

BCA BAR ASSOCIATION

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EDITOR'S COMMENT

by Jim Nagle

The major topic in Board of Contract Appeals litigation continues to be certification of claims under the Contract Disputes Act. The battleground has shifted from the courts and boards (where contractors have been failing resoundingly and frequently) to the regulatory arena and Congress. The Office of Federal Procurement Policy has proposed changes to the certification process that would address who can properly certify a claim, while Senator Howard Heflin of Alabama has introduced legislation which would make an improper certification not affect the jurisdiction of the Claims Court or the Board of Contract Appeals. This issue will be followed by all of us and will be reported in these pages as new developments arise.

Between the Board of Contract Appeals Bar Association and a predecessor, the Armed Services Contract Trial Lawyers Association, I have been editing these newsletters for over five years. Doubtlessly, all of you are begging for a change so that you can have an editor who is articulate, knowledgeable, and with a keen eye for what is important and topical. Unfortunately, everyone we asked that had those qualifications refused to take the job. So, Peter McDonald of Deloitte & Touche has foolishly agreed to accept the responsibility.

In all seriousness, Peter will be an outstanding editor. He is familiar to all of us in the Association as the author of "The Accountant's Corner" and as the co-author of a very important article on the environmental cost principles, Part I of which appeared in our previous issue, and the second part in this issue. Peter, besides being an attorney, is also a certified public accountant. He recently

retired from the Army and now has joined the staff of Deloitte & Touche.

The most important things you can do to help Peter, and yourselves, in his desire to produce a first-rate publication is first, send him materials. (Peter's address and telephone number are: Peter A. McDonald, Deloitte & Touche, 1900 "M" Street N.W., Washington, D.C. 20036, (202) 955-4230) We are always on the lookout for articles of any length, book reviews, case notes, bibliographies. Second, please keep Peter and the Association apprises of any change of address. Nothing is more frustrating to an editor than to have copies returned because of incorrect addresses.

Remember that the Association's Annual Meeting is coming up in October and is mentioned elsewhere in this issue. The Annual Meeting is always a top-flight affair, with an impressive array of speakers, excellent materials, and very topical subjects. I look forward to seeing all of you there. In the meanwhile, I wish Peter the best of luck in what I am sure he will find to be a very rewarding endeavor.

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THE PRESIDENT'S COLUMN

By Frank Carr

This year has been an active one for the BCA Bar Association. I am pleased to report that we have made progress on general administrative matters and special programs. However, we still have a long way to go to meet my vision by our organization.

Our membership chair (and future newsletter editor), Peter McDonald, has been working hard to generate new membership and to put together a current membership roster with up-to-date addresses. He will need your help to spread the word on the advantages of membership and encourage others to join our Bar Association. Furthermore, Peter is developing a directory of our membership that should be available shortly for all members to reference. This should be helpful to everyone.

The Treasurer, Steven Porter, reports that the BCA Bar Association is in good financial posture. Also, Steve informs me that you should be receiving your dues notices soon. Please make sure your address is correct when you return your dues.

Our Secretary, Robert Schaefer, and I have been working to create a certificate of membership suitable for framing. Obviously, this will be an original design. I expect to have the certificate available for distribution at the Annual Meeting this fall.

Concerning special programs, our Bar Association recently sponsored a highly successful and well attended breakout session at the Federal Circuit Judicial Conference held in Washington, DC. The topic was "What Price the Environment? Who Should Pay?" The BCA Bar Association Program Chair, John Chierichella, and Administrative Judge Carol Park-Conroy, were responsible for planning the breakout session and arranging for speakers. John also served as moderator. They deserve our appreciation for a job well done.

The next program to look forward to is the Annual Meeting. The location as well as the Program Chair have changed from last year. This time, the Annual Meeting will be held at the Crown Plaza, Metro Center, Washington, DC. The date is October 26. I mention this important meeting to you so that you can mark it on your calendars. All members are encouraged to attend. We need membership participation to have a good meeting. The new Program Chair is Barbara E. Wixon.

I hope to have more progress to report to you in our next newsletter.

BCA BAR ASSOCIATION ANNUAL MEETING

By Sally B. Pfund

The Annual Meeting of the BCA Bar Association will include a panel discussion addressing potential techniques for obtaining expeditious and cost-effective resolution of mid-size disputes, intending to include those disputes with a monetary value which precludes resort to the accelerated procedures of the Boards, but for which costs must be minimized in order to make claim prosecution worthwhile. The Panel will consider a number of different approaches such as use of discovery limitations, ADR options, or stipulations; and differing perspective, i.e., does the Board have a duty to assist a contractor in containing litigation costs, and/or, does the Government have an interest in expeditious, cost-effective resolution of contractor claims?

RETIREMENT OF JUDGE VASILOFF

On 30 May 1992, Judge Karl S. Vasiloff retired from the Armed Services Board of Contract Appeals after more than 14 years service.

Karl Vasiloff was born in Lansing, Michigan on 18 May 1930. He received his law degree from the University of Michigan Law School in 1955. Prior to his appointment to the Armed Services Board of Contract Appeals, Judge Karl Vasiloff practiced his profession with the National Academy of Sciences 1955-1959, engaged in the private practice of law 1960-1962, tried cases for the Federal Trade Commission in 1962, was an assistant attorney general for the State of Michigan for ten years 1963-1973, tried contract cases for the Department of the Navy 1973-1975, and then became a member of the Interior Board of Contract Appeals in April 1975.

Judge Vasiloff is a member of the Michigan Bar and is also admitted to practice in the U.S. District Courts for the Eastern and Western Districts of Michigan, the former U.S. Court of Claims, and the Supreme Court of the United States. He was appointed to the Armed Services Board of Contract Appeals in January, 1978.

RETIREMENT OF JUDGE GOMEZ

On 3 July 1992, Judge Robert G. Gomez retired from the Armed Services Board of Contract Appeals after nearly 15 years service. Judge Gomez was born in Fall River, Massachusetts on 10 February, 1935. He received his law degree from Georgetown University Law Center in 1967. Prior to his appointment to the Armed Services

Board of contract appeals, Judge Gomez served in the General Counsel's Office in the Maritime Administration from April 1967 - January 1971, was an assistant counsel in the Office of Counsel for the Naval ship Systems Command, Department of the Navy from January 1971 - May 1974, an Assistant to the Navy General Counsel from May 1974 - July 1975, and an Assistant General Counsel, Office of the General Counsel, Department of the Navy from July 1975 - November 1977. He was appointed to the Armed Services Board of Contract Appeals in November 1977. A reception was held at the Fort McNair Officer's Club on 24 June. Goodbyes were exchanged and stories told. Judge Gomez leaves the Board to join American Management Systems, Inc., of Rosslyn, Virginia.

BOARD BASHING

By Philip M. Risk

This is a retrospection on the article, THE DISPUTES PROCESS: A GOVERNMENT PROSPECTIVE, which appeared in the Winter 1992 edition of "The BCA Bar Association."

