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February 3, 1992

The Honorable John Conyers, Jr.
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This responds to your January 10, 1992, letter written jointly with Representative Boxer, requesting a fact paper analyzing the relationship between the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)[1] and the Department of Defense (DOD) allowable cost provisions at 10 U.S.C. § 2324, with respect to the allocation of responsibility for payment of environmental cleanup costs.

CERCLA Liability

CERCLA--also known as Superfund--requires responsible parties to clean up hazardous waste sites and other dangerous chemical releases or to reimburse the government for the cost of the cleanup. Under CERCLA, past and present owners and operators, transporters, and generators of hazardous waste are strictly, jointly and severally liable for hazardous waste cleanup.[2]

Federal agencies, as well as private parties, must comply with CERCLA requirements. In addition, CERCLA's 1986 amendments, the Superfund Amendments and Reauthorization Act (SARA), specifically provide that CERCLA applies to facilities owned or operated by a department, agency, or instrumentality of the United States, "in the same manner and to the extent," it applies to other facilities.[3] Where the cleanup site is owned and operated by a DOD contractor, DOD may share liability for hazardous waste cleanup if it arranged for disposal or treatment, or arranged transport

[1]Pub. L. No. 96-510, 94 Stat. 2762 (codified in part as amended at 42 U.S.C. 9601-9657). See the Short Title note under 42 U.S.C. § 9601 for a complete classification of CERCLA to the U.S. Code.

[2]42 U.S.C. § 9607(a).

[3]Pub. L. No. 99-499, § 120, 100 Stat. 1614 [codified at 42 U.S.C. § 9620(a)(2)].

for disposal or treatment, of DOD hazardous substances.[4] Where the cleanup site is a DOD facility,[5] DOD shares liability with those contractors who operated the facility or transported or generated the hazardous waste.[6]

Because the standard of liability under CERCLA is strict liability,[7] it is not relevant to CERCLA liablity whether or not a government contractor's practices were improper. A potentially responsible party's (PRP) claim that it exercised due care or was not negligent thus cannot be used to avoid liability under the statute. Rather, a PRP may escape liability only by showing that the release and resulting pollution or damages were caused by (1) an act of God, (2) an act of war, (3) an act or omission of a third party or PRP contractor, provided the PRP exercised due care or (4) a combination of the above.

DOD and its contractors will only rarely be able to avoid liability for cleanup costs using the listed defenses since DOD and DOD contractors typically experience a release and resulting damages in the course of normal operations, which cannot be easily characterized as acts of God or an act of war. Neither will the third party defense normally be available to DOD or the contractor since the release and resulting damages typically arise as the result of some act or omission of a DOD employee or agent, or of DOD's prime contractor's employee, agent, or subcontractor. If DOD and its contractors can be characterized as an "owner,

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[4]42 U.S.C. § 9607(a)(3).

[5]This includes facilities where the government operates all of the activity (government owned/government operated, or GOGO), facilities operated in part by government contractors (government owned/contractor operated, or GOCO), and facilities owned by the government but leased to private parties.

[6]42 U.S.C. § 9607(a).

[7]CERCLA section 101(32) provides that the standard of liability under the Act will be the standard of liability imposed by section 311 of the Clean Water Act of 1977. Based on the legislative history of CERCLA and the fact that section 311 has consistently been construed as a strict liability provision, courts have held that responsible parties are strictly liable under CERCLA.

generator, or transporter," they will likely be strictly liable under CERCLA for hazardous waste cleanup costs.[8]

Allowability Limitations

In your letter you express concern that taxpayers may be paying for cleanup attributable to a government contractor's improper waste disposal practices, expenses that you suggest should be borne by the polluter.

There are, at present, no specific provisions in either (1) CERCLA; (2) 10 U.S.C. § 2324, "Allowable costs under defense contracts"; (3) the Federal Acquisition Regulation (FAR) part on contract cost principles and procedures; or (4) the Defense Federal Acquisition Regulation Supplement, governing the allowability of costs incurred by a government contractor in complying with various laws and regulations for protection or cleanup of the environment. Consequently, if the contract contains cost reimbursement provisions[9], a contractor may, as a matter of accounting practice, treat allocable portions of CERCLA cleanup costs as "ordinary and necessary business overhead" expenses, which would be reimbursable if otherwise "allowable" under federal procurement regulations.

As a general matter, a cost is allowable if it meets the criteria for each of the factors set out in FAR § 31.201-2: (1) reasonableness, (2) allocability, (3) compliance with cost accounting standards, (4) compliance with contract terms, and (5) meet any other specific FAR limitations.[10] Particularly relevant to the allowability of environmental cleanup costs are the provisions relating to fines and penalties. The FAR, restating a limitation in 10 U.S.C.

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[8]See Margaret O. Steinbeck, "Liability of Defense Contractors for Hazardous Waste Cleanup Costs," 125 Mil. L. Rev. 55 (1989).

[9]In a cost-reimbursement contract, the contractor is paid for "allowable costs" but is not paid for "unallowable costs." These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without the approval of the contracting officer. Thus, even if a cost is allowable, a limitation-of-cost clause may prevent the contractor from getting reimbursed.

[10]In addition, CERCLA cleanup costs that are accounted for as "ordinary and necessary business overhead" presumably result in increased prices for a contractor's nongovernmental customers as well as for the government.

§ 2324(e)(1)(D), provides that costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, federal, state, or local laws and regulations are unallowable, except when incurred as a result of contract compliance or written instructions from the contracting officer. FAR § 31.205-15. Environmental Protection Agency consent decrees defining the scope of a contractor's CERCLA liability may state specifically that the payment "is not a penalty or monetary sanction." Because liability under CERCLA depends on whether a contractor fits the descriptions in 42 U.S.C. § 9607(a) relating to owners, operators, and transporters or generators of hazardous waste rather than on a determination that the contractor has violated a federal, state or local law, it is questionable whether CERCLA cleanup costs could be disallowed on the ground that they are fines or penalties.

CERCLA cleanup costs included as overhead in a cost reimbursement contract must also be reasonable in order to be allowable. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in conducting a competitive business. FAR § 31.201-3. In addition to whether the cost is of the type generally recognized as ordinary and necessary for the conduct of the contractor's business, reasonableness considerations include determinations of compliance with federal and state laws and regulations and the contractor's responsibilities to the government and the public at large. FAR § 31.201-3(b). In any event, reasonableness determinations are necessarily made on a case-by-case basis and include consideration of all the facts and circumstances surrounding the environmental cleanup. We expect that our continuing work in response to your request will address how agencies have treated the contractor's actions in determining whether to allow CERCLA cleanup costs.

Sincerely yours,

James F. Hinchman
General Counsel