United States General Accounting Office

GAO

Report to the Congress

September 1989

SUPERFUND

Contractors Are Being Too Liberally Indemnified by the Government

GAO/RCED-89-160

GAO
United States
General Accounting Office
Washington, D.C. 20548

**Comptroller General
of the United States**

B-231219

September 26, 1989

To the President of the Senate and the
Speaker of the House of Representatives

During the 1985-86 Superfund reauthorization process in the Congress, concerns were raised about possible delays to Superfund if contractors were unable to obtain pollution insurance for their Superfund cleanup activities. The Superfund Amendments and Reauthorization Act of 1986 authorized a discretionary program to provide federal indemnification to Superfund contractors to ensure their continued participation. The act also directed that we study the application of that program. This report presents the results of our review by discussing

- the extent to which indemnification agreements are being used and claims against these agreements,
- the need for indemnification, and
- the program's compliance with the law and aspects of its management.

Copies of this report are being sent to appropriate House and Senate Committees; the Administrator, Environmental Protection Agency; and other interested parties. Copies will also be made available to others upon request.

This report was performed under the direction of Richard L. Hembra, Director, Environmental Protection Issues, Resources, Community, and Economic Development Division. Other major contributors are listed in appendix V.

Charles A. Bowsher
Comptroller General
of the United States

Executive Summary

Purpose

Superfund contractors who clean up the nation's worst hazardous waste sites risk being sued for injury or damage caused by cleanup activities. As the Congress deliberated the Superfund Amendments and Reauthorization Act of 1986 (SARA), liability insurance for these activities was virtually nonexistent. To ensure that lack of insurance would not discourage contractors from working in Superfund, SARA authorized the government to indemnify Superfund contractors against liabilities caused by negligence.

SARA required GAO to study the indemnification program, including use of indemnification agreements, claims against such agreements, and the need for indemnification. GAO also reviewed the program's compliance with the law and aspects of program management.

Background

The government may, in limited situations, indemnify contractors that provide essential products or services involving high risk. Superfund cleanup can involve high risk and is done by contractors working for the Environmental Protection Agency (EPA), which manages the Superfund program; other federal agencies; state governments to whom EPA has delegated authority; or private parties responsible for causing the contamination. SARA section 119 provides the government discretionary authority to indemnify these contractors.

EPA is responsible for issuing guidelines for section 119 and for granting indemnification to contractors working for EPA, states, and responsible parties. Currently authorized at $10.1 billion, Superfund backs all EPA indemnification agreements. Other federal agencies may use section 119 to indemnify contractors hired to clean up contamination at federal facilities, provided the agencies use their own funds to back the agreements. SARA required that contractors first make diligent efforts to obtain insurance from nonfederal sources and that a limit be set on the amount of government indemnification. EPA set up a task force to develop guidelines for section 119 and issued interim guidance to implement the indemnification program.

Results in Brief

EPA has used SARA section 119 to provide over 1,000 indemnification agreements to Superfund contractors, most of whom work directly for EPA. As of June 1989, no claims had been filed against the agreements.

Evidence indicated that EPA's policy to date of providing blanket indemnification with no set limit to all its Superfund response contractors

results in excessive indemnification and is not in full compliance with the requirements of SARA. Some of the same contractors indemnified by EPA are doing similar work for states and private firms without indemnification. Although insurance for pollution risks remains scarce and limited in coverage, it is not certain that contractors would be unwilling to perform at least some Superfund work for EPA at reasonable prices without indemnification. In fact, EPA believes contractors will work in the Superfund program without indemnification. GAO concluded that EPA should determine, through its procurement process, the minimum indemnification requirements of contractors.

GAO found various compliance and management problems in EPA's section 119 program, including not following the requirements in SARA for determining a contractor's eligibility for indemnification and not setting a limit on the amount of indemnification provided. Unlimited indemnification, provided indiscriminately, may (1) expose the government to potential liabilities that contractors may be willing to assume as a cost of doing business and (2) seriously delay the pace of the Superfund cleanup effort.

Principal Findings

Agreements and Claims Under Section 119

As of June 1989, EPA had provided an estimated 900 indemnification agreements to prime and subcontractors working under its 80 Superfund response contracts; about 90 agreements to prime and subcontractors working for the Corps of Engineers, which helps EPA manage Superfund cleanups; 28 to contractors working for states; and 64 to other parties doing Superfund-related work. No contractors working directly for parties responsible for the contamination have received section 119 indemnification and only one requested it. These contractors would be required to disclose proprietary information and demonstrate that the responsible parties cannot indemnify them.

While no claims have been filed against section 119 agreements, it is premature to make assumptions about the likelihood of future claims. Because pollution incidents are not always detected promptly, many years may pass before claims are brought against an alleged polluter.

Need for Section 119 Indemnification

GAO identified three insurers providing some pollution insurance for cleanup contractors, with limits of coverage up to only $5 million a year and premiums up to one-third the amount of the policy limit. The rest of the insurance industry regards pollution risks as generally uninsurable, believing that an accurate assessment of risk is not possible.

Several contractors told GAO they will not or are reluctant to perform Superfund work without indemnification. However, GAO found that some of these firms do Superfund work for states and responsible parties without indemnification. A 1988 EPA survey of the 50 states found that 8 states have state statutory authority to indemnify contractors while 13 others may require the contractor to indemnify the state. In total, 43 states told EPA they have not had difficulty obtaining cleanup contractor services. Similarly, responsible parties, currently involved in cleaning up about 75 Superfund sites, need not indemnify their response action contractors.

Currently, section 119 indemnification costs a contractor nothing. If indemnification were made an element of competition in the federal contract award process, the marketplace could serve to define the need for indemnification and its appropriate limits.

Compliance and Program Management Problems

SARA requires that indemnification be provided on a discretionary, case-by-case basis after a contractor demonstrates its inability to obtain insurance. In its interim guidance, citing the general unavailability of pollution insurance, EPA did not fully comply with SARA's insurance requirements. Moreover, for reasons EPA officials were not able to explain, EPA did not enforce its interim guidance procedures for granting indemnification. When GAO began this review, EPA was automatically indemnifying all its nearly 900 prime and subcontractors. Because it was not requiring submission of insurance information, there was no incentive for contractors to seek insurance and to stimulate an insurance market for the future. In February 1989, EPA notified its contracting officers that contractors were to comply with SARA's insurance requirements.

Although SARA requires limits on the amount of indemnification provided to contractors, EPA did not set limits. EPA's position is that the appropriated, unobligated amount in Superfund is the implied limit. GAO believes that, in stipulating a need for a limit, the Congress intended some amount other than the entire unobligated fund, which, for example, was $1.3 billion, as of March 1989. By failing to establish limits, EPA is jeopardizing Superfund with unknown potential liabilities.

GAO also found that the contractor EPA uses to provide section 119 policy support appeared to have an organizational conflict of interest because it is a direct beneficiary of this policy through two major indemnified Superfund contracts. At GAO's request, EPA examined the contractor's potentially conflicting roles and told GAO that it restricted the contractor's policy support activities.

Recommendations

GAO is making recommendations to the Administrator, EPA, to limit the potential exposure facing Superfund by (1) placing a dollar limit on new indemnification agreements and attempting to negotiate limits on existing agreements and (2) identifying and testing options for providing indemnification that include incentives making it competitively unattractive to obtain more indemnification than is needed. To encourage development of pollution liability insurance and limit dependence on federal indemnification, GAO is also recommending that the Administrator, EPA, implement management controls to ensure that indemnification agreements are entered into in full compliance with the law.

Agency and Contractor Comments

In comments on a draft of this report (see app. III), EPA concurred that testing contractor indemnification requirements through competitive procurement could be beneficial, but had concerns about its feasibility. EPA's concerns centered on the difficulty of assigning costs to indemnification requests for purposes of evaluating contractor bids. In response, GAO has suggested factors that could be considered in calculating these costs and added procurement options not requiring these calculations.

EPA justified not setting limits on indemnification by referring to a SARA requirement that it allow public comment on its final indemnification regulations. GAO does not believe this requirement precludes the setting of interim limits pending the issuance of final regulations. EPA said it fulfilled SARA's requirements for determining contractor indemnification eligibility by its general finding of insurance unavailability. In GAO's opinion, SARA's requirements were not satisfied by this overall finding.

The contractor that assisted EPA in developing indemnification policy commented that its work was unbiased (see app. IV). In its report, GAO does not charge actual bias in the indemnification work the contractor has done for EPA. GAO's concern is over the potential bias associated with organizational conflicts of interest. Since receiving GAO's draft report, EPA announced plans to adopt a policy to prevent future potential conflicts of interest.

Contents

Abbreviations

AIG	American Insurance Group
ARCS	Alternative Remedial Contract Strategy
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
EPA	Environmental Protection Agency
EPAAR	Environmental Protection Agency Acquisition Regulations
ERCS	Emergency Response Cleanup Services
FAR	Federal Acquisition Regulations
FIT	Field Investigation Team
GAO	General Accounting Office
NPL	national priorities list
OC	Office of the Comptroller
OGC	Office of General Counsel
OSWER	Office of Solid Waste and Emergency Response
PCMD	Procurement and Contracts Management Division
PRC	Planning Research Corporation
PRP	potentially responsible party
RAC	response action contractor
REM	Remedial Planning
SARA	Superfund Amendments and Reauthorization Act
SITE	Superfund Innovative Technology Evaluation
TAT	Technical Assistance Team
TES	Technical Enforcement Support

Introduction

On October 9, 1988, two firms operating under an Environmental Protection Agency (EPA) response action contract at a federal Superfund site in Nitro, West Virginia, successfully conducted a controlled explosion of an unstable cylinder of deadly hydrogen cyanide. According to press accounts, some 3,000 residents who live near the site, which holds among other hazardous chemicals an undetermined number of drums containing phosgene, a component of nerve gas, were temporarily relocated. The incident underscored the extent of risk posed by some hazardous waste sites. Equally important, the successful destruction of the cyanide cylinder demonstrated the critical role played by response action contractors and the potential liabilities involved in cleaning up Superfund sites.

Background

The Superfund program, enacted with the passage of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), gave EPA a broad mandate and a $1.6 billion fund to clean up hazardous sites and to respond to emergency releases of hazardous substances. The 1986 Superfund Amendments and Reauthorization Act (SARA) extended the program for 5 years, provided an additional $8.5 billion, and expanded EPA's responsibilities by, among other things, requiring EPA to seek permanent solutions to site contamination problems rather than temporary measures that could need additional attention later. It also set mandatory schedules for initiating and completing certain steps in the cleanup process and called for increased involvement by state and local governments in site cleanups as well as public participation in cleanup decisions.

EPA evaluates sites where hazardous wastes are or were stored, treated, disposed of, or released to determine whether they meet the criteria for federal cleanup. EPA lists the nation's worst hazardous waste sites—those it identifies as needing priority Superfund cleanup action—on the national priorities list (NPL). As of May 1989, 1,173 sites were on the NPL and EPA was evaluating thousands of other sites for possible listing.[1] The actual cleanup of hazardous waste sites involves developing and implementing remedies to alleviate the dangers posed by the hazardous waste. Superfund resources are used to clean up those hazardous waste sites posing serious threats to human health and the environment, as well as those sites requiring long-term cleanup activities. EPA may use enforcement authorities in SARA to initiate legal actions against responsible parties to recover cleanup costs paid for by Superfund.

[1]The 1,173 sites on the NPL included 890 sites listed in final and 283 sites that have been proposed.

Response Action Contractors Perform a Variety of Superfund Tasks

Response action contractors (RACs) perform a wide range of services essential to Superfund's overall mission of cleaning up hazardous waste sites. While many of these services are conducted for EPA, contractors may provide similar services for other federal agencies and state or local governments as well as potentially responsible parties (PRPs) who have opted to clean up, in accordance with the Superfund law, the pollution they caused.

Contractors working on Superfund assignments are generally involved in one of two types of response actions—removal or remedial. Removal actions are generally short-term, emergency responses taken to address the uncontrolled release or threatened release of hazardous substances. Remedial actions are long-term, more permanent remedies to clean up contaminated sites. Response actions include such removal and remedial activities as evaluation, planning, engineering, surveying and mapping, design, construction, equipment supply, or ancillary services performed in the course of the removal or remediation.

EPA categorizes its Superfund contractors by contract type, determined by the nature of the activities performed under the contract. As of June 2, 1989, EPA had a total of 95 active Superfund contracts with a total potential value of about $8 billion. Most EPA-contracted response actions are carried out under one of the contract types described in table 1.1.

Table 1.1: Types, Number, and Potential Value of EPA Superfund Contracts as of June 2, 1989

Dollars in millions

Type of contract	Number	Total potential value	Activities
Alternative Remedial Contract Strategy (ARCS)	38	$5,481	Oversee site cleanup from initial study to remediation over a period of up to 10 years. Includes site investigations, remedial investigations, feasibility studies, design of remedial and corrective actions, and management of that construction.
Emergency Response Cleanup Services (ERCS)	15	606	Provide equipment, material, and personnel to remove and dispose of hazardous substances. Includes installing perimeter fences, constructing drainage control systems, stabilizing or impounding liquid waste lagoons, capping contaminated soils, and removing hazardous waste containers and/or soil.
Field Investigation Team (FIT)	2	284	Provide pre-remedial investigation activities at hazardous waste sites. Includes (1) establishing priorities for remedial actions at NPL sites, (2) performing preliminary assessments and site inspections to identify problems at sites, (3) supporting enforcement case development, and (4) providing general technical assistance.
Remedial Planning (REM)	4	444	Conduct studies leading to the selection of remedies for NPL sites. Includes remedial investigations and feasibility studies to determine the type and extent of contamination at a given hazardous waste site, engineering design, and construction of small remedial actions. May involve aerial photography, geotechnical consulting, well monitoring, and various types of data management and lab support.
Technical Assistance Team (TAT)	2	219	Provide technical assistance to EPA regional offices for emergency response, removal, and prevention. Includes contingency planning, training, aerial survey and mapping, sample collection, and analytical support.
Technical Enforcement Support (TES)	7	776	Support enforcement activities of EPA's Office of Waste Programs Enforcement and assist EPA regional offices in a variety of Superfund compliance and enforcement tasks. Includes ground water monitoring, enforcement case support, expert witness support, compliance oversight, and endangerment/health assessments.

In addition, EPA had 27 other active Superfund contracts, as of June 2, 1989, totaling about $276 million. These contracts included, among other activities, administrative support, technical policy assistance, and expert witness support for the Superfund program. EPA considers 12 of

these contracts (valued at about $142 million) to be for response activities.

At the time of our review, EPA was revising its approach to Superfund contracting. It was incorporating most Superfund response action work done under REM contracts, which were often large, multi-regional contracts, into the ARCS contracts. EPA began awarding these geographically smaller regional ARCS contracts in January 1988 and had 45 ARCS in place across the country by July 1989.

Indemnification of Superfund Contractors

Products and services provided by certain types of contractors to the federal government may involve high-risk or hazardous activities. The commercial property/casualty insurance industry ordinarily provides liability protection against claims of injury or damage to third parties. In situations in which the availability of insurance is limited for some reason, the federal government has on occasion decided to "hold harmless" and indemnify contractors—agreed to reimburse them for any losses—from liability for damages, provided special conditions are met. Thus, the federal government has provided indemnification to, among others, contractors operating nuclear power facilities for liabilities associated with a nuclear release (under the Price-Anderson provisions of the Atomic Energy Act of 1954), as well as those involved in the launch, operation, and recovery of federally owned space vehicles for liabilities associated with a launch (under the National Aeronautics and Space Act of 1958 as amended).

