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Contractors Should Be Accountable for Environmental Performance

Statement of
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Before the
Transportation and Hazardous Materials Subcommittee
Committee on Energy and Commerce
House of Representatives

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to present our views on the Departments of Energy (DOE) and Defense (DOD) policies and practices regarding (1) payment of contractor Resource Conservation and Recovery Act (RCRA) penalties, settlement payments, and associated legal costs and (2) reductions of contractor award fees for noncompliance with environmental regulations. My testimony today is primarily based on our October 30, 1989 report,[1] prepared at the joint request of you, as Chairman of this Subcommittee; Representative Dingell, as Chairman of the Subcommittee on Oversight and Investigations; and Representative Wyden.

Mr. Chairman, holding contractors accountable for their environmental performance plays an important role in helping to ensure compliance with our hazardous waste laws at federal facilities. Our work has shown, however, that

-- DOE's and DOD's policies and practices regarding paying contractors' RCRA penalties, settlement payments, and related legal costs are significantly different. Although both DOE and DOD contractors have been charged with nearly identical RCRA violations, DOE does not hold its contractors financially accountable for these charged violations while DOD does. DOE's policy and practice is to

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[1]Hazardous Waste: Contractors Should Be Accountable for Environmental Performance (GAO/RCED-90-23, Oct. 30, 1989).

pay for all contractor RCRA penalties, settlement payments, and related legal costs unless the costs were incurred for intentional misconduct on the part of the contractors' top management. In contrast, DOD requires its contractors to pay costs resulting from charged RCRA violations unless the contractors can demonstrate that these costs resulted from circumstances beyond the contractors' control. Although legally permissible, we believe DOE's current policy and practice reduces contractors' accountability and incentives to comply with RCRA.

-- Although both agencies consider contractors' environmental performance in the award-fee process to varying degrees, neither DOE's nor DOD's regulations require such consideration. In most of the cases we reviewed, the contractors received satisfactory or better ratings for environmental performance and the majority of the available award fees, even though the Environmental Protection Agency (EPA) and the states had repeatedly charged the contractors with RCRA violations. We believe that without regulations requiring DOE and DOD consideration of environmental performance, there is no assurance that environmental performance will be considered in future award-fee determinations, and an opportunity may be lost to provide contractors with additional incentives to comply with environmental laws and regulations.

BACKGROUND

The Congress, the courts, EPA, and the states have long recognized that penalties are an important mechanism to enforce the law. The primary purpose of a penalty is to deter the violator from noncompliance and to convince others that they should comply. Recognizing the important role penalties play in compliance, the Congress provided for administrative, civil, and criminal penalties against violators of RCRA. These penalties can range from $25,000 per day of noncompliance up to $1,000,000 for criminal acts. Facility owners or operators charged with RCRA violations and penalties may resolve these enforcement actions by entering into settlement agreements with EPA or the state. These agreements are intended to remedy problems identified at the facility.

Although federal regulations generally do not allow agencies to pay their contractors' penalties and related legal costs, the regulations provide for several exceptions that do allow such payments. Further, the regulations do not specifically address agencies' payment of contractors' settlement payments. H.R. 2597 was introduced on June 8, 1989, which if enacted would, among other things, preclude federal agencies from paying penalties, settlement payments, and legal costs that contractors incurred for RCRA violations. The bill provides for an exception if the violation occurred through no fault of the contractor. The bill would allow

agency payment of these contractor costs only if the contractor could not correct the violation without agency authorization or funding, the contractor timely notified the agency of the conditions that caused the violation, and the agency did not provide the needed authorization or funding. As you know, the bill is currently pending before this subcommittee.

Award-fee contracts can also provide incentives for contractors to comply with RCRA and other environmental laws. Award-fee contracts are used when an agency determines that the likelihood of meeting the contract's objectives will be enhanced by motivating the contractor toward exceptional performance by financially rewarding success through payment of award fees. These contracts provide contractors payment of (1) incurred costs, (2) a base fee fixed at inception of the contract, and (3) an award amount that the contractor may earn in whole or in part. The amount of the award fee to be paid is determined by the contracting agency's judgment about the contractor's performance in evaluation areas specified in the contract. The number and types of evaluation areas differ among contracts but are frequently geared towards the contractors' output such as production, cost reduction, and delivery time.

PAYMENT OF CONTRACTORS' RCRA PENALTIES, SETTLEMENT PAYMENTS, AND RELATED LEGAL COSTS

DOE's Policy and Practice

DOE's policy is to pay for virtually all contractor penalties, settlement payments, and related legal costs. DOE traces this policy back to the World War II relationship developed between government, industry, and academic organizations where the three groups worked together under emergency conditions to develop the atomic bomb. According to DOE, because this project was at the frontier of scientific and technological knowledge and involved formidable risks, only the compelling needs of the war, coupled with government protection of the contractor from financial liability, could induce even the largest of corporations to accept a role. This relationship and the principle of shielding contractors from financial liability continued through the war to the present day and is reflected in DOE procurement regulations and contract terms.