Although the title of the article is sufficiently general to include the entire procurement process, almost 90% of the lineage deals with board and lawyer bashing. The remaining three paragraphs advance a plan for pre-decisional review of proposed contracting officer decisions, coupled with an inconsistent belief that the authority of the contracting officer should be strengthened. The review is recommended to be accomplished by "an impartial party within an agency, someone not intimately involved in the contract in dispute," The intimation is that such a review would discourage unwarranted decisions in favor of the government, as well as frivolous defense of appeals to the boards and courts.

Since interference in the business functions of the contracting parties should not, in this writer's opinion, be a primary function of lawyers or bar associations, further comment on the tangled web spun by the article will be eschewed by this writer. Indeed, he will wear earplugs during the remainder of this writing so as to block out the cries of anguish emanating from the Virginia side of the Potomac (which may still be within the District of Columbia at high tide according to strange law).

Also, the intervention of this new Disputes Czar would accelerate the disputes process in some arcane way.

Board Bashing. In the Oxford American Dictionary a bash is defined alternatively as "a violent blow or knock" and "(slang) a party or festive good time." With but a modicum of poetic license both can be applied to the sport of generally belittling the boards, decrying their existence, but offering no constructive suggestions. Probably the most notable suggestion comes from those who maintain that board procedures are too "judicialized"; appeals should be

decided without discovery, pleadings, papers, documents, witnesses or hearings. "Those" include even a former board chairman who insisted that well-appointed board members were aware of all of the problems that could engender disputes and appeals, and therefore the latter should be decided "down, quick and dirty." The reader will pardon the omission of a footnote crediting the source of the quoted expression.

Another form of board bashing is to focus on one tiny opinion of one tiny board and generalize from that tiny opinion that all boards and judges would be guilty of the same imagined sins. The vox populi rise up and shout "Fix or kill all the boards and judges."

The subject of this writing is an excellent example of both types of bashing.

According to the article, a statement by the chairman of one board in his annual report "is indicative of a [board] process that is broken." The author strikes (bashes) at the very bowels of the existence of the boards with the comment "I don't mind saying to you that as far as I am concerned, the system is constipated

and it needs drastic measures to fix it and needs them soon."

What was the terrible dictum uttered by the embattled chairman which prompted the author's medical diagnosis? The report stated "The filings in FY 1991 show a considerable increase over the previous 5 years. This is most welcome (sic). I believe it is indicative of the level of activity to be anticipated from [the agency's] current programs." Perhaps the chairman was too expansive. But as far as this writer is concerned he was simply expressing relief at the fact that his agency's activities, which had been severely cut back in recent years, were beginning to repercolate. It is difficult to relate the attitude expressed pressed by the chairman to the efficiency and raison d'etre of about a dozen boards and more than 60 judges. Even the author's prescription is questionable. Rather than some antidote for constipation, perhaps a dose of Kaopectate might have been in order.

The next horrible example cited in the article was a decision by the GSBGA on an ADP protest, in which the board ordered that the protester's legal fees and expenses be reimbursed to the judgment fund from Navy appropriations. The author was of the opinion that the board did not have the authority to so order, stating "I am troubled by what appears to me to be an expansion into the realm of authority of the federal agencies, where they do not even have a legal right."

Although claiming to have "had enough experience with the Board of Contract Appeals to last a lifetime," the author failed to note that the GSBGA was not acting in a contract dispute under the CDA, but was merely the desig-

The vox populi rise up and shout "Fix or kill all the boards and judges."

nated agent of GSA to carry out a statutory function in certain protests. In the view of this writer, a board judge rarely concerns himself (herself) with the business functions of the agencies or contractors and cares little where the money is found to pay awards or judgments. To be sure, it has happened, particularly in connection with certifications of claims, but not often enough to constitute a trend. And, not often enough to consider the boards as "broken."

Taking a cue from the Vice-President's remarkable foray at the last ABA Annual Meeting, the author proposes that the principal monkey-wrench is the Bar. They have a duty to prevent contractors from pursuing cases that do not "have a chance of winning," and "lawyers are taking the contractor for a ride at our expense." The author challenges our association to come up with a list of 50 reforms like that other fellow did and claims that they "are being implemented." The fact is that the ABA agreed with about 20 basic points; disagreed with about a dozen; and did not even comment on the balance. The ABA also produced a blueprint of more than 20 proposed improvements, to which the reaction of the Vice-President's press secretary, admitting he had not read the ABA product asked "Is this the one that calls for more money in the pockets of lawyers?" Apparently there is a party line emanating from the White House down to the author of the article.

The author proposes that Administrative Judges should "have a code of what they should be doing, what they should be looking at, and what their limits are." Perhaps the association should send the author copies of the Board Rules and the ABA Code of Judicial Conduct.

It must be admitted that the author has a point when referring to our annual and other meetings she writes "What is the value of these meetings if the same things are discussed year after year? What have you done? (sic)"

It is suggested that the association might have a good answer to the author's question: "How many years are you going to continue hearing from people like me who are anxious to talk about the broken process?" (Emphasis supplied.)

Which brings this writer to the nub of this exercise. Having analyzed the performance of a Board Basher has the exposition exposed the futility of that practice? The defenseless boards have to weather bashing from both the agencies and the contractor community. One could surmise that it is a *res ipsa loquitur* which *per se* proves the impartiality of the boards; or that if they always err (as each losing party believes) they are at least erring without fear or favor. In the long view, even that is a plus.

This concludes with a plea: Let us eschew Board Bashing. Let us critique ideas, concepts, procedures and

even individual decisions; and, above all, let us propose improvements; not indulge in saber-rattling with a view toward cutting off 60 heads in one fell swoop. Nor should the pro-ram committee suffer speakers who revel in that sport; nor should the editors of this fine publication waste space by printing such non-thoughts. Amen.

THE ACCOUNTANT'S CORNER TYPES OF AUDITS

By Peter A. McDonald, C.P.A., Esq.

All audits are not alike, but many attorneys who work in government contracts are unmindful of the differences between compliance audits, operational audits, audits of financial statements, compilations, and reviews. This brief article will highlight the differences between these engagements.

Compliance audits are exactly what their name represents them to be. Auditors determine whether (and to what extent) an entity complied with applicable laws, regulations, or policies. For example, OMB Circular A-133 details the standards for all recipients of federal grants. In order to receive continued federal funding, such organizations must submit to an audit. In this manner, federal agencies ensure that federal funds were properly accounted for and used toward their intended purposes. In government contracts, both DCAA and GAO perform a variety of compliance audits and their reports are occasionally made public. The typical DCAA audit verifies whether a contractor's financial representations set forth in a proposal or claim comports with the cost accounting standards (CAS), the FAR cost principles and generally accepted accounting principles (GAAP). The audit report usually goes to regulatory officials.

