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A NOT-SO EQUITABLE ALLOCATION: THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE⁺

Captain Joshua H. Van Eaton^{*}

INTRODUCTION

The President recently called for fiscal responsibility within the federal government by issuing Executive Order 13423, directing all federal agencies to conduct their respective missions “in an environmentally, economically and fiscally sound, integrated, continuously improving, efficient, and sustainable manner.”¹ Unfortunately, within a given agency, the many moving parts that comprise the whole often operate with indifference to one another’s distinct and separate missions. When the proverbial left and right hands do not know what the other is doing, inefficiency frequently results. When a business operates inefficiently, its profit margin suffers and its shareholders decide whether or not to continue investing in that business. When the government operates inefficiently, its shareholders, the tax payers, just keep paying. This article will explore the lack of coordination between two significant Department of Defense (“DOD”) activities, procurement and environmental cleanup, identify the conflicting policies that lead to inefficiencies between these two activities, and propose a step toward resolving those inefficiencies.

The need to prudently manage tax dollars, ever-widening deficits, and growing long-range fiscal challenges requires DOD to maximize its return on investment while simultaneously providing warfighters with

⁺ The positions and opinions stated in this article are those of the author and do not represent the views of the United States government, the Department of Defense, or the United States Army.

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¹ See Exec. Order No. 13423, 72 Fed. Reg. 3919 (Jan. 26, 2007).

world class capabilities at the best value by spending funds wisely and buying the “right things, the right way.”² The General Accountability Office (“GAO”), Congress’s investigative arm, recently reported that DOD spending on goods and services has increased by 88% since fiscal year 2000 to nearly \$270 billion in fiscal year 2005.³ DOD reports that its environmental liabilities, the second largest financial liability in DOD behind pensions and salaries, constitute nearly 4% of DOD’s \$1.7 trillion total financial liabilities.⁴ Over the past 10 years, DOD invested almost \$43.4 billion to ensure the success of its environmental programs.⁵ DOD procurement liabilities are “voluntarily” created by contracting to purchase goods and services, and are satisfied with funds appropriated by Congress for the specific purpose of buying those goods and services. On the other hand, DOD environmental liabilities are “involuntarily” created by federal statute, incurred through litigation or by regulation, and are satisfied with a few distinct appropriations or “pots of money,” depending on how the specific liabilities are incurred.

Environmental laws and regulations require liable parties to bear the financial burden of their own equitable share of the cleanup costs under “the polluter pays” principle. Many DOD contaminated sites involved activities by private parties - often government contractors - who share liability for the contamination with DOD. Courts frequently allocate liability for environmental cleanup costs at such sites between DOD and its contractors, to each their own “fair share,” based upon activities resulting from defense contracts of decades past. Many of these same contractors continue to do business with DOD today. In doing so, they

² See U.S. GOV'T. ACCOUNTABILITY OFFICE, DEP'T OF DEF. ACQUISITIONS: CONTRACTING FOR BETTER OUTCOMES, GAO-06-800T (2006) (testimony of David M. Walker, Comptroller General of the U.S.), *available at* <http://www.gao.gov/new.items/d06800t.pdf>.

³ *Id.*

⁴ See Office of the Deputy Under Secretary of Defense (Installations & Environment) Environmental Management Office, *Environmental Liability*, *available at* https://www.denix.osd.mil/denix/Public/Library/Cleanup/CleanupOfc/current_focus/liability.html (last visited Apr. 24, 2007).

⁵ See FISCAL YEAR 2005 DEFENSE ENVIRONMENTAL RESTORATION PROGRAM ANNUAL REPORT TO CONGRESS: DEFENSE ENVIRONMENTAL PROGRAMS, at 2 (2005), *available at* <https://www.denix.osd.mil/denix/Public/News/OSD/DEP2005/dep-body.pdf> [hereinafter *FY 2005 DERP Report*].

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

often charge a portion of their cost allocated “fair share” of environmental cleanup costs at a given site right back to the government as overhead (or, in simple business terms, the “cost of doing business”). The net result is that often one or more polluters - government contractors - may not pay and the other polluter - the government - may pay twice. This practice, while perfectly legal under current federal acquisition law, can hardly be characterized as prudent stewardship of taxpayer funds, or as economically and fiscally sound business practice.

This article addresses the need to coordinate DOD’s environmental and procurement functions to address the inequities resulting from contractors passing on part of their “fair share” of previously incurred environmental cleanup costs to the government, and ultimately, to the taxpayer, as overhead in current government contracts. Part I outlines how the United States primarily incurs environmental liabilities, including a review of CERCLA’s creation and its liability scheme, the Defense Environmental Restoration Program (“DERP”), and how environmental liabilities are paid. Part II discusses the basic guidelines for the allowability of environmental costs under the current defense procurement contracting scheme and the resultant ability of government contractors to pass on many of their environmental costs to the taxpayers. It also addresses a prior failed attempt to promulgate an environmental cost principle. Part III details DOD’s past failure to seek environmental cost-sharing partners and its resulting affirmative environmental claims policy. Part IV proposes the promulgation of an environmental cost principle in light of conflicting interests inherent in DOD’s procurement and environmental cleanup activities. Such a principle would remedy the subjectivity of the current cost scheme by creating a common set of guidelines to assist DOD in executing its primary mission “in an environmentally, economically and fiscally sound, integrated, continuously improving, efficient, and sustainable manner.”⁶

⁶ See *supra* note 1.

I. FEDERAL ENVIRONMENTAL LAW: HOW DOD INCURS AND PAYS
FOR ITS ENVIRONMENTAL LIABILITIES

*A. The Basics of CERCLA's Liability Scheme and "The Polluter Pays"
Principle*

The Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") is the primary federal statute addressing the cleanup of hazardous waste sites resulting from past activities.⁷ CERCLA establishes a framework under which four categories of potentially responsible parties ("PRPs") may be liable for the costs to clean up releases⁸ of hazardous substances,⁹ pollutants, or contaminants. A cornerstone of the CERCLA liability scheme is the "polluter pays" principle, which is akin to equitable restitution. That is, those who create pollution should ultimately be responsible for the costs of cleaning it up.¹⁰ "Responsible" parties include: (1) current owners and operators of facilities¹¹ where hazardous substances have been disposed;¹² (2) previous owners or operators of facilities at the time of the disposal of hazardous substances;¹³ (3) persons who, by contract, agreement, or otherwise, arranged, directly or indirectly, for disposal or treatment of hazardous substances;¹⁴ and (4) persons who transported hazardous substances to a disposal or treatment facility selected by them.¹⁵ The United States, a State, or in certain circumstances, a private party may bring an action against a responsible party to recover cleanup costs under CERCLA's liability scheme. CERCLA was amended in 1986 by the Superfund Amendment and Reauthorization Act ("SARA") which expressly applied

⁷ 42 U.S.C. §§ 9601-9675 (2006).

⁸ 42 U.S.C. § 9601(22).

⁹ 42 U.S.C. § 9601(14).

¹⁰ *United States v. Olin Corp.*, 107 F.3d 1506, 1514 (11th Cir. 1997), (citing *Redwing Carriers, Inc. v. Saraland Apartments*, 94 F.3d 1489, 1501-1502 (11th Cir. 1996)) (internal citations omitted) ("An essential purpose of CERCLA is to place the ultimate responsibility for the cleanup of hazardous waste on 'those responsible'").

¹¹ 42 U.S.C. § 9601(8)(A) & (B).

¹² 42 U.S.C. § 9607(a)(1) (2006).

¹³ 42 U.S.C. § 9607(a)(2).

¹⁴ 42 U.S.C. § 9607(a)(3) (also called "arrangers").

¹⁵ 42 U.S.C. § 9607(a)(4) (also called "transporters").

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

CERCLA to facilities owned and operated by a department, agency, or instrumentality of the United States “in the same manner and to the same extent” that it applies to non-governmental facilities.¹⁶ As part of SARA, Congress also created the DERP, specifically codifying DOD environmental responsibilities.¹⁷ The DERP operates within the overall CERCLA framework and provides for the cleanup of hazardous waste at DOD facilities.¹⁸

CERCLA liability is strict,¹⁹ retroactive,²⁰ and joint and several.²¹ Only three complete defenses to CERCLA liability exist, and they are rarely applicable.²² Therefore, avoiding liability altogether is extremely difficult if a party had any degree of involvement at a CERCLA site.

¹⁶ 42 U.S.C. § 9620(a)(1) (2006).

¹⁷ 10 U.S.C. §§ 2701-2707 (2006).