Pre-SARA Indemnification

Prior to SARA, Superfund response action contractors relied on commercial liability insurance together with indemnification to offset their liability risks. From the enactment of Superfund in 1980 to its reauthorization in 1986, EPA used its general contract authority to provide indemnification to contractors.[2] EPA would indemnify the contractor against claims to the extent that the claims could not be otherwise compensated by insurance or self-insurance. Under these agreements, EPA provided unlimited indemnification to the contractors above the first $1

[2]Indemnification clauses in Superfund contracts during this period generally followed guidelines provided by Federal Acquisition Regulation (FAR) 52.228-7 or Environmental Protection Agency Acquisition Regulation (EPAAR) 1552.228.

million for third-party liabilities and legal defense expenses.[3] The indemnification did not cover gross negligence or willful misconduct in the performance of duties.

Despite the availability of contractual indemnification for removal and remediation services during the first 5 years of Superfund, response action contractors raised a number of concerns regarding EPA's policy during the Superfund reauthorization debate. Specifically, the contractors contended that:

- EPA had no explicit statutory authority to provide the indemnification.
- Since there was no identified source to pay claims, payment might be prohibited by the Anti-Deficiency Act.[4]
- Indemnification was available only to those contractors working directly for EPA and not those under contract to other federal agencies, states, or PRPs.

Contractor Indemnification Under SARA Section 119

The Congress enacted section 119 of SARA in an effort to retain the services of response action contractors in the Superfund program, i.e., to ensure that site cleanups would not be delayed by the absence of pollution liability insurance. The section's two key provisions are (1) a federal negligence standard that exempts response action contractors from the strict liability standard to which parties responsible for contaminating the site are held[5] and (2) limited indemnification of contractors for whom liability insurance is not available on reasonable terms (the subsection on which this report focuses).

Section 119 addresses some of the concerns raised by contractors during the Superfund reauthorization debate. In authorizing limited indemnification, the Congress established section 119 as explicit statutory authority to indemnify response contractors. Section 119 designates Superfund

[3]We use the term "unlimited indemnification" to refer to an indemnification agreement with no specified limit. Under each such agreement, the federal government's exposure extends to the entire appropriated, unobligated agency/program funds at the time the legal judgment on the claim is presented.

[4]The Anti-Deficiency Act (31 USC 1341) prohibits federal agencies from obligating the United States to spend money that has not been appropriated by the Congress. The Comptroller General has ruled that most open-ended federal indemnification clauses violate the provisions of the act.

[5]Under CERCLA section 107, the parties that contributed to the dangerous conditions at waste sites are liable for the cost of the cleanup. The government need not prove negligence (failure to exercise due care). Thus, anyone who owned, operated, or disposed of waste at a site is liable for cleanup regardless of whether he or she caused the release of the hazardous substance.

as the source of funding indemnification agreements (except with respect to federally owned or operated facilities, which must use agency-designated funds). Each of the section 119 indemnification agreements EPA has granted is backed by the amount of unobligated funds in Superfund at the time a claim is presented. On March 1, 1989, for example, the amount unobligated was about $1.3 billion. If sufficient funds are not available in Superfund to make payments pursuant to indemnification or if Superfund is repealed, SARA authorizes the Congress, at its discretion, to appropriate amounts necessary to make such payments. It also excludes section 119 indemnification agreements from the requirements of the Anti-Deficiency Act.

Finally, section 119 indemnification extends beyond contractors working for EPA to include those contractors performing removal or remediation services for other federal agencies, states and their political subdivisions, and PRPs (under special conditions).

Under a section 119 indemnification agreement, a contractor may be indemnified for any liability, including the expenses of litigation and settlement, for negligence arising out of the contractor's performance of a response action. SARA provides that these agreements be subject to a stipulated deductible and limit on the amount of indemnification provided. Also, section 119 indemnification does not cover damages resulting from a contractor's gross negligence or willful misconduct.

Definition of a Contractor for the Purpose of Section 119 Eligibility

SARA section 119, as amended, makes the following entities eligible for indemnification:

- Contractors working for EPA under contract to perform Superfund response activities, including those working for the Army Corps of Engineers, which, under interagency agreements, manages certain cleanup activities for EPA at Superfund-financed sites.
- Persons demonstrating emerging waste treatment technologies at Superfund sites, pursuant to SARA section 209, under cooperative agreements with EPA.
- Nonprofit organizations that, under grants authorized by section 126, are providing worker protection training for persons engaged in hazardous substance cleanup.
- Contractors performing Superfund response activities under contract to states that have cooperative agreements with EPA.
- Contractors performing Superfund response activities under contract to PRPS.

- Contractors performing Superfund response activities under contract to other federal agencies to clean up hazardous waste sites located on their land.

The sections 209 and 126 RACs do not perform traditional Superfund response activities but are defined as RACs for the purpose of indemnification eligibility. Section 209 authorizes EPA to develop a program to test and evaluate alternative or innovative hazardous waste treatment technologies. In response, EPA established the Superfund Innovative Technology Evaluation (SITE) Program. SITE participants are eligible for indemnification during the time period when they are actually conducting field demonstrations of their technologies.

Section 126 authorizes a program to provide grants to not-for-profit entities for training workers in the hazardous substance industry. The National Institute of Environmental Health Sciences, within the National Institutes of Health, Department of Health and Human Services, administers this program. Not originally defined as RACs, participants were made eligible for section 119 indemnification in December 1987 by an amendment to CERCLA.

EPA Implements an Interim Section 119 Indemnification Program

SARA section 119 required the President to develop guidelines and promulgate regulations for carrying out the indemnification provision. Executive Order 12580 of January 23, 1987, effectively transferred this responsibility to EPA.

In January 1986, in anticipation of its responsibilities under section 119, EPA established a Task Force on Response Action Contractor Indemnification within its Office of Solid Waste and Emergency Response (OSWER), which runs the Superfund program. The task force is comprised of representatives from EPA's Offices of Waste Programs Enforcement, Emergency and Remedial Response, Solid Waste, General Counsel, the Comptroller, and Administration; and the U.S. Army Corps of Engineers. The primary goals set for the task force were to

- establish an EPA RAC indemnification program,
- develop final section 119 indemnification guidelines and regulations,
- ensure a forum for adequate public comment on RAC indemnification, and
- promote the future availability of RAC pollution liability insurance by providing technical assistance to the insurance industry.

In late 1989, the task force expects to publish proposed guidelines for application of section 119 government-wide. It expects the final guidance to be issued in 1990, after which EPA will develop conforming regulations. The final guidance will take into consideration public comment on the proposed guidelines as required in SARA.

During the interim period, from enactment of SARA to implementing final section 119 guidance, EPA is providing RACs with section 119 indemnification on an interim basis, using procedures set forth in its "Interim Guidance on Indemnification of Superfund Response Action Contractors Under Section 119 of SARA," issued October 6, 1987.[6] The interim guidance contains general policy guidelines, procedural guidance for EPA's contracting officers to use to indemnify contractors working in the EPA-managed Superfund program, and model indemnification agreements.

The interim guidance sets forth a discretionary program in which RACs seeking federal indemnification must meet specific requirements regarding their efforts to obtain pollution liability insurance. Any agreement by EPA to indemnify must be recommended by the task force, authorized by OSWER, and concurred with by EPA's Office of the Comptroller, according to this guidance.

Objectives, Scope, and Methodology

In SARA section 119(c), the Congress directed GAO to conduct a study during fiscal year 1989 on the application of the indemnification provision, including

- whether indemnification agreements are being used and the number of claims that have been filed under such agreements and
- the need for indemnification.

We also reviewed the program's compliance with the law and evaluated aspects of its management. SARA directs the Comptroller General to report the findings of the study to the Congress no later than September 30, 1989.

We performed our work primarily at EPA headquarters in Washington, D.C. We obtained information from EPA's 10 regional offices; the National Institute of Environmental Health Sciences, which is responsible for administering the SARA section 126 worker training program; and

[6]OSWER Directive 9835.5.

the Departments of Defense, Energy, and the Interior, which use contractors to clean up their agency-owned hazardous waste sites.

In the course of this review, we spoke with officials of associations representing the property/casualty insurance industry, responsible parties, architectural and engineering contractors, remedial contractors, and construction contractors, and we interviewed selected individual contractors and state contracting officials. We used written requests and telephone interviews to gather information from sources outside the Washington, D.C., area. See appendix I for a detailed discussion of our methodology.

This is one of six studies that GAO is required to conduct under SARA. Three have been completed with reports to the Congress on Hazardous Waste: Issues Surrounding Insurance Availability (GAO/RCED-88-2, Oct. 16, 1987), which examined the legal environment and economic condition of the pollution insurance market; Superfund: Improvements Needed in Work Force Management (GAO/RCED-88-1, Oct. 26, 1987), which studied the shortage of skilled personnel in EPA's Superfund program; and Superfund: Insuring Underground Petroleum Tanks (GAO/RCED-88-39, Jan. 15, 1988), which looked at the liability of underground petroleum storage tank owners. We are also currently reviewing the liability of parties responsible for hazardous waste at closed sites. Finally, SARA requires us to examine and report to the Congress by June 1991 on the toxic chemical release provisions of the Emergency Planning and Community Right-to-Know Act of 1986, SARA Title III.

Our work was performed from August 1988 through June 1989 in accordance with generally accepted government auditing standards. We provided a draft of this report to EPA for formal comment. EPA's comments and our responses appear in appendix III. We discussed sections of the report related to agencies' use of section 119 with Defense, Energy, and Interior officials and incorporated their comments where appropriate. We also obtained formal comment from the Planning Research Corporation on those aspects of the report dealing with its contract to provide policy support to the task force and its other Superfund contracts with EPA. Comments from the Planning Research Corporation and our responses appear in appendix IV.

Section 119 Indemnification Agreements Used but No Claims Filed

EPA is the only federal agency currently using section 119 to indemnify Superfund response action contractors. According to EPA procurement officials, all prime and subcontractors working in the Superfund program under EPA-managed RAC contracts are receiving section 119 indemnification. Of the approximately 1,000 section 119 indemnification agreements EPA had granted, as of June 1989, about 900 were with prime contractors working for EPA and their subcontractors. The rest were with contractors working at Superfund sites for the Army Corps of Engineers, states, or others doing Superfund response-related work.

EPA has provided no indemnification to contractors working for potentially responsible parties and, in fact, has received only one request to do so. EPA officials attribute this to the stringent financial disclosure requirements SARA places on responsible parties in order to secure section 119 protection for their contractors. Also, no other federal agencies are using section 119 indemnification. Lack of final guidance from EPA is one reason they cite for not doing so. However, some agencies are indemnifying certain of their RACs using indemnification provisions in other laws or in general procurement regulations. We found no explicit legal barrier to their use of other statutory authorities. However, we believe that agencies should no longer indemnify RACs using general, nonstatutory procurement authorities because section 119 establishes specific statutory authority for indemnifying Superfund contractors.

No claims had been brought against section 119 agreements as of June 1989. It is too early to say whether this reflects a low risk of a contractor-caused release or the long-tail character of pollution claims in which damage from a pollution release may take several years to become evident. However, it may reflect something else entirely.

Use of Section 119 Indemnification Agreements

As of June 1989, EPA was the only federal agency using section 119 indemnification; it had granted over 1,000 such agreements. As table 2.1 indicates, prime contractors and subcontractors working at EPA-managed response activities account for the vast majority of section 119 indemnification agreements.[1] (See app. II for a list of EPA's prime Superfund contracts containing section 119 indemnification.) SITE demonstrators, worker safety instructors, and some RACs doing Superfund work for states were also indemnified by EPA. No RACs working for PRPs or for

[1]The number of distinct contracting firms working in the Superfund program is smaller than the number of indemnification agreements because some contractors have multiple contracts with EPA. In addition, a firm may be a subcontractor on more than one contract. We did not determine the number of contracting firms in the program.

agencies cleaning up federally owned contaminated property were receiving section 119 indemnification.

Table 2.1: SARA Section 119 Indemnification Agreements as of June 1989

Eligible RACs	Number of agreements	
RACs in the EPA-managed Superfund program:		
EPA prime contractors	80	
EPA estimate of subcontractors	800	
Corps of Engineers prime contractors	26	
Corps estimate of subcontractors	64	970
SITE program participants		8
Worker safety training grantees		56
RACs working for states		28
RACs working for PRPs		0
RACs working for other federal agencies		0
Total		**1,062**

RACs Working for EPA

The 970 EPA RAC indemnification agreements shown in table 2.1 include 80 agreements with prime contractors and an estimated 800 with subcontractors working on Superfund response action contracts managed by EPA headquarters or regional offices. It also includes an estimated 90 section 119 indemnification agreements EPA was providing to contractors working for the Army Corps of Engineers at Superfund-financed cleanups—26 agreements with prime contractors and about 64 with their subcontractors.

According to EPA task force and procurement officials, all major EPA prime Superfund response action contracts (see table 1.1) contain "boilerplate" language providing section 119 indemnification. As the language indicates, EPA's contract clauses extend indemnification to the prime contractor and allow the prime contractor to extend or "flow down" this indemnification to its subcontractors. Two model contract clauses illustrate this:

- Clause indemnifying prime contractors

"Pursuant to section 119 of CERCLA, the EPA will hold harmless and indemnify the Contractor against any liability (including the expenses of litigation or settlement) for negligence arising out of the Contractor's performance under this contract in

carrying out response action activities. Such indemnification shall apply only to liability not compensated by insurance or otherwise and shall apply only to liability which results from a release of any hazardous substance or pollutant or contaminant if such release arises out of the response action activities of this contract. Further, any liability within the deductible amounts of the Contractor's insurance will not be covered under this contract clause . . . ."

- Clause providing flowdown to subcontractors

"With prior written approval of the Contracting Officer, the Contractor may include in any subcontract under this contract the same provisions in this clause whereby the Contractor shall indemnify the subcontractor . . . . The government will indemnify the Contractor with respect to his obligation to subcontractors under such subcontract provisions . . . ."

A Corps of Engineers official told us that similar clauses are contained in each Corps contract with RACs working on sites managed by the Corps for EPA under interagency agreements.

According to EPA procurement officials, no EPA prime RACs have been denied section 119 indemnification. They were also unaware of any denials to subcontractors.

SITE Program Participants

EPA has accepted 41 applicants to participate in the SITE program to conduct field demonstrations of their technologies at Superfund sites. According to an official in EPA's Office of Research and Development, which administers the SITE program, as of June 1989, EPA was providing section 119 indemnification to eight of these SITE program participants to cover their demonstrations. This official said that indemnification was provided by a clause EPA inserted in the cooperative agreements it entered into with the SITE participants. The number of indemnified participants is low because EPA does not enter into a cooperative agreement until it is ready to demonstrate the technology at a site.

All SITE program participants that qualify as response action contractors are offered section 119 indemnification. However, a SITE program official said that some of the program's smaller participants had expressed concern that the indemnification deductible of $100,000, which RACs assume under EPA's interim guidance, was too high.