Operational audits are internally oriented examinations of individual departments or programs. Their results are reported to management. Through such audits, the effectiveness and efficiency of a directorate or project is scrutinized. (Efficiency as used by accountants, means how economically the allocated resources were used. Effectiveness refers to how well the stated objectives were achieved.) Operational audits frequently precede organizational reorganizations and realignments.

The most common type of audit is the audit of financial statements. Because DCAA auditors do not audit financial statements to prepare an auditor's opinion, this type of audit is one that government attorneys are most unfamiliar with. DCAA auditors examine a contractor's financial records not to attest to their consistency with GAAP, but to ascertain whether expenses were properly charged to government contracts, whether accounting policies and procedures conform to CAS requirements, and so on. Disagreements between the government con-

tractor are resolved by the contracting officer. In audits of financial statements, however, disagreements are resolved between the auditing firm and the company's management.

Financial statements are composed of a balance sheet an income statement and a statement of cash flows. The preparation of these statements is the responsibility of a company's management who are also responsible for their content. Creditors (banks, bondholders) and investors (stockholders) are very interested in the accuracy of a company's financial reports, which is why third party verification is so important. This is where the C.P.A. comes in. The C.P.A. audits the financial statements by reviewing the accounting records, inspecting inventory, verifying assets checking liabilities with suppliers, and otherwise performing an extensive process of doublechecking management's representations. An unqualified opinion from the auditor attests that the financial statements conform to GAAP, thus providing a degree of assurance to those who extend credit or invest in the company.

Then there are review engagements. A review of financial statements is not an audit. The C.P.A.'s accompanying report specifically states that the review involved only inquiries of employees and certain limited analytical procedures. The financial statements themselves are usually stamped "unaudited."

Finally, there are compilation engagements. A compilation is also not an audit. Rather the C.P.A. organizes financial data provided by management and formats the presentation of that data in a manner consistent with the practices of the particular industry concerned. The C.P.A. does not verify the accuracy of the data which is why a compilation report states:

These financial statements have not been audited or reviewed, and accordingly no opinion or any other form of assurance is expressed.

The type of audit engagement depends on the needs of the client who knows that the greater the amount of audit work required the higher the cost. Also C.P.A.s must comply with far more comprehensive and stringent auditing standards for an audit of financial statements than for a review, and those standards are constantly being revised and updated. Because large audit engagements lie beyond the capabilities of most accounting firms the audits of almost all major corporations are performed by one of the "Big 6" (Deloitte & Touche, Price Waterhouse, Coopers & Lybrand, Arthur Andersen, Ernst & Young, & KPMG Peat Marwick).

While there is considerably more to be learned about the nuances of the different types of audits this overview should enable attorneys to grasp the essential distinctions.

THE JUDGE'S CORNER THE LAZY JUDGES' GUIDE TO MANAGING QUANTUM CASES

By E. Barclay Van Doren

I regard quantum cases with a warmth otherwise reserved for tax returns. So I was reticent when asked to capsule a partly tongue-in-cheek presentation on managing quantum cases which I made at the January 1992 educational seminar of the Board of Contract Appeals Judges Association (BCAJA). But my tormentor was persistent and I capitulated. So here it is, with tongue-still-lodged-in-cheek and with its original if-you-can-find-anything-worthwhile-the-more-power-to-you tenor.

Because of my warm feelings about quantum cases, I've tried to make them easier, and my efforts have led to the Lazy Judges' Guide to quantum. There are four rules in the Lazy Judges' Guide -- Lazy Judges' Rules (LJRs) 1-4, inclusive. Most litigators have no more love for proof of quantum than do judges -- unless, of course, their fee is contingent. Nearly all of us are beset by quantum malady at one time or another. These LJRs are sure relief from this affliction (-- not!).

So here are the rules, which, for illustrative purposes, are discussed in the context of a contract change:

LJR No. 1. A judge must become learned in the law of quantum and from that law derive her/his own definitions of key quantum terms. These definitions should be made a matter of record, and, most importantly, used throughout the proceeding and in the decision-making process with unrelenting discipline. A judge should insist that counsel follow adopted definitions in their filings and their proof whenever they employ defined terms. Rule No. 1 is the foremost rule in the Lazy Judges' Guide.

If we have learned anything at the Energy BCA, it is to make sure everyone uses the same dictionary. Otherwise, at best, the judge and counsel will talk past each other, and the record will be a dense fog of confusion. Failure to bring consistency to terminology will haunt a judge just as certainly as the new year brings those ugly 1040s.

Think back. How many times has Appellant represented that its proof is on the basis of "actuals," when the critical proof is not actuals at all? Frequently, while there may be actuals, i.e., auditable cost records for the job as performed, many actuals will be records of consumption of such fungible things as common items of labor, supply or equipment usage. Often, such records do not and, indeed, cannot, establish that there was an increase in costs caused by the change --which is, of course, the issue. These records do not establish the actual cost of a change, and counsel should not be allowed to claim that such proof is based on actuals. If

Government counsel doesn't effectively oppose by making clear that only part of the proof is based on actuals, the judge should "enlighten" Appellant's counsel at the first opportunity and "assist" both counsel in using terms accurately.

Again, think back. How many times has Government counsel fairly shouted "Total Costs," when Appellant sought to prove increased costs caused by a change by establishing the difference between what it actually cost to perform the contract as changed and estimates of what it would/should have cost to perform the contract if it had not been changed? This method of proof is not the disfavored and dubious total cost method. The total cost method seeks to recover not the difference between the actual costs of performing the changed contract and estimates of what it would/should have cost to perform the unchanged contract, but, rather the difference between those actual costs and the bid or negotiated price of the contract -- two very different forms of proof in terms of their potential probative value both as to amount and causal connection. Government counsel, nevertheless, sometimes attempt to classify as "total cost method" all forms of proof that attempt to establish quantum on an aggregated basis, including those proofs based upon estimates. If Appellant's counsel doesn't effectively oppose by making appropriate distinctions, the judge should "enlighten" Government counsel at the first opportunity and "assist" both counsel in using terms accurately.

LJR No. 2. A judge should apply the Best Available Evidence Test (distinguish, please, from the Best Evidence Rule) and ensure both that counsel understand the Test and that the judge and the Board apply it. Case law requires claimants to produce the most competent form of evidence which is, or, reasonably, should be available both to prove the increased costs caused by a change and the amount of the increased costs. A judge should also ensure that counsel understand that if they rely on indirect proofs when contemporaneous records were-required-to-have-been (should-have-been? See, *Dawco*, 930 F2d 872 (Fed. Cir. 1991)) maintained, their quantum case will be in a peck of trouble unless they have a powerfully good explanation. Further, a judge should make clear to counsel that the true total cost method almost never passes the Best Available Evidence Test. And finally, a judge should guide counsel to an understanding that mere proof of greater than expected costs or greater than normal costs are not alone proof that any part of the excess was caused by a change.

