



Chapter 12: Environmental Funding



CHAPTER 12

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CHAPTER 12

ENVIRONMENTAL FUNDING ISSUES

I. INTRODUCTION.

- A. Cost Issues. Cost issues involve the “allowability” of a contractor’s environmental costs. The government reimburses contractors for “allowable” costs but does not reimburse contractors for “unallowable” costs.
- B. Funding Issues. Funding issues involve the means by which a federal agency will pay its environmental costs. These issues raise various fiscal law questions, such as whether an appropriation is being used for a proper purpose to satisfy a bona fide need of its period of availability.

II. COST ISSUES IN ENVIRONMENTAL CONTRACTING.

- A. Overview. Department of Defense (DOD) contractors annually spend millions of dollars to comply with Federal and State environmental laws, and these costs are likely to increase. Contractors will often attempt to charge these costs to their government contracts. This section will focus on the allowability of contractors’ environmental costs.
 - 1. Indirect Costs.
 - a. Costs not directly identified with any particular contract but instead included in the contractor’s overhead or general and administrative (G & A) pools will often be charged to government contracts as indirect costs. FAR 31.203. Cleanup costs will generally be treated as indirect costs.
 - b. To be allocable to a government contract, indirect environmental cleanup costs must either benefit that contract and other contracts or must be necessary to the overall operation of the contractor’s business. FAR 31.201-4.

- c. Remediation of environmental problems created under prior contracts generally will not confer any benefit on current contracts and would, therefore, only be allocable if necessary to “the overall operation” of the contractor’s business. FAR 31.201-4.
 - d. Costs incurred in one accounting period are not allocable to contracts in a different accounting period. Thus, contractors cannot allocate their environmental cleanup costs to government contracts in the current accounting period if those costs were incurred in a prior accounting period. Cost Accounting Standard (CAS) 410.40(b)(1).
 - 2. Direct Costs. Costs (allowable and reasonable) arising under a government contract may be charged completely to that contract. If the costs of compliance, or pollution avoidance, relate only to the requirements of one contract, those costs will generally be charged directly to the contract under which the costs arose.
 - B. Reasonableness and Allocability Generally. An incurred cost, either direct or indirect, must be reasonable, allocable to the contract, measured in accordance with accounting standards, and not specifically disallowed by the contract or the FAR.
 - 1. Reasonable Costs. FAR 31.201-3. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of a competitive business. FAR 31.201-3. The mere fact that a contractor incurs a cost does not create a presumption of reasonableness. FAR 31.201-3(a). But see Bruce Constr. Corp. v. United States, 324 F.2d 516 (Ct.Cl. 1963).
 - a. Factors affecting reasonableness.
 - (1) Generally recognized as ordinary and necessary.
 - (2) Generally accepted sound business practices, arms length bargaining, Federal, State, and local regulations.
 - (3) The contractor’s responsibilities to the government, its other customers, its owners, and the public.

(4) Significant deviations from established practices.

2. Allocable To The Contract.

- a. A cost is allocable if incurred specifically for the contract; or
- b. The cost benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- c. Is necessary for the overall operation of the business.

3. Proper Accounting Standards. Contractors must measure their costs by any generally accepted cost accounting method that is equitably and consistently applied, FAR 31.201-1, and in accordance with the CAS (if applicable). For example, treat costs of a “similar” nature in the same manner. CAS 401; CAS 402; FAR 31.202; FMC v. United States, 853 F.2d 882 (Fed. Cir. 1988).

4. Contract or regulation must not specifically disallow the cost. FAR 31.205 sets forth the cost principles applicable to government contracts.

C. Environmental Costs. There are essentially two types of environmental costs that a contractor may incur: compliance costs and cleanup costs. Compliance costs are costs incurred to avoid harm to the environment and comply with environmental statutes and regulations. Cleanup costs are costs incurred to remedy past environmental contamination.

D. Allowability of a Contractor’s Environmental Compliance Costs. The contractor’s costs of complying with environmental laws in its current operations, if reasonable, will generally be allowable, either as direct or indirect costs.