¹⁸ *Id.* § 2701(a)(2), (c)(1). The DERP requires that restoration activities be conducted in accordance with, and in a manner consistent with CERCLA, and gives the Secretary of Defense the basic responsibility to carry out “all response actions with respect to releases of hazardous substances” from DOD facilities. *Id.* See DERP program discussion *infra* p. 448. While this article focuses on DOD environmental liabilities, it is important to note that other government agencies have significant environmental cleanup costs as well. For instance, the Department of Energy’s Environmental Management Program was established in 1989 to clean up the environmental legacy of nuclear weapons production and nuclear energy research from the Cold War. See DEPARTMENT OF ENERGY FY 2008 CONGRESSIONAL BUDGET REQUEST: ENVIRONMENTAL MANAGEMENT, Volume 5, DOE/CF-018 (February 2007), available at http://www.cfo.doe.gov/budget/08budget/Content/Volumes/Vol_5_EM.pdf. DOE’s fiscal year 2006 Environmental Management appropriation was over \$6.5 billion. *Id.* at 7.

¹⁹ The absence of fault, the exercise of due care, and good faith prevention efforts are all irrelevant to the issue of liability. See *United States v. Ne. Pharm. & Chem. Co.*, 810 F.2d 726 (8th Cir. 1986).

²⁰ See *United States v. Olin Corp.*, 107 F.3d 1506, 1513 (11th Cir. 1997) (“By imposing liability upon former owners and operators, Congress manifested a clear intent to reach conduct preceding CERCLA’s enactment.”).

²¹ See e.g. *United States v. Stringfellow*, 661 F. Supp. 1053, 1059-60 (C.D. Cal. 1987) (discussing that joint and several liability promotes legislative intent); *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2nd Cir. 1985); *In Re Bell Petroleum*, 3 F.3d 889 (5th Cir. 1993); *United States v. Alcan Aluminum Corp.*, 990 F.2d 711 (2nd Cir. 1993).

²² 42 U.S.C. § 9607(b) (2006). The defenses are: (1) an act of God; (2) an act of war; and (3) an act or omission of a third party exercising due care, other than an employee, agent of, or one whose act or omission occurs in connection with a contractual relationship with a PRP. *Id.*

Where multiple parties exist, liability may be apportioned among various responsible parties if the harm is reasonably divisible.²³ Once liability is established, the focus shifts to allocation of costs among responsible parties.²⁴ Courts have considered various factors in their efforts to equitably allocate costs among PRPs.²⁵ Court allocations have varied widely, covering the full range of allocation between owners, operators, arrangers, and transporters.²⁶ In cases involving DOD and its contractors, results have also varied, sometimes with very unfavorable allocations for DOD.²⁷

DOD is potentially liable under every category of “responsible party” under the CERCLA scheme due to both its vast property holdings

²³ See *United States v. Alcan Aluminum Corp.*, 964 F.2d 252, 268-69 (3d Cir. 1992).

²⁴ See *Control Data Corp. v. SCSC Corp.*, 53 F.3d 930, 935 (8th Cir. 1995).

²⁵ *Id.* Noting the widely used “Gore factors,” which consider: (1) the ability of the parties to demonstrate that their contribution to a discharge, release, or disposal of a hazardous waste can be distinguished; (2) the amount of hazardous waste involved; (3) the degree of toxicity of the hazardous waste; (4) the degree of involvement by the parties in the generation, transportation, treatment, storage, or disposal of the hazardous waste; (5) the degree of care exercised by the parties with respect to the hazardous waste concerned, taking into account the characteristics of such hazardous waste; and (6) the degree of cooperation by the parties with Federal, State, or local officials to prevent any harm to the public health or environment. *Id.*

²⁶ See, e.g., *FMC Corp. v. Aero Indust., Inc.* 998 F.2d 842 (10th Cir. 1993) (25% allocated to owner/operator, 75% allocated to arranger/ transporter (divided among four arrangers)); *Amoco Oil Co. v. Dingwell*, 690 F.Supp. 78 (D. Me. 1988), *aff'd*, 884 F.2d 629 (1st Cir. 1989) (65% allocated to owner/operator, 35% allocated to arranger/ transporter (divided among 15 arrangers)); *BCW Ass'n Ltd. v. Occidental Petroleum Corp.*, 1988 WL 102641 (E.D. Pa. 1988) (one third allocated to owner, two thirds allocated to operator); *Cadillac Fairview/Cal., Inc. v. Dow Chem. Co.*, 299 F.3d 1019 (9th Cir. 2002) (100% allocated to owner (allocated to the United States as both owner of hazardous material and the arranger of its production), 0% allocated to operator); *Danella Sw. v. Sw. Bell Tel. Co.*, 775 F. Supp. 1227 (E.D. Mo. 1991) (100% allocated to arranger/ generator, 0% allocated to transporter); *Envtl. Transp. Sys., Inc. v. ENSCO, Inc.*, 969 F.2d 503 (7th Cir. 1992) (0% allocated to arranger/ generator, 100% allocated to transporter).

²⁷ See *United States v. Shell Oil Co.*, 294 F.3d 1045 (9th Cir. 2002) (100% allocation to the United States); *Cadillac Fairview/Cal., Inc. v. Dow Chem. Co.*, 299 F.3d 1019 (9th Cir. 2002) (100% allocation to the United States).

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

and its various long-running defense-related activities.²⁸ It is responsible as a current owner and operator, with 21,192 total DERP sites at active installations reported in Fiscal Year (“FY”) 2005.²⁹ One of DOD’s most expensive currently owned sites is the Rocky Mountain Arsenal in Colorado, which has received over \$1.4 billion in DERP funding as of FY 2005, with estimated completion costs in excess of an additional \$500 million.³⁰

DOD also faces significant liability as a past owner and operator due to the strict and retroactive aspects of CERCLA liability. Accordingly, DOD is exposed to potential CERCLA liability at every installation owned by, and at every facility operated by, any of the armed services or other DOD entities (such as the Defense Logistics Agency (“DLA”)), for any activity that occurred at any time in the history of that entity.³¹

One example of significant DOD liability as a past owner is found in the *Cadillac Fairview/California, Inc. v. Dow Chemical Company* case, which discusses DOD’s CERCLA liability for WWII-era activities at one particular site.³² During WWII, the United States government created the “Rubber Reserve,” a group of agencies tasked with creating, practically overnight, a domestic synthetic rubber industry to support the war effort.³³ To accomplish this mission, the government entered into agreements to finance and retain ownership of manufacturing facilities, which private companies would lease from the government and operate in exchange for management fees and royalties.³⁴ The Rubber Reserve paid all of the

²⁸ DOD is comprised of the armed services (Army, Navy, Air Force) and other sub-agencies which are usually the PRP under CERCLA rather than DOD proper. For the purposes of this article however, I will simply refer to DOD as the PRP.

²⁹ *FY 2005 DERP Report*, *supra* note 5, at Figure 14: DOD Active Installations Summary Status as of September 30, 2005. The DERP has different programs which are designed to address different types of these sites which are currently owned by DOD. *Id.*

³⁰ *FY 2005 DERP Report*, *supra* note 5, at Appendix I: Installation Narrative Summaries.

³¹ To illustrate the magnitude of this potential liability exposure, consider that the U.S. Army was formed in, and has continually existed since 1775, a year before the Declaration of Independence was signed and the United States as a country was born. See AMERICAN MILITARY HISTORY VOLUME I, THE UNITED STATES ARMY AND THE FORGING OF A NATION 1775-1917, at V. (Richard W. Stewart ed., 2005), available at <http://www.army.mil/cmh-pg/books/AMH-V1/index.htm>.

³² *Cadillac Fairview v. Dow Chem. Co.*, 299 F.3d 1019 (9th Cir. 2002).

³³ *Id.* at 1022.

³⁴ *Id.*

operating expenses and private companies with the requisite expertise managed the facilities.³⁵ Corporations such as Goodyear, Dow Chemical, and Shell Oil contributed to the rubber production, which created toxic waste. In 1983, a developer that purchased one of the former rubber manufacturing sites in Torrance, California, brought suit to cover the expenses for investigating and cleaning up the site.³⁶ The court allocated 100% of the remediation expense to the United States.³⁷

DOD also faces CERCLA liability where it was involved in arranging for the treatment or disposal of hazardous waste, or where the materials were government owned.³⁸ In short, DOD's exposure to potential liability under CERCLA is vast, requiring considerable assessment and planning to ensure DOD can meet the financial burdens associated with its cleanup obligations.

B. Satisfying the Liability – Which Pot of Money?

DOD pays for its CERCLA liabilities from different appropriations, or “pots” of federal money. The first pot, the Defense Environmental Restoration Account (“DERA”), contains funds which are appropriated by Congress annually as part of the DOD Appropriations Act. That appropriation provides funds specifically to enable DOD to perform its agency responsibilities under CERCLA. The second pot, the “Judgment Fund,” contains funds that are available to pay for litigation and compromise settlements entered into generally on the part of the United States.³⁹ Each of these pots of money may be utilized only under limited circumstances and for specific activities.

³⁵ *Id.*

³⁶ *Id.* at 1024.