Worker Training Grantees

The National Institute of Environmental Health Sciences has selected 11 not-for-profit grantees for the section 126 worker training program,

including 5 unions, 5 universities, and 1 fire department. The program's administrator, an official with the Institute, expects 200,000 workers to be trained in hazardous waste cleanup activities under the program.

The program's administrator told us that he and an EPA task force official had developed the indemnity agreement language that was being offered to all participants. As of June 1989, according to the official, EPA was indemnifying the 11 program grantees and all their 45 subcontractors.

RACs Working for States

SARA authorizes EPA to enter section 119 indemnification agreements with contractors working at state-led Superfund cleanups. While the contractors and their subcontractors are eligible RACs under section 119, they do not automatically receive section 119 indemnification because their contracts are with states. Thus, unlike EPA's RACs, whose contracts routinely provide section 119 indemnification, state RACs must separately request such indemnification from EPA.

EPA requires the state to submit the request on behalf of the contractor and include evidence from the RAC demonstrating that the RAC meets all the requirements in SARA as a precondition to receiving indemnification. According to a task force official, as of June 1989, EPA had granted section 119 indemnification to 28 prime and subcontractors working for 8 states. This included agreements with 11 prime contractors—two each from Illinois, Montana, and Texas and one each from Colorado, Florida, Idaho, Minnesota, and Oklahoma—and 17 subcontractors in Illinois.

Relatively few of the state RACs that are eligible for section 119 indemnification have requested it. As we discuss in chapter 3, EPA regional officials told us that there were 109 prime contracts under cooperative agreements for Superfund response work in 18 states, as of May 1989. The low number requesting section 119 indemnification may be attributable to the legal environment at the state level with regard to contractor indemnification. A task force survey of states found that contractors in some states may receive indemnification from the state when performing Superfund work. These contractors may not seek federal indemnification. Other states may require their contractors to indemnify the state. The different state scenarios regarding indemnification are discussed in greater detail in chapter 3.

Some Eligible RACs Are Not Receiving Section 119 Indemnification

SARA provides that RACs working for PRPs may, under certain circumstances, be eligible for section 119 indemnification agreements backed by Superfund. It also authorizes other federal agencies to indemnify contractors they hire to perform response work at their agency-owned contaminated property. These agencies must use their own agencies' funds, not Superfund, to back their indemnification agreements. According to a task force official, as of June 1989, no RACs working for PRPs or for other federal agencies were receiving section 119 indemnification.

RACs Working for PRPs

SARA imposes certain additional requirements for obtaining section 119 indemnification on RACs working for PRPs that may make section 119 indemnification unattractive to both the PRP and the contractor. Moreover, in its interim guidance, EPA has taken the position that indemnification of a RAC working for a PRP will be granted only in extremely limited cases. As of March 31, 1989, 76 NPL sites were being cleaned up by PRPs.

SARA stipulates that a determination must first be made of the amount the PRP is able to indemnify the contractor. Then the determination must be made that such amount is inadequate to cover the contractor's reasonable potential liability. The PRP's total net assets and resources must be taken into account in making this determination. SARA also requires that no claim under an indemnification agreement with a RAC working for a PRP can be paid until the contractor has exhausted all administrative, judicial, and common law claims against all other PRPs participating in the cleanup. In addition, under EPA's interim guidance, the PRP must prove that, as a result of its inability to adequately indemnify a contractor, it is unable to obtain the services of a qualified RAC.[2]

To satisfy the requirements of both SARA and the interim guidance, PRPs would have to disclose extensive proprietary information. To collect under section 119, a RAC might spend years in courts before exhausting all other avenues of recovery. Task force officials believed that, for these reasons, only one request had come to the task force for section 119 indemnification from a RAC working for a PRP, which the task force subsequently denied.

[2]We use the term "qualified" to refer to a contractor that is technically and financially qualified to perform the terms of the contract.

RACs Working for Federal Agencies

Although SARA authorizes them to do so, federal agencies are not using section 119 to indemnify contractors hired to perform response activities at sites they own. Under SARA, those agencies must use their own agency funding to back any section 119 indemnification agreements they grant. Federal agencies cannot use Superfund as the source of funding for their section 119 indemnification claims or, for that matter, to pay any costs associated with the cleanup of their property.

We spoke with officials at the Departments of Defense, Energy, and the Interior about their use of section 119 indemnification. These three agencies, according to EPA, are the only agencies currently far enough along in their Superfund cleanup activities to have contracted for RAC services. Officials at these agencies cited one or more of the following reasons why they are not using section 119 indemnification:

- They do not have final implementing guidance and regulations from EPA.
- They have not had to offer indemnification to obtain the services of qualified RACs.
- They already indemnify RACs under authorities other than SARA section 119.
- They lack a funding source to back their indemnification agreements.

As of May 1989, the Department of Defense had 52 sites listed or proposed for listing on the NPL. According to Defense officials, the Department owns over half of the more than 1,100 potentially contaminated federal facilities under evaluation for possible listing.[3] It therefore has had extensive experience contracting for RAC services. According to a Defense procurement official, the Department includes indemnification in certain of its contracts with RACs using general procurement authorities other than SARA section 119. This official told us that all of Defense's cost-reimbursable contracts contain Federal Acquisition Regulations (FAR) clause 52-228, a general procurement clause that provides indemnification. Cost-reimbursable contracts would generally be used for preconstruction phases of Superfund cleanups, such as assessing the extent of contamination and designing a remedy. Construction and removal contracts, according to officials, would generally be fixed-price, competitively bid contracts that would not include this FAR clause.

[3]SARA section 120 requires federal agencies to report to EPA all their potentially contaminated property. EPA maintains this inventory as the Federal Facilities Hazardous Waste Compliance Docket. Docket sites are evaluated for the extent of their hazard and listed on the NPL if warranted.

Defense environmental program officials told us they have had no problem obtaining an adequate number of qualified bidders on contracts to perform RAC services.

The Department of the Interior had 1 site listed in final and 1 site proposed for the NPL, as of May 1989, with another 252 sites under evaluation. Interior is in the early stages of its cleanup efforts and, according to Interior officials, its RAC contracting experiences are limited. At the time of our review, Interior had put out a request for bids, which did not include indemnification, and received what an official described as an adequate number of qualified responses. According to a senior environmental review officer, Interior's procurement regulations have a provision that supersedes and prohibits Interior's use of the FAR 52-228 indemnification clause in Interior contracts. However, where statutory authority exists that allows indemnification, Interior's contract can be modified. According to an official in Interior's Office of General Counsel, prior to SARA, Interior had no statutory indemnification authority. The officials also told us that Interior will consider the appropriateness of using section 119 indemnification for contractors it hires to clean up Interior-owned contaminated facilities once EPA issues final guidance and regulations.

The Department of Energy had 8 sites on the NPL—5 proposed and 3 listed in final—and another 37 sites under evaluation, as of May 1989. Energy uses contractors to manage and operate its facilities and indemnifies those contractors using both statutory and general, nonstatutory procurement authorities. Energy has specific statutory authority, under the Price-Anderson Amendments Act of 1988, to indemnify contractors at risk for liability to the public stemming from a nuclear incident. For liabilities arising out of nonnuclear incidents, Energy provides indemnification to its contractors using the FAR 52-228 contract provision in all cost-reimbursable types of contracts. According to an Energy procurement official, the contractors and subcontractors hired to clean up contaminated Energy facilities are generally working under cost-reimbursable types of contracts that include the FAR 52-228 indemnification clause.

Section 119 Supersedes General Indemnification Authorities for RACs

EPA determined that section 119 authority preempts any previously existing EPA indemnification authorities and is the sole authority available to EPA for indemnifying RACs. Because the Congress established such specific statutory authority for indemnifying response contractors in

SARA section 119, we believe section 119 must also be used by other federal agencies in place of general procurement regulation authorities, such as FAR 52-228, that agencies might otherwise use to indemnify these contractors. It is our position that specific indemnification authority set in law, with conditions and limitations stipulated by the Congress, such as SARA's requirements for documenting contractors' uninsurability and limiting indemnification amounts, supersedes general indemnification authorities based on procurement regulations that have not undergone direct congressional scrutiny.[4]

In total, 18 agencies have identified to EPA over 1,100 potentially contaminated sites on federally owned properties that must be assessed for extent of hazard and possible listing on the NPL. These agencies are the Departments of Agriculture, Commerce, Defense, Energy, Health and Human Services, Housing and Urban Development, the Interior, Justice, Labor, Transportation, and Treasury; the Central Intelligence Agency; EPA; General Services Administration; the National Aeronautics and Space Administration; the Postal Service; the Tennessee Valley Authority; and the Veterans Administration. As their properties are evaluated and subsequently listed on the NPL, if warranted, these agencies will face decisions regarding the need to indemnify cleanup contractors.

No Claims Have Been Filed Against Section 119 Agreements

As of June 7, 1989, no claims had been filed against any agreements with RACs indemnified under SARA section 119. The task force representative from EPA's Office of General Counsel identified four pending lawsuits against RACs indemnified by EPA under pre-SARA agreements that may result in claims. According to that official, no suits had been settled against RACs indemnified under these pre-SARA indemnification agreements, although EPA had paid $8,000 in legal defense costs for one indemnified contractor as of June 1989. It is difficult to estimate future section 119 claims because the number of completed Superfund cleanups is limited and data on general pollution insurance claims are unavailable.

Relatively Few Superfund Cleanups Have Been Completed

One possible explanation for why so few lawsuits have been filed against indemnified contractors is that the principal focus of the Superfund program to date has been on emergency removals and site evaluations. The most recent data compiled by EPA as of June 15, 1989, showed that of the approximately 1,200 sites on or proposed for the NPL,

[4]See 62 Comp. Gen. 361, 83-1 CPD para 501 (1983).

cleanups had been completed at only 41 sites and begun at another 204. Therefore, as the cleanup program moves increasingly into construction, suits against contractors—both those who plan and design the remedy and those who carry it out—and claims against indemnification agreements may increase. An EPA task force draft issue paper, in noting the relative absence of claims against RACs in the first 6 years of Superfund before SARA, stated that the existence of a federal indemnification program created by SARA makes it more likely that EPA will see an increase in suits filed against its indemnified RACs because the well-known Superfund, backing these agreements, may be seen as a source for third-party compensation.[5]

There Is Insufficient Information to Project Future Claims

EPA's indemnification task force attempted to develop information with which to project the frequency and magnitude of claims likely to be brought against contractors covered by section 119 indemnification agreements. According to a draft task force document, EPA was unable to do so because of, among other things, the absence of a significant amount of loss data on RAC pollution releases. A task force official told us that when EPA attempted to solicit information on pollution claims directly from RACs, it received only a few responses. One task force draft document addressing the uncertainty of future claims points out that loss experience and court decisions on pollution liability claims are only now emerging; therefore, the damages resulting from a release of a hazardous substance are very difficult to estimate.[6]

We have had similar difficulty in obtaining data on pollution liability claims. In two earlier reviews we attempted to obtain data on actual loss history sustained by the property/casualty insurance industry for pollution claims. The insurance industry cited the potential enormity of pollution liabilities for its withdrawal from the pollution insurance market in the early 1980's. However, insurance industry officials told us that the industry did not maintain pollution claims data separately and could not provide us with documentation to support its position. We were also unsuccessful in obtaining pollution liability loss information from hazardous waste manufacturers, disposers, or handlers, who regarded such information as proprietary. In our two resulting reports, we suggested, among other things, that to determine the cost and extent of third-party

[5]Section 119 Issue Paper: Section 119 Indemnification Claim Loss Control Issues, July 31, 1987.

[6]Response Action Contractor (RAC) Indemnification Program: Deductibles, Limits of Indemnity, Umbrella Coverage, High Risk Industries, September 1987.

pollution liabilities, the Congress consider requiring insurers or responsible parties, as appropriate, to report to EPA the amounts of indemnity payments made to cover pollution cleanups and related third-party bodily injury and property damage.[7] Without this information on which to build a loss history, there remains no basis for projecting the potential magnitude and frequency of such claims.

Conclusions

EPA is the only federal agency using section 119 indemnification. Two other agencies—Defense and Energy—are using other authorities to indemnify certain of their RAC contractors. EPA, in approximately 1,000 agreements, is indemnifying prime contractors and their subcontractors working at EPA-managed Superfund sites, SITE program participants, worker training grantees, and some state RACs, but no RACs working for responsible parties. Thus far, no claims have been brought against any of these section 119 agreements. A few lawsuits are pending, however, against Superfund contractors that EPA indemnified prior to enactment of SARA.

Federal indemnification should be based on specific authorizing legislation rather than general procurement authorities. General procurement authorities do not contain specific conditions and limitations, such as SARA's insurance documentation and indemnification limit requirements, established by the Congress. Section 119 establishes such specific authority for indemnifying RACs. Therefore, we believe that federal agencies must use section 119 rather than general, nonstatutory contracting authorities to indemnify response contractors.

Recommendation to the Administrator, EPA

Because SARA section 119 establishes specific statutory authority to indemnify Superfund response action contractors, we recommend that the Administrator, EPA, advise federal agencies to use section 119 rather than general contracting authorities if they choose to indemnify Superfund contractors.

EPA Comments and Our Response

In a June 30, 1989, letter commenting on a draft of this report (see app. III), EPA's Deputy Assistant Administrator, Office of Policy, Planning and Evaluation, stated that EPA does not have the authority to require

[7]Hazardous Waste: Issues Surrounding Insurance Availability (GAO/RCED-88-2, Oct. 16, 1987) and Hazardous Waste: The Cost and Availability of Pollution Insurance (GAO/PEMD-89-6, Oct. 28, 1988).

other federal agencies to use section 119 rather than general contracting authorities if they choose to indemnify Superfund contractors as we had proposed in our draft recommendation. The report was revised to recommend that the Administrator, EPA, advise, rather than require, agencies to use section 119.

EPA May Not Need to Indemnify All Superfund Response Action Contractors

The need for section 119 indemnification depends on the availability of pollution liability insurance and the willingness of RACs to work without insurance or indemnification. Pollution insurance for RAC risks continues to be scarce and limited in coverage. We identified only three insurance sources actively seeking to insure response contractors' risks. Most representatives of the commercial insurance industry see little or no likelihood of expansion in the availability of pollution insurance for response risks in the foreseeable future.

Whether RACs would work for EPA at Superfund sites without insurance and indemnification is uncertain. While contractors contend they are reluctant to work without indemnification, they are, to some extent, doing similar work for states and PRPs that do not indemnify their contractors. EPA has not adequately explored the terms under which contractors are willing to work without indemnification. Because indemnifying contractors jeopardizes the Superfund by subjecting it to unknown future liabilities, EPA should determine, through its procurement process, the extent to which indemnification is necessary to obtain contractor services.

