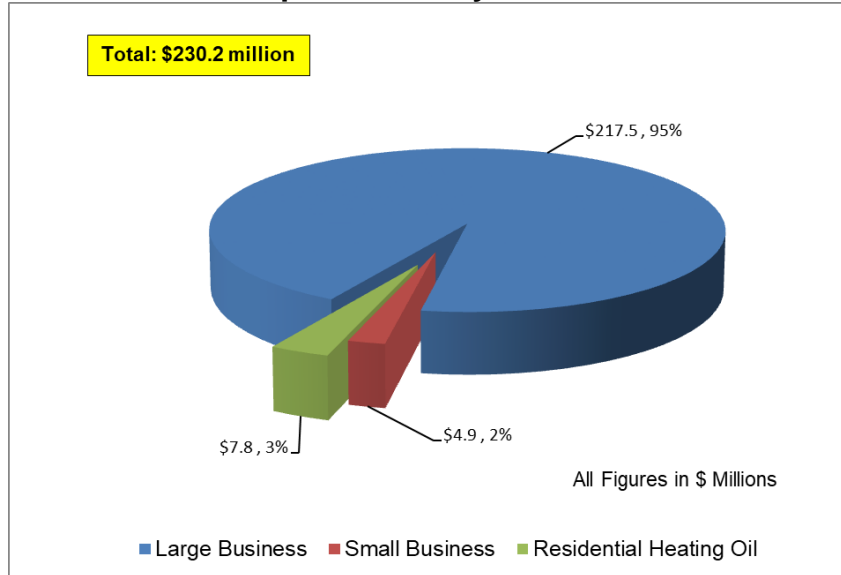
Adhere to Legislative Intent for the Petroleum Fund

The Fund should adhere to legislative intent by providing awards to small businesses and residential properties. Adhering to legislative intent could benefit the state by up to \$7.5 million dollars annually.

The Fund has strayed from its legislative intent of helping small businesses operating in the competitive petroleum business. As of March 2019, only \$4.9 million of almost \$230.2 million has been spent on small business clean-ups, approximately 2.1 percent of total fund expenditures. See Exhibit I for a chart of fund expenditures by classification.

Exhibit I

Fund Expenditures by Classification



Source: Nevada Division of Environmental Protection.

Notes:

- a. "Small Business" refers to a business that receives less than \$500,000 in gross annual receipts.

Large Corporations Taking Advantage of Small Business Funds

Statute states the intent of the Fund is to meet the federal government's financial responsibility requirements and to level the playing field for small businesses.¹ "The capital of smaller operators is too little to meet these requirements and insurance to cover this liability is prohibitively costly for these smaller operators." Further, it states that "free competitive access to the business of distributing petroleum therefore requires a system of funding this liability in which all engaged in the business must participate equitably."



¹ NRS 445C.290

The statute classifies businesses as small or other. A small business is defined as “a business which receives less than \$500,000 in gross annual receipts from the site where the tank is located.”² Since the Fund’s inception in 1989, only four businesses have been designated as small businesses. Two out of 144 current open cases are classified as small businesses. To date they have received \$2.2 million. The two closed cases received \$2.7 million.

While the statute’s intent was to provide assistance for small business owners, the statute makes provisions for assistance for all businesses. However, Fund assistance has been dominated by large corporations in opposition to statutory intent. Since the Fund’s inception in 1989, only 5 percent of Fund expenditures have been spent on small business or home heating oil tank clean-ups. These large businesses are likely financially able to cover the cost of clean-up activities or private insurance.

Fund Reimbursements Are Based on Business Classification

Fund reimbursements differ based on business classification. Small businesses are responsible for 10 percent of the first \$1 million per tank for clean-up and 10 percent for the first \$1 million per tank for third-party liability. The fiscal year maximum for two or more tanks is \$1.9 million for clean-up and \$1.9 million for third-party damages. The owner/operator would be responsible for a maximum of \$50,000 out-of-pocket costs for clean-up and \$50,000 for third-party damages regardless of the number of storage tanks involved.

For all other businesses, owner/operators are responsible for the first 10 percent of the first \$1 million per tank for clean-up and 10 percent of \$1 million per tank for third-party damages. The fiscal year maximum for two or more tanks is \$1.8 million for clean-up and \$1.8 million for third-party damages. The owner/operator would be responsible for a maximum out-of-pocket cost of \$200,000.

The Fund was also established to provide corrective action funding for home heating oil tank spills. Since 1989, the Fund has spent \$7.8 million on 500 residential heating oil sites. These storage tanks must have a capacity of 1,100 gallons or less and be used to store heating oil consumed on the same premises. Owners pay the first \$250 for clean-up and \$250 for any third-party damages. The Fund pays up to \$250,000 per discharge and \$250,000 for third-party damages.

Exhibit II summarizes the eligibility amount of reimbursement for each business classification and the maximum out-of-pocket costs.

² NAC 445C.210(f) adds “based upon annual gross receipts for the following period: (1) If the business has been in operation for 5 or more fiscal years on the date on which the discharge is discovered, the 5 fiscal years immediately preceding the date on which the discharge was discovered; or (2) If the business has been in operation for less than 5 fiscal years on the date the discharge is discovered, the total number of years the business has been in operation.”

Exhibit II

Fund Coverage by Business Classification

| Coverage Limits | | | | |
|-------------------------|-------------------------|------------------|--|------------------|
| | Clean-up Costs Coverage | | 3 rd Party Liability Coverage | |
| | <u>Per Tank</u> | <u>Aggregate</u> | <u>Per Tank</u> | <u>Aggregate</u> |
| All Businesses | \$1 million | \$2 million/year | \$1 million | \$2 million/year |
| Residential Heating Oil | \$250,000/release | | \$250,000/release | |

| Copayment Limits | | | | |
|-------------------------|--------------------------|----------------|---|----------------|
| | Clean-up Costs Copayment | | 3 rd Party Liability Copayment | |
| | <u>Per Tank</u> | <u>Maximum</u> | <u>Per Tank</u> | <u>Maximum</u> |
| Small Business | 10% | \$50,000 | 10% | \$50,000 |
| Large Business | 10% | \$200,000 | 10% | \$200,000 |
| Residential Heating Oil | \$250/release | | \$250/release | |

New Grant Program Considers Financial Need

The Fund created a new needs-based grant program in December 2017. The grant program allows the Fund to award grants to owner/operators who can demonstrate a financial need to defray costs for infrastructure repairs and upgrades required by new federal regulations.³ Applicants are ranked by financial need, then by the amount of fuel dispensed, and finally proximity to another petroleum dispensing facility.

NDEP estimates \$2 million annually is available for grants to comply with federal regulations after expenditures on clean-ups. Individual maximum grant amounts will be based on the number of tanks located at a petroleum dispensing location.⁴ If requests for grant funds exceed the available funds, grant requests are prioritized by need.

The new federal regulations were established to prevent leaks. Money spent on testing and repairs prior to a leak will prevent future, costly clean-up activities and third-party damage claims.⁵ The Fund would have more funding available for prevention if it limited its reimbursements to the small businesses outlined in the statute’s original legislative intent.

³ NRS 455C.310(2) establishes the grant program and requires that the Fund limit grant funds to owner/operators who can demonstrate a financial need.

⁴ One tank will be eligible for \$38,000; two tanks will have a maximum of \$64,000; and three tanks will be eligible for a maximum of \$90,000.

⁵ 40 CFR 280.20-280.21 outline the new federal regulations governing UST testing and maintenance.

Conclusion

The Fund was intended to level the playing field and assist small business in a highly competitive industry. Adhering to the original legislative intent may reduce public spending and allow the Fund to make more grant funding available to prevent spills. The Fund was not intended to primarily provide state funding for large corporations. Limiting funding to small businesses would allow the Fund to make more grant funding available to prevent spills. Adhering to legislative intent could save \$7.5 million annually. ⁶

Recommendation

1. Adhere to legislative intent for the Petroleum Fund.

⁶ The Fund's annual starting balance is \$7.5 million.

Follow Statute for Third-Party Liability Funds

The Petroleum Fund (Fund) should adhere to statute and ensure that third-party liability funds are exclusively used for damages incurred by a third-party as a result of a tank release. By limiting the use of these funds to those uses proscribed in statute, the Fund would ensure that innocent third-parties could recover for damages that they experience. The state could save up to \$25 million for clean-ups on open cases if funds were limited to their intended use.

Third-Party Liability Funds Are Used For Clean-up Activities

Third-party liability funds should only be used to pay for damages incurred by third-parties that are caused by an Underground Storage Tank (UST) release.

The Fund is awarding third-party liability funds for use in additional clean-ups contrary to Nevada statutory authority. In 2007, the Board to Review Claims (Board) passed Board Resolution 2007-10. This resolution allows owner/operators to use third-party liability funds for corrective actions. The owner/operator must have used all corrective action funds and show that the use of these funds for clean-up could possibly prevent third-party legal actions. To receive these funds, owner/operators are only required to acknowledge these funds will no longer be available if a third party action arises, creating risk to the public.

Damages are defined as bodily injury or property damage that the owner/operator becomes legally liable to pay to a third-party due to the release.⁷ Regulation states the “Board will not authorize payment for the fund unless it has received the order of judgment or it has received settlement agreement and has approved the terms of such agreement.”⁸

As of March 18, 2019, 30 out of 144 open cases have been approved to use third-party liability funds to complete their clean-up. In all of these cases, the Board approved reimbursements using third-party liability funds without a final judgement or a settlement agreement. Third-party liability funds give owner/operators access to an additional \$1 million per tank. These owner/operators are eligible for almost \$36 million in corrective action funds and over \$36 million in third-party liability funds.⁹ As of March, almost \$47 million have been spent on these 30 cases.

⁷ NAC 445C.210(1)(b) defines “Damages” as “any money the operator of a storage tank becomes legally obligated to pay as damages because of bodily injury or property damage to any person other than the State or the operator caused by a discharge.”

⁸ NAC 445C.280(3).

⁹ \$35,830,000 was available for corrective action and \$36,250,000 was available for third-party liability. Three claimants received reduced eligibility for corrective action funds due to non-compliance with regulatory requirements.