E. Allowability of a Contractor's Environmental Cleanup Costs.

1. Contractors may incur cleanup costs in response to an environmental agency's determination that the contractor's operations have violated Federal or State environmental laws or as the result of an independent management decision to investigate and correct environmental problems to forestall an agency finding of non-compliance.
2. Determining allowability of these costs is complicated but cleanup costs will generally be unallowable if contractor wrongdoing resulted in the contamination requiring cleanup.
3. Since a contractor's cleanup obligations may be based on strict liability, e.g., 42 U.S.C. § 9607(a), a contractor may be responsible for remediation costs as a principally responsible party (PRP) and yet still be entitled to reimbursement for these costs if such costs are otherwise reasonable. See e.g., Cadillac Fairview/California Inc. v. Dow Chemical Co., 299 F.3d 1019 (9th. Cir. 2002) (denying the government's contention that it should not be held liable for reimbursement of cleanup costs along with other responsible parties because: (1) the government had control over the rubber-producing facility causing the contamination; (2) the government made a management decision to forego prevention methods in lieu of WWII production needs; and (3) contract included a "held harmless" clause.
4. Waiver. If a contracting officer knows that the contractor is incurring environmental cleanup costs, the contracting officer should ensure that the contractor is not led to believe that the agency considers these costs allowable. Generally, the government cannot retroactively disallow costs that the government acquiesced in or approved. General Dynamics Corp., ASBCA No. 31359, 92-1 BCA ¶ 24,698; Litton Sys., Inc. v. United States, 449 F.2d 392 (Ct.Cl. 1971).

F. Guidance.

1. On 14 October 1992, the Defense Contract Audit Agency (DCAA) issued guidance that states "environmental costs are normal costs of doing business and are generally allowable if reasonable and allocable." DCAA Letter, "*Audit Guidance on the Allowability of Environmental Costs*," (14 October 1992).

- a. The DCAA Guidance provides for the disallowance of “unreasonable” costs and explains that environmental costs are unreasonable if the contractor could have avoided the contamination that is generating the costs.
 - b. In order to be allowable under the Guidance, the contamination must have occurred despite the contractor’s due care to avoid the contamination, and despite the contractor’s compliance with applicable law.
 - c. Since it is unreasonable for a contractor to allow contamination to continue once it becomes aware of the problem, increased costs due to contractor delay in taking action after discovery of the contamination are not allowable.
2. On 13 April 1994, the DCAA and the Defense Contract Management Command (DCMC) jointly addressed questions arising from guidance issued by DCAA on 14 October 1992. The DCAA/DCMC Guidance states, *inter alia*, that:
- a. An environmental violation, which would render associated costs unallowable, may be established without a formal citation by a government agency.
 - b. Contractors should “expense” costs to remediate property which was not contaminated when acquired by the contractor, but costs to remediate property that was contaminated when acquired by the contractor should be capitalized as an improvement, rather than expensed in a single accounting period. Applying the guidance provided by CAS 404, environmental cleanup costs that increase the value of the contractor’s real property should be capitalized and should not be directly charged to one contract.
 - c. If a contractor incurs costs as a PRP and cannot collect from another PRP because that PRP no longer exists, such costs are not “bad debts,” and therefore allowable under FAR 32.205-3.

- G. **Fines and Penalties.** Fines and penalties resulting from violations of, or failure of the contractor to comply with federal, state, local, or foreign laws and regulations, are unallowable except when incurred as a result of compliance with specific terms and conditions of the contract or the written instructions of the contracting officer. 10 U.S.C. § 2324(e); FAR 31.205-15.
- H. **Effects of Reimbursement.** Government reimbursement of a contractor's cleanup costs has several undesirable effects:
1. Cleanup obligations imposed by one government agency (e.g., the EPA) upon a private concern (the contractor) are, at least, partially paid for by another government agency (the contracting agency);
 2. The contracting agency will generally pay the contractor a profit on its cleanup costs since these costs are types of indirect costs on which the government pays a profit or fee;
 3. After the government has subsidized at least part of the contractor's cleanup effort, the contractor may sell its environmentally sound property at a profit with no obligation to repay the government for its contribution to the cleanup effort.
- I. **Specifically Allowable Costs.** Independent research and development (IR&D) and bid and proposal (B&P) costs are allowable to the extent they are incurred for "projects that are of potential interest to DOD." DFARS 231.205-18. This includes IR&D/B&P costs incurred to develop efficient technologies for environmental data gathering, environmental cleanup and restoration, pollution reduction in manufacturing, environmental conservation, and environmentally safe management of facilities. DFARS 231.205-18.
- J. **DOD Reporting Requirement.** The Secretary of Defense must submit a report to Congress each year, not later than 30 days after the date on which the President submits the budget to Congress summarizing the payments made to DOD contractors for the costs of environmental response actions. 10 U.S.C. § 2706.