The Test has a substantive aspect and a procedural aspect. The substantive aspect is that some forms of evidence are inherently better than others. For example, suppose a change, issued after nailing has been completed, requires the contractor to reduce the interval between nails from two feet to one foot. In that case, two paid invoices for an appropriate numbers of nails, one

dated before the change and one after, are, when coupled with connecting fact testimony, inherently better proof than expert testimony that it should have cost one cent per foot for nails when they are on two foot centers and two cents per foot when the nails are on one foot centers. The opinion evidence should not be accepted as sufficient to establish the increased cost of nails without foundation evidence that direct proof of the cost of the nails for both the changed and unchanged work, reasonably, was not available.

The procedural aspect suggests, when caseload permits, that a judge should start talking quantum early in a proceeding. Currently, the Energy BCA is able to involve its judges at an early stage. After pleadings are complete, we hold a telephone conference which, in all but small appeals, results in a "Comprehensive Discovery and Scheduling Order" specifically tailored to the appeal. Unless entitlement and quantum are bifurcated, the order, inter alia, requires, at a minimum, that the parties seasonably exchange and file statements of their quantum proof and theories and copies of exhibits, including demonstrative exhibits. This and other provisions of the order, especially those relating to identification of quantum witnesses in sufficient time for deposition, are discussed with counsel. The judge usually uses this discussion to begin the process of term definition and to explain his/her expectations. This process, not dissimilar to processes employed by judges at other boards, has proven useful to the Energy BCA and parties alike.

LJR No. 3. Judges should recognize that a contractor is entitled to prove quantum -- even if the best evidence available is, reasonably, indirect and circumstantial. If a Board finds for Appellant on entitlement, it follows that the Government is legally responsible for the Appellant's resulting situation. If Appellant's situation is such that injury is established, but the best evidence available as to the amount of the injury is replete with uncertainties as to amount, Appellant is, nevertheless, entitled to prove its quantum through that evidence, provided it also establishes that the absence of better evidence is reasonable. See, *Pickard*, 532 F2d 739 (Ct.Cl. 1976); *Neal*, 945 F2d 385 (Fed. Cir. 1991); *Dawco*, 930 F2d 872 (Fed. Cir. 1991).

Rule No. 3 is really a variant of the First Rule of Jurisprudence going back to Deuteronomy: Seek justice. Judges should conduct proceedings and decide cases in a manner which allows the parties to realize their contractual expectations. The contract gives the Contractor the right to an equitable adjustment if the Government issues, or is otherwise liable for, a change that increases the cost of performance. Clearly, the parties expect that the Contractor will be fully compensated for the allowable costs of such a change. Clearly, the parties do not expect that a contractor must eat the costs of a change solely because it is not feasible to maintain records accurately

allocating costs to the change.

In many instances, it is simply impossible to maintain contemporaneous records which document meaningful allocations of common item costs between a change and the work as originally contracted. For one, while a change may be a discrete new item of different work for which separate cost records could be maintained, more often they are not. Rather, the most common change is one that modifies an as-contracted specification for an item of work in some particular such as materials, methods, tolerances, etc. When this occurs, there are usually items of labor, equipment and supply consumed in the performance of the changed specification which would also have been consumed to perform the unchanged specification -- only, the changed specification may have consumed different amounts of these common items than would have been required for the unchanged specification. Under such circumstances, records purporting to allocate costs between the changed and the unchanged item are almost certainly futile and spurious. Thus, there are times when direct proof of increased costs through contemporaneous records is not possible and the only available proof is indirect proof. When this is so, it is virtually axiomatic that some form of indirect proof, usually employing estimates, will pass the Best Available Evidence Test.

Then, too, multiple overlapping events, some "owned" by the Government and some by the contractor, may affect the same work stream. Records purporting to make allocations may be far from probative and are likely to be misleading. In other instances, pervasive changes or extensive delays affect work streams in ways that preclude meaningful allocation through contemporaneous records. In these instances, too, indirect proof may be the best evidence available.

LJR No. 4. The final rule is really a collection of four maxims relating to evidentiary hearings on quantum: (1) a judge should not go to trial unless both counsel know the theories and proofs that they and the opposing counsel will advance; (2) a judge should not go to trial unless the judge knows the theories and proofs that counsel will advance; (3) a judge should emphasize the importance of cross-examination and rebuttal evidence in quantum cases and set the stage for counsel to effectively cross and rebut; and (4) a judge should not let key witnesses, particularly summarization witnesses, leave the stand until the judge fully understands their testimony. If a judge fails to follow these principles, the judge will spend his/her evenings engaged in something worse than the preparation of tax returns and, at the very least, will surely fail in the obligation to render a prompt decision.

There is simply nothing worse for a judge than trying a heavy quantum case when counsel doesn't know what sheorhe is trying to prove or disprove -- or when the

judge doesn't understand what counsel is or is not doing. Incomprehensible quantum evidence creates an uncomfortable sensation akin to tax return phobia (a deep and uncontrollable dread, if ever there was one). Experience teaches judges that transcripts rarely provide insights not obtained during trial. Experience also teaches judges that an incomprehensible quantum case is far worse than an incomprehensible entitlement case. In the entitlement portion of a case, if the proponent doesn't present its case in a comprehensible fashion, the proponent is likely to fail to meet its burden of proof and its case will crash and burn. Somehow, failures of proof always seem clearer in the entitlement portion of a case than in the quantum portion, and the consequences of such failures always seem more obvious and certain. So, a judge, observing counsel flounder through a quantum case, is filled with dread and foreboding over the decision-making and opinion-writing that lie ahead.

A judge, however, can do much through prehearing activities to assure that both counsel have their quantum ducks in a row and, at the same time, help the judge to become prepared to follow the evidence. A judge can also enhance the probabilities of a comprehensible record by emphasizing to counsel the particularly important role that cross-examination and appropriate rebuttal can play in the quantum portion of a case. Too, a judge can improve counsel's ability to effectively cross and rebut quantum evidence by getting theories, available evidence, and the identity and potential testimony of available witnesses out in the open as early as possible and by requiring an early pretrial exchange of exhibits and, when appropriate, of written direct testimony.

As mentioned above, the effect of quantum proof on a decision is often very different than that of entitlement proof. The distinction is not always evident to counsel and, therefore, an explanation to counsel may be helpful. Entitlement is usually all or nothing. Often, opposing counsel's optimal tactic on entitlement is to leave a perceived failure of proof to argument rather than risk helping the proponent to correct flaws in its proof by pointing up the flaws during cross or rebuttal.

Quantum is different. The calculus is often complex. Notwithstanding the numerical nature of the evidence and result, the apparent precision of the evidence is usually illusory. Moreover, quantum evidence is frequently more judgmental than entitlement evidence. A wide range of outcomes is often possible. Proof that fails, often clearly fails only in part. For this reason, cross or rebuttal may be unusually valuable to the trier of fact by narrowing the range of possible outcomes. Also, in the quantum portion of a trial, some of the guidelines generally followed by litigators in the entitlement portion of the case should be reversed: counsel will frequently obtain better results by delving into the shortcomings of quantum

proof through cross and rebuttal than by simply arguing a perceived failure of proof after the record is closed.