Non-Compliant Owner/Operators Take Advantage Of Third-Party Liability Funds

The Board is allowing owner/operators who are penalized for non-compliance to take advantage of third-party liability funds. Owner/operators who have received a reduced clean-up amount due to non-compliance with regulatory requirements received third-party liability funds for additional clean-up activities. Reductions are imposed for an owner/operator's non-compliance with regulatory requirements. Board resolution 94-023 states, "When a determination of non-compliance is made, the staff of the Nevada Division of Environmental Protection will recommend to the Board that any reimbursement awarded be reduced in accordance with the Reimbursement Reduction Schedule." Reductions normally range from 10 percent to 40 percent and reduce the total amount of funds available for the claimant to use for corrective action.

In three of the 30 cases, owner/operators received a reduction of the corrective action amount they were eligible to receive. Cumulatively, they were eligible for almost \$2.6 million in corrective action funds. To date, these three cases have received the \$2.6 million in corrective actions funds, an additional \$1 million in third-party liability funds, and are still eligible for \$2 million in available third-party liability funds. Further, two of the three cases are over 25 years old.

Additional funding should not be given to owner/operators who receive reductions due to non-compliance with regulations. The owners ought to be liable to pay for the additional clean-up activities out-of-pocket and not be awarded additional funds that were meant to pay for damages and injuries incurred by third-parties.

Board Policy Violates Statute

The Board cannot change statutory requirements by a resolution. Board resolution 2007-10 allowed the Fund to approve the use of third-party liability funds to complete clean-up activities. This resolution is in conflict with statute. The statute specifically designates third-party funding for damages incurred by a third-party. Regulation requires an owner/operator to submit a settlement agreement or judgement to receive these funds.

Conclusion

The Fund is currently approving third-party liability funds to pay for clean-up activities in violation of the requirements of the statute. The Fund should be adhering to the statute requiring third-party liability funds to be paid to injured third-parties. The statute requires that third-party funding only be paid to third-parties that have suffered damage or injury as a result of a release. It requires the owner/operator to submit a judgment or a settlement document to receive third-party liability funds.

The Fund should ensure that funds are available to pay for injuries incurred by third-parties by adhering to the statute and restricting the use of third-party funds to those uses outlined in the statute. Further, limiting third-party liability payments as designated by statute would have saved the Fund over \$11 million to date and potentially as much as \$25 million.¹⁰

Recommendation

2. Follow statute for third-party liability funds.

¹⁰ To date, the board has approved \$11,399,320 in third-party liability funds to be used for clean-up activities by owner/operators. These 30 cases were eligible for \$35,830,000 in clean-up funds and \$36,250,000 in third-party liability funds.

Adopt Internal Controls to Prevent Petroleum Fund Fraud

Nevada Division of Environmental Protection (NDEP) should adopt adequate internal controls and processes to monitor costs and reduce the risk of fraud and abuse of the Petroleum Fund (Fund) by auditing project sites. Internal controls will safeguard the assets of the state, increase operational efficiencies, prevent malfeasance, and ensure adherence to statutes and regulations. Audit activities could allow the state to recoup between \$2.3 million and \$11.5 million from fraudulent or misused funds.

Three Instances of Fraudulent or Abusive Behavior Have Been Discovered

The priority of Fund staff is to ensure clean-ups are completed as quickly as possible; however, adequate and effective internal control measures need to be in place to ensure the integrity of the Fund. NDEP has determined there have been three instances of fraud and/or abuse within the last five years:

- 2014 – a Certified Environmental Manager (CEM) manipulated the bid process by instructing contractors to inflate their bids and the CEM worked with a specific contractor to secure the bid;
- 2015 – a group of subcontractors and a CEM inflated their clean-up costs for heating oil tanks; and
- 2016 – a CEM submitted false contractor invoices for reimbursement.

NDEP has not implemented audit or additional review procedures to address these instances of fraud. Further, no action was taken against the CEMs or subcontractors for their actions. Fund staff noted they would closely monitor the CEM in the 2016 incident. CEMs are not state employees. They are private contractors hired by an owner/operator to oversee clean-up activities.

Sites are Not Audited to Ensure Reimbursements are Appropriate

Fund staff have not conducted audits on the \$230.2 million spent on all Fund cases; of this amount, \$97.6 million has been spent on open Fund cases. In 2015, the Fund implemented a new claim tracking database to account for expenditures. This database tracks invoices, payments, and project costs more efficiently for the reimbursement process. The previous process included manual tracking over two antiquated databases.

Fund staff are currently utilizing the database and are working with its software developer to get the database fully-operational. The database is able to reconcile contractor's invoices with quotes. The database is also able to track the costs stated in the Not-to-Exceed Project (NTEP) costs received from CEMs. A NTEP is a cost proposal submitted by CEMs to NDEP case officers for approval. The

NTEP consists of a breakdown of costs to clean-up a site. Any deviation from the approved NTEP requires prior approval from the case officer.

No Written Policies for the Reimbursement Process

The Fund does not have written policies and procedures in place for the new database or the reimbursement process. Written policies and procedures would ensure consistency and standardization within the Fund. With the amount of time potentially saved with the new database, there are internal Fund discussions regarding the ability of staff to be able to complete audits and site inspections of its projects.

Noted Deficiencies in Previous Audit

In the Division of Internal Audits Report No. 01-05, a recommendation was made to NDEP to, “obtain other evidence of work completion or perform additional on-site inspections as necessary before paying a claim.” NDEP reported on March 30, 2001 that this recommendation was fully implemented. NDEP reported that site inspections stopped in 2005. During interviews with Fund staff and management, there are currently no site inspections being completed.

Other States Audit UST Fund Requests

We surveyed other states to determine best practices for managing Underground Storage Tank (UST) funds.¹¹ We found several states using audits and management techniques to reclaim misspent clean-up funds.

The State of Louisiana’s Underground Storage Tank Trust Fund sends its staff into the field to conduct visual inspections at the project sites to ensure that the work started has been completed. The program is currently in the process of completing an actuary study to review its historical data to provide recommendations to decrease clean-up times and areas of improvement and to close out older sites.

Established in 2013, the California State Water Resources Control Board (CSWRCB) Underground Storage Tank Enforcement Unit has saved the state over \$187 million in civil penalties, denials of claims, and reductions in future coverages.¹²

¹¹ Alabama, Arkansas, California, Colorado, Georgia, Illinois, Indiana, Kentucky, Louisiana, Montana, Tennessee, and Utah.

¹² Figures provided by the State of California State Water Resources Control Board, Office of Enforcement. From 2015-Current, there were \$30,031,000 in imposed penalties, \$1,628,587 in restitution payments ordered, and \$156,234,174 in savings (forgoing of reimbursements, denials of claims, and reductions in coverages).

The Enforcement Unit is devoted to preventing and investigating cases of fraud against the UST Clean-up Fund. The Enforcement Unit is comprised of engineers, geologists, scientists, program analysts, and in-house legal counsel. The Enforcement Unit is authorized to:

- Impose administrative civil penalties up to \$500,000 per violation against those who make fraudulent claims and misrepresentations to the fund;
- Bar claimants and consultants convicted of fraud against the fund from further participation in the fund;
- Recover costs associated with investigating and prosecuting fraud cases against the fund; and
- Grant administrative authority to prosecute cases.

The State of Utah is developing an audit program to check time cards and records to confirm hours and dates worked on UST projects. The Utah UST Trust Fund issued sanctions on one of its contractors for not paying its subcontractors in a timely manner. The consultant was reimbursed over \$20,000 by submitting false proof of payments to the Utah Fund, but did not pay its subcontractor. The contractor was not disallowed from participating in the program, but could no longer receive direct payments.

The State of Colorado has developed an audit program to review its consultants and to provide education and training to them. During their audits, Colorado audit staff review timesheets to ensure consultants are actually working on a specific project, as well as not double billing for multiple projects. Additionally, they complete a review of the consultant's invoices and subcontractors' invoices. This review also includes a visual site inspection of the equipment installed and remediation work completed. Colorado has reported that over the past 30 years, audits have saved the state over \$6.5 million (1 percent of costs submitted for reimbursements) by declining payments for inadequate documentation or exceeding project rates.

California and Colorado reported UST fund savings of \$187 million and \$6.5 million, respectively. Exhibit III summarizes this data.

Exhibit III

Dollars Recovered/Saved with Audit Activities

| State | Percentage Recovery | Total Dollars Saved |
|------------|---------------------|---------------------|
| California | 5.00% | \$ 187,000,000 |
| Colorado | 1.00% | \$ 6,500,000 |

Source: Division of Internal Audit state survey.

Exhibit IV shows the potential Fund savings if audits had been completed on projects in Nevada. We used the statistical percentage recovery range of 1 percent to 5 percent (recovery percentages of Colorado and California).

Exhibit IV

Potential Dollars Recovered/Saved with Audit Activities Nevada

| Funds Spent-to-Date ^a | Potential Percentage Recovery | Potential Recovered Dollars |
|----------------------------------|-------------------------------|-----------------------------|
| \$ 230,200,000 | 1% | \$ 2,302,000 |
| | 5% | \$ 11,510,000 |

Source: Division of Internal Audit state survey.

Notes:

- a. Funds Spent-to-Date are total monies spent from the Fund since inception.

NDEP could benefit from implementing a task force to investigate claims of fraud and/or abuse. It would also be imperative for the task force to be able to pursue cases of fraud and/or abuse against a CEM or contractor.