III. FUNDING ISSUES.

- A. General Sources of Funding. Compliance with mandated environmental standards is integral to the operation and maintenance of military installations. Consequently, an installation will use Operations and Maintenance (O&M) funds to dispose of and treat wastes generated by the installation. AR 200-1, para. 6-15; AFI 32-7001
- B. Environmental Restoration Accounts.
1. Generally. In FY 1984, Congress established the Defense Environmental Restoration Account (DERA) by consolidating funds from various military service accounts into one DOD account. The DERA fund manager transferred funds from the central DOD account to any appropriations account, e.g., O&M, Procurement, MILCON, or RDT&E. Once transferred to a particular appropriation, the funds were merged with the receiving account and were available for the same purposes and for the same time period as the receiving account. 10 U.S.C. § 2703(b); AFI 32-7001, para. 2.2.4.; DFAS-IN 37-1. On 23 September 1996, Congress abolished DERA and reestablished individual accounts for the Army, Navy, Air Force, and DOD.¹
 2. Each year Congress appropriates an amount to each environmental restoration account.
 3. Funds transferred from the individual environmental restoration accounts may only be used for environmental restoration. Use of these funds for an unauthorized purpose violates the “purpose statute.” 31 U.S.C. § 1301.
 4. These funds are available for a variety of restoration projects and are available until expended (see 10 U.S.C. § 2703(b)).
 5. Amounts Credited to the Account. Certain funds may be credited to the appropriate environmental restoration account:

¹ National Defense Authorization Act for Fiscal Year 1997, Pub. L. No. 104-201, §322, 110 Stat. 2422 (1996)(amending 10 U.S.C. § 2703; any reference to DERA in any Federal law, Executive Order, regulation, delegation of authority, or document shall be deemed to refer to the appropriate (military service or DOD) environmental restoration account).

- a. Amounts recovered under CERCLA² for response actions.
 - b. Any other amounts recovered from a contractor, insurer, surety, or other person to reimburse DOD or military department for any expenditure for environmental response activities.
6. None of the funds appropriated to DERA for FYs 1995 - 1999 or to any individual restoration account for FY 1997 - 1999 may be used for the payment of a fine or penalty imposed against DOD, unless the act or omission for which the fine or penalty is imposed arises out of activities funded by the account. 10 U.S.C. § 2703(e).
- C. Environmental Remediation Services. Effective 22 July 2003, the DOD issued an interim rule permitting DOD agencies to enter into multiyear contracts for environmental remediation services for military installations. (Defense Federal Acquisition Regulation Supplement; Multiyear Procurement Authority for Environmental Services for Military Installations, 68 Fed. Reg. 43,332 (July 22, 2003) (codified at 48 C.F.R. pt. 217). Section 827 of the National Defense Authorization Act for Fiscal Year 2003 amended current laws to add environmental remediation services for military installations to the list of services eligible to utilize multiyear contracting methods. (Pub. L. No. 107-314, 116 Stat. 2458, 2617 (2002) (amending 10 U.S.C. 2306c (2000)).
- D. Paying Environmental Judgments. The permanent indefinite Judgment Fund may be used to pay “litigative” awards obtained against federal agencies to reimburse claimants for the agencies’ share of response costs and natural resource damages paid or payable by CERCLA claimants. Matter of the Judgment Fund, B-253179, 73 Comp. Gen. 46 (1993). Before an agency may use this fund to pay an award, GAO must certify:
1. The award is final;
 2. The award provides monetary instead of injunctive relief;
 3. The award is made under one of the authorities specified in 31 U.S.C. § 1304(a)(3) (e.g., judgments of district courts and the Court of Federal Claims, and compromise settlements made by DOJ); and

² Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§ 9601 to 9675.

4. Payment of the award is not otherwise provided for.
- E. Specific Statutory Spending Authority. Congress will often fund environmental initiatives with specific sums.
1. To implement the requirements of the Noise Control Act of 1972, 42 U.S.C. § 4901, Congress funded the additional cost of low-noise products through supplemental appropriations until the end of fiscal year 1977.
 2. The obligation to purchase alternative fueled vehicles is subject to the availability of funds and life-cycle cost considerations. Exec. Order 12844, sec. 2. However, the Order also requires the Secretary of Energy to provide assistance to other agencies that acquire alternative fuel vehicles, including payment of the incremental cost of acquiring such vehicles and the incremental costs associated with their acquisition and disposal. Exec. Order 12844, sec. 3.
 3. DOD installations with qualifying recycling programs may retain a share of the proceeds from the sale of materials recovered through recycling or waste prevention programs. Exec. Order 12873, sec. 703; AR 200-1, para. 6-14.
- F. Specific Funding Limitations.
1. Each agency must implement paper conservation techniques so that total annual expenditures for recycled content printing and writing paper do not exceed current annual budgets for paper products. Exec. Order 12873, Section 504(2).