DOE's regulations state that "It is DOE policy to reimburse . . . contractors for fines and penalties that are incurred in the performance of their contracts" unless they were incurred as a "result of the willful misconduct or lack of good faith on the part of the contractor's corporate officers, directors or supervising representatives." According to a DOE procurement attorney, this

language means that DOE will pay its contractors' penalties in virtually all circumstances and would only withhold such payment if the contractors' top management engaged in behavior worse than "gross negligence," such as fraud or theft. DOE's regulations also provide for agency payment of contractors' settlement payments and legal costs.[2]

We found that DOE's practice is consistent with its policy. Since 1983, EPA and the states have assessed penalties in six cases against DOE contractors for charged RCRA violations. Of these six cases, two were resolved through settlement agreements and four are being contested by the contractors and remain unresolved. In the two resolved cases, states assessed $295,000 in penalties against the contractors for charges of RCRA violations.[3] DOE has paid in full both of these assessments as well as about $529,000 for RCRA-related contractor legal costs.

In both of these settled cases, while the contractors and/or DOE agreed to remedy the identified problems, the contractors did not admit wrongdoing, and the payments made under the settlement agreements were classified as administrative or settlement costs rather than penalties. The payments in both cases resolved charges

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[2]According to a DOE procurement attorney, DOE is placing greater restrictions on payment of contractors' legal costs, as required by the Major Fraud Act.

[3]In one of these cases, the assessed amount was also for charges of violations of other environmental laws, and the amount related to RCRA violations was not specified in enforcement documents.

of operational violations, including failure to obtain required permits, improper storage of hazardous wastes, and inadequate waste analysis plans.

In the four unresolved cases, EPA and the states assessed contractor penalties for RCRA violations, totaling about $367,000. According to DOE procurement and field officials, absent the finding of willful misconduct or lack of good faith on the part of its contractors' top management, DOE plans to pay any resulting contractor penalties or settlement payments following resolution of these cases.

DOD's Policy and Practice

Unlike DOE, DOD's policy and practice is to not pay penalties, settlement payments, or related legal costs for RCRA violations charged against its contractors that operate DOD facilities. DOD's policy is based on the federal procurement regulations' restrictions on paying such contractor costs and on the premise that contractors should be aware of their RCRA compliance responsibilities and should therefore be financially responsible for violations that occur during the normal day-to-day management of its facilities. According to DOD procurement and legal officials, DOD would make exceptions to this policy only in cases where a contractor received a penalty (or incurred settlement and/or legal costs) for a violation for which it was not

responsible. For example, if a contractor notified DOD of a compliance problem that could only be resolved with DOD's assistance and DOD did not provide the needed assistance, DOD would pay any resulting penalties or settlement payments.

We found that DOD's practice has, in fact, been consistent with its policy. Since 1983, EPA and the states have assessed penalties in nine cases against DOD contractors for charges of RCRA violations. Of these nine cases, six were resolved through settlement agreements and the remaining three are being contested by the contractors and remain unresolved. In the six resolved cases, EPA and the states assessed the contractors about $1.5 million in penalties for violations nearly identical to those charged against DOE contractors, such as failure to install a groundwater monitoring system and improper marking and storage of hazardous waste containers. Of this amount, the contractors paid about $900,000, although they did not admit to wrongdoing. The remaining $600,000 would only be paid if the contractor did not meet the terms of the settlement agreement. In each of the six resolved cases, DOD did not pay any of the contractors' penalties, settlement payments, or related legal costs.

IMPACT OF ENVIRONMENTAL PERFORMANCE ON AWARD FEES

While neither DOE nor DOD regulations require consideration of contractors' environmental performance in determining award

fees, based on the eight award-fee determinations we reviewed, both agencies considered such performance to varying degrees. We reviewed award-fee determinations for the one DOD and three DOE contractors that had enforcement actions taken against them for repeated RCRA violations. The charged violations and enforcement actions for the three DOE contractors spanned seven award-fee determinations covering the periods from April 1, 1984, through September 30, 1988. The charged violations and enforcement action for the DOD contractor occurred during the award-fee determination covering the period January 1, 1988, through December 31, 1988.

Although all four DOE and DOD contractors were charged with repeated RCRA violations, in six of the determinations (five of which were for DOE contractors and one for a DOD contractor), the contractors' environmental performances were rated satisfactory or better.[4] Because the contractors also received satisfactory or better ratings in the other evaluation areas--such as production, cost, and quality--their overall performances were rated as exceeding expectations and the contractors received the majority of the available award fees--ranging from 55 to 91 percent--in addition to incurred costs and base fees. In the remaining two determinations we reviewed, the DOE contractor's entire award fee

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[4]One of the six determinations did not use adjective ratings. In this case, the contractor received a rating of 86 (on a scale of 0-100) for the evaluation area in which environmental performance was considered.

was withheld, primarily because of unsatisfactory environmental performance.