³⁷ *See id.*

³⁸ *See United States v. Shell Oil Co.*, 294 F.3d 1045 (9th Cir. 2002) (court allocated 100% of the costs associated with government-owned benzol waste to the U.S. at the McColl Superfund Site in Fullerton, California).

³⁹ 31 U.S.C. § 1304 (2006) (The Judgment Fund is codified at 31 U.S.C. §1304, it is not a DOD specific appropriation.).

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

1. The Defense Environmental Restoration Account

The DERP was created in 1986 as part of SARA.⁴⁰ It provides DOD authority to respond to all types of releases from its facilities.⁴¹ The primary component of the DERP is the Installation Restoration Program (“IRP”) which is aimed at remediation of past contamination.⁴² Specifically, the IRP is designed to carry out “response actions.”⁴³ In FY 2005, DOD invested approximately \$1.3 billion in Environmental Restoration (“ER”) funding for environmental restoration activities alone at active installations and formerly used defense site (“FUDS”) properties.⁴⁴ Of this amount, which remained consistent with ER spending levels for the last decade, \$1.2 billion was for the IRP.⁴⁵ The Defense Environmental Restoration Account (“DERA”), which was also created under the SARA amendments, is the funding source for the DERP. Each year, Congress appropriates DERA money into five separate ER accounts for the various service components and DOD agencies to fulfill their

⁴⁰ 42 U.S.C. § 9607(a)(2) (2006).

⁴¹ 10 U.S.C. § 2701(c)(1) (2006).

⁴² See OFFICE OF THE UNDER SECRETARY OF DEFENSE, MANAGEMENT GUIDANCE FOR THE DEFENSE ENVIRONMENTAL RESTORATION PROGRAM § 6.1.1 (Sept. 2001), available at <https://www.denix.osd.mil/denix/Public/ES-Programs/Cleanup/guida.html> [hereinafter 2001 DERP Management Guidance].

Other components include: the Military Munitions Response Program (“MMRP”), *id.* § 6.1.2 (designed to manage responses to military munitions sites which not only involve cleanup issues encountered at typical CERCLA sites, but also explosives safety issues); the Building Demolition/Debris Removal Program (BD/DR), *id.* § 6.1.3 (designed to remove unsafe buildings); and the Formerly Used Defense Sites Program (FUDS), *id.* § 9, § 9.2 (addresses “real property that was formerly owned by” DOD or where activities were conducted by contractors but “accountability” rested with DOD; i.e., government-owned, contractor-operated (GOCO) properties).

The FUDS program is managed by the U.S. Army Corps of Engineers as DOD’s Executive Agent. *Id.* § 9.

⁴³ “Response actions” are defined in the IRP, consistent with CERCLA, as “the identification, investigation, and removal actions, remedial actions, or a combination of removal and remedial actions.” *Id.* § 6.1.1.

⁴⁴ FY 2005 DERP Report, *supra* note 5, at Appendix E: Restoration Budget Summary, E-1.

⁴⁵ FY 2005 DERP Report, *supra* note 5, at 3.

DERP responsibilities.⁴⁶ Moreover, funding for environmental restoration activities at installations that are closing or realigning pursuant to the Base Realignment and Closure (“BRAC”) statutes is provided through separate BRAC accounts, but environmental restoration at BRAC installations is still managed as part of the DERP.⁴⁷

Generally, when DOD faces liability under CERCLA based upon its current ownership of a contaminated site, its restoration activities fall within the DERP, and DERA funds cover the associated costs. In such cases, funding comes from the appropriate service ER account on an active installation or, from a BRAC account if the installation is realigning or closing. Where DOD is a former owner at a site upon which contamination occurred during its ownership, the FUDS component of DERP generally manages the restoration activity, and the ER, FUDS account pays the costs.

DOD typically encounters operator-type liability in situations where it assisted in the design or installation of production facilities or processes. Operator liability may also arise where DOD had inspectors or other government employees on-site managing a contractor’s daily operations. DOD’s arranger-type liability normally results from sending wastes containing hazardous substances to a disposal or treatment facility that is subsequently found to be contaminated. Properties that fall into one of these two categories are referred to as “third-party sites” (“TPS”).⁴⁸ By definition, a TPS is not “on real property that is or was owned, controlled, or otherwise under the jurisdiction of DOD,”⁴⁹ but where DOD is nonetheless a PRP under CERCLA. DOD’s TPS liabilities are generally paid from the Judgment Fund, not from DERA.

⁴⁶ See Department of Defense Appropriations Act of 2005, Pub. L. No. 108-287, 118 Stat. 951 (2004); *FY 2005 DERP Report*, *supra* note 5, at Appendix E: Restoration Budget Summary, E-2. The five accounts are ER, Army; ER, Navy; ER, Air Force; ER, FUDS; and ER, Defense-Wide. *FY 2005 DERP Report*, *supra* note 5, at Appendix E: Restoration Budget Summary, E-2.

⁴⁷ *2001 DERP Management Guidance*, *supra* note 42, § 8; *FY 2005 DERP Report*, *supra* note 5, at Appendices C, E.

⁴⁸ For the definition of “third party site” see *2001 DERP Management Guidance*, *supra* note 44, § 3.2.2.

⁴⁹ *Id.* § 3.2.2.

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

2. The Judgment Fund

The Judgment Fund⁵⁰ is a permanent and indefinite appropriation.⁵¹ “[I]t has no fiscal year limitations, there is no limit on the amount of the appropriation, and there is no need for Congress to appropriate funds to it annually or otherwise.”⁵² “It is, in effect, standing authority to disburse money from the general fund of the Treasury.”⁵³ The Judgment Fund is only available for money judgments, awards, and compromise settlements which are “not otherwise provided for” and “final,” and is only available upon certification of the Comptroller General.⁵⁴ Funds are deemed “not otherwise provided for” if no other source of funds specified by any statute is legally available to pay the liability.⁵⁵ “[A] judgment against the United States is final for payment purposes when the appellate process is completed.”⁵⁶ Where a portion of a claim can be divided for purposes of decision or judgment, judgments as to discrete parties or claims are considered final, as are compromise settlements, since they can not be appealed.⁵⁷

⁵⁰ 31 U.S.C. § 1304 (2006).

⁵¹ See U.S. GENERAL ACCOUNTING OFFICE, OFFICE OF GENERAL COUNSEL, PRINCIPLES OF FEDERAL APPROPRIATION LAW 14-12 (2d. ed. 1994), available at <http://www.gao.gov/special.pubs/og94033.pdf>.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 14-24 to 58. If a judgment is properly payable from the judgment appropriation, then payment of that judgment from agency funds violates 31 U.S.C. § 1301(a), commonly known as the “Purpose” Statute, which requires that all appropriations must be spent for their proper purpose. *Id.* at 14-26.

⁵⁶ *Id.* at 14-59.

⁵⁷ *Id.* at 14-60 to 61. For DOD’s TPS liability, compromise settlements of discrete portions of larger claims that are still pending (e.g. a party’s past response costs) may be paid. So long as the criteria normally applied are otherwise satisfied with respect to particular CERCLA contribution judgments and Justice Department compromise settlements, those awards will normally be payable from the Judgment Fund. See U.S. GEN. ACCOUNTING OFFICE, DECISIONS OF THE COMPTROLLER GEN. OF THE U.S., DECISION B-253179, THE JUDGMENT FUND AND LITIGATIVE AWARDS UNDER THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT, REP. NO. GAO/OGC 94-10 (1993), available at <http://archive.gao.gov/t2pbat4/150585.pdf>.

In the case of DOD CERCLA liabilities, the Judgment Fund is typically used to pay TPS cleanup costs resulting from judgment or settlements in three broad categories: response costs, oversight costs, and natural resource damage claims. Response costs are costs pertaining to studying or remediating a site.⁵⁸ Oversight costs are paid to a governmental agency, normally the Environmental Protection Agency ("EPA"), to cover the costs of its regulatory review and approval of the studies, the remedy, and work that is carried out at each site. Natural resource⁵⁹ damage claims must also sometimes be paid for interim or residual damages to natural resources which are incurred notwithstanding the remedial action at the site.⁶⁰

Procedurally, these costs arise in several ways. If the EPA performs the investigation and cleanup actions at a site (using Superfund⁶¹ dollars), it may then seek to recover these costs from private parties, either administratively or judicially.⁶² The private parties may then pursue contribution claims against DOD.⁶³ A state agency may perform the same investigation and cleanup actions as the EPA, and seek a similar recovery from either private parties or directly from DOD. The private parties may, again, pursue DOD for contribution. Also, the EPA may compel, administratively or judicially, private PRPs to conduct the site investigation and cleanup, and seek to recover past and future response costs. Again, the private parties may seek contribution from DOD if all of the statutory prerequisites are satisfied.⁶⁴

⁵⁸ Response costs are not specifically defined by CERCLA, but courts have held that they include the costs of investigations, monitoring, testing, legal costs, expert witness fees, as well as normal cleanup costs. *See, e.g., United States v. Ne. Pharm. & Chem. Co., Inc.*, 810 F.2d 726 (8th Cir. 1986).