Finally, a judge should be prepared to be more activist in the quantum portion of a case than in the entitlement portion. Frequently, it is more necessary/appropriate for a judge to follow up quantum testimony than entitlement testimony to assure that he/she fully comprehends it. A judge who releases a key witness without resolving doubts about the internal consistency of the witness's testimony or the relationship of an expert's testimony to other key evidence will surely pay a heavy price in the decision-making process and runs a considerable risk of a wrong, if not erroneous, result.

Well, those are the LJRs -- a lighthearted treatment of a most weighty subject. A more down-to-earth view is that quantum cases are difficult and most lawyers and judges find them boring. For these reasons, they are often poorly tried. However, quantum is that which is usually of greatest importance to the parties. For the claimant, winning on entitlement only to lose on quantum is winning the battle but losing the war. For the defending party, there are often opportunities to retake much of the ground seemingly lost in the entitlement engagement. For the judge, a well-developed record on entitlement may be for naught if quantum plays out poorly. Effective advocacy on quantum issues and sound case management by the judge are often the most critical aspects of a case.

The fact that quantum cases may be difficult should not daunt lawyers since handling difficult subjects is a hallmark of our profession. Further, once lawyers and judges really get into quantum and gain command of the facts, the boredom is greatly alleviated and trial of quantum can even become heady, and perhaps exhilarating. Disciplined preparation and presentation pay handsome dividends in quantum cases. Some of the principles embodied in the LJRs may help you in these endeavors. But Caution: Read the fine print. Excessive reliance on the LJRs may be hazardous to your case.

ENVIRONMENTAL COSTS FOR GOVERNMENT CONTRACTORS: GORDIAN KNOT REDUX, PART II

**By Peter A. McDonald and
Scott P. Isaacson**

Introduction

Part I of this article highlighted the lack of legal authority on the question of allowability of environmental costs and the scarcity of helpful discussion of this issue in current literature.¹ In short, present accounting for environmental costs under government contracts can at best be described as anarchy marked by conflicting public policy considerations. For example, some agencies have

refused to recognize certain environmental costs on the grounds that such costs are unallowable. However, such agency determinations should validly be questioned in light of the very specific definition in FAR 31.001 of "unallowable cost" as "any cost which, under the provisions of any pertinent law, regulation or contract, cannot be included in prices, cost reimbursements, or settlements under a Government contract to which it is allocable." Virtually no law, regulation or FAR clause makes environmental costs unallowable.

In Part II, we discuss what we believe should be guiding principles in analyzing and resolving disputed environmental costs, whether in a judicial forum or in settlement negotiations. These analytical principles concern the issues of compliance, risk, harm, and pervasiveness. Through the application of these principles, we suggest these equitable tools be used to resolve disputed cost claims in a climate of legal uncertainty. While all four principles are equally weighted in this presentation, they are not intended to be rigidly applied like trigonometry axioms, but are jurisprudential in nature so as to adapt to particular circumstances.

Background

As discussed in Part I of this article, two types of environmental costs potentially may be incurred by a government contractor -- costs related to current compliance with environmental laws (compliance costs) and those costs related to remedial requirements (cleanup costs). Compliance costs are generally covered by the Permits and Responsibilities clause² which requires contractors to comply with all applicable federal, state and local laws in the performance of the work, even if those laws are enacted after contract award.³ Any costs incurred by a contractor associated with meeting applicable environmental requirements (e.g., special containers, handling equipment, hazardous waste disposal, protective gear, or measuring instruments) relate to the operation of the contractor's business and are costs of complying with the contract. On the other hand, cleanup costs are those expenses incurred to remediate property currently or formerly owned or operated by the contractor or property for which the contractor is otherwise liable to remediate. In many cases, it is not possible to determine all of the parties responsible for contaminating a facility because the site history is unclear, the liable parties cannot be found or no longer exist, the relevant records are unavailable, or the nature and extent of the contamination sources are not ascertainable. From the above discussion, the distinction between compliance and contamination costs can be seen: Compliance costs relate to work under the contract, while cleanup costs typically relate to property owned or operated by the contractor.

In the case of compliance costs, a contractor has no choice but to bear these expenses. Failure to do so would not only be a breach of the terms of its government contract, but would also violate pertinent federal, state, or local environmental laws. Costs for complying with environmental laws are legally indistinguishable from costs to comply with safety regulations, fire codes, or labor laws, all of which are allowable.⁴ It logically follows that all environmental compliance costs should be allowable. However, this is not to say that these costs may not be legitimately questioned by a contracting officer on reasonableness or allocability grounds. Absent such objections, environmental costs related to current compliance should be payable under the contracts in which they arose.

As stated above, cleanup costs typically arise from the remediation of a contractor's real property. Land is classified by accountants as a fixed asset. For accounting purposes, land does not lose its ability to be used over time, and hence, it does not suffer from periodic cost expiration (i.e., depreciation). The value of a parcel of land is carried on a corporation's books at its historical cost, and when that land is sold the company recognizes either a gain or loss on the sale. However, the value of any asset may be impaired prior to disposition, and land should be no different from other assets in that respect.⁵ Accordingly, where land has been contaminated by hazardous substances, its market value has been diminished and the owner has suffered a business loss, but one which is not recoverable under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund law").⁶ Moreover, title to contaminated property may be extremely difficult to transfer. For cleanup costs, the questions presented in government contracts are to what extent a federal agency should be liable to the contractor for the property's lost value, and whether the measure of the loss is the land's diminished value or the costs of cleanup. Clearly, a company cannot ignore such a problem as its very competitiveness depends on its ability to maintain its assets.

Regarding a contractor's cost pooling under its government contracts for cleanup expenses, this should be permissible to the extent that a contractor's cleanup costs are determined to be allowable. As for the measure of the loss, there is no simple solution. There have been circumstances where a facility's cleanup costs have actually exceeded the land's value. If the loss is measured by the cleanup costs, liability becomes open ended, but if the loss is to be the reduced worth, liability is limited to the

land's historical cost on the corporation's books. Landowner contractors obviously would not prefer the latter yardstick. Federal agencies are not about to embrace an unlimited liability such as a contractor's cleanup costs, but neither can contractors afford to bear these costs alone. While advance agreements and settlements may accommodate some disputes, it is doubtful that cleanup costs can be recovered amicably from federal agencies by contractors. Even the process for formulating such agreements could be prohibitively time-consuming and difficult. Further, once executed, these agreements could be an endless source of interpretive disputes. In short, unless a rule enables contracting officers to resolve disagreements efficiently, a considerable amount of litigation may result over these costs. After all, affected contractors will have little to lose by suing for those claimed costs denied them by the bureaucracy. Federal agencies would likewise suffer years of uncertainty in their programs because contracting officer determinations of unallowability are not final until a court or board renders its opinion.⁷

Litigation is clearly not the answer to the problem, however. The commercial sector has already discovered that looking for answers through the courts is time-consuming, expensive, and inconsistent in its results. The interminable lawsuits and immense transaction costs attendant to litigating environmental liability issues will dishearten even the most impassioned potential litigant. Examples of ongoing legal battles include litigation with respect to issues of insurance coverage,⁸ the application of bankruptcy law,⁹ liability of corporate successors and a host of other issues dealing with the same question confronting government contractors, i.e., who will pay for the cleanup of contaminated property. If government contractors are forced to litigate their cleanup costs through boards of contract appeals or the Claims Court, their experience is likely to be similar.