RAC Pollution Insurance Remains Scarce

RAC officials told us that they are concerned about (1) large damage awards that would threaten the solvency of their companies and (2) the unavailability of insurance for these damages. Uncertainty over the possibility of these large awards has led most insurers to withdraw pollution liability coverage from the hazardous waste market. Firms that comprise the potential market for pollution liability insurance number in the tens of thousands and include, among others, hazardous waste treatment, storage, and disposal facilities; hazardous materials transporters; chemical producers; and manufacturers who use chemicals or other hazardous substances in their production processes. Because of the unknown nature of the risks found at Superfund sites, RACs are regarded as a high-risk segment of the market by the insurance industry. As such, insurance options and policy terms available to RACs are likely to be more limited than those available to less risky segments of the pollution industry, such as waste transporters.

Pursuant to SARA requirements and requests from congressional committees, we have been following the availability of pollution liability insurance for the hazardous waste industry since mid-1986 and have issued three reports on this issue. In October 1987 we reported that only one

commercial property/casualty insurance company was actively marketing pollution liability insurance.[1] We also identified (1) a few insurers who were, as an accommodation, providing pollution insurance to selected clients and (2) two risk-retention groups that were being formed as an option to traditional insurance. Risk-retention groups result when companies that share a common risk—in this case, pollution liability—join together to spread the risk among the members of the group. In two 1988 reports, we found that the pollution liability insurance market had not recovered from the recent insurance "crisis" as other types of liability insurance had done.[2]

In the course of this review, we again found no indications that pollution insurance is increasing in availability. We identified only two commercial insurers and one risk-retention group offering pollution insurance policies that provide coverage to certain Superfund response action risks. The coverage is usually site-specific and therefore would generally not cover an EPA prime contractor for multiple-site work. Also, it is for only limited annual dollar amounts of liability. A representative of the American Insurance Association, whose member companies represent the major underwriters of the commercial property/casualty insurance industry, told us he was not aware of any of his member companies insuring RAC pollution risks and does not anticipate their doing so in the future.

The one active commercial insurer identified in our first study, the American Insurance Group (AIG), is still actively marketing pollution insurance and will insure certain response risks. An AIG representative estimated that the company had about 400 pollution insurance policies, as of May 1989; he was certain that some of them covered contractors engaged in Superfund response work but did not know the exact number of RACs AIG was insuring. AIG policies provide up to $5 million in pollution insurance coverage for Superfund contractors. The representative added that AIG will knowingly insure response contractor activities only when it can assess the potential risk and that the policies would generally be site-specific.

The other commercial property/casualty insurance company that was actively marketing pollution liability insurance for RACs at the time of

[1]Hazardous Waste: Issues Surrounding Insurance Availability (GAO/RCED-88-2, Oct. 16, 1987).

[2]Hazardous Waste: The Cost and Availability of Pollution Insurance (GAO/PEMD-89-6, Oct. 28, 1988) and Liability Insurance: Effects of Recent "Crisis" on Businesses and Other Organizations (GAO/HRD-88-64, July 29, 1988).

this review was the Reliance Insurance Company. Reliance representatives told us they would issue about 125 pollution insurance policies in 1989, including about 20 to 25 for response action contractors. The only RACs Reliance will insure, according to the representatives, are construction firms subcontracting for site-specific work. Reliance does not insure EPA prime contractors because they work at multiple sites, according to the representatives. Reliance will provide RACs up to $2 million in pollution liability insurance coverage at premiums up to $300,000, depending on the risk involved.

The one risk-retention group we identified, Demeter Ltd., insures only professional engineering firms against pollution risks. Demeter is a wholly owned subsidiary of a Bermuda-based risk-retention group, the Terra Insurance Company, which provides professional liability insurance for its approximately 90 member companies. Demeter was formed to provide pollution insurance, which is expressly excluded from professional and commercial liability insurance, for firms with an environmental practice. Demeter will not insure remedial or construction contractors. A Demeter representative told us that Demeter had issued 13 policies to architectural and engineering firms. The Demeter policy provides up to $1 million in coverage with premiums up to $300,000.

Contractors Are Working Without Indemnification

Contractors told us they either will not or are reluctant to do Superfund work without indemnification. However, many of the same contractors who are working for EPA with indemnification are doing similar work for states and private parties that do not indemnify their contractors.

EPA RACs Work for PRPs Without Indemnification

EPA's 80 prime Superfund response action contracts in place as of June 1989 were with 44 prime contractors. As discussed in chapter 2, these prime contractors and their approximately 800 subcontractors are indemnified under section 119. (App. II lists each of the EPA prime response action contractors, the type of contract(s) awarded, and the potential contract value and period of performance.) We contacted 14 of these EPA prime contractors, who together account for 38 Superfund contracts totaling $4.7 billion, and asked them whether they did similar work for PRPs. Six of the 14 told us that they do at least some Superfund response work for PRPs without receiving indemnification; 4 said they work for PRPs only if the PRP indemnifies them; and 4 told us they will

not do Superfund work for PRPs. Each contractor we talked to is a member of either the Hazardous Waste Action Coalition or the Remedial Contractors Institute, two of the associations representing RACs that we met with during the course of our review. We selected these contractors because they participated in meetings we had with their associations or their associations told us they would be willing to talk with us on an individual basis.

EPA RACs Work for States Under Various Indemnification Scenarios

In October 1988, EPA's section 119 task force surveyed the 50 states to determine state indemnification practices. Among other things, the survey gathered information on the effect of state indemnification of RACs on the state's ability to retain RAC services. The survey indicated that 8 states have state statutory authority to indemnify RACs, while 13 states have authority to require the RAC to indemnify the state. Five of those 13 states told EPA that they had "some difficulty" procuring qualified RACs. However, only 2 of the 29 states that neither indemnify RACs nor require RAC indemnification of the state had "some difficulty" procuring qualified RACs. The task force concluded, based on this survey, that states generally were able to retain without indemnification a sufficient number of qualified contractors to ensure the continued operation of their cleanup programs. EPA also concluded that RACs are willing to perform essentially the same response action activities for states without indemnification that they perform for EPA with indemnification. In some cases RACs are even indemnifying the states. Table 3.1 summarizes the results of EPA's survey.

Table 3.1: State Indemnification Practices

State	State indemnifies RACs	RAC indemnifies state
Alabama	No	No
Alaska	No	Yes
Arizona	No	No
Arkansas	No	Yes
California	Yes	No
Colorado	No	No
Connecticut	No	No
Delaware	No	No
Florida[a]	Yes	Yes
Georgia	No	No
Hawaii	No	No
Idaho	No	Yes
Illinois	Yes	No
Indiana	No	Yes
Iowa	No	Yes
Kansas	No	No
Kentucky	No	No
Louisiana	Yes	No
Maine	No	Yes
Maryland	No	No
Massachusetts	Yes	No
Michigan	No	No
Minnesota	No	No
Mississippi	No	No
Missouri	No	No
Montana	No	Yes
Nebraska	No	No
Nevada	No	No
New Hampshire	No	Yes
New Jersey	Yes	No
New Mexico	No	No
New York	No	No
North Carolina	No	No
North Dakota	No	No
Ohio	No	Yes
Oklahoma	No	No
Oregon	Yes	No
Pennsylvania	No	No
Rhode Island	No	Yes
South Carolina	No	No

(continued)

State	State indemnifies RACs	RAC indemnifies state
South Dakota	No	No
Tennessee	No	Yes
Texas	Yes	No
Utah	No	No
Vermont	No	No
Virginia	No	No
Washington	No	No
West Virginia	No	No
Wisconsin	No	Yes
Wyoming	No	No

[a]Florida indemnifies the RAC for a negligent pollution release, and the RAC indemnifies Florida for all other liabilities.

Source: State Indemnification Practices for Response Action Contractors, EPA, October 21, 1988.

We, too, found several instances where EPA-indemnified RACs were working for states without indemnification. We queried EPA regions to find out the extent to which RACs were working at state-led Superfund cleanups without receiving SARA section 119 indemnification from EPA. The regions reported that states, under cooperative agreements with EPA, had 98 prime contracts that did not include section 119 indemnification. The 98 contracts were with 58 different contractors. Fifteen of the 58 state contractors, working on 40 contracts that do not contain federal indemnification, are also EPA RACs who receive section 119 indemnification for the work they do for EPA.

In meetings with the three RAC associations, contractors told us that situations where they work without indemnification are exceptions they made based on their assessment that there was very little risk involved. While we did not assess the extent of risk that the specific work involved, this unindemnified work was at NPL sites, which, by definition, pose serious health and/or environmental risks.

Other Factors EPA Needs to Consider in Developing an Indemnification Policy

Our review of the need for indemnification has focused primarily on its value in ensuring an adequate supply of contractors for Superfund work. SARA's legislative history indicates that this was the principal purpose of the indemnification provision. However, there are other considerations that EPA may need to take into account in setting indemnification policy or making decisions of whether or how much to indemnify individual contractors. These considerations include

- who will compensate for damages to public health and the environment caused by contractor negligence if no federal guarantee exists,
- how indemnification affects competition,
- how indemnification affects contractor performance,
- the impact of indemnification on Superfund costs,
- the effect of indemnification on the cleanup of higher risk sites, and
- the effect of indemnification on the development of pollution liability insurance for response contractor risks.

Compensation for Damages

As we reported, we found that some contractors do response work for PRPs and states without receiving indemnification. However, it is not known whether those contractors have reserved sufficient funds or arranged for insurance to compensate for future damages. If not, without indemnification, the victims of contractor negligence could go uncompensated. Presumably, without indemnification, contractors would charge higher prices to cover the potential liabilities otherwise covered by indemnification. However, there is no assurance that added funds from these higher prices could be used to purchase insurance or be set aside to compensate for future damages.

Competition

Another consideration is the effect of indemnification on competition. Lack of indemnification may be an important barrier to entry into the cleanup market, especially for smaller firms. One EPA regional administrator told us that this issue could be construed to limit competition to those larger firms that have access to costly pollution liability insurance or that can afford to self-insure, thereby closing out small and/or disadvantaged but fully capable businesses. In addition, without indemnification or insurance, there is a risk that companies that do not have adequate financial resources to cover their potential liabilities may be drawn into the industry. Such companies would go bankrupt if found to be negligent, making compensation for damages a cost to society.

Contractor Performance

Indemnification may also affect the standard of care exercised by RACs in cleanup actions. If a contractor has substantial assets at risk, low levels of indemnification, or no indemnification, can act as a deterrent to contractor negligence because the contractor would have to assume a greater share of potential liabilities. Conversely, as the risks assumed by the government increase with higher levels of indemnification, the contractor may become less prudent in preventing toxic releases as its liability exposure diminishes. However, even with higher indemnification

levels, the government can require deductibles proportionate to the amount of indemnification offered. In this situation, the contractor has an incentive to take adequate precautionary measures to prevent releases and thereby avoid paying a sizable deductible at some future date.

Cost to Superfund

Not indemnifying contractors may give EPA better control over direct costs incurred in Superfund cleanups. However, because contractors' prices are likely to be higher with no indemnification, larger Superfund outlays may occur in the near term. With indemnification, Superfund outlays would occur later, when claims are paid. If more claims were to materialize than expected by contractors at the time contractors bid on cleanup projects, a policy of indemnifying may mean higher Superfund outlays than a policy of not indemnifying. As a result, section 119 indemnification, which the Congress provided as a tool to help keep Superfund cleanups on track, may, in fact, disrupt the Superfund program. Without indemnification, however, the government may incur costs for compensating damages resulting from negligence through separate appropriation. These would be direct costs to the government but not to Superfund.

Cleanup of High-Risk Sites

Because EPA-led NPL sites posing the greatest risks to contractors may be located near population centers, failure of the federal government to indemnify may result in a reluctance by contractors to clean up those sites. According to a December 1988 survey conducted by the American Consulting Engineers Council, contractors cited a remote location as one reason they were sometimes willing to work without indemnification. Offering indemnification may make it more likely that contractors will be available, as they in fact are now, to clean up sites in densely populated areas.

Development of Pollution Liability Insurance

It is unclear what effect indemnification has on the development of the pollution liability insurance market for RAC risks. On the one hand, most of the insurance industry views the risks to be insured against as unknown in both magnitude and frequency. Information on risks may be forthcoming in the future, but it is unclear how long it will take to gain enough experience to make insurers view these risks as insurable. Moreover, an important source of uncertainty deals with how broadly courts will interpret negligence. Indemnification may encourage plaintiffs to

charge negligence against contractors whenever cleanup complications arise.

On the other hand, SARA requires, as a condition to receiving indemnification, that contractors make diligent efforts to obtain reasonably priced insurance. Compliance with this requirement could encourage demand for pollution insurance and thus stimulate the industry. However, as we discuss in chapter 4, EPA has not conscientiously enforced this requirement.

A Competitive Market Approach to Indemnification

To better determine the extent to which section 119 indemnification is actually needed and in what amounts, EPA should explore options for a market-based strategy to test contractors' willingness to do Superfund response work with various amounts of indemnification or with no indemnification. Keeping the above policy considerations in mind, such a strategy should be designed so that the contractor under competitive constraints, rather than EPA, would decide how much indemnification is needed. Another potential value of such a strategy would be to achieve adequate protection against negligence at a lower federal expense. EPA could test, through the procurement process, various market strategy options for their impact on the supply of quality contractors competing in the Superfund program. At the same time, with minimum disruption to the program, EPA could assess the cost to EPA and the applicability of the options tested to the different types of contracts EPA uses in the Superfund program.

During this review, EPA task force, procurement, and general counsel officials told us that making indemnification an element in the competition for Superfund contracts would be desirable and, at least to some extent, possible. Moreover, in the May 1989 draft proposed guidance for section 119, EPA acknowledged that indemnification of Superfund RACs may be neither appropriate nor necessary. Mindful of the policy considerations we discussed earlier, we believe that exploring options for a market-based indemnification strategy merits EPA's serious consideration.

The different types of contracts EPA uses to procure response services may require different approaches to develop a market-based indemnification strategy. Most of EPA's major prime Superfund response contracts are cost-reimbursable, covering work at multiple sites where the extent and nature of the work may be unknown. The contractor is selected on the basis of technical and other quality factors and cost. EPA reimburses

the allowable, allocable, and reasonable costs of performing work assignments and pays the contractor a base fee of about 3 percent of costs and an award fee up to 7 percent of costs based on EPA's subjective evaluation of the contractor's performance. EPA uses fixed-price contracts when the nature and extent of work can be clearly defined. The contract is awarded to the lowest qualified bidder.

The focus of the Superfund program to date, as we pointed out in chapter 2, has been on emergency removals and site evaluations, which would generally be performed under cost-reimbursable contracts. Fixed-price contracts are generally used for Superfund construction activities. Procurement officials estimated that, currently, very few of EPA's prime contracts are fixed-price. However, as Superfund cleanups progress into the construction phase, the officials noted that EPA, both directly and through the Corps of Engineers-managed work, will rely increasingly on fixed-price contracts to complete site cleanups.

Because the reasonable cost of insurance, including an imputed cost of self-insurance, is an allowable cost in a cost-reimbursable contract, EPA would have to carefully examine the cost of a contractor self-insuring for pollution liabilities to prevent the contractor from transferring excessive costs back to EPA.

In addition, SARA section 119(f) requires that certain contractors, including architectural and engineering contractors, must be selected in accordance with the provisions of title IX of the Federal Property and Administrative Services Act of 1949 (40 USC 541 et seq.). Title IX provides that cost may be considered only after the most qualified contractor is selected. A procurement official estimated that about half of EPA's prime Superfund RACs are architectural and engineering contractors.