One of the DOE award-fee contractors that received the majority of the available award fee was charged with seven RCRA violations, including failure to maintain accurate records, an inadequate waste analysis plan, and improper marking of hazardous waste containers. Although the evaluation covering this period noted problems in the contractor's RCRA program, it stated that the contractor's initiatives in this area "appear to be responsive to the needs of the plant." Despite the charged RCRA violations and other documented environmental deficiencies, the contractor received a "good" rating in the evaluation area in which environmental performance was considered. Because the contractor received the same or higher ratings in the remaining evaluation areas, its overall performance was rated as exceeding expectations and the contractor received 77 percent of the available award fee.

This is not the first time we have identified this problem. Problems with DOE's award-fee process were also disclosed in another recently-issued GAO report.[5] That report disclosed that DOE downplayed significant environment, safety, and health problems in the award-fee evaluation process and placed more emphasis on production than environmental, safety, and health performance. The

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[5]Nuclear Health and Safety: DOE's Award Fees at Rocky Flats Do Not Adequately Reflect ES&H Problems (GAO/RCED-90-47, October 23, 1989).

report recommended, among other things, that the Secretary of Energy (1) ensure that there is a reasonable balance between production and environmental, safety, and health performance in the award-fee process and (2) restructure the award-fee process to reduce the level of discretion exercised in making award-fee determinations.

A simultaneously-issued GAO report disclosed that during fiscal years 1987 and 1988, contractors at six DOE facilities were paid annual award fees that ranged from about $1.4 million to nearly $10 million and that represented about 47 to 89 percent of the total amount available to them. In addition, the weight given to environment, safety, and health performance in the overall scoring process varied greatly, with such performance not considered as a distinct evaluation area in some award-fee determinations.[6] On October 24, 1989, GAO testified on these reports before the Environment, Energy, and Natural Resources Subcommittee, House Committee on Government Operations.[7]

As you know, in June 1989, the Secretary of Energy announced a 10-point initiative aimed at improving DOE's accountability in the areas of environment, safety, and health. One of these initiatives

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[6]Nuclear Health and Safety: Information on Award Fees Paid at Selected DOE Facilities (GAO/RCED-90-60FS, October 23, 1989).

[7]DOE's Award Fees at Rocky Flats Do Not Adequately Reflect Environmental, Safety, and Health Problems (GAO/T-RCED-90-7, October 24, 1989).

will, among other things, modify the criteria for award fees so that at least 51 percent of the available award fee will be based on compliance with environmental, safety, and health requirements. To date, however, DOE has not promulgated this change in its regulations.

CONCLUSIONS AND RECOMMENDATIONS

In summary, Mr. Chairman, penalties and award fees are both valuable tools to increase contractor accountability and incentives to comply with environmental requirements. We believe that DOE's policy and practice of paying its contractors' penalties, settlement payments, and legal costs reduce contractors' accountability and compliance incentives. In addition, neither DOE nor DOD have fully used the award-fee processes' potential to improve environmental compliance at contractor-operated facilities. Without such accountability, the federal government does not serve as the role model for the private sector in complying with environmental protection requirements.

To ensure that DOE's contractors are held accountable for charged RCRA violations and resulting costs, we recommended in our October 30, 1989, report that the Secretary of Energy, in consultation with appropriate congressional oversight committees, initiate a rulemaking to revise DOE's current policy and practice for paying penalties, settlement payments, and legal costs incurred by its contractors. Recognizing that there may be limited circumstances warranting such payments, the revised policy should

include criteria that detail when such payments should or should not be allowed. As previously discussed, H.R. 2597 if enacted, would restrict agencies' payment of contractors' RCRA penalties, settlement payments, and related legal costs and includes criteria specifying when such payments could be allowed. We believe that enactment of H.R. 2597 would go a long way in holding contractors accountable for charged RCRA violations.

As a first step in helping to maximize award-fee contractors' incentives to comply with environmental laws and regulations, we recommended in our October 30, 1989 report that the Secretaries of Energy and Defense initiate a rulemaking to revise DOE and DOD regulations to require all award-fee contracts to include environmental performance as a distinct evaluation area. While the Secretary of Energy's award-fee initiative is a step in the right direction, we believe that this recommendation, together with the DOE award-fee recommendations previously discussed, would help ensure that contractors' environmental performance is adequately considered in all future award-fee determinations.

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Mr. Chairman, this concludes my testimony. We would be happy to answer any questions at this time.

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