⁵⁹ 43 C.F.R. § 11.14(z) (2006).

⁶⁰ 2001 *DERP Management Guidance*, *supra* note 44, § 25.

⁶¹ The Hazardous Substance Response Trust Fund ("Superfund") was created by Section 221 of CERCLA, 42 U.S.C. §9631, and repealed by Section 517(c)(1), Pub. L. No. 99-499, 100 Stat. 1774 (1986), and then continued as the "Hazardous Substance Superfund" under Section 517 of SARA, 100 Stat. 1613, 1772 (adding 26 U.S.C. §9507 to the Internal Revenue Code).

⁶² *See* 42 U.S.C. §§ 9606-9607 (2006).

⁶³ *See* 42 U.S.C. § 9613 (2006).

⁶⁴ *See, e.g.,* 42 U.S.C. § 9613(f).

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

In sum, DOD overtly incurs environmental costs administratively, judicially, by contribution, and through settlements. It pays for these liabilities with the DERA and the Judgment Fund. DOD's owner-type sites are easier to plan and budget for, compared to third-party sites, because they are a known quantity. Given the often fact-intensive equitable allocations at all types of sites, however, DOD still faces uncertainty in its environmental costs. Congress appropriates funds, in the billions to date,⁶⁵ to satisfy these liabilities in compliance with the equitable framework of CERCLA such that when DOD is the polluter, it pays its fair share.

Notwithstanding the complexities of attempting to predict and budget for cleanup costs at sites presently owned by DOD, budgetary uncertainties are exacerbated when, having already paid its "fair share" of environmental costs at a site, DOD pays for all or some of a contractor's "fair share" of environmental costs at the same site. That situation arises when contractors include their environmental liabilities as overhead in their current contracts with DOD. In those situations, DOD pays these covert environmental costs with funds which were appropriated to purchase war materiel. The impact is often not felt, or even noticed, on a daily basis by those who manage the DERP and work to satisfy DOD's environmental responsibilities, because they are not involved with DOD's procurement activities. Nor are those who spend DOD's procurement dollars mindful of DOD's environmental programs and expenditures; highlighting the lack of integration which leads to the fiscally unsound and inefficient business practices that Executive Order 13423⁶⁶ aims to curb.

DOD's environmental litigators and the Department of Justice will spend untold hours and taxpayer dollars fighting for an equitable allocation of liability between DOD and a contractor at a given site, only to have DOD procurement activities allow the use of procurement funds to satisfy those same liabilities. As a result, DOD isn't just spending its procurement dollars procuring things; it is also spending procurement dollars to subsidize contractor environmental liabilities. This incongruent practice is not only legal under the current acquisition laws, but is actually encouraged.

⁶⁵ See *FY 2005 DERP Report*, *supra* note 5 and accompanying text.

⁶⁶ See Exec. Order No. 13,423, 72 Fed. Reg. 3919 (Jan. 26, 2007).

As a result, DOD contractors often pay less than their “fair share” of environmental costs. How do they do this and who does pay for it? The next section of this article examines those questions.

II. ARE DOD CONTRACTORS REALLY PAYING THEIR “FAIR SHARE” OF ENVIRONMENTAL COSTS?

DOD contractors are often sophisticated corporations, operating with a distinct profit motive. Greater profits can result from passing on costs to others. As a result, DOD contractors have long sought methods to shift their environmental costs back to the government. The government does not make it difficult for them because current federal contracting laws and regulations permit contractors to charge certain costs against government contracts as indirect costs.

A. Allowability of Environmental Costs in Defense Procurement Contracting: Industry “Cost-Sharing”

DOD contracts are administered by the Defense Contract Management Agency (“DCMA”) through contracting officers. Because all costs in a government contract must be “allowable” under the Federal Acquisition Regulation (“FAR”),⁶⁷ contracting officers are responsible for determining the allowability of costs submitted by government contractors, including environmental cleanup costs. The Defense Contract Audit Agency (“DCAA”) helps them perform this task by auditing costs charged to the government contracts and determining allowability by applying the rules set forth in the FAR.⁶⁸ Currently, the FAR does not contain a cost principle that specifically addresses reimbursement of environmental costs. Consequently, the allowability of government contractor environmental cleanup costs is evaluated by applying the general cost principles found in FAR Part 31.⁶⁹

Under FAR Part 31, costs are generally allowable if they are reasonable, allocable, in accordance with applicable cost accounting

⁶⁷ See Federal Acquisition Regulations System, 48 C.F.R. § 31.201-2 (2006) (“Determining Allowability”).

⁶⁸ *Id.*

⁶⁹ *Id.*

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

standards or generally accepted accounting principles, and not made specifically unallowable by regulation or the contract terms.⁷⁰ In government contracting, there are both direct and indirect costs. Direct costs arise under a specific contract and are charged directly to that contract.⁷¹ Indirect costs are not directly identified with any particular contract, but contractors are able to include them in their overhead or general and administrative (“G&A”) costs, and charge them to the government.⁷² Environmental cleanup costs are commonly treated as indirect costs.⁷³

The fact that a contractor incurs environmental cleanup costs does not create a presumption that the costs are reasonable.⁷⁴ Costs are reasonable only if their nature and amount do not exceed those which would be incurred by a prudent person in the conduct of a competitive business.⁷⁵ Historically, many of the contractor activities that caused environmental harm occurred before the existence of environmental laws and regulations generally and before the enactment of CERCLA specifically. Accordingly, such activities were de facto “reasonable” at the time they were performed. Consequently, the environmental cleanup costs associated with those activities are generally considered reasonable under the FAR.

Generally, costs are allocable if they are incurred specifically for the contract to which they are being charged, if they benefit the contract and other work and are distributed to them in reasonable proportion to the benefits received, or if the costs are necessary to the overall operation of the contractor’s business.⁷⁶ Because environmental cleanup costs are indirect costs that typically result from activities arising under a previous contract, they are generally considered allocable to a current contract as costs “necessary to the overall operation of the business.” As such, they

⁷⁰ *Id.* § 31.

⁷¹ FAR, 48 C.F.R. § 31.202 (2006).

⁷² FAR, 48 C.F.R. § 31.203 (2006).

⁷³ Major Cameron, *Fiscal Law Update: Congress Proposes Major Changes in the Funding of Minor Military Construction Projects*, Sept. 1992 ARMY LAW. 29 (discussion on the allowability of environmental cleanup costs).

⁷⁴ *Id.*; FAR, 48 C.F.R. 31.201-3(a) (2006); *but see* Bruce Constr. Corp. v. United States, 324 F.2d 516 (Ct. Cl. 1963).

⁷⁵ FAR, 48 C.F.R. § 31.201-3 (2006).

⁷⁶ FAR, 48 C.F.R. § 31.201-4.

are typically allocated as overhead or through the contractor's G&A expense pool.⁷⁷

Additionally, allocation of costs must follow the generally mandatory Cost Accounting Standards,⁷⁸ although government contractors have the discretion to decide which specific accounting practices they will use. They may use any generally accepted method of determining or estimating costs that is equitable and is consistently applied.⁷⁹ Thus, when environmental costs are charged as overhead, there are no specific rules that govern; only general accounting concepts control the range of contracts to which costs may be allocated. This leaves contractors considerable discretion as to the range of contracts across which they may allocate environmental costs.⁸⁰

Finally, in order for costs to be allowable, they may not be specifically unallowable under the FAR or by the terms of the contract. Just as the FAR contains no specific environmental cost principle addressing the allowability of environmental costs, it lacks a provision specifically disallowing environmental cleanup costs. Consequently, as with the general allowability determination of environmental cleanup costs, the unallowability of environmental costs are determined using the general concepts under FAR Part 31; if a cost is not reasonable, it may be specifically unallowable. For instance, if a contractor experiences increased costs due to its own delay in taking action after the discovery of contamination, the delay would be considered unreasonable and the increased costs resulting from that delay would not be allowable.⁸¹ Another example of costs that are specifically unallowable are fines and

⁷⁷ Defense Contract Audit Agency, *DCAA Contract Audit Manual* [hereinafter "CAM"] at §7-2120.6 at 7186, available at http://www.dcaa.mil/cam/Chapter_07_-_Selected_Areas_of_Cost.pdf (last visited June 21, 2007).

⁷⁸ 48 C.F.R. §§ 9903, 9904.

⁷⁹ FAR, 48 C.F.R. § 31.201-1.

⁸⁰ Under the Cost Accounting Standards, costs generally must be charged to contracts in the time period in which they are incurred. Costs are usually incurred for these purposes when the bill comes due, not when the damage was done. Where a specific program or business segment that may have originally caused the liability no longer exists within the remaining corporation, it would be inequitable for the contractor to automatically allocate the liability across only their Defense segment.