Some Options for a Market-Based Indemnification Strategy

A market-based strategy for providing section 119 indemnification should be designed to avoid unnecessary Superfund outlays while, at the same time, ensuring an adequate supply of qualified contractors for Superfund work. The terms of indemnification (including the amount of indemnification, combination of insurance and indemnification, and the deductible) may either be set by EPA in the contract solicitation or stipulated by the contractor in its bid or during contract negotiation. In developing a market-based strategy, some options may warrant consideration and pilot testing by EPA:

- Stipulating the amount of indemnification in contract solicitations, perhaps starting with no indemnification or relatively low amounts. If no qualified bidders respond, the solicitation could be reopened with a higher stipulated indemnification amount. This approach may have potential applicability to both fixed-price and cost-reimbursable contracts. After a few offerings, standard minimum industry requirements for indemnification may become evident.
- Considering the amount of indemnification requested on a cost-reimbursable contract subject to the requirements of section 119(f) in determining whether the contractor rated most highly qualified will perform at a fair and reasonable price. As we noted above, with this type of contract, cost may be considered only after the most qualified contractor is selected. If EPA is unable to negotiate a satisfactory contract with the firm considered to be the most highly qualified at a price it determines to be fair and reasonable to the government, it should negotiate with the next most qualified firm, and so on, until an agreement is reached. To comply with procurement regulations, EPA will need to develop a system for reasonably computing the potential cost to the government for various indemnification proposals, which is admittedly a difficult task.
- Placing a negative evaluation factor on requests for indemnification made in response to solicitations for cost-reimbursable contracts that are not subject to section 119(f). The negative factor could increase with the amount of indemnification requested. A prospective bidder would indicate an amount of indemnification or combinations of insurance and indemnification in the contract solicitation phase of Superfund procurement. Using this approach, a contractor willing to work without indemnification would have a competitive advantage over a contractor that requests indemnification. There would also be a competitive incentive to minimize the amount of indemnification requested. Again, to compare contractor bids on cost-reimbursable contracts, EPA would need to develop a system for computing the potential cost to the government of the various combinations of insurance and indemnification proposals, which would enable EPA to relatively rank contractors that bid on a given contract solicitation.
- Adapting a state RAC indemnification approach for soliciting fixed-price contracts in the federal program, such as the approach that appears to be working successfully for New Jersey. According to a New Jersey program official, contractors submitting bids to perform state-solicited response activities may request indemnification from the state in amounts up to $5 million for engineering and design work or $10 million for construction. New Jersey calculates a cost for the amount of indemnification requested on the basis of a state-devised formula, adds that

cost to the contractor's bid, and awards the contract to the qualified contractor with the lowest (adjusted) bid. Similarly, EPA would have to develop a system for computing the cost to the government for the amounts of indemnification requested in fixed-price bids. As of February 1989, New Jersey had granted 30 engineering and design contracts that included state indemnification and two construction contracts that did not. According to the official, New Jersey has obtained qualified bidders using this approach.

- Requiring EPA prime contractors to subcontract using an approach similar to the first option, that is, require prime contractors to stipulate the amount of indemnification in solicitations for subcontractors, beginning with no indemnification or a relatively low amount. Allow a higher stipulated amount of indemnification only if the prime contractor can show that it received no qualified bids. The activities solicited under these subcontracts may more closely resemble the unindemnified work contractors do for states and PRPs.

By examining other state and federal indemnification programs as well as the terms under which contractors work for states and PRPs without receiving indemnification, EPA may identify further options for consideration in determining the extent to which indemnification is needed, and in what amounts, to keep Superfund on track.

EPA Draft Proposal Is Undergoing Revision

Under SARA, EPA is required to develop guidelines and promulgate regulations for carrying out section 119 indemnification. EPA has drafted, and in late 1989 expects to publish for comment, proposed guidance on indemnification of Superfund RACs. The May 1989 draft of the guidance, the latest version available at the time we completed our audit work, had cleared peer review at the program level but was being revised following review at the Assistant Administrator level. EPA officials anticipate further revisions by the Office of Management and Budget.

Conclusions

The need for indemnification depends on the availability of pollution liability insurance and the willingness of contractors to work without insurance and indemnification. Pollution liability insurance for the RAC community is limited, and additional commercial insurers are not likely to enter the market in the near future. However, EPA has not fully explored the extent to which contractors (and their subcontractors) would be willing to work without indemnification. Several of the same contractors who work in EPA's Superfund program and receive section

119 indemnification are doing Superfund work for states and PRPs without indemnification. Thus, it seems plausible that, in some cases, EPA might be able to lessen the government's potential liability by reducing or eliminating indemnification while still attracting qualified contractors to its Superfund program. As discussed above, in doing so EPA should be aware of the effects upon other policy objectives.

EPA's present indemnification policy essentially passes all risks for contractor negligence to the government. At the same time, EPA task force and procurement officials questioned the need for this indemnification. We agree that it is not an easy matter to determine whether and how to indemnify contractors working on multi-year, multi-site contracts. As we discuss in the next chapter, EPA plans to set limits in its final section 119 guidance on the amount of indemnification it will provide to contractors. Such limits should reduce the risks to the government stemming from contractor negligence. However, we believe additional risk reduction would further protect the government and the viability of the Superfund program. Therefore, we believe that EPA should explore options for including indemnification as an element of contract competition and that a market-based indemnification strategy merits EPA's serious consideration.

A closer examination of the terms under which contractors are willing to work for states and PRPs may help EPA to identify different indemnification approaches. Finally, we believe that testing, through the procurement process, affords EPA an opportunity to explore the viability and applicability of the different indemnification approaches.

Recommendations to the Administrator, EPA

To limit the government's potential exposure to liabilities caused by contractor negligence and keep qualified contractors working in the Superfund program, we recommend that the Administrator, EPA, (1) identify and test, through the procurement system, options for providing section 119 indemnification that will make it competitively unattractive for Superfund contractors and subcontractors to obtain more indemnification than is needed and (2) incorporate the options that are more cost beneficial to the government into the regular Superfund procurement process.

EPA Comments and Our Response

In its comments on a draft of this report (see app. III), EPA stated that it might be beneficial to determine the extent to which indemnification is necessary to obtain contractor services. However, EPA expressed concern

that the approaches we identify pose difficulties that may limit their appeal.

EPA noted that it may be difficult to ascertain the true cost of indemnification with reasonable certainty for fixed-price contracts. While we agree that precisely quantifying that cost is not a simple matter, we believe it should be done because indemnification is clearly not without cost to the government. EPA has premium information on pollution liability insurance from those companies that provide this coverage. Moreover, as EPA builds claims experience, the "true cost" of indemnification will become more precisely quantifiable.

EPA also indicated that, for cost-reimbursable contracts, it may be difficult to relatively rank offerors based on indemnification requests or to ascertain an appropriate weight to place on an indemnification request when the precise work to be performed under the contract is unknown. We recognize the need to have a rational basis for relatively ranking indemnification requests that would be acceptable under the FAR. However, we do not believe that a rational system necessarily has to be precisely quantifiable. In fact, there are other contract evaluation factors that are not precisely quantifiable.

EPA further noted that such a rank-ordering may not be consistent with section 119(f). As EPA rightly points out, section 119(f) requires that, in selecting certain types of contracts, including architectural and engineering contracts, competing bidders may be evaluated solely on competence and qualifications. Only after that evaluation may the government negotiate a "fair and reasonable" price, first with the most qualified bidder; if that fails, the second most qualified bidder, etc. The selection is made from the three or more most qualified bidders. This precludes including indemnification as a competitive factor in the bid selection process for about half of EPA's prime RACs. We have revised the text to include a discussion of section 119(f) and expanded the options to include a competitive approach to indemnify RACs subject to section 119(f).

EPA also suggests that, in discussing the potential cost of indemnification to Superfund, we fail to recognize the increased cost of insurance, including self-insurance, associated with not indemnifying contractors. We disagree. We recognize that without indemnification contractors might charge higher bid prices resulting in larger federal outlays in the near term. Indemnification, on the other hand, may result in even

greater outlays over the long term. EPA is obligated to reimburse contractors only for reasonable insurance costs. Therefore, we also caution EPA on the need to closely examine insurance costs (including self-insurance) to prevent contractors from transferring excessive costs back to the government.

EPA Noncompliance With Key Indemnification Requirements

EPA has not followed safeguards in SARA and the agency's own guidance for ensuring that section 119 indemnification is granted only in situations and in amounts needed to cover uninsurable risks. For example, EPA has indemnified, as a matter of policy, all of its Superfund response action contractors and subcontractors although SARA and the agency's guidance require that indemnification be provided on a discretionary, case-by-case basis after a contractor demonstrates inability to obtain insurance. As a result, contractors have little incentive to seek pollution liability insurance, and the agency may have missed opportunities to stimulate the development of an insurance market.

In addition, although SARA requires limits on the amount of indemnification provided to contractors, indemnification agreements under EPA's interim program do not specify any. Consequently, Superfund, which would pay for claims against section 119 agreements, has been exposed to potential liabilities limited only by the available fund balance and any additional authorized funds the Congress may appropriate.

In its final section 119 guidance, EPA needs to include adequate management controls to ensure that agreements under the section 119 indemnification program will be implemented consistently and in full compliance with the law.

EPA Has Not Controlled Indemnification Awards as SARA Requires

According to SARA section 119, a federal agency may indemnify a contractor only after each of the following requirements is met:

- The liability covered by the indemnification agreement exceeds or is not covered by insurance available to the contractor at a fair and reasonable price at the time the contractor enters the contract, and adequate insurance is not generally available.
- The contractor has made diligent efforts to obtain insurance from nonfederal sources to cover such a liability.
- In the case of a contract covering more than one facility, the contractor agrees to continue to make diligent efforts to seek insurance coverage each time the contractor begins work at a new facility.

EPA has not fully complied with or enforced these requirements.

Liability Exceeding Available Insurance

EPA did not fully comply with the first SARA requirement in its interim section 119 guidance. According to the guidance, EPA determined that adequate contractor insurance was not available. On the basis of that

determination, EPA authorized blanket indemnification to all its contractors without first determining on a case-by-case basis that insurance was not available at a fair and reasonable price to cover each contractor's liability. In our opinion, EPA's determination that insurance was not available was not in full compliance with SARA.

Although it is reasonable to assume that the current insurance market does not cover the risks of major Superfund contractors doing hundreds of millions of dollars of work under long-term contracts, this assumption may not be accurate for all contractors, and especially subcontractors, whose potential liabilities may be more limited. Also, making a general determination of insurance unavailability in the interim program guidance resulted in a policy that has not reflected the current pollution liability insurance market. As we discussed in chapter 2, some insurance for RAC pollution liabilities is available.

An EPA procurement official told us that the agency's indemnification task force had given the Procurement and Contracts Management Division verbal permission to insert boilerplate indemnification language into all of its prime Superfund response action contracts several months before the interim guidance was issued. Similarly, we found that EPA did not give individual consideration to indemnifying its estimated 800 Superfund subcontractors. According to the boilerplate contract clause, EPA allowed its prime Superfund contractors to pass along EPA's indemnification to their subcontractors with approval of the EPA contracting officer provided that the subcontractors met all the section 119 requirements. However, EPA regional and headquarters officials told us they did not believe that prime contractors were consistently following the SARA requirements or clearing the indemnification of subcontractors with EPA contracting officers.

Initial Proof of Efforts to Obtain Insurance

As indicated above, SARA requires that a contractor seek insurance before it may be granted federal indemnification. In its interim guidance, EPA modified this requirement by allowing a contractor 30 days after receiving indemnification to document diligent efforts to seek insurance. We believe that allowing contractors to provide proof of uninsurability after indemnification is granted does not comply with SARA's mandatory requirement that EPA determine that the contractor make diligent efforts to obtain insurance before granting indemnification.

In addition, EPA has not enforced even the modified requirement for indemnification agreements entered under its interim guidance. An EPA

procurement official told us that the procurement staff had been more concerned with updating contracts to reflect the change in the indemnification clauses than with contractors' efforts to seek insurance.

Because EPA realized contractors were not complying with SARA's requirement to make diligent efforts to obtain insurance, the procurement division sent Superfund contracting officers a memorandum, dated February 14, 1989, directing them to remind contractors of their insurance obligations under SARA. Officials in EPA's regional offices informed us that while some contractors have made efforts to seek insurance, others had not begun to do so until after the February memorandum.

EPA's interim section 119 guidance established procedures that EPA could have used to monitor compliance with the requirement for proof of efforts to obtain insurance. These procedures authorized indemnification on a case-by-case basis following (1) a recommendation from the agency's task force regarding the contractor's eligibility, (2) approval from OSWER, and (3) concurrence from EPA's Office of the Comptroller within 7 days of the recommendation. However, according to EPA officials, these procedures were almost never followed. Although EPA indemnified Superfund contractors in over 1,000 section 119 indemnification agreements, officials from EPA's Office of the Comptroller told us that only about eight requests for indemnification—all awarded to contractors working for states—had undergone the authorization process required by the agency's interim guidance. According to procurement officials, on the basis of discussions they had with the task force several months before the interim guidance was issued, it was their understanding that the task force waived these procedures for EPA's Superfund response contractors. However, this waiver was not documented, and EPA officials could not explain why it was granted or why it continued once the interim guidance directive was issued.

By not strictly enforcing the SARA section 119 insurance requirements, EPA has reduced contractors' incentives to seek private insurance alternatives to federal indemnification. Indemnified contractors may be reluctant, in fact, to seek any insurance alternatives that could possibly jeopardize their ability to qualify for EPA indemnification, which they receive at no cost. The SARA insurance requirements could have served as a catalyst for developing a market for RAC pollution liability insurance. In not using the insurance requirements as intended, EPA may have missed an opportunity to stimulate the currently small insurance market for RAC risks.

Subsequent Proof of Efforts to Obtain Insurance

In its interim guidance, EPA did not comply with the SARA requirement that contractors continue to make diligent efforts to seek insurance each time they begin work at a new site. An EPA task force official told us that contractors have asserted that this requirement is unduly burdensome for multi-site contracts covering large geographical areas. Again, EPA has not required its Superfund response contractors to comply with this mandatory SARA requirement.

EPA Has Not Limited Indemnification Amounts Under Its Interim Section 119 Guidance

SARA section 119 established Superfund as the source of funding for third-party liability claims against indemnified contractors. The Congress mandated in SARA section 119 that each indemnification agreement be limited to a maximum dollar amount.

EPA's interim guidance does not establish a limit on indemnification because, as EPA explained in a July 1988 draft of its proposed final section 119 guidance, it "did not want to arbitrarily establish limits on indemnity levels without thoroughly researching the issue." Moreover, the agency's position under the interim program is that the unobligated balance of Superfund represents the limit of any and all indemnification claims. The July 1988 draft guidance further stated that once final section 119 limits of indemnity levels are determined, explicit limits would be applied to all contracts.

We believe that the agency's decision not to place a limit on indemnification, other than the unobligated balance of Superfund, under its interim guidance did not comply with SARA. This decision in effect continues a nearly decade-long practice of providing indemnification in unspecified amounts to its contractors. But since the enactment of SARA, contracting activity under Superfund has increased significantly. Between January 1988 and June 1989 alone, EPA awarded 38 ARCS contracts valued at about $5.5 billion and 6 TES contracts worth about $710 million. All of these contracts contain clauses that provide indemnification in unspecified amounts. Potential claims against these agreements could reduce the fund's unobligated balance, seriously delaying the pace of the national cleanup effort.