State Purchasing Requirements Not Being Followed

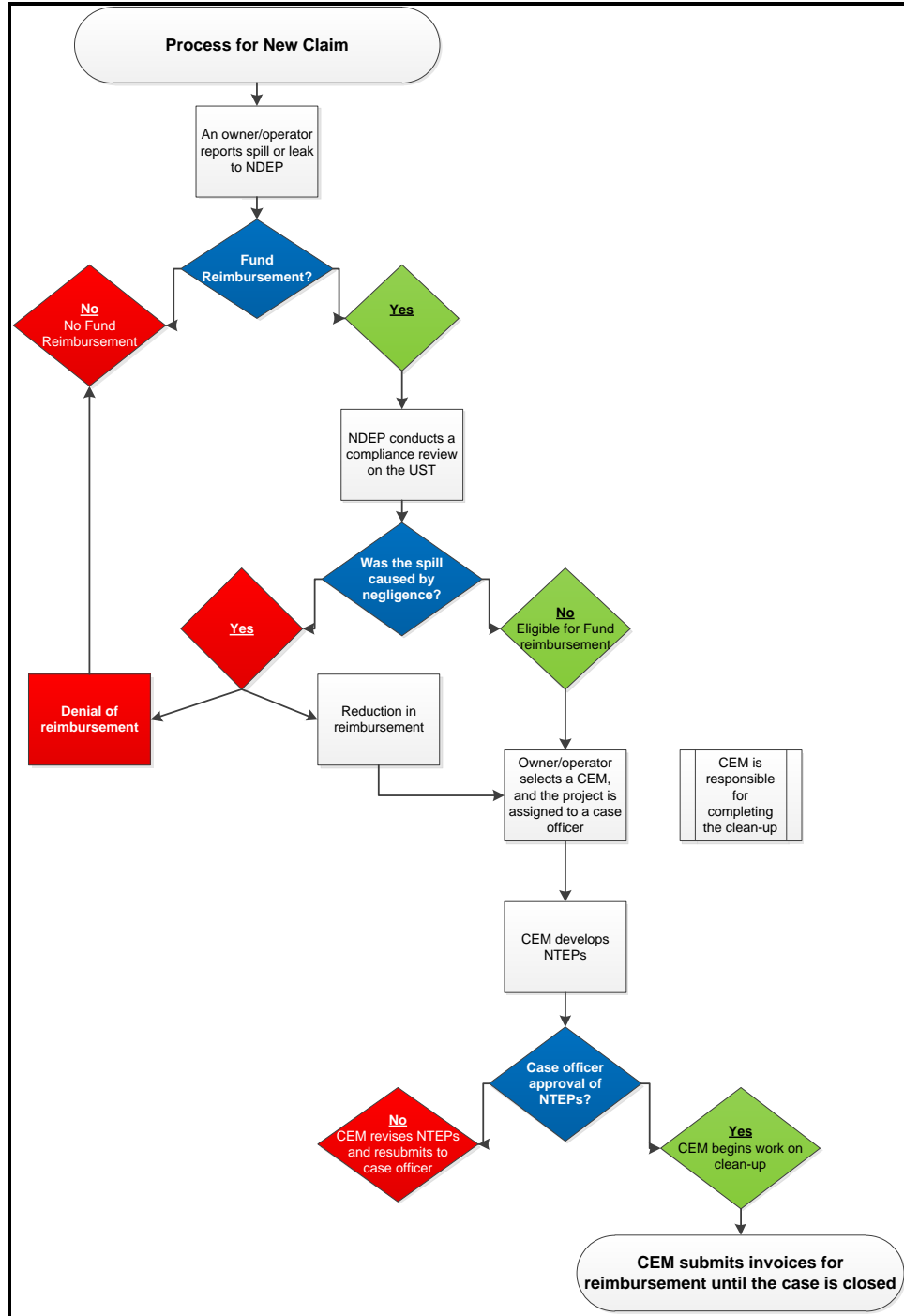
Board Policy Resolution 2015-01 requires the CEMs to solicit bids for clean-up costs that are reviewed and the successful bid is selected by the CEM. The CEM is required to provide documentation to an NDEP case officer that three bids were received or at least solicited. In certain situations, the case officer has the authority to waive the three-bid requirement, for example, an emergency spill or limited contractor pool.

Under normal circumstances, the process for a Fund case is as follows and is depicted in Exhibit V:

- An owner/operator reports a spill or leak to NDEP.
- If covered by the Fund, NDEP will conduct a compliance check on the owner/operator's tank records to ensure the spill or leak was not caused by owner/operator negligence.
- If eligible for coverage, the owner/operator selects a CEM and the case is assigned to one of NDEP's case officers for oversight.
- The CEM is responsible for completing the clean-up, and develops NTEPs to complete the clean-up, which includes any subcontracted work.
- The CEM submits the NTEPs to the case officer for review and approval.
- If approved, the CEM can begin work. Any deviation from an approved NTEP requires written approval from the case officer.
- The CEM submits invoices to the Fund staff for reimbursement until the case is closed.

Exhibit V

New Claim Flow Chart



Source: Nevada Department of Environmental Protection.

Fund policy requires the CEM to obtain three competitive bids for any non-CEM costs that exceed \$3,000. Fund approval is required for those costs over \$25,000 before the project can begin. All bids are reviewed by the case officer assigned to the project.

NRS 333 – Procedures for State Purchasing, outlines the requirements for bid advertising; such as, name of the agency, publication of the bids, and timeframe for the bids. With the exception of electronically submitted bids, bids are to be sealed, opened, and read publicly. Statute allows for an appeals process for unsuccessful bidders and requires contracts to be approved by the Board of Examiners.

NDEP represented CEMs are not adhering to all bid advertisement requirements for Fund projects. NDEP reported bids are not sealed and are not opened publicly, leaving the process open to manipulation by CEMs. This manipulation was seen in the 2014 and 2015 fraud/abuse cases previously noted.

Fund staff and case officers rely heavily on the documentation submitted by the CEMs. It would be beneficial for Fund staff and case officers to require additional documentation to ensure CEMs are adhering to state purchasing requirements, specifically bid advertisement, sealed bidding, and appeals of unsuccessful bids.

NRS 333.310 states that bid advertisements should contain a description of work to be completed; specifications of date and time when bids will be accepted; date and time when bids will be opened; and proof of publication. Fund staff can improve bid oversight by developing specific language for purchasing and bid processes for the CEMs that reflect state purchasing requirements.

Conclusion

NDEP does not audit Fund reimbursement claims for fraud or misuse of funds. Developing adequate internal controls decreases the potential for fraud and/or abuse in the reimbursement process. Performing periodic reviews or audits would ensure that reimbursement requests are appropriate. The lack of consequences for malfeasance on Fund cases increases the possibility CEMs will engage in abusive behavior or submit fraudulent costs. Auditing cases and conducting site visits could allow the state to recoup between \$2.3 million and \$11.5 million.

Recommendation

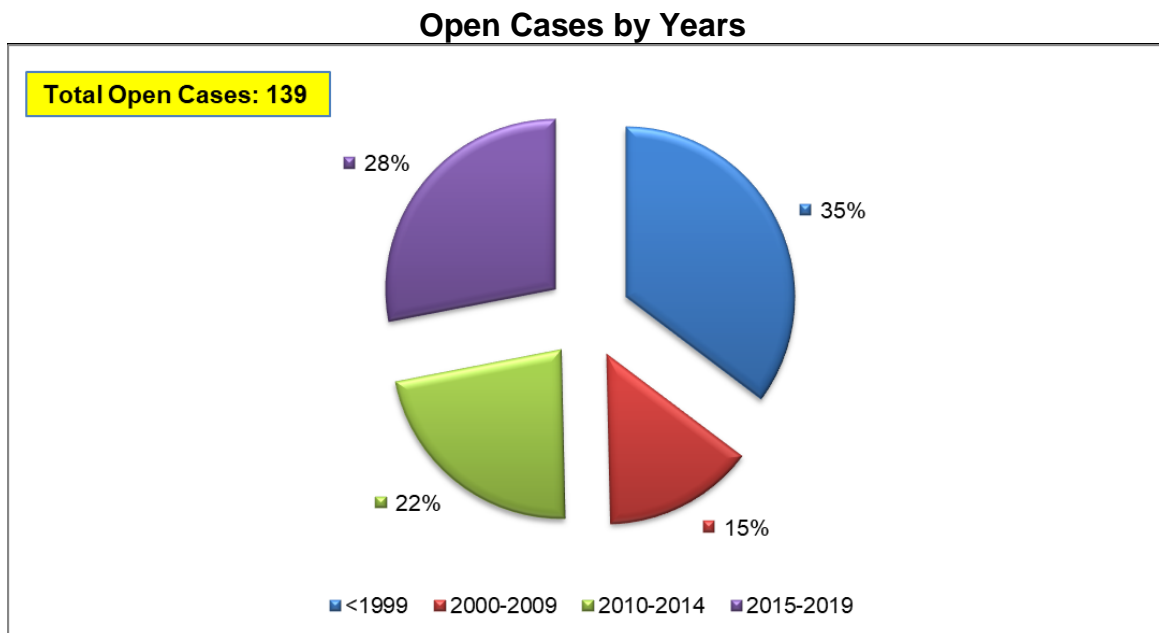
3. Adopt adequate internal controls and processes to monitor costs and reduce the risk of fraud and/or abuse of the Fund by auditing cases and conducting site visits.

Develop Additional Risk-based Decision-making Tools to Assist in Reducing Clean-up Times

The Nevada Division of Environmental Protection (NDEP) should develop additional risk-based decision-making tools to reduce clean-up times. NAC 445A.22725 authorizes NDEP to provide exemptions for corrective actions during the clean-up process.¹³ Additionally, NDEP provided a draft risk-based decision-making tool from 2014 called, “Groundwater Exemption (Closures).” Further development of this tool and additional risk-based decision making tools would help NDEP close cases more efficiently.

Our survey of other states shows the average clean-up time for a site is approximately seven years.¹⁴ The percentage of legacy cases over 20 years old ranged from 24 percent in Colorado to 78 percent in California. To date, the Fund has spent \$63.5 million on open cases initiated prior to 1999. Exhibits VI and VII show open cases by year ranges and by dollar amounts, respectively.