⁸¹ CAM, § 7-2120.5.

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

penalties resulting from violations of federal or state law or regulation.⁸² Cleanup costs are, however, generally considered distinct from fines and penalties under CERCLA, and are therefore rarely unallowable under this rule.⁸³

The DCAA Contract Audit Manual (“CAM”) specifically contemplates situations in which contractors are PRPs and further recognizes that they may ultimately incur cleanup costs in excess of their fair share under the equitable allocation scheme when cleaning up a site pursuant to an EPA order.⁸⁴ In that case, the CAM states that only the “contractor’s share of the cleanup costs based on the actual percentage of the contamination attributable to the contractor” may be allowable environmental costs under the contract.⁸⁵ The CAM further states that a “contractor should not be denied recovery of cleanup costs if it complied with the laws, regulations, and permits in effect at the time of the contamination.”⁸⁶ Thus, while acknowledging the CERCLA scheme exists, the guidance found in the Defense Contract Audit Agency’s audit manual directly undermines CERCLA’s core “polluter pays” principle. Linking reimbursement to compliance with laws and regulations in effect at the time contamination occurred contradicts CERCLA’s basic strict liability and retroactivity tenets. Additionally, it not only permits, but actually directs, DOD contractors to pass on their share⁸⁷ of environmental cleanup costs to the government. Such an approach stands the principle of equitable allocation on its head.

The following hypothetical illustrates this point: two PRPs, the United States and a government contractor have each incurred CERCLA liability at a site. A court determines, based upon application of equitable allocation factors, that each party’s fair share amounts to 50% of the total environmental cleanup costs. CERCLA, and the “polluter pays” principle

⁸² FAR, 48 C.F.R. § 31.205-15 (fines and penalties may be allowable if incurred as a result of compliance with specific terms and conditions of the contract or the written instructions of the contracting officer).

⁸³ See Major Tomanelli, *Allowability of Environmental Cleanup Costs*, Nov. 1992 ARMY LAW. 31, 31 and n.141 (comparing 42 U.S.C. § 9607(c)(1) (remediation costs) with *id.* §9607(c)(3) (punitive damages) and 42 U.S.C. § 9609 (penalties)).

⁸⁴ CAM, § 7-2120.9.

⁸⁵ *Id.*

⁸⁶ CAM, § 7-2120.13(e).

⁸⁷ CAM, § 7-2120.9.

upon which it is based, requires both the United States and the contractor to pay their own 50% of the overall cost. Based upon current procurement regulations and guidelines however,⁸⁸ the government contractor has the right to seek recovery from the United States for at least some of those same costs. Even assuming that a portion of the contractor's "fair share" of costs is disallowed for some reason, the United States will nonetheless pay for more than its fair share. The current procurement scheme permits contractors to seek reimbursement for their "fair share" of cleanup costs under current government contracts, thus allowing them to circumvent CERCLA's "polluter pays" principle and shift the costs of their polluting activities to the taxpayers, rendering the phrase "fair share" something of a misnomer.

DOD contractors often "forecast" their costs as estimates when competing for government contracts. Accordingly, their final CERCLA cost allocation and ultimate financial liability may be unknown when they claim their environmental costs. The FAR does provide some limited protection for the government from contractors receiving a potential financial windfall through this process. In circumstances where the (estimated) claimed costs exceed the (eventual) actual costs, contractors have an obligation to reimburse the government under the FAR "Credit Clause."⁸⁹ It requires "the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor" to be "credited to the Government either as a cost reduction or by cash refund."⁹⁰ While credits for indirect costs (e.g., environmental costs) do result in an adjustment of the contractor's indirect cost rate, such adjustments do nothing to prevent contractors from charging all or some of their share of environmental cleanup costs to the government in the first place. Thus, the FAR's credit provision operates to prevent *further* inequity to DOD, but does not prevent the FAR's initial disregard for CERCLA's equitable scheme.

The FAR's general allowability principles are inadequate to prevent inequities resulting from what is, by definition, an equity-based restitution system. Not only do these general principles fail to adequately accommodate the equitable underpinnings of CERCLA, the absence of a

⁸⁸ See FAR, 48 U.S.C. § 31; CAM, § 7-2120.

⁸⁹ FAR, 48 U.S.C. § 31.201-5.

⁹⁰ *Id.*

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

specific, black-letter environmental cost principle leads to subjective and inconsistent reimbursement of government contractors for their environmental costs.⁹¹ The lack of an environmental cost principle that accounts for and harmonizes the business realities of government procurement and the equity-driven environmental scheme results in a situation in which polluters do not pay their fair share and taxpayers pay more than intended. That this is perfectly legal is all the more disconcerting. This is not a new problem. It was identified in the early 1990s and resulted in a proposal for an environmental cost principle.

B. The Draft Environmental Cost Principle: Dead on Arrival

The initial attempt to formulate an environmental cost principle came in 1987.⁹² That proposal attempted to make compliance costs allowable and cleanup costs unallowable, except for government-owned, contractor-operated (“GOCO”) facilities that met certain criteria.⁹³ It was subsequently modified to exclude the provision on compliance costs, and ultimately was withdrawn after complaints by industry.⁹⁴

Revisions were later made to the draft cost principle, and in December of 1991, proposed FAR 31.205-9⁹⁵ was completed by a joint DOD and civilian agency group.⁹⁶ The draft was approved by the Defense Acquisition Regulation Council and by the Civilian Agency Acquisition Council.⁹⁷ The proposed rule was sent to the FAR Secretariat on May 20, 1992, for final publication;⁹⁸ however, due (ostensibly) to a moratorium

⁹¹ An ironic result given that the FAR purportedly requires “any generally accepted method of determining or estimating costs that is *equitable* and is *consistently* applied” to be used. See FAR, 48 U.S.C. § 31.201-1. (emphasis added).

⁹² See Captain Gerald R. Kohns et al., *A Primer on Contractor Environmental Remediation and Compliance Costs*, Nov. 1993 ARMY LAW., 22, 28.

⁹³ *Id.* at 28 & n.55 (citing Defense Acquisition Regulation (“DAR”) Case 88-127).

⁹⁴ *Id.* at 28 & n.56 (citing *Recovery of Environmental Costs*, COST, PRICING AND ACCT. REP. 5-7 (Fed. Pub.) (Mar. 1992)).

⁹⁵ FAR, 48 U.S.C. § 31.205-9 (Proposed 1991). See attached Appendix for full text of the proposed Environmental Cost Principle.

⁹⁶ See U.S. GEN. ACCOUNTING OFFICE, ENVIRONMENTAL CLEANUP, OBSERVATIONS ON CONSISTENCY OF REIMBURSEMENTS TO DOD CONTRACTORS, REP. NO. GAO/NSIAD-93-77 at 7 (1992), available at <http://archive.gao.gov/d35t11/147876.pdf>.

⁹⁷ *Id.*

⁹⁸ Kohns, *supra* note 92, at n.58.

on new federal regulations imposed by President George H.W. Bush, the draft was never released for public comment.⁹⁹

Proposed FAR 31.205-9 made a contractor's costs incurred for preventing environmental damage, properly disposing of waste, and complying with environmental laws and regulations, specifically allowable.¹⁰⁰ Costs incurred for correcting environmental damage were disallowed, unless the contractor met certain conditions.¹⁰¹ The rule required the contractor to show that it (or the previous owner responsible for the contamination) was performing a government contract at the time the condition requiring cleanup occurred and that the performance of that government contract contributed to the creation of the condition.¹⁰² The contractor was also required to show that it exercised reasonable business judgment, complied with all environmental standards (applicable at the time the condition was created), acted promptly to mitigate the condition, and exhausted (or was diligently pursuing) all available legal avenues to recover or defray the cleanup costs (i.e. insurance).¹⁰³ In addition, under the draft rule, costs which resulted from liability to a third party were unallowable.¹⁰⁴

Just as the draft cost principle was being "finalized" in May of 1992, GAO released a fact sheet on its findings regarding DOD reimbursement of its contractors' environmental cleanup costs.¹⁰⁵ A sampling of only 10 contractors yielded estimates from \$.9 billion to \$1.1 billion in future cleanup costs.¹⁰⁶ GAO noted that these estimates were conservative, noting DOD's poor data collection due to inadequate cost

⁹⁹ See REP. NO. GAO/NSIAD-93-77, *supra* note 96, at 7.

¹⁰⁰ Kohns, *supra* note 92, at 28.

¹⁰¹ *Id.*

¹⁰² See Lieutenant Colonel Cheryl Lynch Nilsson, *Defense Contractor Recovery of Cleanup Costs at Contractor Owned and Operated Facilities*, 38 A.F. L. Rev. 1, 6 (1994).