We believe that EPA should have imposed at least some interim indemnification limits on response action contracts entered into since the date of enactment of SARA. Instead, EPA's decision not to apply specific limits on indemnification agreements until its final guidance creates a "window"—from date of enactment of SARA to issuance of the final guidance.

During this period, contractor negligence can give rise to government liabilities up to the entire unobligated Superfund balance plus any additional authorized funds appropriated by the Congress for this purpose as provided in SARA. As of March 1, 1989, the unobligated balance in Superfund amounted to about $1.3 billion.

EPA's Proposed Final Guidance Addresses Some of Our Concerns

In its May 1989 draft guidance on section 119, the latest version available at the time of this review, EPA proposes to require contractors to conform with SARA's insurability provisions. EPA either did not comply with or did not enforce these provisions in the interim program. This guidance also proposes to require a specified limit on the amount of indemnification to be provided. We believe that EPA needs to develop management controls to ensure that any procedures it issues are followed.

Specifically, in the draft guidance, EPA asserts that it has no authority to indemnify a contractor that fails to meet the statutory requirements of section 119. Contractors will be required to comply with SARA's insurance requirements. The guidance states that EPA will determine on a case-by-case basis whether adequate insurance is available and that such determination will be based on documentation submitted in fulfillment of the "diligent effort" requirement. To be eligible for indemnification, diligent efforts must be demonstrated both initially and when work begins at a new facility, for multi-site contracts, and that no indemnification will be granted until the contractor submits the required documentation. The proposal also stipulates that each agreement will specify a limit on the amount of indemnification provided.

EPA has not implemented a system of internal controls for managing the indemnification program and ensuring that SARA's requirements are followed. A system for managing the section 119 program should include controls to, among other things, track and monitor contractors' diligent efforts to obtain insurance, ensure that indemnification agreements are authorized and executed only by persons authorized to do so, and maintain information on the extent to which subcontractors receive flowdown indemnification.[1] EPA's experience with its interim section 119 program indicates that EPA needs a management control system to

[1]The Comptroller General, in Standards for Internal Controls in the Federal Government, identified the internal control standards that government managers should follow to achieve program objectives.

ensure consistent application of SARA's requirements and EPA's procedures. Under the new ARCS contracts, EPA is moving to decentralized management of Superfund response contractors. With greater reliance on regional contract management, EPA's need for proper management controls for granting and overseeing indemnification agreements will be essential.

Conclusions

The Congress intended that federal agencies limit the application of SARA section 119 to situations in which the requirements in the law are met. Specifically, an indemnification agreement can be provided only after it is determined that (1) adequate insurance is not available to cover a contractor's liability at a reasonable price, (2) a contractor made diligent efforts to obtain insurance, and (3) a contractor seeks insurance before commencing work at each new site. EPA is routinely providing indemnification to all its response contractors without fully complying with these requirements. Additionally, because the agency is not strictly enforcing the SARA insurance requirements, contractors have had little incentive to seek pollution liability insurance, and the agency may have removed a stimulus to the further development of a contractor insurance market.

Although SARA section 119 clearly mandates that federal agencies limit the amount of indemnification available to contractors, EPA has been providing indemnification in unspecified amounts under its interim section 119 guidance. The potential obligations associated with claims against these agreements could be higher than SARA intended and delay the Superfund program by diverting funds that ordinarily would be available to finance actual cleanups. In its draft proposed final guidance, EPA addresses some of our concerns. However, EPA does not expect the final guidance to become effective until 1990, at the earliest. Moreover, in its proposal, EPA has not developed a system of management controls to ensure that the indemnification program will be administered in compliance with the law.

Recommendations to the Administrator, EPA

To encourage the development of pollution liability insurance for response action contractors and limit dependence on federal indemnification, we recommend that the Administrator, EPA, implement management controls for the section 119 indemnification program that will ensure that the insurance requirements in SARA are strictly enforced and that indemnification decisions are made on a discretionary case-by-case basis, as the Congress intended.

In addition, to avoid unnecessary exposure of Superfund while EPA's section 119 guidance is being developed, we recommend that the Administrator attempt to reach an immediate agreement with contractors indemnified under the interim program to place a specific limit on the amount of indemnification they are being provided and specify a limit in indemnification agreements provided under the interim program for new contracts.

EPA Comments and Our Response

In its comments on a draft of this report (see app. III), EPA stated that it did not set a limit on indemnification agreements in the interim guidance because section 119 requires it to allow public comment before issuing final guidance. In our view, this requirement would not preclude interim limits or interfere with the public's right to comment on final limits. In addition, it is noteworthy that EPA set a deductible of $100,000 on indemnification agreements in its interim guidance. This, however, was below the deductible of $1 million that appears in some pre-SARA contracts. In addition, EPA said that indemnification limits will be retroactively imposed on contractors when the final guidance is issued. Our discussions with EPA officials and our review of contracts indicates that EPA has the right to negotiate limits with contractors but has no right to unilaterally impose limits or make them effective retroactively. In addition, if EPA does not implement our recommendation to negotiate a limit on existing contracts and impose them on new contracts under the interim program, it will continue to face unlimited liability until the final guidance comes out and will lose its chance to limit its liability on contracts that expire before then.

EPA also stated that the indemnification provided under its interim guidance was not open-ended, that it was limited to the Superfund appropriations available at the time a claim is presented and, therefore, EPA was not out of compliance with the section 119(c)(5) requirement for indemnification limits. In our view, interpreting SARA's requirement to include the entire amount of funds remaining in the Superfund unobligated appropriation is incorrect because it makes the requirement essentially meaningless. We believe that the section requires that EPA set limits for indemnifying individual contracts at some amount less than the entire unobligated appropriation.

EPA said that it satisfied the requirements of section 119 dealing with eligibility for indemnification. These are, as discussed earlier in this chapter, that a determination is made that (1) adequate insurance is not

available to cover a contractor's liability, (2) the contractor made diligent efforts to obtain insurance, and (3) the contractor seeks insurance before commencing work at each new site. In addition, the law defines an approved subcontractor as a response action contractor eligible for indemnification. Therefore, these requirements must be met by each indemnified contractor and subcontractor. EPA said its general finding, early in the program, that insurance was unavailable, and its recent actions to inform contractors of available insurance sources and directing them to inquire about this coverage, satisfied the SARA requirements. We do not believe that these limited EPA actions complied with SARA, which calls for a case-by-case determination of eligibility. Insufficient attention was given in particular to subcontractor eligibility and to contractor efforts to seek insurance both at the time of contract award and as work commenced at new sites.

Potential Organizational Conflict-Of-Interest Issues

To help develop policy guidance for implementing section 119, in September 1985 OSWER obtained the services of the Planning Research Corporation (PRC), an indemnified contractor. Since that time, at a cost of almost $1 million, PRC has assisted in preparing the agency's interim guidance and drafting proposed final guidance. PRC has also produced several issue papers on indemnification for agency use. In addition, following the initiation of its policy support work, PRC was awarded two major Superfund response action contracts containing section 119 indemnification; their combined potential value is over $300 million.

An important principle underlying federal and EPA procurement regulations directs contracting officers to prevent potential organizational conflicts that might bias a contractor's judgment. However, despite PRC's seemingly conflicting roles—as indemnification policy adviser and indemnified response action contractor—there was no documentation that EPA made a determination as to whether an organizational conflict of interest existed until March 1989, when EPA made such a determination at our request.

On a broader scale, EPA could strengthen its ability to prevent Superfund conflicts of interest from occurring by implementing recent recommendations we have made dealing with this issue.

Contractor Duties

For 4 years, PRC has played a major role in developing the interim and final guidance governing section 119 indemnification. According to PRC officials, PRC drafted a document entitled "Proposed Section 119 Guidelines—Federal Register Notice," which EPA distributed in July 1988 among the response action contractor community for comment. In its role of providing assistance to the task force on section 119, PRC has also prepared several issue papers on indemnification, including, for example, a study of whether section 119 represented the federal government's sole authority for indemnifying Superfund response action contractors. According to a procurement official, from September 1985 through May 1989, EPA paid $953,302 for PRC's support work, which was performed on work assignments under two major indemnified TES contracts—first as prime contractor on the $30 million TES II contract (Sept. 1985 to Sept. 1987), then as a subcontractor on the $67 million TES III contract (Oct. 1987 to May 1989). The work is currently being performed under PRC's recently awarded TES Zone 4 contract, which we discuss below.

EPA Did Not Resolve Potential Bias Issues

Federal procurement regulations state as a principle that contracting officers are to prevent conflicting roles that might bias a contractor's judgment.[1] However, we found no documentary evidence that EPA made a formal determination about whether PRC's policy support work for section 119 conflicted with the firm's role as a response action contractor until we raised the issue during our review. EPA's acquisition regulations require that contracting officers document, in writing, the resolution of any identified actual or potential conflicts of interest.[2]

On June 3, 1986, PRC submitted a letter to the OSWER official who was at the time overseeing the agency's development of section 119 guidance. In this letter the contractor acknowledged that, since it was a response action contractor, the appearance of a conflict of interest might arise. The contractor also maintained in the letter that the assignment team performing the indemnification work was independent of the firm's corporate components responsible for insurance and risk management tasks. The contractor further emphasized that its analysis for section 119 indemnification issues provided only policy alternatives and not recommendations for EPA to adopt.

The OSWER official to whom this letter was addressed did not raise the potential conflict with EPA's contracting officer for the PRC TES II contract, who, under agency procurement procedures, would have been responsible for determining whether an actual organizational conflict existed. Moreover, during the solicitation process preceding the award of PRC's subsequent ARCS Region V and TES Zone 4 contracts, EPA contracting officials received no indication of a potential conflict regarding PRC's section 119 policy support work. PRC officials told us in April 1989 that the contractor assumed that any problem had been resolved since EPA had not responded to its June 1986 letter that had originally raised the issue. The ARCS Region V and TES Zone 4 contracts have a total combined potential value of about $328 million.

At our request, EPA agreed to review this issue in February 1989. Initially, the agency concluded that, although there was an appearance of a conflict of interest, no actual conflict existed involving PRC's dual role as indemnification policy adviser and indemnified Superfund response action contractor. EPA supported PRC's contention that the work had been conducted in an unbiased, objective manner. In April 1989, however, a

[1]Federal Acquisition Regulation (FAR) Part 9, Subpart 9.5.

[2]Environmental Protection Agency Acquisition Regulation (EPAAR), Subpart 1509.5.

Superfund procurement official told us that EPA was continuing to look into potential conflicts involving PRC's section 119 policy support work.

In its June 30, 1989, comments on a draft of this report, EPA said that contrary to assertions made in this report, EPA had reviewed PRC's role for conflict of interest before GAO requested a review. EPA said that its contracting officer had determined that PRC had no conflict of interest when its use as an indemnification adviser was first proposed. As mentioned above, however, our review disclosed no documentation of a conflict-of-interest review in EPA files. EPA had the contracting officer currently responsible for PRC's indemnification work review this issue. According to that review, EPA's original contracting officer said he was not at the meeting PRC referred to in its June 1986 letter with an indemnification task force official to discuss potentially conflicting roles. The current contracting officer said that it appeared that the original contracting officer had never been notified of the potential conflicts.

EPA also said in its comments that the subsequent April 1989 review determined that there was a potential for an apparent conflict of interest. Accordingly, EPA said that PRC's "work assignment was modified to restrict the further involvement of PRC in any activities that could be construed as having any bearing on their business interests as a response action contractor."

We concur with EPA's decision to examine this matter and to limit the scope of PRC's work assignment. In our view, it can be difficult for a contractor with indemnified contracts as large as PRC's to totally ignore its own interests and provide completely objective analysis in support of EPA's implementation of section 119 indemnification.

The adequacy of EPA's procedures for preventing conflicts of interest on Superfund contracts was the subject of a recent GAO review. In February 1989, we reported that EPA needs to improve its system for preventing such conflicts and recommended that EPA (1) check compliance with its requirements for avoiding, neutralizing, and mitigating conflicts of interest during its reviews of contractor performance; (2) direct contracting officers to follow requirements for documenting actions taken to resolve conflicts; and (3) provide contractors and contracting officers with additional written guidance for avoiding conflicts.[3] EPA has not yet formally

[3]Superfund Contracts: EPA's Procedures for Preventing Conflicts of Interest Need Strengthening (GAO/RCED-89-57, Feb. 17, 1989).

responded to our recommendations. EPA's implementation of these recommendations would help prevent or mitigate future potential conflicts of interest.

Conclusions

The contractor providing policy support for the agency's development of section 119 guidance is also a direct beneficiary of this policy through its role as a major Superfund response action contractor with large indemnified contracts. We concur with EPA's decision to examine potential conflicts regarding this contractor's roles and to curtail the contractor's policy support activities. As we recommended in our February 1989 report, EPA needs to strengthen its system program-wide for avoiding Superfund conflicts of interest.

EPA Comments and Our Response

According to EPA's comments (see app. III), PRC's policy role was limited and EPA substantially changed PRC's draft guidelines before they were released. While EPA may have made revisions to PRC's draft guidance, it is clear that PRC played a major role in developing the indemnification program. For example, PRC was the only contractor providing policy assistance to EPA for the indemnification program and prepared issue papers on such topics as the need for indemnification and appropriate indemnification limits.

EPA also said it took "exception to the implication that PRC's activities in support of the indemnification task force are improper." The objective of this chapter is not to imply that PRC's activities were improper but, rather, that EPA gave insufficient attention to an apparent conflict of interest. In the EPA Administrator's June 1989 report on his review of the Superfund program,[4] the Administrator concluded that contractors should "refrain from executing policy and regulatory analysis or guidance preparation on work they are also charged with carrying out in the field." The report recommended that:

"To protect the integrity of the program and to preserve the reputations of participating contractors who are so important to Superfund's success, EPA should begin immediately to develop guidance proceedings and award criteria to preclude firms from holding both policy and regulatory support contracts as well as response action contracts under the Superfund program."

[4]"A Management Review of the Superfund Program," EPA, June 1989.

PRC Comments and Our Response

In a June 13, 1989, letter commenting on a draft of this chapter (see app. IV), attorneys for PRC said that PRC "unconditionally denies its judgment is in any respect biased in the performance of the technical and support assistance provided to EPA . . . ." Our report does not charge actual bias in the indemnification work PRC provided for EPA. Our concern is the potential bias associated with organizational conflicts of interest. EPA's regulations (EPAAR 1509.509(b)) list, as an example of such a conflict, a company that proposes, in response to a request for proposals, to undertake an analysis of an industry from which it derives substantial income. The regulations state that

> "the appearance of an . . . [organizational conflict of interest] . . . could undermine the credibility of the data generated under the contract and render such data useless for its intended purpose, regardless of whether any bias is actually reflected in the data."