Exhibit VI



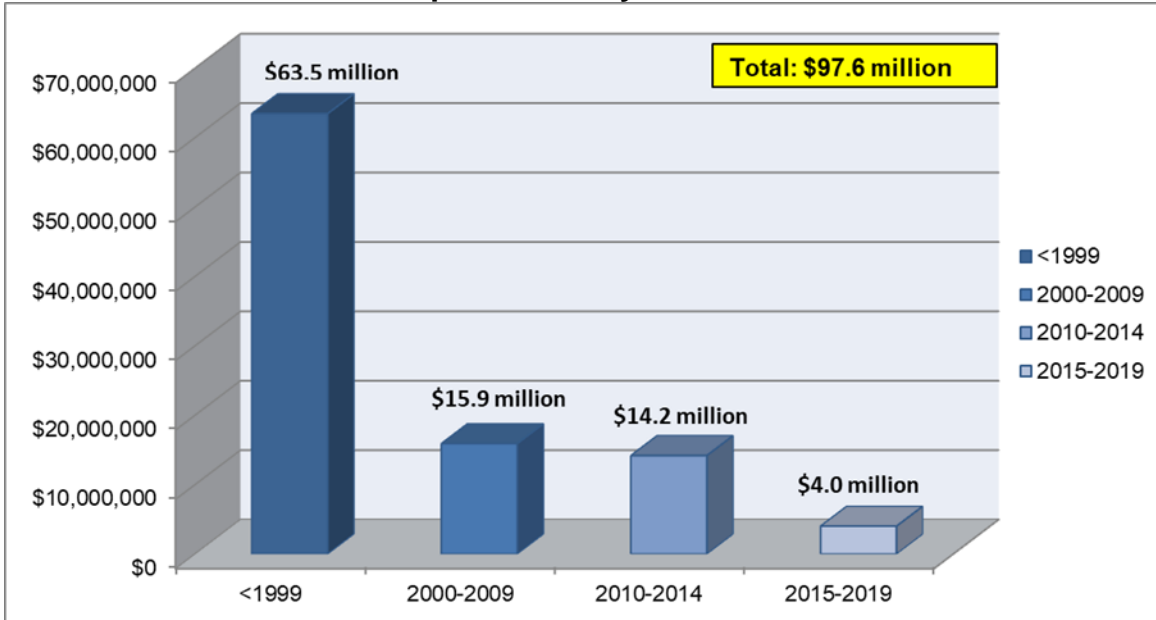
Source: Nevada Division of Environmental Protection.

¹³ NAC445A.22725 (4) states: “The Director shall not require an owner or operator to take corrective action pursuant to subsection 1 to achieve the remediation standard required by the Division if the owner or operator files with the Division a study which is acceptable to the Division and which demonstrates that, based on a review of available technology and the prohibitive cost of the corrective action, it is not feasible to achieve the required remediation standard.”

¹⁴ California, Colorado, Georgia, Kentucky, and Utah

Exhibit VII

Open Cases by Dollars



Source: Nevada Division of Environmental Protection.

Exhibit VIII takes into account inflation. The price of \$63.5 million in 2019 dollars is \$96.3 million.

Exhibit VIII

Current Dollar Value of Open Legacy Cases

| \$ in 1999 | Cumulative Inflation | \$ in 2019 |
|---------------|----------------------|---------------|
| \$ 63,452,319 | 151.82% | \$ 96,333,311 |

Notes:

- a. Dollars totaled from all open cases initiated prior to 1999.

Utilizing the average clean up time of seven years and taking into account applicable inflation rates, Exhibit IX shows the cost savings had those cases initiated prior to 1999 been closed within the seven year timeframe. We compared the dollar amounts of the cases initiated prior to 1999 and adjusted for the applicable inflation rates to determine the current dollar values (\$76.0 million).

Exhibit IX

Cost Savings of Cases Closed within 7-Year Average Period

| Date Case Initiated: | Past \$ Amount: | 7-Year Closure Date: | Inflation Factor: ^a | Current \$ Value: |
|----------------------|---------------------|----------------------|--------------------------------|--|
| | Column A | | Column B | Column A X Column B (rounded to the nearest dollar) |
| 1992 | \$2,143,551 | 1999 | 1.188 | \$ 2,546,539 |
| 1993 | \$4,477,450 | 2000 | 1.192 | \$ 5,337,120 |
| 1994 | \$16,934,779 | 2001 | 1.196 | \$ 20,253,996 |
| 1995 | \$5,578,605 | 2002 | 1.180 | \$ 6,582,754 |
| 1996 | \$4,631,256 | 2003 | 1.173 | \$ 5,432,463 |
| 1997 | \$826,039 | 2004 | 1.177 | \$ 972,248 |
| 1998 | \$7,053,286 | 2005 | 1.199 | \$ 8,456,890 |
| 1999 | \$21,807,353 | 2006 | 1.211 | \$ 26,408,704 |
| TOTAL | \$63,452,319 | | | \$ 75,990,714 |

Note:

- Inflation factor was calculated by dividing Average Consumer Price Index (ACPI) for the 7-Year Closure Date by the ACPI for the Date Case Initiated.

Inflation is an important consideration in determining the effects of having a high percentage of legacy cases with the Fund. Closing these legacy cases could have resulted in a potential savings of approximately \$20.3 million (\$96.3 less \$76.0 million).

Legacy Cases Grandfathered Under Old Statute

Prior to July 1, 1995, owner/operators were only required to pay a \$10,000 deductible. The Legislature changed the deductible to 10 percent on all project costs commenced after July 1, 1995. The Board to Review Claims (Board) adopted Policy Resolution No. 95-028 to implement SB 121.¹⁵ The resolution clarified that applications for Fund eligibility submitted prior to July 1, 1995 would be grandfathered in under the “laws that were in place at that time.”¹⁶

The Fund is paying 100 percent of clean-up costs on 12 open legacy cases, totaling approximately \$21.5 million. The grandfathered legacy cases constitute 34 percent of the total dollar amount spent on all open legacy cases. Since the Fund pays 100 percent of the reimbursements on these 12 open legacy cases, there is no incentive for the owner/operators or CEMs to close these cases.

¹⁵ State Board to Review Claims. *Resolution to Adopt a Statement of Policy Regarding the Implementation Date of SB 121*. Resolution No. 95-028 (1995).

¹⁶ State Board to Review Claims. *Resolution to Adopt a Statement of Policy Regarding the Implementation Date of SB 121*. Resolution No. 95-028 (1995).

NDEP Does Not Extensively Use Risk-Based Decision-Making Tools

There is an opportunity for NDEP to decrease the amount of legacy cases with the further development of its provisional risk-based decision-making tool. The basic premise for risk-based tools is to ensure the safety of the public while reducing costs.

The U.S. Environmental Protection Agency (EPA), Office of Solid Waste and Emergency Response defines risk-based decision-making as "...a process that utilizes risk and exposure assessment methodology to help Underground Storage Tank (UST) implementing agencies make determinations about the extent and urgency of corrective action and about the scope and intensity of their oversight action by UST owners and operators."¹⁷

NDEP provided information on its draft "Groundwater Exemption (Closures)" guidance document from 2014.¹⁸ This provisional document provides guidance on a "Pathway to Closure" to clean-up a site for an owner/operator or CEM. The pathway provides a basic framework for an owner/operator to obtain closure of their site. This can be accomplished by developing a plan for reducing the contaminant levels at the spill/leak. Another method is to develop a monitoring plan to evaluate the remediation efforts at the site.¹⁹ This methodology is in line with the NDEP's goal to clean up a site as quickly as possible.

At the Board meeting on March 13, 2019, NDEP speculated that the reason for the substantial amounts of Funds being spent on legacy cases was due to the spill/leak sources being difficult to access.²⁰ Further development of its draft risk-based decision-making tool and additional tools could provide NDEP with adequate information and a procedure to close these legacy cases.

Other States Use Risk-Based Decision-Making Tools

We surveyed other states to determine best practices for utilizing risk-based decision making tools in reducing clean-up times.²¹ We found several states using risk-based tools to decrease clean-up times and ensure funds are spent efficiently.

¹⁷ The EPA, Office of Solid Waste and Emergency Response issued this directive on March 1, 1995: "OSWER Directive 9610.17: Use of Risk-Based Decision-Making in UST Corrective Action Programs.

¹⁸ Draft Nevada Division of Environmental Protection, Bureau of Corrective Actions. *Groundwater Exemption (Closures)*. June 2014.

¹⁹ Draft Nevada Division of Environmental Protection, Bureau of Corrective Actions. *Groundwater Exemption (Closures)*. 6. June 2014.

²⁰ Draft State of Nevada Board to Review Claims Board Meeting Minutes. 11. March 13, 2019.

²¹ Alabama, Arkansas, California, Colorado, Georgia, Illinois, Indiana, Kentucky, Louisiana, Montana, Tennessee, and Utah.

A risk-based correction model was developed by the State of Georgia's UST Fund. This risk assessment tool allows Fund staff to assess the amount of remediation efforts necessary for a project site. Additionally, prior to approving any remediation efforts, the Georgia UST Fund has developed an internal Remediation Review Committee.²²

Overall, Georgia UST Fund staff have seen a reduction in clean-up times due to being able to evaluate remediation efforts proposed by contractors. These evaluation tools allow staff to ensure remediation efforts are necessary and supported with statistical and scientific evidence.

During the past four years, the Colorado Petroleum Storage Tank Fund has seen an increase in the number of historical sites closed due to its implementation of a more aggressive risk-based approach. This approach implements a four tier "Closure Criteria" strategy based on the EPA drinking water standard maximum contaminant levels. This strategy allows the state to close out cases that meet a certain level of criteria to ensure public safety and not fund potentially unnecessary remediation efforts and monitoring.

California has implemented its Low-Threat Underground Storage Tank Case Closure Policy, which is a risk-based assessment tool that defines the minimum criteria necessary to close out a case. They are consulting with the EPA to increase its focus on stalled cases and close those cases.

The Fund would benefit by investigating risk-based criteria and tools to ensure that any remediation efforts requested are necessary and essential to close out a project. The case officer assigned to the case uses his/her professional judgment to approve the NTEPs. There are also no milestones developed to monitor costs during various parts of the clean-up process. Risk-based criteria and tools would be an internal control that holds all parties accountable in the clean-up process, and ensures funds are spent appropriately and effectively.

²² The internal Remediation Review Committee is responsible for reviewing project sites that may require remediation activities to obtain a "No Further Action Required" status. After internal discussions, a meeting is requested with the consultant to ask questions about the consultant's remedial plan.