¹⁰³ *Id.*; see also Kohns, *supra* note 92, at 30 (regarding the pursuit of insurance policies as possible sources of contribution).

¹⁰⁴ Nilsson, *supra* note 102, at 6 (citing FAR, 48 U.S.C. § 31.205-9 (Proposed 1991)).

¹⁰⁵ See U.S. GEN. ACCOUNTING OFFICE, *DOD ENVIRONMENTAL CLEANUP- Information on Contractor Cleanup Costs and DOD Reimbursements*, REP. NO. GAO/NSIAD-92-253FS (1992), available at <http://archive.gao.gov/d33t10/147069.pdf>.

¹⁰⁶ *Id.* at 1.

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

tracking systems.¹⁰⁷ The report did mention, somewhat hopefully, that as of the time that GAO/NSIAD-92-253FS was published, DOD was “developing an environmental cost principle to provide more definitive criteria for determining the allowability of environmental cleanup costs.”¹⁰⁸

In October of 1992, GAO issued a follow-on report with specific observations on the consistency (or lack thereof) of reimbursements of environmental costs to DOD contractors.¹⁰⁹ The draft cost principle had still not been passed, and contracting officers were still left responsible, as they are today, for determining allowability of costs using only general principles, which resulted in inconsistent treatment of environmental claims and cost reimbursement decisions (as it still does today). Not surprisingly, the report found that contracting officers varied widely in the extent of investigations into possible wrongdoing by contractors in making their environmental cost allowability determinations.¹¹⁰ The report detailed the history of the draft environmental cost principle, and again suggested that its ultimate adoption might provide needed guidance for contracting officers.¹¹¹

The moratorium on new federal regulations remained in effect into 1993, preventing the draft principle from being adopted.¹¹² In May of 1993, GAO again reported, this time in testimony before the House Committee on Government Operations, Subcommittee on Legislation and National Security, that 15 of DOD’s largest contractors alone estimated their future environmental cleanup costs at \$2.1 billion, much of which would be reimbursed by DOD.¹¹³ GAO again highlighted the inconsistent practices being used for environmental cost reimbursement, and called for DOD to develop and implement specific guidance on reimbursement of

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 2.

¹⁰⁹ See REP. NO. GAO/NSIAD-93-77, *supra* note 96.

¹¹⁰ *Id.* at 1 (“Decisions on reimbursement varied from complete denial to reimbursement in proportion to the government’s share of a company’s business.”).

¹¹¹ *Id.*

¹¹² See U.S. GEN. ACCOUNTING OFFICE, ENVIRONMENTAL CLEANUP- *Unresolved Issues in Reimbursements to DOD Contractors*, REP. NO. GAO/T-NSIAD-93-12 (1993), available at <http://archive.gao.gov/t2pbat5/149250.pdf>.

¹¹³ *Id.* at 1.

environmental costs in light of the stalled draft cost principle.¹¹⁴ In the interim, DCAA issued its first specific instructions on accounting for environmental cleanup costs in an audit guidance memorandum.¹¹⁵ DCAA chose to treat environmental costs as normal business expenses.¹¹⁶ In response, GAO pointed out the problems associated with treating cleanup costs from prior years as normal business expenses under current contracts, noting that cleanup costs often have no relationship to production costs.¹¹⁷ GAO further recognized the interplay between such a reimbursement scheme and the CERCLA equitable allocation scheme. Because environmental costs often result from strict liability, unrelated to a contractor's fault, GAO noted that determinations about which costs can be reimbursed is a potentially research-intensive exercise for contracting officers.¹¹⁸

Another major problem that GAO highlighted in the overall environmental cost reimbursement scheme was the allowability of profits.¹¹⁹ It noted that costs which are accounted for as G&A expenses, such as environmental cleanup costs, do not allow for a profit.¹²⁰ However, their investigation disclosed that Boeing, and six of the thirteen largest defense contractors were charging prior-year cleanup costs to overhead accounts other than G&A, meaning those costs included a factor for profit.¹²¹ Theoretically, this positioned DOD to pay not only its own fair share of environmental costs, but at least a portion of the contractor's fair share of environmental costs through reimbursement, and pay the contractor a profit premium on the contractor's reimbursed share.

In addition to GAO's continuing criticism of DOD's inconsistent cost reimbursement practices, DOD environmental attorneys pointed out that the interim DCAA guidance, which treated environmental costs as

¹¹⁴ *Id.* at 5. For the third time in a year, GAO suggested that the draft environmental cost principle might "provide guidance" regarding the inconsistent treatment of environmental cleanup costs. *Id.*

¹¹⁵ *Id.* at 6 (referencing an October 14, 1992 DCAA memorandum issued by the Director of Defense Procurement).

¹¹⁶ *Id.* at 7.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 6.

¹²⁰ *Id.* at 7.

¹²¹ *Id.*

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

“normal costs of doing business,” and thus applied a “reasonably prudent businessperson” standard, was unhelpful¹²² because environmental costs are often determined through hard-fought litigation, not reasoned corporate decision-making.¹²³ Moreover, state and federal environmental regulatory agencies, not the contractors, determine the actual cleanup costs to be incurred by selecting remedies for sites based on CERCLA processes, not best business practices.¹²⁴

Conversely, numerous industry and bar groups opposed the cost principle primarily because it made environmental costs presumptively unallowable.¹²⁵ The American Bar Association Public Contract Law section argued that the proposed principle’s presumption against allowability is inconsistent with the FAR’s general framework, and that the burden should not be on contractors to show that they acted properly.¹²⁶ While DOD’s exposure to enormous cleanup costs was clear, industry attorneys felt that the potential exposure for government contractors was overly “broad.”¹²⁷ They feared that promulgation of the draft cost principle would “threaten to affect significantly the contractor’s business and the costs associated with working on government projects” because under the new principle, costs would be presumed unallowable and contractors would have the burden of establishing their allowability.¹²⁸ “By getting involved now (at the time the draft was being considered),” they said, “contractors can influence the Government’s handling of environmental costs.”¹²⁹ Influence they did.

In May of 1997, Director of Defense Procurement, Eleanor Spector, announced that DOD was terminating the effort to develop the

¹²² Kohns, *supra* note 92, at 27-28.

¹²³ *Id.* at 27.

¹²⁴ *Id.*

¹²⁵ See Nilsson, *supra* note 102, at 6 & n.36 (citing Letter from Allan J. Joseph of Rogers, Joseph, O'Donnell & Quinn to Mrs. Eleanor Spector, Director of Defense Procurement (Jan. 14, 1992) and *DOD Environmental Cost Principle*, FED CONTR. DAILY (BNA) (Aug. 13, 1992).

¹²⁶ See Kohns, *supra* note 92, at 30.

¹²⁷ Chris M. Amantea & Stephen C. Jones, *The Growth of Environmental Issues in Government Contracting*, 43 Am. U.L. Rev. 1585, 1590 (1994).

¹²⁸ *Id.* at 1634 and n.334.

¹²⁹ *Id.* at 1634-35.

environmental cost principle.¹³⁰ Industry had won. One industry attorney observed that "government auditors and lawyers remain uncertain as to how the rules should be applied in individual cases," despite additional guidance by DCAA in its CAM.¹³¹ He asserted that contractors would have "more flexibility" in arguing the allowability of environmental costs in the absence of a specific environmental cost principle.¹³²

Contractors would continue to take full advantage of "cost-sharing" with DOD. It was legal, but was it equitable? Contractors were suing the United States in contribution under the environmental scheme, fighting for the most favorable allocation from the courts, then passing on as much of their resulting costs, or, their "fair share," as they could through their government contracts, without resistance from DOD. GAO had highlighted the problems associated with DOD's reimbursement of environmental costs, and suggested the passage of the environmental cost principle, but to no avail. The problems associated with environmental cost reimbursement did not end there however. Next, GAO identified another issue; if the battle over environmental costs would, in fact, take the form of "cost-sharing," GAO determined that DOD was not adequately seeking such cost-sharing opportunities.

III. DOD COST-SHARING: A PROBLEM RECOGNIZED

A. The Genesis of the DOD Affirmative Claims Program

Having repeatedly highlighted DOD's inconsistent environmental cost reimbursement practices with little or nothing to show for it, GAO turned its attention to a distinct but related DOD problem: inconsistent environmental cost-sharing procedures. In July 1994, GAO reported that the military services and DLA projected environmental cleanup costs of \$3 billion to clean up 78 GOCO plants and the Rocky Mountain

¹³⁰ Michael T. Janik, *Confronting Environmental Liabilities As a Government Contractor*, FED. CONTR. REP (BNA) (Sept. 8, 1997).