PRC also said that both EPA and PRC had taken "significant action to neutralize or mitigate any bias that could have resulted from PRC's role as a Response Action Contractor." PRC then described these significant actions as (1) its June 3, 1986, letter to EPA, referred to in this chapter, in which it discussed potential conflicts of interest and (2) EPA's creation of the indemnification task force and various technical review panels to develop section 119 guidelines and regulations. In our view, neither of these actions resolved the potential conflict of interest. As we indicated earlier, we found no documentary evidence that EPA's contracting officer acted on PRC's letter. Further, EPA's creation of the task force and review panels were not actions taken to resolve contractor conflict of interest.

Further Description of Methodology

As indicated in chapter 1, SARA section 119(c) directed GAO to study the application of the indemnification provision, including

- whether indemnification agreements are being used,
- the number of claims that have been filed under such agreements, and
- the need for indemnification.

We also reviewed the program's compliance with the law and evaluated aspects of its management.

To determine the status of implementation of section 119 indemnification government-wide and within EPA, we met with program officials of EPA's Task Force on Section 119 Indemnification. We obtained and reviewed interim guidance for implementing section 119 at EPA, draft proposed guidelines for government-wide implementation, comments received on the draft guidelines, and contractor-prepared issue papers on indemnification.

To determine the extent to which section 119 indemnification agreements were being used, we met with contracting officials in EPA, who manage contracts for the federal Superfund program, and in the Departments of Defense, Energy, and the Interior, the only federal agencies whose cleanup efforts at Superfund sites were far enough along at the start of our study to be contracting for RAC services. From EPA's contracting and grants officers, we obtained copies of applicable contracts, agreements, and grants to review actual language and verify the extent to which EPA is using section 119 indemnification. We did a limited review of selected contract files at EPA and obtained copies of representative contracts with prime contractors that include indemnification.

To determine the number of section 119 agreements, we obtained names of prime contractors and estimates of the number of subcontractors indemnified by EPA from Washington-based procurement officials for EPA headquarters-managed contracts, grants, cooperative agreements, and interagency agreements. From each of the 10 EPA regional offices, we obtained similar information on region-managed contracts and contractors working for states for which the region maintains oversight. We obtained names of EPA-indemnified prime contractors and estimates of EPA-indemnified subcontractors working for the Army Corps of Engineers from the Corps' Missouri River Division. We obtained information on the number of EPA-indemnified SARA section 126 grantees from the National Institute of Environmental Health Sciences.

To determine if claims have been filed against section 119 indemnification agreements, we met with the attorney from EPA's Office of General Counsel who is responsible for reviewing any claims submitted by indemnified contractors to determine the extent of EPA's legal obligation to indemnify.

To assess the need for section 119 indemnification, we examined availability of insurance for RAC risks and the terms under which RACs work without indemnification. Building on recent GAO work on liability and environmental insurance,[1] we met with the American Insurance Association, which represents major underwriters of the commercial property/casualty insurance industry, to determine if there had been any increase in the availability of pollution insurance since we issued those reports. We also discussed the future outlook for commercial insurance and reinsurance for these risks and perceptions of legal and regulatory incentives that would make this market insurable. We contacted the task force, EPA regions, and associations representing RACs to determine the extent to which insurance from nontraditional sources had emerged since our earlier reviews.

To determine the terms under which RACs are willing to work without indemnification, we attempted to examine the extent to which they are actually doing work similar to their Superfund work without indemnification for states, responsible parties, and other agencies. To determine the extent to which RACs are working without indemnification for states, we obtained from EPA regional officials the names of prime contractors working for states. We compared this with information provided by the task force on the results of its survey of a sample of state indemnification policies and a telephone interview survey of the 50 states conducted by the Hazardous Waste Action Coalition, which represents architectural and engineering contractors. The two surveys identified states that require contractors to indemnify the state or have laws prohibiting contractors from receiving indemnification.

We spoke with selected response action contractors working for EPA to determine whether they do similar work cleaning up NPL sites for states and PRPs and whether the PRPs agree to assume any portion of liability caused by their contractors' negligence. We selected these contractors because they participated in meetings we had with their associations or

[1]Recent work included Hazardous Waste: Issues Surrounding Insurance Availability (GAO/RCED-88-2, Oct. 16, 1987) in response to another SARA mandate; Liability Insurance: Effects of Recent "Crisis" on Businesses and Other Organizations (GAO/HRD-88-64, July 29, 1988); and Hazardous Waste: The Cost and Availability of Pollution Insurance (GAO/PEMD-89-6, Oct. 28, 1988).

their associations told us they would be willing to speak with us on an individual basis. We also asked Defense, Energy, and Interior officials about their RAC indemnification policies.

We met with the Hazardous Waste Action Coalition; the Remedial Contractors' Institute, which represents both architectural and engineering, and construction contractors; and the National Constructors Association, which represents construction contractors, to obtain their views on the need for section 119 indemnification. We also discussed with these representatives under what terms they work for states, responsible parties, and other federal agencies; how Superfund cleanups for EPA differ; the amount of indemnification they need; and the availability of pollution liability insurance for their work.

We reviewed EPA's oversight of the indemnification agreements and adherence to the interim guidance for implementing section 119. We assessed the adequacy of the interim guidance as an internal control system using the criteria set forth in the Comptroller General's Standards for Internal Controls in the Federal Government. With task force officials, we discussed EPA's policy, guidelines, etc., for granting indemnification, including determining who, within EPA, is authorized to approve indemnification. We also analyzed EPA's interim guidelines, procedures used to grant indemnification, contract language, and indemnification clauses for conformity with the requirements in SARA.

Finally, we examined a potential organizational conflict of interest involving the Planning Research Corporation, which had contracted with EPA to provide assistance with the development of indemnification policy. We reviewed federal and EPA acquisition regulations, policies, and procedures for preventing and handling conflicts of interest. We discussed areas of potential bias with EPA procurement officials, the contractor, and the task force and mitigating steps they had taken.

EPA Prime Superfund Program Contractors Indemnified Under SARA Section 119 as of June 2, 1989

Dollars in millions

Prime contractor	Response action contract[a] Type	Potential value	Performance period
NUS Corp.	ARCS Region III	$216	Jan. 1988-Dec. 1997
CH2M Hill	ARCS Region V	227	Feb. 1988-Jan. 1998
Black & Veatch	ARCS Region V	220	Mar. 1988-Feb. 1998
WW Engineering & Science	ARCS Region V	58	Mar. 1988-Mar. 1998
PRC	ARCS Region V	212	Apr. 1988-Mar. 1998
Ecology & Environment	ARCS Region V	61	May 1988-May 1998
Ecology & Environment	ARCS Region III	63	May 1988-May 1998
Roy Weston	ARCS Region V	222	Jun. 1988-May 1998
CH2M Hill	ARCS Region III	233	Jun. 1988-Jun. 1998
Tetra Tech	ARCS Region III	65	Jun. 1988-Jun. 1998
Donohue & Associates	ARCS Region V	227	Jun. 1988-May 1998
Black & Veatch	ARCS Region III	65	Jun. 1988-Jun. 1998
Ebasco	ARCS Region II	223	Sept. 1988-Aug. 1998
CH2M Hill	ARCS Regions VI, VII, VIII	152	Sept. 1988-Aug. 1998
NUS Corp.	ARCS Region I	146	Sept. 1988-Sept. 1998
Arthur Little	ARCS Region I	69	Sept. 1988-Sept. 1998
ICF Technology, Inc.	ARCS Region II	63	Sept. 1988-Sept. 1998
Jacobs Engineering	ARCS Regions VI, VII, VIII	150	Sept. 1988-Sept. 1998
Fluor Daniel	ARCS Regions VI, VII, VIII	142	Jan. 1989-Dec. 1998
TAMS Consultants	ARCS Region II	63	Feb. 1989-Jan. 1999
Roy Weston	ARCS Regions VI, VII, VIII	156	Feb. 1989-Jan. 1999
Roy Weston	ARCS Region I	66	Feb. 1989-Jan. 1999
Ecology & Environment	ARCS Regions IX and X	71	Mar. 1989-Feb.1999
CDM	ARCS Region II	229	Mar. 1989-Mar. 1999
Roy Weston	ARCS Region II	66	Mar. 1989-Mar. 1999
CDM	ARCS Regions VI, VII, VIII	155	Mar. 1989-Mar. 1999
Ebasco	ARCS Region I	64	Mar. 1989-Mar. 1999
TRC Companies	ARCS Region I	63	Mar. 1989-Mar. 1999
CH2M Hill	ARCS Regions IX and X	268	Mar. 1989-Mar. 1999
Sverdrup	ARCS Regions VI, VII, VIII	67	Mar. 1989-Mar. 1999
Morrison Knudsen	ARCS Regions VI, VII, VIII	155	Mar. 1989-Mar. 1999
Metcalf and Eddy	ARCS Region I	138	Apr. 1989-Mar. 1999
CDM	ARCS Region I	149	Apr. 1989-Apr. 1999
Roy Weston	ARCS Regions IX and X	271	May 1989-Apr. 1999
Ebasco	ARCS Region IV	146	Jun. 1989-Jun. 1999
CH2M Hill	ARCS Region IV	150	May 1989-May 1999
Malcolm Pirnie	ARCS Region II	232	May 1989-May 1999
URS Consultants	ARCS Regions VI, VII, VIII	158	May 1989-June 1999

(continued)

	Response action contract[a]		
Prime contractor	**Type**	**Potential value**	**Performance period**
O.H. Materials	ERCS Zone 1 (Regions I, II, III)	116	Jul. 1987-Jul. 1991[b]
O.H. Materials	ERCS Zone 2 (Region IV)	65	Jul. 1987-Jun. 1991[b]
PEI	ERCS Zone 3 (Region V)	64	Oct. 1987-Sept. 1991[b]
Riedel	ERCS Zone 4 (Regions VI-X)	176	Mar. 1987-Feb. 1991[b]
S&D Engineering	ERCS Region II	11	Oct. 1988-Sept. 1991[b]
BES Environmental	ERCS Region III	10	Feb. 1988-Feb. 1991[b]
Guardian	ERCS Region III	10	Feb. 1988-Feb. 1991[b]
Environmental Health, Research & Testing	ERCS Region III	16	Mar. 1988-Mar. 1992[b]
Westinghouse HAZTECH, Inc.	ERCS Region IV	17	Aug. 1988-Aug. 1991[b]
O.H. Materials	ERCS Region IV	19	Aug. 1988-Aug. 1991[b]
MaeCorp, Inc.	ERCS Region V	48	Oct. 1986-Oct. 1990[b]
Ensite, Inc.	ERCS Region IV	17	Aug. 1988-Aug. 1991[b]
Westinghouse HAZTECH, Inc.	ERCS Region II	15	Feb. 1989-Feb. 1992[b]
Environmental Technology, Inc.	ERCS Region III (Areas 2&3)	12	Apr. 1989-Apr. 1992[b]
Guardian	ERCS Region III (Areas 2&3)	10	Apr. 1989-Apr. 1992[b]
Jacobs Engineering	TES IV (Zone 2, Regions V-X)	66	Sept. 1986-Sept. 1989[b]
CDM	TES (Zone 1, Regions I-V)	124	Dec. 1988-Dec. 1993
Alliance Technologies	TES (Zone 1, Regions I-V)	136	Dec. 1988-Dec. 1993
CDM	TES (Zone 1, Regions I-V)	118	Dec. 1988-Dec. 1993
Dynamac Corp.	TES (Zone 2, Regions III and IV)	107	Dec. 1988-Dec. 1993
SAIC	TES (Zone 4, Regions VIII, IX, X)	109	Dec. 1988-Dec. 1993
PRC	TES (Zone 4, Regions VIII, IX, X)	116	Dec. 1988-Dec. 1993
Ebasco	REM III (Regions I-IV)	198	Nov. 1985-Sept. 1990
CH2M Hill	REM IV (Regions V-X)	204	Nov. 1985-Sept. 1990
Williams, Russell, and Johnson	REM V (Regions II-VI)	21	Jul. 1987-Jun. 1991
Peer Consultants	REM VI (Regions II-VI)	21	Sept. 1987-Sept. 1991
NUS Corp.	FIT (Zone 1, Regions I-IV)	130	Nov. 1986-Oct. 1991
Ecology & Environment	FIT (Zone 2, Regions V-X)	154	Nov. 1986-Oct. 1991
Roy Weston	TAT Zone I (Regions I-V)	136	Dec. 1986-Sept. 1990[b]
Ecology & Environment	TAT Zone II (Regions VI-X)	83	Dec. 1986-Sept. 1990[b]
Kimmins Environmental	Incineration (DelRay Beach, FL)	2	Dec. 1987-Apr. 1989[b]
Envirite	Incineration (Prentiss, MS)	2	Dec. 1987-Feb. 1989[b]
CH2M Hill	Tech Support for Superfund Policy	13	Jul. 1988-Jul. 1991[b]
Riedel	Dioxin Excavation (Region VII)	40	Sept. 1987-Sept. 1992[b]
Geotrans	Groundwater Modelling and Expert Witness Support (Niagara Falls, NY)	2	Apr. 1986-Apr. 1990
Cambridge Analytical	Chemical Analysis and Expert Witness Support (Niagara Falls, NY)	3	May 1986-Apr. 1990
Gradient Corporation	Chemical Fate, Human Exposure/ Expert Witness Support (Niagara Falls, NY)	2	Aug. 1986-Aug. 1990

(continued)

Prime contractor	Response action contract[a] Type	Potential value	Performance period
Ganet Fleming Water Resources Engineering	Engineering Support (Niagara Falls, NY)	7	Aug. 1986-Aug. 1990[b]
Ecology and Environment	Engineering and Expert Witness Support (Niagara Falls, NY)	3	Mar. 1986-Mar. 1990[b]
Roy Weston	Environmental Services Assistance Teams, Zone I (Regions I, II, III, and V)	30	Jul. 1987-Jul. 1991[b]
ICF Technology, Inc.	Environmental Services Assistance Teams, Zone II (Regions IV, VI, VII, VIII, IX, X, and Headquarters)	35	Sept. 1987-Sept. 1991[b]
Warzyn Engineering	Remedial Planning Activities (Wausaw, WI)	3	Jul. 1987-Sept. 1991[b]
Total potential value		**$7,952**	

[a]Most recent data available at the time of this review.

[b]Dates reflect full range of performance period options to be negotiated between EPA and contractor.

Comments From the Environmental Protection Agency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
POLICY, PLANNING AND EVALUATION

JUN 30 1989

Mr. Richard L. Hembra
Director, Environmental Protection Issues
Resources, Community, and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Hembra:

I am responding to your letter of May 24, 1989, requesting official Agency comments on a General Accounting Office (GAO) draft report. The draft report is entitled "Superfund: Contractors Are Being Too Liberally Indemnified by the Government." Your letter asked the Environmental Protection Agency (EPA) to review and respond officially to the report within 15 calendar days.

We met your request by meeting with your staff on Wednesday, June 7, and provided oral comments on behalf of the Agency. Productive discussion ensued and a followup meeting was scheduled to maintain the dialogue.

This letter is the official written Agency response to the report. For the most part, these comments summarize the issues discussed at the June 7 meeting. Under separate cover, I am providing hand written staff comments that clarify particular issues and provide the most recent information that should be reflected in the final report.

Chapter 2 - Section 119 Indemnification Agreements Used But No Claims Filed

Now on p. 28.

See comment 1.