Aggravating the cleanup problem, the disposal of hazardous waste is increasingly becoming more difficult and expensive. The number of properly permitted hazardous waste disposal facilities is limited, only 15 states have commercial hazardous waste disposal facilities and none are being constructed.¹⁰ Remedial actions under EPA's Superfund program are one of the biggest sources of hazardous substances sent to these facilities.¹¹ While hazardous waste may also be burned, there are only a limited number of licensed hazardous waste incinerators.

Finally, there is hope for the future as the science of environmental protection is very dynamic. New meth-

The interminable lawsuits and immense transaction costs attendant to litigating environmental liability issues will dishearten even the most impassioned potential litigant.

ods of treatment and disposal of hazardous substances are constantly evolving and the Superfund program requires the development of innovative treatment technologies.¹² Further, new materials are being substituted by companies in their production processes in place of more hazardous substances (for example, petroleum-based products being replaced with silicon substitutes).¹³ As various environmental programs mature, improved technology in some cases will undoubtedly provide faster and cheaper solutions to environmental problems. However, the near future for environmental costs is one of ever-increasing expenses for both compliance and remedial requirements.

III. Analytical Principles for Environmental Costs

An analysis of the allowability of environmental costs concerns the principles of compliance, risk, harm, and pervasiveness.

A. Principle of Compliance

As a matter of prudent public policy and sound contract management, besides fulfilling its own legal obligations, the government must insist upon full compliance with environmental laws by the contractor. Such an approach not only promotes law-abiding activity, but insures that prospective contractors factor compliance costs in their bids and proposals. For specific regulatory authority, the Permits and Responsibilities clause¹⁴ requires the contractor to comply with all applicable laws, regulations and ordinances. Environmental harm that results from violations of such laws creates potential liability for the government due to the contractor's noncompliance. Under certain circumstances, both the contractor and the government may be liable to a regulating agency in an enforcement action. Essentially, the principle of compliance holds that a party engaged in environmentally harmful activities (e.g., handling regulated hazardous substances) has a clear responsibility to comply with pertinent federal, state and local regulations. The less compliance by a contractor, the less liability should be shouldered by the government, and vice versa. This principle should not be confused with compliance costs, which should always be allowable as set forth earlier. Rather, this principle applies to cleanup costs (after all, contamination may occur even where a contractor strives to meet all applicable requirements).

B. Principle of Risk

This principle holds that the greater the potential for environmental harm due to the activities under the contract, the greater the burden on the contractor to show due care with regard to the activity. For example, a contractor handling significant quantities of hazardous waste would be held to a higher standard of due care than one

using minimal amounts. Similarly, in a contract dealing with extremely toxic materials where the consequences of adverse effects to human health or the environment are severe if mishandling occurs, a contractor would bear the higher degree of the risk associated with these materials.

C. Principle of Harm

To the extent that a contractor's actions cause actual environmental harm or create significant potential of environmental harm, a contractor should face a more difficult hurdle in justifying a claim for cleanup costs. In effect, a contractor would be penalized because of specific conduct that lead to the harm and could be precluded from being reimbursed for expenses that would have been otherwise allowable had the damage not occurred. This principle recognizes that some regulated substances are extremely hazardous or toxic, while others are less so. Further, as noted in Part I some materials not classified as hazardous substances by the EPA are so categorized by one or more states. Clearly, those activities or materials that are potentially more dangerous to human health and the environment warrant more stringent measures for proper safeguarding and disposal, however, the cost of such measures is not justified for nontoxic substances.

The principle of harm holds that the greater the adverse consequences that actually occur, the heavier the burden a contractor bears to demonstrate the allowability of its cleanup costs.

D. Principle of Pervasiveness

In our industrial society, the use of hazardous substances permeates our daily lives. Virtually thousands of products are either made from or use hazardous substances in their manufacturing process. In fact, the economic utility of these substances is their *raison d'être*. The use of some hazardous substances, however, is considerably less widespread than others, which is one reason why environmental compliance costs related to hazardous substances vary widely by industry. For some government contractors, the employment of hazardous substances arises only pursuant to the requirements of their government contracts (such as the use of chemical agent resistant coating paint). On the other hand, many government contractors use hazardous materials in their normal operations regardless of whether they are working under a government or commercial contract.

The principle of pervasiveness recognizes this reality. Accordingly, a government agency that mandates the use of hazardous substances for which there is little or no commercial application should bear greater liability for cleanup costs associated with these materials. For a hazardous substance that is pervasively used in the commercial sector, the agency should only bear a reasonable allocation of such costs. Obviously, some federal agencies,

like contractors, will pay more for environmental costs than others. This principle is consistent with FASB Concept No. 2, which states that there must be a neutrality in accounting¹⁵:

Behavior will be influenced by financial information just as it is influenced and changed by the results of elections, college examinations, and sweepstakes. Elections, examinations, and sweepstakes are not unfair - nonneutral - merely because some people win and others lose. So it is with neutrality in accounting.

IV. Proposed FAR Revision

The Department of Defense established an ad hoc group to resolve the several issues regarding the proposed environmental cost principle. That group recently concurred in yet another proposed FAR rule that is set forth below.

FAR 31.205-9 ENVIRONMENTAL COSTS (DAR Case 91-56)

(a) Environmental costs are those costs incurred by a contractor for:

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

(2) Correcting environmental damage. Environmental costs do not include any costs resulting from a liability to a third party.

(b) Environmental costs as defined in (a)(1) above, generated by current operations, except those resulting from violation of law, regulation, or compliance agreement, are allowable.

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

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

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

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

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

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

(1) The previous owner, user, or other lawful occupant's actions satisfy the criteria in (c)(1)-(3) above, and

(2) The current contractor has complied with (c)(3) and (4) above during the period that it has owned, used, or occupied the property.

However, this provision does not apply to costs incurred in satisfying specific contractual requirements to correct environmental damage (e.g., where the government contracts directly for the correction of environmental damage at a facility which it owns).

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

(f) Costs incurred in legal and other proceedings, and fines and penalties resulting from such proceedings, are governed by 31.205-47 and 31.205-15, respectively.¹⁶

The proposed FAR provision is laudable in many respects. It commendably recognizes the distinct categories of environmental costs and attempts, for the first time to clearly recognize that compliance costs should be allowable. The proposed rule creates another bright line in dealing with the difficult issues of liability to third parties. Finally, the provision attempts to reasonably limit the allowability of cleanup expenses.