Conclusion

Evaluating the methods used by the CEMs of the 12 legacy cases could expedite the closure of these cases, and would ensure suggested remediation activities are necessary, industry best practices are used, and could have saved \$21.5 million. Further developing its risk-based decision-making tool, “Groundwater Exemption (Closure),” as well as developing additional tools could provide NDEP with adequate information to decrease the amount of open legacy cases. This methodology is in line with the Division’s goal of getting the clean-up completed as quickly as possible.

Recommendation

4. Develop additional risk-based decision-making tools to assist in reducing clean-up times.

Revise Enrollment and Reimbursement Policies

The Board to Review Claims (Board) should revise the Underground Storage Tank (UST) enrollment and reimbursement policies to better regulate USTs not previously enrolled in the Petroleum Fund (Fund) and to decrease Fund expenditures for non-compliant USTs. Revised policies could have saved the state approximately \$19,000 during Fund fiscal year 2018.

Current Policies Inadequate

Owners of USTs may voluntarily enroll in the Fund as a mechanism for demonstrating financial responsibility. Financial responsibility is required by federal UST regulations to ensure that UST owners can afford to remediate damage caused to the environment or third-parties in the event of a petroleum leak.²³ To enroll in the Fund, owners must provide documentation demonstrating tightness of the tanks and lines of each system, but there is no requirement to provide assurance that tanks had not leaked prior to enrollment in the Fund, and there is no requirement for UST owners to be in compliance with all federal UST regulations prior to acceptance in the Fund.

Board Approved Reimbursement for Leak That Occurred Prior to Enrollment

We examined 38 Fund cases and noted the Board granted reimbursement to one UST owner for a leak that had occurred prior to enrollment in the Fund. Although the UST had been installed in 1979, the owner did not enroll until June 2017.

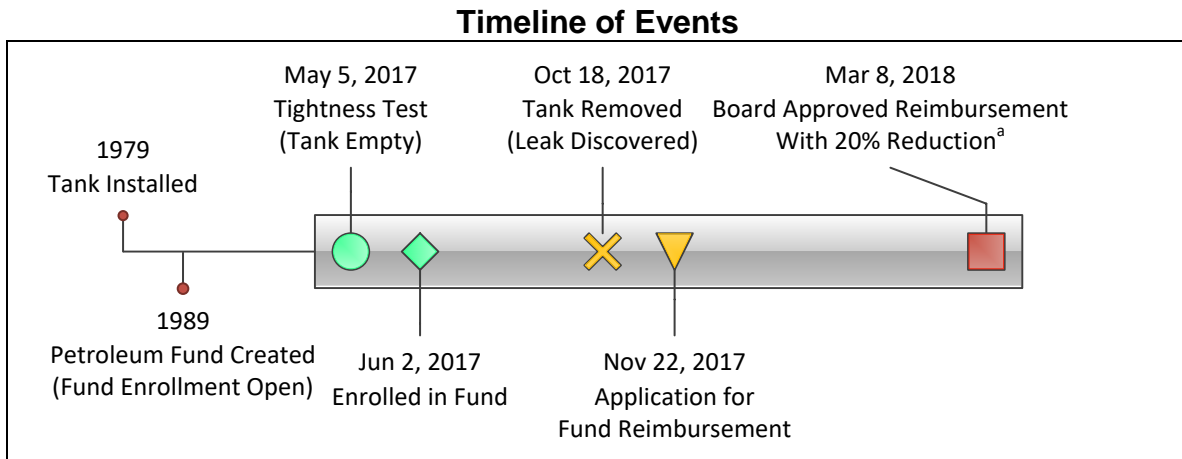


In May 2017, a tank tightness test was passed and the tank was determined to be empty. The UST was enrolled in the Fund in June 2017. The owner permanently removed the UST in October 2017 and submitted an application for Fund reimbursement in November 2017. The Board approved clean-up reimbursement in March 2018 because the Board determined that the owner was enrolled in the Fund at the time

²³ 40 CFR 280.90 through 280.116 regulates UST systems and financial responsibility requirements.

of leak discovery (when the UST was removed). However, since this UST passed a tightness test and was determined to be empty in May 2017, this UST could not have leaked petroleum after enrollment in the Fund. See Exhibit X for the timeline of events.

Exhibit X



Source: Nevada Division of Environmental Protection.

Note:

- a. The owner received a 20 percent reduction due to non-compliance with Petroleum Fund requirements.

Board Granted Reimbursement for Pre-Enrollment Leak

The Board approved a reimbursement claim for a leak that occurred prior to this UST's enrollment in the Fund. This UST was installed in 1979, enrolled in the Fund in June 2017, and permanently removed in October 2017. Therefore, the owner made two contributions to the Fund (fiscal year 2017 and 2018) and no longer contributes to the Fund via annual tank enrollment fees.

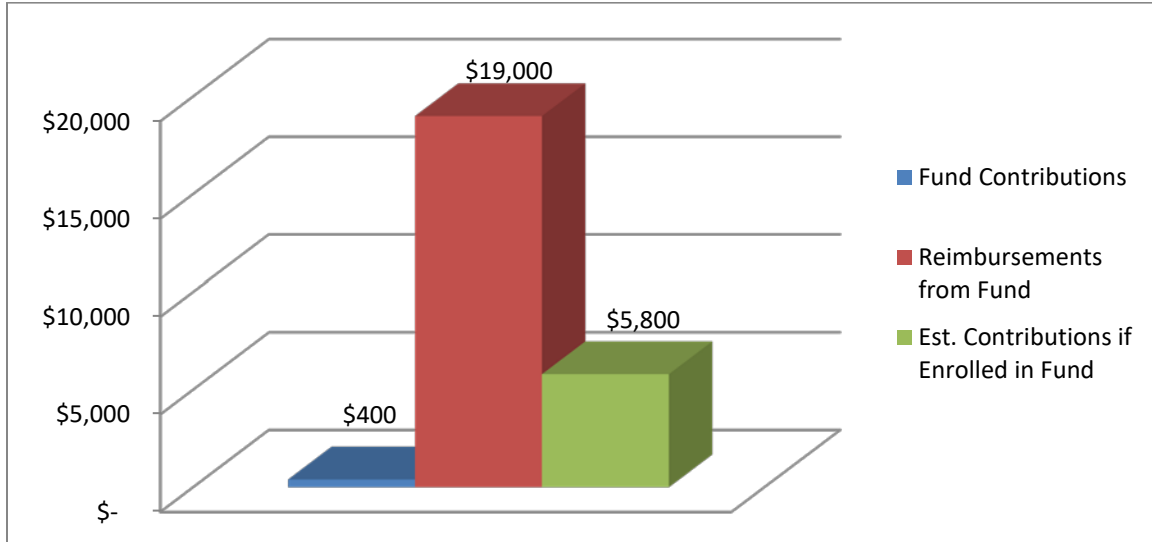
The owner paid \$400 in tank enrollment fees to the Fund and the Fund has paid approximately \$19,000 for the costs of remediation associated with this claim. If the owner had contributed to the Fund annually since 1989 via tank enrollment fees like other UST owners, the Fund would have been able to offset expenses with \$5,800 of contributions.²⁴ Even after considering the subsequent 20 percent reimbursement reduction made for noncompliance (approximately \$5,300), the UST owner actually saved money by not enrolling in the Fund until the time when the UST was to be removed.²⁵ See Exhibit XI for a comparison of contributions to the Fund and reimbursements from the Fund for this case.

²⁴ \$200/year enrollment fees x 29 years (assuming fees paid beginning program fiscal year 1989 through 2018).

²⁵ \$5,800 (enrollment fees since program inception through Fund fiscal year 2018) less \$5,300 (reimbursement reduction) and less \$400 (actual enrollment fees paid) = \$100 saved by not enrolling in the Fund until the time when the UST was to be removed.

Exhibit XI

Contributions Versus Reimbursements



Source: Nevada Division of Environmental Protection.

Reimbursement Granted Despite Non-Compliance

The owner of this UST had not been in compliance with federal UST regulations which could have prevented the leak from occurring or could have detected the leak when it had occurred. Early detection of petroleum leaks is critical to protecting the environment and mitigating the cost of remediation. Despite non-compliance, reimbursement was granted under current Fund policy with a 20 percent reimbursement reduction for violation of federal release detection regulations, in addition to the standard 10 percent copayment amount. Therefore, the Fund reimbursed 70 percent of remediation costs for a UST that was neither enrolled in the Fund when the leak occurred nor was the owner in compliance with federal UST regulations.

UST Improperly Classified as “Abandoned” Despite Same Property Owner

NDEP represents that this UST qualified for Fund reimbursement as an “abandoned storage tank” pursuant NAC 459.994; however, this UST was owned from installation in 1979 to removal in 2017 by the same property owner. Classifying non-compliant USTs that have yet to be closed as “abandoned”, despite sole ownership from installation to removal, allows owners to take advantage of the Fund.

The Board was aware that this UST had a single owner. The March 8, 2018 Board meeting minutes reflect that a Board member asked whether the case involved the original property owners, and was told yes, the UST had a single owner. In this case, the sole property owner:

- Enrolled in the Fund a few months prior to removal of the UST;
- Paid \$400 in Fund enrollment fees;
- Circumvented compliance with federal and state UST regulations for decades; and
- Still received approximately \$19,000 in reimbursements from the Fund.

The total amount of coverage recommended by the Board for this incident was \$720,000.²⁶ Revising Board policy to prevent incidents like this from occurring would reduce Fund expenditures. Based on a sample, there could be as many as 40 similar cases with potential reimbursement decision issues.

AST Enrollment Requires Six Month Waiting Period

Pursuant to NRS 445C.410, acceptance of an Above-ground Storage Tank (AST) into the Fund begins six months after the tank is registered with the Fund. During this waiting period, owners perform visual inspections and a tightness test, and they are not eligible for reimbursement of any remediation costs.

If the UST enrollment policy required a six month waiting period, then Fund reimbursement for this incident would have been denied. Revising the UST enrollment policy to require a waiting period for owners of USTs not previously enrolled in the Fund could prevent owners from taking advantage of the Fund and reduce Fund expenditures.