The recommendation on page 34 states that the EPA Administrator should require federal agencies to use section 119 rather than general contracting authorities if they choose to indemnify Superfund contractors. Since federal statutes do not empower the Administrator to require other federal agencies to carry out their missions, I suggest that GAO substitute draft report language to reflect this fact. GAO could appropriately recommend that the Administrator advise or suggest that federal agencies use section 119. GAO could also recommend that the Office of Management and Budget require that federal agencies use SARA section 119.

Chapter 3 - EPA May Not Need To Indemnify All Superfund Response Contractors

In this chapter, GAO suggests that "EPA should determine, through its procurement process the extent to which indemnification is necessary to obtain contractor services." While we concur that this might be beneficial, we are concerned that the approaches suggested by GAO pose certain difficulties not addressed by GAO that may limit its appeal.

See comment 2.

For fixed price contracts, GAO suggests that EPA could use the New Jersey system as a model and add the cost of indemnification to a bid. EPA then would evaluate, for award purposes, this adjusted bid. The award price, however, would be at the unadjusted bid price. There may be a procurement risk associated with this approach. Under the existing acquisition regulations, in order to consider indemnification cost in a sealed bid procurement, the cost must be quantified with reasonable certainty. At this time, it may be difficult to ascertain the true cost of indemnification to the government with reasonable certainty.

See comment 2.

For a cost reimbursement contract, it may be difficult to relatively rank offerors based on the indemnification requested by offerors as suggested in this chapter. Such a rank ordering would have to be done through the technical evaluation factors set forth in the Request For Proposal (RFP). At the RFP stage, it would be difficult to ascertain the appropriate weight to be placed on indemnification since, for most EPA contracts, the precise work to be performed under the contract is unknown. Furthermore, CERCLA 119(f) effectively precludes the consideration of cost as an evaluation factor in a significant number of EPA Superfund cost-reimbursement procurements. One could argue that GAO's recommended approach is inconsistent with section 119(f), in that it uses, as an evaluation factor, a weighted rank-ordering system as a proxy for indemnification cost.

See comment 2.

In its discussion on the need for indemnification, GAO correctly notes that there are several factors that EPA should take into consideration when considering whether (or how) to indemnify. One of those factors noted by GAO is the effect of indemnification agreements on Superfund costs. GAO emphasizes that a policy of indemnifying contractors may cause increased federal outlays in the future. GAO has, however, not given equal emphasis to the certainty of increased insurance costs in the short term if EPA fails to indemnify, and has ignored completely the certainty of increased costs (in the form of reimbursement for the cost of insurance or self-insurance) on cost reimbursement contracts.

Chapter 4 EPA Noncompliance With Key Indemnification Requirements

Chapter 4 concerns the Agency's interim guidance implementing section 119. In several passages, GAO suggests that EPA should have implemented a section 119 policy structure, including contract modification for specific dollar limits on indemnification, without opportunity for public comment. This approach is contrary to section 119. The Agency, in the interest of issuing timely interim guidance, prepared guidance on noncontroversial and technical issues compatible with section 119. Policy details in the final guidance will be implemented retroactively to the SARA authorization and all contracts will be amended to include terms of the final guidance, including specific dollar limits.

See comment 3.

GAO frequently refers to contractor indemnification offered before enactment of section 119 and under the interim guidance as "unlimited" or open-ended. We disagree with this characterization. Both pre-SARA indemnification and indemnification provided under the interim guidance are limited by the availability of Superfund appropriations at the time a claim is submitted to the Agency. We disagree with any suggestion that we have not complied with the section 119(c) (5) requirement that indemnification agreements include "limits on the amount of indemnification to be made available".

See comment 3.

The GAO draft report states that EPA is not complying with the provisions of section 119 relating to insurance coverage for contractors. Moreover, GAO states (page 52) that EPA "acknowledges" that it does not have authority to "waive" the requirements that contractors seek out and obtain insurance at a fair and reasonable price. EPA does not acknowledge non-compliance with section 119 and disputes GAO's characterization of the Agency's actions. EPA did not "waive" this requirement. Rather, EPA determined, based on its extensive analysis of the insurance market in the period immediately preceding and following enactment of section 119, that pollution insurance was simply not available for response action contractors at a fair and reasonable price (indeed this dilemma prompted the enactment of section 119 and was a generally recognized fact). EPA reflected this finding in its interim guidance. The guidance provides that contractors must continue to monitor the insurance market and document their efforts to obtain insurance. As a limited market has begun to emerge in recent months, EPA has informed the contractor community and directed contractors to inquire about coverage. It is our view that these actions comply with the statutory provisions of section 119(c) (4).

Now on p. 45.

See comment 3.

Now on p. 49.

We disagree with GAO's assertion in the last sentence on page 57 that the Agency has not developed a system of management controls to ensure that the indemnification program will be administered in compliance with the law. Prior to and immediately following CERCLA reauthorization, the Office of Waste Programs Enforcement recognized the need to address Superfund's new discretionary authority to indemnify response action contractors. Steps were taken for the development of guidance and regulations each of which were specifically mandated by statute, and an action plan was drafted with specific milestones for the completion of interim and final guidances and publication of regulations.

See comment 4.

Chapter 5 Apparent Conflict Of Interest Not Satisfactorily Resolved By EPA

Now on p. 53.

EPA takes exception to several statements made in Chapter 5. The first is on page 59, in which the following statement appears: "...Planning Research Corporation (PRC) drafted a policy document entitled "Proposed Section 119 Guidelines--Federal Register Notice," which EPA distributed among the response action contractor community for comment."

The implication is that PRC independently developed section 119 draft guidance. This is not the case. PRC assisted the Agency indemnification task force in the development of the guidance.The document underwent extensive review by Agency staff and was substantially changed throughout the course of this review. To imply that PRC's draft was accepted by the Agency and released for distribution to the response action contractor community is misleading and wholly inaccurate. To imply further that PRC has influenced the Agency's indemnification policy proposal, through stating that the June 1988 draft document "serves as a basis for EPA's final policy proposal", is a misrepresentation.

See comment 5.

Now on p. 53.

A second inaccurate statement appears on page 60. The report states that PRC will continue to assist the (indemnification) task force by helping to assess the public response to the Agency's proposed guidance and preparation of the final guidance." This is not the case. Agency staff will perform the analysis of public comments to the draft guidance and will write the final guidance as well.

See comment 6.

Now on p. 54.

A third error also appears on page 60 where it is stated that "EPA did not make a formal determination about whether PRC's policy support work for section 119 conflicted with the firm's role as a response action contractor until we raised the issue during our

See comment 5.

review." The Contracting Officer, who issued the work assignment that called for support for the indemnification task force, did indeed determine that there was no conflict of interest when the original work plan (proposing use of PRC staff) was submitted. He made this determination based upon information available to him at the time regarding the proposed tasks to be performed under contract.

A subsequent review of potential conflict of interest on work performed under this work assignment was performed in April 1989. At that time, the Agency determined that, while PRC's activities up to that point did not constitute an actual conflict of interest, there was a potential for an apparent conflict of interest. Accordingly, the work assignment was modified to restrict the further involvement of PRC in any activities that could be construed as having any bearing on their business interests as a response action contractor.

See comment 5.

The Agency takes exception to the implication that PRC's activities in support of the indemnification task force are improper. The implication detracts from the considerable effort to analyze issues and develop the draft and final guidance undertaken by highly capable Agency staff. PRC's staff functioned as technical advisors on issues pertaining to the insurance industry. Any analysis they performed of indemnification issues was then subject to extensive Agency review. All key decision-making responsibility was maintained in-house. PRC did not draft policy or make decisions on behalf of the Agency.

I appreciate the opportunity to respond formally to the draft and GAO's sensitivity to our comments.

Sincerely,

Robert H. Wayland III
Deputy Assistant Administrator

The following are GAO's comments on the Deputy Assistant Administrator's letter dated June 30, 1989.

GAO Comments

1. Response provided in chapter 2.

2. Response provided in chapter 3.

3. Response provided in chapter 4.

4. We revised the report to make clear that while EPA's interim guidance includes written internal control procedures, such as requirements for Office of the Comptroller review of indemnification applications, EPA had not implemented them. EPA's draft proposed final guidance does not include implementing procedures.

5. Response provided in chapter 5.

6. Statement was deleted.

Comments From the Planning Research Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

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S. NEIL HOSENBALL

June 13, 1989

Mr. Richard L. Hembra
Director, Environmental Protection Issues
Resources, Community, and Economic
Development Division
General Accounting Office
Washington, DC 20548

Dear Mr. Hembra:

Now on pp. 53-57.

PRC has reviewed Chapter 5 (pp. 59-62) GAO Draft Report "Superfund: Contractors Are Being Too Liberally Indemnified by the Government" and, having been afforded the opportunity by GAO hereby submits the following comments.

GAO finds that because Planning Research Corporation (PRC) has provided technical assistance to EPA in support of EPA's development of interim guidance and final guidance implementing Section 119 of Superfund Amendments and Reauthorization Act of 1986 (Pub. L. 99-499) and was the successful offeror in April and December 1988, being awarded two Superfund Response Action Contracts (RAC) which contained Section 119 indemnification clauses, an apparent conflict of interest exists and EPA has not satisfactorily resolved the perceived conflict.

See comment 1.

It should be made clear in the report that the awards made to PRC in 1988 were competitive procurements in which all RAC proposers receive equal benefit of any indemnification provisions included in the RFP and therefore the work performed under the PRC TES contract did not and does not provide PRC with a competitive advantage in competing for RAC procurements.

See comment 2.

The report states that because PRC was providing "policy advice" and was also an Indemnified Response Action Contractor that this fact might have biased PRC's judgment in performing its support work in EPA's development of guidance implementing Section 119. PRC again unconditionally denies its judgment is in any respect biased in the performance of the technical and support assistance provided to EPA as communicated to you at the meeting to discuss this issue on April 14, 1989.

EPA had been providing broad indemnification coverage to its Response Action contractors for 8 years prior to the enactment of Section 119 of the 1986 Superfund Amendments and Reauthorization Act. Congress after extensive hearings on the 1986 Superfund legislation enacted Section 119(c) granting EPA discretionary authority to indemnify RAC contractors and provided further in Section 119(c)(7) that the President shall develop guidelines before the promulgation of regulations carrying out the provisions of subsection (c). PRC is providing technical assistance and support to the EPA in the development of such guidelines and regulations.

See comment 2.

Both PRC and the EPA have taken significant action to neutralize or mitigate any bias that could have resulted from PRC's role as a Response Action Contractor. As early as June 3, 1986, as is noted in your draft report, PRC submitted a letter to OSWER referring to both EPA's and PRC's concern about the potential appearance of a conflict of interest and informed officials overseeing the agency's development of Section 119 guidance of actions taken by PRC to avoid such appearance of conflict of interest. The letter stated:

> Although PRC is a response action contractor, the work assignment team is independent of its corporate components that are responsible for insurance and risk management. The Technical Enforcement Support Contract QA/QC procedures and the oversight from the EPA Task Force on RAC Indemnification will assure that the products from the work assignment are based on objective, technical analysis. In particular, the amended Work Plan on Work Assignment 404 has presented the information and methodology that are to be reviewed and approved by the EPA Task Force. Furthermore, the work assignment team understands that its analysis only provides policy alternatives for EPA's consideration. The team makes no recommendation as which alternative EPA should adopt.
>
> The goal of the work assignment team is to provide EPA with an analysis of the RAC indemnification issues based on verifiable data and its experience in this field. All analytical results will be fully justifiable and open for examination. Nevertheless, PRC wishes to avoid any appearance of conflict of interest. We hope the above measures will

alleviate EPA's concern. Please let us know if you have any questions or suggestions as to other means to address this issue of potential conflict of interest.

As indicated in the letter, EPA had established an Indemnification Task Force. The Task Force consists of members from the following EPA offices: Office of Solid Waste and Emergency Response, Office of Enforcement and Compliance Monitoring, Office of Administration and Resource Management, and the Office of General Counsel. The representatives of these offices were fully aware of the assistance and support of PRC. It was the responsibility of this Task Force composed solely of public officials to develop the interim guidelines, to publish guidelines and then to promulgate regulations implementing the indemnification authority provided by Section 119 and to insure that there would be adequate public comment from all interested parties on the guidelines and regulations. EPA also established technical review panels consisting of experts in actuarial science, risk management, insurance/indemnity contracts, pollution liability underwriting, as well as representatives of environmental groups, together with potentially responsible parties who under Section 119(c)(6) would be liable for amounts EPA expended for indemnification.

The actions therefore taken by both PRC as well as EPA avoids, neutralizes and mitigates any potential for PRC bias. The work performed by PRC was conducted in an unbiased and objective manner as is evidenced by the data it collected and provided to EPA as well as the issue papers and alternative approaches provided for EPA consideration. These alternative approaches ranged from providing no indemnification to RAC contractors to incentive based alternatives that would stimulate the availability of adequate commercial insurance at reasonable cost.

Conclusion

It is clear that both PRC and EPA were sensitive to the fact that PRC could be a beneficiary of whatever policy was finally adopted by EPA and both adopted measures to assure that the policy would be based on objective and unbiased information and considerations. The perceived conflict of interest identified by GAO in its draft report had been previously addressed and satisfactorily resolved by EPA and PRC. The EPA final guidance and regulations will be the result of the recommendations of its Task Force and the public comments from all the interested parties. The decision as to what policy to

adopt is solely that of EPA. Further any proposed regulations will be subject to the review and approval of the Office of Management and Budget.

Respectfully submitted,

DAVIS, GRAHAM & STUBBS

S. Neil Hosenball

Attorneys for Planning Research Corporation

The following are GAO's comments on the letter from PRC dated June 13, 1989.

GAO Comments

1. Our report does not address whether PRC had a competitive advantage because of its indemnification work.

2. Response provided in chapter 5.

Major Contributors to This Report

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Related GAO Products

Making Superfund Work Better: A Challenge for the New Administration (GAO/T-RCED-89-48, June 15, 1989).

Sound Contract Management Needed at the Environmental Protection Agency (GAO/T-RCED-89-8, Feb. 23, 1989).

Superfund Contracts: EPA's Procedures for Preventing Conflicts of Interest Need Strengthening (GAO/RCED-89-57, Feb. 17, 1989).

Superfund: Missed Statutory Deadlines Slow Progress in Environmental Programs (GAO/RCED-89-27, Nov. 29, 1988).

Availability of Insurance for Petroleum Underground Storage Tanks (GAO/T-RCED-88-9, Nov. 18, 1988).

Hazardous Waste: The Cost and Availability of Pollution Insurance (GAO/PEMD-89-6, Oct. 28, 1988).

Superfund: Interim Assessment of EPA's Enforcement Program (GAO/RCED-89-40BR, Oct. 12, 1988).

Environmental Protection Agency: Protecting Human Health and the Environment Through Improved Management (GAO/RCED-88-101, Aug. 16, 1988).

Liability Insurance: Effects of Recent "Crisis" on Businesses and Other Organizations (GAO/HRD-88-64, July 29, 1988).

Superfund Contracts: EPA Needs to Control Contractor Costs (GAO/RCED-88-182, July 29, 1988).

Superfund: Insuring Underground Petroleum Tanks (GAO/RCED-88-39, Jan. 15, 1988).

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