¹³¹ *Id.*

¹³² *Id.*

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

Arsenal.¹³³ GAO found that as a result of a lack of clear guidance from DOD, the services had not consistently requested that GOCO operators share in the cost of cleaning up past contamination.¹³⁴ During their investigation, each of the services and DLA described a different policy for cost sharing, and within each service the policy sometimes differed from the headquarters to the command level.¹³⁵ For instance, at the Army command level, officials reported that most of the Army's GOCO ammunition plant operators were indemnified against environmental liability.¹³⁶ However, at Army headquarters, a procurement policy official stated that the Army does not indemnify contractors against environmental expenses.¹³⁷ GAO highlighted the importance of identifying PRPs who might be required by CERCLA to pay for a share of cleanup costs at DOD sites, such as GOCOs, and who otherwise might pay nothing if DOD failed to seek recovery from them.¹³⁸ GAO recommended that the Secretary of Defense provide uniform guidance to the services on cost-sharing to resolve the existing disparities.¹³⁹

The recommendation met with the same results as GAO's previous effort to promote the environmental cost principle; nothing was done. In March 1997, GAO delivered a blistering report on the inconsistent cost-sharing policies and practices within DOD, highlighting the fact that GAO had been reporting on increasing environmental cleanup costs and inconsistent DOD policies since 1992, without responsive action from DOD.¹⁴⁰ In the absence of sufficient DOD guidance, they reported that the

¹³³ See U.S. GEN. ACCOUNTING OFFICE, ENVIRONMENTAL CLEANUP, INCONSISTENT SHARING ARRANGEMENTS MAY INCREASE DEFENSE COSTS, REP. NO. GAO/NSIAD-94-231, at 1-2 (1994), available at <http://archive.gao.gov/t2pbat3/152126.pdf>.

¹³⁴ *Id.* at 2.

¹³⁵ *Id.* at 7.

¹³⁶ *Id.* at 8. As support for their position, Army officials provided memorandums from the Secretary of the Army, citing Public Law 85-804, authorizing the major command to insert indemnification provisions into contracts with 19 Army ammunition GOCO plant operators. *Id.*

¹³⁷ *Id.* The official stated that Public Law 85-804 was not the basis for paying environmental cleanup costs for GOCO plant operators. *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.* at 11.

¹⁴⁰ See U.S. GEN. ACCOUNTING OFFICE, ENVIRONMENTAL CLEANUP AT DOD, BETTER COST-SHARING GUIDANCE NEEDED AT GOVERNMENT-OWNED, CONTRACTOR OPERATED

services had taken widely disparate approaches to seeking out PRPs associated with GOCOs with which to share in cleanup costs.¹⁴¹ “Notwithstanding [their] recommendations to do so, DOD has not given the services adequate guidance for making decisions on whether and when to seek recovery of environmental cleanup costs incurred by DOD from contractors and other parties at GOCO facilities.”¹⁴² GAO attributed the inconsistent approaches to cost sharing, which yielded situations where PRPs were not pursued, and the associated financial detriment, to the lack of uniform DOD guidance on the subject.¹⁴³ Again, GAO recommended that DOD issue guidance to its components to resolve the disparities. In its recommendation, GAO noted that they had been reporting for five years that DOD could pay hundreds of millions of dollars to, and on behalf of contractors, due to inconsistent environmental reimbursement policies and now, in addition, for inconsistent cost-sharing efforts. Yet, DOD had failed to act.

Then Congress stepped in. In November 1997, Congress directed the Secretary of Defense to provide guidelines to the services on environmental restoration cost sharing and cost recovery by including the requirement in the National Defense Authorization Act for FY 1998.¹⁴⁴

SITES, REP. NO. GAO/NSIAD-97-32, at 1 (1997), *available at* <http://www.gao.gov/archive/1997/ns97032.pdf>.

¹⁴¹ *Id.*

¹⁴² *Id.* at 2.

¹⁴³ *Id.* at 3.

¹⁴⁴ Recovery and Sharing of Costs of Environmental Restoration at Department of Defense Sites Section 348, Pub. L. No. 105-85, 111 Stat. 1689 (1997), *available at* http://www.gulflink.osd.mil/medical/storyboard/getdoc.pdf?dbname=105_cong_public_laws&docid=f:publ85.105.pdf

. It provides in relevant part:

- (a) Regulations-- ...the Secretary of Defense shall prescribe regulations containing the guidelines and requirements described in subsections (b) and (c).
- (b) Guidelines.-- ...the regulations prescribed...shall contain uniform guidelines for the military departments and defense agencies concerning the cost-recovery and cost sharing activities of those departments and agencies.
- (c) Requirements.-- the regulations prescribed...shall contain requirements for the Secretaries of the military departments and the heads of defense agencies to—

- (1) obtain all data that is relevant for purposes of cost-recovery and cost-sharing activities; and

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

On February 27, 1994, DOD finally responded by issuing a policy memorandum to the services and DLA addressing cost recovery and cost sharing activities under the DERP program.¹⁴⁵ The policy requires DOD components to: (1) identify all potential environmental restoration cost sharing opportunities from PRPs at DOD sites; (2) investigate each activity where cost-sharing potential exists to determine the likelihood of success; and (3) pursue cost-sharing to the extent practicable by obtaining relevant data, identifying any Defense contractor negligence or misconduct, and initiating actions, where appropriate, to recover environmental cleanup costs incurred by DOD.¹⁴⁶

The policy sets forth a multi-step process, potentially requiring significant time and resources to complete. First, the services must investigate each activity in which cost-sharing may be possible and determine whether the likelihood of recovering or sharing costs outweighs the expense associated with pursuing an action. Then, if potentially cost-effective, they must obtain all relevant data, which can cover long periods of time and involve complex environmental and contractual matters. Next, they must identify any defense contractor negligence or other misconduct, requiring very fact-specific inquiries, which may limit or negate any DOD *obligation to indemnify or reimburse* the contractor for the costs of environmental restoration. Finally, they must initiate actions, including legal actions, *where appropriate*, to recover environmental costs incurred, or to be incurred by the services.

Presently, the DERP Management Guidance requires DOD components to establish processes to identify other CERCLA PRPs at DOD sites and to pursue them to either take responsibility for environmental restoration or to contribute to the cost of response actions, on a total recovery or contribution basis, as appropriate.¹⁴⁷ The services even have extra incentive to affirmatively pursue these environmental

(2) identify any negligence or other misconduct that may preclude indemnification or reimbursement by the Department of Defense for the costs of environmental restoration.

¹⁴⁵ DOD Policy Memorandum (Feb. 27, 1998) (on file with author). The policy covers both cost sharing and full cost recovery; thus references to "cost sharing" in this article include "cost recovery."

¹⁴⁶ *Id.*

¹⁴⁷ 2001 DERP Management Guidance, *supra* note 42, § 16.2.

claims. Pursuant to 10 U.S.C. §2703(d)(1) and (2), the DOD components are authorized to credit their ER accounts¹⁴⁸ with amounts recovered pursuant to CERCLA for response costs at DERP sites attributable to other PRPs or the negligence of DOD contractors.¹⁴⁹

GAO had been identifying problems associated with environmental costs and government contractors for years. CERCLA's strict liability scheme had long captured the government contractors' activities at DOD sites. DOD had finally taken a step toward reducing the budget strains that environmental cleanup costs posed, specifically identifying government contractors as obvious cost sharing candidates to pursue, where appropriate. But, what is "appropriate" and who determines it?

B. Government Contractors: "Appropriate" Cost-Sharing Partners?

DOD components are required to plan, program, and budget DERP and BRAC environmental restoration program requirements, to defend those requirements, and to execute the programs in a manner consistent with DOD fiscal and programmatic guidance.¹⁵⁰ Naturally, seeking to have a PRP either take responsibility for environmental restoration or contribute to the cost of response actions, on a total cost recovery or contribution basis, is preferable to expending appropriated ER funds to pay for response costs that represent the liability and responsibility of other parties.¹⁵¹ This is especially true when PRPs are so readily identifiable, as is the case with government contractors. Why then, is refusing to reimburse all or some of DOD contractors' environmental costs not equally preferable to expending appropriated DOD procurement dollars for response costs that represent the liability and responsibility of other parties, particularly where, in many cases, those costs have been judicially determined to be a particular contractor's "fair share?" Can it really be said that DOD is conducting its mission "in an environmentally,

¹⁴⁸ See *DOD Appropriations Act*, *supra* note 46; see also *FY 2005 DERP Report*, *supra* note 5, at Appendix E.

¹⁴⁹ *2001 DERP Management Guidance*, *supra* note 42, § 26.1.

¹⁵⁰ U.S. DEP'T OF DEF., INSTRUCTION 4715.7 §5.6.4 (1996), available at <https://www.denix.osd.mil/denix/Public/ES-Programs/Cleanup/DoDI/4715-7.html>.

¹⁵¹ *2001 DERP Management Guidance*, *supra* note 42, § 26.3.