Other States Deny Reimbursement For Non-Compliant Systems

Other states, such as California, Utah, and New Mexico have created statutes, regulations, or policy to deny petroleum fund enrollment or reimbursement for owners of non-compliant UST systems. If the Fund enrollment policy prohibited non-compliant owners from enrolling, or if the reimbursement policy disallowed reimbursement for non-compliant UST systems, then this UST system owner would have been denied reimbursement and the Fund would have saved approximately \$19,000.

²⁶ \$1,000,000 less the 20 percent reduction for noncompliance equals \$800,000, less the standard 10 percent copayment equals \$720,000 of Fund coverage.

Conclusion

The current UST enrollment and reimbursement policies do not prevent UST owners from enrolling in the Fund when they are not in compliance with federal UST regulations. Additionally, these policies do not preclude owners of UST systems not previously enrolled in the Fund from enrolling in the Fund after a leak has been discovered or should have been discovered. Revising these policies would prevent UST owners from taking advantage of the Fund and would reduce Fund expenditures.

Recommendation

5. Revise enrollment and reimbursement policies.

Exhibit XII**Summary of Audit Benefits**

| | Recommendation | Benefit |
|---|--|--------------------------------|
| 1 | Adhere to legislative intent for Petroleum Fund awards. | \$ 7,500,000 |
| 2 | Adhere to statute for use of third-party liability funds. | \$25,000,000 |
| 3 | Adopt adequate internal cost controls and processes to reduce the risk of fraud and/or abuse of the Fund by auditing project sites. | \$ 2,300,000 – \$11,500,000 |
| 4 | Develop additional risk-based decision-making tools to assist in reducing clean-up times and expedite close out of historical cases. | \$21,500,000 |
| 5 | Revise enrollment and reimbursement policies to better regulate USTs. | \$0 |
| | Total estimated benefit: | \$56,300,000 – \$65,500,000 |

Appendix A

Scope and Methodology, Background, Acknowledgements

Scope and Methodology

We began the audit in January 2019. In the course of our work, we interviewed management and discussed processes inherent to the Petroleum Fund (Fund). We researched Nevada Division of Environmental Protection's records, policies and procedures, scientific journals, professional publications, Nevada Revised Statutes (NRS), Nevada Administrative Code (NAC), the Board to Review Claims' Policies, State Administrative Manual (SAM) sections, and other state and federal guidelines. Additionally, we reviewed applicable federal and independent reports and audits. We concluded fieldwork in May 2019.

We conducted our audit in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Background

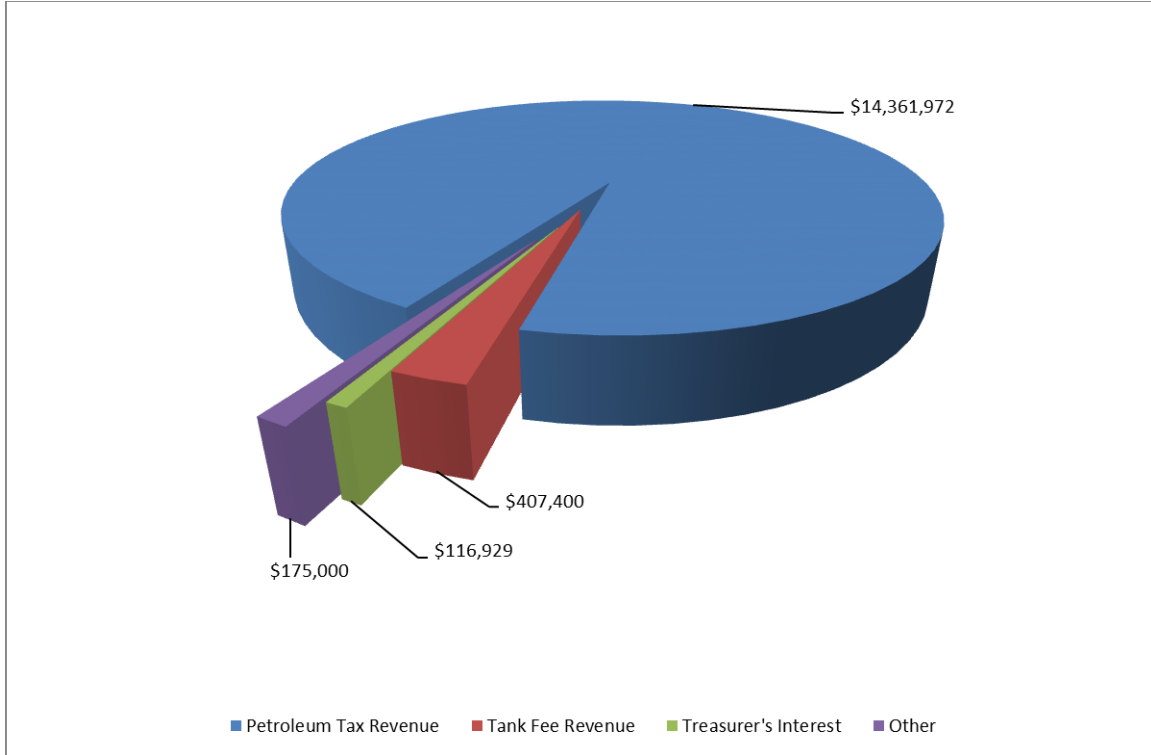
The Nevada Division of Environmental Protection (NDEP) is one of five divisions under the Department of Conservation and Natural Resources. NDEP's mission is to preserve and enhance the environment of the state to protect public health, sustain healthy ecosystems, and contribute to a vibrant economy. NDEP is organized into 11 bureaus and three boards and commissions. The Petroleum Fund (Fund) is managed administratively by NDEP's Bureau of Corrective Actions, and functionally by the Board to Review Claims (Board). The Board is a seven member board that governs reimbursement claims against the Fund for expenses associated with remediation of petroleum releases from registered storage tanks and heating oil tanks. The Board is composed of three statutory members and four governor-appointed members who meet quarterly to review claims against the Fund.

Fund revenues for fiscal year 2018 approximated \$15 million, with claim reimbursement expenses of \$9.6 million, and administrative expenses of approximately \$1.8 million. When the balance remaining in the Fund at the end of any fiscal year is estimated at more than \$7.5 million, the excess amount is transferred to an account within the State Highway Fund pursuant to NRS 408.242. For fiscal year 2018, the amount transferred to the State Highway Fund was approximately \$3.6 million. Fund revenues exceeded expenses during each of the last ten years. The Fund is supported by 19 staff: three full-time Fund staff that process all claims against the Fund and 16 auxiliary staff within the Bureau of

Corrective Actions who dedicate a portion of their time to Fund-related activities. See Exhibit XIII for the Fund's 2018 revenue sources.

Exhibit XIII

2018 Petroleum Fund Revenue Sources



Source: Data Warehouse of Nevada.

Notes:

- a. "Other" includes reimbursements for Fund expenses.

Acknowledgments

We express appreciation to NDEP management and staff, Fund staff and Board members, and Governor's Office of Finance, Budget Division staff for their cooperation and assistance throughout the audit.

Contributors to this report included:

Michelle D. Isherwood, JD, MBA
Executive Branch Audit Manager

Craig Stevenson, MBA
Executive Branch Auditor

Brian Wadsworth, MBA
Executive Branch Auditor

Appendix B

Division of Environmental Protection Response and Implementation Plan



NEVADA DIVISION OF
**ENVIRONMENTAL
PROTECTION**

STATE OF NEVADA
Department of Conservation & Natural Resources
Steve Sisolak, Governor
Bradley Crowell, Director
Greg Lovato, Administrator

Warren Lowman, Administrator
Division of Internal Audits
Governor's Finance Office
209 W. Musser Street, Suite 302
Carson City, NV 89701-4298

RE: Division Response to Draft Audit Report
Division of Environmental Protection, Petroleum Fund

Dear Mr. Lowman:

In consultation and coordination with the Department of Conservation and Natural Resources, transmitted herein is the Nevada Division of Environmental Protection (NDEP) response to the May 20, 2019, draft audit report of the Petroleum Fund (Fund). NDEP appreciates the opportunity to provide these comments and are ready to assist you and your staff as necessary to complete the audit process. This letter provides NDEP's summary response to each of the Recommendations and the Attachment provides additional supporting information.

At the outset, it is important to note that NDEP administers Fund operations, but overall Fund policy and practices are governed and approved by the Board to Review Claims ("Board") as provided for under NRS 445C.150 et seq. and attendant Board Policy Resolutions. To the extent any changes to Fund Policy Resolutions or Board practices are recommended as a result of this audit, approval from the Board will be required, and those are not changes NDEP can commit to on behalf of the Board.

Recommendation 1 – Adhere to legislative intent for Petroleum Fund awards

NDEP Response: NDEP agrees that fund operation should adhere to legislative intent and offers to further research and evaluate opportunities for increasing benefits to small businesses from the Fund.

NDEP's review has determined that NDEP and the Board have administered petroleum funds in adherence to law and legislative intent. (See NDEP's legal analysis in Attachment A.) With respect to small operators, NDEP's review of NRS 445C.290(2) and legislative history¹ indicate that the legislative intent was to create a Fund that would assist small, independent operators in meeting the new federal financial responsibility requirements. The Fund has allowed small operators to satisfy federal financial responsibility requirements by registering storage tanks for a minimal annual fee and the Fund has maintained solvency while reimbursing all valid claims from small businesses and independent operators.

Recommendation 2 – Adhere to statute for use of third-party liability funds.

NDEP Response: NDEP agrees that it should adhere to statute for use of third-party liability funds, and proposes to further evaluate appropriate use of third-party liability funds. With the assistance of the Attorney General's Office, NDEP will conduct a review of the legally permissible use of third-party liability funds, and present that review for Board consideration and potential action.