Despite these praiseworthy features, we view the proposed cost principle as inadequate. Because of its general disallowance of environmental cleanup costs except under the most stringent circumstances, it will needlessly foment a considerable amount of litigation against the government. Recall the stated objective of any cost principle "is to provide that, to the extent practicable, all organizations of similar types doing similar work will follow the same cost principles and procedures."¹⁷ In the final analysis, this draft cost principle does not accomplish this objective. If this cost principle is adopted, contractors will have no choice but to seek recovery of their environmental costs through claims.

A careful review of the proposal reveals several weaknesses. Note that the definition of environmental costs in (a)(1) uses the term "preventing environmental damage." A contractor may incur many and varied costs which involve both preventing and correcting environmental damage. This inherent ambiguity creates a clear potential for inconsistent decision-making. Secondly, such a

term is unrealistic from the accounting standpoint. Many contractors have incurred costs for programs which both prevent as well as contain or diminish previous environmental damage, the costs of which are spread out over a number of years.

Regarding this final sentence of subparagraph (a), the standard Insurance-Liability to Third Parties clause¹⁸ appears in all cost reimbursement supply, service, R&D and facilities contracts. That clause makes a contractor's costs for liabilities to third parties generally allowable. To the extent that subparagraph (a) specifically excludes third party liabilities from the scope of "environmental costs," it calls into question the allowability of these costs under other FAR provisions. A proposed cost principle should not conflict with an existing cost principle, but this inconsistency does not appear to have been considered.

Also not addressed in paragraph (a) is what the draft cost principle was intended to cover. For example, this cost principle does not consider problems of off-site contamination. In short, paragraph (a) needs a tightly written "scope of coverage" subparagraph.

A serious flaw of the proposed cost principle is the language in paragraph(b) which would allow only those costs arising from "current operations." In the accounting sense, what does that term mean? Does it mean only costs incurred after the effective date of the new cost principle? Does it refer only to costs incurred in the fiscal year in which the new cost principle becomes effective? Does it refer back to the base year for contractors who are in their fourth or fifth option year? The use of this undefined term only promotes confusion. Secondly, the term "resulting from violation of law, regulation, or compliance agreement" can be subjectively interpreted to support the most picayune agency position. In that regard, many contractors only learn of their noncompliance, or "violations" under this cost principle, after obtaining a regulatory interpretation from local, state, or federal authorities (through inspection reports or other communication). Are such contractors barred from recovery? From the draft cost principle, it would seem so. This would be unreasonable, especially where an environmental inspection cites only minor and easily correctable shortcomings.

Paragraph (c) conflicts with all other FAR cost principles by placing the burden of proof on the contractor at the outset, rather than after a governmental disal-

lowance. On this same point, it will be difficult for many contractors to meet their burden of proof because of the inherent vagary of the language used in subparagraphs c(1) - c(4). For example, subparagraph c(2) requires the contractor to prove that it was "conducting its business prudently at the time" (What does that mean?), "in accordance with then™ accepted relevant standard industry practices" (What are they? Where are they found?), and "in compliance with all then-existing environmental laws, regulations, permits, and compliance agreements." Subparagraph c(3) requires a contractor to have "acted promptly to minimize the damage." How prompt is prompt? If a contracting officer determines that a contractor's response was not "prompt," that bars all of the contractor's otherwise allowable costs. Here again, use of vague, undefined terminology enhances uncertainty and creates confusion.

Paragraph (c) may work other inequities upon a contractor. Subparagraphs (c)(2) and (c)(3) attempt to do what the drafters of CERCLA assiduously avoided - to review the propriety of the past conduct of a potentially responsible party ("PRP"). CERCLA drafters carefully created a liability regime that applied strictly to all PRPs without looking behind the conduct that led to the release of hazardous substances. An adverse contracting officer fault determination has a significant potential to otherwise detrimentally affect a contractor. Further, subparagraph (c)(1) requires that a

contractor must demonstrate that it had a government contract at the time of the "conditions requiring correction" (release of hazardous substances?) and that the performance of that contract contributed to those conditions. Without even considering the fairness of the enormous factual obstacle faced by a contractor (to show a nexus between contract performance and these "conditions" years after the occurrence of what typically are obscure events), public policy does not justify the injustice accorded the government contractor who cannot make this exacting demonstration.

In order for its costs to be allowable, paragraph (d) forces a contractor to prove that the previous owner meets the criteria of subparagraphs c(1) - c(4) in addition to proving its own compliance with the same provisions. In situations where liability for environmental contamination arises among former and present owners, an otherwise "deserving" contractor (i.e., one that meets the requirements of subparagraphs c(1) - c(4)) will be forced

Paragraph (c) conflicts with all other FAR cost principles by placing the burden of proof on the contractor at the outset, rather than after a governmental disallowance

to meet an almost impossible burden of proof through mere lack of cooperation by the previous owner. Under other circumstances, federal agencies could get dragged into litigation between the present and former owners, an undesirable state of affairs.

Paragraph (e) is unartfully drafted and, depending on its interpretation, inconsiderate of the reality that insurance coverage for environmental cleanup costs until recently has been virtually unavailable. Was this intended to cover a narrow category of costs that arguably would be allowable under preceding subparagraphs? On the other hand, did the redactors of this clause intend to establish an entirely new category of unallowable costs related to matters not covered by insurance?

V. Recommended Revisions to FAR Proposal

It is not the purpose of this article to definitively resolve the issue of environmental cost allowability. Rather, by proposing a cost principle that apportions cost responsibility between the government and its contractors, we suggest a model that can serve as a focus for debate and commentary. In the spirit of setting forth a cost principle that adopts the four principles outlined earlier, the following is submitted for consideration.

FAR 31.205-9 ENVIRONMENTAL COSTS (Proposed)

(a) Environmental costs are those incurred by a contractor for:

(1) The primary purpose of preventing pollution, properly disposing of waste generated by business operations, complying with environmental laws and regulations, or

(2) Cleanup, remedial or corrective actions arising from the effects of past activities impacting the environment.

The above environmental costs shall include but not be limited to associated consulting, equipment purchase, investigative, monitoring, regulatory fees or oversight reimbursement, treatment, storage, transportation and disposal costs.

(b) Environmental costs under (a)(1) are allowable.

(c) Environmental costs under (a)(2) incurred to remedy environmental damage caused by past activities or inactivity, or for which a contractor has been judicially or administratively determined to be liable (including where a settlement or consent decree has been issued), are allowable except where:

(1) The environmental damage resulted from noncompliance with then existing laws and regulations;

(2) The contractor failed to exercise the proper degree of due care commensurate with the risk associated with the materials under its control; or

(3) The contractor failed to exercise the proper

degree of due care commensurate with the harm or potential for harm regarding the materials under its control.

(d) Allowable environmental costs will be allocated in the ratio of contractor's commercial/government contract costs of using such regulated substances or materials during the same period.