2. The FY 1995 DOD MILCON Appropriations Act prohibits expenditure of MILCON funds under cost plus fixed fee (CPFF) construction contracts over \$25,000 without “the specific approval in writing of the Secretary of Defense.” Pub. L. 103-307, § 101, 108 Stat. 1659 (1994).³ Although the BRAC account is under the MILCON Appropriations Act, agencies were using CPFF contracts for BRAC contracts without obtaining the required approval. The DOD Principal Deputy Comptroller considers this practice a violation of the Antideficiency Act. Memorandum, Principal Deputy Comptroller, Dept of Defense, subject: Cost-Plus-A-Fixed-Fee (CPFF) Contracts Funded With BRAC Appropriations (Apr. 7, 1994).
 - a. The Secretary of the Army has delegated the authority to approve MILCON funded BRAC contracts to Heads of Contracting Activities. Secretary of the Army Letter, SARDA 94-5, subject: Delegation of Authority to Approve Certain Cost Contracts Funded With Military Construction Appropriations (June 30, 1994). This authority may be redelegated to a level no lower than the chief of the contracting office.
 - b. The Secretary of the Air Force has granted blanket authority to obligate and expend BRAC appropriations through CPFF contracts awarded to support Air Force environmental and compliance actions. Secretary of the Air Force Letter, subject: Expenditure of Base Realignment and Closure (BRAC) Funds Under Cost Plus Fixed Fee (CPFF) Contracts for Environmental Remediation Projects (May 26, 1994).
 - c. On 8 January 1997, DFARS 216.306 was amended to implement Section 101 of Fiscal Year 1997 Military Construction Appropriations Act (Public Law 104-196). Section 101 continues to restrict the use of CPFF contracts for military construction, but provides an exception for contracts for environmental restoration at installations that are being closed or realigned where payments are made from a BRAC Account.

G. Funding Requirements Unique to Federal Agencies. The House Report preceding the National Defense Authorization Act for Fiscal Years 1990-1991 stated:

³ Prior MILCON Acts included substantially the same restriction. See, e.g., Military Construction Appropriations Act of 1994, Pub. L. 103-110, § 101, 107 Stat. 1037, 1041 (1993).

1. The statutory enforcement strategy does not take into account the national security mission of the DOD installation being regulated. Attempting to treat a major military installation without considering its missions and mode of operation could result in regulatory decisions that are not in the national interest.
2. A cost-is-no-object criterion may make sense for private parties that generally operate in one state or region, but is unrealistic for an agency that operates in every state and depends entirely on federal funding. H.R. 2461, 101st Cong., 1st Sess., p. 863 (1989).

H. Fines and Penalties.

1. Operation and Maintenance Funds.
2. Judgment Fund.
3. ERA Accounts.

IV. PROBLEM AREAS.

- A. Identifying Cleanup Sites. *See* GEN. ACCT. OFF. REP. NO. GAO-02-423, *Environmental Cleanup: Better Communication Needed for Dealing with Formerly Used Defense Sites in Guam*, (Apr. 11, 2002) (recommending several measures to improve coordination between EPA Regulators and Army officials on Guam regarding contamination on formerly used defense sites). *See also* GEN. ACCT. OFF. REP. NO. GAO-02-658, *Environmental Contamination: Corps Needs to Reassess Its Determinations That Many Former Defense Sites Do Not Need Cleanup*, (Aug. 23, 2002) (concluding that the Corps of Engineers did “not have a sound basis for determining that about 38 percent, or 1,468 of 3,840 formerly used defense sites do not need further study or cleanup action.”).

- B. Identifying Cleanup Costs. *See* GEN. ACCT. OFF. REP. NO. GAO-02-103, *Defense Environmental Issues: Improved Guidance Needed for Reporting on Recovered Cleanup Costs*, (Oct. 26, 2001) (citing a lack of DOD guidance as the cause of inflated, incorrect and varied recovery costs). *See also* GEN. ACCT. OFF. REP. NO. GAO 02-117, *Environmental Liabilities: Cleanup Costs From Certain DOD Operations Are Not Being Reported*. (Dec. 14, 2001) (citing incomplete property and installation record data from which to accurately calculate future cleanup costs).

V. CONCLUSION.