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

economically and fiscally sound, integrated, continuously improving, efficient, and sustainable manner”¹⁵² when on the one hand it seeks to avoid paying for a contractor’s environmental costs while on the other hand, it is readily paying those costs? Such a system certainly does not attain the best value for taxpayers by spending funds wisely, buying the “right things, the right way.”¹⁵³

Each of the armed services now has an affirmative environmental cost recovery program in place, but to what end? DOD environmental practitioners who endeavor to pursue “appropriate” affirmative environmental claims against government contractors under the existing system will do so at the peril of their time and their agency’s resources. Determining which cases are “appropriate” to pursue requires exhaustive analysis. The difficulty of such analysis is compounded by pursuing a claim that may be charged right back to, and paid for, by the government. Is it “appropriate” to pursue a case under the CERCLA scheme when DOD is obliged to reimburse some or all of the costs that will be allocated to a contractor? DOD must reconcile its procurement and environmental cost sharing responsibilities in a coherent policy that will achieve the goals of each, cost effective purchases from government contractors, and equitable sharing of environmental costs with those same contractors.

IV. A PROPOSAL: PROMULGATING AN ENVIRONMENTAL COST PRINCIPLE

In the early 1990’s, “no realistic estimate” of future environmental costs to DOD existed.¹⁵⁴ Actual DOD Environmental spending from FY 2002 through FY 2005 alone exceeded \$15 billion, with an additional \$3.8 billion appropriated for FY 2006.¹⁵⁵ GAO recognized the need for an environmental cost principle as early as 1992 to help control DOD costs,

¹⁵² See Exec. Order No. 13,423, 72 Fed. Reg. 3919, 3919 (Jan. 26, 2007).

¹⁵³ GAO-06-800T, *supra* note 2.

¹⁵⁴ Kohns, *supra* note 92, at 33.

¹⁵⁵ *FY 2005 DERP Report*, *supra* note 5, at Appendix C: Environmental Management Funding Summary, E-6. (DOD has spent over \$1 billion in environmental restoration funding alone per year for the past decade). Importantly, these substantial figures do not account for the additional environmental costs being charged back by contractors under their DOD contracts; those costs are paid for with DOD procurement dollars which are not tracked with DOD’s traditional environmental program costs.

but still none exists. Consequently, government contractors continue to charge environmental cleanup costs as overhead in their government contracts, and the government continues to pay them. What's more, some of those costs may have been incurred solely due to the fact that the government successfully pursued the contractor via lawsuit as a PRP through DOD's affirmative claims program, creating a disincentive for DOD to pursue such claims despite the requirement to do so. Without an environmental cost principle, contracting officers apply only the general cost principles under FAR Part 31, with subjective, inconsistent, and inequitable results.

DOD must promulgate a new environmental cost principle. From an overall DOD perspective, such a principle would assist in reconciling two costly DOD responsibilities, environmental compliance and procurement. The environmental cost principle will provide common language and a common standard for the environmental attorney and the contracting officer to apply when determining allowability of environmental costs. Contracting officers will have an objective standard to achieve consistent results in assessing the allowability of contractor cleanup costs, making budgeting for future years more reliable and achieving cost savings by paying only for DOD's actual liabilities. Environmental attorneys charged with carrying out Congress's affirmative environmental cost-sharing directive will be better suited to analyze which cases are actually "appropriate," spending resources only where a discernable "delta" between a contractor's allowable and unallowable costs render a case sufficiently cost-effective to pursue.

Industry would, of course, strongly oppose any such measure, just as they successfully did with the Draft Environmental Cost Principle of the early 1990's. Industry can be expected to urge that costs should remain allowable simply because "that's the way we have always done it." Of course, as is evident from this discussion, past practice does not represent an efficient or equitable approach, and costs the taxpayers millions.

Another industry argument might emphasize that allowable costs are part of the consideration paid for the goods and services that the contractors provide, simply known as the "cost of doing business." Such costs should be costs which are truly part of conducting a contractor's actual business. For instance, environmental compliance costs, which contractors incur to comply with environmental laws and regulations, such

THE NEED FOR AN ENVIRONMENTAL COST PRINCIPLE

as costs incurred to prevent environmental damage or to properly dispose of waste, might reasonably be considered “costs of doing business.” Environmental remediation costs for past business activities should be paid by a PRP, however, as equitable restitution under CERCLA’s “polluter pays” principle. Furthermore, complying with the FAR is a longstanding part of the consideration that a contractor pays to willingly do business with the United States. Complying with a new environmental cost principle, then, could fairly be considered a contractor’s “cost of doing business” with the government.

Contractors might also point to the limitation on the actual environmental costs that they are permitted to claim for reimbursement under the CAM.¹⁵⁶ If a contractor incurs actual cleanup costs in excess of their fair share, it is true that a claim for actual costs incurred will fail, and only their fair share of the costs incurred will be reimbursed in accordance with the CAM.¹⁵⁷ From a government contracting perspective, such a result is entirely equitable. When viewed in light of the CERCLA scheme, however, reimbursement of a contractor’s portion of cleanup costs runs contrary to equitable principles.

Environmental cost reimbursement issues are numerous and complex. Simply promulgating an environmental cost principle does not even begin to address them all; however, it would assist in resolving the present inherent conflict between DOD’s procurement and environmental cost-sharing responsibilities. Integrating these functions would, in turn, provide a net financial benefit for DOD and its shareholders, the taxpayers. It isn’t necessary to replicate environmental cost principles advanced in the early 1990s, but it is necessary to promulgate something. Such a principle should provide, at a minimum, that environmental cleanup costs be presumed unallowable instead of presumed allowable, as they are currently. This would place the burden on industry to overcome the presumption and prove the allowability of their environmental cleanup

¹⁵⁶ See CAM, § 7-2120.9 available at http://www.dcaa.mil/cam/Chapter_07_-_Selected_Areas_of_Cost.pdf (“The allowable environmental cost should only include the *contractor’s share* of the clean-up costs based on the actual percentage of the contamination attributable to the contractor.”) (emphasis added).

¹⁵⁷ If a contractor ended up claiming excessive projected cleanup costs in a given contract, the costs would be unallowable since the contractor may not charge as overhead costs that they either never incurred, or never reasonably intended to incur.

costs, instead of DOD having the burden to prove that they are unallowable. Savvy corporations, armed with a profit motive, should have little difficulty in identifying and justifying allowable cleanup costs under the new cost principle. On the other hand, the DOD bureaucracy will be better suited to analyze environmental cost allowability under a common, integrated standard, moving DOD closer to executing its overall mission "in an environmentally, economically and fiscally sound, integrated, continuously improving, efficient, and sustainable manner."

APPENDIX

31.205-9 Environmental Costs.

(a) Environmental Costs—

(1) Are those costs incurred by a contractor for:

(i) The primary purpose of preventing environmental damage; properly disposing of waste generated by business operations; complying with environmental laws and regulations imposed by Federal, State, or local authorities;
or

(ii) Correcting environmental damage.

(2) Do not include any costs resulting from a liability to a third party.

(b) Environmental costs in paragraph (a)(2)(i) of this subsection, generated by current operations, are allowable, except those resulting from violation of law, regulation, or compliance agreement.

(c) Environmental costs in paragraph (a)(2)(ii) of this subsection, incurred by the contractor to correct damage caused by its activity or inactivity, or for which it has been administratively or judicially determined to be liable (including where a settlement or consent decree has been issued), are unallowable, except when the contractor demonstrates that it:

(1) Was performing a Government contract at the time the conditions requiring correction were created and performance of that contract contributed to the creation of the conditions requiring correction;

(2) Was conducting its business prudently at the time the conditions requiring correction were created, in accordance with then-accepted relevant standard industry practices, and in compliance with all then-existing environmental laws, regulations, permits, and compliance agreements;

(3) Acted promptly to minimize the damage and costs associated with correcting it; and

(4) Has exhausted or is diligently pursuing all available legal and contributory (e.g., insurance or indemnification) sources to defray the environmental costs.

(d) In cases where the current contractor is required to correct environmental damage which was caused by the activity or inactivity of a previous owner, user, or other lawful occupant of an affected property, the resulting environmental costs are unallowable, except when the current contractor demonstrates that:

- (1) The previous owner, user, or other lawful occupant's actions satisfy the criteria in paragraphs (c)(1) through (3) of this subsection, and
- (2) The current contractor has complied with paragraphs (c)(3) and (4) of this subsection during the period that it has owned, used, or occupied the property.

(e) Paragraphs (c) and (d) of this subsection do not apply to costs incurred in satisfying specific contractual requirements to correct environmental damage (e.g., where the Government contracts directly for the correction of environmental damage at a facility which it owns).

(f) Increased environmental costs resulting from the contractor's failure to obtain all insurance coverage specified in Government contracts are unallowable.

(g) Costs incurred in legal and other proceedings, and fines and penalties resulting from such proceedings, are governed by 31.205-47 and 31.205-15, respectively.