(e) The contracting officer may disallow environmental costs otherwise allowable if he determines that the attendant facts and circumstances make such allowance unfair to the Government. Such a determination must be made by final decision and is subject to the Disputes clause

(FAR 50.233-1).

(f) Costs incurred in legal or quasi-legal proceedings, and as a result of the outcome of such proceedings, are governed by 31.205-47 and 31.205-15, respectively.

Paragraph c(1) embodies the principle of compliance. The language used is significant as the damage must have "resulted from" the noncompliance. Contractual violations of noncompliance not related to the environmental harm would not result in a disallowance of cleanup costs.

Paragraph c(2) relates to the principle of risk, discussed earlier. The "proper degree of care" is a standard that varies with the risks associated with the substances involved. This flexibility is necessary because of the widely disparate nature of contaminants and manufacturing operations.

Paragraph c(3) also establishes a flexible standard ("proper degree of care") but for the actual or potential harm associated with the hazardous substances. This is the principle of harm. In this area, environmental expertise will have its greatest application.

Paragraph (d) translates the principle of pervasiveness into a rule of allocability. Essentially, agencies pay for the employment of hazardous substances to the extent they call for their use compared to other customers.

The most singular feature of the proposal is its inherent presumption of allowability for all environmental costs and the need for specific disputable determinations by the contracting officer before such costs will be unallowable.

VI. Conclusion

Litigating environmental cost claims would be time-consuming, wasteful, lead to haphazard results, and only address one case at a time. Moreover, awaiting judicial resolutions is reactive (as opposed to proactive) and merely masks professional inertia. The public policy question presented is who should pay for environmental liabilities of government contractors, and courts are not appropriate forums for formulating this crucial public poli-

cy. Because the problem is systemic, the solution should be as well.

Other proposals to resolve the problem of environmental costs do not appear feasible. For example, it has been suggested that the Cost Accounting Standards Board (CASB) promulgate a new rule. This is not appropriate, however, because the Cost Accounting Standards do not deal with the allowability of costs, but how allowable costs should be allocated and accounted for in government contracts. Once the issue of cost allowability is settled, a cost accounting standard concerning permissible allocation methodologies may be necessary.

Others have recommended an expanded use of P.L. 85-804 for agencies to accord affected contractors relief. This course of action would result in only a favored few receiving anything and contractors would be forced to rely on the sympathies of diverse agencies. Furthermore, there would be no appeal from subjective bureaucratic determinations. Finally, some members of Congress have strongly questioned the propriety of this use of P.L. 85-804.

The creation of a new FAR cost principle is the most feasible vehicle to establish a practical framework for deciding the allowability of environmental costs in government contracts. To the extent that pollution exists, the liabilities have already been incurred by contractors. But this does not mean that the problem is a technically narrow accounting question (e.g., the proper accounting treatment for contaminated assets). Rather, the issue is political in nature because it deals with the proper distribution of the public fisc to alleviate a recognized societal problem.

The management of environmental restoration is a responsibility shared by the Federal government and its contractors. Because neither side alone can bear all the costs of cleanup, an apportionment mechanism fair to both is needed. The cost principle proposed in this article, embodying equitable principles of compliance, risk, harm and pervasiveness, is a means toward that end.

In drawing the line on environmental costs, the FAR Council bears a responsibility to those economically impacted by their decision. In the final analysis, however, only a cost principle that attains general acceptance will be effective, so the Council should be mindful of what can be politically achieved. After all, compromise is inherent in the political process.

The allowability of environmental compliance costs is at present an unresolved, uncertain and complex area of government contract law. Many disputes are anticipated, and some undoubtedly will end up before the courts. It is hoped that these articles will assist in discussion on this topic to enable disputes to be resolved at the

lowest level possible with a minimum of expense.

ENDNOTES

1. "Environmental Liability: 'Uncertain Times' for Government Contractors", by Robert T. Lee, National Contract Management Journal, Vol. 23, Issue 2, p. 45 (1990).

2. FAR 52.236-7.

3. Appeal of Shirley Construction Co., ASBCA No. 42954, November 14, 1991, Federal Contracts Report, Vol. 56, No. 22, p. 791 (December 9, 1991).

4. Although one author has expressed a dissimilar view (see Lee, p. 52), compliance costs cannot fairly be said to fall within the scope of the Maintenance and Repair cost principle at FAR

31.205-24.

5. The accounting materials that should be consulted are Financial Accounting Standards Board (FASB) Statement No. 5, Accounting for Contingencies; Interpretation No. 14, Reasonable Estimation of the Amount of a Loss; FASB's Emerging Issues Task Force (EITF) Issue 89-13, Accounting for the Cost of Asbestos Removal, and EITF Issue 90-8, Capitalization of Costs to Treat Environmental Contamination. Auditors should review Statement of Auditing Standards (SAS) No. 12, Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments; SAS No. 54, Illegal Acts by Clients; and SAS No. 57, Auditing Accounting Estimates. See also "Environmental Matters", The CPA Letter, Vol. 71 No. 10, page 4b, November, 1991; "Assessing Environmental Risks," by George R. Zuber and Charles G. Berry, Journal of Accountancy, March, 1992, p. 43; "Accounting for Environmental Costs: A Hazardous Subject," by John P. Surma and Albert A. Vondra, Journal of Accountancy, March, 1992, p. 51.

6. 42 U.S.C. Section 9601-9675

7. DFARS 231.7003-1(a)(2).

8. "Michigan Backs Insurers on Pollution Issue," by Jonathan M. Moses and Milo Geyelin, Wall Street Journal, August 28, 1991, p. B4, col. 4. Since 1986, such liability policies generally have excluded all pollution coverage. But not all decisions have been in favor of the insurer. See, for example, "Insurers Lose Round Over Cleanup Costs," by Jonathan Moses and Wade Lambert, Wall

Because the problem is systemic, the solution should be as well.

Street Journal, September 16, 1991, p. B9, col. 4; "Liability Insurance Covers EPA Cleanup Costs, Iowa Court Rules," by Amy Stevens and Ellen Joan Pollack, Wall Street Journal, September 23, 1991, p. B7, col. 4; see also, Independent Petrochemical Corporation v. Aetna Casualty and Surety Company, 944 F.2d 940 (1991).

9. "Paying for Cleanup, " by Carolyn J. Buller and Geoffrey K. Barnes, The National Law Journal, October 21, 1991, p. 51, col. 2.

10. "Toxic Waste Sparkes War Between States", by Jeff Bailey, Wall Street Journal, August 16, 1991, p. B1, col. 4.

11. Ibid.

12. 40 C.F.R. Section 300.430(e)(5).

13. "Lab Notes," by Amal Kumar Naj, Wall Street Journal, 6 November 1991, page B1, col. 1.

14. FAR 52.236-7.

15. Financial Accounting Standards Board, "Qualitative Characteristics of Accounting Information," Concept No. 2, May 1980.

16. DAR Case 91-56, CAAC Case 90-101.

17. FAR 31.101.

18. FAR 52.228-7.

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