NDEP's review has determined that it and the Board have used third-party liability funds in adherence to statute. (See NDEP's legal analysis in Attachment A.) NDEP's experience with comparable forms of pollution liability insurance indicates that use of third-party liability funds to mitigate a release directly benefits third parties by mitigating or preventing potential future damage claims. NAC 445C.280(3) only requires that the operator provide a copy of the judgment or settlement in order to receive third party liability funds to pay for that judgment or settlement. It does not restrict access to third-party liability funds to pay for damage mitigation that would serve to directly prevent or mitigate any potential third-party damages, as is the current practice under Board Policy Resolution 2007-10.

Recommendation 3 – Adopt adequate internal controls and processes to monitor costs and reduce risk of fraud and/or abuse of the Fund by auditing cases and conducting site visits.

¹ See, <https://www.leg.state.nv.us/Division/Research/Library/LegHistory/LHs/1989/SB238,1989.pdf> at 2, 10, 18, 41, and 49.

NDEP Response: NDEP agrees that it can further enhance its efforts to reduce risk of fraud and/or abuse of the Fund by auditing cases and conducting site visits. NDEP notes that its development and implementation of the web-based database will allow it to re-allocate staff resources to auditing cases and conducting site visits going forward. Additional review of steps currently taken by NDEP to monitor costs and reduce risk of fraud and/or abuse are presented in Attachment A.

Recommendation 4 – Develop risk-based decision-making tools to assist in reducing clean-up times and expedite close out of legacy cases.

NDEP Response: NDEP agrees that it can further develop and increase use of risk-based decision-making tools to assist in reducing clean-up times and expedite close out of legacy cases.

NDEP has developed risk-based decision-making tools to assist in reducing clean-up times and expediting close out of legacy cases. In 2009, NDEP proposed and the State Environmental Commission and Legislative Commission approved several changes to contaminated site regulations within NAC 445A.226 et seq. that reduce clean-up times and expedite close out of new and legacy cases. NDEP has been implementing those regulations since 2009 and further developed guidelines in 2014. Prior to 2009, leaking underground tank cases with contaminated groundwater could only be closed if all contamination in groundwater, regardless of human or environmental receptor exposure potential, was below drinking water standards or other cleanup had been implemented and groundwater contaminant concentration trends reached asymptotic conditions. These restrictive requirements originally implemented in 1996 made it unlikely for many cases with groundwater contamination to reach conditions needed to close the case. Implementation of these changes has resulted in closure of cases under a groundwater exemption process that is protective of human health and the environment, and protects sources of drinking water and other sensitive receptors.

These new measures have allowed NDEP to close an additional 29 Fund-covered cases that could not have been closed prior to enactment of the regulations in 2009.

See additional summary information on legacy cases in Attachment A.

Recommendation 5 – Revise enrollment and reimbursement policies to better regulate USTs.

NDEP Response: NDEP agrees to further evaluate options for enrollment and reimbursement policies for better regulation of underground storage tanks, or USTs, and present those as appropriate for Board consideration and potential action.

NDEP suggests that the example included in the audit report be considered within the following context:

- 1. It is not representative of tanks enrolled in the Fund or that may attempt to enroll in the Fund in the future.*
- 2. The releases that occurred at the example site are not indicative of a chronic high volume release from the tank or piping, but instead are indicative of small releases that can occur from a tank system that operated in compliance with physical leak prevention and testing regulations. (See additional supporting information in Attachment A.)*
- 3. Granting Fund coverage encourages owner/operators to report and cleanup releases to protect water resources and the environment, which is the main purpose of the Fund, including releases in sensitive environments such as the Lake Tahoe Basin where the example was located.*
- 4. Reduction in Fund coverage provides incentive to owner/operators to operate USTs in compliance with UST regulations.*

NDEP notes that current policies are in place to prevent enrollment of storage tanks that may have leaked (Policy Resolution #95-001) and decrease fund expenditures due to non-compliance (Policy Resolution #94-023). Additional description of circumstances under which the program has denied Fund coverage for tanks is included in Attachment A.

Finally, NDEP suggests that the potential fiscal benefits estimated in the audit report may be revised based on actual steps taken in response to the audit, after further review and evaluation.

It is NDEP's understanding that this entire statement (including the Attachment) shall be included in the final audit report (NRS 353A.085(1)).

Mr. Warren Lohman
Page 5

NDEP provides additional support for its responses in Attachment A to this letter.
Please contact me at 775-687-9373 if you have any questions or would like to
discuss further.

Sincerely,



Greg Lovato

Attachment: NDEP Supplemental Draft Audit Response Information

cc: Bradley Crowell, Director, Department of Conservation and Natural Resources

Recommendation 1 – Adhere to legislative intent for Petroleum Fund awards

The Legislature created the “Fund for Cleaning up Discharges of Petroleum” (Fund) to protect the “State’s environment, particularly its supplies of water” and provide for the “prompt cleaning up of any discharge of petroleum from a storage tank.” NRS 445C.290(1). In creating the Fund, the Legislature recognized that “federal law and regulations require each operator of a storage tank to show financial responsibility for this purpose” and that “the capital of smaller operators is too little to meet these requirements and insurance to cover this liability is prohibitively costly.” NRS 445C.290(2). For this reason, the Legislature believed “free competitive access to the business of distributing petroleum . . . requires a system of funding this liability in which all engaged in the business must participate equitably.” NRS 445C.290(3).

The plain language of the statute at NRS 445C.280(2) and legislative history² indicate that the legislative intent was to create a Fund that would assist small, independent operators in meeting the new federal financial responsibility requirements. The legislative record indicates that the State needed to establish the Fund because independent operators were unable to demonstrate financial responsibility in the form of \$10 million net worth or \$1 million insurance. Had the State not created the Fund, the legislative record indicates small petroleum businesses would have had to cease operation in Nevada. The Fund has allowed small operators to satisfy federal financial responsibility requirements by registering storage tanks for minimal annual fee.

The Fund provides financial assurance for all owners and operators of storage tanks and serves to create equity in this market. In particular, NRS 445C.330(1) establishes a 0.75 cent fee “for each gallon of motor vehicle fuel, diesel fuel of grade number 1, diesel fuel of grade number 2 and heating oil imported into this State in one of those forms or refined in this State.” This fee accounts for the majority of money deposited into the Fund on an annual basis, and these costs are distributed equally to all operators, and, would not in and of itself create a market advantage for operators regardless of size. The Fund also requires that operators pay an annual registration fee of not more than \$100 for each storage tank, which is a minimal charge that likely does not have any impact on motor vehicle fuel or diesel pricing.

If a discharge or release occurs from a covered storage tank and the resulting cost of cleanup exceeds \$5,000, the Fund will cover up to \$1,000,000 for the costs of cleanup and up to \$1,000,000 for liability damages per tank. *See generally*, NRS 445C.380(2), (3)(a). Such coverage ensures that the storage tank operator has immediate access to funding for prompt cleanup of the discharge or release and the State does not need to engage in enforcement action or litigation to compel such action.

Enrolling a storage tank in the Fund does not alleviate an operator’s financial responsibility for a cleanup. Rather, the operator must contribute a percentage of the coverage amount expended from the Fund. The total contribution is dependent on whether the operator is designated as a small business

² See, <https://www.leg.state.nv.us/Division/Research/Library/LegHistory/LHs/1989/SB238,1989.pdf> at 2, 10, 18, 41, and 49.

Attachment A
NDEP Supplemental Draft Audit Response – Page 2

or not. More specifically, the contribution amount for small businesses, defined as having gross receipts less than \$500,000, is capped. NRS 445C.380(2), (6). These operators are required to make a contribution payment of ten percent of the total awarded coverage for cleanup up and liability damages up to a maximum of \$50,000 for each, or \$100,000 total. NRS 445C.380(2). For the vast majority of other operators³, the Fund requires a contribution payment of ten percent of the total awarded coverage for cleanup and liability damages per covered storage tank up to \$100,000 each, or \$200,000 total. NRS 445C.380(3).

The text of NRS Chapter 445C indicates that “equitable participation” is focused on providing small operators access to financial assurance. NRS Chapter 445C specifically authorizes Fund distributions for small business operators and all other operators. NRS 445C.380(2), (3). Additionally, NRS 445C.400 provides that in the event the Fund balance is insufficient for full payment of claims, amounts shall be paid on a pro rata basis. There is no mention of priority for payment of claims from small business. Accordingly, NRS 445C.400 indicates that legislative intent was that the Fund treat all claims equally, regardless of business size.

While the Audit Report points out that four businesses have been designated as small businesses since the Fund’s inception in 1989, the Audit Report does not identify the cause for the limited number of small business designations. NDEP’s review indicates that the low percentage is attributable to the market distribution of petroleum operators and not directly to administration of the Fund. NDEP notes that NRS Chapter 445C does not provide a definition of a “large corporation” or exclude such corporations from fund coverage.

Recommendation 2 – Adhere to statute for use of third-party liability funds.

For operators, the Fund provides “\$1,000,000 for cleaning up each tank” and “\$1,000,000 of liability for damages from each tank to a person other than this State or the operator of the tank, or both amounts” NRS 445C.380(2), (3)(a). The statute does not specifically define how liability damages are to be conferred to these persons – whether it must be conferred as a result of a monetary judgment or settlement with the operator of the leaking storage tank or whether it may be conferred through remedial action which mitigates the damage the person incurred as a result of the discharge or release of motor vehicle or diesel fuel.

The Audit Report contends that these funds may only be accessed through a monetary judgment or settlement. As support for this position the Audit Report cites to NAC 445C.210(1)(b), which defines damages as “any money the operator of a storage tank becomes legally obligated to pay as damages because of bodily injury or property damage to any person other than the State or the operator caused by a discharge.” While Nevada has not specifically addressed the issue of what constitutes a “legal obligation” in the context of access to environmental liability insurance, the majority of jurisdictions in the United States that have addressed this issue have held that a legal obligation occurs when a party

³ Exceptions: Operators of heating oil tank with a capacity of 1,100 gallons or less per NRS 445C.370, or an operator that is an agency, department, division, or political subdivision of the State per NRS 445C.380(1).

Attachment A
NDEP Supplemental Draft Audit Response – Page 3

undertakes an environmental cleanup as a result of statutes or regulations making the party strictly liable for a release. See *e.g.*, *Bausch & Lomb v. Utica Mutual Ins. Co.*, 625 A.2d 1021 (Md. App. 1993); *Weyerhaeuser Co. v. Aetna Casualty & Surety Co.*, 874 P.2d 142 (Wash. 1994); *Compass Ins. Co. v. Cravens Dargan & Co.*, 748 P.2d 724 (Wyo. 1988); *Metex Corp. v. Federal Ins. Co.*, 675 A.2d 220 (N.J. App. 1996). These courts also interpret the term damages in the context of environmental liability to include environmental response costs. See *Id.* This interpretation is consistent with NAC 445C.210(1)(b)(1), which states that the term damage “does not include any expense excluded [as a cost for cleanup].” By implication, costs for cleanup, which are “any expense of corrective action necessitated by a discharge from a storage tank,” may be damages. NAC 445C.210(1)(a), (b). Therefore, to the extent that a leaking storage tank contaminates a “person[’s]” property, a legal obligation to pay damages should extend to both a monetary judgment or settlement and cleanup costs to mitigate damages to property. As a practical matter, an operator should not have to wait to be sued or, alternatively, a person whose property has been damaged should not have to sue, to compel cleanup under the Fund when cleanup would otherwise be completed voluntarily.

The audit report also cites to NAC 445C.280(3) as support for its position that coverage for liability damages is restricted to a monetary judgment and settlement. Under that regulation, an operator who is the subject of a civil action for damages caused by a discharge from the operator’s storage tank must notify the Division in writing within 60 days after the operator is served with the action. NAC 445C.280(1). To the extent the operator seeks coverage for liability damages incurred as a result of that proceeding, the operator must submit either a copy of the final judgment entered by the court ordering the operator to pay damages or a copy of the settlement agreement, whose terms have been approved by the Fund’s Board. NAC 445C.280(3). Nothing in the text of the regulation specifically prevents access to third-party liability damage coverage where damage mitigation is sought informally and through voluntary cooperation of the operator of the leaking storage tank.

The Fund’s Board interprets third-party liability damage coverage to include “reimbursement requests related to obligations to pay for either bodily injury or for property damage” and for “corrective action measures to reduce the potential for a third-party liability action.” Board Resolution 2007-10. Aside from the interpretation being legally sound, the interpretation is sound public policy as it alleviates the need to expend resources on litigation related to environmental liability and expedites cleanup efforts. For these reasons, the Division disagrees with the Audit Report’s narrow interpretation of third-party liability coverage under NRS 445C.380.

Recommendation 3 – Adopt adequate internal controls and processes to monitor costs and reduce risk of fraud and/or abuse of the Fund by auditing cases and conducting site visits.

NDEP believes that existing cost controls including use of CEM Cost Guidelines, three party bid processes, and the Not-To-Exceed Proposal (NTEP) review and approval process, amongst other practices, provide generally adequate controls to reduce risk of fraud and/or abuse of the Fund. Additionally, the draft audit report recognizes the controls provided by the database, including prevention of duplicate invoices, bid package submittal requirements, reconciling of bids to invoices, and tracking of costs against approved NTEPs. Both NDEP claim staff and supervisor review each claim for adherence to these

cost control measures. Because of these reviews, NDEP has disallowed or recovered \$460,709.86 since December 2016, which amounts to 1.9% of the requested claims values. This information is not readily accessible in the old database for claims prior to December 2016.

The audit report mentions instances of potential fraud or abuse suspected, but not confirmed, by NDEP over the past five years. NDEP notes that the program has taken steps to prevent or reduce potential fraud under similar circumstances:

1. In September 2015, the Board enacted Policy Resolution 2015-01 requiring three competitive bids for costs more than \$3,000⁴ and submittal of bids to NDEP for costs over \$25,000, including certification forms from contractors and vendors that submit bids. NDEP does not have any record of potential bid process manipulation occurring since enactment of that resolution.
2. In March 2016, the Board enacted revised Policy Resolution 2001-01 to include a formula to cap the costs for heating oil tank removal and cleanup. NDEP does not have any record of inflation of clean-up costs for heating oil tank removal since enactment of that resolution.

While NDEP agrees that it can further enhance efforts to reduce risk of fraud and/or abuse of the Fund, NDEP believes existing cost control measures already save funds at a rate of 1.9%, which is within the range of the 1% to 5% estimated in the audit report.

Recommendation 4 – Develop risk-based decision-making tools to assist in reducing clean-up times and expedite close out of legacy cases.

Although 139 cases (at the time of the audit) remain open, the vast majority of cases covered by the Fund have been closed. The Fund has covered approximately 1,449 cases, of which 91% have been closed to date. All closed cases meet requirements for protection of human health and the environment, which is the primary objective of the Fund.

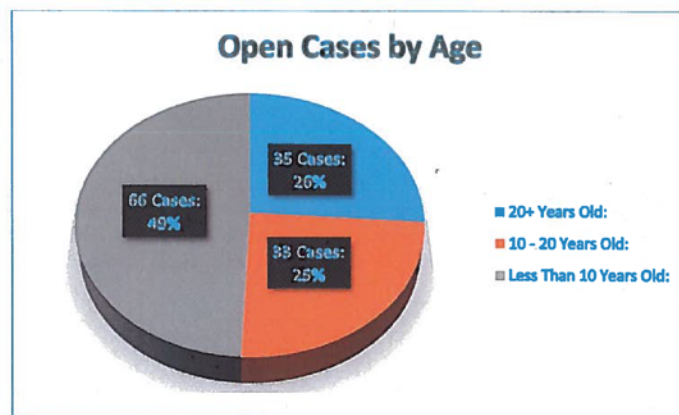
Summary of Longstanding Fund Cases

| | |
|--|-------------------------------------|
| Total Remediation Cases Covered by the Fund Since Inception: | 1,449 |
| Total Number of Fund Cases Closed: | 1,315 (~91% of Total Covered Cases) |
| Number of Currently Open Fund Cases: | 134 |

⁴ This amount has been adjusted as provided for in NAC 445C.270.4(e) to \$6,000

Number of Open Fund Cases

- Less Than 10 Years Old: 66 (49% of Open Cases, 4.6% of Total Covered Cases)
- Between 10 and 20 Years Old: 33 (25% of Open Cases, 2.3% of Total Covered Cases)
- Greater Than 20 Years Old: 35 (26% of Open Cases, 2.4% of Total Covered Cases)



Reasons for prolonged cleanup for longstanding Fund cases:

- Prior to 2009, leaking underground tank cases with contaminated groundwater could only be closed if all contamination in groundwater, regardless of human or environmental receptor exposure potential, was below drinking water standards or implemented cleanup methods resulted in groundwater contaminant concentrations trending toward asymptotic conditions.
- There are still a number of legacy cases that do not meet the criteria for a groundwater exemption established after 2009 for the following reasons:
 - The source of the contamination has not been delineated, controlled, and removed
 - Impediments to accessing the release source are preventing timely cleanup (e.g. building foundations, right of ways, and other structures)
 - Free product is still measureable above the one-half inch on the water table
 - Drinking water sources are in close proximity to the release source
 - The contaminant plume is unstable.

Recommendation 5 – Revise enrollment and reimbursement policies to better regulate USTs.

The single example of an abandoned underground tank at a residence is not representative of tanks enrolled in the Fund or that may attempt to enroll in the Fund in the future. The vast majority of tanks subject to regulation are at large businesses, government owned and operated facilities, or commercial fueling stations, not residences such as the example.

The releases that occurred at the example site are not indicative of a chronic high volume release from the tank or piping but instead of small releases that can occur from a tank system that operated in compliance with physical leak prevention and testing regulations. It is important to note that the tightness test used to determine if the tank had leaked prior to enrollment is the most stringent test available. The test method tests for 0.1 gallon per hour leak rate. In order to pass this test with confidence, the test threshold is generally about ½ of the leak rate tested (i.e. 0.05 gallons per hour). Had a leak occurred at a rate below 0.05 gallons per hour over time, the test would not have detected a failed tank. For example, a 0.04 gallon per hour leak could amount to over 350 gallons per year. A tank installed in 1979 and removed in 2017 could have released a large volume of fuel in that time. The fact the project has been closed and a total of \$19,053.40 was spent would suggest the leak from the tank system was quite small.

NDEP reviewed files to determine the circumstances under which the program has denied coverage. Representative causes for denial include:

- Tanks were ineligible for coverage because they were not registered/enrolled at the time of discharge discovery;
- The source of the release was ineligible for coverage (e.g. spill, overfill, dispenser component above shear-valve);
- An initial claim (and likely the application for coverage) was not submitted within 12 months of the release discovery (NAC 445C.310);
- The discovery of the release pre-dates the Fund (1989); and
- Costs of cleanup did not exceed minimum required cleanup amount (reference NRS 445C.380).

Appendix C

Timetable for Implementing Audit Recommendations

In consultation with the Nevada Division of Environmental Protection (NDEP), the Division of Internal Audits categorized the recommendations contained within this report into two separate implementation time frames (i.e., *Category 1* – less than six months; *Category 2* – more than six months). NDEP should begin taking steps to implement all recommendations as soon as possible. NDEP's target completion dates are incorporated from Appendix B.

Category 1: Recommendations with an anticipated implementation period less than six months.

| <u>Recommendation</u> | <u>Time Frame</u> |
|--|-------------------|
| 2. Follow statute for third-party liability. (page 9) | Sep 2019 |
| 3. Adopt adequate internal controls and processes to prevent Petroleum Fund fraud. (page 15) | Jan 2020 |
| 5. Revise enrollment and reimbursement policies. (page 26) | Jan 2020 |

Category 2: Recommendations with an anticipated implementation period exceeding six months.

| <u>Recommendations</u> | <u>Time Frame</u> |
|--|-------------------|
| 1. Adhere to legislative intent for Petroleum Fund awards. (page 6) | Jan 2022 |
| 4. Develop additional risk-based decision-making tools to assist in reducing clean up times. (page 21) | Jul 2020 |

The Division of Internal Audits shall evaluate the action taken by NDEP concerning the report recommendations within six months from the issuance of this report. The Division of Internal Audits must report the results of its evaluation to the Executive Branch Audit Committee and NDEP.